**UNITED STATES OF AMERICA**
**BEFORE THE**
**FEDERAL ENERGY REGULATORY COMMISSION**

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| Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects | Docket No. RM05-1-000 |

## COMMENTS OF THE STATE OF ALASKA ON PROPOSED RULEMAKING

The State of Alaska ("Alaska" or "State") is pleased to submit the following comments pursuant to the Federal Energy Regulatory Commission's (the "Commission" or "FERC") November 15, 2004 Notice of Proposed Rulemaking ("NOPR")[1] in the above-referenced docket.

The Promise of Alaska Natural Gas

Before plunging into the technicalities of the open season rules, the State wants to emphasize again the vast potential of Alaska natural gas resources. At FERC's December 3 Technical Conference ("Technical Conference"),[2] Alaska's Commissioner of Natural Resources, Tom Irwin, and a panel of witnesses from the Bureau of Land Management, the Minerals Management Service, and the United States Geological Survey filled the record with numerous estimates of the abundance of Alaska's natural gas resources.[3] The Prudhoe Bay and Point

[1] *Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects*, 109 FERC ¶ 61,160 (2004).

[2] *See Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects*, Supplemental Notice of Technical Conference and Agenda, Docket No. RM05-1-000 (Nov. 29, 2004).

[3] *See* Tr. at 178:25-181:13 (Tom Irwin, Commissioner, Alaska Department of Natural Resources), 194:22-197:20 (Colleen McCarthy, Bureau of Land Management), 192:9-194:19 (Jeff Walker, Minerals Management Service), 197:23-201:11 (David Houseknecht, United States Geological Survey), 201:15-202:22 (Timothy Collett, United States Geological Survey).

Thomson fields, for example, contain 32 Tcf of confirmed gas reserves.[4] With reasonable deliverability assumptions, these fields alone could sustain approximately 4.3 Bcf/day of pipeline throughput for approximately 15-20 years. But these resources are only the tip of the iceberg with respect to future gas development in Alaska. Geological information available to the State suggests that a mean estimate of conventional, technically recoverable North Slope and offshore arctic gas that exceeds 225 Tcf. The National Petroleum Reserve (NPRA), the Foothills of the Brooks Range, the central North Slope and ANWR all have promising natural gas futures. Alaska natural gas is poised to make a huge contribution to reducing the nation's dependence on foreign sources of oil and gas.

A pipeline must be built to realize the promise of Alaska's gas resources. Despite intense private, federal and state activity for nearly four decades beginning in 1973, and sporadically thereafter, no pipeline has been built. Alaska natural gas, which is a significant portion of the nation's natural gas, remains stranded. Over the same time, as lower 48 fields have matured and become less productive, industry has turned to alternative sources of supply, particularly LNG imports from outside the U.S. Alaska gas is available in the nation's own backyard and its development should be the first priority of the nation's energy policy.

The development of the Alaska's natural gas is fundamental to the State's future well being. The State owns the lands at Prudhoe Bay and Point Thomson that are leased to the developers of those gas fields. The State holds a royalty interest in production from those fields and also levies a gas production tax on production from those fields. A pipeline would create a new source of revenue for Alaska as oil revenues taper down. As a landowner the State also will

[4] U.S. Energy Information Administration, Oil and Gas Supply Module, Assumption to the Annual Energy Outlook, *available at* http://www.eia.doe.gov/oiaf/aeo/assumption/oil_gas.html (last visited Dec. 17, 2004).

grant a right of way to an Alaska gas pipeline. Further, the State has environmental and regulatory responsibilities that will affect any pipeline project. Additionally, an Alaska gas pipeline will spur employment and growth of Alaska's economy. This complex of interests will affect Alaska and Alaskans in many ways for decades and decades to come.

These comments first will set forth overall policy objectives regarding Alaska natural gas transportation projects—goals that can and should be advanced by the open season regulations. Next, the State will discuss the proposed regulations and suggest certain changes. Finally, the State will address the specific questions set out in the NOPR and the November 29, 2004 Supplemental Notice of Technical Conference and Agenda ("Supplemental Notice").[5] Attached to these comments is an appendix containing Alaska's recommended text of the regulations.

## I. OVERALL POLICY OBJECTIVES

Governor Murkowski succinctly stated Alaska's three objectives at the Technical Conference:

> First is to get the pipeline project under way as soon as possible. Second, to make sure the pipeline project serves ... Alaska['s] domestic needs for natural gas and, three, to make sure that the pipeline is sized correctly and has the right terms of access so that all explorers and developers of Alaska's natural gas, whether affiliated with pipeline ownership or not, can be assured that they can ship their gas on the pipeline under fair, reasonable and predictable terms.[6]

### A. Getting a Pipeline Project Underway

The State is taking aggressive steps to get the pipeline launched as soon as possible. First, it enacted a novel law, the Alaska Stranded Gas Development Act ("SGDA") that gives

[5] *Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects*, Supplemental Notice of Technical Conference and Agenda, Docket No. RM05-1-000 (Nov. 29, 2004).

[6] Tr. at 16:12-23.

the State government the power to offer incentives and rewards for the development of Alaska's gas resources. The SGDA authorizes the State to negotiate a so-called fiscal certainty contract with sponsors of a qualified gas project. Such a contract will be designed to stabilize and make predictable State tax and royalty arrangements for a gas pipeline for a defined period of time, something that potential pipeline owners have said they strongly desire and need in order to invest in a project of this dollar magnitude. In return, through the SGDA the State of Alaska expects responsible commitments by the pipeline sponsors to a timetable for the development of their qualified project, and a commitment for facilities to ensure service of the natural gas needs of Alaskan communities and citizens. The State is presently actively conducting negotiations with various parties, and hopes that one or more fiscal certainty contracts will be submitted to the Alaska legislature for approval in its upcoming session that begins in January 2005.

Second, as part of the SGDA negotiations, Alaska is proposing to invest in and own part of the Alaska gas pipeline. If an agreement is reached on this investment, it would be unprecedented in the interstate gas pipeline world. Alaska's ownership percentage could approximate its eventual ownership interest in the gas that would flow through the pipeline. If so, then the necessary investment and proportionate risk of the other owners in the pipeline would be reduced, thereby improving the prospects of getting an Alaska gas pipeline built. Alaska could also take on the role of shipper of its proprietary gas, either on a pipeline that it partially owns or one it does not.

### B. Ensuring That Alaska's In-State Needs for Natural Gas Are Met

Another critical goal for Alaska and its citizens is to ensure that in-State gas needs are met. Unfortunately, the NOPR is entirely silent on this subject and nowhere addresses the Congressional requirements for promoting in-State access. The Alaska Natural Gas Pipeline

Act ("ANGPA")[7] has two separate provisions that speak to in-State needs. The need for access to North Slope natural gas in the Interior regions is real today and in south central Alaska will be real by the time a pipeline is built, as was emphasized, for instance, by ENSTAR's presentation at the technical conference.

### 1. The State's Needs

Congress recognized that any approved Alaska pipeline project study in-State needs. Section 103(g) of ANGPA provides:

> The holder of the certificate of public convenience and necessity issued, modified, or amended by the Commission for an Alaska natural gas transportation project shall demonstrate that the holder has conducted a study of Alaska in-State needs, including tie-in points along the Alaska natural gas transportation project for in-State access.

In Section 103(g), Congress made the pipeline responsible for ascertaining in-State needs and identifying tie-in points for local service. That responsibility is to be fulfilled before the pipeline applicant receives certification from the FERC. Congress plainly wanted to make sure that the pipeline integrated into its planning the need for, and means to provide local service. Given the large markets for natural gas outside Alaska, Congress foresaw the need to ensure that markets inside Alaska also were served by a gas pipeline. Fairness requires as much, for Alaska will produce all of the natural gas shipped by the pipeline and bear much of its environmental and socio-economic impact.

Alaska believes that the logical time for a pipeline to conduct a natural gas demand study is prior to, and preparatory for its open season process. A commonly recognized purpose of the open season process is to solicit market interest in a proposed pipeline's capacity, services, and

[7] Alaska Natural Gas Pipeline Act, Pub. L. No. 108-324, div. C, §§ 101-116, 118 Stat. 1220 (2004).

route, which will be used to refine the project's costs, facilities configuration, and sizing. Requiring a pipeline applicant to study in-State natural gas needs prior to holding an open season will allow the pipeline to consider those needs in designing the project's facilities, size, future expansibility and, to some extent, route. If the study precedes the open season and its results are integrated into the open season process, the open season process will also provide a natural venue for stakeholders to review and assess the pipeline's study of in-State needs. It will also allow the pipeline an opportunity to "fine tune" its project, including any fine-tuning needed to serve local needs based upon bids and comments received in the open season process.

Review and resolution of in-State needs by the parties in the open season process may also serve to forestall or minimize unresolved issues regarding in-State needs during the Commission's certification process. To this end, the State proposes that the Commission include in its open season regulations a requirement that the pipeline applicant perform a study of in-State needs prior to initiation of the open season:

> §157.34(b) *Study of In-State Needs.* The applicant for a certificate of public convenience and necessity shall, at least six months prior to the commencement of its initial open season, complete a study of Alaska in-State needs, including tie-in points along the Alaska Natural Gas Transportation Project for in-State access, and shall make the study publicly available at least two months prior to the commencement of its open season.

Speakers at the open season Technical Conference identified the issues that the study should address. In particular, the State references the testimony of Governor Murkowski, Senator Murkowski, ENSTAR, the Representatives of the Alaska Legislature, and the Alaska Natural Gas Development Authority. Any application for Commission authorization should build upon the study and demonstrate how identified local needs can or will be satisfied. The State stands ready to assist pipeline applicants in conducting a proper study and designing options for in-State access.

Establishing and confirming how much natural gas is needed in-State could be highly relevant to the proper design of the pipeline. The testimony of several parties at the Technical Conference indicated that designing tie-in points or taps as part of the initial design is a relatively easy exercise and certainly far less complicated than retrofitting an operating pipeline.[8] More importantly, if projected in-State demand is substantial, proper pipeline design might encompass a higher capacity pipeline between the North Slope and the Fairbanks to Anchorage area, and a somewhat smaller pipeline design South and East of the taps for service to those areas. The more the pipeline knows, and the earlier it knows it, the more efficiently it can approach the task of achieving an appropriate pipeline configuration.

### 2. Alaska Royalty Gas

A second provision in ANGPA also addresses Alaska's in-State needs. Section 103(h) provides that the Commission, on a request by the State and after a hearing, may provide for "reasonable access" to the Alaska natural gas transportation project by the State or its designee, for the transportation of Alaska's royalty gas for the purpose of meeting local consumption needs within the State. This section further provides that the rates of existing shippers shall not be increased as a result of such access.[9]

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[8] *See, e.g.*, Tr. at 124:9-125:6.

[9] Sec. 103(h) Alaska Royalty Gas provides:

(1)In general. - Except as provided in paragraph (2), the Commission, on a request by the State and after a hearing, may provide for reasonable access to the Alaska natural gas transportation project by the State (or State designee) for the transportation of royalty gas of the State for the purpose of meeting local consumption needs within the State.

(2)Exception - The rates of shippers of subscribed capacity on an Alaska natural gas transportation project described in paragraph (1), as in effect as of the date on which access under that paragraph is granted, shall not be increased as a result of such access.

Some or all of Alaska's North Slope royalty gas could be a part of the overall gas supply requiring transportation to meet local consumption needs. Hence, it would be reasonable for the Commission, upon a request by the State, to hold a hearing prior to completion of the pipeline's open season to determine the mechanics of access to the pipeline for the transportation of royalty gas, along with other gas, to meet local consumption needs. This will allow the State's royalty gas transportation needs to be considered within the context of the overall in-State natural gas needs as identified in the pipeline's study.

Further, assuming the State wants access for royalty gas shipments at the start of pipeline operation, which is likely, then once again to be useful in the planning cycle for the project and useful to the Commission in its review process, the State proposes that the Commission confirm the State's option to request that such a hearing be held prior to completion of the pipeline's open season.[10] Resolving issues of use of royalty gas in-State prior to the completion of the initial open season could provide all affected parties with the certainty necessary to respond appropriately in the open season process. Further, the SGDA requires that part of the consideration the State must receive in return for the financial stability contract that it is allowed to approve is the assurance of gas supplies for in-State use. Because this issue is so central to the participation of the State in the development of any project, it must be resolved early in the process.[11]

[10] Assuming that the in-State study is completed six months prior to the commencement of the open season, and that the open season is at least 90 days, the Commission should have adequate time to hold such a hearing.

[11] There is an interplay between the SGDA negotiations and the requirements of Section 103(h). Assurance of access for royalty gas might be obtained in the SGDA negotiations.

Accordingly, the State asks the Commission to include the following provision in its final regulations:

> § 157.34(d) *Alaska Royalty Gas*. Upon request by the State of Alaska, the Commission shall hold an on the record hearing to establish the terms of access to the Alaska Natural Gas Transportation Project by the State (or State designee) for the transportation of royalty gas of the State for the purpose of meeting local consumption needs within the State. If requested, the hearing shall be held prior to the completion of the initial Binding Open Season contemplated by these regulations.

### 3. Non-Discrimination for In-State Access

The State proposes that all open seasons be conducted without undue discrimination or preference as to the rates, terms, or conditions of service, expressly including requests for in-State delivery points. The costs associated with the establishment of in-State delivery points should be afforded treatment similar to the costs for export delivery points. Non-discriminatory treatment is necessary to ensure that all markets, both in-State and export, have equal access to Alaskan natural gas both in terms of the rates and terms and conditions of service on the pipeline and the pipeline's treatment of the costs of establishing delivery points.

For example, if export delivery points are economical and rolled into the cost of service rates, then in-State delivery points that are economical should be rolled into the cost of service rates as well. Additionally, the pipeline should not be allowed to favor potentially higher revenue export service over potentially lower revenue in-state service, if both services are contracted at recourse rates. Additional discussion of capacity allocation issues and suggested regulations (see proposed § 157.34(a)(3)), are contained in II.B. Inclusion of the following

provisions in the regulations will help ensure the development of a robust market for natural gas within the State of Alaska.[12]

> §157.33 Mandatory Open Seasons.
>
> (a) *Requirement.* Initial capacity and any Voluntary Expansion capacity on any Alaska Natural Gas Transportation Project shall be awarded through one or more Binding Open Seasons. Such Binding Open Seasons are to be conducted in accordance with the rules set forth in this subpart. Nothing in these regulations shall prohibit the Pipeline from conducting Non-Binding Open Seasons for the purpose of determining shippers' interest in capacity or facilities on a non-binding basis.
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> (b) *Non-discrimination.* Binding Open Seasons and Non-Binding Open Seasons shall be conducted without undue discrimination or preference in the rates, terms, or conditions of service. All requests for delivery points, including requests for in-State delivery points, shall be considered on a non-discriminatory basis with regard to the rates, terms, or conditions of service and the costs associated with establishing the delivery points shall be afforded similar treatment irrespective of the location of the delivery points.

### C. Ensuring Access for Explorers

A third policy objective that the final open season regulations must achieve is to provide reasonable certainty to explorers for natural gas that, when they successfully discover new gas supplies, they will have access to the pipeline. In the ANGPA, Congress established a guiding principle that the open season regulations will promote competition in the exploration and development of Alaska's abundant natural gas resources. Congress' intent is clear: more competition in exploration and development should lead to the discovery and exploitation of more gas reserves. Hence, Congress bestowed upon the Commission a broader mandate than the FERC historically has recognized in its open season policy. To fulfill that mandate, FERC

[12] As discussed in the next section, requiring non-discrimination for in-State access will provide explorers with an additional market for any gas that they discover.

should require that its open season regulations establish in advance as clearly as possible the rules for access to the pipeline—both in the initial open season and later. The State's suggestions follow.

The importance of access for undiscovered reserves cannot be overstated. While the large Prudhoe Bay and Point Thomson units are certainly sufficient to support construction of the pipeline, they represent but a fraction of the total possible gas supplies from Alaska. North Slope and arctic offshore conventionally recoverable gas potential exceeds 225 Tcf. In addition, North Slope gas hydrate potential in the Prudhoe Bay/Kuparuk River/Milne Point area alone exceeds 100 Tcf. Further, Alaska's Interior basins are for the most part unexplored, but some data indicates that they also have significant gas resource potential. The pipeline will pass very near some of these basins, and in order to motivate explorers to drill for and develop at least some of the yet to be discovered gas sooner rather than much later, the pipeline likely will have to be expanded early in its life. Explorers will not explore today if the pipeline is undersized or cannot be expanded early and easily, or both. It is simply unacceptable to explorers to have to wait for the decline in gas production at Prudhoe Bay and Point Thomson in order to monetize their gas; as Alaska's Commissioner of Natural Resources testified, that decline in pipeline throughput may not occur until some 15 years after startup of the flow of gas.

Further, it stands to reason that explorers will not risk exploration capital in Alaska if they do not believe that they will have reasonable access to both the initial and the expansion capacity in the gas pipeline. Individual companies or individual producers may not benefit or may benefit differently from early expansion of the pipeline (that is, there inevitably will be winners and losers), but collectively the nation will benefit from more gas from Alaska. This is why Congress for the first time gave FERC the power to order mandatory pipeline expansion and

also required the adoption of open season regulations that are designed to promote competition in exploration, development and production of Alaska gas.

The Commission can promote the competition that Congress contemplated by ensuring the adequate sizing and expandability of the pipeline, providing sufficient information about pipeline design and economics, and requiring that the initial capacity and any expansion capacity be sized to fully accommodate all qualified bids. These topics are discussed next.

## II. COMMENTS ON DISCRETE ISSUES

### A. The Original Sizing and Future Expandability of the Pipeline

Getting the pipeline's original size and future expandability correct are extremely important considerations for successfully delivering North Slope gas reserves. In all likelihood, given the very nature of the Alaska pipeline project, it will be the only pipeline built from Alaska to supply the lower 48 states with natural gas. Planning today for a pipeline that flows gas for many decades and for the likely expansion of capacity on that gas pipeline only makes good sense for the nation and for Alaska.

The ultimate objective here is full accommodation of all gas that can be economically developed. That goal is promoted by providing sufficient information to potential shippers about the pipeline's capacity and expandability, and ensuring that the pipeline can accommodate all qualified bids after the open season. How the pipeline is originally sized—the diameter, wall thickness and tensile strength of the pipe and the number, size and location of the initial compressor stations—will be critically important to shippers and owners alike. The NOPR's requirement that the open season notice provide potential bidders with information on some 17 factors, including various sizing factors, is fully supported by the State, but even more is needed.

With regard to the Commission's 17-point list of items for inclusion in the pipeline's open season,[13] the State recommends the addition of the following three items in § 157.34(a)(5) of the proposed regulations:

(v) Pipeline's minimum economic cost recovery target, if any, for purposes of going forward with the pipeline system development and construction and the Pipeline's proposed consequences and/or remedies if such economic target is not met;

(ix) Feasibility and estimated cost of pipeline expansions, either through compression or looping, including any physical limitations;

(xviii) Date by which the Pipeline must commit to constructing the pipeline, or the Voluntary Expansion capacity;

Including these items better fulfills the requirements of competition in exploration and development of the ANGPA. These items go directly to the economics of launching exploration and development programs, and the related issue of structuring capacity bids in an open season. Other participants at the Technical Conference also addressed the need and rationale for each of these measures. Thus, these disclosure information items should aid in the objective of sizing the pipeline correctly.

With regard to voluntary expansions, many, but not all, of the Commission's list of items should still be applicable. The State suggests that the Commission include the proposed Section 157.34(a)(6) and (7) provisions in the Commission's final regulations in order to address open seasons related to voluntary expansions.

In addition, the open season regulations should specifically state that the full accommodation of all qualified bids is an objective that the pipeline should meet. Qualified

[13] The State's 21-point list contains other clarifying language changes from the proposed regulations.

tenders are those made by creditworthy parties willing to execute firm long term transportation contracts for the required capacity at agreed-upon rates. Potential pipeline owners are better off if they know early what the Commission's expectations are with respect to size and expandability. If the pipeline's certificate application contains a design that does not accommodate all qualified tenders, the open season regulations should require the applicant to justify why the pipeline could not be sized to accommodate all qualified gas tenders. Failure to provide sufficient economic or technical justification for a pipeline that is sized to accommodate less than the qualified initial tenders should merit either rejection or at least close scrutiny of any certificate application.

To help minimize the possibility of an undersized pipeline or pipeline expansion, the State recommends that the Commission include the following provisions in its final regulations:

> §157.34 *Criteria for Open Seasons.*
>
> (a)(2) The initial design of an Alaska Natural Gas Transportation Project shall accommodate the capacity requests of all bidders in the initial Binding Open Season that are able to satisfy the Pipeline's creditworthiness requirements and willing to execute firm transportation agreements at maximum recourse rates for twenty (20) or more years for the requested capacity. In its application for a certificate of public convenience and necessity, a pipeline applicant shall demonstrate that its initial design will accommodate the capacity requests of all such bidders or factually demonstrate what technical or economic factors prevent such a design.
>
> § 157.34 *Criteria for Open Seasons.*
>
> (a)(7) Any design pertaining to a Voluntary Expansion of an Alaska Natural Gas Transportation Project shall accommodate the capacity requests of all bidders in the expansion open season that are able to satisfy the Pipeline's creditworthiness requirements and willing to execute firm transportation agreements at maximum recourse rates of reasonable duration. In its application for a certificate of public convenience and necessity to expand the pipeline, a pipeline applicant shall demonstrate that its design will accommodate the capacity requests of all such bidders or factually

demonstrate what technical or economic factors prevent such a design.

In determining what constitutes "reasonable duration" in any given expansion, the State recommends that the Commission should be guided by the principles embedded in § 157.34(a)(2): the required term should strike a balance between the pipeline company's and the shippers' risks, and be of substantial duration but less than the depreciable life of the capital asset.

**B. Capacity Allocation for An Oversubscribed Pipeline**

With correct sizing, capacity allocation issues may be totally alleviated, or at least substantially reduced. If the pipeline is unable to accommodate all initial gas tenders notwithstanding the pipeline's best reasonable efforts (or in later open seasons where capacity may be constrained), then a fair capacity allocation methodology must be implemented. The NOPR is silent on this matter other than to require the pipeline in its open season to describe the allocation methodology. Its silence does not satisfy ANGPA Section 103(e)(1) requirement that the regulations establish "procedures for the allocation of capacity." The need for clear rules and a level playing field require that the Commission address the allocation methodology now.

Alaska recommends that the final rule should direct that in the case of bids exceeding the pipeline's capacity, all bids of 20 or more years at maximum intrastate or interstate rates be treated equally, and prorated if necessary. In a situation where all intrastate and interstate bids of 20 or more years at maximum rates can be accommodated, but all bids less than 20 years cannot, then those latter bids should be awarded on a net present value (NPV) basis.

Competitive concerns are raised by unusually long bids. If the known resource holders bid for extremely long commitments of capacity, that capacity will be tied up by those owners to the possible exclusion of those who later find gas and need capacity. The State recognizes that

firm long term transportation agreements may constitute the essential backbone of the financing of the pipeline. There likely will be a direct relationship between the length of those commitments and the term of the substantial debt offerings that will be an integral part of the financing of the pipeline. The State believes that a reasonable balance between competitive and financing concerns is to preclude a bid evaluation methodology that gives additional value to bids of durations greater than twenty years than it does to bids of twenty years or less.

The specific language the State recommends be adopted is the following:

> § 157.34 *Criteria for Open Seasons.*
>
> (a)(3) To the extent that all requests for service cannot be accommodated, the Pipeline shall employ a *pro rata* allocation process among all bidders to provide allocation of the available capacity up to nominated quantities, provided that bidders have nominated such capacity at maximum recourse rates, or the economic equivalent, for a minimum term of twenty (20) years. Terms greater than twenty (20) years shall be considered as if they were twenty (20) years. Otherwise, capacity shall be allocated to those bids that produce the highest net present value (NPV). The Pipeline shall disclose the NPV methodology to be used, including the discount rate, determination of term, rate, capacity, and expected cash flows.

The State's proposed language for the allocation of capacity will create a level playing field for shippers that desire to transport natural gas wholly within the State of Alaska. This is accomplished in two ways. First, capacity is proposed to be allocated *pro rata* amongst shippers that bid at maximum recourse rates, or their economic equivalent, for a minimum term of twenty (20) years. This language would accord shippers that bid on capacity for in-State delivery the same standing in the capacity queue as those shippers that export gas, provided that the in-State shipper pays the maximum recourse rate, or its economic equivalent, for 20 years. Thus, even if the pipeline implements zone rates, in which case the in-State haul would presumably cost less and have a lower net present value than the combined in-State/export haul, the in-State shipper

would have an equal claim on the pipeline's capacity as the export shippers, so long as it bid at maximum recourse rates for a minimum term of twenty years.

This proposal is equitable to export shippers because they would pay the in-State zone rate along with the in-State shipper and receive the benefit of the increased billing determinants (i.e., a lower rate) for the in-State rate zone resulting from the increased throughput in the zone. For this reason, it is not inequitable to accord in-State shippers the same right to pipeline capacity as export shippers.

Second, the proposed twenty (20) year term cap for economic evaluations will also level the playing field for in-State shippers, as their in-State gas needs may not be longer than twenty years. Shippers to the Canadian hubs and the lower 48 states have many more market outlets for their gas, and they may be willing and able to enter into transportation contracts with terms longer than twenty-years, particularly if longer-term contracts would be advantageous for capacity allocation purposes. Thus, the term cap provides in-State shippers a better opportunity to compete on an equal footing with export shippers for pipeline capacity.

### C. Duration of the Open Season

There is no one theoretically correct answer to how long an open season should last. Certainly, an open season of 30 days is too short for a project of this size. Likewise, an open season lasting one year could seriously delay the project without appearing to have a sufficient offsetting benefit. Given the size, cost and complexity of this project, and the substantial disclosure that will come about in the Open Season notice, potential bidders will need substantial time to evaluate the information and prepare responsible and responsive bids.

Alaska recommends that the pipeline be permitted a "safe harbor" range of time—from 90 to 120 days—to conduct its open season. Even a period of 120 days may challenge the ability of smaller or non-traditional bidders to participate. The suggested language is the following:

§ 157.34 *Criteria for Open Seasons.*

(a)(4) Requesting shippers shall have a minimum of ninety (90), but not more than one hundred twenty (120), days from the date on which the Binding Open Season materials are noticed by the Commission within which to submit requests for transportation services.

In some past open seasons, a preference has been given to the first bids received over later bids within the open season. Here, the State believes that there is no justification for permitting a preference for earlier bids. Allowing a preference to earlier bids could advantage those large bidders and affiliated shippers that have superior knowledge and resources to begin with. Conversely, small shippers and inexperienced bidders who are likely to require more time could suffer a disadvantage.

## III. COMMENTS ON COMMISSION POSED QUESTIONS

In addition to seeking comments on the proposed rules, the Commission also requested comments on certain questions that it posed. Alaska's answers are set forth in this section.

### A. Questions in the November 15 Notice

*(1) Should the Commission require that prospective applicants for Alaska natural gas transportation projects, before conducting open seasons, file with the Commission proposals for how the open seasons will be conducted? If so, should the proposals be filed for notice and comment, or for a decision or pre-determination by the Commission that such proposals conform to the regulations? What other procedures are suitable to facilitate the expeditious resolution of objections or concerns regarding any open season for an Alaska natural gas transportation project?*

Alaska supports early FERC involvement in the open season process. To that end, Alaska recommends that the pipeline's proposed open season notice package be submitted to the FERC at least three months prior to the opening date of the proposed open season. FERC should notice the filing for comments and should then decide whether the open season notice package complies with the Alaska gas open season regulations. Standard FERC practice typically has

addressed open season issues on the basis of complaints after the open season has occurred. In those situations, however, there have not been a detailed set of regulatory requirements that must be satisfied. These requirements could give rise to disputes about compliance. Although reasonable parties could differ, Alaska believes that it would be better, as much as is possible, to resolve disputes prior to the open season rather than risk disputes afterwards that would require resetting the open season. Minimizing such risk is a major reason supporting early FERC involvement and review. The following is the State's recommended language:

> § 157.34 *Criteria for Open Seasons.*
>
> (c) *Submission and Approval of Notice.* The pipeline shall, at least three (3) months prior to the proposed commencement of its open season, submit an open season notice in accordance with the requirements of this Subpart B, which shall be subject to notice by the Commission for comment prior to a Commission determination as to whether the proposed notice complies with the requirements of Commission regulations.

Although this recommendation and language varies from the ordinary process of complaints about open season procedures that are made during or after an open season, the special circumstances of the Alaska gas pipeline warrant different treatment. By requiring pre-open season public submission of the open season package, interested parties will see the relevant information earlier and will have the opportunity to raise issues about the adequacy of the disclosure before the open season begins. This will help avoid disputes about open season after it occurs and will also give parties a longer time and better information to plan for the open season. Because parties would receive the core information package earlier, it should also help avoid delaying the pipeline by extending the open season beyond a customary length.

> *(2) Should the Commission issue regulations now, pursuant to section 105 of the Alaska Natural Gas Pipeline Act, with respect to the Commission's authority to require expansion of any Alaska natural gas transportation project? If so, should those regulations deal with the rate treatment (rolled in or incremental) of any such expansion?*

The State submits that the open season regulations are not the vehicle to take up this important and complex topic. While Section 103(c) of the ANGPA requires the Commission to expedite and promulgate its open season rule within 120 days, its mandate to promulgate a rule governing expansions flows from Section 105(e), a different section. Section 105 does not require the issuance of regulations within a defined time period.[14] Accordingly, the Commission need not and should not address expansion pricing in this rulemaking or on the 120 day schedule for a rule governing the open season process.

Nonetheless, the expansion parameters are one of the important rules of the road that a potential pipeline owner (and shipper) must know and understand. The expansion pricing issue is multi-faceted and complex and includes the question of not only how the expansion will be "priced," but how the associated fuel costs will be allocated. It should be emphasized that very little is publicly known about the cost or engineering of expansion of any of the proposed pipeline projects.[15] An early and full public vetting of expansion issues should take place in time to inform *all* interested parties, owners and shippers alike. While it is certainly desirable to have answers at an early date to any questions regarding how expansion capacity will be priced, a separate proceeding completed on a deliberate but aggressive schedule, would be timely in meeting the needs of all potential participants while not unduly burdening this proceeding with this additional major issue. Alaska recommends that a notice of inquiry on expansions and expansion pricing be issued in early 2005.

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[14] In addition, Section 103(e)(3) provides that the open season regulations do not apply to Section 105 expansions.

[15] Certain information regarding currently existing proposals may be found in applications submitted pursuant to the Alaska Stranded Gas Development Act at http://www.revenue.state.ak.us/GasLine/index.asp.

There was much discussion at the Technical Conference over expansions and the related issue of whether they would receive rolled in or incremental price treatment. Resolution of this issue is highly important to explorers who are not affiliated with the owners of the pipeline. As testimony at the Technical Conference reveals, how expansion capacity will be priced and whether expansion capacity will be available are important inputs to their decision to commit resources to drilling and development.[16]

The arguments for rolled in pricing of expansion capacity appear strong. The pipeline will be operated on an integrated basis, but incremental pricing would result in differing rates for shippers who are receiving the same service. Unlike the lower 48, there is or should be no concern about overbuilding pipeline capacity as against competing pipelines. For a pipeline that will be the sole route to market for frontier gas resources, rolled in pricing may provide the best incentive for development of all of those resources (and thereby facilitating the provision of in-State gas needs). Also, the National Energy Board of Canada, FERC's sister agency in the authorization of a new gas pipeline, has long followed a practice of rolling in expansion capacity.

At the same time, Alaska realizes that complex economic, technical and legal issues are connected with expansion. There may be either voluntary or, for the first time, mandatory expansions. The optimal rate treatment may differ between these two kinds of expansion. Congress itself provided in Section 103(e)(3) that the open season regulations shall not apply to mandatory expansions. And in Section 105(c), Congress implicitly suggested that expansion capacity will be first committed to the party that petitioned the FERC for an expansion order, a concept that may be at odds with presently existing open season policy. A policy of rolled in price treatment may be inappropriate in all circumstances. However, the State believes that

[16] *See, e.g.*, Tr. at 43:14-22.

appropriate sideboards (possibly reflecting the language of Section 105) can be developed to appropriately determinate when rolled-in rates should be abandoned in favor of incremental rates.

For all of the reasons stated above, although its initial preference is for rolled-in pricing Alaska does not have a final position on price treatment for either mandatory or voluntary expansions. It firmly believes, however, that the time is ripe for the Commission to explore expansion issues publicly and carefully to arrive at the optimal policy result.

*(3) Should the Commission allow pre-subscribed, reserved capacity such as was allowed in connection with open seasons for certain new Outer Continental Shelf pipeline facilities? See, e.g., Garden Banks Gas Pipeline, LLC, 78 FERC ¶ 61,066 (1997); Green Canyon Pipe Line Co., 47 FERC ¶ 61,310 (1989)?*

The anchor shipper issue received much comment at the Technical Conference. Any discussion of the issue must begin with recognition that the anchor shipper concept is not well established in Commission precedent. *Garden Banks* and *Green Canyon* both involve offshore pipeline projects that present circumstances different than those posed by the Alaska Gas Pipeline. At bottom, they do not involve a project that will open up huge new production basins as in the case of the Alaska pipeline. There is no commonly accepted definition of anchor shipper, what the limits of the concept are, or how the anchor shipper concept would interrelate to open season requirements.

Today, three companies control 98% of the gas reserves at Prudhoe Bay and 82% of the reserves at Point Thomson. These same three companies are the sponsors of one of the leading projects to build the Alaska Gas pipeline. These companies have vast financial resources, a fact that should bolster the viability of the project.

The concern of the State and prospective shippers is that if these companies committed as anchor shippers to the project, the remaining capacity available for bid in the open season

would be quite limited. Conceivably, the anchor shippers would seek more favorable rates or tariff terms and conditions than open season bidders in return for their early subscription. To some, allowing anchor shippers would be another chapter in the continuing controversy about the domination of North Slope oil development by affiliates of the owners of TAPS.

In general, the rationales for presubscriptions of capacity do not seem applicable to or appropriate for this project. Presubscriptions, it is said, may allow projects to attract seed capital for further project design and engineering. Early commitments by substantial potential shippers may enhance the markets' perception of the viability of the project. But one must ask what the motive and incentives would be of those who presubscribe? They might rationally expect to lock in their capacity, perhaps on more favorable terms, or to gain an information advantage over other bidders in the formal open season whenever that occurs. Certainly it is contrary to open season policy to permit preferential access to information relevant to the open season. Equally, allowing pre-subscribers a preferential rate poses serious issues of discrimination. If the only form of presubscription is one that offers the same rates and terms as were later available in the open season, what would be the attraction of presubscriptions? In short, the State cannot support the anchor shipper concept as we understand it.

If the Commission decides to allow some for of presubscription for the Alaska gas pipeline, despite the various reasons, why pre-subscriptions should not be permissible, it should set careful limits on them. First, any form of presubscription must be available, to all parties on equal terms. The State believes that the only way to eliminate, or at least mitigate, the inherent competitive information advantage of integrated pipeline proponents would be to ensure that later participants in the final open season be assured that they will have capacity available to them on the same terms as the pre-subscribers. This would of necessity include the offering of

the same pricing and service terms to open season participants as is available to pre-subscribers as well as provisions for pre-subscribers to be curtailed *pro rata* with qualified tenders from the open season should the pipeline be oversubscribed as a result of sizing decisions. The TransCanada proposals at the Technical Conference appear to have merit should the Commission decide to allow presubscriptions, and should be considered carefully by the Commission.[17] However, as stated, the State is opposed to any anchor shipper concept that would give any preferential rate to anchor shippers as opposed to later shippers.

Second, it is important that the timing for any period for pre-subscription opportunities or for a pre-subscription open season be such that it would not significantly delay the timing for the filing with the Commission for an application for a certificate of public convenience and necessity. Whether the pre-subscription process would be accomplished by a "pre-subscription open season" or through negotiated agreements the process likely would be relatively lengthy and time consuming for representatives of all involved parties who could otherwise be productively moving the project forward. Whatever advantage that might be gained through allowing some form of pre-subscription could be largely or totally negated by a process that extends the timeline for completion of the project.

Third, it is important that both the size and readily available expandability necessary to promote competition in exploration, development and production of Alaska natural gas be determined on the basis of the combined results of any pre-subscription procedure and the final open season rather than being determined on the basis of pre-subscription sales and then changed only if the open season results in sales that would exceed the already planned expandability of the system. In order to foster the competition in exploration, development and production

[17] Tr. at 78:10-79:19.

mandated by the Congress, we strongly believe that a reasonable level of inexpensive and relatively easy expandability must be incorporated into the initial size and design decisions for the pipeline.

Finally, conducting a pre-subscription period could lead to less ready expandability on the pipeline. If initial sizing decisions are made principally as a result of pre-subscription levels rather than the result of a single open season then it is quite possible that the capacity to accommodate the open season sales could consume a significant portion of the planned ready expandability of the system.

> *(4) Congress has made expressly clear that the open season rules must promote competition in the exploration, development, and production of Alaska natural gas. Commenters are invited to discuss whether, and to what extent, any tension may exist between this mandated purpose and the application of existing Commission policies to the open season rules due to circumstances unique to access to capacity on any Alaska natural gas transportation project.*

Potential tension exists between the Commission's policy on the one hand that open seasons be open and non-discriminatory and, on the other hand, the anchor shipper and small producer set-aside proposals. The anchor shipper concept is discussed in detail in Section III.A. in response to Question #3. The State has substantial concerns with it in a case where it is likely that only one pipeline will be constructed, to serve a vast new producing area.

The State has concerns of principle and practicability with set asides for particular classes of users. The definition of the class could prove elusive in practice. If, however, the pipeline cannot accommodate all tenders, no entity should be given a guaranteed amount of capacity because, to do so, would be to discriminate against those who do not have such a guarantee.

> *(5) To what extent should the Commission's open season regulations address the issues of tying the receipt of capacity on any Alaska natural gas transportation project to ancillary services involving the treatment of gas to meet specified gas quality requirements or allocating capacity at a gas treatment plant or other facility?*

As a general matter, the Commission should not allow tying receipt of capacity on the pipeline to receipt of certain other services for the treatment of gas, or to certain other requirements. For example, not all shippers may need to use all of such services, but would be forced to pay for them under a tying arrangement. This may be the case if gas is discovered in the Foothills area south of the North Slope because it is unlikely that the shippers will use the North Slope conditioning plant. It follows that shippers of such gas should not be charged for use of that plant. It also stands to reason, however, that third-party producers should have the option to process their gas at the North Slope gas conditioning plant if they require those services to market their gas; otherwise, their gas may remain stranded.

The following language should be included in the final regulations to address these concerns:

> §157.34 *Criteria for Open Seasons.*
>
> (a)(8) The Pipeline may not condition the execution of a binding precedent agreement or a firm transportation agreement on agreement by a shipper to do any of the following:
>
> (i) pay for non-jurisdictional, ancillary services offered by the Pipeline (such as, for example, conditioning, gathering, dehydrating, or treating);[18]
>
> (ii) transfer without reasonable compensation any natural gas liquids to the Pipeline;
>
> (iii) purchase corresponding transportation service on a gas pipeline in the lower 48 United States or Canada that is owned by, or affiliated with, the Pipeline, except for shipments continuing on a Canadian pipeline beginning at the international border between Alaska and Canada; or
>
> (iv) purchase capacity on any other interconnecting gas pipeline, except for shipments continuing on a Canadian

[18] As indicated by BP at the Technical Conference, the gas treatment plant may be jurisdictional. If so, it may also have a FERC tariff or FERC set rate. In any event, the same prohibition on tying should apply.

pipeline beginning at the international border between Alaska and Canada.

### B. Questions in the November 29 Supplemental Notice

The Commission listed four general topics as a guide to the discussions at the December 3rd Technical Conference in Anchorage, and the State offers the following comments on those selected topics:

*(1) Explain how the proposed rule meets or does not meet the requirements of the Alaska Natural Gas Pipeline Act.*

The principal shortcoming, discussed above in Section I.B., is the proposed rule's failure to address Alaska's in-State gas needs. Adopting the regulatory provisions set forth in that section would cure that shortcoming. The proposed regulations do not address, as they should, capacity allocation. Adopting the regulatory provisions discussed in Section II.B would cure this shortcoming, as would adopting the State's suggestion of prohibiting capacity presubscriptions unless certain conditions are met.

Finally, the proposed rules do not address the statutory requirement of affirmatively promoting competition in exploration and development of North Slope gas. Adopting Alaska's recommended pipeline sizing and capacity allocation provisions, as well as including the four additional items in the pipeline's open season notice, will aid in achieving the statutory requirement that the open season regulations promote competition in the exploration and development of Alaska's natural gas resources. Further, because competition in gas exploration is closely tied to pipeline expansion matters, the State, as discussed above, asks the Commission to commence a pipeline expansion inquiry in early 2005.

*(2) When should FERC oversight of capacity allocation activities of potential project sponsors begin? What capacity allocation activities happen before an open season under the rule is undertaken?*

As discussed in Section III.A., the State recommends that Commission oversight commence when the pipeline submits an open season notice package, which we recommend take place at least three months prior to the commencement date of the open season. That open season notice package should contain capacity allocation procedures/activities, among other things. At that early stage, the Commission can then suggest or order needed changes to the proposed procedures.

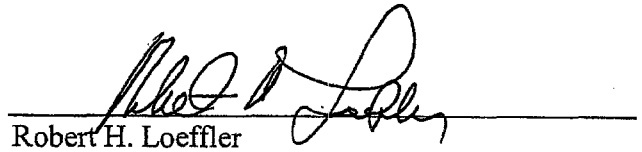
(3) *Are there certain capacity allocation issues/factors that are specific to the type of project sponsor, whether producer owned or independent pipeline owned; in-State shipper/user or lower-48 market shipper; producer/marketers or end-users; down-stream transporter, upstream gathering/processing, local utility regulators?*

No, the procedures should be fair and non-discriminatory. An entity's status should not be a factor in adopting or applying capacity allocation rules.

(4) *Should potential project sponsors be required to conduct and release results of Alaska market need studies before capacity is allocated? Should potential project sponsors be required to conduct and release results of Alaska infrastructure studies before capacity is allocated?*

Yes, see the discussion in Section I.B.

Respectfully submitted,



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