

# Finding A Solution to the Natural Gas Price Reporting Conundrum: The Energy Transaction Repository

By **GREG LANDER**, Principal, Skipping Stone, Inc.

**WHAT STARTED AS** an issue of false price reporting and inaccurate data is swelling to encompass other aspects of the energy trading business and causing a host of new problems. In addition, the Commodity Futures Trading Commission (CFTC) has levied fines for false price reporting ranging from US\$3 - 20 million each on nearly half a dozen current and former energy trading giants with more such penalties rumored to be in the works. This has resulted in many market participants choosing not to report their transactions to index publishers for fear that doing so would open them up to unwanted scrutiny and potential liability if their transactions fall outside of a "normal distribution of prices".

pushed this issue up the priority list at the Federal Energy Regulatory Commission (FERC). The culmination of a series of stakeholder meetings is that FERC issued a policy statement at the end of July.

This policy statement is the first in what promises to be a series of steps that the FERC will be taking to establish guidelines for energy transaction price reporting. Future FERC actions will likely be driven by how the industry responds, or doesn't, to this initial step.

With the promise of "safe harbour" against investigations of inadvertent reporting errors, FERC is attempting to encourage increased voluntary reporting and adoption of a self-written code of conduct. Unfortunately, this blueprint for

improved reporting practices leaves many questions unanswered. For example, the statement requires

reporting, but does not designate to whom one must report. It sets out a minimum code of conduct for index publishers but specifies no consequences if the index publishers do not establish or maintain that level of conduct. It recommends that indexes be based on verified transactions of matched trades between buyers and sellers, but stops short of requiring those reporting to provide counterparty information essential to such matching.

As the unanswered questions lead to confusion and therefore inertia, the FERC seems to be setting the stage to require all companies that buy and sell natural gas to report all their transactions and to place themselves on what might be charitably termed a "target list" for future non-compliance investigations.

## Market Response

While there is broad consensus among the industry that this problem needs to go away, there is a lack of consensus on how to make it do so.

Significant progress was made prior to the FERC policy statement release by a confluence of industry associations in an attempt to get everyone on the same page. While a number of issues were resolved, several key areas remained, including the all-important counterparty identification.

One area that all parties agree on is that more stringent government regulation and oversight is not the preferred method of solving this problem. This leaves the industry in a position to migrate toward one or more solutions that present themselves. On the other hand, if the industry chooses not to migrate to any solution, the risk is high that the government will make the migration decision a moot point.

## Solution Options

There are four basic types of solutions: the index publishers resolve the issue; a government mandated solution; the electronic trading platforms resolution; independent data collection agencies.

The index publishers have been performing the transaction data collection and reporting for some time. The issue with this solution is that publishers have no interest in being compliance-reporting entities for government purposes. In addition, the index publishers have control over editorial content, which seems to be a problem for some of those reporting transactions. There are also technology and related issues with this solution that will be discussed later in this article.

The electronic trading platforms, such as ICE and NYMEX, also currently perform transaction collection, matching and confirmation. The issue with using this as the sole source for index and compliance reporting is that they neither collect nor include all transactions, only those from members doing trades. Given this, significant sections of the market participants are left out of the loop and unable to comply with the FERC.

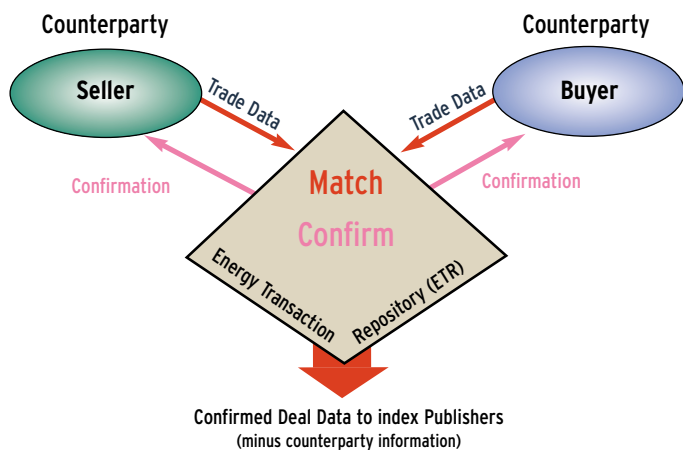
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This trend has resulted in index locations that do not have enough reported transactions to justify publishing a price for that location. As the trend gains momentum, there is an increased probability that ever more pricing locations will go un-published.

Not having an index price for a particular location is extremely problematic for an industry that is heavily reliant on their use for establishing value in transactions and settlements between counterparties. Without an index, a cascading set of issues besets all involved, which will ultimately result in more upheaval, more finger pointing and potentially much stricter government mandated controls. The negative impact to the energy industry is enormous at a time when the market participants are trying so hard to restore investor and customer confidence.

## Regulatory Response

The visibility of the price reporting issue in the press, congress and among the various industry stakeholders has



This leaves either the government mandated solution, which is an unknown solution, or the independent data collection agency. Currently there are two proposed independent agency solutions, Energy Transaction Repository (ETR), and the University of Houston's Global Energy Markets Institute (GEMI). There are distinct variations in the two approaches, although both are proposed not-for-profit entities.

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The ETR proposes a voluntary system which would collect transaction information, provide "confirmations" to the market participants and make the digested information available to index developers and FERC. The GEMI proposes a solution that would have the government mandate that market participants report their information to them and they would then make it available to index publishers as well as creating indices themselves.

### The Energy Transaction Repository

ETR was co-conceived by Greg Lander [article author] and Peter Weigand, of Skipping Stone Inc., an energy-consulting firm, as an outgrowth of issues raised by clients who were trying to deal with the price index issue as well as other issues around Sarbanes-Oxley compliance and the impact on internal business process change.

During the creation phase, it became apparent that ETR could provide a solution to not only the price index issue but also provide value added benefits for

the market participants, the government, and for the index publishers. At its core, the ETR will collect data on energy transactions, match the trades, provide a confirmation to the counterparty's, report on participation rates and provide data to index publishers. The sensitive components of the information will be kept confidential (i.e., the counterparty data) and data will be stored in perpetuity and fed back to market participants for internal audit and other related purposes as needed.

### Matching & Confirmation enables Sarbanes-Oxley Requirements

Deal confirmations have traditionally been a spotty practice at best. Without same day confirmations, verifying cash positions and exposure - as well as a host of other compliance reporting needs - are not possible within the new tight constraints of Sarbanes-Oxley.

Central to the value proposition for market participants is the fact that ETR will provide independent

confirmation of matched trades to the counterparty. These independent confirmations will enable a solid foundation of internal information, externally validated, for compliance with Sarbanes-Oxley reporting and internal control requirements.

This validation process, integrated into the reporting process, has the advantage of clearing up 'mis-matches' early in the business process (the day the trades are executed). Issues are resolved much sooner than has traditionally been the case, creating a significant improvement in processing settlements, invoicing processes, and post-period gas accounting. Today, such matters are generally not addressed until the time-consuming invoice and settlement period occurs, often a month or months after the transaction was executed.

### Simplifying the Complex

On paper, the ETR solution sounds simplistic, however in practice there are several significant hurdles that ETR

has addressed and overcome. Among those hurdles, the need for simplified technology that enables market participants to use the solution regardless of the level of technology sophistication and recognition that natural gas has over 70,000 transaction points (meters) and thousands of wholesale market participants (entities).

The significance of this can be seen in the following example of what it takes to 'match a transaction':

- **Location (points):** The key is matching which point names, abbreviations, and codes are synonyms for one another, are associated with which pipelines, and are resident in which zones. This would be simple if everyone used the exact same nomenclature, but that is not the case.
- **Counterparties (entities):** It is not as simple as just using the name because many large companies have numerous sub-entities active in natural gas transactions. Therefore, to match counterparties, an underlying database with all the entities and sub entities with all the abbreviations, codes, legal names, etc. is needed to pinpoint exactly which entity is involved in the deal.

Imagine a transaction between two different companies who record the transaction respectively at "Zone 6 NY" and "ConEd City Gate" and who use abbreviations for each other's names. This simple example illustrates the complexity of matching points and entities regardless of what each company calls them.

If the natural gas industry is to adopt a solution that matches trades and fixes the index and other reporting issues, then a solution is needed that already comes with all the points and entities, with all their permutations, and extensive cross referencing to a standardised set of universal codes. Fortunately, ETR already has such a database available from CapacityCenter.com, that has been compiling and tracking this information for many years and has developed the most extensive cross-reference of energy industry participants and transaction locations in the market today.

Without such capability, the only other means available to another solution

provider or index publisher is the time-consuming and error prone manual inspection method, which even if it can be done for the thousands of likely reported transactions, does not provide any service back to the market participants (i.e., the transaction confirmation that ETR will provide).

### Turning 70,000 Transaction Points into 100+ Published Index Points

Another major challenge for any data collection and index generation endeavour is the association of the 70,000 or so transaction locations in North America, with the 50 to 100 reported pricing reference points. This was underscored when one index publisher recently filed a request with the North American Standards Board (NAESB) to standardise indexing locations in order to establish which of the 70,000 locations belonged to which of the 50 to 100 index points. Substantial controversy within the NAESB was set in motion, since NAESB was uncertain as to whether such a request was even within the NAESB scope of activities.

ETR realises that there will be a number of transaction locations that are not appropriately associated with any reported Index pricing point. Nevertheless, its own experience with capacity, basis, and release transaction data indicates that better than 80% of those 70,000 can be associated with a currently published index. The trick is to know which ones go to where - something Capacity Center has mastered; it has long provided such information to those looking for comparable capacity segments to serve and connect published pricing points. Should NAESB ever process the standardisation request and the outcome alter what ETR uses for its transaction location to index location associations, those changes would be simple for ETR to implement on a go-forward basis, and even on a look-back basis, should that be desirable.

### Voluntary Versus Mandatory

Unless FERC mandates otherwise, ETR is based on voluntary participation, with peer pressure and a drive to emulate and proliferate "best-practices" to spur participation. ETR will provide confirmations and notices of "failure to match" to its reporting members to promote the

clean-up of simple data entry errors as well as overall adoption. In addition, ETR will provide a "scorecard" report depicting who is and is not reporting and to what degree. The scorecard will assist regulators and market participants alike and determine who is

in compliance and therefore eligible for safe harbour under the FERC policy. The scorecard will not reveal specific transaction data or other sensitive data.

It is envisioned that reporting participants will prevail upon their trading partners to report for three reasons:

1. That the indices derived from matched trades and provided to index publishers will be more reliable and more reflective of actual market conditions - a benefit to all consumers of published indices.

2. That reporting provides safe-harbour from federal investigations (in the absence of malfeasance), a benefit to all who desire to be free of investigatory scrutiny and the potential liability that entails.

3. That a bedrock upon which Sarbanes-Oxley representations can comfortably rest will have been established. The transactions in each participants' tracking and accounting systems are reflective of audited and auditable matched transactions with valid counterparties - a benefit to all internal auditors seeking smooth sailing with respect to outside auditing procedures.

It is believed that these benefits will be ample cause for participants to prevail upon one another to report.

### ETR is Industry-Run

Once the membership is established and operations commence, ETR will be run under the direction of an industry-elected board. Its not-for-profit structure and formulation around one purpose - the collection, confidential maintenance and processing into publisher defined indices - assure that participants will not be faced with the prospect that a competitor would get access to their confidential, proprietary information.

Likewise, ETR will contract with all publishers on an "equal fee for equal service" basis. With a comprehensive source of transaction data, it is antici-

pated that there may be competition among publishers to create more robust indices as well as other value-added products and analytics-based offerings.

> ... the time has come for an industry sponsored & run, independent transaction repository <

For those publishers who desire to continue with their own data collection, ETR has proposed that the data flow could be two-way, thus enabling the independent confirmation of the publishers' data.

### ETR Moving Forward

Efforts are currently underway to recruit a founding member executive committee as well as securing the funding needed for the start-up phase of ETR. Once seed funding is secure, ETR has been working toward a launch that could occur before year-end. Meanwhile, the interim executive committee, made up of founding donors, is hammering out operational details, such as: What to report? How to interact with government agencies? What types of details for compliance and participation reports should ETR have?

ETR believes that, by all indications, the time has come for an industry sponsored and run, independent transaction repository. This independent organisation can take the lead in providing not only a solid source for published indices, but also a solid, secure and reliable means of verifying transactions. This process can build a clear and auditable foundation underpinning all financial reporting by energy producing, marketing and consuming companies and provide a huge boost in efforts to restore confidence in the natural gas marketplace. The Energy Transaction Repository is confident that with continued industry support and leadership by interested and like-minded industry members, it can do just that ■

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His accomplishments include starting one of the first independent natural gas marketing firms, establishing a successful energy consulting practice, and founding an energy technology solutions company.

Mr. Lander was a founding member of the Gas Industry Standards Board (GISB)

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