

# An Alaska Natural Gas Future *for Alaskans*

House Bill 4: In-State Gasline Development Corp.  
Rep. Mike Hawker and Speaker Mike Chenault

*Section 33 Amendment Presentation to House Resources Committee, March 1, 2013*

# Alaska Gas for Alaskans

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## Resolves regulatory uncertainties

- Regulatory uncertainties add risk, which adds costs and can deter private sector participation. AGDC needs to know how a pipeline will be regulated before soliciting private sector partners

## House Bill 4:

- Allows natural gas pipelines to operate as contract carriers through changes to the Right-of-Way Leasing Act and through Regulatory Commission of Alaska oversight
- Reinforces state policy that pipelines should be fair; offer reasonable access to new/future shippers; and encourage future development of Alaska's oil and gas resources

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## Why a contract carrier?

- Shippers need to know that the space they are 'reserving' by signing long-term commitments will be available
- Those firm, uninterruptible contracts are the way gas pipelines are financed
- The future income promised through those contracts secures revenue bonds
- House Bill 4 establishes contract carrier status while providing for expansions in the future

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## Definitions

*(Not official definitions ... but practically speaking)*

**Tariff:** A package of the rates and the terms and conditions that a pipeline offers. Rates may be a 'schedule' of rates distinguishing different classes of service.

**Recourse tariff:** A tariff that is kept on file as the pipeline's official 'offering'. The recourse rate is available to customers who do not negotiate rates with the pipeline.

**Just and reasonable:** A concept; generally, just is fair to all, reasonable is within a range of acceptableness.

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## Refresher: The Process

Pipeline puts together a project

Before taking that project to the market to sign up customers, pipeline has to develop its rates and terms/conditions of service = the tariff

Pipeline has to file the tariff as a 'recourse tariff' with the RCA before holding an open season to sign up customers

Recourse tariff is the sticker price; customers can negotiate final price

Supported by a full cost study

Amended, HB 4 would require RCA pre-approval of recourse tariff before an open season

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## Refresher: The Process

With an approved recourse tariff, the pipeline holds an open season

Pipeline negotiates rates with potential customers: price, volume, where the gas comes into the line, where the gas leaves the line, etc.

Once a deal is reached, the pipeline signs up customers with a 'precedent agreement'

May include conditions the pipeline has to meet over the next couple years

If the conditions are met, the precedent agreement eventually becomes a firm transportation agreement

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## Refresher: The Process

Negotiated contracts in an open season is one of several ways a customer can sign up for pipeline service

A customer could simply sign up using the recourse rate (instead of negotiating)

Or, the pipeline and a customer could make a 'presubscription agreement' before the open season starts – but only using the same terms/conditions everyone else will get, and subject to the same standard of review as all the open season contracts

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## Refresher: The Process

After the open season, the pipeline keeps working on design, permitting, engineering, commercial structures

And, the pipeline turns all those precedent agreements in to the RCA

RCA needs to decide whether those agreements are 'just and reasonable'

These contracts, once approved, cannot be changed by anyone, including the RCA (unless the contract allows for the contracting parties to make changes)

Disputes about the contract terms, if they arise, get handled through a dispute resolution method that is spelled out in the recourse tariff



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## Refresher: The Process

### Just and Reasonable – What does it mean?

Just and reasonable is a standard – in this case, a contract must meet this standard

Just: Everyone is treated fairly and in a reasonable way

Reasonable: Not too much, not too little: within an acceptable range and defensible

How do we know?

Was the contract made at arm's length?

Arm's length is a legal principle pulled from contract law. An agreement is arm's length if it was made by independent parties, on equal footing; if parties are connected by 'shared interests', an arm's length agreement that stands up to scrutiny is important.

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## Meeting the Arm's Length Standard

Start with the contract. Does it include the recourse rate offered to everybody?

**YES:** Contract is at arm's length and acceptable.

**NO:** Next step: Was the contract made between two state entities?

**YES:** Contract is at arm's length and acceptable.

**NO:** Next step. Is the contract between two unaffiliated parties?

**YES:** Contract is at arm's length and acceptable.

**NO:** Parties are affiliated. Next step: Is the contract 'substantially similar' to one made between unaffiliated parties?

**YES:** Contract is at arm's length and acceptable.

**NO:** Next step. Triggers deeper review by the RCA to determine 'just and reasonable' by new standards, using all cost data, digging into the details – BUT, the RCA must also consider the consequences of failing to approve the contract at hand.

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## Refresher: The Process

Once construction ends, the pipeline will know a lot more detail about costs

At that point, the pipeline has to go back to the RCA with that ‘actual’ information, and update the old ‘recourse tariff’ that was based on estimates (HB 4 amended)

The pipeline also has to update the recourse tariff in the future, whenever the pipeline plans an open season to expand the pipeline or to ask for customers for capacity if extra space becomes available (HB 4 amended)

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## Amendment:

1. Significantly increases the RCA's role in resolving disputes, offering better accountability to potential shippers; the public; and interested parties
2. Ensures that all parties with shipping contracts and potential shippers have an opportunity to participate in disputes not directly involving them
3. Protects against the potential of 'runaway' rates of return, making the pipeline more accountable to customers and ratepayers
4. Amplifies the role of the recourse tariff by adding substantial RCA review, creating a more accountable, open and fair process for shippers, future shippers, related customers, and ratepayers

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## Amendment: Disputes

1. Contracts between shippers and a pipeline can include a dispute resolution method
2. If so, the method must be included in the pipeline's recourse tariff (terms and conditions of service)
3. A dispute resolution method must:
  - Notify all shippers of a dispute
  - Result in a process determined by an independent third party/panel
  - Allow existing shippers and creditworthy potential shippers to participate
    - Participants must meet the RCA's standards for intervention

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Amendment: Dispute resolution, con't.

When can the RCA step in?

1. Disputes related to things that are not subject to contractual dispute resolution methods (catch-all)
2. Complaints brought by someone who doesn't have a contract with the pipeline
3. Complaints about the way an open season is conducted
4. Disputes that cannot otherwise be resolved that involve a public utility and would result in an immediate threat to the public health and safety

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## Amendment: Excessive rates of return protection

\* Excessive rates of return are *not* anticipated, however:

Every three years the carrier has to submit a detailed cost study to the RCA

- Actual, current costs, within 90 days of the close of the pipeline's annual accounting period
- Report has to include a calculation of the three-year average actual return on equity

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Amendment: Excessive rates of return protection, con't.

- The RCA must review the cost study and verify if the rate element 'actuals' are the same as the RCA previously approved
- If the elements do not match, the RCA requires a corrected report
- If there is more profit than allowed per the approved rate of return, the excess has to go into a segregated operating reserve fund
- The pipeline has to keep putting excess into the fund, until the fund hits 20% of the annual average operating costs of the pipeline
- Once the fund is full – 20% - the pipeline uses any remaining excess to reduce the firm service rates for all shippers in the next 3-year period
- The pipeline can draw on these reserves in three-year periods in the future when operating costs are high and result in a shortage of rate of return



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## Amendment: Recourse tariff

Previously, required the pipeline to file a recourse tariff in advance of an open season; an open-to-all-comers sticker price

Now, RCA must use a pipeline's cost study to review and approve a recourse tariff

Heightened scrutiny

Standard of review: not unduly discriminatory (fair)

The recourse tariff must include the procedure for conducting open seasons

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Amendment: Recourse tariff, con't.

When does a recourse tariff come into play?

1. Before the first open season for a new pipeline
2. After construction, when costs are about 95% known
3. In advance of any open season for new capacity or pipeline expansions

Why?

- Sticker price
- Terms that anyone has the option of using to get in on the pipeline, whether they choose to negotiate or not
- Everyone has had the opportunity to get in on the pipeline on the same terms (although rates in the recourse tariff may vary per shipper category)
- Commonly used for short-term interruptible capacity, when available

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Amendment: Recourse tariff, con't.

Review process:

RCA must review and approve initial recourse tariff, and any substantial amendments

1. Terms and conditions may not be 'unduly discriminatory'
2. Rates need to be supported by an accompanying cost study

RCA looks at rates and, weighing the risks of the particular pipeline, looks at:

1. Is the proposed rate of return within a reasonable range per recent FERC decisions?
2. Does the cost model incorporate a reasonable depreciation method and economic life?
3. Does the cost model use a reasonable capital structure?

RCA can deny recourse tariff; RCA must rule on a recourse tariff within 30 days

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Amendment: Recourse tariff, con't.

What is “reasonable?”

These elements are reasonable if they are “commonly accepted or used by the commission or the Federal Energy Regulatory Commission”

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## Amendment: Recourse tariff, con't.

- Same review process, standards, apply for recourse tariff revisions in the future
- Rate elements previously ruled 'reasonable' now have to match what the RCA initially allowed
- RCA shall deny recourse tariff revisions if terms/conditions are unduly discriminatory
- RCA shall deny recourse tariffs if they do not include the previously approved rate element values, unless the pipeline can prove the new element is just and reasonable
- For recourse tariff revisions, the RCA has 90 days to act

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## Amendment: Overall

1. Because the amendment creates a significant review and approval process for the recourse tariff, the recourse tariff becomes more important
2. So, the amendment has some pieces where the recourse tariff plays a greater role; for example, the tariff must include procedures for holding an open season, and the recourse tariff will be the 'official' record of the pipeline's offering (rates, terms/conditions)
3. Also, some housekeeping: giving the RCA greater latitude (similar to other regulatory chapters) to investigate; to access pipeline accounts, financials and records;
4. And, as we've directed the RCA to clearly 'do' some things in relation to the recourse tariff, we go back into the 'General Powers and Duties' to be clear on the boundaries of the RCA's powers

Thank you

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## House Bill 4: In-state Gasline Development Corp.

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