8/31/10

Background and Talking Points for House Energy Committee Meeting on 9/1/2010

1. Description of Project

- CINGSA is a 70/30 partnership between Semco Energy (ENSTAR's parent company) and MidAmerican energy. The estimated cost of the project is $180MM.
- The project is intended to provide reliable delivery and encourage development of Cook Inlet gas. For example, ENSTAR's peak winter demand can be up to 14X higher than the summer lows.
- The initial capacity of the project is 11 BCF, expandable to 18 BCF. The maximum injection/withdrawal rate is 150 MMCFD.
- The project will consist of 5 injection/withdrawal wells on a 7 acres lease from DNR, a separate 7.5 acre compression/gas conditioning facility on land CINGSA purchased from the University, and associated pipelines connecting these facilities with the gas storage lease (which will be within the current Cannery Loop unit) and the Kenai-Nikiski Pipeline. The wellpad area has been designed to allow for the installation of 2 additional injection/withdrawal wells, if necessary.
- CINGSA's schedule has permitting complete by November 2010; surface and sub-surface construction completed and first injection by late summer of 2012, and first withdrawal by winter 2012/13.

2. Non-DNR Regulatory Issues

- The AOGCC has scheduled a public hearing on CINGSA's Storage Injection Order application for October, 2010. To the best of our knowledge, there are no outstanding issues.
- The current agreement between CINGSA and ENSTAR could fall apart if the RCA does not approve CINGSA's application for a CPCN by 1/31/11. CINGSA has requested expedited consideration, which is likely to be approved. Interestingly, MEA has opposed expedited consideration asserting that approval of the project would represent a de facto commitment of credit capacity of Southcentral utilities and raise the bar for other projects. RAPA has raised issues regarding CINGSA's rate structure, maintaining inception rates for 5 years (rather than being subject to an earlier "true-up) and other factor, such as a proposed 50/50 dept equity structure.

3. Tariffs and Third Party Access

- Tariffs - **Capacity Rate**: $0.13 / MCF / Month * 11 BCF * 12 months / year = $17 MM / year: **Volumetric Rate**: $9.95 / MCF / Month * 150000 MCF * 12 months / year = $18 MM / year: **Total Fixed cost of system for firm service** is $35 MM per year: Usage charge is $0.016 / MCF

- If all of the capacity were used one time each year the effective cost would be about \$3.30 / MCF. Assuming the system uses 90 BCF per year, the average cost per MCF is about \$0.40 / MCF. While the \$3.30 / MCF charge is high for the stored gas, when averaged across the gas consumption the cost seen by the consumer is more palatable.
- Third Party Access –
  - a) Any Customer may request CINGSA to increase design capacity
  - b) CINGSA is obligated to hold an open season "on a commercially reasonable basis".
  - c) All open season bids "shall be evaluated on a non-discriminatory basis"; bidders must meet the existing tariff terms on creditworthiness
  - d) Post open season, CINGSA informs bidders of non-discriminatory capacity award, and indicative costs and rates that are consistent with the pre-existing tariff.
  - e) Bidders have 30 days to sign an expansion firm storage service agreement (precedent agreement)
  - f) After bids have been tendered, "seller shall proceed with the expansion if it is technically feasible and commercially reasonable."
- CINGSA, in other words, commits to expand if doing so is "commercially reasonable and technically feasible". Should there be a dispute about this from an aggrieved shipper, the RCA can be brought in to help resolve the question of what "commercially reasonable" means in a given instance.
- Because of the existence of a regulatory backstop this is, in essence, all that is necessary to ensure adequate third party (so long as the regulators do their job).

B. DNR Issues

1. The Oil and Gas Lease

- The Division has met with both Marathon and CINGSA (when it was CINGS) about assigning Marathon's interest in the underlying oil and gas leases to CINGSA. Marathon and CINGSA have not yet completed their negotiations. There are a number of outstanding issues.

2. Gas Storage Lease

- Major terms of the storage lease are agreed upon. It's for an initial term of 15 years, with a 5 year renewal provision. It consistent with the provisions HB 280. Under HB 280, the fee is waived for 10 years, and withdrawn gas is considered to be non-native until the cumulative withdrawn volume of gas exceeds the cumulative injected volume.

3. DNR Land Use and Permitting

- In addition to the gas storage lease discussed above, the project requires the following State permits and approvals: plans of development and operations; a surface lease; a pipeline easement and land classification order; an ACMP consistency determination; an AOGCC storage injection order; an RCA issued CPCN; and a DEC issued air permit and 401 water quality certification.

- All of these permits are on track to being noticed and finalized consistent with CINGSA's schedule.
- The DNR surface lease, pipeline easement, land classification and ACMP consistency determination all went out for public review on July 26, 2010 (the gas storage lease was also included in the package but is not subject to public review), and there was a public meeting held in Kenai on August 5, 2010. Seven comments, both critical and supportive, were received by the August 24th deadline. The department is currently reviewing and preparing to respond to the public comments.
- The final ACMP determination is scheduled for September 13, 2010, and agency permits may be issued as soon as five days after that.
- There are, however, two land issues that must still be resolved. The first involves the 7 acre surface lease from DNR for the wetlands that lies within lands purchased under a North American Wetlands Act (NAWCA) grant for conservation purposes. The 7 acres must be "converted" from its current conservation status and substitute lands acceptable under the NAWCA grant must be provided. CINGSA must therefore purchase substitute lands of equal or greater value and donate those lands to DNR for management under terms acceptable to NAWCA. Finalization of the acquisition, and NAWCA acceptance, of suitable replacement lands may delay start up of wellpad clearing.
- The second involves an old Chevron well that sits next to a fish cannery. CINGSA has said, to ensure safe operation of the gas storage facility, it must re-enter and completely plug to a higher standard an old plugged and abandoned exploration well which intercepts the gas storage reservoir. That exploration well is beneath pavement immediately adjacent to a building on land leased by the City of Kenai for the fish cannery operation. Re-entry and plugging the well would require demolishing the adjacent building and CINGSA is still trying to come to terms with the lessee about this.