

## **SAFETY AND UTILITY OVERSIGHT OF NATURAL GAS GATHERING PIPELINES IN PENNSYLVANIA**

Chairman Cawley, and Commissioners, thank you for the opportunity to appear here today. My name is Kathryn Klaber. I was hired just the three months ago as the first President of the Marcellus Shale Coalition (MSC). The MSC was formed in 2008 and has since grown to include 92 members, representing the majority of companies now operating in the Marcellus. We are a young organization, we are a vibrant and growing – a reflection of the growing recognition of the benefits that the Marcellus brings to Pennsylvania’s businesses and residents.

The Marcellus Shale Coalition was founded to advance the responsible development of natural gas from the Marcellus Shale geological formation in Pennsylvania and the enhancement of the Commonwealth's economy that can be realized by this clean-burning energy source. The members of the coalition work with our partners across the Marcellus play to address issues with regulators, government officials and the people of the Commonwealth about all aspects of producing natural gas from the Marcellus Shale formation. All of us are dedicated to developing natural gas resources safely and efficiently.

The natural gas industry is bringing huge investment capital and the associated job creation to Pennsylvania. The Marcellus presents a very special opportunity for all of us in the Commonwealth, and we must take care to foster this development with modernized statutes and a competitive regulatory framework. We also must continue to keep public safety and environmental protection as the cornerstone of how we conduct business in the Commonwealth. With the industry’s contribution of more than 100,000 jobs and \$1 billion in revenues for state and local governments this year alone, there is a lot riding on our collective deliberations and actions.

I would also like to introduce Lindsay Sander. Lindsay has worked in the pipeline industry for nearly a decade. She has worked actively on the definition and re-regulation of natural gas gathering and much of her career has been dedicated to pipeline safety and utility regulatory issues.

We appreciate the opportunity to appear here today to discuss issues relating to the development of pipeline infrastructure resulting from the development of the Marcellus Shale. The Commission put forth several questions relating to pipeline safety and the utility regulation of gathering and intrastate pipelines. We want to address those questions in addition to providing information on the history, and current regulation, of those assets. We know our time before you today is limited. We will do our best to

address your questions and look forward to working with the Public Utility Commission in the future.

We want to make three key points this afternoon.

- Industry supports the regulation of gathering pipeline consistent with the requirements of 49 CFR 192 overseen by U.S. Department of Transportation's Pipeline and Hazardous Materials Safety Administration (PHMSA). We would support the PUC becoming a "State Agent" for the purpose of inspecting and enforcing the current safety regulatory requirements found in 49 C.F.R. 192 for natural gas gathering pipelines.
- The MSC believes gathering facilities are regulated appropriately for safety under federal law and are sufficient to address the development of the Marcellus safely and efficiently.
- The MSC believes that the regulation of a natural gas gathering system for safety purposes, and that system's utility status, are independent issues and should not be intermingled. They are two distinct issues- one addressing the operational conditions of a system and the other dealing with financial transactions and contracts of an entity. For these reasons, we have segregated these issues for the purposes of today's discussion.

A core principal of the MSC is recognizing the absolutely critical role of protecting public safety and the environment. Operators take numerous actions in designing, constructing and maintaining their pipelines to ensure the integrity of their systems. Frankly, it is in the best interest of everyone to keep the material being transported inside the pipeline. Several of the questions put forth by the PUC focus on safety issues, and specifically the regulation of natural gas gathering assets. To address these questions, it is important to briefly review the structure of the pipeline safety program, the last decade of pipeline safety oversight and some of the on-going efforts to address current safety issues.

It is vital to understand that pipeline safety is a federal and state coordinated effort. In 1968, Congress established a national pipeline safety effort that was designed to provide minimum standards with enforcement of those standards primarily residing in qualified state agencies. The pipeline safety laws allow individual states to adopt safety standards, but those standards must be consistent with the federal standards. This structure has produced an exemplary safety record in the pipeline industry as federal and state officials have worked with pipeline operators and the public to achieve continuously improving results.

The primary question the PUC has posed to the stakeholders here today is: Which agency is responsible for the enforcement of the existing regulatory requirements for

natural gas gathering pipelines? Under the federal and state cooperative arrangement established by Congress, PHMSA has been granted authority by Congress to regulate all pipelines for the purposes of safety with the additional authority to delegate that power to qualified state programs. The Pennsylvania Public Utility Commission (PUC) operates a pipeline safety program that is considered qualified by PHMSA to oversee local distribution systems and intrastate natural gas transmission pipelines.

If the PUC or PHMSA seeks to further clarify who is responsible for the inspecting and enforcing of the current safety regulatory requirements found in 49 C.F.R. 192 for natural gas gathering pipelines, the MSC will work cooperatively with the appropriate agency officials, legislative members and other stakeholders to address this issue. Any clarification of authority, however, should not be based on or determined by the utility status of a pipeline.

If there is a need for additional funds to support the PUC pipeline safety program due to the Commonwealth being granted state agent status for gathering pipelines, the MSC will be supportive of a reasonable fee structure based on the number of regulated miles of pipeline. However, the fees assessed should not exceed the total cost of the program. The PUC already receives funds from PHMSA on an annual basis to help fund the PUC safety division. Paying a fee based on mileage is the most accurate and fair manner of allocating the cost of such a program. Fees based on an entity's revenues are not reflective of the regulatory oversight and will not provide a stable source of revenue.

The oversight of pipeline safety has been heavily scrutinized over the last decade. Congress has passed two major bills addressing pipeline safety issues. The Pipeline Safety Improvement Act of 2002 and the Pipeline Inspection, Protection, Enforcement and Safety Act of 2006 mandated significant new and increased requirements for gathering, transmission and local distribution pipeline operators. These requirements focused on ensuring the integrity of pipelines through identifying and addressing both internal and external factors posing potential risks to the safe operation of the nation's infrastructure. During this time, PHMSA also took action to complete many outstanding regulatory initiatives that had been discussed or started, but were yet to be completed. One of the outstanding regulatory issues mandated by Congress was defining what a natural gas gathering line was and determining the appropriate level of regulation for those lines meeting the new definition.

At that time, the definition of natural gas gathering had been debated for several decades and had yet to be settled in any formal fashion. PHMSA had initially tried to address the issue in 1991 but the effort was halted after significant unfavorable responses were received from stakeholders. Congress then directed the agency to review the issue in 1994, but the agency did not raise the issue again until 1999. That effort too was delayed until the end of 2002. However, PHMSA issued an advisory

bulletin in late 1999 to clarify their interpretation of the end of gathering based historical decisions and court precedent.

Prior to the early 2000's, the definition of gathering line was circular, and safety regulations were only applicable if a gathering line was located within the boundaries of an incorporated or unincorporated city, town or village. In many people's opinion, this was not appropriate because boundaries are arbitrary in nature and did not adequately represent the actual risk posed to the public. Members of the public, industry stakeholders, and regulatory officials from around the country, including the National Association of Pipeline Safety Representatives (NAPSR), the organization of state pipeline safety officials, participated in the effort to clarify both the definition and the appropriate level of regulation. Industry also worked with PHMSA to conduct an extensive study of the history and safety record of gathering facilities across the nation.

Those participating in the discussion focused on defining the beginning and endpoints of natural gas gathering. Several years prior to PHMSA's effort, production and midstream industry representatives had attempted to define "gathering" through a comprehensive document that later became API Recommended Practice 80, or RP 80. RP 80 is a 53 page document that identifies and discusses the different operations all of the possible configurations of equipment used to produce, move and manufacture gas in order to prepare it for long-distance transportation. The document is complete with a decision making tree and more than 20 diagrams. For this reason, many, and especially regulatory agencies at the state and federal levels, did not want to accept RP 80 as it was drafted. Those objecting cited two primary reasons: the document's complexity and the ability to interpret the beginning and endpoints of gathering for the purposes of avoiding regulation altogether.

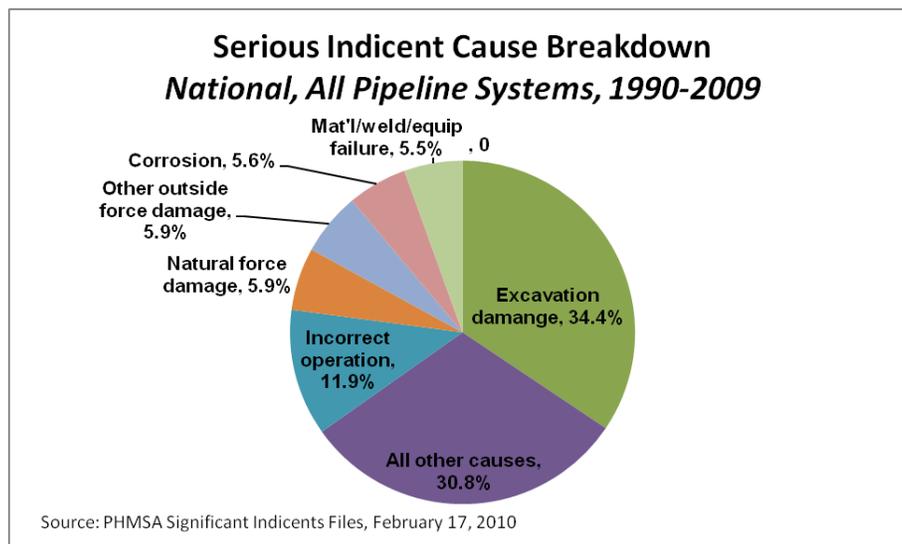
To address these concerns, PHMSA placed certain restrictions on the beginning and endpoints of gathering when it released its final rule in March of 2006. While PHMSA based its definition of gathering on RP 80, the agency clarified that the beginning of gathering may not extend beyond "dual-use" equipment. In other words, whether facilities were "gathering" would be determined using an operational test regarding the purpose of the facility rather than determining the type of operator. Additionally, PHMSA placed specific limitations on the endpoint of a gathering line. The endpoint may not extend beyond: 1) the first downstream processing plant; 2) the commingling of gas from separate fields more than 50 miles apart; and 3) the furthestmost downstream compressor used to increase gathering line pressure for delivery into a transmission or distribution pipeline.

PHMSA also clarified how gathering lines were to be regulated by establishing different categories based in the risk to the public. Gathering lines operating in densely populated areas and operating at higher pressures and stresses are required to follow the vast

majority of the requirements applicable to transmission pipelines. Those gathering lines operating at a lower pressures and stresses in densely populated areas are required to meet certain construction standards, to be protected through the use of cathodic protection, to participate in one-call damage prevention programs, to be marked and to conduct public education efforts with key stakeholders. It is important to note these are the minimum required safety standards. Operators often go beyond these requirements during the design, construction, and daily operational activities conducted to maintain the integrity of the system.

The MSC supports the definition of natural gas gathering adopted by PHMSA. The MSC believes that it provides a measure of certainty for operators, clear guidance to regulatory enforcement agencies, and, most importantly, the protection of the public and the environment. For operators, certainty equates to safety. The MSC also supports the current regulations for the safety of gathering lines because they reflect the differing levels of risk to the public from the operation of those pipelines. Operators are aware of an on-going effort by PHMSA to reevaluate the beginning point of gathering. If PHMSA changes the definition of gathering or the regulatory requirements in the future, the industry will abide by those changes. In the mean time, the MSC believes the current definition of natural gas gathering identifies and appropriately regulates those lines that pose the greatest risk to the public.

The requirements to conduct public awareness efforts and participate in a state-one call program are also particularly important to highlight here. The greatest risk to any pipeline is excavation by private individuals or commercial excavators. According to PHMSA, more than 34 percent of all pipeline accidents are caused by excavation activities.



The best way to prevent this damage is educating the public, and especially commercial excavators, as to the importance of calling before they dig and waiting the appropriate time before beginning any work. For this reason, the MSC is supportive of the Pennsylvania one-call program and believes all gathering and transmission pipelines should participate in that process. The enforcement of the one-call law is also crucial to discuss. The sufficient enforcement of the state one-call law is an even greater incentive for excavators to take the steps required to protect the integrity of underground facilities and the public.

Now, I would like to turn to the subject of utility regulation and the questions posed by the PUC concerning how specific terms in Pennsylvania statute are applicable to the operations of natural gas gathering entities.

Under current statutes, the Pennsylvania General Assembly empowered the PUC to regulate local distribution companies serving the public. Pennsylvania statute defines a public utility as "[p]ersons or corporations owning or operating in this Commonwealth equipment or facilities for producing, generating, transmitting, distributing, or furnishing gas for the production of light, heat, or power to or for the public for compensation."<sup>1</sup> The section specifically provides that "the term does not include a producer or manufacturer of natural gas not engaged in distributing the gas directly to the public for compensation."<sup>2</sup> .

The MSC does not believe that natural gas gathering pipelines and processing facilities meet or should be included in this definition or that of "natural gas supplier" or "supply services". There are several reasons for this, most notably the operational structure of the systems, the quality of the gas being transported, and the customers being served by gathering operations.

Historically, gathering line operators have not been considered public utilities under Pennsylvania law because gatherers do not provide consumer quality gas to the public. They are simply the entity which gathers the raw gas stream from the production field. Gatherers are often considered manufactures because of the processes by which they have to condition or treat the gas before it can be transported by transmission pipelines to end-use consumers. Pennsylvania law specifically provided an exemption for those engaged in production or manufacturing of gas.

The PUC also posed several questions as to how operators handle gas entering the systems with regard to the operations of their individual systems. The answers to these questions will differ greatly depending on individual business structure of an entity and

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<sup>1</sup> See also 66 Pa.C.S. § 102 and 66 Pa.C.S. § 2202.

<sup>2</sup> Id. and 52 PA Code 59.1

the contracts that the entity enters into with its customers. The business of gathering gas is complex. It should remain one that permits flexibility to producers and gatherers to negotiate the terms of service necessary to transport and process the gas while also preserving market competition.

Let me give you an example of one gathering system that I believe will highlight the complexity of the gathering business and demonstrate the need to preserve the non-utility status of gathering operations. Consider a producing area where there are four producers and two gathering entities, one that is a utility and the other that is a non-utility. Each producer has a different quantity of gas to be moved to market, and the quality of the gas stream is different for each well. Producer A is a small producer that has gas requiring processing before it can be delivered to a transmission pipeline. The producer does not want to deal with anything beyond his facilities and just wants to sell his gas at the well head to someone, but not necessarily the gatherer. Producer B also has gas that needs to be processed before delivery to a transmission pipeline but wants to be more involved in the marketing of his gas. Producer B is comfortable in working with the gatherer to market the gas and wants a percentage of proceeds contact where in the gatherer and producer will split the proceeds of any gas or related products sold after processing. The split of proceeds is subject to negotiation between the gatherer and the producer and is ultimately defined by the terms of the contract. Producer C wants to handle the marketing and processing of his gas and just needs transportation to the transmission pipeline. In this case, he will pay a fee for service to transport his gas from Point A to Point B. Producer D wants to have the same amount of BTUs at the tailgate of the processing plant as he produces at the well head. However, the gas must be processed before delivery to a transmission pipeline. In this case, Producer D secures a contract with an entity for transporting and processing the gas for a fee, but retains ownership of the gas and markets pipeline quality gas to interested parties.

This scenario highlights the importance of flexibility in the marketplace and the ability of operators to enter into unique contracts that meet the needs of their clients. Those who utilize space in the pipeline or services related to gathering can negotiate with the gathering entity for the terms, conditions and fees paid. Unlike utilities, non-utility gathering pipelines have greater flexibility to negotiate contracts to meet the needs of individual producers or transporters rather than prescribed terms and fees required by typical utility regulation. Thus, the contracts for each of these producers can be radically different.

The utility, on the other hand, would only be able to offer specific services for a predetermined rate. Each producer would be able to make the decision as to whether the terms and conditions for moving their gas stream were more appealing from the utility or the non-utility. However, each producer chooses the non-utility because they are able to negotiate better terms and fees with the non-utility. This is because the non-

utility has flexibility in the way they conduct their business. They know they have to offer competitive rates and service or they will lose to those with controlled rates of service and return. In other words, non-utilities are able to respond quickly to producers' needs, rather than being bound by a prescribed process.

This situation is somewhat analogous to the difference between a private car and a public bus. If you are the owner of the car, you have the ability to make personal choices about where and when you drive the car. With a public bus, you have no control over when or where the bus goes. The only choice you have over the bus is which of the scheduled pick-up times you use to get on the bus. The length of time it takes to get from your location to your destination and the cost of a bus ride is determined by others. Non-utilities serve the role of a private car as opposed to the public transportation offered by the bus which in this example represents the public utility lines serving the public for compensation.

Under Pennsylvania statute, gathering systems are non-utilities unless they specifically seek utility status. In theory, the only reason a gathering entity would seek utility status would be to gain the power of eminent domain. However, for many gathering operators, securing the power of eminent domain is not worth the additional regulation generated by being designated a public utility. An entity may want a controlled rate of return, secured through a potentially burdensome rate-making process, but that is unlikely.

The presence of non-utility gatherers also promotes competition. If only one pipeline is in an area, that entity may charge rates that the market will bare. However, if an operator becomes too expensive or whose services or operating practices are unresponsive to the needs of their clients, other pipelines will build systems that compete for its business because there is no barrier to enter the marketplace. This environment is healthy because it has a natural way of balancing the needs of producers with those of the gathering operators. However, if a public utility pipeline is in an area, other pipelines are less likely to build additional capacity because of the monopoly like system it creates. Establishing rates are costly and burdensome and rate cases can be complex, especially when different services are being provided.

I would like to cover one more issue before closing, the PUC asked what the role of the agency should be in siting gathering and intrastate pipeline facilities. The PUC should not seek to expand its jurisdiction in order to site pipeline infrastructure, whether gathering or transmission facilities. Any action to do so will likely stifle the development of the Marcellus. Pipelines are incredibly expensive to build. Pipelines operators will not build facilities that are unwanted or unneeded. Please know that operators take all kinds of factors into consideration when deciding when and where to build pipelines. These factors include the path of least resistance, environmentally sensitive areas, the

willingness of landowners to negotiate for easements, and the topography of the area, locations of supplies and locations of markets, among other things. It is in the pipeline operator's best interest to select the best, most economical and environmentally friendly path. If an entity is able to secure the proper permits and negotiate with landowners to their satisfaction, there is no need for additional regulatory oversight.

The PUC should preserve open markets, the ability of private operators to support the industry, and encourage the development of the Marcellus. The Marcellus provides an exciting opportunity for the Commonwealth and the nation to develop clean burning natural gas that will help fuel the nation's economy going forward.

The MSC, the pipeline industry and regulatory agencies are all dedicated to pipeline safety and transporting energy resources in the safest, most efficient and economical manner possible. We believe the regulations in place to ensure public safety in concert with the development of the Marcellus Shale. We know that any incident is a reflection on the industry and we take the safety of our lines and facilities in this regard very seriously.

We appreciate the opportunity to be here today. We are happy to answer any questions you may have today or in the future.