UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Criteria for Reassertion of Jurisdiction	**)**	
Over the Gathering Services of	**)**	**Docket No. PL05-10-000**
Natural Gas Company Affiliates	**)**	

COMMENTS OF THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Pursuant to the Commission's Notice of Inquiry ("NOI")[1] issued September 15, 2005 in the above-captioned proceeding, the Independent Petroleum Association of America ("IPAA") provides its comments on a number of key gathering issues of concern to its members. In support hereof, IPAA states the following:

I. Communications

Communications concerning these comments should be addressed as follows:

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II. Identity of Commenter

IPAA represents thousands of American independent oil and natural gas producers and associated service companies.[2] Independent producers drill 90 percent of the

[1] *Criteria for Reassertion of Jurisdiction Over the Gathering Services of Natural Gas Company Affiliates*, "Notice of Inquiry," 112 FERC ¶ 61,292 (2005)("NOI").

[2] The comments contained in this filing represent the position of IPAA as an organization, but not necessarily the view of any particular member with respect to any specific issue.

wells in the United States and produce approximately 85 percent of the nation's natural gas and over 65 percent of the country's domestic crude oil supply (and well above that amount in the Lower-48 states).

III. Comments

IPAA is pleased that the Commission has issued this NOI addressing critical issues associated with gathering. In addition to those matters on which the Commission is seeking comment, IPAA also wishes to take this opportunity to reiterate certain broader concerns with existing gathering policies, both with regard to onshore matters as well as those pending in the ongoing examination of offshore matters in Docket No. AD03-13.[3]

A. Onshore Gathering – The States Fail to Bridge the Regulatory Gap

As a threshold matter, IPAA notes the continuing problem many domestic producers face with the current lack of regulatory oversight of onshore gathering rates, terms and conditions of service. During restructuring in the post-Order No. 636 world as pipelines moved from merchants of natural gas to solely providing a transportation function, the industry saw a restructuring of the gathering industry as well. In many instances, gathering lines that had once been owned by interstate pipelines were either spun down to affiliates or spun off to third parties. As part of these spin down and spin off proceedings, the parameters of the Commission's authority to exert some sort of residual control over gathering rates in connection with the previously bundled interstate transportation/gathering function was tested in the courts. In sum, the courts have determined that FERC has extremely narrow residual regulatory authority.[4]

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[3] *Application of the Primary Function Test for Gathering on the Outer Continental Shelf*, Docket No. AD03-13-000, "Statement on Behalf of the Independent Petroleum Association of America" (filed Sept. 23, 2003), and "Comments Following September 23, 2003, Public Conference of the Independent Petroleum Association of America" (filed Oct. 3, 2003).

[4] (cite to *Conoco* and the offshore case on in connection with jurisdiction)

As a practical matter, in light of Section 1(b) of the NGA coupled with judicial precedent, it is now up to the states to step in and fill the regulatory gap. However, and also as a practical matter, IPAA's members report that some states have failed to take up the mantle of exerting authority over gathering, leaving producers at the mercy of the gathering companies.

Unlike other commodities, it is not practical to move natural gas from domestic wells to mainline transmission lines in any manner other than through smaller diameter gathering lines. In the absence of either federal or state regulation or other form of oversight, domestic producers are held hostage to whatever rates the gathering company wishes to charge. On the one hand, the price of the natural gas commodity is set by the marketplace. On the other hand, the mainline interstate transportation rates are set by the Commission in recognition of the pipelines' monopoly power and the need to protect consumers from the exercise of this monopoly power. However, absent similar state regulatory protection, producers are caught in the middle with no way to reach the mainline without paying whatever the gathering company demands and no way to guarantee that they can recover these gathering costs in the commodity sales price. Domestic producers who wish to operate their wells have only one viable choice – pay the gathering rates demanded. The other choices of not producing or shutting in existing production are unfortunate business outcomes for the domestic producer and, more broadly, unfortunate policy results for the American consumer, who would suffer from higher gas prices.

B. Offshore Gathering – Regulatory Uncertainty as a Hindrance to the Development of Offshore Resources

The recent hurricanes in the Gulf of Mexico have highlighted our nation's vulnerability to unpredictable supply disruptions. As exploration and production companies, members of IPAA believe that all parties should be encouraging certainty in the natural gas industry in order to promote increased E&P and help bring much needed supplies to the domestic markets.

Unfortunately, current Commission policy related to gathering in the Outer Continental Shelf ("OCS") is far from certain. Although not addressed in the NOI, IPAA urges the Commission to reexamine its natural gas gathering/transportation test and reformulate that test in order to provide certainty for all participants in the natural gas industry, including producers and gatherers.

1. The Commission Initially Must Use Section 7 of the Natural Gas Act to Determine Whether a Previously Jurisdictional Pipeline is Non-Jurisdictional.

IPAA continues to be concerned that the current uncertainty over the regulatory framework governing offshore gathering fails to provide the adequate economic certainty needed to incentivize producers to make large capital expenditure in new wells, for example, approximately $14 million on average for drilling and completion of a natural gas well in the offshore. When producers invest large sums of money into a well, they are necessarily linking that well to an existing pipeline or a proposed new pipeline in order to get the gas to market. If that pipeline could be ruled non-jurisdictional, producers would then be subject to the pipeline's unregulated transportation rates, thus completely disrupting the initial economic analysis that resulted in the decision to produce the given well. This is an untenable result.

To remedy this, for pipelines that already are certificated as jurisdictional pipelines, the Commission must consider any request for non-jurisdictional status as a request for abandonment of service and, accordingly, review the request pursuant to Section 7 of the Natural Gas Act ("NGA"). This examination should include the impact of abandonment on existing shippers, the market power of the pipeline, the commercial considerations underlying the contracts entered into between the pipeline and the shippers, and the ongoing useful life of the facility. If the pipeline is already certificated pursuant to Section 7, then this is simply applying the law to the

pipeline as it should be applied. There is no attempt to violate NGA Section 1 through the regulation of gathering line rates; rather, the pipeline's assets are already committed to interstate transportation service, and so it is a matter of applying applicable law to the circumstances. Only once the pipeline is classified as gathering do the prohibitions against regulation of gathering lines kick-in.

IPAA reiterates its belief that, while there is existing case law that apparently contradicts this argument, it is time for the Commission to act and clearly articulate the Section 7 requirement in a Policy Statement that is well-reasoned and can withstand court review. Given the current supply-demand outlook, it is inapposite to the goals of the Commission and the Department of Energy to allow pipelines simply to abandon Section 7 status and negatively impact potential sources of supply.

2. FERC Must Determine the Proper Classification of the Pipeline Through Consideration of Physical and Non-Physical Factors.

Once the Commission has analyzed the proposed transfer from jurisdictional to non-jurisdictional status of the pipeline pursuant to the requirements of Section 7, it then must determine whether the pipeline is properly classified as a gathering line. IPAA does not support a bright-line primary function test; fundamentally there are too many factors that need to be considered for a bright-line test. Nonetheless, IPAA believes that too much emphasis has been placed on physical factors in imposing the primary function test. As IPAA has noted previously, the "central point in the field," "central point of aggregation" and "behind the plant" standards are not workable in the offshore and should not be considered as elements of the primary function test for offshore lines.

Rather, IPAA urges the Commission to employ non-physical factors in any determination as to whether a pipeline is classified properly as gathering. Examples of non-physical criteria

include: the purpose, location and operation of a facility; the general business of the owner; whether the jurisdictional determination is consistent with the objectives of the NGA and other legislation; and the changing technical and geographic nature of exploration and production. IPAA believes that among these, the purpose, location and operation of a facility should receive the most weight in any determination. Moreover, IPAA also notes that in the *Sea Robin* case, the Fifth Circuit did not direct the Commission to eliminate non-physical factors from the gathering evaluation; therefore, the Commission should employ such factors in its review of a pipeline's gathering status.

3. Transparency in Reporting is Critical to Ensuring Certainty and Promoting Infrastructure Investment.

IPAA believes that it is imperative that FERC be granted the statutory authority to mandate price transparency and to implement reporting obligations for offshore gathering as yet another critical regulatory component to promote investment in the offshore. In light of the D.C. Circuit's rejection of FERC's prior efforts to mandate price reporting,[5] it appears that the only solution is through federal legislation, such as that recently included in the bill voted out of the House Energy and Commerce Committee and passed by the full House of Representatives on October 7, 2005.[6]

IV. Conclusion

IPAA urges the Commission to adopt a policy addressing the jurisdictional status and gathering classification of pipelines that fosters the production and development of new sources of natural gas. The current uncertain state of affairs in the Commission's gathering policy discourages new E&P activities as producers have increasing anxiety that investments once

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5 *The Williams Cos. v. FERC*, 345 F.3d 910 (D.C. Cir. 2003).

6 *Gasoline for America's Security Act*, H.R. 3893, 109th Cong. (2005)

thought to be based in sound economics may be rendered worthless, or even worse harmful, as a result of the change in jurisdictional status of pipeline and the pipeline's ensuing imposition of significantly higher, unregulated rates on shippers. As the nation heads into a winter heating season with the prospect of greatly elevated natural gas prices and potential shortages of supply in certain regions, it is incumbent upon the Commission to take what steps it can to try and remedy the current situation.

WHEREFORE, the Independent Petroleum Association of American respectfully requests that the Commission consider the Comments above.

Respectfully submitted,

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