August 4, 2005

The Honorable Thad Cochran
Chairman
The Honorable Robert C. Byrd
Ranking Minority Member
Committee on Appropriations
United States Senate

The Honorable Jerry Lewis
Chairman
The Honorable David R. Obey
Ranking Minority Member
Committee on Appropriations
House of Representatives

The Honorable Ted Stevens
Committee on Appropriations
United States Senate

Subject: Small Business Participation in the Alaska Natural Gas Pipeline Project

Alaska currently holds 35 trillion cubic feet of proven recoverable natural gas resources, about 19 percent of total U.S. reserves. Efforts to construct a pipeline to transport this natural gas from Alaska's North Slope to the lower 48 states have been stalled since 1982. The recent increase in natural gas prices has renewed interest in completing the pipeline, a project that is estimated to cost up to $20 billion. In addition to providing access to significant natural gas reserves, some expect the project to generate thousands of jobs and billions of dollars in revenues for the federal government and the State of Alaska.

This report responds to a mandate in the Alaska Natural Gas Pipeline Act (the Pipeline Act) that we conduct a study to determine the extent to which small business concerns have participated in the construction of oil and gas pipelines.¹ The Pipeline Act includes a “sense of Congress” provision that the sponsors of the

Alaska natural gas pipeline should maximize the participation of small business concerns in contracts and subcontracts awarded for the project. This provision, while setting out a statement of congressional opinion, does not establish a legal requirement for small business participation. After consultation with your staff, we confirmed that this report would focus on small business participation in the Alaska natural gas pipeline. It describes (1) the status of the Alaska natural gas pipeline project and (2) the extent to which any regulatory or oversight structure is in place to monitor small business participation in the construction of the pipeline.

In addressing these objectives, we focused primarily on the federal role in the approval and construction phase of the proposed project and, more specifically, in the monitoring of small business participation in pipeline construction. We reviewed relevant federal laws and regulations. In addition, we interviewed Federal Energy Regulatory Commission (FERC), Department of Energy (DOE), and Small Business Administration (SBA) officials and analyzed documents they provided or referenced. Although the Pipeline Act established the Office of the Federal Coordinator for Alaska Natural Gas Transportation Projects (Office of Federal Coordinator) as an independent office in the executive branch, a Federal Coordinator had not been appointed at the time of our review. As such, we contacted DOE in its capacity as the temporary Federal Coordinator. We limited our work at the state level to discussions with representatives of Alaska’s Governor’s Office and Department of Law. We also contacted representatives of several of the potential sponsors of the Alaska natural gas pipeline—ConocoPhillips, ExxonMobil, and TransCanada—to determine the extent to which they routinely track small business participation in pipeline construction. We performed our work in Washington, D.C., from January 2005 to June 2005 in accordance with generally accepted government auditing standards.

**Results in Brief**

Given the lengthy steps required for state and federal approval of the project, the earliest that construction can begin on the Alaska natural gas pipeline is late 2009. As of June 2005, the State of Alaska had not concluded negotiations with potential project sponsors under the Alaska Stranded Gas Development Act (Stranded Gas Act), which allows the state to negotiate fiscal terms (e.g., taxes and royalties) with project sponsors. In addition to being approved by the state, prospective project sponsors must, under the federal Pipeline Act, (1) conduct a study of gas consumption needs and prospective points of delivery within the State of Alaska and (2) hold an open season allowing potential customers to compete for and

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2“Sponsors” refers to the companies that will construct and operate the pipeline.

315 U.S.C. § 720d. The Pipeline Act vested the functions, authorities, duties, and responsibilities of the Federal Coordinator in DOE until the latter of the appointment of the Federal Coordinator by the President, or 18 months after October 13, 2004—April 13, 2006 (15 U.S.C. § 720d(g)).

4Alaska Stat. §§ 43.82.010-43.82.990.
acquire capacity on the proposed pipeline. Also, the sponsors have been strongly encouraged to submit a prefiling request to FERC. Prefiling allows the sponsors to begin the environmental review process prior to submitting a formal application to FERC. In this way, stakeholders become involved early, issues are identified and resolved, and FERC’s statutory deadline for acting on an application to construct the pipeline can be met. After completing the prefiling process, the sponsors must then submit an application to FERC for a certificate of “public convenience and necessity,” authorizing construction and operation of the pipeline. Once FERC determines that the application is complete, it then has 20 months to prepare the environmental impact statement and issue a final order granting or denying the application. According to FERC officials, it could take several years to complete the above steps before actual construction of a pipeline can take place, but the beginning of the process is controlled by the project sponsor(s).

No structure exists at the federal or state level to monitor small business participation in the construction of the Alaska natural gas pipeline. Although the pipeline will be privately funded, the project sponsors must apply to FERC for a certificate authorizing construction of the pipeline and to DOE if they wish to participate in $18 billion in loan guarantees authorized by the Pipeline Act. According to FERC officials, they typically do not monitor small business participation as part of the permitting process. They noted that FERC does not have expertise on small business matters and that, while FERC could gather the information, other federal agencies such as the Office of Federal Coordinator, created by the Pipeline Act, or SBA might be better situated to do so. According to DOE officials, that agency does not have a legal requirement to track small business participation as part of the loan guarantee process. In the absence of such a requirement, DOE officials stated that their agency has no plans at this time to track small business participation in the pipeline project. Finally, while the Governor of Alaska lists small business participation as one objective for the pipeline project, state officials told us that the State of Alaska does not have a structure in place to monitor or track small business participation. They noted that the state’s focus has been on negotiating financial terms with potential sponsors. They also stated that the participation of Alaska businesses (both large and small) and resident hire provisions continue to be issues of discussion with the applicants.

Background

The Alaska Natural Gas Transportation Act (ANGTA) of 1976 established streamlined procedures for the consideration, approval, and construction of a natural gas pipeline to bring Alaskan natural gas to the lower 48 states.¹ Under the act, the Federal Power Commission (now FERC) was to recommend to the President a specific transportation proposal, the President then would submit a

decision and report to Congress, and Congress would vote on the proposal.\(^6\) In 1977, President Carter designated a route that would follow the existing Alaska oil pipeline and the Alaska Highway into Canada, proceed through Canada to Alberta, and split into two legs continuing to the West and Midwest. Congress approved the plan, and FERC issued a conditional certificate to designate project sponsors.\(^7\) Phase I—1,500 miles of pipeline that transports Canadian gas from Alberta, Canada, to Oregon and Iowa—was completed in 1982. Phase II, the Alaska portion of the project, was delayed because market conditions made the project commercially unfeasible. That is, the expected market value of the natural gas was not considered to be sufficient to justify the expected cost of constructing the pipeline and transporting the natural gas.

The recent increase in natural gas prices has renewed interest in constructing an Alaskan pipeline. In October 2004, Congress passed the Pipeline Act, which, among other things, (1) authorized FERC to consider and act on an application for a certificate of public convenience and necessity for an Alaska natural gas transportation project other than the Alaska natural gas transportation system designated under ANGTA; (2) established an expedited approval process; (3) required FERC to issue regulations governing the conduct of open seasons—periods during which potential customers compete for and acquire capacity on the proposed pipeline; (4) created the Office of Federal Coordinator, an independent office in the executive branch, to coordinate all federal activities relating to the Alaska natural gas transportation project; (5) authorized up to $18 billion in loan guarantees for the project; and (6) included a sense of Congress provision that the sponsors of the pipeline should maximize the participation of small business concerns in contracts and subcontracts awarded for the project.\(^8\)

The Pipeline Act adopted the Small Business Act’s definition of “small business concern” that is set out in 15 U.S.C. § 632(a). This definition provides that small business concerns must be independently owned and operated and must not be dominant in the applicable field of operation. Further, in addition to these criteria, the SBA has statutory authority to establish detailed standards, known as “size standards,” that may be based on the number of employees, dollar volume of business, net worth, net income, a combination of these factors, or other appropriate factors.\(^9\) SBA publishes these size standards, which are almost always stated either as the average employment or average annual receipts of a business concern and vary by industry. SBA’s size standard for companies that construct oil and gas pipelines is $28.5 million in annual receipts.\(^10\) SBA’s size standard for

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\(^{6}\)15 U.S.C. §§ 719c, 719e, and 719f.


\(^{10}\)13 C.F.R. § 121.201, North American Industry Classification System (NAICS) code no. 237120.
specialty trade contractors (such as structural steel and precast concrete contractors) that may assist in the construction of pipelines is $12 million in annual receipts.\textsuperscript{11}

### Start of Construction at Least 4 Years Away

Construction has not yet begun on the Alaska natural gas pipeline. Before construction can begin, a number of events must occur. The State of Alaska, under its Stranded Gas Act, may negotiate with prospective project sponsors regarding fiscal terms (e.g., taxes and royalties) related to the cost of the pipeline. For example, the Alaskan administration might negotiate a contract of regular payments from pipeline owners in lieu of state and municipal taxes. Through negotiations, the legislation is intended to encourage new investment to develop Alaskan stranded gas resources by establishing fiscal terms for such investment, establish some certainty for calculating taxes and royalties over the life of a project, and maximize the benefit to the people of Alaska. Further, under federal law, sponsors must (1) conduct a study of gas consumption needs and prospective points of delivery within the state of Alaska and (2) hold an open season allowing potential customers to compete for and acquire capacity on the proposed pipeline.\textsuperscript{12} A detailed open season plan must be submitted to FERC.\textsuperscript{13} Also, the project sponsors are encouraged to submit a prefiling request to FERC. Prefiling allows the sponsors to begin the environmental review process prior to submitting a formal application to FERC. Thus, it will involve stakeholders, identify and resolve issues early, and ensure that FERC’s statutory deadline for acting on an application to construct the pipeline will be met. After completing prefiling, the sponsors may submit an application to FERC for a certificate of “public convenience and necessity” authorizing construction and operation of the pipeline.\textsuperscript{14} Once FERC determines that the application is complete, it has 20 months to prepare the environmental impact statement and issue a final order granting or denying the application.

As of June 2005, three groups had submitted applications under the Stranded Gas Act expressing interest in constructing the pipeline and begun negotiations with the

\textsuperscript{11}Id., NAICS code no. 238120.


\textsuperscript{13}18 C.F.R. § 157.38.

\textsuperscript{14}In their application, the sponsors must show that the proposed project is or will be required by the present or future public convenience and necessity.
State of Alaska: (1) a consortium of three oil and gas producers—BP Exploration (Alaska) Inc., ConocoPhillips Alaska, Inc., and ExxonMobil Alaska Production Inc.; (2) the TransCanada Corporation, a Canadian-based energy company that focuses on gas transmission; and (3) the Alaska Gasline Port Authority, a municipal port authority formed by the North Slope Borough, Fairbanks North Star Borough, and the City of Valdez. As shown in figure 1, the earliest projected date for construction to start is late 2009.

Figure 1: Projected Time Line for FERC Action on Approval of the Alaska Natural Gas Pipeline Project

No Structure Is in Place to Track Small Business Participation in the Pipeline Project

No federal or state regulatory or oversight structure exists specifically to monitor small business participation in the construction of the Alaska natural gas pipeline. According to FERC officials, they typically do not monitor small business participation as part of the permitting process. While indicating that FERC could gather the information, the officials noted that other federal agencies such as SBA or the Office of Federal Coordinator might be better suited to do so, particularly because FERC does not have small business expertise. When regulating pipelines, FERC typically focuses on protecting the environment, ensuring that the pipeline is designed correctly and operated safely, and requiring open access at just and reasonable rates. According to DOE officials, that agency does not have a legal requirement to track small business participation in the pipeline as part of the loan guarantee process. The officials told us that, as a result, their agency does not have plans at this time to track small business participation in the project. Similarly, because it will not involve federal procurement, SBA officials told us that their agency has no plans to track small business participation in the project. However, they noted that, if required, SBA would provide assistance to any interested party concerning ways of tracking and increasing small business participation for the project.

15In May 2005, DOE published a notice of inquiry seeking comments and information from the public to assist it in developing regulations implementing the loan guarantee provisions in the Pipeline Act. The information requested included questions regarding collateral and monitoring and reporting requirements. See 70 Fed. Reg. 30707 (May 27, 2005).
As is the case at the federal level, no one at the state or project level currently has a structure in place to track small business participation. According to representatives of the Governor’s Office, the Governor of Alaska includes small business participation among the project objectives. However, the state does not have a mechanism in place to track small business participation in the construction of the pipeline. The officials noted that the state’s focus has been on negotiating financial terms with potential sponsors. They also stated that the participation of Alaska businesses (both large and small) and resident hire provisions continue to be issues of discussion with the applicants. Additionally, none of the potential sponsors that we interviewed has developed a tracking system specifically for the Alaska natural gas pipeline project. However, according to one company’s officials, they typically track their use of small businesses and report it for internal purposes. The officials added that, if they were required to track small business participation in the construction of the pipeline from the start of the project, they could track and share information on small business participation in their contracts and subcontracts. They stressed that there would be no way to track every aspect of small business participation because of the sheer magnitude of the project.

Representatives of another potential sponsor told us that they track similar information and, therefore, it would not be difficult for them to add a tracking requirement regarding use of small businesses. In contrast, a representative of a third potential sponsor noted that the company would be concerned about a tracking requirement because it is their policy to minimize the number of constraints they place on their prime contractors.

Although no monitoring structures are in place for the pipeline project, the federal government has created regulatory and oversight systems to track or oversee similar private contracting initiatives. For instance, ANGTA included an equal opportunity requirement that was directed to federal agencies and authorized the appointment of a Federal Inspector to, among other things, monitor compliance with applicable laws and other requirements. Specifically, ANGTA required that all federal officers and agencies take such affirmative action as was necessary to assure that no person—on the grounds of race, creed, color, national origin, or sex—be excluded from receiving or participating in any activity conducted under any certificate, permit, right-of-way, lease, or other authorization granted or issued pursuant to the act. The implementing regulations stated that (1) each certificate (including the certificate of public convenience and necessity issued by FERC), permit, right-of-way, lease, or other federal authorization must include an equal opportunity clause and (2) the project sponsors and certain contractors and

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subcontractors must have affirmative action plans. These entities also were required to submit compliance reports. Finally, the Office of the Federal Inspector (similar to the Office of Federal Coordinator created under the Pipeline Act) was responsible for tracking compliance, including compliance with the equal opportunity and affirmative action requirements.

As another example, the United States and Canada reached an agreement that required the companies approved to build the Alaska natural gas pipeline to report information on bidders they proposed to supply certain goods and services. In 1977, the two countries reached an agreement on Principles Applicable to a Northern Natural Gas Pipeline where they would endeavor to ensure that the supply of goods and services to the Alaska gas pipeline would be on generally competitive terms. In 1980, the two countries entered into a procurement procedures agreement outlining procedures designed to ensure procurement on a generally competitive basis for the Alaska gas pipeline. The agreement stated that the appropriate regulatory authority in each country (the Office of the Federal Inspector in the United States and the Northern Pipeline Agency in Canada) would be responsible for implementing the procedures. For example, the procedures included a requirement that the project companies submit a list of qualified bidders they proposed to invite to tender bids on certain items subject to the agreement (e.g., line pipe and pipe fittings) to the appropriate domestic regulatory authority. The regulatory authority of the other country would have the opportunity to review the bidders’ list and propose the addition of any firms that it considered should also be invited to tender bids.

Observations

Congress expressed the opinion (in a sense of Congress) that the sponsors of the Alaska natural gas pipeline should maximize the participation of small business concerns in contracts and subcontracts awarded in carrying out the project, but no federal structure has been designated or currently exists to track small business participation in the proposed project. The federal agencies currently involved in the pipeline project, FERC and DOE, cited limited roles in the process or lack of small business expertise. While we cannot quantify the costs the federal government and sponsors would face to monitor small business participation, federal precedents for monitoring private contracting initiatives exist. For example, under ANGTA the federal government created an office to monitor, among other things, equal opportunity compliance. Further, the Pipeline Act established the Office of Federal Coordinator to coordinate all federal activities relating to the project. The Federal Coordinator, once appointed, would be uniquely situated to work with federal and state agencies on monitoring the extent of small business participation in the pipeline’s construction. However, we note

\[17\] 43 C.F.R. § 34.6 and 43 C.F.R. § 34.8. The regulations required each ANGTA contractor and subcontractor with 50 or more employees and with a contract of $1 million or more and certain contract bidders to have an affirmative action plan.

\[18\] 43 C.F.R. § 34.9.
the concerns of project sponsors who, while generally able to obtain and report information on small business contracting, may not be able to capture all levels of small business participation because of the magnitude of the project.

Agency Comments

We provided a draft of this report to DOE, FERC, and SBA for their review and comment. All three agencies provided technical comments, which we have incorporated where appropriate.

We are sending copies of this report to the Secretary of Energy, Chairman of the Federal Energy Regulatory Commission, Administrator of the Small Business Administration, and interested congressional committees. We also will make copies available to other interested parties upon request. In addition, the report will be made available at no charge on the GAO Web site at http://www.gao.gov.

Please contact me at (202) 512-8678 or shearw@gao.gov if you or your staff have any questions about this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Other major contributors to this report were Harry Medina, Paige Smith, Linda Rego, and Barbara Roesmann.

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