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FEDERAL ENERGY  
REGULATORY COMMISSION

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

	)	
Application of the Primary Function	)	
Test for Gathering on the Outer	)	Docket No. AD03-13-000
Continental Shelf	)	
	)	

INITIAL POST-TECHNICAL CONFERENCE COMMENTS  
OF THE NATURAL GAS SUPPLY ASSOCIATION

Pursuant to the schedule established by the Federal Energy Regulatory Commission (“Commission”) Staff during the technical conference conducted in the above-captioned proceeding on September 23, 2003, the Natural Gas Supply Association (“NGSA”) submits its initial post-technical conference comments. NGSA’s core positions on the issues that are the subject of this proceeding were stated both in NGSA’s initial pre-technical conference comments and in oral remarks presented during the conference on September 23. The purpose of these comments is to address in summary form further issues identified by the Commission Staff and other participants during the technical conference.

1. Must the Commission Declare All Offshore Facilities to Be Either Transportation or Gathering?

No. In *Gas Pipeline Facilities and Services on the Outer Continental Shelf—Issues Related to the Commission’s Jurisdiction under the Natural Gas Act and the Outer Continental Shelf Lands Act*, 74 FERC ¶ 61,222 (1996), *reh’g dismissed*, 75 FERC ¶ 61,291 (1996) (“OCS Policy Statement”), the Commission recognized that widespread

industry consensus opposed making any generic “one size fits all” determinations regarding the jurisdictional status of offshore facilities:

Commenters maintain that a declaration that all OCS facilities are of one generic type would constitute a precipitous departure from the Commission’s past practice of case-specific consideration, upset parties’ reliance upon functional classifications in developing offshore reserves and accepting terms and conditions of service, and invite judicial reversal. Gatherers Leviathan and Tejas note that NGA section 1(b) specifically exempts gathering facilities from the Commission’s NGA jurisdiction; thus, particularly in light of EP Operating, the Commission is without authority under the NGA to find all OCS facilities to be jurisdictional. OCS Producers concur, and add that it would constitute an abdication of the Commission’s regulatory responsibility under NGA section 1(b) to classify all OCS facilities as gathering. OCS Producers argue that pipeline systems, including facilities offshore, perform different functions, that the Commission’s historical practice has been to recognize the different functions through application of a primary function test, and that courts have upheld this practice. OCS Producers also raise concerns about the Commission’s need to regulate the rates charged by the pipelines. Producers Blue Dolphin Exploration and Energy Development assert that OCS pipelines possess market power and it is the Commission’s responsibility under the NGA is to protect gas consumers from the exercise of such power.

Based on the comments submitted in that proceeding, the Commission concluded that it should continue to apply its primary function test on a case-by-case basis. Almost a decade later, these same arguments remain true and the Commission should continue to rely upon its earlier finding that a “one size fits all” approach offshore is inappropriate.

2. Should the Commission Consider Offshore and Onshore Facilities Under the Same Test Using the Same Factors?

No. Deviation from a policy that recognizes the fundamental physical and operational distinctions between offshore and onshore natural gas production would foster further litigation and enhanced regulatory uncertainty in a manner fundamentally contrary to the stated goals of this technical conference proceeding. Nor would such a policy shift be based on reasoned decisionmaking. The Commission previously

recognized the distinction between onshore and offshore facilities when it found that the “behind-the-plant” factor is not necessarily determinative when applied to offshore facilities. The Commission stated in *Sea Robin* that, “the nature of OCS production and the movement of gas from the platform to consumers onshore does not make for a tight fit with the weight afforded the criteria historically applied by the Commission to onshore production and gathering.”<sup>1</sup> Furthermore, the comments submitted in this case by the Commission’s Office of Administrative Litigation illustrate clearly why the “behind the plant” test employed by the Commission in connection with onshore facilities is not applicable to offshore production activities.

Williams alleged at the September 23 conference that costs per volume can be more expensive onshore than costs per volume offshore<sup>2</sup> and used this claim to support their position that there are few distinctions between offshore and onshore development to warrant distinct jurisdictional consideration. NGSA cannot determine what this comparison is supposed to represent given that the *total investment cost* of an offshore project is a key factor to consider when examining potential “barriers to entry” on the offshore as opposed to the onshore.<sup>3</sup> In fact, Williams’ chart itself shows that the cost comparison between onshore and offshore pipelines are significantly different. On the E&P side, the average cost to drill and complete for a typical onshore well is

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<sup>1</sup> *Sea Robin, Order on Remand*, 87 ¶ FERC 61,384, page 4.

<sup>2</sup> See handout prepared by Williams for distribution at September 23 Conference, at 5.

<sup>3</sup> In addition, concluding that costs are more expensive onshore based on volumes without any consideration of distance, whether the pipeline is a mile long or 300 miles long, seems simply disingenuous.

approximately \$400,000 while typical offshore wells will cost in the millions of dollars and offshore development projects can run into the billions of dollars.<sup>4</sup>

Williams' claims are particularly misguided in the shallow water where investments have already been made. In those instances, often captive producers do not have sufficient gas production to support the construction of a new line, thus the "analysis" in Williams' table is inapplicable. Captive shallow-water production cannot support the construction of a new line by either the producer or a new pipeline transporter. Therefore, the Commission needs to continue to regulate the existing shallow water pipelines to ensure that monopoly rents are not forced on captive production.

3. Does Protection of the Reliance Interests of Shippers on Historically Regulated Offshore Interstate Pipeline Systems Effectively Subsidize the Production of Those Shippers?

No. During the technical conference, Williams and KeySpan asserted that maintenance of cost of service based regulation on historically regulated offshore interstate pipeline systems created subsidies and inhibited competition. This is incorrect.<sup>5</sup>

What Williams seeks is the opportunity to replace cost of service based regulation with a new layer of monopoly rents, one entirely unrelated to the historical costs of the facilities often long used to provide offshore transportation service. Layering on such monopoly rents creates a chilling effect when assessing the economics of future prospects for development activities and, in the long run, inflates costs. As Judge Brenner found in

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<sup>4</sup>Department of Energy, Office of Fossil Energy, Environmental Benefits of Advanced Oil and Gas Exploration and Production Technology 34 (October 1999).

<sup>5</sup> Rate design or cost allocation issues should be addressed in a pipeline rate case, not in connection with jurisdictional determinations.

his Initial Decision in *Shell Offshore Inc. v. Transcontinental Gas Pipe Line Corp.*, 99 FERC ¶ 63,034 (2002), *order on initial decision*, 100 FERC ¶ 61,254 (2002), *reh'g denied*, 103 FERC ¶ 61,177 (2003):

Even if it is correct that only NPI producers would be affected by WFS and Transco's abuse of their monopoly power over NPI gathering, and further assuming that the high spindown gathering price and other terms sought from multiple NPI producers would not affect prices to the downstream market purchasers at points such as Station 30, this is no defense to that abuse. I agree with Shell that this argument is a cynical attempt to deflect attention from WFS's and Transco's abuse of monopoly power, and as discussed below, the resultant frustration of the Commission's regulation. Shell RB at 32-35. WFS and Transco are attempting to shift from their regulated transportation portion of NPI gas to the unregulated gathering portion of the unitary service, monopoly rents that they were not permitted to collect under regulation of their interstate transportation monopoly. SOI-1 at 11-12 (Means); SOI-10 at 12 (Means); SOI-4 at 9 (Harris). And they could not earn such monopoly rents in an unregulated gathering market if the market were competitive. SOI-1 at 11-12 (Means). In effect, the abusive monopoly behavior allows WFS, in concert with its affiliate Transco, to take a share of Shell's (and the other affected NPI producers') profits. This taking is the other part of the equation of the reaping of monopoly profits by WFS, for the combined benefit of both affiliates and their parent, TWC. This frustration of Commission regulation should not be permitted even if only Shell and other producers are hurt.

In addition, even if the clearest, most direct victim of the WFS NPI gathering grip is Shell and other producers, it is not clear that consumers would ultimately not be harmed. If abusive concerted monopoly market behavior and frustration of Commission regulation is acceptable in this and other specific, individual cases because it is small, how then can it be remedied and prevented before multiple such occurrences have a cumulative effect on downstream consumer markets. Distortions of price signals by monopoly abuse of ratepayer producers, on a long-term cumulative basis, cause distortions of production and development decisions that ultimately cause bad economic results. SOI-1 at 12-13 (Means). And what does it mean for the integrity and therefore efficacy of proper NGA regulation of the monopoly of interstate transportation of natural gas to allow small abuses of the system? It would be a signal that if affiliates are careful not to affect too much or too directly the consumer market for gas, they could get away with abusing their market power over gathering services where producer/shippers are dependently captive. This would frustrate Commission regulation.

The Commission agreed with the ALJ that repeated abuses of market power could have a significant cumulative effect on downstream markets by distorting producers' price signals. The Commission went further by stating that the public would thereby suffer from reduced competition and "distortions of production and development decisions could also have a negative economic impact."<sup>6</sup> These are not impacts that should be disregarded particularly in light of the market conditions the industry is operating under today.

4. Should the Commission be concerned if producers own and operate jurisdictional gas pipeline infrastructure on the offshore?

No. Regardless of whether it is owned by a producer of natural gas, an interstate pipeline holding company, or any other type of market participant, any company that accepts a certificate to operate a regulated gas pipeline system must be willing to operate the system in accordance with the Commission's open access rules and regulations. These rules and regulations should include an adequate code of conduct that calls for separation of responsibilities and firewalls where appropriate. In this regard, NGSAA supports the Commission's efforts in docket RM01-10 to establish code of conduct standards regarding relationships between interstate pipelines and their energy affiliates.

5. Are there special services that a non-jurisdictional gathering pipeline can offer that a jurisdictional pipeline cannot?

No. While some pipeline companies may contend they can provide better services if unregulated; we believe regulated pipelines can provide both the level of service and the flexibility needed offshore on a timely basis, while still operating in an environment

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<sup>6</sup> 103 FERC ¶ 61,177, at P. 22 (2003).

that provides the needed protections for customers that are afforded by the Natural Gas Act. This is evident from the flexible rate schedules that the Commission has permitted several regulated pipelines to put in place to better accommodate their offshore shippers.

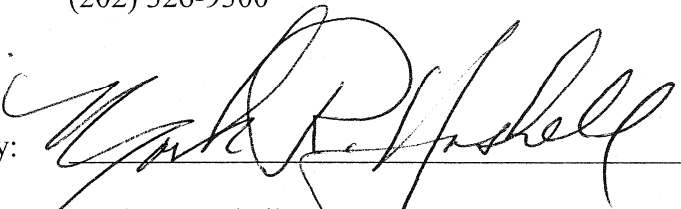
NGSA appreciates the initiative of the Commission in re-examining its policy with respect to historically regulated offshore interstate pipeline systems operating in shallow water. NGSA requests that the Commission act favorably in this proceeding on the recommendations outlined in NGSA's pre-technical conference comments.

Respectfully submitted,

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October 3, 2003

**UNITED STATES OF AMERICA  
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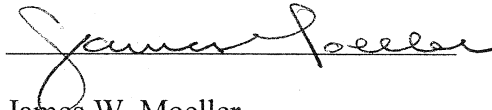
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**Docket No. AD03-13-000**

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of the foregoing filing upon each person designated on the service lists compiled by the Secretary in the above-captioned proceedings.

Dated at Washington, D.C. this 3rd day of October 2003.



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