

# An Alaska Natural Gas Future *for Alaskans*

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

*Presentation to the Senate Finance Committee, April 5, 2013*

# Alaska Gas for Alaskans

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By 2010, frustration with a lack of progress on a big line

- Trying to make others develop a pipeline for Alaska, on our terms, wasn't delivering the results Alaskans wanted

Fresh approach: Decide what Alaska wants, and do it ourselves

- In-state energy as primary driver
- Use the state as a catalyst
- Make use of existing work, investment
- Provide opportunities for private sector partners

Legislature in 2010 passed HB 369: AGDC charged with the mission of getting Alaska gas to Alaskans

- Electric and home heating costs
- Economic development for communities
- Industrial development opportunities - jobs

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## House Bill 369 of 2010 goals:

1. Build a team under AHFC leadership
2. Consolidate state's gas pipeline work to date
3. Fill in data gaps; decide optimal route
4. Report back to the Legislature with a project plan

*House Bill 369 passed with broad, bipartisan support*

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## AGDC delivered with the July 2011 Project Plan

- A pipeline for Alaskans is possible; an in-state line could deliver competitively priced gas
- Projects will require firm, long-term contracts to support financing

## Including recommendations for legislative action:

- AGDC to determine pipeline ownership structure; work confidentially with private sector partners; operate as contract carrier; decide rates and terms
- State to waive property taxes and state land lease fees; provide sufficient funding and create a pipeline fund; limit judicial review

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## Now, House Bill 4:

- Provides further direction for AGDC
- Provides the framework for AGDC to serve as Alaska's natural gas pipeline corporation
- Maximizes state's efforts in gas pipeline development
- Resolves regulatory uncertainties while supporting future development of Alaska resources
- Includes AGDC recommendations
- Maintains momentum – delays hurt!
  - AGDC estimates \$200 million per year inflation
  - Southcentral gas supply (and costs) increasingly uncertain
  - Fairbanks energy costs and air quality – no end in sight
  - As urban costs increase, rural communities hurt more
  - Continuing expectation for state to offset high cost

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## HB 4: Establishes AGDC as Alaska's gas pipeline entity

- Section 3; transition language in Section 1, Section 25
- HB 4 moves AGDC from its present location as a subsidiary of Alaska Housing Finance, to a stand-alone state corporation
- Locates AGDC under Department of Commerce, Community and Economic Development *for administrative purposes only*
  - AGDC will be governed by a 7-member board with expertise in relevant fields, appointed by the governor, confirmed by the legislature. 5 public members, two commissioners
- Provides clear transition language

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## Clearly states AGDC's purpose (Section 3):

- To advance an instate gas pipeline as described in the July 2011 project plan, with modifications as appropriate, making gas available to Fairbanks, Southcentral, and other communities in the state at the lowest rates possible;
- To develop pipelines serving utility and industrial customers, at commercial reasonable rates;
- To develop pipelines offering commercial rates to shippers and that offer access for shippers producing gas in Alaska
- Once a mainline is complete, to consider additional pipelines to extend the reach of gas to other communities, industrial users
- Pipelines should also be developed to make propane and other non-oil, gas-related materials available to Alaskans

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Provides statutory abilities to AGDC to function as a corporation and to accomplish its purpose (Sec. 3)

AGDC may:

- Enter into ownership and operating partnerships
- Create subsidiaries, including a subsidiary to market gas
- Issue revenue bonds limited to AGDC's own backing to finance a pipeline
- Enter into confidentiality agreements necessary to participate with private sector shippers, partners, financiers
- Keep confidential information like field studies and tariff models that are assets AGDC is developing for the state
- Exercise the state's existing power of eminent domain



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## House Bill 4 also:

- Exempts AGDC from the state procurement code and state personnel act (Section 3; and Sections 4 and 14)
  - \* (AGDC is currently exempt from the procurement code as an AHFC subsidiary (per HB 369 of 2010))
- Exempts AGDC's operating budget only from the Executive Budget Act (Section 3)
- Applies public official disclosure rules to AGDC board members (Section 15)

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## HB 4: Maximizes state's efforts in gas pipeline development

- Additional state support for a project in the public's interest will help reduce delays and keep costs as low as possible
  - Limits judicial review of state permitting decisions and authorizations to avoid delays (Section 13)
  - Directs DNR to waive annual fees on a state right-of-way lease for AGDC (Section 3; Section 12)
  - Waives state and local property taxes during pipeline construction (Section 22)
  - Sunsets the Alaska Natural Gas Development Authority, per a 2010 Leg Audit recommendation

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- Directs AGDC to avoid duplicating other state work
- Requires state entities to cooperate and share information with AGDC (Section 3)
  - AGDC requests receive priority (except for AGIA requests)
  - AGDC and state entities can enter into confidentiality agreements if necessary to protect third-party information in the state's possession
- Calls on the state to provide water, sand, gravel, and other non-hydrocarbon natural resources to AGDC (Section 3)
  - AGDC will pay usual prices; cost cannot be included in tariff base and passed on to pipeline shippers

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## Resolves regulatory uncertainties

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

## House Bill 4:

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

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## Why a contract carrier?

- Shippers need to know that the space they are 'reserving' by signing long-term commitments will be available
- Those firm, uninterruptible contracts are the way gas pipelines are usually financed: future income promised through contracts secures revenue bonds
- Ensures gas customers (utilities, industry) their shipments are reliable and will not be curtailed
- House Bill 4 establishes contract carrier status while providing for expansions in the future

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## Interfaces

- Key common carriage principles – expansions, access – are retained
- Contract carriage is allowed
- Interface between right-of-way leasing act and new regulatory chapter for instate contract carrier natural gas pipelines:
  - Both require expansions on commercially reasonable terms
  - Both allow that expansions cannot make an initial shipper pay more than is allowed per the shipper's contract with the pipeline
  - Both sections require a pipeline to offer service without undue discrimination
  - Open season oversight by the RCA ensures that new entrants have opportunity
  - Capacity availability notification rules in Sec. 21 ensure new entrants have opportunity

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## Right-of-Way Leasing Act

- Section 11: Sections 6, 8, 9 and 10 are conforming
- Includes a set of 14 covenants a lessee must agree to
- HB 4 modifies covenants reflecting common carrier principles, to allow for contract carriage
  - Covenants (a) (3), (4), (6), (7), (8), (9), (10), (11), (12), (13), and (14) apply to both common carrier pipelines and to contract carrier natural gas pipelines
  - Covenants (a) (1), (2) and (5) are rebuilt to retain the general policy principle while allowing for contract carriage
    - Contracts govern terms for connections, facilities
    - Expansions required on commercially reasonable terms
    - Ship without discrimination

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## Regulatory Commission of Alaska oversight for a contract carrier gas pipeline

- Section 21 is new regulatory chapter; Section 18 is related. Sections 19, 20, 5 are conforming)
- New kind of regulation for Alaska, for a new kind of pipeline
- Multiple-stage review by RCA
- Contract carrier concepts derived from federal process
- Provisions built in for Alaska concerns
- Provides certainty and protection for public utilities
- Sets timelines for thorough review that also support commercial process



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## Terms

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

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

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

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

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## Overview: The Process

1. Pipeline puts together a project – engineering, design, cost estimate
2. Develops tariff – a combination of rates and terms/conditions of service – to present to potential customers
3. Pipeline has to file the tariff as a ‘recourse tariff’ with the RCA before entering contracts, before open season  
Supported by a full cost study
4. Recourse tariff is the default rate; customers can negotiate final price

*HB 4 requires RCA pre-approval of recourse tariff before an open season*

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When does a recourse tariff come into play?

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

Why?

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

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## Recourse tariff:

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

- Supported by a full cost study
- Must include procedures for conducting open seasons

RCA has 90 days to review; may suspend for additional 90 days

- Terms and conditions not unduly discriminatory
- Rates cost-based
- Proposed rate of return, capital structure, depreciation reasonable

*(Reasonable = commonly accepted or used by the RCA or FERC)*

Same process for revisions in the future

- RCA has 90 days to act on revisions

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With approved initial recourse tariff, pipeline holds an open season

- RCA oversees open season
- Commercial negotiations
- Precedent agreement

Overall, 3 ways to get pipeline service:

1. Negotiated contracts in open season
2. Recourse tariff
3. Presubscription agreements

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## Just and Reasonable – What does it mean?

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

Just: Everyone is treated fairly and in a reasonable way

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

How do we know?

Was the contract made at arm's length?

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

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## Meeting the Arm's Length Standard

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

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

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

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

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

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

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

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

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

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## Certificate of Public Convenience and Necessity

CPCN required: Legislature makes special findings only for AGDC

1. Required for the public convenience and necessity (Sec. 1)
2. In the best interests of the state (Sec. 1)
3. Per Sec. 21, 42.08.020:
  1. AGDC is financially fit willing and able (because it is a corporation of the state)
  2. AGDC's board of directors and officers are managerially fit, willing and able (because the Governor has appointed directors with the precise qualifications required by HB 4)
  3. An AGDC pipeline is required for the public convenience and necessity (evidenced by the Legislature creating a state corporation to pursue gas pipeline projects)
4. Per Sec. 21, 42.08.020(e): The RCA shall determine whether the AGDC is technically fit, willing and able



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

At that point, the pipeline has to go back to the RCA with that 'actual' information, and update the initial recourse tariff

The pipeline also has to update the recourse tariff in the future, whenever the pipeline plans an open season to expand the pipeline

Revisions do not affect contractual, negotiated rates

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## Excessive rates of return protection

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

- Detailed current cost study every three years
  - Includes calculation of 3-year average actual return on equity
- RCA reviews: do rate elements 'match' allowable
- Excess profit into segregated operating reserve fund
  - Capped at 20% average annual operating costs
- If excess remains, reduce firm service rates for all shippers over next 3 years
- Pipeline can draw on reserve account when operating costs are high

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## Disputes

- Contracts between shippers and a pipeline can include a dispute resolution method
  - Method must be in resource tariff terms and conditions, uniform
  - Notify all shippers and creditworthy potential shippers
  - Allow existing and potential new shippers to participate
  - Culminate in independent third party/panel
- When can RCA step in?
  - Disputes related to things not covered in contracts
  - Complaints brought by someone who doesn't have a shipping contract
  - Complaints about expansions and open season conduct
  - Disputes that pose an immediate threat to the public health and safety

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## The Future

Expansions are required on commercially reasonable terms (providing they do not violate AGIA)

- Must include an open season
- Same process as initial capacity: recourse tariff, open season, negotiated contracts, precedent agreements, updated recourse tariffs

Excess capacity at any time must be noticed and offered

Thank you

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

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