

Stranded Gas Hearings (0407281615 Minutes)

The Array of State Tools for Improving Access

Marty Rutherford, Deputy Commissioner, Dept. of Natural Resources, July 28, 2004.

MS. MARTY RUTHERFORD, Deputy Commissioner, Department of Natural Resources (DNR), said her presentation addresses both the regulatory and commercial tools available to the state to improve access to pipeline capacity, including expansion capacity. She would discuss the Stranded Gas Development Act as a key commercial tool giving the state the ability to negotiate conditions for access along with other contract terms.

Another key tool are the oil and gas lease provisions, specifically the state's ability to take its royalty either in value or in kind and our discretion to switch between these periodically.

On the regulatory front, the state has the opportunity to influence other policy makers, both the regulatory and the legislative arms, including Ottawa, Canada and Washington D.C., also the U.S. Federal Energy Regulatory Commission (FERC), Canada's National Energy Board (NEB), which is an independent federal agency in Canada that regulates several aspects of Canada's energy industry and the Regulatory Commission of Alaska (RCA). My comments are organized around the structure of relationships, specifically, government to industry, government to agency and government to government.

So, let me begin with the first category, which is government to industry. I might note here that the first category will take the bulk of my time, the second and third categories will be pretty brief.... As I said previously, and other parties like Bob Loeffler from Morrison and Forester has said, negotiations under the Stranded Gas Development Act do provide significant commercial tools that could, not necessarily should, include scheduled open seasons for expansion with, of course, very specific terms that are fair to all parties. I want to note here, and I think that Bob Loeffler noted it as well, that scheduled open seasons are not standard FERC practices. Another potential Stranded Gas Development Act tool is our ability to require pipeline design specifications that are favorable for expansions. For example, the initial design should allow for efficient expansion. It should be preplumbed for intake, off-take and expansion points. These could include:

1. An intake in the Foothills in order to by-pass the Prudhoe Bay Unit gas treatment plant
2. An intake at Fairbanks for the Nenana and Yukon Flats Basin development when it occurs as well as an off-take at Fairbanks for several possible purposes, including various spur lines, such as to Valdez in the Cook Inlet, for petrochemicals and for rural Alaska. I believe that ANGDA has probably talked about some of the ideas that group is discussing for providing rural Alaska energy such as propane shipped in tanks or barges to rural Alaska and compressed natural gas
3. Future compression stations for expansion purposes
4. Intakes for other gas basins, such as Susitna and the Copper River Basin.

In addition to requiring open seasons for expansion and design specs, the state could consider ensuring through the Stranded Gas Development negotiations, tariff structures that are favorable to the entry of new gas. There are known devices that could assist...rolled-in tariffs, for example, for both expansion of the main line and for feeder pipelines. Rolled-in tolls for expansion means that the cost of expansion are rolled into the existing base rates. Then, even if the expansion is expensive, the overall tolls only increase modestly. The effect of this is to promote exploration and development of new gas. This is Canada's National Energy Board policy, but not the usual U.S. FERC policy. FERC's policy provides that expensive expansion costs are assigned to only those parties who will use the new capacity, in other words, the new guy on the block.

When this same rolled-in tolls approach is extended to new feeder pipelines, such as at National Petroleum Reserve Alaska (NPRRA), and they are treated as an expansion of the existing main project, then the cost of bringing new gas to market will also be reduced. Here again, the effect is to promote exploration of new gas. Canada has, in one circumstance that we are aware of, adopted such a policy as this.

Conversely, an incremental tariff structure, which is the normal approach that FERC assigns to extensions, and to expensive expansions, is to assign costs to only those parties who will be using the new capacity. I want to emphasize that both of these rolled-in toll approaches could be a very difficult exercise to sell to FERC, because it is outside their normal policy and they must approve all tariffs including negotiated tariffs.

Another example of a tariff structure that could favor entry of new gas into expansion capacity is a negotiated levelized tariff rate. The use of a levelized tariff allows any producers lower costs in the early years, maintaining this rate over time. This may improve exploration and development economics. Conversely, a recourse rate will start off high and it may be reduced if shippers successfully request lower tolls with FERC.

One additional point here on tariffs, one means of improving the use of a recourse rate might be regular updates of that rate. As you heard at your last hearing and today, again, the FERC hasn't been exercising authority under the Natural Gas Act to require a pipeline company to periodically file new rates. A shipper can protest rates, but relief is provided only prospectively, not retrospectively. As a result, recourse rates paid by shippers on a pipeline such as this one can often be too high. As well, there is some incentive for pipeline companies to prolong litigation. However, if the pipeline company were contractually required to periodically file new rates with the FERC, then much of this problem might be resolved.

The final point I want to make under tariff structures is that it might be appropriate for the conditioning plant rates to also be reasonable and transparent. Again, this could be accomplished either by negotiations or by making them subject to a rate-making process.

Moving away from the Stranded Gas Development Act, another key tool available to the state is the oil and gas lease provision. That provides the state its ability to take its gas either in value (RIV) or in kind (RIK) and our discretion to switch periodically. This tool could be used to promote explorer access to early open season. This term of the state's lease could be used to backstop explorer commitments to initial pipeline capacity and this was the concept that DNR invented in the proposed RIK gas sales to Anadarko and EnCana [USA, Inc.] in 2002. That was never moved forward for legislative approval or even a royalty board approval, but we did send it out for RFP and EnCana and Anadarko did win that. This could allow explorers to ensure they have the necessary gas available to fill an open season commitment if there is insufficient time to explore and develop their own lease acreage prior to open season. In the interests of full disclosure here, I want to note that this proposed RIK gas sale in 2002 was endorsed by independent explorers and opposed by the producer sponsor group.

The last two items I would like to briefly note under the government to industry category are the state's right-of-way leasing provisions. It is conceivable for the state to condition a state pipeline right-of-way approval on reasonable access provisions and we could encourage the federal government to do the same with their federal rights-of-way. I must note that we have not so conditioned any right-of-way such as this to date.

And finally, using our oil and gas lease terms, it is also conceivable that we could develop provisions in new leases that require facility sharing and pipeline access, but again that would be prospectively, not for existing leases.

So, moving on to my second category of tools, or what I call government to agency, the first of

these are the state administration's existing ability to provide input to FERC on rate cases. This is an opportunity that the state may avail itself of currently. It provides no surety that that input is welcomed by the FERC and as Bob Loeffler mentioned a little bit ago, under the yet to be adopted U.S. federal energy legislation, that legislation provides that open season regulations shall (mandatory) be promulgated by FERC and, of course, the state will have the opportunity to affect those regulations to our benefit. That legislation provides capacity expansion regulations may (this is discretionary) be promulgated and it might be possible to encourage FERC to promulgate these optional regs and if they do to try to affect that package of regulations to the state's benefit.

The final issue that I might note in this area, and I've never discussed it with Morrison and Forester, but that would be to approach FERC regarding open season regulations in advance of U.S. federal energy legislation. If the legislation passed this fall or early next spring, it might not be necessary, but if it does not, it is something that I think the state might pursue.

Another tool available to the state under government to agency category is the Regulatory Commission of Alaska's influence with FERC. Under the existing Natural Gas Act, the FERC may establish a FERC/RCA joint board for consultation purposes. While this is currently an option under the Natural Gas Act, it becomes a mandate under the proposed federal energy legislation and we have successfully used this device in the past on at least one tariff structure on the Alpine pipeline, I believe.

Finally, I think it's appropriate to reiterate the obvious. A tool available to the state is to maintain our options for all gasline projects. This includes LNG, the natural gas pipeline into or through Canada and other pipelines within Alaska.

My final category is what I refer to as government to government. Briefly, this category includes the state's influence on the federal energy legislation provisions that support access. This influence has been and continues to be, until passage, extremely important. Finally, the state has begun to develop relationships with Canada to encourage favorable outcomes for design and access of a Canadian portion of the natural gas pipeline. This can be pursued both on a federal level in both the U.S. and Canada as well as in the Canadian provinces and with the First Nation Tribal entities.

In closing, while I've identified a whole suite of tools the state has available to it, I also believe there are a limited number of truly effective tools that are under the state's direct control. You'll note I spent more time focusing on the Stranded Gas Development Act negotiations and the RIK/RIV switching option because I believe these offer the greatest leverage to the state. Therefore, it is important that the state has full knowledge of what they're worth. That completes my testimony.

SENATOR ELTON asked if the state can condition right-of-way approval on reasonable access provisions.

MS. RUTHERFORD replied, "I believe that is a possibility, yes."

SENATOR ELTON said that seemed to be a rather bold intrusion into something FERC has control over. "Would FERC have to endorse any provisions that were contractually agreed on in a right-of-way contract?"

MS. RUTHERFORD answered:

FERC has to approve of tariffs, no matter whether they are negotiated or not. I know they have policies on open seasons; I don't think they have regulations on open seasons. I believe they would probably be open to a negotiated agreement on open seasons for expansion purposes.

SENATOR ELTON asked if that was included under right-of-way agreements.

MS. RUTHERFORD responded, "Well no; I think that would be under the Stranded Gas Development Act negotiations."

CO-CHAIR OGAN plugged the up-coming September Energy Council meeting in Anchorage with Alberta and British Columbia attending as official first-time members.

We literally run coast to coast from Canada now – Nova Scotia and Newfoundland to British Columbia. So, it's a good opportunity to get to know some of our Canadian friends and help keep those relationships going.

He thought a pipeline would provide better opportunities for creating long-term jobs once it was built and gas had gone down it.

MS. RUTHERFORD agreed that a lot of jobs in the future would be associated with looking for new gas and trying to fill the pipeline. "Based upon what USGS said earlier today and in which DNR concurs, that we feel there are significant undiscovered resources, more than adequate to fill expansion capacity."

CO-CHAIR OGAN said the AOGCC regulates the waste of hydrocarbons and DNR deals more with the economic waste issues and asked if she has the statutory authority to insure the state has no economic waste.

MS. RUTHERFORD replied, "We believe we do, Senator."