# Stranded Gas Hearings

(0502110810 Minutes)

**Informal Work Session: FERC Order #2005 –**
*Donald C. Shepler, Counsel, Legislative Budget and Audit Committee, February 11, 2005.*

DONALD C. SHEPLER, Counsel, Legislative Budget and Audit Committee, summarized the terms of the Alaska Natural Gas Pipeline Act enacted October 13, 2004, which helped further the process of the Alaska gas pipeline. The terms of the Act direct the Federal Energy Regulatory Commission (FERC), within 120 days from enactment of the Act, to promulgate regulations governing the conduct of open seasons for Alaska natural gas transportation projects, including procedures for allocation of capacity for the Alaska pipeline. On February 9, 2005, the FERC issued its final order for the open seasons for Alaska transportation projects. Mr. Shepler related his belief that the new rules set forth are "good" for Alaskan interests and offer all participants [in the Alaska pipeline project] the regulatory certainty desired.

MR. SHEPLER explained that the FERC statute regarding open seasons - the vehicles for which the capacity is bid on and awarded in a non-discriminatory manner for interstate gas pipelines - requires the promotion of competition in the exploration, development, and production of Alaska natural gas. Another open season requirement is to provide the opportunity for the transportation of natural gas other than from the Prudhoe Bay and Point Thompson units. Hence, all shippers would share equally in the cost of the initial capacity, plus the expansion capacity. Alaska's pipeline drilling development reserves is incumbent upon certainty as to expansion, he noted. The FERC has established a "rebuttable presumption," for the issue of rolled-in pricing for expansions.

MR. SHEPLER stated that the open season regulations apply to any initial or voluntary expansion capacity on any Alaskan natural gas transportation project. He said that the FERC sees the pipeline as "being built" and being subject to expansion in stages. The FERC will mandate low pricing as long as there is no subsidy during the pipeline expansion. The four producers have certainty that when the pipeline is built and the gas is brought to the line, the price the producers paid will be competitive with those of the existing shippers and other competitors in the production business.

MR. SHEPLER, in response to Chair Therriault, relayed his understanding that the status quo in Canada deems rolling treatment as appropriate.

MR. SHEPLER, in response to Chair Therriault, stated that the initial major shippers are not assured that their rates will never go up, but are assured that rates will never go beyond the initial rate agreed upon.

MR. SHEPLER stated that the FERC recognizes that pre-subscription agreements are essential for project sponsors to obtain financing for "risky projects." The FERC allowed prescription agreements on the initial capacity of the Alaska pipeline, but the stipulations were that the pre-subscription agreements must be made public within 10 days, all other bidders will have the choice of the best pre-subscription terms, and the pre-subscription capacity will be subject to pro-rata reductions. The original concern for Alaska was that all the oil capacity was going to be contracted outside the regulated season rules, but that has been diminished due to the fact it has to be published and all bidders have the right to negotiate for the same terms and conditions, he noted.

MR. SHEPLER said that the FERC complied with the administration's request for a study of instate gas needs. The study will be completed and published before the open season. The effective parties involved will receive the full benefit of the market and demand analysis. Thus, the parties can make decisions as to whether or not to bid for capacity to deliveries in the state. He informed the committee that the FERC's study should be of equal detail to the Department of Natural Resources' 2002 study on the Alaska natural gas instate demand. The FERC required the study to be conducted, approved, or otherwise sanctioned by an appropriate government agency, office, or commission, in the state. The study will allow the state to control the pipeline design because the pipeline sponsors must show that it can accommodate the instate needs, he noted.

MR. SHEPLER said the FERC originally proposed 120 days of opportunity to obtain the open season documents for the pipeline details. Hence, the parties had to make financial arrangements in a short period of time, he noted. The state suggested that 180 days would be more appropriate for the opportunity to complete the due diligence to submit bids. Despite the state's efforts, the FERC stayed at 120 days. He pointed out that the pipeline sponsors have to file the terms detailing the proposed open season with the FERC at least 90 days before the 120 days. Thus, effected parties will have 210 days of bidding opportunities, which is more beneficial than what the state anticipated, he noted. If the open season appears to be discriminatory or preferential, the issues will be resolved with the FERC in that 90 day filing resolution period, which ensures the open season will "move forward."

MR. SHEPLER recalled that the Legislative Budget and Audit Committee was concerned that all parties should be able to conduct their own assessments based on their own needs. Thus, the committee urged the FERC to require that the sponsors maintain a public request for service, including: the market demand for capacity and the engineering data. Although the committee didn't receive the requested dated market testing data the FERC agreed to review the project design. However, based on the open season data published by the applicants, combined with the instate study, and along with engineering data, the FERC believes that a party will properly be able to ascertain its own evaluations and negotiate with sponsors to have the pipeline voluntarily expanded.

MR. SHEPLER said that although the FERC provisions have "well served" Alaska it has yet to add the request of updated market testing data. The FERC usually awards capacity to the parties valued most, which has led the commission to adopt the net present value methodology for evaluating bids. He recalled that the Legislative Budget and Audit Committee was concerned that some parties would secretly acquire the capacity and deprive the market access to the capacity by biding on that capacity for decades. In order to counteract that, the committee urged FERC to propose a bid evaluation cap. However, when the FERC tried to cap bid capacity once, it was overturned by the court of appeals. As a compromise, the FERC [agreed] to monitor and investigate the appropriate capacity levels, he noted.

MR. SHEPLER concluded that the FERC's draft rules allowed the project sponsors to draft the rules of order as to how capacity is to be awarded and allocated on the pipeline. However, the Legislative Budget and Audit Committee suggested that under the statute, the FERC ought to write the rules of how capacity is to be awarded and allocated. He related his belief that the FERC provisions, thus far, are fair to all parties involved.

MR. SHEPLER added that the instate study required that the project sponsors notice proposed or tentative rates for deliveries of gas in the state of Alaska. Those rates will be based only on the cost of providing delivery in Alaska and do not include the downstream cost. The instate deliveries will be subject to a rate based on the cost of the provided service, thus, the short-haul contracts should not be discriminated against on a net present value evaluation, he noted.

CHAIR THERRIAULT pointed out that the original Alaska pipeline legislation had some unusual language dealing with competition and exploration. However, the FERC worked with the state to reword the language. The aforementioned proved a successful effort, he opined.

MR. SHEPLER, in response to Chair Therriault, said the pre-subscribed portion gets prorated if the bidders for the pre-subscription capacity totaled less than 100 percent and the additional parties who join put it over 100 percent.

MR. SHEPLER said that the FERC wants the pre-subscription customers, and not the open season bidders, to bear any shortfall on the pipeline project.

MR. SHEPLER, in response to Senator Wilken, said that the process has "probably very little" to do with an all Alaska gas pipeline. The proposal is only applicable if the pipeline leaves Alaska and goes to the Lower 48 where it becomes a FERC jurisdictional pipeline, he noted.

MR. SHEPLER, in further response to Senator Wilken, said that a ship traveling from Valdez to another Alaskan destination would be considered an interstate pipeline. But, a pipeline starting at the North Slope and traveling to Valdez for processing to the liquefied natural gas (LNG) that travels to California, would probably be considered a FERC jurisdictional pipeline. He added that he didn't believe such a pipeline would qualify for the loan guarantees.

MR. SHEPLER, in response to Senator Ben Stevens, clarified that a pipeline to an LNG terminal to move gas to another state is a FERC jurisdictional activity. However, that would not be part of this process or October's Alaska Natural Gas Pipeline Act, he added.

MR. SHEPLER, in further response to Senator Ben Stevens, commented that the 2002 Department of Natural Resources' study addressed the instate demand, but it did not address the delivery, take-off, and tie-in points, and he related his belief that the state needs to identify an agency or body to conduct and/or sanction the study of demand and delivery points within Alaska. He said that study would be "the bible," on how the pipeline has to be designed to accommodate the state's demands and the delivery points.

MR. SHEPLER, in response to Senator Ben Stevens, relayed that the study should be conducted before the sanction of the project. He said "There is no drop dead date by which anybody has to come forward with an open season, but certainly there is the 90 days before this order takes effect, and then there's some other amount of lead time by which time the applicant is going to have to identify the study that is sanctioned by the state."

MR. SHEPLER, in response to Senator Therriault, recalled the antitrust issue, as follows:

> In early January, [a] state legislator sent a letter to the Chairman of the FERC pointing out historical facts going back to 1977, when President Carter under the 1976 Alaska Natural Gas Transportation Act, issued his decision in recommendation with respect to the appropriate company to build an Alaskan pipeline and the route to be taken. At that time based on a report to Congress by the attorney general the presidential decision flatly prohibited the ownership in any equity interest by any producer of natural gas in Alaska. Based on advice by the attorney general ... that would be contrary to the antitrust laws of the country ... until 1981, under another provision of the Alaska Gas Transportation Act, President Reagan proposed and Congress agreed to waive that prohibition and the genesis for that wavier was the difficultly that the project sponsors in the '70s and '80s were having financing the project and they wanted to bring in to the table the producers and allow them to have an equity ownership in order to have them sign on for part of the debt burden for the project ... so that flat prohibition was waived by the president and the Congress. But the waiver was somewhat conditional. The waiver of the prohibition was conditioned upon if any producer of Alaska gas was to own any interest in the pipeline, in the context of the FERC certificating that pipeline project, the FERC would be required to specifically consult with the attorney general's Office, the Department of Justice, to determine whether or not there was a violation of the anti-trust laws and requirements as a result of that ownership and then separately the FERC itself was required to make its own specific findings that such ownership would not be in violation ... the anti-trust laws of the country .... The letter to the FERC Chairman, by another legislator here, asked the commission to advise the legislature ... if the producers came to own the line .... And in response, of the letter back dated at the end of January, Chairman Wood indicated that ... the commission would be mindful of the congressional and presidential policies that were articulated in the '70s and the '80s. And indicated that it would be prudent for the Alaska Legislature to assume that the concerns that prompted the prohibition and the waiver in the '70s and '80s continue to be valid and would be looked at by the commission, whenever they were presented with an application for an Alaska natural gas pipeline .... It appears that the FERC intends to be mindful of the foremost ancient history of what happened in 1977 .... And in the event that there is a producer ownership of the pipeline ... [it] is going to have different level of review, which is going to have a different timeline ... based on this history there will have to be other analysis done ....

MR. SHEPLER added that his expertise is in 30 years of FERC law and he is not an anti-trust expert. He

suggested that the state should consult a competent anti-trust law firm for the current developments of anti-trust laws and the regulatory environment for a natural gas pipeline.

CHAIR THERRIAULT relayed that he and Representative Samuels have had conversations with Chairman Wood of FERC and the administration in order to better understand the implications for pipeline development in the state of Alaska.