

Stranded Gas Hearings (0407281130 Minutes)

Access to Capacity for Producers and Explorers Without an Ownership Interest in or Effective Control of the Pipeline

Mark Hanley, Manager, Public Affairs for Alaska, Anadarko, July 28, 2004.

MR. MARK HANLEY, Manager, Public Affairs for Alaska, Anadarko Petroleum, said Anadarko is an explorer with an interest position, being partners with ConocoPhillips, and owns acreage at Alpine, NPRA and in the Foothills. Anadarko is very supportive of getting a gas pipeline built. He would focus today on areas of differences and concerns.

You've heard a few things here and one of the issues you've heard is that FERC will guarantee - FERC is your protector. I would only say that we all look at what are the exceptions to the rules and where can we be disadvantaged potentially. Part of the problem in this process is it's all speculation. So, we have to speculate things that many times they won't all occur. But, if we don't look at what possibly could occur, we're not being responsible to our shareholders. I would say for you folks one of the things is that you've got to listen to all the parties, but you ought to have your independent folks. Because I would agree that generally, the FERC is going to regulate this pipe; they are going to be the ones that make a lot of the determinations. So, understanding the rules of the game...and looking at it from, maybe, the state's perspective, as well, and saying how can we be disadvantaged....

MR. HANLEY reminded the committee that a few years ago the state chose its royalty in kind and actually put out a bid for its royalty gas. Anadarko bid on it successfully - wanting the gas so it could go to an initial open season. However, Anadarko doesn't have reserves right now and is not likely to go to an initial open season. The three producers really didn't like what Anadarko did a few years ago - because in the terms of its contract, it could get capacity and then go out and explore for the gas. When it found the gas, it could return the state's gas with certain notice provisions. The state gas would then have to be carried by the other folks. So, they would get pro-rated even though they have a contractual right to that capacity.

Anadarko was told from the beginning to not worry about capacity because the pipeline could be expanded, but when the shoe was on the other foot, the producers were reluctant to expand capacity saying that would increase risk to the pipeline.

That sends a message to us. Maybe when they're telling us it isn't a problem to get it, maybe it is. I don't know what, but that gives you an example of one of the concerns that we have about this process when they say it's fair for expansion....

MR. HANLEY moved to the subject of producer owned or independently owned pipelines and which is better. His general testimony in the March meeting was that Anadarko doesn't care who owns the pipe as long as there is fair access terms and conditions at a reasonable price. But, there's always a natural tension between the shipper, whose goal is to have the lowest rate, and a pipeline owner, whose actual goal is to make as much money as they can. "This is what all the protections are out there for."

MR. HANLEY read Bob Loeffler's comments in Petroleum News:

What determines how high the rate of return is on equity is how risky the pipeline is. Pipelines will argue I'm not an average pipeline. I'm more risky than anyone else, so I deserve more. Of course, shippers on the pipeline argue they're not risky at all.

MR. HANLEY reflected:

That's that natural tension.... If the shippers are largely the owners, as well, you've heard the natural tendency there - there's an incentive there to shift your profit as much as possible to the pipeline system. That's a concern for most of us.

For the state it should be a concern because it decreases the wellhead value and it decreases the state's revenue if the profit is taken out of the pipe instead of out of the gas. For explorers, it means our costs are higher. So, it's a concern for us. When you get into a natural system and you're going before FERC arguing what is that rate of return - should it be 12%, 14.5% -

everybody is arguing that this is a huge risky pipeline. I'm not going to argue that it isn't. But the tension isn't necessarily there, because if the big shippers didn't own the pipe, they'd be pushing as hard as they can to have it closer to a 12% rate of return, because that's going to mean the pipeline tariff is lower.

In this case, if the pipeline owners own it, I'm not sure that the big shippers are not likely to be out there arguing. In fact, they won't be opposing the higher rate of return on the pipeline, itself, because they know that it also helps both competitively as well as through their overall rate of return, because the state's picking up about 20% of any increased cost in that. That's something that doesn't have to do with the pipeline costs.... I think anybody who is a shipper would want the pipeline operated at the lowest cost and not built over cost to try and capitalize that.

MR. HANLEY related also that the Natural Gas Policy Council said:

The state must develop a clear and sophisticated understanding of open season rules governing access to a contract carrier pipeline and devise strategies to facilitate access to the pipeline for firms exploring for or developing new gas discoveries on the North Slope or Interior basins.

The Legislature also passed a resolution in 2002 that said:

Provisions for access to the pipeline by explorers on a fair and reasonable basis including a proper open season with fair and reasonable tariffs and...they and the state have the ability to obtain expansion of the pipeline if it's economically and technologically feasible.

A letter from Governor Knowles to Senator Bingham also states:

Access for new discoveries - is necessary to mandate that in the event of new discoveries on or around the North Slope or Interior Alaska. And, whether on federal or state lands, the owners of these discoveries will have access to the pipeline in order to market their gas. It is estimated that undiscovered gas reserves may be in the order of 100 TCF or more. Legislation should give the FERC clear authority to require the owners of the Alaska portion of the Alaska Highway project to expand the capacity of the pipeline in order to accommodate all new discoveries. Absent such a provision, new gas discoveries could be left at the back of a long [line] of gas awaiting shipment or worse, indefinitely stranded in place, because, unlike most areas in the Lower 48 states, one pipeline will be the sole source of available transportation.

MR. HANLEY emphasized that Alaska is different in that it will have only one pipeline. Nan Thompson, who was chair of the Regulatory Commission of Alaska (RCA), said:

A pipeline owned by producers will not have an incentive to transport gas developed by their competitors to market.... If the state wants to encourage competition amongst producers and full development of its gas resources, we need legislative authorization for our regulatory agency to evaluate the economics of the proposed expansion and require support for an application for expansion at the FERC when expansion promotes the state's best interest.

A letter from Governor Murkowski said:

We also believe it is in the best interests of the state for the pipelines to be owned and operated by an unaffiliated pipeline company assuming that such a company is able to provide the lowest possible tariff.

MR. HANLEY suggested that there's enough people with concerns about ownership of the pipeline to urge the Legislature to look at the issue closely. Alaska is different than the Gulf Coast, which has competition, because it has a monopoly. Three producers control 90% of the gas on the North Slope. They have spent many years jointly working on the project.

To be honest with you, there really isn't competition for that gas getting into it, nor can there be and I'm not saying it's their fault. But, when you're at Prudhoe Bay, BP can't just produce its gas and leave every body else's in the ground. There's a lot of legal precedence about overlift, underlift and lots of problems with that. So, there's going to be an agreement from Prudhoe Bay owners about what is the optimal off-take of gas from that field. There has to be. The same thing at Point Thompson - they have to come to an agreement among the owners on what's the optimal amount coming out. When they know that... they know how much they need to go to the open season and nominate capacity. It's not a negative thing; it just shows you they've worked together building the pipe.... There is one group out there doing this thing and when you get to the open season, they will say.... typically...it's conducted to determine how big the pipeline needs to be, what interest there is going to be out there, are there other people that are willing to commit so

they can size the pipe. To be honest with you, that's all done. I think they would be very surprised if anybody other than Prudhoe Bay and Point Thompson owners...if significant gas came in from somewhere else.

Whether or not there is an anchor shipper agreement or whether they can set aside capacity that isn't in there really isn't the huge issue, particularly in the initial open season, because frankly, they are the only ones that have expansion capacity. I think I've explained to you before, as an explorer, without identified reserves, and that's us or any of the other people out there, we can't go to the open season, nominate .5 BCF a day and make a commitment of \$300 million a year, in that range, for 20 or 30 years without knowing we actually have the gas to put in there. It's a chicken or egg thing.

The explorers are going to be focused on the expansion, what the terms and conditions are, if the pipe is actually built so it can be easily expandable, how much it can be expanded. What those terms and conditions are are going to rely a lot on FERC and others to make sure that we do have that ability.

Again, who is going to look out for our interests? The FERC is out there looking at this stuff, but I would say the state has some ability. There is a Stranded Gas Act where the state can include provisions; they do have some leverage. I would say our RIK (royalty in kind) process has not been finalized and we haven't been actually granted, but I would say don't give up your right to take your gas in kind. That's one of the few leverage points you have. I suspect they would ask you to not do that, but I think as a state, you should not do that.

When you go back to the ownership of the pipe by a producer, where is the tension in the system? Let's just say that the producers own a third each of the pipe and I don't know what the interests are going to be, and they control 90% of the gas. If you don't count the state's gas, it's less, but they are probably going to carry it in value, well they're a net owner. Their interests are largely going to be 100% ownership of the pipe, so their interest is going to be as a pipeline owner. That's the concern.

MR. HANLEY explained that Order 2004 (a) tries to put a firewall between the pipeline owner and the affiliates. There is an attempt to not share information, but one must look at the exceptions. He tried giving the committee an idea of how FERC balances this.

Order 2004(a) - The commission (FERC) is balancing its concerns that a transmission provider (the pipeline) will abuse its relationship with a marketing or energy affiliate by providing it unduly preferential access to information about potential expansion plans or new production areas against the need to facilitate infrastructure development by allowing the transmission provider to coordinate construction and planning with an interconnecting gatherer pipeline or producers....

Therefore, the commission clarifies that transmission also includes an interconnection to facilitate gas transportation service. Thus, discussions between a natural gas transmission provider and an energy affiliate to provide an interconnection or expansion for the energy affiliate would be covered by the transaction-specific exception.

MR. HANLEY translated that to mean that there is a transaction specific exception to the rule that says you can't have conversations out there. They say that interconnecting entities may discuss the location, practicality and cost of potential interconnections with an affiliated transmission provider. The purpose is to encourage the transmission provider and interconnecting energy affiliate to work together to develop additional infrastructure to facilitate development of production.

There are exceptions to the rules.... If they do that, they have to record the meeting, they have to keep a transcript of it, they have to keep it for three years and they have to make it available to FERC. This is all intended to make sure that nothing goes wrong.

The Order of 2004 had a discussion about whether a non affiliate could voluntarily consent in writing to allow a transmission provider of the pipeline to share the non affiliate's information with the pipeline owner's marketing affiliate. He didn't know why he would want to get them information that they could share with their own affiliate, but it was allowed and says:

Several commenters, including indicated shippers, urged the commission not to adopt the voluntary consent provision. They argued that it is anti-competitive, because even if a shipper agreed to disclose the information, the consent may not truly be voluntary, because the transmission provider could be exercising market power.... That's the normal tension that occurs in these things....

BP argues that the commission should eliminate the voluntary consent exemption in the natural gas area. There is no business reason why a customer would allow the transmission provider to share that customer's information with a transmission provider's marketing or energy affiliate.

According to BP, transmission providers could coerce a customer to consent. Therefore, the consent is not truly voluntary. So, these are the comments. So, when people say am I being paranoid, I would just point to an example like this and say....

This is a very complex field. There are lots of things that are out there. There are companies who are shippers who have very legitimate concerns about the pipeline companies and the power that goes with both.

MR. HANLEY concluded by urging the Legislature to watch the terms and conditions closely.

REPRESENTATIVE LES GARA said he also had concerns about letting FERC control the state's destiny, but asked assuming the state is skeptical that FERC will get us the best price for transporting gas, what can the state do to ensure the lowest possible transportation price.

MR. HANLEY again pointed out leverage in the Stranded Gas Act, but he didn't know if it was significant. The state needs to understand and participate in the FERC process.

REPRESENTATIVE MIKE HAWKER asked if he had any immediate concern that the state is abrogating its responsibility or is he being cautious.

MR. HANLEY replied that he is being cautious. One provision in the Federal Energy Bill says within 120 days of its enactment the commission shall promulgate regulations governing the conduct of open seasons for Alaska natural gas transportation projects, including procedures for the allocation for capacity and the regulations shall include the criteria and timing for any open seasons, promote competition in the exploration, development and production of Alaska natural gas and for any open season for capacity exceeding the initial capacity provide the opportunity for the transportation of natural gas other than from Prudhoe Bay and Point Thompson. That's part of the federal package that includes preliminary judicial review, expedited permitting, etc. It also has a provision specifically allowing FERC to force an expansion of a pipe.