STATE OF ALASKA
DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT

Sean Parnell, Governor
Susan K. Bell, Commissioner
Robert M. Pickett, Chairman

Regulatory Commission of Alaska

February 18, 2011

The Honorable Bob Herron
House of Representatives
Alaska State Legislature
State Capitol Room 411
Juneau, Alaska 99801

Dear Representative Herron:

On behalf of Chairman Pickett I submit the following information for the record of the hearing of the House Special Committee on Economic Development, Trade, and Tourism held February 15, 2011, on the subject of LNG Plant Closure:

1. A document containing two schedules, one showing each Cook Inlet gas contract submitted to the Regulatory Commission of Alaska (RCA) for approval since 2000 and the second containing detailed information about each of the contested gas contract cases heard by the RCA.

2. A copy of each RCA order resolving disputed issues in a contested gas contract proceeding.
    a. Order U-01-007(8)
    b. Order U-03-084(7)
    c. Order U-06-002(15)
    d. Order U-08-58(8)

    All separate statements of commissioners, appendices, and other orders and documents detailing the above proceedings are available on the RCA's website at www.rca.alaska.gov by entering the docket number (e.g., U-01-007) in the "Find a Matter" search box on the right-hand side.

Do not hesitate to call or email if you or members of the committee have questions or if we can send you further documents directly.

Sincerely,

Janis W. Wilson

Janis W. Wilson, Commissioner
Regulatory Commission of Alaska

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RCA REVIEW OF RECENT MAJOR COOK INLET GAS SUPPLY CONTRACTS ENTERED INTO BY ECONOMICALLY REGULATED GAS AND ELECTRIC UTILITIES

ENSTAR Natural Gas Company

Supplier	Date Contract Filed	Date of RCA Action	Processing Time (Days)	Contract Contested	RCA Action	Commission Proceeding
Phillips/Anadarko	6/15/2000	9/19/2000	96	No	Approved	TA114-4
Unocal	12/12/2000	10/25/2001	317	Yes	Approved, with modifications*	U-01-007
NorthStar Energy Group	8/08/2003	3/23/2004	228	Yes	Approved, with modifications*	U-03-084
Marathon	11/14/2005	9/28/2006	318	Yes	Not approved*	U-06-002
Marathon	4/11/2008	10/31/2008	203	Yes	Approved, with modifications*	U-08-058
ConocoPhillips	4/11/2008	10/31/2008	203	Yes	Approved, with modifications*	U-08-058
Anchor Point Energy LLC	9/21/2009	11/05/2009	45	No	Approved	TA180-4
Marathon	4/09/2010	5/24/2010	45	No	Approved	TA187-4
ConocoPhillips	8/13/2010	10/11/2010	59	No	Approved	TA193-4

*The attached page contains more detailed information about the contested contracts

Chugach Electric Association, Inc.

Supplier	Date Contract Filed	Date of RCA Action	Processing Time (Days)	Contract Contested	RCA Action	Commission Proceeding
ConocoPhillips	5/12/2009	8/21/2009	101	No	Approved	TA305-8
Marathon	4/02/2010	5/17/2010	45	No	Approved	TA316-8

Average Processing Time in Days for *Uncontested* Contracts (including 30-day public notice period)	65
Average Processing Time in Days for *Contested* Contracts (including 30-day public notice period)	254
Average Processing Time for *All* Contracts (including 30-day public notice period)	151

FURTHER INFORMATION ON CONTESTED GAS CONTRACT PROCEEDINGS
(all proceedings are ENSTAR proceedings)

Supplier and Year Filed	Parties in Proceeding	Days of Hearing	Number of Witnesses	Pages of Transcript	RCA Action
Unocal 2000 (U-01-007)	PAS, Marathon, Unocal, ENSTAR	4	7	841	RCA approved the contract *with modifications* (limiting volume to 450 Bcf, limiting third party gas to 15%, and giving ENSTAR a right of first refusal to buy non-economic gas) Unocal and ENSTAR accepted the modifications
NorthStar Energy 2003 (U-03-084)	RAPA, NorthStar, ENSTAR	3	5	591	RCA approved the contract *with modifications* (reducing floor price from $3 to $2.75, capping transportation rate at $0.30 per Mcf, and limiting third party gas to 15%) NorthStar and ENSTAR accepted the modifica-tions [no gas was ever sold under this contract]
Marathon 2006 (U-06-002)	RAPA, Tesoro, Trading Bay, Walker, Marathon ENSTAR	13	10	2619	RCA approved the contract to the extent the contract price did not exceed weighted average cost of gas from existing contracts Marathon and ENSTAR did not put the contract into effect
Marathon ConocoPhillips 2008 (U-08-058) [both contracts were considered in one proceeding]	RAPA, Chugach, HEA, Aurora Power Resources, Fairbanks Natural Gas, ENSTAR	13	11	2267	RCA approved the contract *with modifications* (ConocoPhillips contract—a floating price cap based on production basin prices) (Marathon contract—a similar floating price cap and deletion of a particular provision to the extent inconsistent with unbundling of price and volume) Modifications were not accepted

PAS was RCA Public Advocacy Section; RAPA is Regulatory Affairs and Public Advocacy Section of the Attorney General

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: G. Nanette Thompson, Chair
Bernie Smith
Patricia M. DeMarco
Will Abbott
James S. Strandberg

In the Matter of the Gas Sales Agreement Between ALASKA PIPELINE COMPANY, a Wholly-owned Subsidiary of SEMCO ENERGY, INC., of Which the ENSTAR NATURAL GAS COMPANY is a Division, and the UNION OIL COMPANY OF CALIFORNIA, Filed as TA117-4	U-01-7 ORDER NO. 8

ORDER CONDITIONALLY APPROVING TA 117-4 (GAS SALES AGREEMENT) AND REQUIRING FILING

BY THE COMMISSION:

Summary

We conditionally approve a gas sales agreement (GSA) between Unocal[1] and Enstar[2] and require the parties to file an executed addendum to the GSA consistent with this Order.

[1]Union Oil Company of California.

[2]Enstar Natural Gas Company is a division of SEMCO ENERGY, Inc. Alaska Pipeline Company (APL), is a wholly-owned subsidiary of SEMCO ENERGY. APL, not Enstar Natural Gas Company, is the actual party to the GSA. The Commission has historically regulated APL and Enstar as a single entity. The use of the name Enstar in this proceeding includes both APL and Enstar.

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Background

On December 12, 2000, Enstar filed a tariff advice letter (TA117-4)[3] requesting approval of a new GSA between Unocal and Enstar. Enstar also requested that we approve the addition of the GSA to Section 708 of Enstar's tariff as a base supply contract and the inclusion of all costs related to the GSA in calculating Enstar's Gas Cost Adjustment. TA117-4 was publicly noticed on December 19, 2000.

We suspended TA117-4 for a period of six months[4] to allow Enstar an opportunity to show that the GSA provisions were in the public interest, that a reasonably competitive procurement process was undertaken,[5] and to explain the GSA's impact on long-term regional gas supply.

We received comments from the public regarding the GSA.[6] Phillips Alaska, Inc., (Phillips) supported Enstar's desire to spur additional exploration, but expressed concern that the proposed GSA would make Unocal a gas broker because the GSA did not contain a definite term, volume or geographical limitation for Unocal's supply. Phillips stated that, for a gas explorer, uncertainty about when an opportunity to supply Enstar's unmet requirements might arise adds to the standard risks of

[3]The tariff advice letter was filed as TA117-4.

[4]Order U-01-7(1), dated January 18, 2001. In Order U-01-7(5) we extended the suspension for good cause to January 25, 2002.

[5]In Order U-01-7(7), dated August 9, 2001, we clarified our interest in ensuring that any contract that affected the public interest was the result of an arms-length transaction and that the ratepayers would receive a fair price. We limited our inquiry to the merits of the GSA terms, the GSA as a whole, and how it compares to other signed contracts.

[6]We received comments opposing GSA approval from, among others, Agrium; Alaska Sea Food Exports; Aurora Power Resources, Inc.; Chevron U.S.A Inc.; Marathon Oil Company and Marathon Alaska Natural Gas Company; and Phillips Alaska, Inc. We also received comments supporting GSA approval from the City of Kenai; Homer Electric Association, Inc.; Kenai Peninsula Borough; and Peak Oilfield Service Company.

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exploration. Uncertainty reduces Phillips' incentive to invest in Cook Inlet exploration relative to other exploration opportunities.[7]

Chevron U.S.A. Inc. (Chevron) stated it had significant volumes of uncommitted natural gas reserves in the Beluga River Gas Field, and that it needs a reasonable opportunity to secure a viable market for its Cook Inlet gas reserves. Chevron said the GSA could reduce competition among producers and limit Cook Inlet exploration activities. Producers will hesitate to make necessary capital investments to locate and develop new reserves if they don't have a reasonable expectation of a gas market. If Unocal is unsuccessful in finding new reserves during the GSA's term and competitors do not explore, projected gas supply shortages will remain.[8]

Aurora Power Resources, Inc. (Aurora) opposed Enstar entering into a "requirements" contract. Aurora stated that GSA approval would close the largest potential market for natural gas through 2005 and would discourage exploration and development activities in Cook Inlet. Aurora stated that the public interest would be served by requiring Enstar to purchase reasonable quantities of gas from smaller producers and smaller existing fields.[9]

Steve Toth of Alaska SeaFood Exports and six individuals opposed the GSA as embodying a rate hike.[10]

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[7]Letter from Phillips Alaska, Inc., dated January 19, 2001.

[8]*Chevron's Comments to Enstar's Tariff Advice Letter No. 117-4,* filed June 19, 2001.

[9]Letter from Aurora Power, dated January 18, 2001.

[10]Letter from Steve Toth dated January 15, 2001, and letters from M. Eaton, R. Haye, C. Hickey, J. Schnell, R. Schnell, and B. Worley-Callander, dated January 18, 2001.

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Agrium Inc., a producer and wholesaler of fertilizer and retail supplier of agricultural products, expressed concern over the GSA's possible impact on the export competitiveness of Cook Inlet industrial production.[11]

Homer Electric Association, Inc. (HEA) supported the GSA and stated that a secure long-term gas supply is essential to the viability of its customers. New discoveries on the peninsula may be the key to bringing natural gas to Homer.[12] The City of Kenai, Kenai Peninsula Borough, and Peak Oilfield Service Company expressed hope that the GSA will encourage the discovery of new gas resources and be the impetus to providing natural gas to the lower Kenai Peninsula.[13]

We designated the Public Advocacy Section (PAS) as a party and granted intervention by Marathon Oil Company (Marathon) and Unocal.[14] A public hearing on the GSA was held from August 14, 2001, through August 20, 2001.

Standard of Review

In deciding whether to approve the GSA we are guided by our obligation to act in the public interest. The GSA is a commercially negotiated agreement. We will not speculate whether a better agreement could have been obtained by Enstar with Unocal or with another potential supplier.

Our primary concern is to ensure reliable and reasonably priced utility service. We will determine whether the GSA is fair as a whole and we make modifications only to protect the public.

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[11]Letter from Agrium, dated February 2, 2001.

[12]Letter from HEA, dated January 19, 2001.

[13]Letters from Peak Oilfield Service Co., dated January 18, 2001; Kenai Peninsula Borough, dated January 19, 2001; and City of Kenai, dated January 19, 2001.

[14]Order U-01-7(1) and U-01-7(2).

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Discussion

Cook Inlet gas production began as a by-product of oil exploration. Several major gas fields were discovered between 1955 and 1965.[15] It was estimated initially that the gas fields would supply local gas needs for at least a hundred years. Accordingly, the oil companies focused on developing demand for the overabundance of gas. They built a liquefied natural gas (LNG) plant and a fertilizer plant.[16] Also, the historical abundance of natural gas has allowed Cook Inlet consumers to pay less than the national average for gas.[17]

Natural gas reserves, while plentiful in the past, are declining. It is predicted that the known natural gas reserves in Cook Inlet will be exhausted by 2012. Exploration for new sources of gas in Cook Inlet has not kept pace with other areas.[18] There is also concern that the older fields of Cook Inlet will be unable to deliver natural gas at the rates required.[19] The ability to meet peak demand may also be affected by the lack of gas storage facilities. Exploration and development of new natural gas sources takes many years and requires that exploration companies act years before reserves are exhausted by customer demand.[20]

The GSA's genesis was when Marathon informed Enstar that it would not be able to exercise the APL-4 contract option for 400 Bcf of gas and recommended

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[15]Barnes prefiled testimony at 2.

[16]Barnes prefiled testimony at 3. These two users account for approximately sixty-one percent of the natural gas consumption in southcentral Alaska today. Strickland reply prefiled testimony at 9. The LNG plant has a license to export LNG until 2009. *Id.* at 24; McConnell prefiled testimony at 21.

[17]Strickland prefiled reply testimony at 12.

[18]"A Review of Cook Inlet Natural Gas Supply and Demand" by Northern Economics. Dieckgraeff prefiled testimony exhibit DMD-5 at 2, 4, 10.

[19]Strickland at 21.

[20]*Id.* at 25.

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in 1995 that Enstar seek a new gas supplier.[21] In protracted contract discussions for additional gas, only a few options were available to Enstar. Enstar did contract for gas from the Moquawkie field. Marathon could supply gas under various scenarios including acceleration of long term gas commitments, but these scenarios did not fit Enstar's strategic planning needs for future gas supplies. Little was offered in new gas reserves. Enstar believed greater economic incentives were necessary to motivate new drilling,[22] so it agreed to move toward market prices. Enstar asserted this has resulted in successfully executed gas supply agreements in 2000 with Anadarko, Phillips and Unocal.[23]

The opposing parties imply that the GSA shifts the risk for future Cook Inlet gas exploration to the Enstar ratepayer. We understand that concern. However, we find that Enstar has identified its future requirements and developed a credible compendium of gas supply contracts to meet those requirements. While Marathon and the PAS advocate disapproval of the entire GSA, we do not find cause for such action. No party convincingly demonstrated a fatal flaw in any GSA condition. We are satisfied that the negotiations were at arms-length, and that the GSA with the modifications as more fully set forth in this Order is in the public interest.

As the GSA is a matter of public record we do not intend to set forth all of its terms. Instead, we focus on the essential objections and issues raised by the parties.

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[21] Barnes prefiled testimony at 9.

[22] Barnes prefiled testimony at 12, 14.

[23] Barnes prefiled testimony at 15.

Price

The gas price Enstar pays Unocal will be determined annually by using a thirty-six-month daily average of the Henry Hub[24] natural gas futures (HHF) and a floor price of $2.75 per thousand cubic feet (Mcf) adjusted for one-half of the inflation rate after 2002.

The PAS argued we should not adopt a price tied to HHF because it is volatile and the HHF is tied to gas prices in the eastern United States. The PAS believes an HHF price results in higher prices and volatility not related to Cook Inlet market conditions. The PAS also objected to the price because it includes a floor price but no ceiling price. The PAS recommended a composite index of Light Sweet Crude Futures and a dual index that captures the price of natural gas paid by Agrium and the LNG plant for Cook Inlet gas. The PAS is also concerned that the price allows arbitrage of gas from other sources. [25]

Marathon argued that the price is not a fair price.[26] Marathon believes the price reflects a price premium without a correlating firm contract volume commitment to justify the premium.[27] Marathon states the GSA should "be tested in the marketplace against actual firm volume commitments offered by other producers."[28] Marathon argued that Enstar's commitment of its entire unmet

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[24]Henry Hub is a large pipeline interconnection in Louisiana. Strickland prefiled reply testimony at 52.

[25]McConnell prefiled testimony at 18-21.

[26]Marathon defines a fair price as one that reflects the obligations of the party entitled to payment under a contract, as tested in the market. Risser prefiled testimony at 26.

[27]*Id.*, at 27, 31.

[28]*Id.*, at 30.

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requirement to Unocal creates a disincentive for other producers to explore and develop natural gas resources in Cook Inlet.[29]

Unocal and Enstar characterize the GSA as an "exploration contract" because the focus of the GSA is on exploration for new gas sources. Existing gas fields are old and the likelihood of discovering large fields is slim.[30] While Unocal is confident new gas will be discovered, the fields are likely to be small and the cost of production and transporting the gas to market will be high.[31]

Exploration for new sources of gas is risky[32] and investment capital in Cook Inlet must compete with investment opportunities worldwide. Demands from other gas users, like Marathon's LNG plant and Agrium's fertilizer plant, have not created sufficient incentive for new exploration. We acknowledge that the discovery of a large gas field poses a risk of depressing Cook Inlet gas prices; and that North Slope gas may significantly impact the Cook Inlet area, but when it may be available is speculative.

Exploration is needed in order to ensure an adequate supply of gas for Enstar ratepayers. The risk associated with exploration must be compensated or exploration will go elsewhere. While the HHF price structure is higher than previously approved contracts, we weigh the risk that Enstar will not have an adequate natural gas supply in the future against a higher exploration price. The HHF volatility risk is mitigated by the use of a thirty-six month trailing average. Testimony disclosed that

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[29]*Id.*, at 31.

[30]Tr. at 593.

[31]Tr. 637, 652-653.

[32]Strickland prefiled reply testimony at 28; Tr. at 622-624, 629-632.

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companies would not explore for new gas without assurance that their investment could be recovered.

The evidence persuades us that Enstar must pay a competitive price to attract necessary capital and encourage exploration in Cook Inlet. The HHF price is necessary to attract exploration capital. We find that a price tied to the HHF, with a floor of $2.75 is a reasonable balance of the risks associated with gas exploration and the need to assure an adequate supply of gas for Enstar's ratepayers.

Peaking Fee

Any day that Unocal supplies more than its pro rata share of maximum deliverability, Enstar must pay Unocal a peaking fee of $1.00 per Mcf (in addition to the price) for the excess.[33] Testimony by Unocal and Enstar estimate that peaking fees will not exceed $10,000 a year.

Peaking gas covers times when Enstar's shippers do not supply all the gas that Enstar customers need on a particular day. The GSA allows Enstar to get the needed gas from Unocal. There is a premium associated with this peaking gas because of the additional costs Unocal bears to produce and deliver it. When a particular shipper does not supply its committed gas to Enstar, the peaking fee will be passed back to that shipper. When Enstar's swing is greater than normal (for example, when Anchorage has an extremely cold temperature and the demand for gas is unusually high), Enstar can go to Unocal for the extra swing gas and pay the peaking fee. This peaking fee would be passed on to the ratepayer through Enstar's Gas Cost Adjustment. In both cases Enstar needs the ability to get the extra gas for

[33]GSA 4.6 and 4.1.1.2. The fee will be adjusted each year.

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its customers. Unocal considers peaking gas as a service to Enstar, not an opportunity to make money.[34]

The PAS views the peaking fee as a penalty assessed against Enstar passed to ratepayers. The PAS suggests that Unocal should deliver peaking gas without charge, subject to Enstar replacing the gas within six months.[35] The PAS stated Enstar should be required to correctly forecast and contract for its needs. The risk of an incorrect forecast should be borne by Enstar's shareholders, not by its ratepayers.[36]

We weigh the risk of ratepayers not having enough gas on peak days against the price. The prospect of Enstar's customers not having sufficient gas outweighs the price concern. Peaking gas is a safety net for Enstar.[37] We do not find the peaking fee to be unreasonable.

Transportation Fees

Unocal has the responsibility to build all pipelines and other facilities necessary to deliver gas to receipt points on Enstar's pipeline system. The price for gas includes all RCA-approved tariffs for pipelines operating on the effective date of the contract. Enstar will reimburse Unocal for RCA-approved tariff charges (up to $1.00 per Mcf) on pipelines constructed after the contract effective date. The parties must agree to any reimbursement in excess of $1.00 per Mcf.

The PAS indicates that the transportation fee provision could require Enstar ratepayers to pay for the construction of Unocal's gas storage facilities, or any

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[34] Tr. 569-570.

[35] The PAS cites the APL-1 contract as an example of this type of provision. McConnell prefiled testimony at 22.

[36] McConnell prefiled testimony at 22.

[37] Tr. 570-571.

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other unspecified service or facility that is used to transport gas to and from storage for delivery to Enstar, or for a pipeline constructed to deliver gas to a third party in exchange for gas delivered to Enstar. PAS states these costs are capital expenditures that should be incurred by Enstar and then included in rate base.[38]

If new gas is discovered, pipelines may need to be built. The cost of construction and operation of pipelines are recovered in tariffed rates. The GSA new pipeline transportation costs are capped at $1.00 per Mcf.[39] Before these costs may be passed through to ratepayers, we must approve the tariff. Therefore we have an opportunity to determine if the rates are just and reasonable. We see no reason to interfere with this portion of the GSA.

GSA Term

The proposed GSA does not contain a definite termination date. The agreement will not terminate until Unocal has delivered all of the gas it has committed to deliver. This is the equivalent of an all-requirements agreement as long as Unocal can deliver Enstar's unmet requirements.

The PAS opposed this provision because Enstar cannot terminate the GSA. The PAS supported an April 2009 termination date that coincides with the Department of Energy LNG export license expiration and would allow the Commission and Enstar to evaluate the availability of North Slope gas. The PAS also stated that Enstar should be able to terminate the contract for good cause shown.[40]

While an open-ended GSA may encourage exploration, it binds Enstar and Enstar ratepayers indefinitely. New large gas reservoirs might be discovered.

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[38]McConnell prefiled testimony at 23-24.

[39]The actual transportation rate may be less. Enstar insisted on the one-dollar cap. Tr. at 573.

[40]McConnell prefiled testimony 27-28.

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Gas from the North Slope may become available. Unocal testified that a volume of 450 Bcf created sufficient incentive to explore and recover its capital investment.[41] We limit the GSA term to delivery of 450 Bcf to preserve exploration incentive and give us an opportunity to review whether continuation of the GSA remains in the public interest.[42]

<u>Arbitrage</u>

The GSA does not prevent Unocal from purchasing gas from other sources at a lower price and reselling it to Enstar at the higher HHF contract price. The PAS argued that Unocal should not be allowed to buy gas from other producers at a lower price and sell it to Enstar at the GSA price. Marathon agreed.[43]

Unocal sees the possibility of reselling lower priced gas to Enstar as an unlikely scenario.[44] The Cook Inlet basin is old. Some of the fields are producing on a flat or declining basis and do not have the swing capabilities to meet Enstar's needs. Unocal says it should not be prevented from buying third party gas to meet Enstar's unmet requirements. Unocal envisions a situation where it would take gas from flat or declining fields or from a one well producer, inject it into storage and then produce it at a rate that would match Enstar's needs. Through the process of injecting gas into storage the value of the gas would be increased and could be used to meet Enstar's needs.[45] Although Unocal believes a prohibition against purchasing third party gas would strand a lot of gas that could be used by consumers, limiting its ability to sell gas

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[41]Tr. at 580, 595.

[42]A 2009 termination date, as suggested by the PAS, would cause an avoidance of the contract and discourage exploration. Tr. at 581, 655.

[43]Risser prefiled testimony at 30.

[44]Tr. at 414, 416.

[45]Tr. at 416-419, 422, 565-568, 598.

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to fifteen percent of the total annual gas volume sold would not affect its ability to insure certain supply.[46]

While we agree with Unocal that gas in declining fields should not be stranded, we also understand the arbitrage concerns. We find limiting Unocal's ability to sell third party gas to fifteen percent of the total annual gas volume sold is a reasonable limitation to the GSA and adequately protects the ratepayer.

Non-economic provision

If Unocal forecasts and an independent engineer agrees that gas production will not be economic, Unocal's obligation to produce, deliver and sell gas will be suspended as long as production is not expected to be economic. However, during any period that gas production is not economic, Unocal may make sales to third parties at a swing rate[47] of 1.2 or less.[48]

The PAS objects to allowing gas production to be declared non-economic without our review. The PAS states that Unocal should not be free to sell the non-economic gas to third parties whose swing rate is 1.2 or less and that Enstar should have first priority to all such gas. The PAS also requested that we permit Enstar to terminate the GSA with the same 180-day notice required of Unocal if Unocal declares gas production not economic.[49]

We understand that exploration and production of new gas at the contract price may not be economic. We do not find the contract's non-economic

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[46]Tr. at 568.

[47]GSA at 8.

[48]GSA at 19-20.

[49]McConnell prefiled testimony at 29.

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clause to be unreasonable. However, before Unocal sells gas to third parties under this provision, Enstar should have a right of first refusal to purchase the gas at a flatter swing rate.[50] Accordingly, we direct the parties to modify the GSA to provide Enstar with a right of first refusal before Unocal may sell non-economic gas to third parties.

Conclusion

We have reviewed the GSA and considered the evidence and testimony presented. Enstar will be permitted to recover the costs of the GSA under Section 708 of its tariff, gas cost adjustment in accordance with the discussion. We find that the GSA, with modifications as more fully set forth in this Order, is in the public interest. Its purpose is to provide Enstar ratepayers with a reliable supply of reasonably priced gas. While it is not certain that the exploration envisioned in the GSA will be successful, it may lead to discovery of new gas reserves. The GSA also creates an incentive for more than one gas producer to remain in Cook Inlet.

We will review whether continuation of the GSA, with modifications as more fully set forth in this Order, remains in the public interest when Unocal delivers 450 Bcf of gas to Enstar or when the contract terminates due to Unocal's inability to discover new gas reserves.

We do not by approval of the GSA, with modifications as more fully set forth in this Order, waive any jurisdiction now or in the future. We will continue to take all actions necessary or proper to fulfill our obligations and duties mandated by AS 42.05.141.

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[50]Unocal does not disagree. Tr. at 577.

ORDER

THE COMMISSION FURTHER ORDERS:

1. The Gas Sales Agreement between Union Oil Company of California and Alaska Pipeline Company as filed in TA117-4 is approved with modifications as more fully set forth in this Order.

2. By 4 p.m., November 14, 2001, the parties must file an executed addendum to the Gas Sales Agreement consistent with this Order. The executed addendum will limit the term of the Gas Sales Agreement to delivery of 450 Bcf, limit Unocal's ability to sell third party gas to fifteen percent of the annual gas volume sold, and provide Enstar with a first right of refusal to purchase non-economic gas before Unocal may sell non-economic gas to third parties.

DATED AND EFFECTIVE at Anchorage, Alaska, this 25th day of October 2001.

BY DIRECTION OF THE COMMISSION
(Commissioners Bernie Smith and Patricia DeMarco, not participating.)

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Application by ENSTAR NATURAL GAS COMPANY to Amend its Natural Gas Public Utility Certificate of Public Convenience and Necessity No. 4 to Include Additional Areas in and Around Homer and Seward	U-96-108 ORDER NO. 12
In the Matter of the Gas Sales Agreement between ENSTAR Natural Gas Company, a division of SEMCO ENERGY, INC. and NORTHSTAR ENERGY GROUP, INC. filed as TA125-4	U-03-84 ORDER NO. 7

ORDER CONDITIONALLY APPROVING GAS SALES AGREEMENT, INCLUSION OF COSTS OF GAS SALES AGREEMENT IN GAS COST ADJUSTMENT, AND HOMER AREA SURCHARGE; DENYING, WITHOUT PREJUDICE, THE REQUEST TO AMEND SERVICE AREA; VACATING PREVIOUS FILING REQUIREMENT; AND REQUIRING FILINGS

BY THE COMMISSION:

Summary

We approve the Gas Sales Agreement (Agreement)[1] between ENSTAR[2] and NorthStar Energy Group, Inc. (NorthStar) on the condition that the parties execute

[1] *Gas Sales Agreement between NorthStar Energy Group, Inc. and ENSTAR Natural Gas Company, a Division of SEMCO Energy, Inc.*, executed July 31, 2003.

[2] ENSTAR Natural Gas Company, a division of SEMCO Energy, Inc.

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and file an addendum to the Agreement that: (1) establishes a floor price of $2.75; (2) modifies the transportation rate to include a cap of $.30 per thousand cubic feet (Mcf); and (3) limits arbitrage to not more than 15 percent of the total volume of gas sold under the Agreement. We find that the Agreement, as submitted for our approval, is not in the public interest and require modifications to the Agreement that resolve our public interest concerns. We approve 1) the inclusion of the Agreement with the addendum in Section 708 of ENSTAR's tariff; 2) the inclusion of all costs related to the Agreement in ENSTAR's Gas Cost Adjustment (GCA); and 3) a line extension surcharge for the Anchor Point to Homer pipeline extension, subject to filing and approval of the addendum. We deny ENSTAR's request for an additional amendment to its service area. We also vacate Ordering Paragraph No. 2 of Order U-96-108(11).[3]

Background

Exploration in the area to the north of Homer has shown promise of yielding an adequate supply of natural gas that would make feasible a natural gas utility service in Homer. ENSTAR and others before have worked to bring gas supply to the City of Homer for the last twenty years to no avail.[4]

ENSTAR and NorthStar are before us with a proposed gas supply agreement to exploit gas reserves in the North Fork gas field, located north of Homer, and deliver this gas to Homer. This gas field is close enough to Homer to make

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[3]*Order Acknowledging Filings, Granting Motion for Extension of Time, Requiring Filings and Vacating Filing Requirements*, dated August 28, 2003.

[4]The record shows there are potential alternative gas supplies to the north of Homer in Happy Valley, and further north at Ninilchik. At one time, there were plans to extend the Kenai Kachemak Pipeline (KKPL) to Anchor Point, but the Unocal Exploration program did not reveal commercial quantities of gas. ENSTAR indicates at some point in time Unocal gas may become available. However, ENSTAR considers these as alternatives to be pursued, if NorthStar is unable to fulfill its contract terms.

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transportation and distribution of gas to retail customers economically feasible, and the volumes appear adequate to supply Homer's needs for at least twenty years.

There is public support for natural gas service in Homer. ENSTAR surveyed 70 potential small and large commercial customers and 216 potential residential customers, and both groups indicated strong support for natural gas service in the Homer area. (T-3, p. 10.) Thomas Clark, a member of the public, testified during the hearing in support of gas service for the Lower Kenai Peninsula, and particularly for Anchor Point, where he lives.[5] Mr. Clark asserted that natural gas is a foundational mechanism for community growth. (Tr. 77.)

ENSTAR was granted a Certificate of Public Convenience and Necessity (Certificate), subject to certain conditions, to serve Homer, Alaska, on November 3, 1997.[6] The primary condition of certification was that ENSTAR provide natural gas service to Homer by December 31, 2000. (T-1, p. 3.) At ENSTAR's request, that deadline was extended to December 31, 2002,[7] and then to March 31, 2003.[8] On April 1, 2003, ENSTAR requested an additional extension until August 31, 2003, which we granted.[9] We also granted ENSTAR's most recent request to extend the deadline to January 2, 2004.[10]

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[5]Mr. Clark is also vice chair of the Kenai Peninsula Borough Planning Commission.

[6]Order U-96-108(6)/U-96-109(6), dated November 3, 1997.

[7]Order U-96-108(8), dated April 16, 2001.

[8]Order U-96-108(9), dated December 26, 2002.

[9]Order U-96-108(10), dated April 28, 2003.

[10]*See* n. 2.

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On August 8, 2003, ENSTAR filed a tariff revision, designated as TA125-4, which included the Agreement between ENSTAR and NorthStar. ENSTAR requested that we:

1) approve the Agreement between ENSTAR and NorthStar, which will provide a 20-year gas supply for Homer;

2) approve the addition of the Agreement to Section 708 of ENSTAR's tariff as a base supply contract;

3) include all costs related to the Agreement in ENSTAR's GCA; and

3) approve a line extension surcharge for Homer.

We suspended TA125-4 for investigation and scheduled a hearing.[11] The hearing was held on January 13, 14, and 15, 2004. ENSTAR presented the testimony of Dan Dieckgraeff, Manager, Finance and Rates, and Treasurer of ENSTAR; and Dr. Bruce Fairchild, consultant. NorthStar presented the testimony of Stephen J. Easley, Vice President for Corporate Development and External Affairs. The Attorney General (AG) presented the testimony of Dr. Arlon R. Tussing, consultant.

The Agreement provides that NorthStar will supply, and ENSTAR will purchase, all of the gas required to serve Homer for twenty years from the date of first delivery. (T-1, p. 5; T-6, p. 11.) The Agreement requires NorthStar to use the gas well at North Fork drilled in 1965, and to drill at least one additional well. (T-1, pp. 4-5; T-6, p. 8.) NorthStar must also prove up its gas reserves and establish, according to an independent petroleum engineer, that its leases constitute a commercial quality gas field. (T-1, p. 5.)

NorthStar proposes to construct a pipeline to transport gas from its leases to Anchor Point. (T-1, p. 5; T-6, p. 12.) ENSTAR will then construct a pipeline

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[11]Order U-03-84(2), dated October 31, 2003.

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extension from Anchor Point to Homer and install local gas distribution facilities in Homer. (T-1, p. 5.) The local distribution facilities would be a part of ENSTAR's system-wide rate base. (T-1, p. 12.) Initially, these pipelines will not be interconnected with the existing gas pipeline network on the Kenai Peninsula. (T-1, p. 5.) However, NorthStar hopes to find sufficient gas reserves to exceed the gas volumes necessary to meet ENSTAR's load in Homer and to interconnect with the KKPL. (T-1, p. 5.) NorthStar would like to sell additional gas into the south-central market so it contemplates building a pipeline to Anchor Point large enough to accommodate both the gas necessary to serve ENSTAR plus additional volumes. (T-2, p. 9.) If the pipeline were built just to serve ENSTAR's load, it would need to be a 4-inch line. (T-2, p. 10.)

NorthStar asserted that it will spend between $8 and $12 million for expenses associated with drilling, completing, and testing wells that target new gas reserves and in constructing a pipeline. (T-6, p. 12.) NorthStar asserted that it must further spend in excess of $500,000 on technical staff salaries and in excess of $500,000 in lease rentals, seismic data, and potentially, additional land acquisition costs. (T-6, p. 12.)

Under the Agreement, the gas is priced annually using a 36-month daily trailing average of the Henry Hub index of natural gas futures prices. (T-1, p. 6.) The gas has a floor price of $3.00/Mcf adjusted for half of inflation using the Gross Domestic Product Implicit Price Deflator. (T-1, p. 6.)

ENSTAR will reimburse NorthStar for production costs and taxes, and ENSTAR will pay NorthStar's approved tariff rate for transportation costs once those are established. (T-1, p. 6.) The transportation costs are limited to payment for the pipeline and do not include drilling and production facilities. (Tr. 101-102.)

The Agreement also requires NorthStar to maintain clear title to its leases, demonstrate that its leases qualify as a commercial quality gas field, maintain financial

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and operational "fitness, willingness, and ability" to perform according to ENSTAR, construct necessary facilities and meet other ongoing obligations. (T-1, p. 6; T-6, p. 22.)

At hearing, ENSTAR requested an additional amendment to its service area. (Tr. 87-88.)

Discussion

In deciding whether to approve the Agreement, we are guided by our obligation to act in the public interest. Our primary concern is to ensure reliable and reasonably priced utility service. We will determine whether the Agreement is fair as a whole, and we make modifications to the Agreement to protect the public. We also review the rate methodologies that ENSTAR has proposed to recover the costs of providing gas to Homer customers.

Uncontested Issues

ENSTAR proposed the use of postage stamp rates for Homer customers and a Homer specific line extension surcharge. The AG did not oppose these rate methodologies.

We find that the rate structure proposed by ENSTAR is consistent with its historical rate methodology, and reasonable. We find that permitting ENSTAR to charge "postage stamp" rates and a line extension surcharge for service to Homer customers is just, fair, and reasonable. We find that ENSTAR should be permitted to recover the costs of the Agreement through its GCA.[12] The GCA will blend the cost of

[12]ENSTAR recovers its general non-gas revenue requirement, consisting of its capital accounts including depreciation and interest, under one track; while the second track consists of the costs of purchased gas, or a gas cost adjustment. ENSTAR's general revenue requirement is periodically reviewed in a general rate case, while the cost of gas is flowed through to customers on a dollar-for-dollar basis.

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NorthStar gas into ENSTAR's overall cost of gas, including the transportation charge, to be borne by all ratepayers.

Homer ratepayers will directly bear some of the costs unique to serving Homer through the imposition of a $1.00/Mcf surcharge. The surcharge permits a delayed recovery of the contribution customers must make for ENSTAR to build its line extension from Anchor Point to Homer, termed CIAC.[13] This CIAC is normally required to be paid before a customer can receive service under ENSTAR's current tariff.

ENSTAR proposed to collect the Homer surcharge only until the total actual capital costs associated with the pipeline (including construction costs, rate of return, and income taxes) are recovered. (T-1, p. 11.) ENSTAR estimates that it will be necessary to collect the Homer surcharge for approximately ten years. (T-4, p. 4; T-1, p. 11.) In order to track recovery of the cost of the line extension, we require ENSTAR to file yearly reconciliation of Homer surcharge collections. ENSTAR shall append the yearly accounting to its annual report.

Contested Issues

The AG argued that the fairness and reasonableness of the Agreement must be evaluated, as well as its consistency with the public interest. (T-8, p. 5.) Specifically, the AG expressed concern with the gas pricing methodology, price of gas, the treatment of arbitrage opportunities, and the term of the agreement and need for a market-out clause.

Gas Pricing Methodology

The AG argued there were two fundamental errors of principle incorporated in the Agreement and that these errors can create serious harm to the ratepayers and public interest. (T-8, p. 12.) According to the AG, the first error is the

[13]CIAC = Contribution in aid of construction.

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use of the 36-month trailing average of Henry Hub natural gas futures prices. The AG argued there is no logical or economic relationship between Southern Louisiana and the Cook Inlet natural gas markets.[14] The AG asserted that the second error is the link between Henry Hub futures prices and the purchase price computed by the Agreement. (T-8, p. 14.) The AG contended that this link is unorthodox, inconsistent with the customary language and practice of commerce, and is misleading. (T-8, p. 14.)

We do not find the use of the Henry Hub futures prices as an index inconsistent with customary language and practice of commerce. ENSTAR's current long-term gas supply agreements have typically included annual price adjustment clauses that are tied to various price indices. These include the 3-month average for Light Sweet Crude futures in addition to the Henry Hub futures.[15] We recently allowed use of the Henry Hub futures price as an index for the Unocal Gas Supply Contract.[16]

The AG further stated that the link greatly understates the true price of North Fork gas taken into the ENSTAR system and obscures the fact that it obligates ENSTAR to pay, and to pass on to its ratepayers, a cost of gas that is priced higher than Henry Hub prices. (T-8, p. 14.) The AG asserted that the Henry Hub price

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[14]The Henry Hub is a cluster of direct pipeline connections among thirteen natural gas pipelines in southern Louisiana that directly connect to thirteen other pipelines. (T-8, p. 12.) The dense network of pipelines results in gas prices that vary by only a few cents per unit and fluctuate in close formation. (T-8, p. 13.) The twenty-six pipelines that directly interconnect at Henry Hub connect with each other and with hundreds of other pipelines throughout North America. Altogether, these pipelines constitute a unified transport infrastructure that extends into every state except Alaska and Hawaii, into all but two Canadian provinces, and into much of Mexico. (T-8, p. 13.)

[15]Order U-03-84(1), dated September 18, 2003, at 9.

[16]Order U-01-7(8), dated October 25, 2001. Docket U-01-7 is titled *In the Matter of the Gas Sales Agreement Between ALASKA PIPELINE COMPANY, a Wholly-owned Subsidiary of SEMCO ENERGY, INC., of Which the ENSTAR NATURAL GAS COMPANY is a Division, and the UNION OIL COMPANY OF CALIFORNIA, Filed as TA117-4.*

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includes both production taxes and transport charges between the wellhead and the Henry Hub. Because the Agreement includes Alaska specific production taxes and transportation charges as a separate item, the AG asserted the ratepayer pays twice for these charges. (T-8, p. 14.)

We do not agree with the AG's allegation that ENSTAR will be paying for transportation fees and production taxes twice. (T-8, p.14.) We are persuaded that these costs are included in Henry Hub prices, but ENSTAR correctly points out that Henry Hub prices are market-driven auction prices that are not cost-based, but rather supply/demand driven. (Tr. 519.)

This Agreement was negotiated using a number of considerations that likely included cost, but not exclusively cost; therefore, we will not order the Agreement price to be changed to remove production taxes and transportation fees. Such a cost disallowance is not appropriate for the specific circumstances surrounding this Agreement.

Price of Gas

The AG argued that the Agreement was most comparable to the Moquawkie contract where the producer also developed a known field for production through an existing well and drilled a second well. (Tr. 137.) The pricing provision under the Moquawkie contract was a flat rate of $2.75/Mcf, adjusted for inflation. (Tr. 130-131.) The Moquawkie contract was entered into approximately six months before the Unocal contract, so the AG contended that it was contemporaneous with the Unocal contract. (Tr. 130.)

Under the Unocal contract, Unocal was required to explore for gas in new areas rather than develop existing gas fields. (Tr. 140.) The AG further argued that Unocal had a commitment to expend a minimum amount of funds on exploration

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whereas NorthStar does not. (Tr. 163-164.) Unocal actually expended $50 million last year and anticipates spending $60 million this year. (Tr. 166.)

The AG argued that because the North Star gas well development requirement is comparable to Moquawkie, the well head price should be $2.75/Mcf, without the Henry Hub pricing index.

In contrast, ENSTAR asserted the Agreement is more like the Unocal contract and proposed a $3.00/Mcf floor, and use of the Henry Hub pricing index. NorthStar must drill a new well and create a redundant gas supply, and address the risks associated with establishing a second commercial well where earlier drilling efforts had yielded dry holes. (T-6, p. 14.)

We agree with ENSTAR that employing the Henry Hub pricing index, as we did in the Unocal contract, is reasonable for this specific case given the risks associated with development of further proven reserves. First, the Moquawkie contract did not require additional drilling before gas deliveries could begin. (Tr. 155.) This is clearly not the case for this Agreement. ENSTAR and NorthStar established that under this Agreement, NorthStar would need to expend significant investment before it would have the opportunity to sell gas.[17] NorthStar must prove it has 14.5 billion cubic feet (Bcf), and the present proven reserves for the North Fork field are 12.0. (T-2, p. 2.) NorthStar must also drill a second "commercial quality gas field" well to provide a second gas well. (T-6, pp. 12, 14.)

The AG's assertions of similarity to Moquawkie are not persuasive, and we allow the Unocal pricing structure. However, we do not find adequate support to

[17]"They [NorthStar] have to spend whatever it takes to find the gas...that meets the qualification." (Tr. 162.)

"NorthStar does not have a contract unless they are successful." (Tr. 166.)

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allow the proposed $3.00/Mcf floor price, which is a $0.25/Mcf increase over the Unocal floor price. NorthStar arguments of inflation, higher costs of capital and current elevated costs of gas are not supported in the record. We therefore require that the contract floor price be set at $2.75/Mcf.

Arbitrage

ENSTAR asserted that a limit on arbitrage, the possibility that NorthStar could purchase less expensive gas from a third party and provide it to ENSTAR at the contract rate, was unnecessary. (T-2, p. 16.) ENSTAR contended this was because there are no other proven gas sources for NorthStar, there is value and security in NorthStar having the ability to "cover" with gas from other sources, if necessary, and the opportunity for a market may cause some other producer to drill in the area. (T-2, p. 16.) NorthStar stated that the potential for arbitrage was not a legitimate concern because there are no producers in the Cook Inlet with extra gas to sell to NorthStar. (T-6, p. 28.) NorthStar further argued that if there were such a producer, it would sell its gas directly to ENSTAR. (T-6, p. 28.) Finally, NorthStar argued that there would be no way to transport such gas to Homer. (T-6, pp. 29-30.) However, NorthStar did not oppose a limitation on arbitrage, if we decided to impose one. (Tr. 436.)

We conclude that at the present time there is little opportunity for NorthStar to engage in arbitrage because there are no alternate proven gas sources for NorthStar other than the North Fork field. However, NorthStar has indicated an interest in interconnecting with another pipeline in the future if there are gas reserves sufficient to meet ENSTAR requirements to serve the Homer market as well as other customers. Under these circumstances, we must be concerned with the possibility of arbitrage.

NorthStar did not oppose a limitation on arbitrage, so we condition our approval of the Agreement to an arbitrage limitation equivalent to the one approved in

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the Unocal contract; not more than 15 percent of the total gas volume sold under the Agreement may come from third party sources.

Term & Market-Out Clause

The AG asserted that the 20-year term of the Agreement is not, in itself, unreasonable. (T-8, p. 17.) However, the AG argued that the length of the Agreement, coupled with unprecedented high prices, an unprecedented high floor price, an indefinite price escalator unrelated to Alaska markets, and the total lack of downward flexibility, renders the Agreement unreasonable. (T-8, p. 17.)

NorthStar argued that a market-out provision was inconsistent with the risks inherent in a development contract. (T-7, p. 8.) NorthStar argued that before it committed its resources to undertake gas development, it must be reasonably assured that it has a market for the gas at a reasonable price over a long enough time period for the investment to make financial sense. (T-7, p. 8.) NorthStar further argued that investors and financiers must be reasonably assured that NorthStar would obtain sufficient revenues over a long enough period to justify investment. (T-7, p. 8.)

We conclude that twenty years is a reasonable contract term. This contract term ensures that there is a firm gas supply to meet the needs of the additional customers to be served in Homer. We also recognize that the Homer customers will have to bear the costs associated with retrofitting their current heating systems to accept an alternate fuel, natural gas. A twenty-year contract also ensures that there is sufficient gas for a reasonable period of pay-off for customers to recover retrofitting costs. It also provides for investors to reasonably anticipate a return of and a return on investment.

While we agree that it could be beneficial five years into this Agreement to provide a means to allow ENSTAR to secure gas from another available lower-cost provider, this is not appropriate under these circumstances. The AG worries that future

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discoveries could make this Agreement a windfall for NorthStar shareholders, to the detriment of ENSTAR ratepayers; however, there is nothing in the record to justify such a contract modification at this time. We must deal with current information, rather than speculate on the future. We therefore reject the AG's proposed market-out clause.

Contract Conditions

We conclude that the Agreement is not in the public interest as it was presented. As with the Unocal contract approval, we require certain provisions to be modified. First, ENSTAR did not support an increase in the floor price for gas in excess of the rate we approved in the Unocal contract. The Agreement should be modified to establish a $2.75/Mcf floor price.

In the Moquawkie contract, we established a flat rate transportation charge of $.15/Mcf. In the Unocal contract, we approved a $1.00/Mcf cap on any transportation charges approved in a separate tariff filing. In this case, ENSTAR and NorthStar also advocate establishing the transportation rate in a separate tariff. That tariff filing requires our approval before it may be implemented. We conclude that the NorthStar Agreement should also have a transportation rate cap. We find that a $.30/Mcf rate cap is reasonable because this pipeline is approximately one-third the length of the pipeline addressed in the Unocal contract and the diameter of the pipeline necessary to serve ENSTAR's projected Homer gas load is approximately one-third the diameter of the KKPL pipeline.

We limit NorthStar's ability to sell third party gas to not more than 15 percent of the total gas volume sold under the Agreement. ENSTAR must file an addendum to the Agreement reflecting these modifications by the deadline established in this Order.

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Transportation Rate

We also determine that we will not approve transportation rates on NorthStar's pipeline that are in excess of the charges necessary to support a 4-inch pipeline from North Fork to Anchor Point. We will determine the actual transportation rate after we have reviewed and approved NorthStar's future tariff filing on this issue once NorthStar becomes a certificated public utility and becomes dependent, in part, on the actual cost of the pipeline construction. The transportation rate will be recovered from all ratepayers as part of ENSTAR's GCA. (Tr. 188.)

We understand that NorthStar hopes to find sufficient gas reserves to meet ENSTAR's need and to serve third parties. As ENSTAR asserted, if NorthStar is successful ". . . the vast majority of the gas going through that line may be for other purposes and other people." (Tr. 185.) We find that it is not reasonable to include in ENSTAR's rates transportation charges on NorthStar's pipeline in excess of those necessary to support a pipeline of the length and diameter[18] necessary to serve the projected Homer gas load. We place NorthStar on notice that we will only approve transportation charges that recover the costs of a pipeline four inches in diameter from its leases to Anchor Point. With these limitations, we conclude that approval of the Agreement without known transportation charges is reasonable.

We are interested in ensuring that any contract that affects the public interest is the result of an arms-length transaction.[19] Because ENSTAR's affiliate, Alaska Pipeline Company, could be asked to build NorthStar's pipeline, we levy an additional condition on the contract to ensure that the public interest is protected. We

[18]ENSTAR has projected that it will have approximately 1,500 customers in Homer after three years and that a pipeline four inches in diameter will be required.

[19]*See* Order U-01-7(7), dated August 9, 2001.

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place NorthStar on notice that its transportation tariff filing must demonstrate that a valid, reasonably advertised, competitive procurement process was undertaken for the construction of the NorthStar pipeline.[20]

Tariff

ENSTAR has asked us to approve the addition of the Agreement to ENSTAR's tariff, the inclusion of the costs of the Agreement in its GCA, and the addition of a surcharge. We find those requests reasonable, and we grant the requested approvals on the condition that ENSTAR files an addendum to the Agreement that complies with this Order. We require ENSTAR to make tariff filings implementing the requested approvals 90 days before gas is delivered. These tariff filings must include transportation rates, and terms and conditions, subject to the conditions for inclusion of Homer-specific transport costs.

Service Area Amendment

In supplemental testimony, ENSTAR proposed to revise its Homer service area boundaries. (T-2, p. 24.) ENSTAR asserted that it expected to file an application[21] to amend its Certificate to include the area along the KKPL so that it can provide service from the KKPL to those nearby communities.

In reply testimony, ENSTAR proposed an additional service area amendment to include some sections that were inadvertently excluded from the original service area in Docket U-96-108.

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[20] *See* Order U-01-7(1), dated January 18, 2001; Order U-01-7(7).

[21] ENSTAR anticipated filing the application approximately 60 days from the submission of its supplemental direct testimony on October 31, 2003.

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We deny ENSTAR's request to amend its service area. In this proceeding, we are only addressing ENSTAR's proposed Agreement with NorthStar. We will address ENSTAR's request to amend its service area concurrently in Dockets U-96-108 and U-04-31.[22]

Service to Homer

We originally approved ENSTAR's application to provide service to Homer, subject to conditions, including a requirement that it begin service to Homer by December 31, 2000. At ENSTAR's request, we extended that deadline several times, most recently to January 2, 2004, and required it to request an extension of time to provide service, if needed. ENSTAR did neither. While our decision in this case warrants vacating that requirement, we remind ENSTAR that it must comply with all Commission orders or seek appropriate relief. We will not issue a certificate for Homer until gas service begins. We reserve the right to re-impose conditions if there are significant delays.

This Order constitutes the final decision in this proceeding. This decision is appealable within thirty days of the date of this Order in accordance with AS 22.10.020(d) and the Alaska Rules of Court, Rules of Appellate Procedure, Rule 602(a)(2). In addition to the appellate rights afforded by the aforementioned statute, a party may file a petition for reconsideration in accordance with 3 AAC 48.105. In the

[22]On March 17, 2004, ENSTAR filed an amendment to its service area to serve communities along the KKPL in Docket U-04-31. In that filing, ENSTAR asserted that its Homer service area was already amended following a request presented in Docket U-03-84. The proceeding in Docket U-04-31 is titled *In the Matter of an Application filed by ENSTAR Natural Gas Company, a Division of SEMCO Energy, Inc., to Amend Certificate of Public Convenience and Necessity No. 4 to Extend its Service Area to Serve Communities along the Kenai Kachemak Pipeline (KKPL) and KKPL's Proposed Extension, Including Kasilof and Ninilchik.*

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event such a petition is filed, the time period for filing an appeal is then calculated in accordance with Alaska Rules of Court, Rules of Appellate Procedure, Rule 602(a)(2).

ORDER

THE COMMISSION FURTHER ORDERS:

1. The Gas Sales Agreement between ENSTAR Natural Gas Company, a division of SEMCO Energy, Inc., and NorthStar Energy Group, Inc., filed as TA125-4, is approved on the condition that an addendum is filed with the modifications set out in the body of this Order.

2. Inclusion by ENSTAR Natural Gas Company, a division of SEMCO Energy, Inc., of the Gas Sales Agreement filed as TA125-4 in Section 708 of its tariff, is approved on the condition that the addendum required by Ordering Paragraph No. 1 is filed and approved.

3. Inclusion by ENSTAR Natural Gas Company, a division of SEMCO Energy, Inc., of all costs of the Gas Sales Agreement filed as TA125-4 in its Gas Cost Adjustment, is approved on the condition that the addendum required by Ordering Paragraph No. 1 is filed and approved.

4. A surcharge of $1.00 per thousand cubic feet for the Homer service area is approved on the condition that the addendum required by Ordering Paragraph No. 1 is filed and approved.

5. The request to amend the service area of ENSTAR Natural Gas Company, a division of SEMCO Energy, Inc., is denied, without prejudice.

6. Ordering Paragraph No. 2 of Order U-96-108(11) requiring ENSTAR Natural Gas Company, a division of SEMCO Energy, Inc., to commence service to Homer, Alaska, or to file a motion for extension of time by January 2, 2004, is vacated.

7. By 4 p.m., April 23, 2004, the parties must file an executed addendum to the Gas Sales Agreement consistent with this Order.

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8. By 4 p.m., March 31 of each year, ENSTAR Natural Gas Company, a division of SEMCO Energy, Inc. must file an annual reconciliation of Homer surcharge collections, as set out in the body of this Order. ENSTAR Natural Gas Company, a division of SEMCO Energy, Inc. shall append the yearly accounting to its annual report.

DATED AND EFFECTIVE at Anchorage, Alaska, this 23rd day of March, 2004.

BY DIRECTION OF THE COMMISSION
(Commissioner Kate Giard, dissenting, in part, and Commissioners
Mark K. Johnson and G. Nanette Thompson, not participating.)

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Application by ENSTAR NATURAL GAS COMPANY to Amend its Natural Gas Public Utility Certificate of Public Convenience and Necessity No. 4 to Include Additional Areas in and Around Homer and Seward	U-96-108
In the Matter of the Gas Sales Agreement between ENSTAR Natural Gas Company, a division of SEMCO ENERGY, INC. and NORTHSTAR ENERGY GROUP, INC. filed as TA125-4	U-03-84

CERTIFICATION OF MAILING

I, Jessica Desmarais, certify as follows:

I am Administrative Clerk III in the offices of the Regulatory Commission of Alaska, 701 West Eighth Avenue, Suite 300, Anchorage, Alaska 99501.

On March 23rd, 2004, I mailed copies of

ORDER NOS. 12 and 7, respectively, entitled:

ORDER CONDITIONALLY APPROVING GAS SALES AGREEMENT, INCLUSION OF COSTS OF GAS SALES AGREEMENT IN GAS COST ADJUSTMENT, AND HOMER AREA SURCHARGE; DENYING, WITHOUT PREJUDICE, THE REQUEST TO AMEND SERVICE AREA; VACATING PREVIOUS FILING REQUIREMENT; AND REQUIRING FILINGS
(Issued March 23, 2004)

in the proceeding identified above to the persons indicated on the attached service list.

DATED at Anchorage, Alaska, this 23rd day of March, 2004.

Jessica Desmarais

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Kate Giard, Chairman
Dave Harbour
Mark K. Johnson
Anthony A. Price
Janis W. Wilson

In the Matter of the Gas Sales Agreement Between ENSTAR NATURAL GAS COMPANY, A DIVISION OF SEMCO ENERGY, INC. and MARATHON OIL COMPANY Filed as TA139-4

U-06-2

ORDER NO. 15

ORDER REJECTING TA139-4 AS A BASE SUPPLY CONTRACT HAVING THE EFFECT OF INCREASING THE CURRENT AVERAGE COST OF SYSTEM GAS SUPPLY BUT ALLOWING TA139-4 TO TAKE EFFECT IMMEDIATELY AS A BASE SUPPLY CONTRACT HAVING THE EFFECT OF DECREASING THE CURRENT AVERAGE COST OF SYSTEM GAS SUPPLY AND REQUIRING FILINGS

BY THE COMMISSION:

Summary

We reject Tariff Advice Letter 139-4 (TA139-4) which includes the gas supply contract, APL-5, because ENSTAR[1] did not meet its burden of demonstrating that gas supplies pledged under the contract are reliable and that the price is reasonable. We allow APL-5 to go into effect without our approval to the extent that APL-5 has the effect of decreasing the current average cost of system gas supply in any

[1]ENSTAR Natural Gas Company is a division of SEMCO Energy, Inc. (SEMCO). Alaska Pipeline Company (APLC) is a wholly-owned subsidiary of SEMCO. APLC, not ENSTAR Natural Gas Company, is the actual party to APL-5. The commission has historically regulated APLC and ENSTAR as a single entity. The use of the name ENSTAR in this proceeding includes both APLC and ENSTAR.

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year of its implementation subject to ENSTAR making supplemental filings addressing Section 2.7.4 of APL-5.

Background

At issue in this proceeding is TA139-4 filed November 14, 2005, in which ENSTAR requested our approval of a new gas supply contract, APL-5, with Marathon Oil Company (Marathon) providing for deliveries beginning in 2009.[2] ENSTAR operates under Certificate of Public Convenience and Necessity Nos. 4 and 141 as a natural gas transmission and distribution utility in Southcentral Alaska. Marathon is a current ENSTAR supplier under a Gas Purchase Agreement dated May 1, 1988.[3]

ENSTAR requested that the commission approve the addition of APL-5 as a base supply contract to its tariff[4] and also requested inclusion of all costs related to the contract in the calculation of ENSTAR's Gas Cost Adjustment.[5]

ENSTAR's tariff requires we approve any gas sales agreements that increase ENSTAR's current average cost of gas. Tariff Sheet 90, Section 708f, provides:

> Base Supply Contracts.
>
> The base supply contracts are those contracts in effect on September 1, 1987. Additional contracts or revisions of base supply contracts having the effect of increasing the current average cost of system gas supply will be made, subject to Commission approval, by filing with the Commission, 45 days prior to the proposed effective date of such addition or revision, a copy of such addition or revision. Additional contracts or revisions of base supply contracts having the effect of decreasing the current average cost of system gas supply become effective immediately without notification.

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[2]H-1 at 1.

[3]T-9 at 5.

[4]H1-C (Tariff Sheet Nos. 89 and 221).

[5]*Id.*

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ENSTAR believes that a secure supply of gas that is reliably available when its customers most need it is the utility's absolute top priority.[6] ENSTAR's gas supply contracts require ENSTAR to provide an annual forecast of its needs and supplies for the next ten years each October[7] in its "Buyer's Annual Forecast."[8] ENSTAR calculates its annual gas requirements based on existing supplier commitments and identifies any year in which there may be a supply shortfall ("Buyers Unmet Requirements").[9] Under ENSTAR's contact with Unocal,[10] Unocal has the right to supply any projected shortfall for five years into the future, beginning October 10, 2004. ENSTAR may not take gas from any third party so long as Unocal's total commitment of gas brings ENSTAR's unmet requirements to zero.[11]

In October 2004, ENSTAR projected unmet requirements beginning in 2008 and 2009.[12] Unocal was unable to commit to provide all of the additional gas needed for 2009.[13] ENSTAR notified other Cook Inlet producers of its need for new gas supplies. Marathon was the only gas producer that offered to meet ENSTAR's unmet requirements, including its full swing requirements, beginning in 2009 and continuing for a reasonable period.[14]

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[6]T-1 (Izzo) at 3.

[7]T-7 (Dieckgraeff) at 19.

[8]H-1B at 3.

[9]H-1B at 4.

[10]H-26 at 11.

[11]*Id.*

[12]T-7 (Dieckgraeff) at 6.

[13]*Id.*

[14]T-7 (Dieckgraeff) at 10.

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ENSTAR's swing ratio is approximately 3.0, meaning its forecasted peak winter demand can be three times greater than its average daily demand. Chugach[15] and ML&P[16] have swing ratios ranging from 1.4 to 1.6 because electricity usage does not fluctuate as dramatically from season to season as does the demand for gas for space heating purposes. The industrial plants operating on the Cook Inlet - Agrium, the LNG[17] plant, and the Tesoro Refinery - have virtually no swing. They consume a more or less steady volume year-round.[18]

ENSTAR has elected not to develop storage to meet its deliverability requirements. Rather, ENSTAR "subcontracts" this important service to its suppliers.[19] Many gas distribution utilities in the Lower 48 use gas storage facilities to meet deliverability. SEMCO, in Michigan, uses a combination of leased and company-owned storage totaling 15.1 Bcf[20] to provide approximately 40 percent of its winter supply requirements and 25 percent of its peak-day requirements.

ENSTAR has contractual commitments from a 1988 contract with Marathon (APL-4), a 1982 contract with the Beluga producers (Chevron, ConocoPhillips, and ML&P), a 2000 contract with Aurora (also called the Moquawkie Contract), and a 2000 contract with Unocal.[21]

[15]Chugach Electric Association, Inc. (Chugach).

[16]Municipality of Anchorage d/b/a Municipal Light & Power (ML&P).

[17]Liquefied natural gas (LNG).

[18]T-1 (Izzo) at 13.

[19]*Id.*

[20]One billion standard cubic feet (Bcf).

[21]T-7 (Dieckgraeff) at 6.

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The committed volumes supplied by the Beluga, Moquawkie, and APL-4 contracts are declining as illustrated by ENSTAR's 2005 Buyers Annual Forecast as follows:[22]

EXHIBIT A

TO THE OCTOBER 14, 2005 GAS SALES AGREEMENT BETWEEN MARATHON OIL COMPANY AND ALASKA PIPELINE COMPANY

ARTICLE XIVBUYER'S ANNUAL FORECAST

Buyer's Annual Gas Requirements (Bcf)	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total Annual Requirements	26.70	27.50	28.30	29.0	29.7	30.30	31.00	31.60	32.20	32.70
Existing Commitments:										
Beluga	1.10	0.80	0.70	0.60	0.00	0.00	0.00	0.00	0.00	0.00
Marathon APL4	13.00	11.00	9.00	7.00	5.00	5.00	5.00	5.00	5.00	5.00
Moquawkie	1.80	1.50	1.10	0.80	0.60	0.50	0.30	0.30	0.20	0.00
Unocal Commitments	10.80	14.20	17.50	19.00	16.00	13.00	10.00	7.00	4.00	1.00
Total Existing Commit.	26.70	27.50	28.30	27.40	21.60	18.50	15.30	12.30	9.20	6.00
Unocal Conditional Option	0.00	0.00	0.00	0.00	3.00	6.00	9.00	12.00	15.00	18.00
Marathon APL5 Initial Annual Commitment	0.00	0.00	0.00	1.60	5.10	5.80	6.70	7.30	8.00	8.70
Marathon APL5 Additional Commitment	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total Marathon Commit.	0.00	0.00	0.00	1.60	5.10	5.80	6.70	7.30	8.00	8.70
Additional Third-Party Commitments	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Unmet Requirements*	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Starting in the mid-1970s, ENSTAR's first gas supply contract (APL-I) had a portion of its price indexed on a component of the producer price index. The price adjustment term for the Marathon APL-4 contract and Beluga Contract is based on the NYMEX[23] oil futures. The price adjustment term for the Moquawkie contract is based on the Gross Domestic Product Implicit Price Deflator (GDPIPD), a national measure of inflation. In the Unocal and NorthStar[24] contracts, the price itself is based on a

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[22]H-1A, Ex. A at 44-46.

[23]New York Mercantile Exchange (NYMEX).

[24]As of the hearing date, there were no volumes committed from the NorthStar contract.

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36-month daily average Henry Hub natural gas futures.[25] We have attached an appendix which illustrates the differing prices of ENSTAR's gas supply contracts.

ENSTAR presents its new supply contract with Marathon which "should insure that ENSTAR has sufficient gas to meet all of its customers' requirements through at least 2016."[26] Marathon provides all the gas needed by ENSTAR above that which comes from fixed volume contracts. APL-5 is effective October 14, 2005, with the full requirements provisions effective for Contract Years 2009 through 2016.[27] Marathon makes available 62.8 BCF of Proven Reserves to meet its Initial Annual Commitment.[28] There are limits on Marathon's rights to sell gas produced from its Proven Reserves if it can not meet its obligations under APL-5.[29] ENSTAR will have a priority on Marathon's gas delivered into the Cook Inlet area, except for Marathon's existing commitments;[30] and any subsequent contract entered into or any existing contract modified by Marathon must recognize this priority.[31]

The contract price (Index Price) of gas under APL-5 is set annually in October for the next year beginning January 1.[32] The Index Price is calculated using the simple daily average price of the NYMEX Henry Hub natural gas futures market during the preceding twelve months ending September 30.[33]

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[25]T-7 (Dieckgraeff) at 16.

[26]H-1 at 2.

[27]H-1A at 1.

[28]*Id.*

[29]*Id.* at 2.

[30]H-1A, Ex. E.

[31]T-7 (Dieckgraeff) at 15.

[32]H-1A at 2.

[33]*Id.* at 3.

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The Index Price is discounted as follows to determine the Contract Price (defined in Section 3.1, p. 22 of APL-5) which is subject to a Floor and a Ceiling:

i. If the Index Price is $6.00 per Mcf[34] or less, the Contract Price equals the Index Price;

ii. If the Index Price is greater than $6.00 per Mcf and equal to or less than $8.00 per Mcf, the Contract Price equals $6.00 plus 80 percent of the difference between the Index Price and $6.00;

iii. If the Index Price is greater than $8.00 per Mcf and less than or equal to $10.00 per Mcf, the Contract Price is $7.60 plus 95 percent of the difference between the Index Price and $8.00;[35]

iv. If the Index Price is greater than $10.00 per Mcf, the Contract Price is $9.50 plus 85 percent of the difference between the Index Price and $10.00,[36]

APL-5 has a floor price, the minimum price Marathon will receive from ENSTAR, which is set at $4.25 adjusted annually by one-half the annual rate of inflation based on the GDPIPD.[37]

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[34]One thousand standard cubic feet (Mcf)

[35]H-1B, Section 3.1(iii) at 23.

[36]H-1A at 3.

[37]H-1B, Section 3.3 at 23-24 - The Floor Price is equal to the initial price of $4.25 times one plus the floor price adjuster divided by 2. The floor price adjuster is the GDPIPD for the quarter ended June 30 of the year before the price is calculated, divided by GDPIPD for the quarter ended June 30, 2006.

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APL-5 also has a ceiling price of $15.00 that is adjusted annually by one-half the annual rate of inflation based on the GDPIPD; however, the cap cannot change by more than 1.5 percent per year.[38]

APL-5 requires ENSTAR to pay Marathon $0.25 per Mcf as a gas transportation fee to ship the gas to ENSTAR's pipelines. There is also an Excess Peaking gas fee of $2.50 per Mcf for gas that Marathon provides in excess of its pro rata share of ENSTAR's peak day gas requirements. Additionally, APL-5 requires ENSTAR to reimburse Marathon for all production taxes on gas purchased by ENSTAR.[39]

We have previously decided the ENSTAR-Unocal Gas Sales Agreement (Unocal GSA)[40] and the ENSTAR-NorthStar Gas Sales Agreement (NorthStar GSA).[41]

Unocal Gas Sales Agreement

On October 25, 2001, we issued Order U-01-7(8) conditionally approving a Unocal GSA between ENSTAR and Unocal. Unocal and ENSTAR characterized the Unocal GSA as an exploration contract because the focus of the contract was

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[38]H-1B, Section 3.4 - The Ceiling Price is equal $15.00 times one plus the ceiling price adjuster divided by 2. The ceiling price adjuster is the GDPIPD for the quarter ended June 30 of the Year before the Year for which the Price is calculated, divided by GDPIPD for the quarter ended June 30 of the Year two years before the year the Contract Price is calculated. However, the calculation of the ceiling price in any contract year, the ceiling price adjuster used in such calculation will not be more than 1.0300.

[39]H-1B, Article V.

[40]Docket U-01-7, *In the Matter of the Gas Sales Agreement Between ALASKA PIPELINE COMPANY, a Wholly-owned Subsidiary of SEMCO ENERGY, INC., of Which the ENSTAR NATURAL GAS COMPANY is a Division, and the UNION OIL COMPANY OF CALIFORNIA, Filed as TA117-4.* TA117-4 was filed December 12, 2000.

[41]Docket U-03-84, *In the Matter of the Gas Sales Agreement between ENSTAR Natural Gas Company, a division of SEMCO ENERGY INC. and NORTHSTAR ENERGY GROUP, INC. filed as TA125-4.* TA125-4 was filed August 8, 2003.

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exploration for new gas sources.[42] Under the contract Unocal committed to spend in excess of $10 million over two years looking for new gas fields.

The Unocal GSA was the first time we allowed a gas supply contract to be priced to a market index, Henry Hub natural gas futures. We found that ENSTAR needed to pay a competitive price to attract exploration capital and that a price tied to Henry Hub with a floor of $2.75 was a reasonable balance of the risks associated with gas exploration and the need to assure an adequate supply of gas to ENSTAR.[43]

Northstar Gas Sales Agreement

On March 23, 2004, we issued Order U-03-84(7), conditionally approving a full requirements gas sales agreement between ENSTAR and Northstar to serve Homer for twenty years beginning at the first delivery under the contract.[44]

NorthStar stated it would spend between $8 and $12 million for expenses associated with drilling, completing, and testing wells that target new gas reserves and constructing a pipeline.[45] We found that the investment required of NorthStar prior to the opportunity to sell gas, the requirement to prove additional reserves, and the requirement to drill a second 'commercial quality gas field' well as justifications for Henry Hub pricing.[46]

Hearing Proceeding

We convened a hearing on APL-5. It began on July 6, 2006, and continued through July 13, 2006, when it was recessed because Marathon refused to

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[42]Order U-01-7(8) at 8.

[43]*Id.* at 9.

[44]Order U-03-84(7) at 4

[45]*Id.* at 5.

[46]*Id.* at 10.

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provide discovery we ordered. ENSTAR presented the testimony of Paul R. Carpenter (Carpenter); Anthony M. Izzo (Izzo); Oliver Scott Goldsmith (Goldsmith), and Daniel M. Dieckgraeff (Dieckgraeff).[47]

The hearing resumed on August 22, 2006. Intervenor James L. Walker (Walker) presented testimony and was cross-examined[48]. Marathon presented the testimony of Bruce B. Henning (Henning) and Catherine M. Elder (Elder).[49] The Attorney General (AG) presented its witness Arlon R. Tussing (Tussing).[50] Tesoro presented Benjamin Schlesinger (Schlesinger).[51] The final witness was C. Les Webber (Webber), sponsored by Marathon, who had previously been unavailable due to scheduling conflicts.[52] On Sunday, August 27, 2006, we heard closing argument by the parties.[53] The positions of the parties are summarized below.

Positions of the Parties

ENSTAR

ENSTAR requests Commission approval for the addition of APL-5 to Section 708 of ENSTAR's tariff as a base supply contract and for inclusion of all costs related to the contract in the calculation of ENSTAR's Gas Cost Adjustment, including Henry Hub pricing.

ENSTAR stated that it supports using a 12-month trailing average of the Henry Hub Index (Trailing HHI) because it provides 240 data points of actual

[47]Tr. at 118-1261.
[48]Tr. at 1298-1399.
[49]Tr. at 1399-1656.
[50]Tr. at 1687-2050.
[51]Tr. at 2052-2308.
[52]Tr. at 2318-2478.
[53]Tr. at 2054-2619.

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transactions in a highly liquid, transparent, and competitive natural gas market. ENSTAR added that the Trailing HHI reflects price changes more quickly than the 36-month trailing average HHI used in Unocal GSA and NorthStar GSA. ENSTAR stated that a 12-month trailing average in APL-5 buffers the Unocal GSA by reflecting falling prices. An additional advantage of the Trailing HHI price is that it is market-responsive, thereby mitigating the risk that, over the term of the contract, the price will be higher than the HHI price.[54]

ENSTAR asserted that the Henry Hub is a dominant market reference and the commission twice sent signals to the market indicating that contracts with trailing averages of Henry Hub represent a fair price. ENSTAR absolutely believes APL-5 is a fair market price, and that ENSTAR got this gas for less than straight Henry Hub price even with a ceiling. ENSTAR asserted that Cook Inlet gas is in scare supply and that APL-5 diversifies ENSTAR's supply portfolio.

ENSTAR maintained that the purpose of the Henry Hub price was to stimulate additional exploration and development of reserves in Cook Inlet. ENSTAR added that the price needs to be high enough to attract investment capital to this market compared to other markets. ENSTAR stated that the Henry Hub is what the Department of Energy (DOE) uses as a comparative reference. ENSTAR stated that two alternatives have been proposed, one on the West Coast and one in Alberta, but points out that both those markets have a lot of supply. ENSTAR added that the supply and demand balance in those markets is not the same as it is in the Cook Inlet market. ENSTAR hoped that, over the long haul, the Cook Inlet market would come into some sort of a balance.[55]

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[54]TA139-4 at 5.

[55]Tr. at 671-578.

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ENSTAR proposed the $4.25/Mcf price floor and the ceiling being capped at $15.00/Mcf, noting that the floor and cap are adjusted annually by one-half of inflation, but the cap cannot change by more than 1.5 percent from year-to-year. The purpose of the cap and floor is to force the price to fall within a relatively narrow range and to avoid extreme swings in price.[56]

ENSTAR explained that the floor and the ceiling were agreed to by the parties as a mutual allocation of risk.[57] ENSTAR explained that the floor and ceiling price were negotiated terms, and in its opinion, not arbitrary.[58]

APL-5 requires ENSTAR to pay a transportation fee of $0.25/Mcf to Marathon for transportation of all gas provided to ENSTAR. The transportation fee is intended to cover the construction, installation, and operation of Marathon's production, gathering, treating, and processing facilities; and all pipelines necessary to deliver gas to ENSTAR. The alternative, according to ENSTAR, would be to pay the actual tariff for each pipeline, which creates risks that arise from the new regulation of most Cook Inlet gas pipelines. ENSTAR added that the use of actual tariffs is also unworkable because Marathon will have two contracts with ENSTAR; and gas will be delivered simultaneously under both contracts starting in 2009, so there is no way to determine which gas molecules are from APL-4 or APL-5. ENSTAR does not think it wise to expose its customers to these risks and proposes a fixed rate as best for its ratepayers.[59]

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[56]TA139-4 at 5, Tr. 453.

[57]Tr. at 229.

[58]Tr. at 139.

[59]TA139-4 at 6.

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ENSTAR asserted that there is no limitation to the transportation fee, whether a pipeline is preexisting or constructed later.[60] ENSTAR added that Marathon has not indicated from where it plans to ship the gas. ENSTAR further added that it is conceivable that Marathon will be shipping gas through preexisting pipelines, newly-constructed pipelines, and newly-regulated pipelines.[61] ENSTAR stated that Marathon indicated it may ship gas over the Kenai-Nikiski Pipe Line, Cook Inlet Gas Gathering System, and Beluga, which are now regulated pipelines.[62]

APL-5 requires ENSTAR to pay a peaking gas fee of $2.50/Mcf, in addition to the price of the gas for all gas delivered in excess of Marathon's pro rata share of ENSTAR's peak day gas requirements. According to ENSTAR, the additional charge of $2.50/Mcf (in addition to the HHI price) was necessary, if ENSTAR requests and Marathon provides gas (1) in excess of Marathon's pro-rata share of what it would provide on the peak day or (2) in excess of the flow rate that if sustained for 24-hours would cause Marathon to supply more than its pro-rata share of the peak day requirement. However, if the reason for the request for excess gas is due to an inaccurate forecast by ENSTAR of its estimated peak day requirement, the incremental charge of $2.50/Mcf is not applied and the price payable is the HHI price.[63]

ENSTAR stated that the peaking fee contract provision supports the notion that a full requirements contract with swing has a great deal of value. ENSTAR continued that providing for swing is also costly for a producer not in a position to be

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[60]Tr. at 851.
[61]Tr. at 852.
[62]Tr. at 853-854.
[63]TA139-4 at 6.

able to itself go to the spot market and pick up emergency supplies to backfill a contract. ENSTAR stated that swing has value to a buyer and costs to a seller.[64]

ENSTAR also reported awareness that Marathon provided peaking gas to a third party at basically the same price as the peaking price under the Unocal contract. ENSTAR stated that the price for the peaking gas in the Unocal contract price is base price plus $1.00 per Mcf. ENSTAR stated that the reason Marathon received the $2.50/Mcf peaking fee was that it was part of the overall contract negotiations.[65]

APL-5 provides that ENSTAR will reimburse Marathon for all production taxes. ENSTAR asserted that the price includes all royalties. ENSTAR added that these provisions are essentially identical to the Unocal and NorthStar contracts.[66] ENSTAR added that the producers have insisted upon provisions for tax reimbursement in all of ENSTAR's gas supply arrangements since the mid-1970s. ENSTAR stated that no one needs to look further than the flurry of activity around production taxes in the recent legislative session to understand why. ENSTAR added that under the current statutory scheme, the provisions for oil production taxes also apply to gas production taxes.[67]

Marathon will be ENSTAR's full requirements supplier beginning in contract year 2009 and ending in contract year 2016; however, Marathon may provide gas into the future beyond 2018. ENSTAR added that APL-5 is a relatively short-term contract compared to ENSTAR's other gas supply contracts. Further, Marathon has committed to supply ENSTAR's unmet requirements through 2016 and Marathon has

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[64]Tr. at 283-286.

[65]Tr. 1179-1180.

[66]TA139-4 at 7.

[67]T-7 at 19.

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no right to "put" additional gas to ENSTAR unless shortfalls occur for specified reasons during those years. ENSTAR added that Marathon has an option to offer additional gas to ENSTAR under various circumstances; however, ENSTAR has the option to take or not take the optional gas. ENSTAR asserted the contract's term balances the need for an assured gas supply against the possibility that less expensive or alternative gas supplies might become available from the North Slope or new Cook Inlet discoveries or developments.[68]

ENSTAR offered three reasons why APL-5 does not have a limitation on the amount of gas that Marathon can purchase each year and resell. First, when gas is scarce it is not desirable to make it more difficult to discover, produce, deliver, or to otherwise limit the seller's alternatives to procure gas to meet ENSTAR's requirements. Second, Marathon is not obligated to but may wish, in the future, to develop storage facilities for meeting some of its commitments to ENSTAR. ENSTAR stated that purchasing gas when it is available (typically during the summer) and putting it into storage for the winter is very desirable because that maximizes the gas available for ENSTAR. Third, the proposed APL-5 is relatively short-term and it would be beneficial if Marathon can offer additional gas as a result of purchases. ENSTAR does not expect that Marathon will purchase significant quantities of gas to meet its obligations, but believes it unwise to constrain that option during the term of APL-5.[69]

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[68]TA139-4 at 4.

[69]TA139-4 at 5.

Marathon

Marathon supports APL-5 and offers its opinion that the agreement satisfied the "public interest" standard adopted by the commission.[70] Marathon stated that it invested significant amounts of capital to prove up and develop its gas reserves so it can fully serve ENSTAR. As a result of its investment Marathon can now provide a long term secure supply to ENSTAR and its customers.[71] Marathon added that in the contract negotiations it made significant concessions to benefit ENSTAR's customers regarding the pricing of the gas and other key terms.[72] Marathon stated that APL-5 was carefully structured to satisfy the commission's public interest standard, as well as to balance the needs of each of the parties and that in its opinion the public benefits from approval of APL-5.[73] Marathon was the only gas producer that offered to meet specific load-following needs of the ENSTAR customer base and is willing to also meet ENSTAR's unmet requirements beginning in 2009 and for a reasonable period thereafter.[74] In its role as an ENSTAR gas supplier meeting ENSTAR's considerable swing and peak requirements, Marathon suggests that it will incur significantly more cost than the cost of meeting the load of a customer who takes a relatively constant daily volume of gas over an extended period.[75] Marathon witness Henning[76] stated this contract has a very high likelihood of reducing ENSTAR's WACOG (weighted average

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[70]*Comments of Marathon Oil Company* filed December 22, 2005 in TA139-4, at 1.

[71]*Id.* at 2.

[72]*Id.* at 3.

[73]*Id.* at 4.

[74]*Id.* at 2.

[75]*Id* .at 4

[76]T-14 (Henning) at 24.

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cost of gas). Marathon also stated in closing argument there was an extraordinary likelihood in this record that the result of APL-5 will be a decrease to ENSTAR's WACOG.[77]

Attorney General

The AG noted seventeen specific concerns with APL-5 and set them out in his statement of issues and early filed comments.[78] The AG's principal concern is whether the price of gas under APL-5 is unjust and unreasonable such that the pricing provision of APL-5 should be rejected in its entirety.[79] The AG identified three subcomponents of the price inquiry including:

(a) Whether it is appropriate to use the Henry Hub index (HHI) as a pricing proxy under the facts presented in APL-5;

(b) Whether APL-5's use of a twelve-month HH average would be prudent given HH market volatility and the resulting potential for consumer rate shock;

(c) Whether the price floor ($4.25/Mcf) and price cap ($15.00/Mcf) in APL-5 are reasonable.

The AG identified other concerns including such matters as the opportunity for arbitrage, peaking fees, transportation fees, and production taxes. The AG asked whether storage might render suspect Marathon's claim of high cost to meet deliverability and suggested that approval of one or all of the pricing provisions will require a determination of whether the inclusion of such term in APL-5 meets the

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[77]Tr. at 2529.

[78]*Attorney General's Statement of Issues,* filed June 28, 2006, and *Comments of the Attorney General* filed in TA139-4 on December 22, 2005.

[79]*Comments of the Attorney General*, filed December 22, 2005, in TA139-4, at 2.

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standard of fair, just, and reasonable.[80] The AG suggested that the APL-5 raises significant public policy issues and would, if adopted, impact all of ENSTAR's captive ratepayers.[81]

Intervenor Walker

Walker is a residential ratepayer who opposes APL-5.[82] Walker asked that the contract be rejected as the price terms are neither just nor reasonable.[83] Walker stated that the ENSTAR gas cost adjustment mechanism means ENSTAR's captive ratepayers will bear all of the economic and supply risk under APL-5. ENSTAR will bear no economic risk or supply risk at all if APL-5 is approved by the commission.[84] Walker added that public policy should encourage construction of gas storage facilities to ensure the long-term provision of utility services necessary for the public convenience and necessity.[85] Walker stated that the lack of gas production capability in Cook Inlet is not solved by this contract.[86] Walker objected to allowing companies the opportunity to take profits from Cook Inlet without requiring them to reinvest in Cook Inlet, thereby ensuring a long term gas supply for Alaska consumers.[87]

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[80] *Id.* at 2.

[81] *Id.* at 3.

[82] *Comments of James L. Walker*, filed December 19, 2005, in TA139-4, at 1.

[83] *Id.* at 1.

[84] *Id.* at 1.

[85] Tr. 1384-1385 and *Comments of James L. Walker,* filed December 19, 2005, in TA139-4 at 3.

[86] *Comments of James L. Walker,* filed December 19, 2005 at 1.

[87] *Id.* at 4

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Intervenor Tesoro

Tesoro's primary concern with APL-5 is the objectionable pricing mechanisms. Tesoro asserted that a price based on the 12-month trailing average of Henry Hub prices is essentially a "straight Henry Hub" price and approval of straight Henry Hub price will result in ENSTAR paying excessive prices for Cook Inlet natural gas.[88] According to Tesoro, Cook Inlet natural gas is either used locally, used to manufacture fertilizer for export along the Pacific Rim, or converted into LNG for export to Japan,[89] and none of these uses is linked in any direct way to Henry Hub[90] pricing; and therefore, a HHI price bears no logical relationship to the prices of Cook Inlet natural gas.[91] Tesoro stated that the only justification for using HHI pricing is as an incentive for a commitment to explore for additional natural gas, such as in the Unocal GSA.[92] Tesoro asserted that because of the absence of an exploration obligation or other undertakings on the part of Marathon, APL-5 lacks justification in support of the proposed straight HHI pricing.[93] Tesoro is also concerned that the peaking and excess volume price premiums to be paid by ENSTAR customers are excessive.[94]

According to Tesoro, premiums for peaking gas are arguably built into the HHI pricing structure, are reflective of seasonal supply and demand dynamics, and

[88]*Tesoro Alaska Company's Comments on Tariff Advice Letter 139-4 and Petition to Intervene*, filed December 22, 2005, in TA139-4, at 3.

[89]*Id.*

[90]Henry Hub Index.

[91]*Id.*

[92]*Id.* at 5.

[93]*Id.* at 6.

[94]*Id.* at 3 and 7.

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appear to be inappropriate as premiums above HHI pricing.[95] Tesoro said that the propriety of these price adjustments for premium services should be investigated by the commission.[96] Tesoro is also concerned with the ability of Marathon to resell third-party natural gas to ENSTAR at a premium above its acquisition cost without any restrictions or constraints.[97] According to Tesoro, APL-5 puts Marathon in the position of a gas broker, providing it with the opportunity to purchase gas at lower prices from others and sell that same gas to ENSTAR under APL-5.[98]

<u>Intervenor Trading Bay</u>

Trading Bay Energy Corporation (Trading Bay) was granted intervenor status in the Docket proceeding but did not participate at the hearing.[99] Trading Bay is an Alaska business that has as its goal establishing an Alaska owned and operated oil and gas exploration and production company.[100] The company complained that a "[c]onsistent stick in the spokes" as it has sought to grow its business and produce oil or gas, is the lack of opportunity to sell newly discovered gas into the existing marketplace.[101] Trading Bay asked that the commission take steps to require that a set

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[95] *Id.*

[96] *Id.*

[97] *Id.* at 8.

[98] *Id.*

[99] Order U-06-2(2), *Order Granting Motion for Leave to Accept Reply Filed by Tesoro, Denying Motion for Leave to Accept Reply Filed by Agrium, Affirming Electronic Ruling Granting Intervention to Marathon and Denying Intervention to Agrium, Vacating Electronic Ruling Denying Intervention to Tesoro, Granting Petitions to Intervene Filed by Walker and Trading Bay, Rejecting Reply by Trading Bay, Affirming Bench Ruling and Adopting Procedural Schedule, and Granting Motion to Adopt Orders Governing Discovery and Confidential Discovery Material,* dated March 23, 2006.

[100] *Comments by Trading Bay Energy Corporation,* filed in TA139-4 on December 27, 2005, at 1.

[101] *Id.* at 2.

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aside of at least 10 percent of the gas sold under APL-5 come from smaller independent gas producers and that it be sold on the same terms as are enjoyed by the primary seller.[102] Sales by small producers to the ENSTAR market on the same terms as are provided for in a primary seller contract will create economic incentive for exploration and production companies to risk investment capital in gas projects in the Cook Inlet Basin.[103]

Comments by Non-parties

A number of interested individuals and entities commented on APL-5 after issuance of our public notice. While these individuals and entities did not participate in the public hearing, we consider their comments important to our review.

For example, C. Grey objected to the production and transportation costs that would be paid to the producer.[104] Daniel Donkel urged broader competition and asked that the RCA assure that competitors be given a fair share of the ENSTAR gas market.[105] Gregory Micallef requested a 25 percent set aside gas market for smaller producers to encourage new competition amongst major oil companies and mid sized independents.[106] G. Scott Pfoff, the president of Aurora Gas, LLC, cited the commission to two major areas of concern with regard to APL-5: (1) a potential negative impact on exploration and (2) a negative impact on the Moquawkie Contract that Aurora has with ENSTAR.[107] AARP asked that the gas pricing provision of APL-5

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[102]*Id.* at 2.

[103]*Id.* at 3.

[104]E-mail from C. Gray to RCA, filed in TA139-4, December 12, 2005.

[105]Letter from D. Donkel to RCA filed in TA139-4, November 28, 2005.

[106]Letter from G. Micallef to RCA filed in TA139-4, December 23, 2005.

[107]Letter from G. Pfoff to RCA filed in TA 139-4, December 22, 2005.

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be investigated including the appropriateness of the index to which the prices are to be tied, and other price components.[108]

Standard of Review

ENSTAR asked us to find that APL-5 is in the public interest and allow the costs that ENSTAR incurs under the agreement to be recovered in ENSTAR's rates.[109] ENSTAR's focus in this proceeding was on supply. "ENSTAR's main focus is having a secure supply of gas now and in the future." According to ENSTAR, that's the main issue for its customers and Southcentral Alaska.[110]

We believe ENSTAR's position that supply is the "main issue" does not give enough weight to the cost of that supply. ENSTAR ratepayers, not ENSTAR, bear the cost of natural gas supplies that ENSTAR's obtains in its negotiations with the gas producers.[111]

The AG observed,

> "[f]irst, to be consistent with the public interest, any proposed GSA must help provide ENSTAR with a reliable supply of gas. And second, gas sold under APL-5 must be 'reasonably priced.' Both requirements must be met, and a finding of reliability does not trump the need for ENSTAR to also show any proposed GSA is "reasonably priced".[112]

We adopt the Attorney General's observations as our standard of review because it achieves the proper balance between the needs of the utility and the needs of the ratepayers. We will approve APL-5 if we find that it achieves a reliable supply at

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[108] Letter from AARP to RCA, filed in TA139-4, December 22, 2005.

[109] *ENSTAR's Issue Statement and Witness List*, filed June 28, 2006, at 1.

[110] T-8 (Dieckgraeff) at 26.

[111] Tr. at 205.

[112] *Comments of the Attorney General,* filed in TA-139-4.December 22, 2005)

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a reasonable price. Only if both of these factors are met can we find that APL-5 is in the public interest.

Discussion

In the words of ENSTAR's witness Goldsmith, these are times of "unprecedented market uncertainty" in Cook Inlet.[113] Indeed, we cannot predict from the record presented by the parties whether, in the next decade, Cook Inlet will continue to export gas, as it has for almost 40 years, or whether it will import gas, or both. During the latter years covered by APL-5, ENSTAR's customers could, for example, burn exclusively local gas or a mixture of local gas and foreign LNG or even North Slope gas.

We realize from the record that ENSTAR's alternatives for gas supply today in Cook Inlet are limited. The many transportation options and availability of multiple suppliers that exist in the contiguous 48 states are not present in the Alaska market. ENSTAR witness Izzo stated that from a long-term perspective there are three other ways to bring gas to ENSTAR's pipeline system, coalbed methane, conventional gas from interior basins, and import of LNG.[114] On the possibility of North Slope Gas from a spur line, Izzo stated, "[t]he earliest that North Slope gas might be available to ENSTAR would be right around the time that APL-5 expires, approximately 2016, and that's only if everything goes perfectly."[115]

ENSTAR witness Goldsmith testified that the concern over the fall in Cook Inlet gas reserves led us to approve the Unocal and NorthStar contracts.[116] Marathon informed us that it has taken deliberate steps to prove up gas reserves in response to

[113]T-6 (Goldsmith) at 3.

[114]T-1 (Izzo) at 16.

[115]T-2 (Izzo) at 6.

[116]T-5 (Goldsmith) at 18.

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the perceived market signals given to gas producers with ENSTAR's Unocal and NorthStar contracts.[117] Marathon stated it spent substantial sums of money since 2002 which clearly demonstrates that Marathon "reacted in the same way as Unocal and NorthStar to find and develop Cook Inlet gas."[118] Goldsmith explained to us that new fields have been discovered and brought into production and production companies that are new to Cook Inlet and Alaska have been exploring for gas.[119] ENSTAR states its experience with paying higher market-based prices has resulted in Unocal finding over 130 Bcf of gas it committed to ENSTAR.[120] ENSTAR believes that unless new reserves are discovered, it will soon not have enough Cook Inlet gas to meet the needs of the community.[121]

ENSTAR's case in support of APL-5 is based on an assumption that ENSTAR's current ratepayers should, by themselves, pay prices for natural gas high enough to incent future exploration and development in Cook Inlet. Among the recitals in APL-5 is one that reads:

> WHEREAS, Buyer believes that it is in the best interest of its customers to encourage and promote additional Gas exploration and development to meet the Gas demands of the Cook Inlet in 2009 and beyond;[122]

It is evident from that recital, as well as ENSTAR's testimony in support of APL-5,[123] that ENSTAR's case hinges on the assumption that it would be acceptable for its ratepayers to pay more for gas than others pay in the belief that paying extra would help Cook Inlet

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[117]T-9 (Webber) at 3.

[118]T-10 (Webber) at 4-5.

[119]T-5 (Goldsmith) at 17.

[120]T-8 (Dieckgraeff) at 10.

[121]T-1 (Izzo) at 3.

[122]APL-5, at 1.

[123]T-8 (Dieckgraeff) at 9.

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exploration and development along. While it may be advantageous for a public utility's shareholders to promote specific kinds of economic development, we cannot allow ratepayers to bear the cost of this laudable goal alone.

Ratepayers should pay the going price in the regional market from which they buy, a price that secures for them a gas supply with the appropriate swing they need. They should not be required to pay a premium to achieve general economic goals, although it might be acceptable under limited circumstances to acquire particular supplies.

Ratepayers want gas at the lowest price they have to pay to get it. While as Alaskans, they may prefer gas from nearby fields, which benefit the state and local economies, as ratepayers, the price of gas is more important to them than its place of origin. If foreign gas from a reliable source is cheaper, a public utility should not force its captive ratepayers to pay for more expensive, Alaska gas. At this time, foreign gas is not an option for ENSTAR or its ratepayers but, in the longer term, including many of the years covered by APL-5, that option is viable.

The exploratory activity we believed that would lead to additional Cook Inlet reserves as a result of our orders in Unocal and NorthStar has not materialized. In the United States as a whole, the reserves-to-production ratio has historically been about 10:1. In 1970 in the Cook Inlet, it was 30:1.[124] By 2002, the reserves-to-production ratio had fallen to 10.7:1, close to the rest of the U.S. gas market.[125]

ENSTAR stated that January 1, 2006, reserves compare unfavorably with the Department of Natural Resources Cook Inlet reserves as of January 1, 2004.[126]

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[124] *Id.* at 13.

[125] T-5 at 15.

[126] T-8 (Dieckgraeff) at 5.

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Reserves are lower by nearly the amount of production that occurred during the two-year period, decreasing by 439.1 Bcf.[127]

Despite ENSTAR's ratepayers funding millions of dollars in an "exploration and development" incentive plan, Cook Inlet reserves have declined. No party presented evidence that Henry Hub pricing resulted in more reserves for ENSTAR. ENSTAR witness Goldsmith described supply curtailments that occurred in the winter of 2005-2006 and stated that those incidents suggested that the reserves-to-production ratio is lower than it should be and that it is due to insufficient incentives to invest in new reserves.[128]

No party presented evidence to us that would suggest how much price incentive ENSTAR ratepayers must pay to increase Cook Inlet reserves.[129] Marathon witness Henning affirmed that no company ever made an investment exclusively off a pricing signal.[130]

We must reluctantly conclude, based on this record, that the now five year old economic experiment promoted by ENSTAR in both the Unocal and NorthStar contracts has not produced noticeable results. There have been no net reserves added

[127]*Id.*

[128]T-5 (Goldsmith) at 19.

[129]We also cannot ignore the parts of this record that tell us that exploration (as distinct from development of existing reserves) in Cook Inlet cannot be incentivized at any price, that the possibility of a spur line from the North Slope trumps any monetary effort ratepayers could make. And always in the back of producers' minds is the possibility and expected price of imported LNG. ENSTAR offering a price above that expected amount is unlikely to incent general exploration and development, although it might elicit the desired behavior as to particular gas for which ENSTAR pledges to pay its uniquely high price.

[130]Tr. at 1466.

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to Cook Inlet. In fact, what ENSTAR tells us today is that reserves replacement is not keeping up with production.[131]

We note from the record there seems to be only one driver that spurs substantial increases in Cook Inlet reserves—the export of LNG to Japan. Tesoro witness Schlesinger stated, "[t]he export sale of Cook Inlet gas as LNG to Japan also represents Marathon's primary alternative market for its gas sales."[132] Cook Inlet reserves additions were reported in only 3 years between 1977 and 2004.[133] In 1986, Cook Inlet reserves increased by 1,400 Bcf, in 1996 reserves increased by 955 Bcf, and in 1997 by 439 Bcf.[134]

Phillips Alaska Petroleum Gas Corporation and Marathon Oil Company (the owners of the LNG plant) sell LNG to utility companies in Japan. On April 11, 1988, two years after Cook Inlet reserves were increased by 1,400 Bcf, the LNG owners filed an application with the Economic Regulatory Administration (ERA), requesting a fifteen-year export license extension to March 31, 2004[135]

Eight years later, on December 31, 1996, the owners of the LNG plant filed an application requesting that the DOE extend their authorization to export LNG for

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[131]T-8 (Dieckgraeff) at 5.

[132]T-19 (Schlesinger) at 8.

[133]T-5 (Goldsmith) at 16.

[134]H-2 at 71.

[135]H-60 at n.3 referencing DOE/ERA Opinion and Order No. 261, *Order Amending Authorization to Export Liquefied Natural Gas to Japan* (Order No. 261).

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five years through March 31, 2009.[136] In 1996 and 1997, Cook Inlet reserves increased by nearly 1,400 Bcf. The export license was extended through March 31, 2009.[137]

We observe with interest this correlation between Cook Inlet reserves growth and requests for extension of LNG exports[138] revealed in this record. The record before us provides little more than speculation that the use of Henry Hub by one utility provides sufficient incentive to result in Cook Inlet reserves growth.

<u>Reliable Supply of Gas</u>

ENSTAR stated that it applied the following criteria for new gas purchases, (1) full requirements (if possible) (2) full swing, (3) fair price, (4) proven reserves and (5) diversified supply.[139] ENSTAR stated its first priority is always to obtain a reliable, long-term gas supply at the lowest possible price.[140]

ENSTAR witness Izzo stated,

> I see APL-5 as a bridge contract that will give ENSTAR a high level of supply security during a very, very uncertain transition period. APL-5 provides us with an assured supply at a reasonable, market-based price, provided by a highly reliable and responsible supplier that ENSTAR has been able to trust to meet its requirements for over 40-years."[141]

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[136]H-60 at 2.

[137]H-60 at 57.

After taking into consideration all of the information in the record..., we find a five-year extension of the authority.... to export LNG to Japan has not been shown to be inconsistent with the public interest. In particular, the record shows here is a sufficient regional supply of natural gas to satisfy local and export demand through the extension period. Furthermore, we believe the extension will continue benefits provided by the export to the Alaskan economy, energy production, and international trade.

[138]T-5 (Goldsmith) at 16).

[139]T-7 (Dieckgraeff) at 11).

[140]*Id.* at 12.

[141]T-2 (Izzo) at 7.

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ENSTAR bears the burden of proving that this contract will provide that high level of supply security. We test ENSTAR's statements against the record compiled in this hearing.

ENSTAR believed that Marathon has committed to supply ENSTAR's unmet requirements through 2016.[142] It maintained that:

> ENSTAR's most recent major gas supply contract, the Unocal contract was not backed by proven reserves, but rather imposed an exploration obligation on Unocal and it has been quite successful. As a result Unocal has found, and is developing, significant new quantities of gas on which ENSTAR has "first call". ENSTAR believes however that is prudent that the next layer of gas supply be based on proven reserves."[143]

This commitment is embodied in APL-5 contract at Section 2.3, Full Requirements Supplier, which states. In part,

> 2.3 Full Requirements Supplier. The Parties acknowledge and agree that Seller has made the Initial Annual Commitments in such amounts as are necessary, in light of Buyer's current projections, to 'reduce Buyer's Unmet Requirements .to zero (0) for each Contract Year beginning in Contract Year 2009 and ending in Contract Year 2016, and that, for those Contract Years, Seller will be "Buyer's Full Requirements Supplier.[144]".

Section 2.7.4 of the Contract discusses the priority of ENSTAR's position in relation to other of Marathon's gas sales contracts and states, in part,

> 2.7.4 Seller shall not commit to dispose of Gas from Seller's Proven Reserves if such commitment would have a 'material adverse effect on Seller's ability to meet the obligations of Seller under this Agreement. *Except for Seller's Third Party Commitments,* Buyer has first call on Seller's Gas delivered into the Cook Inlet Area necessary to meet Seller's obligations to make Gas available to Buyer under this Agreement. Any agreement' (including an amendment to Seller's Third Party Commitments or exercise of an option under Seller's Third Party Commitments) made on or after October 14, 2005 by Seller to dispose of Seller's Gas from its Proven Reserves during the Term of this Agreement must recognize that Seller has committed

[142]T-7 (Dieckgraeff) at 14.

[143]*Id.*

[144]H-1B at 9.

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> to make Gas available to Buyer under this Agreement and that Buyer has prior call on that Gas to satisfy the obligations of seller to make Gas available to Buyer.[145]

A list of fifteen contracts or agreements between Marathon and third parties are included at Exhibit E to the contract.[146] Several of the contracts appear to be related to Marathon's LNG export activities as well as what appear to be gas supply contracts with Agrium, Tesoro, Chugach Electric Association, XTO Energy, and others.

During the hearing we became aware that ENSTAR had not fully evaluated the effect of Section 2.7.4 on its committed supplies from Marathon.[147]

ENSTAR has relied on Marathon's representations "about not letting the town to go dark while industrials operated"[148] and has required a reserves letter from Marathon but has not yet fully evaluated it.[149] ENSTAR maintained that it takes a lot of comfort from its 40-plus year relationship with Marathon.[150]

ENSTAR stated that its criteria for new gas purchases are based on full requirements, proven reserves, and diversified supply.[151] We have established a standard of review which requires that APL-5 provide a reliable supply of gas at a reasonable price.

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[145]H1-B at 12 (emphasis added).

[146]H-1B, at 58.

[147]Tr. at 151-157.

[148]Tr. at 1016.

[149] Tr. at 1019.

[150]Tr. at 1017.

[151]T-7 (Dieckgraeff) at 3.

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We find that ENSTAR did not meet its burden of proof that APL-5 provides a reliable supply of gas because it has not sufficiently reviewed possible commitments of Marathon's reserves prior to bringing the contract to us for approval.[152]

Were this the only deficiency in ENSTAR's case in support of APL-5, we would be able to conditionally approve APL-5, subject to ENSTAR's submission of further information curing this defect.

Our Unocal and NorthStar orders have been read too broadly by ENSTAR.[153] We have not decided that Lower 48 market prices are a reasonable proxy for Cook Inlet market prices under all circumstances and we certainly have not decided that we will allow ENSTAR or any other public utility to pay Lower 48 market prices plus transportation plus production taxes for all Cook Inlet gas.[154]

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[152] *Id.* at 11 and Tr. 1016-1020.

[153] For example, Marathon's witness Henning testified that "[w]hen the Commission approved the pricing provisions of the Unocal contract with ENSTAR, it sent a clear price signal that the market for natural gas in Alaska would be linked with the broader North American natural gas market." T-14 (Henning) at 12.

[154] Henry Hub prices have departed fundamentally from the basic economics of Cook Inlet since the time of the Unocal contract and the NorthStar contract. Even if our orders could reasonably be read to generally endorse Henry Hub prices, which we do not believe they can, it would be necessary for us now, solely because of that departure, to reexamine that policy decision.

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ENSTAR has told us there is no other company that can provide what Marathon offers to provide in APL-5.[155] Thus, there is no competition for this piece of ENSTAR's gas supply.[156] Competition is what holds down price. In the absence of competition, it is only our review that serves to hold down price. Marathon has every incentive to negotiate for itself the highest price it believes ENSTAR would pay or we would allow ENSTAR to pay. We must carefully assess the agreed-upon price.

The price in APL-5 is not a negotiated price. ENSTAR and Marathon decided not to negotiate a price but rather to select an index and allow that index to set the price of the contract, with add-ons for transportation and production taxes. A market price is not a negotiated price. In that way APL-5 is like the Unocal and NorthStar contracts and unlike the ENSTAR supply contracts that preceded the Unocal and NorthStar contracts. Those legacy contracts contained negotiated prices, based on market conditions in Cook Inlet. The negotiated prices of the legacy contracts are adjusted annually according to an agreed upon index.

Evaluation of APL-5 Price

We evaluate the reasonableness of the pricing terms of APL-5 as a whole rather than picking apart the elements and assessing the reasonableness of each element separately, as we did with the Unocal and NorthStar contracts. We now recognize that pricing terms are negotiated as a whole, that each element is adjusted

[155]T-7 (Dieckgraeff) at 10.

[156]We are not certain there is any meaningful competition for ENSTAR's business. The gas supply in Cook Inlet is largely tied up in long-term contracts. A workably competitive environment for ENSTAR's supply would be one in which producers sold gas on short-term contracts and there was common carrier storage available to take care of ENSTAR's swing requirements. Only under those conditions could small and large producers be on equal footing to compete for ENSTAR's business.

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and fine-tuned to counterbalance each other element of the contract to arrive at terms the contracting parties can embrace. If we were to assess individual items with the intent of conditioning our approval on a change in one or more individual elements, we would be disturbing that balance.

We believe the fairer and wiser course is to approve or disapprove pricing terms as a whole. We take the price of APL-5 and superimpose the changes Marathon offered (none of which ENSTAR objected to) in response to some of the intervenors' concerns and assess the resulting pricing terms as a whole. We cannot find that either the original pricing terms of APL-5 or the pricing terms as revised by Marathon assure that ratepayers will pay no more than a reasonable price for the gas bought for them under APL-5.

The other Marathon contracts entered into evidence in this proceeding (and given confidential status) demonstrate that the price of APL-5, at present Henry Hub 12-month trailing average prices plus 25¢ for transportation plus production taxes,[157] is a radical departure from the basic economics of Cook Inlet. ENSTAR has not sufficiently justified that radical departure in this record.

The best proxy we have for the Cook Inlet market price for gas with the same variable deliverability and swing required by ENSTAR is ENSTAR's own WACOG. The WACOG, by its very nature, represents a diverse base of suppliers, both willing and able to meet ENSTAR's deliverability and swing. ENSTAR's WACOG is also comprised of a blend of legacy pricing based on proven reserves combined with the exploration-driven Henry Hub, through Unocal. That WACOG is currently approximately $5.00 for calendar year 2006. The 2006 price of APL-5 (if in effect, which it is not) is

[157] If ENSTAR were taking gas under APL-5 today the price of gas would be $7.50 plus production taxes. Tr. 924.

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$7.50 plus production taxes. The APL-5 price for proven reserves represents at least a 50 percent increase over ENSTAR's current WACOG. That is an unacceptable divergence because ENSTAR is currently receiving supplies from both proven reserves and exploration efforts at a much lower price.

ENSTAR has not sustained its burden to prove that the price of APL-5 is reasonable. We reject APL-5 based on our conclusion that the price, to the extent that it increases ENSTAR's WACOG, is not reasonable.

We give guidance to the contracting parties on what pricing terms we might be able to accept. In doing so, we do not seek to interfere with future negotiations or second-guess past negotiations. The APL-5 pricing terms are simply too divergent from other prices in Cook Inlet. They must be conformed in some way to the realities of the Cook Inlet market.

As evidenced in our earlier discussion, we have difficulty approving pricing terms if the parties' goal in entering into those terms is to change the Cook Inlet market by paying a higher price than is necessary to obtain the gas needed. We believe ENSTAR should pay prices appropriate to the existing market, considering its deliverability and swing requirements. ENSTAR is likely to need to pay a higher price than other buyers in Cook Inlet because of those requirements but needs to create an adequate record on which we can base our decision in support of that need.

The use of Henry Hub or another market index with or without discounts requires the parties to justify use of the index for their contract and must reconcile use of the market index with Cook Inlet market conditions. Assuming they do so, use of such an index might be acceptable, but only if transportation and production taxes are not added on and if there is a meaningful cap.

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The record reveals that, generally, sellers pay transportation to the hub at which gas is priced and buyers pay transportation away from the hub.[158] Whether transportation should be added on to a hub market index price depends upon the pricing point to which the market price index is applied. In this instance, the only points which make sense under the configuration in Cook Inlet are the KPL junction (where a number of pipelines, including ENSTAR's eastside pipeline, come together) and the inlet to ENSTAR's westside pipeline in the Beluga River field.

The only reasonable alternatives to those points are the wellheads in each field. We believe wellheads are inappropriate pricing points at which to apply a market index. The evidence tells us that sellers pay transportation from the wellhead to the hub.

We do not believe a reasonable price would include a transportation cost added on to a price determined directly by a market index. Transportation was not added on to ENSTAR's legacy contracts. The Unocal contract did provide that a fee would be added on to the market price if gas was shipped through a newly constructed pipeline. A transportation fee was also to be added on to the market index price in the NorthStar contract. The Unocal and NorthStar contracts are distinguishable from the current contract because the pricing terms in those contracts were approved as exploration incentives. We would not allow a transportation fee to be added to a market index price in APL-5.

There is no evidence in this record that buyers at Henry Hub or at any other hub with a market index pay sellers' production taxes. Production taxes are a normal cost of producing gas, like compressors, salaries, and office overhead. Market prices are a function of supply and demand and have no relationship to costs of

[158]T-13 (Elder) at 6-8.

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production. ENSTAR did not provide any support for the tax add-on in APL-5 except to say that the provision is in all its other contracts and that producers preferred it that way.[159] Contrary to our decision in NorthStar, we now find on the basis of the existing record in this proceeding insufficient justification to add production taxes on to market index prices, which already compensate sellers for costs of production.

Prices established on Henry Hub might be acceptable in the presence of a meaningful cap. Neither the $15.00 cap nor the $14.00 cap proposed protects ratepayers from anything other than circumstances in Lower 48 markets that are so dire as to be almost unimaginable. The devastating storms of 2005 resulted only in price spikes to $15.00. The yearly average for 2005 was in the $9.00 range. We find that in this market even a cap of $9.00 does not ensure that ENSTAR's ratepayers will pay a reasonable price when we see other buyers in Cook Inlet paying less than half that amount. Even the Japanese utilities taking Cook Inlet gas pay $2.00 less than this $9.00 cap at the receiving point in Japan. If a contract is priced to another market, there must be a meaningful cap that prevents the price paid by ENSTAR's ratepayers from diverging too far from the price paid by others in Cook Inlet unless that divergence is due to and in proportion with differing deliverability and swing requirements.

We understand that the price of natural gas is rising, in step with crude oil. There is evidence in the record that natural gas prices have been steadily increasing in the Pacific Basin.[160] There is evidence in the confidential record that non-utility contracts for gas supplies have been increasing. We are not opposed to recognizing in APL-5 economically rational price increases that reflect the realities of Cook Inlet's gas market.

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[159]T-8 (Dieckgraeff) at 19.

[160]T-19, Ex. BSA-5.

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Conclusion

On the basis of the evidence in this record we conclude that ENSTAR has failed to meet its burden of proof that APL-5 achieves a reliable gas supply at a reasonable price. Accordingly, we reject the addition of TA139-4 as a base supply contract having the effect of increasing the current average cost of system gas supply as proposed by ENSTAR. We note, however, that ENSTAR's tariff allows it to add base supply contracts having the effect of decreasing the cost of system gas without our approval. We allow ENSTAR to add TA139-4 to its base supply under those limited conditions.

Final Order

This order constitutes the final decision in this proceeding. This decision may be appealed within thirty days of the date of this order in accordance with AS 22.10.020(d) and the Alaska Rules of Court, Rule of Appellate Procedure (Ak. R. App. P.) 602(a)(2). In addition to the appellate rights afforded by AS 22.10.020(d), a party has the right to file a petition for reconsideration as permitted by 3 AAC 48.105. If such a petition is filed, the time period for filing an appeal is then calculated under Ak. R. App. P. 602(a)(2).

ORDER

THE COMMISSION FURTHER ORDERS:

1. TA139-4, as presented by ENSTAR Natural Gas Company, a Division of SEMCO Energy, Inc., is rejected as discussed in the body of this order.

2. TA139-4 , as presented by ENSTAR Natural Gas Company, a Division of SEMCO Energy, Inc., may otherwise go into effect immediately without further approval, provided it has the effect of decreasing the current average cost of system gas as per tariff Sheet No. 90, Section 708f.

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3. By 4 p.m., November 1, 2006, should ENSTAR Natural Gas Company, a Division of SEMCO Energy, Inc., choose to have TA139-4 take effect under Ordering Paragraph No. 2 above, it must file any revisions to its contract terms and perfect its supply commitments under Section 2.7.4 of APL-5.

DATED AND EFFECTIVE at Anchorage, Alaska, this 28th day of September, 2006.

BY DIRECTION OF THE COMMISSION
(Commissioners Dave Harbour and Mark K. Johnson, dissenting.)

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Appendix
ENSTAR Weighted Average Cost of Gas 2002 – 2006

2002 Contract	Price	Vol. BCF	Total $ Millions
APL-4[1]	2.46	21.0	51.67
Beluga[2]	2.43	3.0	8.01
Moquawkie[3]	2.99	1.3	3.84
Unocal[4]	-	-	-
		25.6	63.52
Adjustments			0.28
Total Gas Costs			63.80
Total Sales Volume (BCF)			25.46
Weighted Average Cost of Gas			2.5059

2003 Contract	Price	Vol. BCF	Total $ Millions
APL-4	2.40	19.0	45.69
Beluga	2.42	3.3	7.99
Moquawkie	3.00	4.2	12.64
Unocal	-	-	-
		26.5	66.32
Adjustments			1.14
Total Gas Costs			67.46
Total Sales Volume (BCF)			26.38
Weighted Average Cost of Gas			2.5575

2004 Contract	Price	Vol. BCF	Total $ Millions
APL-4	2.69	17.0	45.68
Beluga	2.78	2.1	5.83
Moquawkie	2.98	2.9	8.70
Unocal	4.74	5.3	25.31
		27.4	85.51
Adjustments			(0.84)
Total Gas Costs			84.67
Total Sales Volume (BCF)			27.20
Weighted Average Cost of Gas			3.1123

2005 Contract	Price	Vol. BCF	Total $ Millions
APL-4	3.38	15.0	50.64
Beluga	3.56	1.6	5.70
Moquawkie	3.02	1.9	5.74
Unocal	5.10	9.2	47.06
		27.7	109.15
Adjustments			(0.87)
Total Gas Costs			108.28
Total Sales Volume (BCF)			27.54
Weighted Average Cost of Gas			3.9321

2006 Contract	Price	Vol. BCF	Total $ Millions
APL-4	4.43	13.0	57.58
Beluga	5.12	1.1	5.64
Moquawkie	3.04	1.8	5.47
Unocal	6.49	10.7	69.32
		26.6	138.00
Adjustments			(6.00)
Total Gas Costs			131.99
Total Sales Volume (BCF)			26.39
Weighted Average Cost of Gas			5.0009

Source: Exhibit H-39, as corrected by RCA Staff

[1] APL-4 Gas Purchase Agreement with Marathon Oil Company, dated May 1, 1988, and approved by the Commission in U-88-49(6), dated July 20, 1989.

[2] Beluga Gas Purchase Agreement between Shell Western E&P, Inc. and Alaska Pipeline Company, approved by the Commission in docket U-83-2(6), dated June 3, 1983. The Commission approved an amended contract, Beluga Schedule 3, in U-92-7(3) dated December 7, 1992.

[3] Moquawkie Gas Purchase Agreement with Anadarko Petroleum Corporation and Phillip's Alaska, Inc., dated May 16, 2000, and approved by the Commission in TA114-4, dated July 27, 2000.

[4] Unocal Gas Purchase Agreement with Union Oil of California Inc., approved by the Commission in U-01-7 dated October 25, 2001.

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Kate Giard, Chairman
Dave Harbour
Mark K. Johnson
Anthony A. Price
Janis W. Wilson

In the Matter of the Gas Sales Agreement Between ENSTAR NATURAL GAS COMPANY, A DIVISION OF SEMCO ENERGY, INC. and MARATHON OIL COMPANY Filed as TA139-4	U-06-2

CERTIFICATION OF MAILING

I, Natasha L. Odom-Brown, certify as follows:

I am Administrative Clerk III in the offices of the Regulatory Commission of Alaska, 701 West Eighth Avenue, Suite 300, Anchorage, Alaska 99501. On September 28, 2006, I mailed copies of

Order No. 15, entitled:

ORDER REJECTING TA139-4 AS A BASE SUPPLY CONTRACT HAVING THE EFFECT OF INCREASING THE CURRENT AVERAGE COST OF SYSTEM GAS SUPPLY BUT ALLOWING TA139-4 TO TAKE EFFECT IMMEDIATELY AS A BASE SUPPLY CONTRACT HAVING THE EFFECT OF DECREASING THE CURRENT AVERAGE COST OF SYSTEM GAS SUPPLY AND REQUIRING FILINGS
(Issued September 28, 2006)

in the proceeding identified above to the persons indicated on the attached service list.

DATED at Anchorage, Alaska, this 28th day of September, 2006.

Natasha L. B.

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Robert M. Pickett, Chairman
Kate Giard
Mark K. Johnson
Anthony A. Price
Janis W. Wilson

In the Matter of the Tariff Revision, Designated as TA167-4, Regarding a Proposed Gas Sales Agreement Between ENSTAR NATURAL GAS COMPANY, A DIVISION OF SEMCO ENERGY, INC. and ConocoPhillips Alaska, Inc. and a Proposed Gas Sales Agreement Between ENSTAR NATURAL GAS COMPANY, A DIVISION OF SEMCO ENERGY INC. and MARATHON OIL COMPANY	U-08-58 ORDER NO. 8

ORDER APPROVING GAS SALES AGREEMENTS, IF AMENDMENTS REQUIRED IN THIS ORDER ARE FILED

BY THE COMMISSION:

Summary

We find that ENSTAR was prudent in its efforts to secure natural gas supplies. We approve the gas sales agreements at issue in this proceeding if ENSTAR files signed amendments to each contract in accordance with this Order.

We establish a floating market-based price cap for the natural gas supplies under each gas supply contract as described in Appendix D and E. We require the use of these price caps for as long as natural gas is exported from Cook Inlet or there are ongoing activities leading to the export of natural gas. Additionally, we do not approve any aspect of Section 2.4(b) of the Marathon GSA that is inconsistent with our directive that future ENSTAR GSAs shall be unbundled as to volume and price to remove the limitation on third party suppliers contained in Section 2.4(b).

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We acknowledge the approval of these contracts with the pricing terms is a compromise of different positions of the parties. By virtue of approving the pricing tiers we accept that ENSTAR's swing profile is more difficult to meet than a flatter swing profile and that tier pricing is justified. We do not, by virtue of our approval, find that pricing or volume increments within the tiers are appropriate for future contracts. We are merely accepting that tier pricing appears to be a reasonable first step to unbundling ENSTAR's future contracts.

We find that the producers of natural gas in Cook Inlet have the ability to exercise market power and were able to do so in their negotiations with local buyers of natural gas. Market power arises from the particular circumstances of supply and demand in Cook Inlet. Producers own the liquefied natural gas (LNG) plant and are themselves the alternative buyer of the gas. Relatively inelastic consumer demand for natural gas, particularly when combined with tightening supply, allows producers to more easily force prices higher. Absent the unequivocal need on the part of ENSTAR consumers for natural gas in the wintertime, producers would not have market power and there would be much less need for regulatory intervention.

We have some of the tools for addressing this situation. Other agencies have additional tools. Based on our record, we believe that U.S. Department of Energy and the State of Alaska could have done a better job in ensuring that local needs were met at reasonable pricing terms before the LNG export license was extended. Approval of the LNG export license weakened ENSTAR's negotiation position and conversely gave the Cook Inlet producers an opportunity to exercise market power.

We also require that ENSTAR unbundle all future natural gas contracts in volume and in price.

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Background

ENSTAR filed a tariff advice letter, TA167-4, in which it requested approval of two proposed GSAs.[1] The proposed GSAs are between ENSTAR and ConocoPhillips and between ENSTAR and Marathon.[2] ENSTAR requested inclusion of the GSAs in Section 708 of its tariff as base supply contracts and requested inclusion of all costs related to the GSAs in the calculation of its gas cost adjustment. We suspended TA167-4, opened this docket for further investigation, and scheduled a public hearing.[3]

The Attorney General, Regulatory Affairs & Public Advocacy (AG) elected to participate in this proceeding.[4] We granted[5] the petitions to intervene filed by Fairbanks Natural Gas, LLC (FNG);[6] Aurora Power Resources, Inc. (Aurora Power);[7]

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[1]TA167-4, filed April 11, 2008 (H-1).

[2]*Id.*; H-1, Attach. A, ConocoPhillips Contract, *Gas Sales Agreement Between ConocoPhillips Alaska, Inc. and Alaska Pipeline Company* (H-2); H-1, Attach. B, Marathon APL-6 Contract, *Gas Sales Agreement Between Marathon Oil Company and Alaska Pipeline Company* (H-3).

[3]Order U-08-58(1), *Order Suspending TA167-4, Inviting Petitions to Intervene, Requesting Participation by the Attorney General, Addressing Timeline for Decision, Establishing Procedural Schedule, Designating Commission Panel, and Appointing Administrative Law Judge,* dated May 12, 2008 (Order U-08-58(1)), as corrected by *Errata Notice to Order U-08-58(1),* dated May 23, 2008.

[4]*Notice of Election to Participate* and *Entry of Appearance,* both filed May 21, 2008.

[5]Order U-08-58(5), *Order Granting Petitions to Intervene Filed by Fairbanks Natural Gas, LLC; Aurora Power Resources, Inc.; Chugach Electric Association, Inc.; and Homer Electric Association, Inc. and Alaska Electric and Energy Cooperative, Inc.*, dated June 12, 2008.

[6]*Petition to Intervene by Fairbanks Natural Gas,* filed May 20, 2008.

[7]*Petition to Intervene of Aurora Power Resources, Inc.,* filed May 21, 2008.

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Chugach Electric Association, Inc. (Chugach);[8] and Homer Electric Association and Alaska Electric and Energy Cooperative, Inc. (together, HEA).[9] We allowed HEA to withdraw as a party from the docket before the scheduled hearing.[10] FNG withdrew its prefiled testimony before the hearing but did not request withdrawal as a party.[11]

We held a public hearing that began on July 28, 2008, and continued through August 13, 2008. FNG did not participate in the hearing.[12] The parties[13] filed post-hearing briefs.[14]

ENSTAR requested a decision regarding the GSAs by October 31, 2008.[15] Both GSAs may be terminated if approval does not occur by October 31, 2008.[16]

ENSTAR filed a notice of amendment to testimony and pleadings on

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[8]*Chugach Electric Association, Inc.'s Petition for Leave to Intervene,* filed May 21, 2008.

[9]*Petition for Permission to Intervene of Homer Electric Association, Inc. and Alaska Electric and Energy Cooperative, Inc.,* May 21, 2008.

[10]Order U-08-58(7), *Order Granting Homer Electric Association, Inc. and Alaska Electric and Energy Cooperative, Inc.'s Motion to Withdraw from Docket,* dated July 25, 2008.

[11]*Final Witness List of Fairbanks Natural Gas*, filed July 21, 2008.

[12]Prehearing conference, dated July 28, 2008, Tr. at 23; Public hearing, dated July 28, 2008 (Vol. II), Tr. at 30.

[13]The parties at hearing were ENSTAR, the AG, Chugach, and Aurora Power.

[14]*ENSTAR's Initial Post-Hearing Brief*, filed August 22, 2008 (ENSTAR Post-Hearing Brief); *Attorney General's Post-Hearing Brief*, filed August 29, 2008 (AG Post-Hearing Brief); *Chugach Electric Association, Inc.'s Post-Hearing Brief*, filed August 29, 2008 (Chugach Post-Hearing Brief); *Aurora Power Resources, Inc.'s Post-Hearing Brief*, filed August 29, 2008 (Aurora Post-Hearing Brief); *ENSTAR's Post-Hearing Reply Brief*, filed September 5, 2008 (ENSTAR Post-Hearing Reply Brief).

[15]H-1 at 2.

[16]H-2 (ConocoPhillips GSA) at 22 (§10.1(b)); H-3 (Marathon GSA) at 35 (§11.3).

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October 15, 2008, a short two weeks before its requested decision date of October 31, 2008.[17] The hearing in this matter concluded on August 13, 2008, and the final post hearing brief, ENSTAR's reply, was filed on September 5, 2008. The AG[18] and Chugach[19] filed motions to strike ENSTAR's notice of amendment. We explicitly did not consider ENSTAR's notice, amended testimony, or pleadings in reaching our decision in this order. Accordingly, we decline to rule on the motions to strike or the propriety of ENSTAR's notice of amendment at this time.

Discussion

Overview of TA167-4 Gas Sales Agreements

ENSTAR is required by its tariff to file for advance approval any new base supply contract that will increase its current average cost of system gas.[20] ENSTAR base supply contracts that decrease the current average cost of system gas become effective immediately without our prior approval.[21]

The GSAs with ConocoPhillips and Marathon (Producers) provide for deliveries of natural gas starting in 2009 and continuing through 2013.[22] ENSTAR states that it will no longer have an unmet requirements supplier beyond 2008 and that

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[17]*Notice by ENSTAR Natural Gas Company of Amendment to Testimony and Pleadings*, filed October 15, 2008.

[18]*Motion to Strike*, filed October 16, 2008.

[19]*Chugach Electric Association, Inc.'s Motion to Strike Notice by ENSTAR Natural Gas Company of Amendment to Testimony and Pleadings; or, in the Alternative, Motion to Reopen Record*, filed October 20, 2008.

[20]ENSTAR's Tariff Sheet No. 90, § 708(f).

[21]*Id.*

[22]H-1 at 1; H-2 (ConocoPhillips GSA) at 23; H-3 (Marathon GSA) at 28-29.

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the GSAs are necessary to fill a gap in its gas supply portfolio beginning in 2009.[23] The two GSAs combine to provide 37.8 Bcf[24] of natural gas over their terms.[25]

The GSAs provide committed volumes that, combined with ENSTAR's other GSAs, meet 100 percent of ENSTAR's projected needs for 2009 and 2010.[26] ENSTAR plans to develop storage and utilize gas storage facilities to meet its peak seasonal fluctuations beginning in 2011.[27] ENSTAR views these relatively short term GSAs as a bridge to the future that will include storage and a possible supply of natural gas from the Brooks Range.[28]

ENSTAR requests approval of the GSAs as base supply contracts under its tariff and for inclusion of all costs related to the GSAs in the calculation of its gas cost adjustment.[29] ENSTAR's tariff advice letter, TA167-4 (Exhibit H-1), the ConocoPhillips GSA (Exhibit H-2), and the Marathon GSA (Exhibit H-3) are attached to this order as Appendices A, B, and C, respectively.

<u>*ConocoPhillips GSA*</u>

The ConocoPhillips GSA provides for an expected total volume of approximately 12.1 Bcf over the five-year term of the agreement.[30] Gas delivered under the GSA is divided into three tiers for pricing purposes described as a Base Tier, a

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[23]H-1 at 2, 4.

[24]Bcf means one billion standard cubic feet.

[25]*Prefiled Direct Testimony of Eugene N. Dubay,* filed May 28, 2008 (E-1) at 4.

[26]H-1 at 4.

[27]*Id.*

[28]E-1 (Dubay Direct) at 6-7, 41-42.

[29]H-1 at 1.

[30]E-1 (Dubay Direct) at 16; H-1 at 5; H-2 (ConocoPhillips GSA) at 34.

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Seasonal Tier, and a Needle Peak Tier.[31] The Base Tier contains gas used throughout the year and is approximately 64 percent of total gas consumption.[32] The Seasonal Tier includes increments above the Base Tier which ENSTAR purchases during October through April.[33] The Needle Peak Tier is used on the coldest winter days and is approximately five percent of overall demand.[34]

Pricing under the ConocoPhillips GSA is based on an Energy Price derived from the twelve-month trailing average of the daily median prices at five West Coast and Canadian trading locations.[35] The "basket" of trading locations is a variation on the Cook Inlet Composite Index (CICI), proposed by the AG's expert Arlon Tussing in Docket U-06-2.[36] The trading locations are TCPL Alberta (AECO-C); Northwest, Canadian Border (Sumas); PG&E Malin; PG&E City Gate; and SoCal Gas.[37] Base Tier volumes are priced at the Energy Price, Seasonal Tier volumes are 125 percent of the Energy Price, and Needle Peak Tier volumes are 150 percent of the Energy Price.[38] The price will be adjusted quarterly.[39]

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[31] E-1 (Dubay Direct) at 17; H-2 (ConocoPhillips GSA) at 10.

[32] E-1 (Dubay Direct) at 17.

[33] *Id.*

[34] *Id.*

[35] *Id.* at 18-19.

[36] *Id.* at 18-19. Docket U-06-2 is titled *In the Matter of the Gas Sales Agreement Between ENSTAR NATURAL GAS COMPANY, A DIVISION OF SEMCO ENERGY, INC. and MARATHON OIL COMPANY Filed as TA139-4.*

[37] *Id.*; H-1 at 5; H-2 (ConocoPhillips GSA) at 40.

[38] H-1 at 5; H-2 (ConocoPhillips GSA) at 15.

[39] E-1 (Dubay Direct) at 21; H-2 (ConocoPhillips GSA) at 12.

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Marathon GSA

The Marathon GSA, also called APL-6, provides for an expected total volume of approximately 25.6 Bcf over the five-year term of the agreement.[40] Gas delivered under the GSA is divided into six tiers for pricing purposes described as Base Load Gas, Seasonal Peak Tier 1 Gas, Seasonal Peak Tier 2 Gas, Needle Peak Gas, Storage Gas up to 1.0 Bcf, and Storage Gas in excess of 1.0 Bcf.[41] ENSTAR states that the tier structure and rationale behind the tier structure is "essentially similar" to that in the ConocoPhillips GSA.[42] Base Load Gas plus Seasonal Peak Tier 1 Gas are consumed year-round, the Seasonal Peak Tier 2 Gas is consumed during October through April, and Needle Peak Gas is consumed on the coldest days during November through March. Storage gas will be taken during the summer months and injected into storage.[43]

Pricing under the Marathon GSA is based on an Energy Price derived from the twelve-month average of the daily median of the midpoint prices at three natural gas trading locations.[44] The "market basket" of trading locations contains two locations that overlap with the ConocoPhillips GSA and seeks to dampen volatility through geographic diversity.[45] The trading locations are Chicago Citygate, PG&E Citygate, and SoCal Gas.[46] Base Load Gas volumes are priced at 98 percent of the Energy Price, Seasonal Peak Tier 1 Gas is 105 percent of the Energy Price, Seasonal

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[40]E-1 (Dubay Direct) at 25-26; H-1 at 7; H-3 (Marathon GSA) at 45-49.

[41]*Id.*at 25-27; H-1 at 7; H-3 (Marathon GSA) at 15-24.

[42]E-1 (Dubay Direct) at 26.

[43]*Id.* at 27; H-1 at 7.

[44]E-1 (Dubay Direct) at 26; H-1 at 7; H-3 (Marathon GSA) at 24-25.

[45]E-1 (Dubay Direct) at 26; H-1 at 7.

[46]E-1 (Dubay Direct) at 26; H-1 at 7; H-3 (Marathon GSA) at 24-25.

Peak Tier 2 Gas is 115 percent of the Energy Price, Needle Peak Gas is 130 percent of the Energy Price, Storage Gas up to 1.0 Bcf is 98 percent of the Energy Price, and Storage Gas in excess of 1.0 Bcf is 88 percent of the Energy Price.[47] The GSA includes an "'S-curve' price dampening mechanism" that dampens volatility through adjusting the Energy Price upward if the market basket value is below $6.00 and adjusting it downward if the index basket value is above $8.50.[48]

Positions of the Parties

ENSTAR states that it needs gas supplies beginning in January 2009.[49] It asserts that the Energy Price provisions, made up of a "basket" of trading locations are reasonable and that the tier pricing provisions are reasonable additions to the base Energy Price and reasonably reflect the value of peaking gas supplies and storage.[50] It claims that the proposed terms for the GSAs advocated by the AG and Chugach are not available in the Cook Inlet market and that the Producers have no obligation to accept contract terms dictated by the commission.[51] Finally, ENSTAR argues that the contracts meet the test of "overall reasonableness in the current market."[52]

The AG argues that the ConocoPhillips GSA and the Marathon GSA are the result of excessive Producer market power and contain unreasonable price terms and unreliable gas supplies.[53] However, the AG does not recommend rejection of the

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[47]H-1 at 7; H-3 (Marathon GSA) at 24.

[48]E-1 (Dubay Direct) at 28; H-1 at 7; H-3 (Marathon GSA) at 24.

[49]ENSTAR Post-Hearing Brief at 4-7.

[50]*Id.* at 11-12, 14-15.

[51]ENSTAR Post-Hearing Brief at 12-3.

[52]*Id.* at 7-11.

[53]AG Post-Hearing Brief at 7-13.

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GSAs.[54] Instead the AG asks that we limit the price under the GSAs with the composite index that was proposed by the AG's expert witness in Docket U-06-2, Arlon Tussing.[55] Tussing did not participate in the current proceeding. The AG's witness in this proceeding, Cristina Klein, adopted Tussing's proposed index and recommends its use in this docket.[56] The AG also asks that we state that approval of these GSAs is not "precedent," that ENSTAR gas storage should be addressed in a separate docket, and that ENSTAR should absorb some costs of the GSAs.[57]

Chugach argues that the GSAs are unreasonable and should be disapproved.[58] It claims that we can help ENSTAR manage 2009 without these GSAs.[59] It suggests that we open a separate docket to address ENSTAR storage and that we "tell" the State of Alaska, Department of Natural Resources (DNR) and the United States of America Department of Energy (DOE) that local utilities need gas under contract before LNG export is authorized.[60] Finally, it requests guidance on reasonable natural gas pricing for Cook Inlet.[61]

Aurora does not oppose approval of the ConocoPhillips GSA and the Marathon GSA.[62] It requests our identification of attributes for acceptable future

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[54]AG Post-Hearing Brief at 2, 20.

[55]*Id.* at 15-17.

[56]*Id.* at 15-17.

[57]*Id.* at 18-19.

[58]Chugach Post-Hearing Brief at 2-13.

[59]*Id.* at 13-16.

[60]*Id.* at 16-19.

[61]*Id.* at 19-20.

[62]Aurora Post-Hearing Brief at 1-2, 20.

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GSAs.[63] Attributes Aurora suggests are shorter terms, unbundled services including deliverability and storage, and unbundled price.

Standard for Evaluation

We have articulated a standard for our evaluation of ENSTAR GSAs on several previous occasions. Although there have been variations, we have consistently looked to the public interest while considering whether ENSTAR acted in a prudent fashion, whether the terms of the GSA at issue are reasonable,[64] and whether the GSA ensures reliable and reasonably priced-utility service.[65] Accordingly, we evaluate the ConocoPhillips and Marathon GSAs to determine whether approval is in the public interest. We consider whether ENSTAR's decision to enter into the GSAs was prudent. We consider whether the future gas supplies provided by the GSAs are reliable.

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[63]Aurora Post-Hearing Brief at 3-18.

[64]AS 42.05.431(a).

[65]Order U-83-2(6), *Order Approving Gas Supply Contracts and Related Tariff Revisions*, dated June 3, 1983, at 6-8; Order U-88-49(6), *Order Approving Contract, Exchange Agreement, and Gas Cost Adjustment; Subject to Conditions and Modifications*, dated July 20, 1989, at 5, as corrected by *Errata Notice to Order No. 6,* dated August 1, 1989; Order U-01-7(8), *Order Conditionally Approving TA117-4 (Gas Sales Agreement) and Requiring Filing*, dated October 25, 2001, at 4, as corrected by *Errata Notice to Order No. 8,* dated December 21, 2001; Order U-96-108(12)/-U-03-84(7), *Order Conditionally Approving Gas Sales Agreement, Inclusion of Costs of Gas Sales Agreement in Gas Cost Adjustment, and Homer Area Surcharge; Denying, Without Prejudice, the Request to Amend Service Area; Vacating Previous Filing Requirement; and Requiring Filings*, dated March 23, 2004, at 6, as corrected by *Errata Notice to Order U-96-108(12)/U-03-84(7),* dated April 8, 2004; Order U-06-2(15), *Order Rejecting TA139-4 as a Base Supply Contract Having the Effect of Increasing the Current Average Cost of System Gas Supply but Allowing TA139-4 to Take Effect Immediately as a Base Supply Contract Having the Effect of Decreasing the Current Average Cost of System Gas Supply and Requiring Filings*, dated September 28, 2006 (Order U-06-2(15)) at 22-23, as corrected by *Errata Notice to Order U-06-2(15),* dated March 8, 2007; Order U-06-2(17), *Order Granting Reconsideration in Part; Denying Reconsideration in Part; and Revising Order U-06-2(15)*, dated December 29, 2006, at 2.

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We are guided by AS 42.05.431(a). Under that subsection, we are required to determine whether the GSAs or particular terms within the GSAs are unjust, unreasonable, unduly discriminatory, or preferential when viewed in the context of Cook Inlet which is unique among regional natural gas markets in the United States.

Prudency of Entering into GSAs

ENSTAR is a natural gas transmission and distribution utility that services 127,000 residential, commercial, industrial, and electric power generation customers.[66] ENSTAR has asserted and presented evidence that without new gas supply contracts it faces a gas shortage beginning January 1, 2009.[67] ENSTAR acted in a reasonable fashion to negotiate these GSAs.[68] We are convinced, based on the testimony, that ENSTAR negotiated the best contracts it was able, given its urgent need for gas and its position in relation to the Producers.[69] We find that ENSTAR acted in a prudent fashion in entering into the ConocoPhillips and Marathon GSAs.

Reliable Supply

The AG questions the reliability of the supplies provided under the ConocoPhillips GSA by highlighting Section 2.3(h) of the GSA which states that deliveries to ENSTAR may be reduced if the State of Alaska (State) elects to take its royalty in kind.[70] Additionally, the AG argues that ratepayers are at risk due to the lack

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[66]*Prefiled Direct Testimony of Mark William Slaughter,* filed May 28, 2008 (E-6) at 2-3.

[67]H-1 at 3; E-1 (Dubay Direct) at 4; E-6 (Slaughter Direct), MWS-2; Public hearing, August 5, 2008 (Vol. VIII), Tr. (Slaughter) at 1273-1274.

[68]Public hearing, dated August 6, 2008 (Vol. IX), Tr. (Klein) at 1416-1417.

[69]Vol. II, Tr. (Dubay) at 99; Vol. IV, Tr. (Dubay) at 423; E-1 (Dubay Direct) at 12-14, 21, 27.

[70]AG's Post Hearing Brief at 13; Vol. II, Tr. (Dubay) at 127-129.

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of a requirement that Marathon deliver Needle Peak gas beyond 2010,[71] or that ConocoPhillips deliver Needle Peak gas beyond the first quarter of 2011[72] and the attendant need for ENSTAR to develop appropriate storage before those times.[73]

ENSTAR argues that the GSAs provide for a reliable gas supply.[74] ENSTAR testified that the gas storage and peak shaving term within the ConocoPhillips GSA will help ensure the reliability of ENSTAR's gas supply.[75] ENSTAR provided testimony that it has purchased gas from Marathon for over forty years with no supply disruptions.[76] Further, ENSTAR provided testimony that it is confident in ConocoPhillips' ability to supply the volumes contracted under its GSA.[77]

We find that the term in the ConocoPhillips GSA allowing a reduction in deliveries to ENSTAR if the State elects to take its royalty in kind is not in the public interest. This provision creates the potential for an impact in the gas supply relied upon by ENSTAR and its customers. However, we will not require removal of the term. As discussed below, there is sufficient evidence in the record to find that gas supplies under the GSAs are reliable even with the inclusion of the offending term.

The DOE, Office of Fossil Energy recently granted the Producers' request to export LNG from Cook Inlet to Japan or one or more countries on either side of the

[71]H-3 (Marathon GSA) at 17, 47-48.

[72]H-2 (ConocoPhillips GSA) at 11.

[73]AG's Post-Hearing Brief at 13; R-1 (Klein) at 62-68; Vol. II, Tr. at 142-145.

[74]ENSTAR'S Initial Post-Hearing Brief at 15-16.

[75]Vol. II, Tr. (Dubay) at 146.

[76]Vol. III, Tr. (Dubay) 366-368; Vol. VIII, Tr. (Slaughter) at 1252-1253.

[77]*Id.* at 369-370; *Id.* at 1251-1252.

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Pacific Rim (DOE Order).[78] The DOE found that Cook Inlet contains adequate supplies to meet domestic utility demand through at least the first quarter of 2011.[79] In its application to the DOE, ConocoPhillips and Marathon provided information that there were 1,726.4 Bcf of "proved and probable natural gas reserves in Cook Inlet" as of January 1, 2006.[80] The State agreed with the Producers that Cook Inlet natural gas resources are more than adequate to satisfy the requested export volumes and utility demand in Southcentral Alaska during the export period.[81] Both of the GSAs contain a requirement for the Producers to curtail the delivery of gas to the LNG facility to the extent necessary to meet their obligations under the GSAs.[82] Further, both Producers committed to undertake new drilling efforts in their settlement agreement with the State of Alaska.[83]

The ConocoPhillips GSA explicitly recognizes ENSTAR's priority, subject to existing commitments, for delivery of natural gas.[84] Both GSAs require the Producers to demonstrate on a yearly basis that they have proven and risked probable reserves sufficient to fulfill their commitments to ENSTAR.[85] No party presented evidence that

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[78] *Order Granting Authorization to Export Liquefied Natural Gas from Alaska,* FE Docket No. 07-02-LNG (June 3, 2008) (H-37) at 70. (The entire record before the DOE in FE Docket No. 07-02-LNG was incorporated into evidence in this docket. Public hearing, August 8, 2008 (Volume XI) Tr. at 1795-1796.)

[79] H-37 at 58-59.

[80] *Application for Blanket Authorization to Export Liquefied Natural Gas,* FE Docket No. 07-02-LNG (January 10, 2007) (H-20) at 10.

[81] *Prefiled Testimony of Cristina M. Klein,* filed June 24, 2008 (R-1), CMK-5 at 7 (§1(c)).

[82] H-2 at 12 (§2.3(i)); H-3 at 23 (§2.4 (c)).

[83] R-1 (Klein), CMK-5 at 6, 9-10.

[84] H-2 at 12 (§2.3(i)).

[85] *Id.*; H-3 at 23 (§2.7).

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Cook Inlet contains insufficient reserves or that either Producer lacks access to sufficient reserves to meet the volume commitments presented in these GSAs.

Based on the evidence presented in this record we find that the future gas supplies provided by the ConocoPhillips GSA and the Marathon GSA are reliable. However, we reserve the right to revisit the reliability of gas supplies under these GSAs if the Producers fail to follow through on the commitments made in the GSAs and during the course of the DOE proceedings.

Statutory Authority

AS 42.05.431(a) states in part:

> When the commission, after an investigation and hearing, finds that a rate demanded, observed, charged, or collected by a public utility for a service subject to the jurisdiction of the commission, or that a classification, rule, regulation, practice, or contract affecting the rate, is unjust, unreasonable, unduly discriminatory or preferential, the commission shall determine a just and reasonable rate, classification, rule, regulation, practice, or contract to be observed or allowed and shall establish it by order.

ENSTAR is a public utility that provides service subject to our jurisdiction.[86] The ConocoPhillips and Marathon GSAs, if approved, will affect the rates charged by ENSTAR.[87] Therefore, we are required by statute to determine whether the GSAs are unjust, unreasonable, unduly discriminatory, or preferential, and if so, determine terms that are just and reasonable, and establish them by order.

Preliminary Issues

During the course of these proceedings, it became apparent that we must address two foundational issues that affect our analysis of the reasonableness of the GSAs. The first issue is whether it is appropriate to price Cook Inlet natural gas used

[86] *See* ENSTAR's Certificate of Public Convenience and Necessity No. 4.

[87] H-1 at 1.

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locally at consumption area prices, as the GSAs do. The second issue is whether the Producers entering into the GSAs with ENSTAR have market power in the Cook Inlet natural gas market that would cast doubt on the reasonableness of all or portions of the GSAs.

Cook Inlet Natural Gas Production

Vast quantities of natural gas were discovered in Cook Inlet by petroleum companies exploring for oil.[88] Natural gas is currently produced in Cook Inlet and has been produced in Cook Inlet for forty years.[89] A majority of the gas produced over those forty years was converted to LNG or manufactured into fertilizer and exported out of the Cook Inlet area.

Today, fertilizer is no longer produced in Cook Inlet. However, LNG continues to be exported to Japan and will be exported to Japan until March 31, 2009. At that time, a two-year extension of ConocoPhillips' and Marathon's export license will take effect and LNG will be exported to Japan and/or one or more other countries on either side of the Pacific Rim, according to the DOE order. The natural gas produced in Cook Inlet and not exported is used for oil and gas production purposes and for electric

[88]E-1 (Dubay Direct) at 7; E-4 (Carpenter Direct) at 9; Ex. H-29, *Economic Analysis of Kenai LNG Export* (H-29) at 4-1.

[89]E-4 (Carpenter Direct) at 9-13 (history of natural gas discovery and production in Cook Inlet), 18 (gas production by owner in Cook Inlet); E-4 (Carpenter Direct), PRC-4 at 27-28 (natural gas supply in Cook Inlet); Public hearing, July 31, 2008 (Vol. V), Tr. at 813 (Carpenter); Public hearing, August 11, 2008 (Vol. XII), Tr. at 1965 (Gibson); Vol. II, Tr. at 66 (Gibson); *See* H-2 (ConocoPhillips GSA); H-3 (Marathon GSA); H-20 at 18-25 (natural gas exploration, development and supply in Cook Inlet); H-29 at 4-1 (RD Report natural gas exploration and development); H-37 (DOE Order) at 45-47 (natural gas reserves in Cook Inlet).

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and gas utility purposes.[90] The quantities to be sold under the ConocoPhillips and Marathon GSAs are among the quantities used locally.[91]

The evidence presented in this record indicates that in 2007, the reserves-to-production ratio for Cook Inlet was approximately 10:1.[92] This means that without the development of additional reserves, proven and probable reserves will be exhausted in ten years.[93] By its nature, a reserves-to-production ratio is calculated for a production area. A reserves-to-production ratio of around 8:1 to 10:1 is typical in Lower 48 states.[94] We find that the reserves-to-production ratio in Cook Inlet is in the same range as is typical for Lower 48 production areas.

The need for natural gas in the Cook Inlet area has always been able to be satisfied by Cook Inlet production. No natural gas has ever been imported into the Cook Inlet area. Further, Cook Inlet is unique as the home of the only plant in the United States that liquefies natural gas and ships it out of the immediate area as LNG.[95] In fact, as previously stated, LNG from Cook Inlet is exported outside of the United States.[96] We find that Cook Inlet is a natural gas production basin.

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[90]E-1 at 8-9 (Dubay Direct); E-4 (Carpenter Direct) at 13-14; R-1 (Klein), CMK-2; Vol. V, Tr. at 711-712 (Carpenter); Vol. VIII, Tr. at 1331-1332 (Klein).

[91]H-2 (ConocoPhillips GSA) at 8 (definition of Receipt Point) and 36 (location of Receipt Points); H-3 (Marathon GSA) at 13 (definition of Receipt Point(s)) and 58-60 (Exhibit C, location of Receipt Points).

[92]E-4 (Carpenter Direct) at 11.

[93]*Id.*

[94]H-29 at 4-4 to 4-5.

[95]Vol. V, Tr. at 774 (Carpenter); Public hearing, August 7, 2008 (Vol. X), Tr. at 1606 (Leitzinger).

[96]H-37 (DOE Order) at 70.

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Cook Inlet Market Power

ConocoPhillips, Marathon, and Union Oil Company of California, a division of Chevron (Union), control the vast majority of the natural gas supplied in Cook Inlet.[97] Of these three, ConocoPhillips and Marathon are the two largest.[98] ConocoPhillips and Marathon own the Kenai LNG export facility.[99] Therefore, the Cook Inlet market is vertically integrated with the Producers as their own best customers through the medium of sales to the LNG export facility.

ENSTAR's witness Carpenter, in earlier proceedings before the Federal Energy Regulatory Commission (FERC), defined market power as:

> [T]he power to raise price profitably above the competitive level (defined as marginal cost) and not lose so many sales in the process that the price increase must be rescinded. Courts have defined market power as "the power to control prices or exclude competition."[100].

In this docket, Carpenter agreed during cross-examination by the AG with a definition of market power which stated in part "when one buyer or seller in a market has the ability to exert significant influence over the quantity . . . of goods and services traded, or the price at which they are sold."[101] These definitions are consistent with the definition of market power provided by Professors Samuelson and Nordhaus in the academic

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[97]R-1 (Klein) at 22; E-4 (Carpenter Direct) at 18.

[98]E-4 (Carpenter Direct) at 18.

[99]*Id.* at 17 (Carpenter Direct); H-20 (DOE Application) at 4; H-37 (DOE Order) at 14.

[100]H-44 at 10 (internal citation omitted).

[101]Vol. V, Tr. at 610-611. (AG quoting a definition of market power from Economist.com).

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textbook *Microeconomics*.[102] We reviewed ENSTAR's GSAs and the record in this proceeding with these definitions of market power in mind.

As a gas utility ENSTAR requires a supply of natural gas for its very existence. The AG presented testimony from its witness, Cristina Klein (Klein), that the Producers in Cook Inlet have considerable or substantial market power.[103] Klein quoted and affirmatively agreed with the State's observation in front of the DOE that "[t]he Lerner Index approximation of basin price and cost indicates a degree of exerted monopoly power is present at current price levels."[104] Eugene Dubay, the Senior Vice President and Chief Operating Officer of ENSTAR's parent corporation, stated, "[W]e're -- we're in a fairly constrained market and using again, my poor rental car analogy, at least the [P]roducers here even though they -- they know to some extent they've got us by the throat, are only asking for [sic] us what lots of other companies are paying in a liquid market."[105] Under questioning from Commissioner Price, Carpenter, ENSTAR's expert witness, stated, "[u]nder those circumstances [circumstances in Cook Inlet] the [P]roducers definitely have market power. I've never -- I've never said they don't have significant bargaining leverage. But it's the reality of the market. It's the reality under which these contracts are negotiated."[106]

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[102]Samuelson and Nordhaus, *Microeconomics*, Thirteenth Edition, McGraw-Hill, Inc., 1989 at 631 ("The degree of control that a firm or group of firms has over the price and production decisions in an industry.").

[103]R-1 (Klein) at 22-23.

[104]*Id.*

[105]Vol. IV, Tr. at 423.

[106]Vol. V, Tr. at 794.

ENSTAR issued a request for proposals (RFP) on February 1, 2007, seeking long-term gas supply contracts to fill its projected need beginning in 2009.[107] ENSTAR requested supply proposals by March 19, 2007.[108] Only ConocoPhillips and Marathon responded to the RFP.[109] The ConocoPhillips GSA was entered into on April 10, 2008,[110] and the Marathon GSA was entered into on April 11, 2008.[111] No supplier would agree to fill the role of unmet requirements supplier for ENSTAR, and no supplier would meet ENSTAR's full deliverability needs beyond the first quarter of 2011.[112]

Union, ENSTAR's current unmet requirements supplier, did not submit a response to ENSTAR's RFP. Further, Union has supplied only the volumes required under its contract with ENSTAR and has not provided any discretionary additional volumes allowed under the contract.[113]

Certain terms that were agreed to by ENSTAR give us concern and provide evidence of an excessive degree of control over the terms of the GSAs by ConocoPhillips and Marathon. These terms include the limitations on the ability for third-party producers to supply gas to ENSTAR found in the Marathon GSA; the requirement for ENSTAR to develop storage to successfully provide service to its customers inherent in both the ConocoPhillips GSA and the Marathon GSA; and the explicit contractual control over ENSTAR's participation in this proceeding by

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[107] E-1 (Dubay Direct), END-1 at 1.

[108] *Id.*,1 at 2.

[109] *Id.* at 13; H-1 at 2.

[110] H-2 (ConocoPhillips GSA) at 4.

[111] H-3 (Marathon GSA) at 6.

[112] E-1 (Dubay Direct) at 14; E-2 (Dubay Reply) at 39.

[113] E-1 (Dubay Direct) at 13; E-6 (Slaughter Direct) at 6.

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ConocoPhillips and Marathon, neither of whom filed a petition to intervene to participate on its own behalf.

The Marathon GSA contains a provision that ENSTAR states "allow[s] increased access by independent producers to the ENSTAR market . . . ."[114] However, the term may be viewed as a restriction on ENSTAR's ability to procure gas from a third-party supplier, rather than an opportunity for such a third-party supplier.[115] The provision states that it accommodates purchases of up to 0.5 Bcf from a new supplier to begin in 2011.[116] However, the third-party supplier must meet all levels of deliverability described under the GSA, meaning Base Load Gas, Seasonal Peak Tier 1 Gas, Seasonal Peak Tier 2 Gas, and Needle Peak Gas.[117] Marathon is no longer required to provide Needle Peak Gas in 2011. ConocoPhillips only provides Base Load Gas after the first quarter of 2011. Therefore, the small third-party supplier must provide a higher level of deliverability than the two largest suppliers of natural gas in Cook Inlet if it seeks to supply relatively small amounts of gas to ENSTAR. It is doubtful that an independent supplier can provide a higher level of deliverability than Marathon itself is willing to provide. This provision is unreasonable on its face, is evidence of Marathon's ability to exclude competition, and is evidence of an excessive degree of control over the terms of the GSA by Marathon. We note that this provision may be inconsistent with our requirement that all future ENSTAR contracts shall be unbundled as to volume and price. To the extent that Section 2.4(b) of the Marathon GSA is inconsistent with our directive, we do not approve the inconsistent aspect of the provision.

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[114]E-6 (Slaughter Direct) at 12.

[115]H-3 (Marathon GSA) at 22-23 (§2.4(b)).

[116]H-1 at 8; H-3 (Marathon GSA) at 22 (§2.4(b)).

[117]H-3 (Marathon GSA) at 23 (§2.4(b)).

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The GSAs contain terms that allowed ConocoPhillips and Marathon to exert a significant degree of control over ENSTAR during these proceedings. Neither ConocoPhillips nor Marathon became a party to this docket. Neither ConocoPhillips nor Marathon filed a petition to intervene in this docket. Under the terms of its GSA:

- ConocoPhillips was affirmatively "not obligated" to file a petition to intervene in this docket;
- ENSTAR was required to provide copies of all pleadings in this docket to ConocoPhillips;
- ENSTAR was required to seek approval for filings that may include content that would impact ConocoPhillips' business in Cook Inlet; and
- ConocoPhillips could have objected and prevented ENSTAR from using content that would affect ConocoPhillips' business.[118]

Both GSAs allow the Producers to terminate the agreements if they determine that discovery requests are "unduly burdensome," while ConocoPhillips may terminate its GSA if it decides that discovery requests are "not relevant to the proceeding."[119] These provisions provide evidence that ConocoPhillips and Marathon possess the ability to exert significant influence over the terms of any sale of natural gas to ENSTAR.

ENSTAR describes the difficulty in meeting its full deliverability for all levels of demand and the consequences that may ensue in its prefiled testimony.[120] The difficulty in meeting deliverability relates to the large differential between ENSTAR's peak demand on the coldest day in the winter and its lowest demand during the

[118]H-2 (ConocoPhillips GSA) at 21-22 (§10.1(a)).

[119]H-2 (ConocoPhillips GSA) at 22 (§10.1(b)); H-3 (Marathon GSA) at 35 (§11.3).

[120]E-1 (Dubay Direct) at 9-11; E-6 (Slaughter Direct) at 5.

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summer.[121] The consequences of failure to meet full deliverability could include service interruptions during the coldest time of the year.[122] Yet, neither GSA will provide ENSTAR with full deliverability for all levels of demand beyond 2010. This shortcoming requires ENSTAR to obtain and implement storage prior to that time. While ENSTAR plans to do so, it has no concrete strategy in place at this time.[123] The deliverability tiers of the GSAs were developed in order to meet the Producers' desired efficiency range.[124] The Producers' implicit refusal to provide ENSTAR with gas at full deliverability throughout the length of the GSAs, and the GSAs' inherent requirement for ENSTAR to develop and implement storage by 2011, is evidence that ConocoPhillips and Marathon exerted significant influence on the deliverability terms of the GSAs.

We find that ConocoPhillips and Marathon have market power over ENSTAR in the Cook Inlet natural gas market. Further, we find that the GSAs that ENSTAR has submitted for approval in this docket contain terms that are affected by the Producers' exercise of their market power.

The finding that the Producers have market power over ENSTAR, and our earlier finding that Cook Inlet is a production area, in and of themselves do not require any particular action on our part in relation to the GSAs. However, the findings do affect our evaluation of whether the GSAs or particular terms within the GSAs are unjust, unreasonable, unduly discriminatory, or preferential when viewed in the context of Cook Inlet, which is unique among United States regional natural gas markets.

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[121]E-6 (Slaughter Direct) at 5.

[122]E-1 (Dubay Direct) at 10.

[123]*Id.* at 41-42; *Errata to Reply Testimony of Eugene N. Dubay,* filed July 21, 2008 (E-2) at 39.

[124]E-6 (Slaughter Direct) at 7; H-2 (ConocoPhillips GSA) at 10-11; Public hearing, dated August 4, 2008 (Vol. VII), Tr. at 1076 (Slaughter).

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GSA Price Terms

The parties presented widely varied viewpoints on the reasonableness of the pricing terms of the GSAs. ENSTAR presented evidence that the price terms are reasonable.[125] Regarding the ConocoPhillips GSA, ENSTAR stated, "The price was arrived at through arm's length negotiations. The Company agreed to this price because it is a reasonable market-based price for the value of natural gas in Cook Inlet."[126] Regarding the Marathon GSA ENSTAR similarly stated, "From the Company's perspective, I would also emphasize that this is a market-based price, negotiated at arm's length in the market in which ENSTAR must buy its gas supplies. It is the price that ENSTAR was required to pay to induce [Marathon Oil Company] to commit the gas to ENSTAR with all of the positive elements that the contract includes."[127] ENSTAR asserts that it is not realistic to expect it to obtain GSA terms that are not available in the market.[128] ENSTAR argues that the tier pricing provisions are reasonable and reflect the value of deliverability and seasonal swing services compared to the value of similar services such as storage.[129] ENSTAR acknowledges that there is some seasonal fluctuation due to demand built into the Energy Price.[130] ENSTAR states that based on its forecasts its calculations show that under the ConocoPhillips GSA, the tier structure

[125]E-1 (Dubay Direct) at 18-28; E-2 (Dubay Reply) at 26-30; E-4 (Carpenter Direct) at 5-9, 32-47; *Prepared Reply Testimony of Paul R. Carpenter,* filed July 14, 2008 (E-5) at 5-9.

[126]E-1 (Dubay Direct) at 19.

[127]*Id.* at 27.

[128]E-2 (Dubay Reply) at 9.

[129]E-4 (Carpenter Direct) at 4, 43-47; Vol. IV, Tr. at 499-501 (Dubay).

[130]Volume II, Tr. at 160 (Dubay).

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will add in the range of $0.95/Mcf[131] to $1.24/Mcf to the Energy Price for 2009.[132] Similarly, it states that based on its forecasts the Marathon GSA tier structure will add in the range of $.75/Mcf to $.88/Mcf to its Energy Price for 2009.[133] ENSTAR claims that the tier additions are not excessive when compared to benchmarks for storage services in Lower 48 markets.[134]

The AG presented evidence in support of his argument that the pricing provisions of the GSAs are not reasonable.[135] The AG claims that a reasonable price for Cook Inlet gas with full deliverability would be "the CICI market index proposed by [the Regulatory Affairs and Public Advocacy Section of the Department of Law] and used in the COP [ConocoPhillips] GSA. . . ."[136] The "CICI market index" proposed by the AG is composed of the same trading hubs utilized by the ConocoPhillips GSA to calculate an Energy Price.[137] The AG states that these trading hubs are reasonable because one, TCPL Alberta, AECO-C, "would be the first liquid point for Alaska gas flowing south by pipeline."[138] And, "The other four hubs have a closer regional affinity to Alaska than East Coast or Midwest hubs, and/or they are locations where Alaska LNG might someday be shipped."[139] The AG claims that the tier pricing provisions within the

[131]Mcf means one thousand standard cubic feet.

[132]E-4 (Carpenter Direct) at 45.

[133]*Id.*

[134]*Id.*

[135]R-1 (Klein) at 30-41.

[136]*Id.* at 41.

[137]*Id.* at 31, 41.

[138]*Id.* at 41.

[139]*Id.* at 41.

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GSAs are unreasonable.[140] Further, the AG asserts that the Energy Price under the GSAs is a yearly average that already includes costs for storage and seasonal swing.[141] The AG advocates for pricing provisions that average out to the CICI median price with discounts for base gas and adders for peaking gas.[142] However, the AG acknowledges that ENSTAR had limited bargaining power and that ENSTAR needs the gas provided by the GSAs.[143] Therefore, the AG recognizes that public policy may require approval of the GSAs.[144]

Chugach offered testimony that ENSTAR failed to present a compelling economic justification for the pricing provisions of the GSAs.[145] Chugach also presented testimony that the price provisions of the GSAs are unreasonable.[146] Chugach presented testimony suggesting that production basin indices are more appropriate pricing proxies for the Cook Inlet than trading hub and city gate indices.[147] Chugach also presented testimony that ENSTAR's weighted average cost of gas (WACOG) may be an "attractive" price for sellers.[148]

ENSTAR responded to Chugach's testimony claiming that production area prices are inappropriate for Cook Inlet as there is consumption as well as production in

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[140]R-1 (Klein) at 42-48.

[141]Vol. IX, Tr. at 1450 (Klein).

[142]R-1 (Klein) at 43.

[143]Vol. VIII, Tr. at 1325 (Klein).

[144]Vol. IX, Tr. at 1394 (Klein).

[145]C-1 (Leitzinger) at 3-27.

[146]C-3 (Gibson) at 3-23.

[147]*Id.* at 8-11.

[148]*Id.* at 13-17.

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Cook Inlet.[149] However, as noted by Chugach, there is generally consumption in a production basin.[150] Further, ENSTAR's witness Carpenter acknowledged during cross-examination that there is consumption in Lower 48 production areas.[151]

We stated in Order U-06-2(15) that the use of a market index to set the price terms for an ENSTAR GSA may be acceptable.[152] However, the use of the market index must be justified and reconciled with Cook Inlet market conditions.[153] We also stated that a GSA may not add costs for transportation or production taxes over and above the index price.[154] Further, we stated that the use of an index requires "a meaningful cap."[155]

The Union contract was intended to be an exploration contract, with a price Union represented it needed to explore and develop additional resources for the local utility market, and, specifically, for ENSTAR. Union's unwillingness to provide additional volumes to ENSTAR, discussed above, is further evidence supporting our conclusion in Order U-06-2(15) that attempts to justify the prices in an ENSTAR GSA through asserting the need to provide an exploration and development incentive in Cook Inlet have not been fully realized.[156]

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[149]E-5 (Carpenter Reply) at 35.

[150]Vol. XII, Tr. at 1976 (Gibson).

[151]Vol. V, Tr. at 707-708 (Carpenter).

[152]Order U-06-2(15) at 34.

[153]*Id.*

[154]*Id.*

[155]*Id.*

[156]*Id.* at 24-27.

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Meaningful Price Cap

The price that ENSTAR pays for natural gas is passed on to its ratepayers. Residential customers need gas for space heating purposes and their demand is fairly inelastic.[157] For the price terms of ENSTAR's GSAs to be reasonable, or for the cap on a market index to be meaningful, they must bear some relationship to the characteristics that exist in Cook Inlet. We find that it is in the public interest to place a dynamic market-based cap on the burden ratepayers are required to bear. For this cap to be meaningful, we tie it to production-area market prices. This is appropriate given the unique nature of Cook Inlet as a production area that exports a significant amount of its natural gas beyond its immediate geographic boundaries and is home to the only LNG export plant in the United States. The cap is necessary to protect the public interest given the market power over ENSTAR that is held by the Producers.

Based on the record presented in this proceeding, we find that a ConocoPhillips GSA Price Cap and a Marathon GSA Price Cap based on the El Paso, Permian Basin; Panhandle, Tx.-Okla.; El Paso, San Juan Basin; Kern River, Opal Plant; and TCPL Alberta, AECO-C trading locations will provide a meaningful and appropriate cap for price terms in ENSTAR's GSAs with ConocoPhillips and Marathon.[158] The Price Cap shall be calculated based on the twelve month trailing average of the trading locations and is further explained in Appendix D and Appendix E to this order. The ConocoPhillips Price Cap and the Marathon Price Cap include production taxes and royalties.

[157] Vol. V, Tr. at 638 (Carpenter).

[158] *See* Ex. H-45, *Production Prices vs. Consumption Prices* (H-45); *Prefiled Direct Testimony of Suzanne L. Gibson,* filed June 24, 2008 (C-3) SLG-3.

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The trading locations were selected because they are net producing locations and export gas beyond their immediate geographic vicinity.[159] They are located in the United States and Canada with geographic diversity to dampen risk. The trading locations are transparent with daily trading volumes.[160] These factors work together to provide a meaningful cap that will help to ameliorate any unreasonable price terms within the GSAs. Correspondingly, the ConocoPhillips Price Cap and the Marathon Price Cap also recognize the need for the Producers to earn market based rates.[161]

Based on our review of the pricing information provided by ENSTAR we find that, with one modification, the calculations embodied in the tier structure for base, seasonal and needle peak gas in the Marathon GSA, is a more accurate representation of seasonal price fluctuations than the calculations embodied in the tier structure proposed by the ConocoPhillips GSA.[162] We do require a minor modification to the price structure for Base Load Gas and Seasonal Peak Tier 1 Gas in the Marathon GSA (§3.1(a)) for purposes of calculating the Marathon Price Cap. Base Load Gas and Seasonal Peak Tier 1 Gas are used year-round, and gas from both tiers is taken every day of the contract year.[163] Therefore it is unreasonable to segment these tiers and unreasonable to charge a 5 percent premium for a portion of this year-round gas. We require the Marathon GSA Price Cap to be calculated such that Base Load Gas and

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[159]E-5 (Carpenter Reply) at 39; C-3 (Gibson Direct) at 9; H-45; Vol. III, Tr. at 208-209 (Dubay); Vol. V, Tr. at 714, 717 (Carpenter); Vol. XII, Tr. at 1975-1977 (Gibson).

[160]*See* C-3 (Gibson Direct), SLG-3.

[161]*See* E-1 (Dubay Direct) at 33; Vol. III, Tr. at 208-209 (Dubay).

[162]*See* H-68 (Carpenter work papers, excel spreadsheet).

[163]E-6 (Slaughter Direct) at 8.

Seasonal Peak Tier 1 Gas are priced at 100 percent of the Energy Price. We are allowing tier additions in the calculation of the Price Caps to recognize the need to compensate the Producers for services such as meeting quality specifications and transporting gas to ENSTAR's system.[164]

We find that the floating market-based caps based on production area trading locations are an appropriate limit and price signal for ENSTAR GSAs given the current market conditions. The ConocoPhillips Price Cap and the Marathon Price Cap shall remain in effect as long as natural gas is exported from Cook Inlet or there are ongoing activities leading to the export of natural gas.

Tier Pricing

We find that storage costs are embedded in the tiers. Therefore, the value of storage is hidden and difficult to analyze. Further, we find that the evidence shows that the tier demarcations were Producer-efficiency driven and then retroactively superimposed on ENSTAR's seasonal demand profile.[165] However, we recognize that ENSTAR's forecasts indicate a need for the gas supplied by these GSAs in 2009. We find that the pricing tiers in these GSAs are the beginning of unbundled pricing of supply to ENSTAR. While imperfect, the tiers are an interim step to achieve unbundled rates. We require the next GSAs filed by ENSTAR for our approval to be fully unbundled, including pricing for storage. We explicitly do not endorse the tier structure in either of the current GSAs; however in the absence of storage, some seasonal differential pricing may be appropriate. In light of the forecasted immediate need for gas and the very tight deliverability constraints in Cook Inlet, and provided that the GSAs are amended to

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[164]*See* E-5 (Carpenter Reply) at 35.

[165]E-6 (Slaughter Direct) at 7; H-2 (ConocoPhillips GSA) at 10.

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incorporate the ConocoPhillips Price Cap and the Marathon GSA Price Cap, respectively, we do not find the tier structures unreasonable.

<u>ConocoPhillips Quarterly Price Adjustment</u>

The AG expressed concern that the quarterly price adjustment contained within the ConocoPhillips GSA[166] presented the potential for rate shock.[167] In response, ENSTAR presented testimony that the quarterly adjustment would dampen any potential swings in pricing.[168] Further, the AG acknowledged that the volumes subject to the quarterly adjustment are small and the potential impact would not be significant.[169] We do not find that the quarterly price adjustment term in the ConocoPhillips GSA is unreasonable.

<u>Public Interest</u>

We find that the public interest is served through ENSTAR's entering into GSAs with terms that are not unreasonable and which reflect the characteristics of the Cook Inlet natural gas production area. We find that ENSTAR acted in a prudent fashion to enter into the ConocoPhillips and Marathon GSAs and that the future gas supplies provided for under the GSAs are reliable. We find that the public interest requires a floating market-based cap on the price terms of the GSAs that reflects the Cook Inlet's unique status as a production area that exports natural gas beyond its immediate geographic area and outside of the United States. The ConocoPhillips GSA Price Cap and the Marathon GSA Price cap are required to help militate against the market power and resultant imbalance in bargaining power held by the Producers over

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[166]H-2 (ConocoPhillips GSA) at 15 (§3.3).

[167]R-1 (Klein) at 48-49.

[168]Vol. II, Tr. at 168-170 (Dubay).

[169]Vol. VIII, Tr. at 1348-1351 (Klein).

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ENSTAR. We find that approval of the GSAs, with the conditions described in the order above, is in the public interest. We require ENSTAR to amend the GSAs to incorporate the appropriate Price Cap.

Involvement of Other Government Agencies

Evidence presented in this record has made clear that it is the State of Alaska, Department of Natural Resources (DNR), which has the ability to require and approve plans of development by natural gas producers.[170] Further, DNR has the ability to influence exploration and development at the time the Producers appear before the DOE to request an extension of their export authorization.[171] It is the United States of America Department of Energy (DOE) which has the ability to place conditions on the Producers' authorization to export natural gas. Our role in the regulatory regime is to review the ENSTAR GSAs presented in this docket in order to hold utility prices to a reasonable level.[172]

In the recent proceedings before the DOE, DNR and the State Attorney General, on behalf of the State as a resource owner,[173] entered into a settlement agreement with ConocoPhillips and Marathon that resulted in the State's unconditional support for the Producers' export application.[174] As a part of the settlement agreement, ConocoPhillips and Marathon committed to act in good faith, in their sole discretion, to complete gas supply agreements with ENSTAR that we would find approvable.[175] The

[170]Tr. at 1826-28 (Hosie).

[171]*See e.g.,* Tr. at 1893-94 (Dubay); CMK-5 at 1, 6, 9-12.

[172]Order U-06-2(15) at 32.

[173]The Attorney General, Regulatory Affairs & Public Advocate was not a party to the settlement agreement.

[174]CMK-5 at 1-2.

[175]CMK-5 at 8.

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recent authorization to export LNG allows the Producers to export up to 98.1 Bcf of LNG between April 2009 and March 2011.[176] In contrast, the ConocoPhillips GSA and Marathon GSA combine to provide 37.8 Bcf of natural gas to local ratepayers through ENSTAR, a local utility. As explained above, we have concerns about the GSAs and are able to approve them only after amendment to incorporate a Price Cap. Based on our review of the record, we find that the DOE's decision to extend the Producers' export authority negatively impacted ENSTAR's negotiating position and the resulting terms of the ConocoPhillips GSA and the Marathon GSA. We recognize that the LNG export facility is a benefit to the State of Alaska as a whole and that the export of LNG stimulates exploration and development of new reserves. However, it is in the best interests of local utility ratepayers to require the Producers to finalize contracts with local utilities before receiving authorization to export natural gas. Therefore, we request that DNR require the Producers to provide completed gas supply agreements, which we have approved, with local utilities before supporting any future export applications from the Producers. Additionally, we request that DOE require the Producers to provide completed gas supply agreements, which we have approved, with local utilities before granting future applications for authorization to export LNG.

Final Order

This order constitutes the final decision in this proceeding. This decision may be appealed within thirty days of the date of this order in accordance with AS 22.10.020(d) and the Alaska Rules of Court, Rule of Appellate Procedure (Ak. R. App. P.) 602(a)(2). In addition to the appellate rights afforded by AS 22.10.020(d), a party has the right to file a petition for reconsideration as permitted

[176]H-37 (DOE Order) at 70.

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by 3 AAC 48.105. If such a petition is filed, the time period for filing an appeal is then calculated under Ak. R. App. P. 602(a)(2).

ORDER

THE COMMISSION FURTHER ORDERS:

1. The *Gas Sales Agreement Between ConocoPhillips Alaska, Inc. and Alaska Pipeline Company*, filed with TA167-4 on April 11, 2008, is approved, subject to filing of an amendment that incorporates the ConocoPhillips GSA Price Cap described in this order.

2. By 4 p.m., December 1, 2008, ENSTAR Natural Gas Company, a Division of SEMCO Energy, Inc. shall file an amendment to the *Gas Sales Agreement Between ConocoPhillips Alaska, Inc. and Alaska Pipeline Company,* filed with TA167-4, that incorporates the ConocoPhillips GSA Price Cap described in this order.

3. The *Gas Sales Agreement Between Marathon Oil Company and Alaska Pipeline Company*, filed with TA167-4 on April 11, 2008, is approved, subject to filing of an amendment that incorporates the Marathon GSA Price Cap described in this order; and subject to the further exception that any aspect of Section 2.4(b) of the agreement that is inconsistent with our directive that future ENSTAR gas sales agreements shall be unbundled as to price and volume is not approved.

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4. By 4 p.m., December 1, 2008, ENSTAR Natural Gas Company, a Division of SEMCO Energy, Inc. shall file an amendment to the *Gas Sales Agreement Between Marathon Oil Company and Alaska Pipeline Company*, filed with TA167-4, that incorporates the Marathon GSA Price Cap described in this order.

DATED AND EFFECTIVE at Anchorage, Alaska, this 31st day of October, 2008.

BY DIRECTION OF THE COMMISSION

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