

## Second Annual Searle Center Conference on Federalism and Energy

### Capturing the Price of Opposition

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# Session Three

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**Federalism and the Rise of Natural Gas**

**Capturing the Price of Opposition**

# Federalism and the Rise of Natural Gas

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- Horizontal Drilling and Hydraulic Fracturing have changed the supply picture by allowing oil and gas producers to go directly to the source rock to extract oil and gas.
- We all know the statistics on this -what was once the unconventional is now the conventional.
- It's in the news daily and is part of our culture.
  - Mick Jagger makes reference to hydraulic fracturing in the Rolling Stone's single, "Doom and Gloom" ("Fracking deep for oil but there's nothing in the sump.").

# Federalism and the Rise of Natural Gas

- As a practicing lawyer I'm asked by my clients to advocate their position.
- I've created a hypothetical question: My client has asked me to develop a strategy to respond to the opponents of Horizontal Drilling and Hydraulic Fracturing. We agree that:
  - My client can't be in every forum and venue to respond to all the challenges.
  - There's no political solution in sight.
  - They can't wait until a revised or new regime is (re)created to resolve the issues.
- As a result they want me to try to work within the current legal and regulatory framework.

# Federalism and the Rise of Natural Gas

Two lines of thought occur to me:

FIRST:

- Although many individuals, communities and some states oppose Horizontal Drilling and Hydraulic Fracturing (and in some cases more broadly drilling for, producing and consuming natural gas) they continue to use natural gas in:
  - Generating electric power (at least in part) and
  - Heating and cooking.

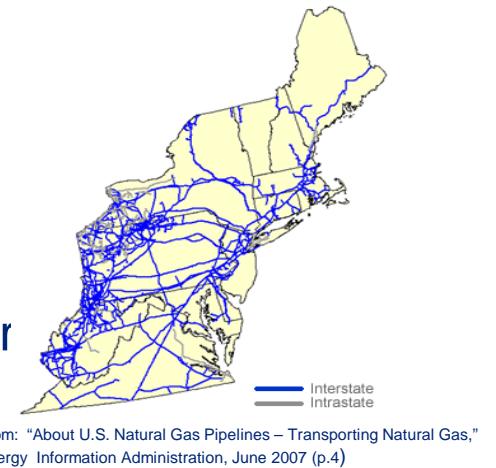
SECOND:

- An economic approach to regulation has been popular for decades in order to encourage or discourage an activity or outcome. (I also think – Chicago, Posner, Coase – a winning approach for today!)
- So how do I combine these two?

# Federalism and the Rise of Natural Gas

- The state of New York is a good laboratory to explore this.
  - It's a major beneficiary of supplies from the Marcellus and Utica shale plays and that supply is produced by Horizontal Drilling and Hydraulic Fracturing technology.
  - At least three major interstate pipelines bring natural gas to the state from these shale gas producing plays.
  - Yet New York has a de facto ban, or at least a moratorium, on Horizontal Drilling and Hydraulic Fracturing.
- At bottom, in New York you can buy or use shale gas extracted by Horizontal Drilling and Hydraulic Fracturing, but only if the technology is applied in another state.

Northeast Region Natural Gas Pipeline Network Transportation



From: "About U.S. Natural Gas Pipelines – Transporting Natural Gas," Energy Information Administration, June 2007 (p.4)

# Federalism and the Rise of Natural Gas

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- What if we internalized the cost of NOT producing natural gas in New York (and of course of similar bans elsewhere) and propose that those choices bear the associated costs, if any?
- If there are costs, how can I make opponents bear the costs of a ban or moratorium?
- Can this be done in a way that may be acceptable to the regulator and within the restrictions outlined by my client?

# Federalism and the Rise of Natural Gas

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- It occurs to me that although the wellhead price of natural gas is deregulated, much of the FERC's statutory authority over natural sales remains intact.\*
- Additionally, the FERC sets the tariff rates and terms of service which apply to the ratepayers of those three interstate pipelines accessing the Marcellus and Utica production for delivery to New York.
- These pipeline tariffs often contain trackers which are used to recover certain costs. For example, they have been used to recover take-or-pay costs associated with natural gas production to ease the transition to a deregulated market.\*\*
- Great, a federal agency has jurisdiction, has successfully done something similar, and so can implement this!

# Federalism and the Rise of Natural Gas

- But, how do I quantify the amount they should pay?
- The May 2013 order issued by the Department of Energy regarding the Freeport LNG export project gives me an idea.\*\*\*
  - The order (in part) addressed comments to a study DOE had requested the Energy Information Administration (EIA) perform on the impact of exports of LNG on energy markets, specifically natural gas prices.
  - Essentially EIA removed from U.S. consumption quantities of natural gas and (re)calculated future natural gas prices. Not surprisingly, EIA projected and quantified the rise in natural gas prices as supplies were removed.
  - DOE also concluded that under certain scenarios coal would be more competitive as a fuel source than natural gas.<sup>1/</sup>

<sup>1/</sup> Note to self: I like that prediction; what a great argument for my client to make.

# Federalism and the Rise of Natural Gas

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- As a result, I recommend to my client that they file a request with the FERC to institute a rulemaking proceeding to add to each MMBtu of gas transported by interstate pipelines to local distribution customers (LDCs) the incremental price resulting from not producing shale gas.
- I recommend my client retain consultants to prepare a report that develops this estimate and also ask the FERC to employ the services of EIA to conduct a study similar to one it did for exports of LNG.

# Federalism and the Rise of Natural Gas

- I tell my client that I have another idea but outside the scope of my retainer. We should propose (to...???) to divide the U.S. into regions based on oil and gas basins, similar to RTOs and ISOs for electric transmission, and adopt their stakeholder process to develop consensus decisions on Horizontal Drilling and Hydraulic Fracturing.
- I can't repeat their answer here but they remind me that the U.S. Bureau of Land Management (BLM) has proposed a rule covering Hydraulic Fracturing on federal lands. The first time the rule was issued in 2012 BLM received 178,00 comments. It was revised and issued for comment a second time in 2013. BLM received 1.35 million comments.
  - - They ask me if that's what I had in mind!

# Federalism and the Rise of Natural Gas: endnote

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\*The FERC grants blanket certificates of convenience and necessity under section 7 of the Natural Gas Act to interstate natural gas pipelines for unbundled sales of natural gas (18 CFR 284.284) and automatically to any person, such as a marketer for sales for resale at unregulated rates ( 18 CFR 284.402). See discussion in *Amendments to Blanket Sales Certificates*, Docket No. RM03-10-000, Order No. 644 (November 17, 2003), 105 FERC ¶ 61, 217. For example: “[T]he Commission’s jurisdiction under the NGA includes all sales for resale by interstate and intrastate pipelines and LDCs and their affiliates, other than their sales of their own production. The Commission’s jurisdiction also includes a category of sales by entities that are not affiliated with any pipeline or LDC. Such entities are those making sales for resale of gas that was previously purchased and sold by an interstate or intrastate pipeline or LDC or retail customer.” (P 11).

\*\* *United Distribution Companies v. FERC*, 88 F.3d 1105 (1996)

\*\*\**Freeport LNG Expansion, L.P. and FLNG Liquefaction, LLC*, FE Docket No. 10-161-LNG, DOE/FE Order No. 3282 (May 17, 2013). Order issued under section 3 of the Natural Gas Act.

THANK YOU.

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