

FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, DC 20426

May 25, 2004

OFFICE OF THE CHAIRMAN

The Honorable John D. Dingell  
Ranking Member  
Committee on Energy and Commerce  
U.S. House of Representatives  
Washington, DC 20515

Re: Accounting Practice Requirements of the Energy Policy & Conservation Act of 1975

Dear Congressman Dingell:

I am pleased to reply to your letter of May 4, 2004, concerning the implementation of accounting practice requirements of the Energy Policy and Conservation Act of 1975 and recent announcements by certain oil and natural gas producers that they had substantially overstated their oil and gas reserves. The questions for which you request information are related to matters that fall within the direct authority and responsibilities of the Securities and Exchange Commission and Financial Accounting Standards Board. I have limited my comments to the Federal Energy Regulatory Commission's (FERC) authority and interest in these areas.

The FERC has regulatory responsibilities over public utilities and licensees, natural gas companies and oil pipeline companies that are engaged in interstate commerce. In the natural gas industry today, FERC regulates the rates and services offered by interstate gas pipeline companies for natural gas transportation, as well as the certifying, permitting and the construction of new pipeline facilities.

In the past, the Federal Power Commission, FERC's predecessor, also regulated the price of natural gas produced in the United States. In 1989, however, Congress enacted the Natural Gas Wellhead Decontrol Act which led to the end of all wellhead pricing in 1993. With the decontrol of the wellhead price of natural gas and the shifting role of pipelines from merchants to transporters after FERC's Order No. 636, jurisdictional companies either divested their exploration and production business to third-parties or transferred it to non-jurisdictional affiliates. At present there is only one FERC jurisdictional entity, Dominion Transmission, Inc., (DTI) that reports any investment in production properties to FERC. In its FERC Annual Report Form No. 2, DTI reported gross investment in production property of \$179 million. DTI sales of natural gas from these wells are not subject to FERC's jurisdiction.

Although FERC no longer regulates the wellhead price of natural gas, and exploration and production activity by FERC jurisdictional entities has practically been discontinued, the accuracy of producer estimates of natural gas and oil reserves in the United States continues to be relevant from a FERC regulatory perspective for several reasons.

First, depreciation rates for investments in interstate gas and oil pipelines are based in part on the recoverable natural gas and oil reserves to which they are attached. Inaccuracies in the estimated reserves could potentially lead to use of incorrect rates of depreciation by gas and oil pipelines. When depreciation expense calculated using the incorrect depreciation rates are included in a pipeline's cost of service, the resulting rates for transportation service would be incorrect.

Second, FERC-regulated companies frequently participate in intra-corporate lending arrangements with other non-regulated affiliated companies to obtain, on a consolidated basis, debt from the capital markets for the purpose of providing financial flexibility and lowering their cost of borrowing. Under these arrangements, adverse consequences that impact one member of the group, such as revisions of natural gas and oil reserves by affiliates of interstate natural gas and oil pipelines, impacts the financial interests or stability of all members of the group. For example, El Paso Natural Gas, a FERC-jurisdictional affiliate of El Paso Corporation (El Paso), reported in its 2003 FERC Form No. 2 that recent downward revisions in other El Paso affiliates' recoverable gas reserves could create liquidity issues for the parent and potentially jeopardize repayment of a substantial cash advance due from the parent.

Third, estimates of recoverable gas and oil reserves potentially influence the timing and placement of gas and oil pipelines needed to exploit and transport those reserves to end-use customers. Much of that pipeline infrastructure may require FERC certificate authority. In considering pipeline requests for certificate authority, it would be desirable for any related estimates of recoverable natural gas and oil reserves to be as accurate and reliable as possible.

Finally, let me assure you that the FERC shares your concern regarding the importance and potentially far reaching implications of entities providing incorrect financial information to the public. Since I became Chairman, the FERC has augmented its financial accounting and reporting requirements for FERC jurisdictional companies three times in order to improve the transparency, relevance and reliability of that information. The latest revision requires comprehensive financial reporting to the Commission (and public) on a quarterly basis starting in July 2004 and new attestation requirements for their Chief Financial Officers to more clearly establish accountability for the accuracy of that information.

I hope these comments are responsive to your request. If I can be of assistance on this or any Commission matter, please do not hesitate to contact me.

Best regards,

A handwritten signature in black ink, appearing to read 'Pat Wood, III'. The signature is stylized with a large, looping initial 'P' and a distinct 'W'.

Pat Wood, III  
Chairman

cc: The Honorable Joe Barton, Chairman  
Committee on Energy and Commerce

The Honorable Cliff Stearns, Chairman  
Subcommittee on Commerce, Trade, and Consumer Protection

The Honorable Jan Schakowsky, Ranking Member  
Subcommittee on Commerce, Trade, and Consumer Protection

The Honorable Spencer Abraham, Secretary  
Department of Energy

The Honorable William H. Donaldson, Chairman  
Securities and Exchange Commission

Mr. Robert H. Herz, Chairman  
Financial Accounting Standards Board