Natural gas gathering, processing, and other midstream services agreements are necessary to get natural gas production to market. The importance of, and risk associated with, such agreements is heightened when additional infrastructure must be constructed to accommodate new production. As a consequence, these agreements have become critical with the recent increase in production from shale plays, such as the Marcellus, Utica, Haynesville, and Eagle Ford. This program will discuss typical legal and commercial issues that arise with these agreements.

The speaker panel includes: Bill Wolf, Assistant General Counsel at CenterPoint Energy, and Randy Rich, Pierce Atwood LLP.
Gathering, Processing and Other Midstream Agreements

EBA Brown Bag

December 13, 2012
Agenda

- Introduction
- What is Gas Gathering and Processing?
- Regulatory Status of Gas Gathering Systems and Gas Processing Facilities
- Contract Structures Typically Deployed in Midstream Arena
- G&P Infrastructure Development and Associated Legal Issues
- Other Midstream Agreements
- Q&A
Introduction: Who is CenterPoint?
Introduction: What is Shale Gas?
What is Gathering and Processing?

- **Gas Gathering**
  - Low pressure pipeline systems
  - Typically connecting large number of wells into pipeline webs that bring gas into larger takeaway pipelines
  - Different production areas dictate different gathering systems
  - Typically exempt from Federal regulation

- **Crude Oil Gathering and Transportation** *(not today, but…)*
  - No similar exemption for crude oil gathering under ICA
  - Common carrier obligations typically apply
  - Historically a producer-provided service; new shale plays driving third party providers
What is Gathering and Processing (cont)?

Gas Processing

- Industrial process to separate natural gas liquids (NGLs) from methane
- Traditionally meant to bring “raw streams” from wellheads within the gas quality specifications of takeaway pipelines
- Current NGL pricing makes NGL extraction key value driver; natural gas almost a by-product of gas processing
- Extraction process dependent on capacity of processing plants
- Fractionation required to further separate NGLs
The Natural Gas “Midstream” Value Chain

Natural Gas Production

Gathering Collection Lines

Treating, Processing and Fractionation

Transmission Pipelines

Storage

FERC Regulated Interstate Pipelines

End Users

LDC’s

Power Plants

Industrials

Other Pipelines

Marketing & Distribution
Gas Gathering
- Typically exempt from Federal regulation
- Often regulated by states; however depth of regulation varies significantly
  - Common access requirements
  - Common carrier obligations
  - Recognition of anchor shippers

Gas Processing
- No Federal regulation of processing unless owned by interstate pipeline
- Typically not “economically regulated” by state PSCs
- Largest single regulatory issue is environmental compliance
Gas Processing (cont.)

- Regulation of takeaway transportation
  - Natural gas transported through inter/intra-state pipeline network
  - NGL transportation either state or Federally regulated
    - Federal regulation under ICA
    - State regulation varies significantly.
  - What might we expect at the state level?
    - Common carrier or common access regulations
    - Possibility of prorationing requirements
    - Possible lack of recognized “anchor shipper” concept
    - Broad non-discrimination principles governing rates and access for NGL transportation
Gas Gathering Agreements
- Acreage dedications versus volume commitments
- Rate structures typically deployed
  - Fixed Fee
  - Sharing / In-Kind
  - Variable
  - Cost-of-Service
- Rates are largely structured in a similar manner to interstate transportation
- Option to provide bundled service
- Focus on gas quality and pressure
Contract Structures in the G&P Area (cont.)

- Gas Processing Agreements
  - Dedications to plant
  - Rate structures typically deployed
    - Fee-based agreements
      - Processor receives a fixed fee for processing gas; producer keeps 100% of NGLs
      - Processor has no direct commodity exposure; returns are fixed by rate and vary only with throughput
  - Considerations when contracting?
    - Demand for processing linked to NGL prices
    - Competes with blending
    - Fixed fees limit upside earning potential
Gas Processing Agreements

- Rate structures typically deployed (cont.)
  - “Keep Whole” Agreements
    - Processor retains NGLs removed from “raw stream” in exchange for keeping producer whole on a Btu basis
    - Processor gets mix of commodity exposure
  - Considerations when contracting?
    - Need to lock in long-term gas supply for “keep whole” arrangements
    - Exposure to commodity prices in NGL marketing agreements changes risk profile
Gas Processing Agreements

Rate structures typically deployed (cont.)

- Percent of Proceeds (POP) / Percent of Liquids (POL) Agreements
  - In POP contract, processor sells NGLs extracted and shares a percent of the proceeds from the sale with producer; processor’s share is payment for services rendered
  - In POL contract, processor takes a share of the extracted NGLs as payment for services rendered and markets them independently from producer

Considerations when contracting?

- POP and POL contracts expose processor to 100% commodity risk
- Require active marketing group within processing business to ensure best returns
- Can be useful when industrial/chemical load is nearby
G&P Infrastructure Development and Associated Legal Issues

- Infrastructure Development
  - Contract chains
    - Investment is predicated on anchor customers contracting for long-term commitments supporting new build-outs.
    - “Farm to market” agreements include commercial deal, upstream and downstream transportation, construction and EPC work, permitting, etc.

- M&A
  - M&A activity increasing in G&P area
    - EBIDTA multiples of publicly announced deals have increased significantly; highly competitive environment
  - Acquiring G&P assets through M&A poses traditional “deal risk”
    - Potential for antitrust issues
    - Need to term-up revenue-generating contracts
    - Acquirer focuses diligence on growth of regional business
Typical legal issues in G&P agreements?

- What is being dedicated to the gathering/processing system?
  - Volumes? Acreages? Specific GPM content of gas?
- Will the gatherer have an obligation to construct facilities to new wells? If so, what will they be?
- Who is responsible for procuring right-of-way? Who pays for it?
- Will the service being provided be firm, or something other than firm service?
Treating Services

- Different than processing
- Typically “field” treating of impurities like CO2 or H2S
- Skid-mounted equipment easily re-deployable
“Other” Midstream Agreements and Field Services Provided (cont.)
● Compression Services

- Third-party compression services to uprate pressure at well connects
- Typically found in fields where gas production meets gas quality specifications of downstream pipelines
- Skid-mounted equipment easily re-deployable
“Other” Midstream Agreements and Field Services Provided (cont.)
• Communication and Monitoring Services
  
  • Many small producers have no well communication or monitoring equipment
  
  • Many midstream companies offer services to remotely monitor or operate wells, provide SCADA services, etc.
“Other” Midstream Agreements and Field Services Provided (cont.)
• Marketing/Takeaway Contracts

  • NGL or crude marketing contracts or transportation agreements downstream of processing facility

  • NGL marketing contracts typically keyed off index price; however could be fixed as well
Questions?
Bill Wolf
Assistant General Counsel
CenterPoint Energy Field Services, LLC
william.wolf@centerpointenergy.com
(713) 207-5125
Energy Bar Association
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Federal Regulation of Natural Gas Gathering

Randall S. Rich
The Natural Gas Act

- Section 1(b) of the NGA exempts the production or gathering of natural gas from FERC's jurisdiction.
  - No Certificate or Abandonment
  - No Rate Authority

- However, gathering facilities belonging to a “natural gas company” (i.e., an interstate pipeline) and used to provide service “in connection with” jurisdictional transportation service are regulated under the NGA.
  - Rates and Charges
  - Terms and Conditions
Primary Function Test
Are Facilities Gathering or Transmission?

The Farmland Criteria:
(1) Diameter and length of the facility
(2) Location of compressors and processing plants
(3) Extension of the facility beyond the central point in the field
(4) Location of wells along all or part of the facility
(5) Operating pressure
(6) Geographical configuration of the system

• Not a mechanical test -- need not meet all criteria to be gathering
Modified Primary Function Test

• Particularly for offshore facilities, FERC considers the changing geographical and technical nature of exploration and production

• FERC established a “sliding scale” for offshore facilities permitting the use of pipeline of increasing lengths and diameters depending upon the distance from shore and water depth in the production area

• FERC also considers:
  • Purpose, location and operation of the facility
  • General business activity of the owner of the facility
  • Whether the jurisdictional determination is consistent with the objectives of the NGA and NGPA
Applying the Test

Indicia of Gathering

- 2-12 Inch Diameter (onshore)
- Short Length
- Web or Backbone Configuration
- Behind Processing Plant
- Central Point in the Field/Centralized Aggregation Point (offshore)
- Low Pressure (can use compression)
- Location of Wells Along Length
- The Owner's Business - Producer/Gatherer/Processor
- Non-Pipeline Quality Gas
  - Shale and Coalbed Methane - Larger, Longer, Higher Pressures
Other Issues

- Crossing State Lines
- No Transmission Upstream of Gathering
- Extensions Downstream of Processing Plants
  - Five Mile Limit
  - Limited Jurisdiction Certificates
- Spin-Offs and Spin Downs
- Unbundled Rates for Interstate Pipeline Gathering
Pipeline Safety

• PHMSA’s Perception: PHMSA perceives that new gas gathering, often associated with shale plays, is of a larger diameter and higher pressure than “legacy” gas gathering, and may pose a greater safety risk.

• Congressional Mandate: The 2011 amendments to the Pipeline Safety Act require PHMSA to review federal and state gathering regulations and report to Congress on whether they are adequate.

• Expanding Oversight: Currently, gas gathering lines in sparsely populated “Class 1” areas are exempt from PHMSA safety regulations. The agency is considering expansion of regulation to Class 1 gathering, and has begun informally collecting information from operators of these facilities.
Pipeline Safety

• Strengthening Existing Rules: In a 2011 Advanced NOPR, PHMSA sought comment on whether it should redefine “gathering line,” and impose new requirements related to corrosion control and integrity management, and new risk-based requirements for high-pressure, large-diameter pipelines.

• An Increased State Role: Under the Pipeline Safety Act, states may go beyond the minimum federal pipeline safety requirements. Recently, some states have expanded their requirements for gathering (e.g. PA and OH).

• What Next?: PHMSA is required to submit its report to Congress on gathering regulations by Jan. 3, 2014, but PHMSA rulemaking on gathering is possible before then.
Conclusion

- Just because your client calls a facility "gathering" does not mean FERC will agree
- Perform a Primary Function Analysis
- Seek advice from FERC Staff or a Declaratory Order for close calls
- Interstate pipeline gatherers should consider rate, spin-off and spin-down options
- Monitor PHMSA's developing jurisdiction over gathering
Thank You!

Randall S. Rich

202.470.6424

rrich@pierceatwood.com

www.pierceatwood.com

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