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Energy Supply and the American Consumer
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Testimony of
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Good morning. My name is Donald Santa and I am appearing today on behalf of the Interstate Natural Gas Association of America (INGAA). INGAA represents the interstate and interprovincial natural gas pipeline industry in North America. INGAA's members transport over 90 percent of the natural gas consumed in the U.S., through a 180,000 mile pipeline network.

This pipeline network provides the indispensable link between natural gas production and the local distribution companies that serve retail consumers. Natural gas represents 25 percent of the primary energy consumed annually in the United States, a contribution second only to petroleum and exceeding that of coal. Consequently, the natural gas pipeline delivery network is a critical part of the nation's infrastructure.

It now is widely recognized that North America is experiencing a fundamental shift in the supply and demand equation for natural gas. INGAA agrees with the assessment that we are not running out of natural gas; rather we are running out of places where we are permitted to explore and produce it. Abundant natural gas resources exist in North America and worldwide and can supply the market with natural gas at reasonable prices, provided that public policies do not unreasonably limit resource and infrastructure development.

An important corollary to this answer is the important role of pipeline and storage infrastructure in ensuring that natural gas supply can satisfy market demand. Two examples, one from a producing region and another from a consuming region, illustrate this point:

The first example concerns how expanding the Kern River Gas Transmission Company interstate pipeline benefited both Wyoming producers and Nevada and California consumers. I am sure that Mrs. Cubin recalls how low Wyoming natural gas prices were a year ago compared to the prices then received by producers elsewhere in the West. The root cause of this disparity was that natural gas production in Wyoming exceeded the pipeline capacity available to export Wyoming gas to consuming markets. Wellhead prices in Wyoming fell to as low as 58 cents per million Btus (mmBtu) while wellhead prices in New Mexico -- where pipeline capacity was much more prevalent -- averaged about $1.60 per mmBtu.

This situation changed dramatically last spring when the Kern River expansion entered service. Kern River doubled the capacity of its pipeline from Wyoming to Nevada and California. As a result, producer prices in New Mexico and Wyoming are nearly identical now. Downstream consumers in Nevada and California have benefited as well from the increased competition between sources of gas supply. Other proposed new pipelines will provide additional outlets for

Wyoming production. For example, El Paso Corporation is working on a new pipeline, called the Cheyenne Plains Pipeline, that will move Wyoming gas to markets in the Midwest. I would note that Rocky Mountain production is projected to continue increasing in the future. Therefore, unless pipeline infrastructure can keep pace, there is the prospect that gas supply again will outstrip the take away capacity for moving it to consuming markets.

The New York City market offers an example from the other end of the natural gas delivery chain. This winter, prices in New York City at times have exceeded $40 per mmBtu compared with average prices of $6 per mmBtu at the benchmark Henry Hub in Louisiana. The blame for this "basis blowout" has been laid squarely on the inadequacy of pipeline capacity for delivering gas into the New York City market. Pipeline capacity serving this market has remained the same for the past four years, despite steadily increasing demand. Because of this bottleneck, New York City residents and businesses pay much higher prices for natural gas than do consumers in other regions and even consumers in other cities in the Northeast. A recent study by the economic consultant Energy and Environmental Analysis concluded that consumers in the Northeast – and particularly in New York City – will continue having to pay unusually high natural gas prices until the bottleneck is relieved by the construction of new pipeline capacity entering the region.

This begs the question: Why hasn't the New York City bottleneck been relieved already? Numerous projects have been proposed, but few have been built. The already daunting task of constructing interstate pipeline infrastructure in developed areas has been made even more challenging by concerted local opposition that is focused increasingly on the state and local permitting process. The irony is that such dilatory tactics are contributing to the significantly higher natural gas prices being paid by consumers who, in many cases, live within the same jurisdictions that these permitting agencies represent.

The short-sighted focus of such opposition becomes apparent when one considers the consumer value that pipeline and storage capacity create by ensuring adequate energy supply and dampening price volatility. A perspective on this can be gained by comparing the cost of such infrastructure with the total cost of delivered natural gas. According to the Energy Information Administration (EIA), over the three-year span between 2000 and 2003, the cost of pipeline transmission and storage represented at most 15 percent of the average winter heating season price of natural gas paid by consumers in the United States. A bar graph illustrating EIA's analysis is appended to this testimony. Investing in adequate pipeline and storage infrastructure is a prudent insurance policy against the risks to consumers and the economy from the price shocks that can be caused by capacity constraints.

What solutions are there to the natural gas supply and infrastructure dilemma now facing us? As the Subcommittee is no doubt aware, liquefied natural gas, or LNG, has captured the attention of both energy policymakers and the energy industry after years of being only a miniscule part of total U.S. gas supply. LNG clearly is <u>part</u> of the answer to the natural gas supply and demand question. It is not, however, a "silver bullet" that single-handedly will solve the problem.

While INGAA is predominantly a pipeline group, INGAA's members include the owners of the four operational LNG terminals in the United States. In addition, our members are among the developers of proposed LNG terminals. Consequently, we have some perspective on the issues associated with operating and developing LNG import terminals.

Federal regulators at the Federal Energy Regulatory Commission (FERC) and the U.S. Coast Guard have streamlined the approval of onshore and offshore LNG terminals. Still, just as with interstate pipeline projects, the need for final approvals issued by other federal, state and local agencies acting pursuant to federal and state law likely will be a significant factor affecting how quickly LNG developers can respond to demands of the market. Furthermore, if the hurdles are too high or if the approval process takes too long, LNG import facility development will be discouraged and project sponsors will deploy their capital elsewhere.

There also must be adequate pipeline take away capacity for getting LNG supplies to consuming markets. Richard Grant, the President and CEO of Tractebel LNG North America, which operates an LNG receiving terminal in Everett, Massachusetts, stated at a conference last week that, unless something is done, "[t]here will be 10 to 15 times more LNG capacity than (pipeline) takeaway capacity." This would be analogous to the situation in Wyoming that I addressed earlier; that is, too much natural gas supply trapped behind to little pipeline capacity.

An important natural gas supply option in North America is Alaska natural gas. The members of the Subcommittee are familiar with the proposal to construct a pipeline that would deliver natural gas from Alaska to the Lower 48. Current estimates suggest a natural gas reserve of approximately 35 trillion cubic feet on the Alaskan North Slope, and possibly even more. In just the last several weeks, two different groups have proposed constructing an Alaskan Natural Gas Pipeline. It is encouraging that two competing sponsor groups have come forward. This healthy competition promises to result in a project that is more innovative and less costly than many previously thought.

These developments highlight the very real price that will be paid if the Congress fails to enact a comprehensive energy bill. Both the loan guarantees and the permitting process that would be authorized by H.R. 6 are essential to making either of the competing proposals a reality. If we as a nation want natural gas from Alaska to begin flowing to the Lower 48 within the next decade, the legislation must pass soon.

While LNG and Alaskan natural gas are promising sources of gas supply, they alone are not sufficient answers to the nation's natural gas supply dilemma. If the United States wants adequate supplies of natural gas at reasonable prices, it must pursue all available supply that can be developed in an environmentally responsible manner. This means that we must expand supply from the Rocky Mountain region, the deepwater Gulf of Mexico, and Arctic Canada, as well as from Alaska and LNG. Failure to do so will cost consumers, the economy and the environment.

Let me now briefly review the public policies that affect natural gas pipeline construction and operation. Interstate pipelines are subject to economic regulation by FERC and safety regulation by the Department of Transportation Office of Pipeline Safety (OPS). Both agencies are widely recognized for their excellent work on natural gas pipeline siting and safety issues. FERC's leadership has emphasized prompt and thorough processing of pipeline construction applications and the agency's Office of Energy Projects has been very responsive to a wide variety of stakeholders in its review of pipeline applications. The OPS also deserves praise. The agency recently issued a wide-ranging, balanced final rule governing pipeline integrity, pursuant to the Pipeline Safety Improvement Act of 2002. The pipeline industry also appreciates the role played by the White House Task Force on Energy Project Streamlining. The White House Task Force took the lead in executing a Memorandum of Understanding to coordinate decision making

among the various federal agencies whose authorizing statutes give them a jurisdictional stake in some aspect of the pipeline permitting process.

Yet, the pipeline industry has serious and growing concerns about the ability of federal, state and local regulators to erect impediments to efficient, timely pipeline construction. In particular, while the Natural Gas Act (NGA) provides FERC with the exclusive authority for determining whether proposed pipeline projects are in the public convenience and necessity, other agencies increasingly are using the jurisdictional hook provided by other laws to second guess the decisions made by FERC after a thorough review as part of the NGA certificate process.

The prime example of this has been some state agencies' use of delegated authority under the Coastal Zone Management Act to question pipeline routes that already have been reviewed and approved by FERC. This is now occurring in at least three instances. The problem has been compounded by the procedures followed by the National Oceanic and Atmospheric Administration (NOAA) of the Department of Commerce in reviewing appeals from state decisions finding a proposal to be inconsistent with its coastal zone management plan. In the one appeal that has been fully litigated at the administrative level, NOAA spent 18 months compiling its own record from scratch after the same issues had been thoroughly vetted as part of the FERC review process. This administrative delay created great uncertainty for the pipeline sponsor and penalized consumers by yet again postponing relief from the costs of the New York City pipeline bottleneck. These events also have cast a cloud over other pipeline projects in coastal states, including another proposal to serve the New York City area, as well as proposed LNG import projects that must run the same regulatory gauntlet.

In order to realize the widely recognized energy security and environmental benefits that can result from abundant and affordable natural gas supplies, the nation must take steps that facilitate the development of natural gas supply and infrastructure. Several important provisions in H.R. 6, the comprehensive energy bill, would remove impediments to building pipeline and LNG infrastructure. These provisions include the following:

- The conference report would amend section 7 of the Natural Gas Act to authorize an appeal to the U.S. Court of Appeals for the D.C. Circuit if an action by a federal or state agency unreasonably delays or conditions the construction of a pipeline project authorized by FERC.
- The bill also would specify that the extensive record developed by FERC in its certificate proceeding must be used by other agencies in any administrative appeals concerning a project that has been reviewed by FERC.
- Reforming the Public Utility Holding Company Act will encourage the capital formation necessary for building energy infrastructure.
- As already mentioned, the Alaska Natural Gas Pipeline authorization is critical to constructing the infrastructure needed to bring this resource to consumers.
- The bill improves access to pipeline right-of-way corridors across federal lands and eliminates uncertainties surrounding the methodology used by the federal government in setting fees for using such rights-of-way. We thank Mrs. Cubin for her leadership in advocating these right-of-way provisions.

In sum, while these are not the provisions in the energy bill that garnered the headlines, they represent areas where changes in the statutory framework for U.S. energy policy can make a real

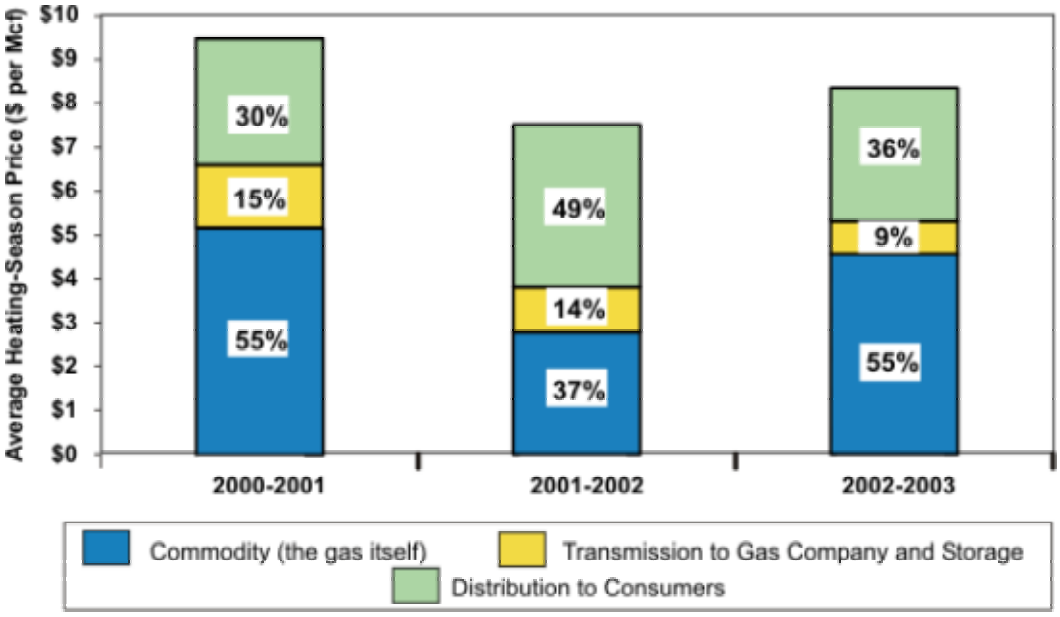
contribution to ensuring that there is adequate pipeline and LNG import infrastructure to serve the energy needs of the nation's consumers and its economy.

Before concluding, I would like to highlight two additional issues for the Subcommittee. The first deals with security and pipeline service surety. Because natural gas pipelines are a part of the nation's critical infrastructure, INGAA and its members have been working with numerous federal and state agencies in developing heightened security procedures. The Department of Homeland Security is now verifying these procedures through audits. A key part of this exercise is contingency planning for response and recovery should an incident occur. Along with the Department of Energy, we are modeling the effect and response to possible attacks/outages on key pipeline systems. We also are encouraging participation by the operators of other parts of the infrastructure so that we can appreciate better the interdependencies within of our national infrastructure and plan for how best to restore service in the event of an emergency.

The second issue is the implementation of the pipeline integrity rule that I mentioned previously. The mandate that natural gas systems in populated areas perform "integrity assessments" is one of the most important provisions in the Pipeline Safety Improvement Act of 2002. The new law establishes strict timeframes for baseline integrity assessments and re-assessment intervals. Beginning this year and continuing throughout the decade, significant pipeline segments will be removed from service in order to perform assessments and any resulting repairs. This unprecedented integrity program will almost certainly affect natural gas deliverability and delivered natural gas prices. The effect could be compounded because, coincidentally, the integrity assessments will happen during what could be a protracted period of tight natural gas supplies. We urge Congress to pay close attention to the implementation of this rule, particularly if significant service disruptions begin occurring.

In closing, let me emphasize the importance of public policies that foster a positive environment for natural gas pipeline construction and investment. The interstate pipeline business model is not "build it and they will come". Rather, given the capital intensity of the pipeline business and its status as a regulated industry, pipelines are built only when a sufficient number of credit worthy shippers have committed to long-term contracts for firm service. Therefore, the overall health of the energy industry and policies that encourage shippers to make responsible choices in contracting for natural gas supply and pipeline capacity are important to maintaining sufficient natural gas infrastructure. The alternative is not desirable, because inadequate pipeline capacity creates supply bottlenecks that result in higher costs for consumers and the economy. Consequently, as it examines policies to increase natural gas supplies, the Congress also should promote policies that encourage a robust natural gas pipeline infrastructure.

Figure 1. Breakdown of Natural Gas Prices Paid by Residential Consumers During the Heating Season



Source: Energy Information Administration, *Natural Gas Monthly, May 2003* .