



Texas Pipeline Association

Thure Cannon
President

May 13, 2016

The Honorable Larry Gonzales
Chairman, Sunset Advisory Commission
P.O. Box 13066
Austin, Texas 78711-3066

RE: Sunset Staff Report on the Railroad
Commission of Texas

Dear Chairman Gonzales:

On behalf of the Texas Pipeline Association (TPA), I am submitting the following comments on the Sunset Staff Report on the Railroad Commission of Texas (RCT). TPA is a trade organization representing 49 member companies who engage in the business of gathering, processing, treating and transporting natural gas and hazardous liquids through intrastate pipelines in Texas.

The TPA very much appreciates the opportunity to submit these comments and is willing to discuss these comments further if desired, including the presentation of testimony at the Sunset Commission's public hearing. For the current comment period, TPA will limit its comments to those recommendations in the Sunset Staff's Report that are most essential from TPA's perspective. However, TPA is willing to discuss and state applicable positions on any of the other issues raised in the report.

Staff Recommendation 1.1: Change the name of the Railroad Commission to the Texas Energy Resources Commission and continue the agency for 12 years.

TPA strongly supports continuing the RCT. The RCT's broad jurisdiction over the Texas hydrocarbon energy industry uniquely positions it to oversee the many interrelationships between different segments of industry and enables it to protect the interests of the State, the public and the industry as a whole.

TPA has no strong position or opinion regarding a name change other than if there is a change, the name be encompassing of all of the functions of the Commission and be implemented in a fiscally responsible manner. At this time, TPA will remain uncommitted on the recommendation of the "Texas Energy Resources Commission" as a new name.

Staff Recommendation 2.1: Require use of the State Office of Administrative Hearings for contested gas utility cases;

TPA strongly opposes this recommendation. In 2001, the Legislature authorized the transfer of contested gas utility cases to the State Office of Administrative Hearings (SOAH). Very few cases were ever taken to SOAH for handling during this time before the Legislature reversed itself the very next session and allowed hearings to be conducted at the RCT. Sunset staff's same arguments were made to support the 2001 transfer as are being made to support a transfer now. Other than an argument for consistency with other agencies, there is no beneficial reason for this recommendation as neither consumers nor the state realized any benefits from SOAH conducting gas utility hearings in the past. Because SOAH is funded by assessments against the various state agencies whose cases are heard by SOAH judges, there are no fiscal savings from this recommendation. In fact, arguments were made in 2003 that the transfer of cases to SOAH resulted in an increased cost to the state.

Furthermore, the RCT has an effective, efficient, fair and transparent hearings process which is a core function of the agency. This hearings process is needed to assist in regulating over 200 investor owned gas utilities. Since 2013, the RCT has effectively reduced litigiousness and ensured that examiners are prohibited from engaging in ex-parte communications. The RCT hearings process should be allowed to continue to work and should not be interrupted simply because Sunset staff believes the universal use of the SOAH process is better policy.

Lastly, this recommendation, as it has in the past, fails to recognize that the RCT has broad jurisdiction over all areas of pipeline and distribution facilities under the Natural Resources Code and portions of the Utilities Code. It also fails to recognize that the vitality of the Texas energy industry and the efficient production of Texas oil and gas are dependent on the transportation of that oil and gas to markets inside and outside of Texas through pipelines. The RCT regulates such things as the connection of wells to gathering facilities or pipeline facilities, the prevention of discrimination in the taking of gas from producers and the circumstances in which a well can be disconnected from a pipeline or service can be terminated, regardless of whether those facilities are "utilities." The RCT's pipeline safety programs and environmental protection programs also apply to facilities whether they are "utilities" or not. RCT must maintain staff and expertise to hold hearings on a variety of pipeline issues other than "utility" issues. There are no real efficiencies to be gained by having the RCT bear the cost of its own staff and facilities, while also paying SOAH for a duplication of that same capacity.

This recommendation will result in a system of regulation that will cost both the RCT and SOAH more money and be less efficient than the current process.

Staff Recommendation 2.2: Require the Railroad Commission to use the State Office of Administrative Hearings for all other contested case hearings.

TPA strongly opposes this recommendation. Again, the contested case hearings process at the RCT is fair, transparent and efficient. Hearings examiners and Technical examiners at the RCT have the expertise and institutional knowledge that ensures that decisions are evidence-based, efficient and impartial. SOAH judges will not provide the same issue specific, technical expertise that is housed at the RCT. It is unusual that Sunset staff spends time in their report

trying to correlate the average years of experience of SOAH judges and trying to conclude that those years of experience make them better than a RCT examiner in complex oil and gas cases. RCT examiners adjudicate cases specifically relating to oil, gas and other natural resource issues. The RCT Examiners include not only oil and gas legal experts but also engineers, geologists and economic analysts. By comparison, the vast majority of cases handled by SOAH are driver's license revocations, (an astounding 84% of its cases as reported by the 2013 Sunset Staff report.) While those case numbers boost the statistics for SOAH, they do not translate into the type of experience with the technically complex cases handled by the RCT's hearings staff.

In addition, the RCT has already taken steps to enhance the independence of its hearings staff and has committed to implementing an electronic docket system to make information more readily available to the public.

Staff Recommendation 2.3: Transfer gas utility regulation from the Railroad Commission to the Public Utility Commission.

TPA strongly opposes this recommendation. Sunset staff would lead you to believe this recommendation will be a seamless change, but it wholly discounts the significant differences between the gas "utility" industry and the electric "utility" industry. Particularly with regard to pipeline regulation, the experience of the PUC is devoid of the type of regulation mandated by statute for that portion of the oil and gas industry.

The RCT currently has the responsibility to regulate natural gas from the well head to the end user. This has resulted in a regulator that understands all aspects of the industry and the need for coordination between the various segments of the industry in order to provide for the efficient and economic development of the State's natural gas and oil resources. The drilling of wells is meaningless unless there is adequate pipeline infrastructure to move the product to a market, either inside Texas or beyond its borders. The RCT has dealt with these coordination issues for decades and separation of the two segments can do nothing but damage that coordination.

The PUC on the other hand has limited or no expertise in the oil and gas industry of which the gathering, pipeline and distribution facilities are integral pieces. Most of the issues involving the facilities which move gas from the wellhead to the customers have little to do with whether those facilities are "utilities" or not. TPA sees no benefit of tearing the regulation of these essential facilities into two pieces based on the Sunset staff's perceived "*potential* benefits from aligning the State's utility regulation within one agency." This recommendation seeks to take out an integral piece of the oil and gas industry, regulate it at another agency, and hope that it fits in the overall Texas oil and gas regulatory structure.

The regulation of pipelines involves extensive safety regulation which is unlike anything done at the PUC with electric utilities. While the recommendation does not suggest that safety regulation be moved to the PUC, the recommendation to move rate regulation ignores the significant cost impacts of safety regulation on the pipeline industry. Those costs have to be taken in account when rates are made and the recommendation would separate the driver of those safety costs, the RCT, from the rate setter. The report proposes that some type of coordination

agreement or understanding between the agencies could be reached, but without some evidence that gas utility regulation is not working appropriately, there is no need to break apart a functioning system and hope that it can be “coordinated” back into a seamless whole.

Sunset staff seems to be promoting a similar, yet much less effective regulatory model used by the Federal government in gas utility regulation. For interstate pipelines, the Federal Energy Regulatory Commission (FERC) regulates rates and the US Department of Transportation Pipeline and Hazardous Materials Safety Administration (PHMSA) regulates pipeline safety. This model is far less efficient than the Texas model and is one of the reasons that Texas is the most effective pipeline regulator in the nation. The recommendation ignores the fact that the RCT has had rate adjustment mechanisms in place to timely address increased costs related to safety for over a decade while the FERC has only begun implementing a limited safety cost tracking mechanism within the last year. As with pipeline integrity management, the RCT is far ahead of the federal regulators. There is no good reason to shift from an efficient and effective regulatory structure to one that has been shown to be less efficient and effective.

TPA also submits that the reliability issues in the gas industry are substantively different than those in the electric industry. For example, rolling blackouts can be used by electric utilities to address peak load situations, but are not a tool which can be used by gas utilities. While electricity can be turned back on by turning a switch, an interruption in gas service requires a serviceman to physically visit each and every consumer to turn off the valve at the meter and subsequently enter every house to assure that pilots are properly relit before the gas service can be restored. A gas distribution utility can be down for days or weeks if supply is lost. Reliability of gas service therefore requires coordination of all of the elements of the supply chain from production, processing and treating facilities, through the transmission pipeline infrastructure and then to the distribution systems, and ultimately to the end-use customer. The RCT has regulatory jurisdiction over every step of that process and has handled the necessary coordination of those industry segments over many years and in some of the most challenging times of supply shortages in Texas’ history. The proposed reorganization will separate downstream regulation from the rest of the oil and gas industry. This eliminates a unified regulatory structure where one regulator has the ability to reach all segments of the supply chain rendering the existing effective system inoperable.

With regard to rate regulation alone, there are significant differences between electric utilities and gas utilities. Virtually all rates on electric distribution systems are cost of service based. However, only a small percentage of gas utility rates are cost of service based. The remainder of the rates are market-based or competitive rates. This is an area in which the PUC has little or no experience while the Legislature has given the RCT the explicit authority to set market-based rates. Moreover, the Legislature has authorized, and the RCT has implemented, an informal dispute resolution process that addresses a wide array of issues, not just rates. Again, this recommendation presents no substantive support or benefits in this area.

Sunset staff’s report leads one to believe the PUC’s primary focus is utility ratemaking in the energy industry. This is clearly not the case as the PUC’s mission and history statement reflects:

The PUC's mission and focus have shifted from regulation of rates and services to oversight of competitive markets and compliance enforcement of statutes and rules for the electric and telecommunication industries.

Effective oversight of competitive wholesale and retail markets for electric and telecommunication is necessary to ensure that customers receive the benefits of competition. For water and sewer utility service, however, the focus remains on the regulation of rates and services.

(<http://www.puc.texas.gov/agency/about/mission.aspx>)

The competitive market oversight mentioned in the PUC mission and history statement is not the same as the RCT's authority to establish market-based rates. The PUC is guarding against market manipulation, not the actual setting of an appropriate rate for a competitive market situation. The RCT regulates the oil and gas industry from wellhead to end user. Gas utility rate regulation is clearly a core function of the RCT and an integral part of its overall energy regulatory activity.

Lastly, a review of the average costs of utility rate cases at SOAH/PUC versus gas utility cases at the RCT shows it has cost rate payers nearly 2 ½ times as much to litigate a utility rate case at SOAH/PUC than at the RCT over the last 10 years. TPA reviewed cost data from over 40 PUC rate cases and over 35 RCT rate cases from 2005 through 2015. The average cost of a PUC rate case was \$ 3.3 million compared to \$ 1.35 million at the RCT. This significant difference in cost between the two processes can be attributed to the fact that precedent has been established in cases in front of the RCT and the hearings examiners do not have to repeatedly re-litigate the same precedents. By moving contested cases to SOAH/PUC, all efficiencies of the RCT process are lost.

Staff recommendation 5.1. Authorize the Railroad Commission to enforce damage prevention requirements for interstate pipelines.

On its face, TPA agrees with this recommendation because it could further enhance the safety of pipelines operating within the State of Texas. The RCT's damage prevention program is one of the country's best and application of this program to additional pipelines is desirable. However, TPA strongly recommends that an adequate amount of pipeline safety inspectors and staff be allotted for this additional duty. TPA also recommends that penalties collected against operators and excavators that violate damage prevention rules be deposited specifically for RCT use in pipeline safety and damage prevention educational efforts. TPA also recommends additional analysis of this issue to ensure that if the RCT assumes this duty, the transition is equitable and funding for the program is seamless.

Staff recommendation 5.2. Authorize the Railroad Commission to create a pipeline permit fee.

TPA can be supportive of this recommendation as long as the fee be used to support the RCT's pipeline safety program, as well as the Oversight and Safety division which oversees the state's gas utilities and pipelines. TPA recommends further analysis of assessing a "permit" fee as opposed to another type of pipeline fee because of the varying impacts on members of industry. TPA suggests that that it will be most prudent to authorize an assessment of a fee with

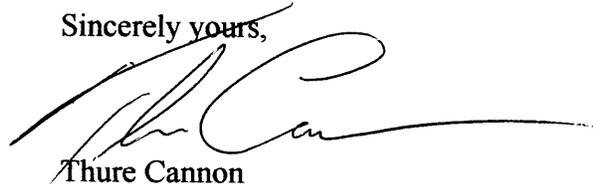
the Commission so it may determine the most equitable basis for any potential fee. Any fee legislation should provide sufficient flexibility for the RCT and contain a mechanism for the fee to be recoverable on an equitable basis. In addition, any fee legislation should also include a limitation that the revenue generated by the fee in combination with the existing pipeline safety and regulatory fee not exceed the total cost of administering the pipeline safety program and the Oversight and Safety division.

Staff recommendation 5.3. Modify language in the Appropriation Act to further ensure that the Railroad Commission collects, and is appropriated back, fee amounts to offset the costs of administering its Pipeline Safety program, including administrative costs.

TPA agrees with this recommendation.

TPA very much appreciates the opportunity to share our views with the Sunset Commission on the Sunset Advisory Commission Staff Report and we look forward to continuing to work with the Commission on these and other related issues important to our State. Thank you for your honorable service to Texas.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Thure Cannon', written over a horizontal line.

Thure Cannon
President

cc: Mr. Ken Levine, Director, Sunset Advisory Commission