

**ALASKA STATE LEGISLATURE**  
**SENATE SPECIAL COMMITTEE ON NATURAL GAS DEVELOPMENT**

July 25, 2006  
9:16 a.m.

**MEMBERS PRESENT**

Senator Ralph Seekins, Chair  
Senator Lyda Green  
Senator Gary Wilken  
Senator Fred Dyson  
Senator Kim Elton  
Senator Bert Stedman  
Senator Lyman Hoffman  
Senator Thomas Wagoner  
Senator Ben Stevens  
Senator Con Bunde  
Senator Donny Olson

**MEMBERS ABSENT**

Senator Albert Kookesh

**OTHER LEGISLATORS PRESENT**

Senator Gene Therriault  
Senator Gary Stevens  
Senator Charlie Huggins  
Representative Ralph Samuels

**COMMITTEE CALENDAR**

SENATE BILL NO. 3001

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the production tax; amending the definition of 'gas' as that definition applies in the Alaska Stranded Gas Development Act; making conforming amendments; and providing for an effective date."

HEARD AND HELD

SENATE BILL NO. 3002

"An Act relating to the Alaska Stranded Gas Development Act; relating to municipal impact money received under the terms of a stranded gas fiscal contract; relating to determination of full and true value of property and required contributions for

education in municipalities affected by stranded gas fiscal contracts; and providing for an effective date."

HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SB3001

SHORT TITLE: OIL/GAS PROD. TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

07/12/06	(S)	READ THE FIRST TIME - REFERRALS
07/12/06	(S)	NGD
07/13/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/13/06	(S)	Heard & Held
07/13/06	(S)	MINUTE(NGD)
07/14/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/14/06	(S)	Heard & Held
07/14/06	(S)	MINUTE(NGD)
07/24/06	(S)	NGD AT 1:30 PM SENATE FINANCE 532
07/24/06	(S)	Scheduled But Not Heard
07/25/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532

BILL: SB3002

SHORT TITLE: STRANDED GAS AMENDMENTS

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

07/12/06	(S)	READ THE FIRST TIME - REFERRALS
07/12/06	(S)	NGD
07/13/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/13/06	(S)	Heard & Held
07/13/06	(S)	MINUTE(NGD)
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07/14/06	(S)	MINUTE(NGD)
07/24/06	(S)	NGD AT 1:30 PM SENATE FINANCE 532
07/24/06	(S)	Heard & Held
07/24/06	(S)	MINUTE(NGD)
07/25/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532

**WITNESS REGISTER**

BOB LOEFFLER  
Morrison & Foerster  
Counsel to the Governor  
Office of the Governor  
PO Box 110001  
Juneau, AK 99811-0001

**POSITION STATEMENT:** Testified during the hearing on SB 3001 and SB 3002 and answered questions.

ROBERT J. CUPINA, Deputy Director for Policy  
Office of Energy Projects  
Federal Energy Regulatory Commission (FERC)  
Washington, DC

**POSITION STATEMENT:** Answered FERC-related questions during the hearing on SB 3001 and SB 3002.

JACQUELINE HOLMES, Associate General Counsel  
for Energy Projects  
Federal Energy Regulatory Commission  
Washington, DC

**POSITION STATEMENT:** Answered FERC-related questions during the hearing on SB 3001 and SB 3002.

REPRESENTATIVE RALPH SAMUELS  
Alaska State Legislature  
Alaska State Capitol  
Juneau, AK 99801-1182

**POSITION STATEMENT:** Asked a question during the hearing on SB 3001 and SB 3002.

ROBERT PEASE  
Division of Investigations  
Office of Enforcement  
Federal Energy Regulatory Commission  
Washington, DC

**POSITION STATEMENT:** Answered FERC-related questions during the hearing on SB 3001 and SB 3002.

KEN GRIFFIN, Deputy Commissioner  
Department of Natural Resources  
400 Willoughby Avenue  
Juneau, AK 99801-1724

**POSITION STATEMENT:** Testified during the hearing on SB 3001 and SB 3002.

KAROL LYN NEWMAN  
Morgan, Lewis & Bockius LLP  
Washington, DC

**POSITION STATEMENT:** Testified on behalf of Anadarko Petroleum Corporation during the hearing on SB 3001 and SB 3002.

SENATOR GENE THERRIAULT  
Alaska State Legislature

Alaska State Capitol  
Juneau, AK 99801-1182

**POSITION STATEMENT:** Testified during the hearing on SB 3001 and SB 3002.

DAVID VAN TUYL, Commercial Manager  
Alaska Gas Group  
BP

**POSITION STATEMENT:** Testified during the hearing on SB 3001 and SB 3002.

BRADFORD G. KEITHLEY  
Jones Day  
Dallas, TX

**POSITION STATEMENT:** Testified at the request of BP during the hearing on SB 3001 and SB 3002.

S.A. (BILL) McMAHON, JR.  
Alaska Gas Development  
ExxonMobil Production Company  
Houston, TX

**POSITION STATEMENT:** Testified during the hearing on SB 3001 and SB 3002.

#### **ACTION NARRATIVE**

**CHAIR RALPH SEEKINS** called the Senate Special Committee on Natural Gas Development meeting to order at [9:16:36 AM](#). Present at the call to order were Senators Bert Stedman, Gary Wilken, Fred Dyson, Kim Elton, Lyman Hoffman, Ben Stevens, Thomas Wagoner, Lyda Green and Chair Ralph Seekins; Senators Con Bunde and Donny Olson arrived soon thereafter. Also present were Senators Gary Stevens, Gene Therriault and Charlie Huggins, and Representative Ralph Samuels.

#### **SB 3001-OIL/GAS PROD. TAX** **SB 3002-STRANDED GAS AMENDMENTS**

[9:16:36 AM](#)

CHAIR SEEKINS opened the hearing on SB 3001 and SB 3002. He noted in a letter to the Federal Energy Regulatory Commission (FERC) the committee had requested discussion of the following with respect to the proposed gas pipeline: FERC's July 10 report to Congress; its prefiling application process; its powers to ensure access to capacity on the pipeline for shippers and prospective shippers not affiliated with pipeline owners; FERC's review of competition issues as part of its processing of

a certificate application; its enforcement powers and procedures with respect to affiliate relationships in a producer-owned Alaska gas pipeline, including the response time of the enforcement hotline; and FERC's review, if any, relating to anticompetitive behavior for a pipeline, including the concept of "basin control."

[9:19:45 AM](#)

BOB LOEFFLER, Morrison & Foerster, Counsel to the Governor, informed listeners he has been counsel to the state in pipeline matters for a long time. Recalling previous discussion of FERC's role and authority, he advised members that this morning he'd added expansion issues to the agenda through an e-mail. He said the FERC representatives, who were on teleconference from Washington, D.C., would answer questions rather than provide testimony as such.

ROBERT J. CUPINA, Deputy Director for Policy, Office of Energy Projects, Federal Energy Regulatory Commission, introduced himself as well as Bob Pease and Jacqueline Holmes; he noted Jeff Wright might join in, depending on the questions.

[9:22:33 AM](#)

CHAIR SEEKINS highlighted expansion and basin control. He asked what safeguards, policies and procedures are in place to preclude basin control if, for example, the three major producers were to hinder access to the proposed pipeline to keep others out of the gas-production business.

MR. CUPINA responded that before there is expansion, there must be a pipe. He indicated FERC laid the groundwork for the capacity in the initial pipeline to be sold on a nondiscriminatory basis when it did its open season rule, as required under the 2004 Act. That was the beginning of ensuring that everyone interested in capacity has an equal opportunity. Once a pipeline is in place and expansion becomes justified because of increased volumes, the pipeline would conduct another open season on the expansion capacity, going through the same process; owners, non-owners and all potential shippers would be under the same terms and conditions to bid for that service.

[9:25:54 AM](#)

CHAIR SEEKINS reported hearing that there is a difficult process in order to get to the expansion.

MR. CUPINA explained that under that same 2004 Act, the Alaska Natural Gas Pipeline Act (ANGPA), two types of expansion are

contemplated. The first, voluntary expansion, is common for interstate pipelines. When a pipeline following its business model deems that an expansion is profitable, it will go into an open season to gauge market interest.

He said the second, mandatory or involuntary expansion, is a brand-new legal authority under ANSPA that applies only to an Alaska gas pipeline. It would enable a potential shipper to file a complaint with FERC, saying it wants an expansion but the pipeline has refused, and asking FERC to order it. Mr. Cupina suggested the argument could be made that because this hasn't been fully tested, it could be subject to an on-the-record complaint proceeding.

CHAIR SEEKINS asked why it was included only for an Alaska gas pipeline and not elsewhere in the country.

9:29:00 AM

MR. CUPINA replied he believes there were a number of variations from FERC's normal policy in that Act, specific to Alaska, recognizing there probably would be only one pipeline, and taking into account concerns of other stakeholders, smaller producers in the state that might want gas before it leaves Alaska and so on. Thus ANSPA was targeted to address some concerns that don't necessarily apply in the Lower 48, where there often is competition between pipelines.

SENATOR WILKEN noted a question has come up with respect to the difficulty new explorers have in accessing the oil pipeline today; he cited examples. He related his understanding that expansion of the proposed gas pipeline beyond 25 percent will no longer allow cheap compressor expansion, but will require expensive looping and additional compressors. He asked in what manner the state and producers will say to FERC that economically they prefer rolled-in pricing rather than incremental pricing on any expansion, to avoid the problems of today, and so new producers can have access 20 years from now and not be burdened with the complete incremental cost of expansion beyond that 25 percent.

9:32:43 AM

MR. CUPINA answered that is a good example of where FERC deviated from its standard policy. On expansions going forward there will be a rebuttable presumption that costs are rolled in. The standard policy, by contrast, is they are rolled in as long as they don't increase the rates of existing customers; otherwise, it's incrementally priced. He added that FERC's open

season rule, in response to comments from parties, addressed that by making that policy pronouncement with respect to rolled-in pricing, thereby giving assurance - to the extent possible without actually having a project and numbers to view - that future expansions will be on a rolled-in basis.

SENATOR WILKEN asked if there is a way today for the people, the administration and the producers to make a formal request for that policy from the date of the contract onward.

MR. CUPINA responded that he couldn't think of anything else required outside of FERC's order and the rehearing of its order. He said he wanted to be sure in this discussion not to get into the provisions of the proposed contract, which they've studiously avoided because it is unique to the State of Alaska.

SENATOR STEDMAN asked whether it automatically goes to incremental pricing if there is any change in the price, or whether some change can be absorbed by the current people.

MR. CUPINA answered, "They didn't lay out any percentage." He recalled at one time, some years ago, a percentage aspect determined whether it was rolled in. In the Alaskan order, however, FERC recognized it was doing something a little different and, to the extent it could, said its policy will be to have rolled-in expansion, not increasing the rates for existing customers. Where FERC was talking about a rebuttable presumption that costs would be rolled in, it was looking at mainly the type of expansions expected as production increases.

SENATOR BEN STEVENS referred to the fiscal interest finding and asked Mr. Loeffler how big the pipeline will be. He recalled it would originally be 4.2 billion cubic feet (Bcf) a day, with cheap expansion to 5.9 Bcf.

MR. LOEFFLER confirmed those numbers are about right, the best known today.

SENATOR BEN STEVENS calculated the cheap expansion to therefore be 40 percent, not 25 percent. He asked Mr. Cupina whether it is up to FERC or the pipeline owners to make a determination with respect to a voluntary-expansion application.

MR. CUPINA responded that FERC ultimately makes the decision, but it usually starts with a proposal from the pipeline owners. He opined that FERC was signaling here its inclination to roll in the cost of expansions, whether or not those costs raise the

rates for existing customers, for reasons mentioned earlier with respect to later explorers.

[9:39:29 AM](#)

SENATOR BEN STEVENS posed a scenario in which the project moves forward and goes through an open season, with capacity fully subscribed; three years later, a leaseholder does some exploration and determines it can now apply for capacity because it has proven reserves. He asked whether that entity would have two options: negotiate with the pipeline operators for voluntary expansion or file a complaint with FERC and request mandatory expansion.

MR. CUPINA affirmed those two options, but pointed out FERC would first expect discussions about a voluntary expansion before going to the next step.

SENATOR BEN STEVENS asked: If there is negotiation between the pipeline operators and a new producer to determine rolled-in versus incremental pricing, would that final determination be made by the pipeline operator or FERC?

[9:41:18 AM](#)

JACQUELINE HOLMES, Associate General Counsel for Energy Projects, Federal Energy Regulatory Commission, replied that if the pipeline operator filed a voluntary application for expansion, the decision whether it would be incremental or rolled in would ultimately be FERC's. The current policy for the Alaska pipeline for voluntary expansion, stated in FERC's open season regulations, is a rebuttable presumption that the cost of expansion is rolled in.

MR. CUPINA, in further response, explained that the rolled-in presumption was a policy change by FERC for all voluntary expansion, whether cheap or expensive. Recalling one issue in the comments, that a rolled-in basis is only beneficial to later shippers if it applies to the more expensive expansion, he emphasized that mandatory expansion isn't automatically incremental. For mandatory expansion, there is another wrinkle in the Act: the cost of the expansion cannot increase the rates of the existing shippers. He said it remains to be determined by FERC exactly how to apply that.

[9:48:08 AM](#)

SENATOR BEN STEVENS asked: If there is a petition for mandatory expansion, does that portion of the expansion capacity go out to open season?

MR. LOEFFLER recalled that Orders 2005 and 2005-A say they don't apply to mandatory expansions. "I think the commission reserved that," he added, offering to check the cite.

MS. HOLMES affirmed that recollection.

MR. CUPINA said he believed the idea of mandatory expansion was viewed as case-specific, with the expectation it would be rare. If Mr. Loeffler is correct, that would be a reason why this whole open season is associated with it.

MS. HOLMES added that technically the current FERC regulations, which mandate open seasons for voluntary expansions, wouldn't apply to a mandatory one. If FERC were to consider a mandatory expansion, it would also consider the process the company would have to go through at that time.

SENATOR BEN STEVENS mentioned the potential for basin control and asked: If a new company found gas, went through the mandatory-expansion process and was granted expansion, would that company have secure rights to the expansion such that existing shippers couldn't outbid for it?

MR. LOEFFLER answered that the expansion statute says if the commission orders mandatory expansion, the order becomes void unless the person requesting the expansion executes a firm transportation (FT) agreement. He interpreted it to say there cannot be an open season, because if the person who applied for the expansion must execute an FT agreement, it implies the person is entitled to that capacity if the commission orders it. He clarified that he didn't know whether FERC had looked at it or taken a view on it.

[9:52:06 AM](#)

SENATOR BEN STEVENS asked whether any provision in Alaska law can override a FERC ruling.

MR. LOEFFLER replied no.

SENATOR BEN STEVENS related his understanding that federal law overrides state law in interstate commerce. He asked whether any provision, in any contract in the U.S. between shippers, could nullify or mitigate a provision required by FERC.

MS. HOLMES said she believed the answer was no. If FERC requires something under its jurisdiction under the Natural Gas

Act or its own regulations, a company generally cannot agree with its shippers not to follow that. There are times, however, when FERC will grant a waiver of its regulations if good cause is shown.

MR. LOEFFLER agreed, adding that when FERC issues a certificate with conditions, the applicant doesn't have to accept it.

[9:55:10 AM](#)

SENATOR BEN STEVENS asked: Under voluntary expansion, regardless of negotiations between the pipeline operator and the applicant for capacity, is the determination of rolled-in versus incremental pricing determined by FERC?

MS. HOLMES replied yes, FERC will set the rate for the service on the pipeline. In response to a hypothetical situation posed by Chair Seekins, she offered her belief that Section 105 [of ANGPA] says the following: Under a mandatory expansion, the commission shall ensure the rates don't require existing shippers on the natural gas transportation project to subsidize "expansion shippers."

She noted it is a question of what constitutes subsidization; that is where FERC would look at the price of the expansion and fair allocation of those costs. Ms. Holmes added that in cases of cheap expansion in the Lower 48 or the interstate system, FERC generally requires a rolled-in basis because it benefits rather than harms existing shippers on the system.

[9:59:17 AM](#)

REPRESENTATIVE RALPH SAMUELS, Alaska State Legislature, asked: If influence in the process is desired, would Congress need to be petitioned, since FERC will decide, and expansion capabilities cannot be affected through the contract or statute?

MR. CUPINA replied that FERC would decide on the public interest in considering whether to issue a certificate. As to whether contract terms can deviate from FERC policies or Alaska Statute, he noted Ms. Holmes had said in general they cannot, but FERC has granted certain waivers, if justified. The law cannot be changed by writing something into the contract, Mr. Cupina added, but it is a question of bringing it before the commission so FERC can see the evidence and reasoning.

MR. LOEFFLER requested confirmation that the contract could influence what is proposed to FERC, but couldn't control what FERC decides.

MR. CUPINA affirmed that, adding that everything which comes to FERC is based on some sort of contract or precedent agreement.

10:02:04 AM

DONALD SHEPLER, Greenberg Traurig, LLP, Consultant to the Legislature, restated that understanding. Highlighting a distinction between a rate increase and a subsidy, he then requested confirmation that the 2004 statute in the context of mandatory expansion doesn't prohibit FERC from ordering expansion if there is a rate increase to existing shippers; rather, it's if FERC finds it would result in a subsidy by existing shippers to the new shippers.

MR. CUPINA agreed, adding that FERC Order 2005-A focused on that definition of subsidy and indicated it could be applied differently than for the Lower 48. For mandatory expansion, there could be rolled-in or incremental pricing, and FERC, to his belief, said it must look at the situation.

MR. SHEPLER clarified that he'd drawn the distinction because Mr. Cupina said earlier that FERC cannot mandate expansion if it results in an increase to existing shippers, whereas it is actually a subsidy. He suggested lawyers will debate this at great length.

MS. HOLMES concurred with Mr. Shepler's interpretation.

MR. CUPINA said the point was well taken.

MR. LOEFFLER agreed, but suggested under mandatory expansion the contract is irrelevant, because mandatory expansion under the statute is initiated by some excluded party - not the pipeline. When talking about what is proposed by the pipeline, therefore, it's only for voluntary expansion, and the contract would have bearing on what is proposed.

MR. CUPINA concurred. Referring to Ms. Holmes' testimony, he said a mandatory expansion culminates in a firm contract. It doesn't begin with a contract, but ends with a contract.

MR. LOEFFLER agreed.

CHAIR SEEKINS asked whether the following understanding is correct: There is a 40 percent expansion capacity in the pipe. The contract terms could provide that, without unreasonable

delay, the state or pipeline owners would participate in voluntary expansion as supplies of gas become available.

MR. LOEFFLER answered yes, noting the LLC agreement describes the process for the pipeline to entertain a voluntary expansion, including how it will be studied and voted on. He also recalled a section that says if someone files for mandatory expansion, the LLC might reverse a neutral position and decide to be in control of it, rather than be subject to a FERC proceeding. The reason is this: If it has a sound economic basis, it would seem to be in the pipeline's interest to expand its business, just as it would be in any business's interest to get more customers.

10:10:17 AM

MR. LOEFFLER asked Mr. Pease: If the pipeline owners engage in behavior viewed as anticompetitive, what remedies does FERC have in Order 2004 or Order 670, for instance?

ROBERT PEASE, Division of Investigations, Office of Enforcement, Federal Energy Regulatory Commission, replied that FERC has a number of remedies and powers, some new. For any violation of the Natural Gas Act or any statute under the commission's jurisdiction or regulations, FERC can impose a civil penalty up to \$1 million a day per violation; this is a significant change in FERC's authority. The commission also has the option of ordering disgorgement of any profits that would have been gained by the illegal behavior. As set out in its enforcement policy statement of last year, it would begin with disgorgement and then proceed to other remedies including civil penalties.

He said FERC has authority to prohibit undue discrimination on the pipeline. The idea of the standards of conduct is a level playing field and similar treatment for all participants, including affiliates and the producers. Mr. Pease pointed out that undue discrimination doesn't have to rise to the level of manipulation to trigger enforcement or FERC's potential million-dollar-a-day civil penalty authority; violations include those involving tariff conditions or certificate conditions. If a violation continued for 100 days, for example, the maximum civil penalty would be up to \$100 million, since it is per day.

10:13:02 AM

MR. PEASE, in response to Chair Seekins, explained that under FERC regulations, Section 358, "energy affiliate" means an affiliate of a transmission provider that is engaged in or is involved in transmission transactions in U.S. energy or transmission markets. Noting that is the broad definition, he

added that there cannot be undue discrimination in favor of an energy affiliate.

SENATOR HOFFMAN asked: What course of action does the state have if there is a disagreement with FERC with respect to rolled-in or incremental pricing, or mandatory versus voluntary expansion, when there is a conflict with Article VIII, Section 2, of the Alaska State Constitution, which says the legislature shall provide for the utilization, development and conservation of all natural resources that belong to the state for the maximum benefit of its people?

MR. PEASE noted this discussion has related to FERC jurisdiction over the pipeline, not the gas itself. He added that in any case before FERC, including pipeline construction or operation, the state can certainly make its case as to why FERC should deviate from something it said previously.

SENATOR HOFFMAN suggested the effort is to determine the maximum benefit of the resource, since the state will be a percentage owner, at 25 percent.

MR. PEASE responded that FERC would consider whatever was in the record of the case, to see whether it justified a change from what it otherwise would do. He pointed out that FERC doesn't regulate commodity prices, production and so forth, but is mindful, under ANGPA, that part of its obligation is to further production and exploration with respect to pipeline operations.

[10:17:06 AM](#)

CHAIR SEEKINS returned to Senator Ben Stevens' remark that federal law would prevail, since this is an interstate commerce issue. Agreeing with the need to ensure that the resource is used for the maximum benefit of Alaskans, Chair Seekins said he didn't know how it would interplay, but the state could certainly present its case if FERC regulation were to somehow affect it.

SENATOR BEN STEVENS asked Mr. Pease whether these enforcement regulations are different from normal FERC regulations.

MR. PEASE clarified that in the Energy Policy Act of 2005 (EPAAct), passed last August, Congress gave FERC enhanced penalty authority that it didn't have before. The regulation he'd read has existed since 2004. Prior to that, for a violation under the Natural Gas Act, FERC had only limited remedies, including: disgorgement, which he views as giving back money they never

should have had to begin with; conditions put on a certificate; or revocation of a certificate if the violation was so egregious, which has rarely happened, if at all, in FERC's history. Since August 8, therefore, Mr. Pease said FERC has civil penalty authority for any violation under any of the rules or statutes that FERC administers.

He further explained that last spring, pursuant to EPCRA, FERC enacted new regulations designed to prevent manipulative behavior, which carried civil penalties that didn't exist prior to the statute. Before that, there were so-called behavior rules, with no civil penalties. Today, there is civil penalty authority under any rule, statute or regulation under FERC's authority. Included are the standards of conduct, which govern affiliate relations, and also the certificate conditions, including construction and operation of the pipeline under those certificate conditions. All those potentially are subject to a civil penalty of \$1 million a day per violation.

MR. LOEFFLER noted it also applies to a violation of the open season regulations.

MR. PEASE agreed, specifying it applies to any and all regulations and statutes relating to gas under the commission's jurisdiction.

[10:21:13 AM](#)

SENATOR WAGONER asked: With 35 trillion cubic feet (Tcf) of proven reserves on the North Slope, and a 52- or 54-inch pipe, what is the advantage to the State of Alaska and smaller producers - which have the potential to find major gas reserves - of an early open season? Someone might want to use a 40- or 48-inch pipe, for instance, thus reducing the ability to take in amounts other than the 35 Tcf of known reserves. Offering his understanding that nothing in the contract talks about pipe size, he recalled that one company wants two 36-inch pipes, and said he was beginning to discover the advantages to that.

MR. LOEFFLER replied there are two parts. First, he suggested FERC may say something about how it will review the pipe size when an application is received, although FERC probably couldn't comment on the larger economic question.

CHAIR SEEKINS suggested the fourth topic on the list, review of anticompetitive issues as part of the processing of the certificate application, may fit with this.

MR. LOEFFLER asked whether someone from FERC wished to address what the commission will look at.

AN UNIDENTIFIED FERC REPRESENTATIVE replied that when FERC gets an engineering application, pipeline engineers do a flow analysis to see whether it is adequate for the proposed maximum throughput. If someone said there were contracts for 4.5 Bcf a day, for instance, FERC would look at the pipe design and flow characteristics to ensure they matched. As for potential expansion, everything FERC looks at is in a contract regime. A lot of timing questions and determinations of public convenience and necessity are based on whether there is a contract with the pipeline for capacity. If there are contracts for 4.5 Bcf a day and a pipeline designed to adequately accommodate that gas, it is one part of determining public convenience and necessity. He noted FERC hears different opinions about the optimum pipe diameter or number of pipes.

MR. LOEFFLER added there are several layers of answers. There is a bit of "the chicken or the egg" with respect to how long to wait for the pipeline. There may be more definite knowledge in five years, but this pipeline has been anticipated a long time.

He gave his view that an early open season results in an earlier pipeline, and that the open season is the first step, where customers are tested to see who is willing to sign up for long-term capacity. Mr. Loeffler recalled that the commission said, in its open season order, that if people aren't ready by the first open season and have a good reason, it will force the applicant to say why later discoveries cannot be accommodated.

He noted designing the right size of pipe is a combination of engineering and economics. Commission precedent has been that extra capacity can be built in a pipeline, beyond existing contracts, but the pipeline must pay for it if nobody is willing to sign up. Mr. Loeffler highlighted the expense of this. He opined that delaying the open season delays the pipeline.

[10:28:58 AM](#)

KEN GRIFFIN, Deputy Commissioner, Department of Natural Resources (DNR), returned to an issue raised by Mr. Loeffler, the requirement to consider accommodating latecomers to the open season. With respect to how an early open season might disadvantage independents, he emphasized that people have been waiting for this pipeline for many years.

He suggested the issue is a premature open season, however, not just an early one. This occurs if an open season is held and then the pipeline doesn't progress for a time. It is difficult for that to happen, Mr. Griffin said, because a binding open season isn't an incidental activity. It requires an enormous amount of preparation. There are commitments made on both sides at that point. If there is some sense that a premature open season has occurred, there are provisions that FERC will consider latecomers; the level of that consideration could be quite significant.

The committee took an at-ease from [10:31:22 AM](#) to [10:53:00 AM](#).

MR. CUPINA informed members that Mr. Pease had to leave in five minutes, in case there were more questions relating to enforcement or discrimination.

CHAIR SEEKINS summarized that FERC has extensive enforcement powers with respect to undue discrimination. He surmised some discrimination could be allowed, and that FERC can fine up to \$1 million a day per violation, but may not necessarily impose that, depending on the egregiousness of the violation.

MR. PEASE affirmed that. He turned to the enforcement hotline, explaining in response to Chair Seekins that it is an informal dispute-resolution service offered under "part 1b" of FERC regulations. An attorney is on duty during all business hours; there is e-mail capability through FERC's website by which questions can be asked; and there is an after-hours recording from which calls are returned the next morning. There can be anonymous treatment.

He said all information gathered through the hotline is treated confidentially. The goal is to resolve disputes as quickly as possible; over 75 percent of calls to the hotline are resolved in less than two weeks. Ms. Pease explained that some calls aren't appropriate for resolution through the hotline, however, and an allegation of wrongdoing, in particular, would be more appropriate to treat as an investigation.

CHAIR SEEKINS asked what kinds of issues are normally brought to the hotline.

MR. PEASE answered they involve anything under FERC jurisdiction, including: multimillion-dollar disputes; requests for help when lights go out in a city; landowner issues, which are frequent; restoration issues; and interpretation of various

regulations, where FERC will try to get staff consensus as to what a particular regulation or provision means.

10:56:35 AM

KAROL LYN NEWMAN, Morgan, Lewis & Bockius LLP, partner in her law firm representing Anadarko Petroleum Corporation, referred to an earlier question as to whether the mandatory-expansion process contemplates an open season and FERC's indication that there weren't any rules yet. She said because there are no rules yet on how Section 105 of ANGPA will be interpreted, it isn't clear whether open seasons will be conducted in conjunction with requests for mandatory expansion by potential shippers. For example, if a small company with some production asked the pipeline for an expansion to accommodate its reserves and the answer was no, then the company would go to FERC and initiate the process for a mandatory expansion.

She suggested it would be consistent with FERC policy if FERC also looked to see whether other potential shippers needed additional capacity at that time. Thus the expansion could be done at one time. Ms. Newman proposed that it is possible, therefore, for open seasons to be conducted in some fashion within a mandatory-expansion process. Although she concurred with Mr. Loeffler's earlier point that the shipper who requested the expansion would have to sign a contract within the requisite period of time, Ms. Newman opined this still wouldn't preclude an open season.

MR. LOEFFLER said he needed to find the statutory provision, but agreed Ms. Newman's description was more consistent than not with FERC policy. "FERC likes open seasons," he remarked. He then paraphrased Section 105(c) of ANGPA, part of the expansion section, which states:

(c) REQUIREMENT FOR A FIRM TRANSPORTATION COMMITMENT - Any order of the Commission issued in accordance with this section shall be void unless the person requesting the order executes a firm transportation agreement with the Alaska natural gas transportation project within such reasonable period of time as the order may specify.

He observed there is a tension between FERC's traditional policies and this particular clause.

11:01:53 AM

SENATOR BEN STEVENS requested confirmation that if a mandatory-expansion application was granted, the capacity in the application would be issued to the applicant.

MR. CUPINA specified that if such a case was brought by a potential shipper seeking capacity, and FERC granted it based on the evidence, it would be subject only to execution of the aforementioned agreement. He noted Ms. Newman was suggesting, however, that during the course of that proceeding FERC might also ask whether anyone else wanted capacity, and would consider that as well. He agreed it certainly is a possibility.

SENATOR BEN STEVENS surmised in that instance the petition would be for an increase above the applicant's capacity, and the original applicant's amount wouldn't be reduced on a pro-rata basis.

MR. CUPINA agreed, noting FERC hadn't seen any of these yet.

[11:03:49 AM](#)

CHAIR SEEKINS posed a scenario under mandatory expansion where person A has applied for 100 units and person B has applied for another 50. He interpreted this to mean that, if successful, person A would get 100 units and person B would get 50; they wouldn't split the 150 units granted.

SENATOR BEN STEVENS agreed, but emphasized his point that if only 125 units were issued in the permit, there wouldn't be a pro-rata reduction.

CHAIR SEEKINS requested confirmation that the application for mandatory expansion wouldn't be on a competitive basis, but would be for a person's particular requested expansion.

MR. CUPINA affirmed that, saying the person would be bringing the action and showing justification, and shouldn't be penalized.

CHAIR SEEKINS related his understanding that under voluntary expansion, by contrast, someone would have to compete in the open season.

MR. CUPINA answered that's one way of putting it, but the open season is so everyone has an opportunity. Ideally, the result is that all participants get exactly what they want.

CHAIR SEEKINS expressed appreciation to Ms. Newman for bringing this to the committee's attention.

MS. NEWMAN remarked that she was pleased the concept of "no subsidy" as opposed to "no increase" had been clarified. She emphasized the desire to make that distinction, as shown by comments made to the committee, the Senate, Congress and others including FERC.

11:06:09 AM

SENATOR GENE THERRIAULT, Alaska State Legislature, agreed that a critical point is the difference between a subsidy and "no increase in rate," and how FERC might treat it. He recalled discussions with FERC's former Chairman Wood which indicated FERC possibly would allow some increase in the rate and still not treat it as a subsidy, as long as the original shipper didn't go beyond the original price at which it signed up to ship.

He also recalled his involvement in the legislature's input into the FERC rule-making process. Senator Therriault told members, "We certainly were advocating for rolled-in pricing across the board, and what we got from FERC was a bit of a mixed bag: this presumption, of course, on voluntary, and there's no determination exactly how things will be treated ... on the mandatory."

MS. NEWMAN recalled that FERC hadn't directly addressed what would be a subsidy. For example, if the tariff rate for the initial capacity of the pipeline was set at \$10 a decatherm and the initial shippers had a contract at \$8, it isn't clear whether the difference would be deemed a subsidy; FERC hasn't ruled. It might be argued it isn't a subsidy because it hasn't even hit the regular tariff rate at this point. Another hypothetical scenario is when someone is at or below the tariff rate and an inexpensive expansion is done; the average tariff rate would drop, and the rate in phase two, looked at across the board on a rolled-in basis, would be \$8 or \$9. The next expansion, looping, would cause the rate to rise from the new level up to \$9 or \$10. That might not be considered a subsidy.

She said there are a number of factors. For example, the initial capacity, but not the expansion, will have the benefit of federal loan guarantees. Will the difference in rates established for those be considered a subsidy? Ms. Newman noted FERC will have a number of questions to address once the next

expansion will raise the rate above what existing shippers pay, and the answers aren't clear.

11:10:21 AM

MR. LOEFFLER agreed it isn't known whether these will be considered subsidies.

SENATOR BEN STEVENS pointed out that those unknowns are to be determined by FERC, not the legislature or the contract.

CHAIR SEEKINS surmised they'll apply to any project, no matter who the sponsor is.

MS. NEWMAN responded that FERC will be the ultimate decision maker on whether something is or isn't a subsidy and thus whether a given expansion will be priced incrementally or on a rolled-in basis; that applies to the Alaska pipeline under the guidelines in ANSPA, which has a provision dealing with mandatory expansion. Suggesting FERC could address this better than she, Ms. Newman added that FERC's current general policy tends to require that expansions be incrementally priced if they'll cause the rates paid by existing shippers to increase. Agreeing FERC will decide, she emphasized that the proposal is always made by the applicant.

11:12:56 AM

CHAIR SEEKINS asked whether this would apply equally to any interstate project that fell within FERC jurisdiction.

AN UNIDENTIFIED FERC REPRESENTATIVE answered yes.

CHAIR SEEKINS asked whether anything in the contract would affect the eventual ruling from FERC.

MS. HOLMES replied that a contract would shape the proposal that FERC ultimately would rule on.

CHAIR SEEKINS surmised in the end it would be based on FERC policy and regulations, not necessarily on the request, probably based on the best public interest.

MS. HOLMES affirmed that.

11:14:36 AM

SENATOR THERRIAULT alluded to Article 8.7 of the contract, voicing concern that the state-sponsored expansion in 8.7 appears more restrictive for the state. It doesn't mention a

subsidy, but relates to an increase in the rate, which is more cut-and-dried and perhaps wouldn't allow latitude for FERC to consider whether it is a subsidy.

CHAIR SEEKINS asked if that concern goes to the scenario described by Ms. Newman: the effective tariff is below the original approved tariff, and new expansion brings it back to the original rate; it would be seen as a rate increase, not a subsidy, since it wouldn't have reached the original tariff.

SENATOR THERRIAULT affirmed that. Based on personal conversation with FERC's former Chairman Wood, he suggested there would be latitude to consider an increase in rates up to the original stated tariff, and FERC might determine it isn't a subsidy. It would still be under the letter of the law, the federal statute.

MR. LOEFFLER agreed that in addition to voluntary and mandatory expansion there is a third type: state-sponsored, state-initiated expansion under the contract. Saying it is a separate dialogue, he acknowledged the point raised by Anadarko and Senator Therriault, but said all that matters is what FERC has put in its orders; conversations with prior chairmen have no value, since FERC operates through the written word. While that precise issue, what a subsidy is, was discussed in Order 2005 or Order 2005-A, he said FERC didn't take a position on it.

[11:17:44 AM](#)

MR. SHEPLER highlighted discussion in either Order 2005 or Order 2005-A of the following issue: If the first phase of the pipeline received federal loan guarantees, reducing the debt cost and lowering the rate for the existing shippers, would that be viewed as a subsidy to those shippers? For purposes of applying subsidy language going forward, Mr. Shepler said, there would be a requirement that the rates had to go above the so-called subsidized rates flowing from the federal loan guarantee. Thus there is some written discussion in FERC's order on how it would approach the issue of a subsidy. He agreed this arises in the context of a mandatory expansion, which current regulations don't address, but said it somewhat illustrates the complexity of issues when starting down the road of mandatory expansion.

MR. LOEFFLER also emphasized the complexity, saying the federal loan guarantee would make credit available on better terms than the private market, but those terms are unknown. "You can't lock yourself into assumptions of what the future will be," he added.

MR. CUPINA agreed there is discussion in both Order 2005 and Order 2005-A, the rehearing, about how FERC's current policy outside of Alaska has been primarily to judge a subsidy by whether or not existing customers' rates would rise. Distinguishing that from this rule for an Alaska pipeline, he noted FERC had said there might be other ways of defining "subsidy" without actually doing so, preserving the ultimate decision to be a case-specific determination.

[11:22:17 AM](#)

DAVID VAN TUYL, Commercial Manager, Alaska Gas Group, BP, emphasized BP's focus on getting the pipeline built, as seen by its submittal of an application and going through negotiations to put a contract before the legislature, and as reflected by chief executive John Browne in the Wall Street Journal two months ago. Mr. Van Tuyl said once a project is built, BP can entertain the possibilities of expansions and rolled-in versus incremental rates.

He related BP's position that it is appropriate for FERC to make decisions once facts are known, on a case-by-case basis. It is limiting and perhaps a bit dangerous to presuppose what those facts should be and limit the outcomes; specifically, mandating what an expansion application must include creates additional risk for the "anchor shippers" of the project. Mr. Van Tuyl told members BP doesn't want to jeopardize the possibility of getting the pipeline built in the first place - its prime objective.

He noted FERC Orders 2005 and 2005-A reflect some of these concerns, and include accommodations for shippers not yet ready at the time of the initial open season. "If those folks choose not to spend the money now to define what their gas resources are, there is even an opportunity after the initial open season that a late bid of firm capacity must be given due consideration," Mr. Van Tuyl told members.

He suggested FERC rules anticipate those kinds of specific needs for the Alaska project. Mr. Van Tuyl said the legislative consultants had even outlined clearly that the state has been able to have its voice heard before FERC in shaping those policies. He emphasized the desire to let the parties freely operate under FERC policies on a case-by-case basis and to allow that process to work.

[11:25:31 AM](#)

MR. CUPINA explained that the accommodation in the initial open season is not to close the door on additional requests for capacity after the open season concludes but before final design of the pipeline is complete. Rather, it leaves the open season door slightly ajar for those that might come in during the time the project is being completely engineered, and recognizes that folks might not be ready the first day of the open season, but might be ready to sign a contract two years later. The commission has said that opportunity should at least be available, and if there is some good reason why they cannot be accommodated, FERC will look at that. It is another special provision recognizing the unique circumstances in Alaska.

11:27:02 AM

BRADFORD G. KEITHLEY, Jones Day, law firm, testifying at the request of BP, noted this morning the focus had been on mandatory-expansion provisions as a protection for nonaffiliated producers with concerns about basin control. He related his view that in the real world, however, the enforcement mechanisms discussed by Mr. Pease will motivate or control producer behavior before ever getting to the mandatory provisions. Mr. Keithley characterized mandatory expansion as the remedy of last resort or the tertiary remedy.

He explained that under the rules described by Mr. Pease, the producer-sponsors of the pipeline will have an obligation, under Orders 2004 and 670, that will significantly control their behavior. Under Order 2004, the producers won't be able to favor their affiliates over nonaffiliates, and must treat them in like fashion. Mr. Keithley said that will apply from the outset, during the initial open season as well as any subsequent open seasons.

He turned to basin control, pointing out that Order 670 is clear that persons governed by that order, including producers and their affiliates, cannot engage in anticompetitive behavior such as squeezing out independent companies from the production markets in order to take over their leases. Mr. Keithley explained that Order 670 was enacted by FERC after Congress passed EAct in 2005 in response to the Enron debacle; the statute and regulations give FERC the million-dollar-a-day violation authority. Those regulations will control how the producers think about this from the outset, and will ensure that the producers don't engage in behavior that can be viewed as anticompetitive.

He said although the mandatory-expansion provision requires a complaint and a formal procedure before FERC, violations of Order 2004 or Order 670 could easily go through the FERC hotline, where, as Mr. Pease noted, 75 percent of the complaints are resolved within two weeks. Mr. Keithley pointed out that this is a quick procedure compared with the lengthy mandatory-expansion procedure.

He also pointed out that the state, as an owner, would have knowledge of the producers' behavior; if it saw a violation or anticompetitive activity, it could raise those issues in ownership meetings, but also report it to FERC. Mr. Keithley emphasized that nonaffiliates wouldn't have to wait until mandatory-expansion provisions kicked in because Orders 2004 and 670 create a right to a remedy far more quickly. Similarly, if people thought something in the initial open season was designed to adversely affect nonaffiliates, they could raise the same concerns under Orders 2004 and 670 with FERC, to have them resolved immediately in connection with the initial open season.

11:32:20 AM

SENATOR ELTON asked whether there has been any application of Order 670 by FERC. He requested assurance that it will significantly change participants' behavior.

MR. KEITHLEY responded that FERC had rules prior to when Congress passed stiffer penalties that resulted in Order 670. Under that order's predecessors, FERC took action against pipelines that engaged in behavior it found inappropriate. For example, FERC imposed penalties in connection with a natural gas pipeline's preferential treatment of its marketing affiliate, including allowing the affiliate to sit in on meetings with respect to pipeline operations; the remedies imposed were so severe, the company decided to give up its marketing affiliate.

He explained that in Order 670, FERC both reinforced that sort of precedent and brought in federal Securities and Exchange Commission (SEC) law with respect to what fraud, anticompetitive behavior or inappropriate behavior is. Mr. Keithley reported that Congress, in passing EAct in 2005, directed that SEC regulations and law be considered; FERC explicitly did that, saying it was because SEC had a substantial body of precedent on what fraud and bad behavior are. Energy lawyers have had that precedent to look at, in addition to FERC precedent under the prior regulations, to judge what FERC's behavior will be.

He related his experience, having represented BP in these situations, that the bias is to err on the side of caution. Mr. Keithley indicated the penalty provisions - \$1 million a day and potential "structure penalties" which could require that one operation be divorced from another - are so severe that these companies tend toward being overcautious. He said FERC has done everything to reinforce that behavior on the part of the pipelines.

[11:36:19 AM](#)

CHAIR SEEKINS asked Mr. Cupina to also provide some history relating to the application of Order 670.

MR. CUPINA deferred to FERC's Office of Enforcement, but said he could obtain post-EPA information. He noted in many public settings the chairman or commissioners have pointed out a main feature of EPA: FERC's receipt of this significant new authority. Mr. Cupina said he has every reason to believe it will be used to its full extent. He offered to follow up any requests after talking with the Office of Enforcement.

SENATOR ELTON asked if he could assume that a complaint about a possible violation of Order 670, with its potential penalties of \$1 million a day, wouldn't be resolved in two weeks.

MR. CUPINA replied he believed that was safe to say, though he wouldn't say "never." He agreed it would likely be a serious matter requiring investigation. In response to Chair Seekins, he noted several possible outcomes from the hotline, including mediation, a fairly quick turnaround or a more formal proceeding. He again deferred to the Office of Enforcement.

MR. KEITHLEY agreed that a complaint of behavior that has resulted in damages won't be resolved in two weeks. Providing his own experience, however, he said a more normal situation is that a nonaffiliate asks a pipeline to do something and the pipeline says no; the nonaffiliate asserts the pipeline did it for its affiliate, and the pipeline denies it; the nonaffiliate calls the enforcement hotline and provides facts; the hotline calls the pipeline, which takes those calls seriously because of potential steep penalties; and the pipeline then either explains what occurred to the satisfaction of enforcement or, more often, moderates its behavior in dealing with the nonaffiliate. Those can be resolved in two weeks.

He explained that what usually goes to the hotline hasn't continued a long time and resulted in a lot of damages.

Mr. Keithley said those front-end situations, where people aren't taking litigation postures, are resolved fairly quickly, even though they may involve substantial issues.

[11:41:17 AM](#)

CHAIR SEEKINS turned attention to FERC's review of competition issues when processing the certificate application.

MR. CUPINA said it isn't usually a competitive issue in the certificate unless talking about some historical periods when there were competing pipeline proposals. A past example was that the FERC might have found, in response to an intervenor or protestor in a case, that an open season was conducted improperly. A person seeking capacity might have followed all the rules and yet, for whatever reason, not received it; thus FERC might have ordered another open season or found the allegation improper, all within the certificate investigation. Mr. Cupina said FERC deals with such issues as they arise, but for the most part they aren't seen in the certificate.

[11:43:11 AM](#)

CHAIR SEEKINS asked where FERC jurisdiction begins and ends in the process of getting gas to market.

MR. CUPINA answered that in jurisdictional cases, some past precedents say interstate movement starts at the tailgate of the plant, where the gas is "pipeline quality" because it has been conditioned and processed; it is a matter of whether the gas meets pipeline-quality specifications at that point. In general, the interstate journey starts after the gas has been collected along a system, before it gets into the main line. The main line is jurisdictional from that point to the terminus.

CHAIR SEEKINS asked whether it's after it comes out of the gas treatment plant (GTP).

MR. CUPINA affirmed that.

CHAIR SEEKINS asked whether the GTP itself is not under FERC jurisdiction.

MR. CUPINA replied not normally, but said he thought in the Alaska Natural Gas Transportation Act (ANGTA) project the treatment plant was, under that statute, part of the project.

[11:45:13 AM](#)

CHAIR SEEKINS turned to issues related to SB 3001, saying the state is proposing a capital-expenditure credit for construction of the pipeline, to go to owners of project. He asked whether a 20 percent credit of \$2 billion, for instance, would be included or excluded as a basis for the tariff. He said it would be credited by the state against taxes on the project.

MR. LOEFFLER recalled that the last time he'd heard about the credit, it was to be on the treatment plant, given to the companies as producers, not as owners of the pipeline. He acknowledged that may complicate the hypothetical situation.

CHAIR SEEKINS opined it would be actually given to the producers as a tax credit, but flows from construction of the pipeline, the capital expense. He asked how Mr. Cupina envisioned it would be treated in terms of establishing a tariff.

MR. CUPINA replied he wasn't sure that sort of side agreement would affect FERC's ultimate transportation rate, and he believed the rate for the pipeline transportation charge to be based on the capital costs, with return and taxes and so forth.

11:48:13 AM

MR. KEITHLEY suggested it goes to the previous question of where FERC jurisdiction begins. Saying he wasn't sure Mr. Cupina had been burdened with all the facts about how the system has been set up, Mr. Keithley explained that in the proposed contract, all parties have agreed that certain facilities - which he would list - will be treated as FERC-jurisdictional, and have agreed to submit an application to FERC governing all these facilities.

He informed Mr. Cupina that the North Slope has extensive field facilities, within each unit, that gather the gas. Mr. Keithley said the facilities covered by the contract are those pipelines that will start at the gathering facilities within the field - Prudhoe Bay or Point Thomson, for instance - and will run from each field to the GTP; there the gas is treated, if necessary, and then goes into the main line, as it's called in the proposed contract, for transportation to Canada.

He noted the parties have agreed in the proposed contract to treat the following as FERC-jurisdictional: those pipelines to the GTP that come from the gathering facilities in each field; the GTP; and the downstream line that will run to Canada. The view that the parties have taken is that the GTP is in the nature of a "straddle plant" - a FERC term describing a plant halfway down a line - as opposed to a field treatment plant.

Asking Mr. Cupina to correct him if necessary, Mr. Keithley offered his experience that FERC has always accepted jurisdiction over an entity that went to FERC and said it was jurisdictional. He emphasized that in the proposed contract all four owners have committed to make applications for FERC jurisdiction over those facilities.

11:51:00 AM

MR. CUPINA built on that clarification, noting FERC Order 2005-A tried to address gas-conditioning facilities that might be jurisdictional, pointing out that precedent cases say that for the treatment of the gas to enhance safe and efficient transportation, it could be subject to FERC's jurisdiction. It also says if an applicant under ANGPA attempts to file an application under Section 7 for authorization for a jurisdictional natural-gas-conditioning service through that plant, FERC will review it and set the rate. The plant may or may not be jurisdictional, but the rate and the service would be unbundled and separate from the transportation rate on the pipe.

MR. LOEFFLER asked: If the plant isn't jurisdictional, how could FERC set the rates for the plant?

MR. CUPINA answered that this seems, depending on the function of the plant, to leave it for the applicant to come in under Section 7 for that conditioning service.

CHAIR SEEKINS asked: Are there two separate charges, one a tariff downstream from the GTP and one for conditioning the gas to put it into the GTP, and both would be jurisdictional and set by FERC?

MR. CUPINA replied that is how this section reads.

CHAIR SEEKINS suggested there are options, rather than a base charge.

MR. CUPINA added that one reason they'd be unbundled and separate is that it might be possible for a shipper to either process its own gas or bring gas that doesn't need to be conditioned.

CHAIR SEEKINS surmised a shipper that brought gas in preconditioned or pretreated wouldn't be subject to that charge.

MR. CUPINA affirmed that.

MR. KEITHLEY concurred, adding that the pipelines from the field to the GTP also will be separately owned and charged, again so that if other producers or marketers want to build and use their own pipeline, they are free to do so. And if they want to bypass the GTP, they may, subject to the quality restrictions of the pipeline.

[11:54:23 AM](#)

CHAIR SEEKINS related his understanding that the contract anticipates that the application will subject those gathering lines to FERC regulation.

MR. KEITHLEY noted "gathering lines" is a term of art for transmission lines. He specified they are short transmission lines that will come from the gathering facilities in the field to the GTP. He informed Mr. Cupina that the vision they've had in mind is the pipelines behind the Venice plant, which FERC asserts jurisdiction over in southern Louisiana.

MR. CUPINA added that the cite in Order 2005-A is to the Venice Gathering Company as an example where FERC could have jurisdiction, depending on the function of that land and if it is enhancing safe and efficient transportation.

[11:55:44 AM](#)

SENATOR STEDMAN restated an earlier question with respect to the rate set on the transmission lines and the GTP. He asked whether the rate is based on the total cost; on debt and equity; or just on equity, which leads into Chair Seekins' earlier question - since equity position can be altered through credits - of whether it has an effect on it. If the capital structure is changed in five years, for example, does the rate ever get reviewed to reflect the different capital structure?

MR. CUPINA answered that the rate base starts with the capital cost itself. Although the debt-equity ratio will ultimately determine the rate of return on equity, it doesn't affect the capital cost.

SENATOR STEDMAN requested clarification.

MR. LOEFFLER explained that generally rates are based on costs, looking at the amount of capital invested in the project. The rate on debt is picked up off of the actual debt instruments; the rate on equity is set by FERC, based on risks the project faces. Typically, the FERC staff extracts a settlement condition, that rates be reviewed within three years of startup

of the operation. Debt-equity ratios do change over time as debt is paid down on the project. He interpreted Senator Stedman's concern to be this: Why isn't a credit given for the plant or the pipeline relevant to the determination of the cost?

SENATOR STEDMAN said that was close. He noted there has been a lot of discussion about the impact on the equity position and any alterations of that. He provided details.

MR. LOEFFLER answered that as shippers come in to complain about rates, causing a review, looked at is whether the current equity rate of return is justified; that could change over time. For example, it could be said that for operating pipelines, it doesn't survive the construction risk; if it is successful as a venture, it gets a lower rate of return.

He noted shippers and pipelines fight about such issues all the time; it's open for review. As to whether the integrated company would be looked at - seeing benefits on one side that reduce the cost of investment on the other side - Mr. Loeffler said this is typically where FERC looks at the pipeline investment, rather the production side. He added that he could see how shippers could construct an argument of what the true cost is, but normally those jurisdictional lines are followed.

12:00:40 PM

SENATOR STEDMAN asked whether the following is accurate: If the tariff is set on the equity position when a company builds a GTP or gas line, any alterations of that equity position get reviewed periodically; if there is future divestiture by one or more owners, then that rate structure would be reviewed because most likely there would be a different debt-equity structure. Or if there is a decision to build it with 60 percent equity and 40 percent debt and then flip it to 80-20, it would be readjusted. In the end, rates are set on the equity position as it changes over time, regardless of divestiture or leverage changes.

MR. KEITHLEY answered that FERC comes at this issue from two different perspectives. First, it starts with the pipeline's costs and debt-equity ratio on its books. If FERC believes that is unrepresentative of the pipeline industry as a whole, however, it has in the past imposed what FERC calls "hypothetical capital structures" on the pipeline, and has calculated rates assuming the pipeline had a certain capital structure. The owner doesn't have the ability to manipulate its capital structure in a way that produces rates that it might

prefer; the commission has the ability to restate those in a fashion that would maintain rates at a level produced by a typical pipeline.

[12:02:53 PM](#)

SENATOR STEDMAN asked: How often has a capital structure been dictated to gas-line owners around the country?

MR. KEITHLEY deferred to Mr. Cupina, but said he'd seen hypothetical capital structures in perhaps 30 to 40 percent of the cases he'd looked at. He noted a pipeline may be a wholly owned affiliate of a parent company that is in an entirely different business or a variety of businesses, with a capital structure reflecting that mix; the commission may impose a hypothetical capital structure to deal with that situation. It's not 100 percent, but not infrequent.

MR. CUPINA said he believed Mr. Keithley's last comment was fair. Noting capital structures vary somewhat but not to extremes, he indicated 60-40, 50-50 and 55-45 are fairly typical structures.

MR. LOEFFLER reported he'd submitted a study on capital structure as of June 2004 to the Legislative Budget and Audit Committee, relating to perhaps 50 recent FERC cases and their capital structures and rates of return; they cluster in a range. He suggested his report could be obtained and resubmitted if the committee so desired.

[12:04:43 PM](#)

S.A. (BILL) McMAHON, JR., Alaska Gas Development, ExxonMobil Production Company, offered clarification with respect to the credit: The commitment allowance that started this whole conversation is something the state is making available to shippers of gas who make the FT commitment required to get the pipeline built. He said the state had envisioned it being available to the three sponsors through the fiscal contract, and to other producers on the North Slope through the uniform upstream fiscal contract that is envisioned. It is truly divorced from the pipeline structure. Not only would ExxonMobil, BP and ConocoPhillips be eligible, but others could make themselves eligible by committing in the open season.

SENATOR BEN STEVENS pointed out Mr. Cupina was being asked to comment on what FERC would do with respect to elements of a contract he hadn't seen, and that hadn't been finalized. He suggested the answers would be determined by FERC once it had

the complete submittal of the application and the financing structure.

He said the incentive for investment via the tax credit against the petroleum production tax (PPT) was exactly that - an incentive. Recalling hours of discussion on whether an incentive should apply to a FERC-regulated facility, and whether the incentives and credits should be passed on to shippers, Senator Ben Stevens said it became evident it was almost a wash for the state: either the credit and sacrifice would be made up front and the money received back through lower tariff costs, or there would be no credit and the money would be received back through higher tariff costs.

He also recalled that the position in opposition to why FERC should be mandated to roll in those investment tax credits was from the basis of an independent producer and shipper that had made no investment. Senator Ben Stevens emphasized that Mr. Cupina didn't have all the information.

MR. CUPINA expressed appreciation for that, noting at the outset he'd told members he didn't want to wade into the stranded gas contract, since FERC is unaware of most of its provisions. He agreed conceptually, however, with the speaker who'd said the transportation rate would stand on its own; he mentioned the costs that went into the rate, rates of return, debt-equity ratios and so forth.

[12:10:13 PM](#)

SENATOR WILKEN told Mr. Cupina he was trying to get a sense of where the Alaska gas pipeline project is in supplying America with gas, which he believes is needed. Noting EPAct required federal agencies to band together and have three meetings on liquefied natural gas (LNG) by August 2006, he asked whether FERC participated in those. He also requested a thumbnail sketch of the meetings and results, and asked where to obtain a summary.

MR. CUPINA answered that those meetings were the task of the U.S. Department of Energy (DOE), and FERC participated along with other agencies. He said EPAct required a minimum of three meetings, and three were held, in Boston, Massachusetts; Astoria, Oregon; and Los Angeles, California. Additional meetings are possible. Mr. Cupina recalled either recent testimony or trade articles about the outcome, noting they were dubbed "LNG forums"; the purpose was to help communicate

unvarnished facts and science to the public and public officials, rather than advocate for any particular project.

He reported that the results seemed good as far as they went, but from what he'd read coming from DOE, DOE hadn't believed those who were opposed to LNG were persuaded to change their minds. Mr. Cupina indicated a FERC person made presentations as part of the forums, and would do so in any additional meetings. He offered to follow up as far as executive summaries of meetings already held, and indicated summaries might be available on DOE's website under the Office of Fossil Energy.

12:13:28 PM

SENATOR WILKEN observed that FERC's July report to Congress talked about a meeting with steel producers about design, testing, manufacturing and so forth for pipe for an Alaska project. He asked Mr. Cupina about the results, including how it might relate to the Mackenzie Valley pipeline and how the industry feels about supplying steel for two major pipelines.

MR. CUPINA said he didn't recall getting into the issue of supplying both projects. They'd wanted to talk about higher-tensile-strength steel and ensuring everything is certified by the Department of Transportation (DOT) as part of working up to whatever steel is needed for an Alaska project. He characterized it as a technical session, a courtesy meeting.

12:15:20 PM

SENATOR WILKEN asked whether it is assumed by all that the Mackenzie Valley pipeline and the Alaska pipeline couldn't happen concurrently.

MR. CUPINA mentioned logistics, skills, resources and materials, saying there seems to be some question about whether both could be done at exactly the same time. He reported hearing that the Mackenzie Valley project would be done earlier, which is hard to gauge at this time.

SENATOR WILKEN asked where supplying America with Alaska's gas is in the pecking order. Noting page 13 of the aforementioned report talks about 23 projects, he said it appears today about 60 Bcf a day is consumed, projected to be 80 Bcf by 2025. Surmising the additional 20 Bcf wouldn't be from Lower 48 production, he highlighted four groups of proposals on FERC's table: the Alaska project; 11 that were approved, LNG terminals to supply about 20 Bcf; an expansion of 2 that were existing, 1 that was under construction and 1 that was operating, for

another 2 Bcf; and then 10 that were proposed, which would contribute 11.5 Bcf.

He estimated the aforementioned would total 39 Bcf, if all 23 projects were built, whereas only 20 Bcf would be needed. Senator Wilken requested a definition of "approved" and "proposed" in this context. When FERC has approved something, for example, where is that in the sequence of building an LNG receiving plant and processing plant?

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MR. CUPINA replied it is probably the biggest step, a necessary but not totally sufficient step because everything FERC approves still must meet conditions related to other federal statutes such as the Coastal Zone Management Act, Clean Air Act or Clean Water Act, administered by the states; applicants usually are successful in meeting those. Although there is a lot of activity, with investment occurring and relationships being formed, all 20-some projects won't be built; rather, the market will sort them out. Typically, the construction timetable is at least 33 months from the start of construction, perhaps 6 months after FERC approval.

SENATOR WILKEN asked whether the Alaska project is in the "approved" category.

MR. CUPINA answered it isn't even "proposed" yet; that is preceded by the "prefiling" stage; then there would be an application for the certificate. In further response, he emphasized that even though a project is already approved, it might not be built for quite a while - or at all.

SENATOR WILKEN asked where Alaska's 4 or 5 Bcf fits in with respect to supplying mid-America with gas.

MR. CUPINA expressed hope that it would be part of the mix to supply the 80-some Bcf projected. In further response, he indicated the 5 projects under construction are in the Gulf of Mexico; some of the 11 that are approved are on the East Coast. As far as what gas goes to which part of the country, however, he said it isn't clear-cut, especially with the hubs and market centers and the way gas can move increasingly in different directions.

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SENATOR BEN STEVENS recalled hearing testimony from the Alaska Gasline Port Authority ("Port Authority") that its project is

approved and ready to go with respect to the Valdez terminal. He asked whether that is included as proposed or approved.

MR. CUPINA replied no. He clarified that a predecessor to that project, Yukon Pacific Corporation (YPC), was approved by the commission at least 15 years ago.

SENATOR BEN STEVENS asked whether the YPC project is listed as a proposed or approved project.

MR. CUPINA answered no. In further response, he indicated the listed terminals are import terminals, bringing gas in to the Lower 48. However, the YPC project at the time was to export gas. The gas-line proposal being contemplated now would, to his understanding, bring gas to the Lower 48, but that hasn't been before FERC. He noted when FERC approved the YPC project an evaluation was made - by the U.S. Department of the Interior, to his belief - on environmental impacts of the pipeline upstream of Valdez, to bring the gas to the terminal before it is liquefied. Possibly some analysis from that environmental impact statement (EIS) is still valid, but it was a long time ago. The project as contemplated today isn't before FERC.

CHAIR SEEKINS surmised the Port Authority project cannot just assume the YPC approval, but must seek its own.

MR. CUPINA said he believed so, and some circumstances are different because the previous project was an export project, while this one would bring gas to the Lower 48; thus it would be interstate commerce, not foreign commerce.

SENATOR WILKEN, in response to Chair Seekins, clarified that his own question hadn't related to the Valdez project; rather, he was trying to figure out where the larger project fit in. He asked whether the website shows the status and capacity of those 23 projects.

MR. CUPINA affirmed that. He explained that the report highlights not so much that demand will be satisfied by these projects, but the importance of being in the game, gaining headway in order to be part of the ongoing dynamic to satisfy the need. It is by no means certain where all these pieces will end up just because they are approved or proposed.

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CHAIR SEEKINS asked whether some of these projects approved by FERC have run into opposition from the states.

MR. CUPINA replied yes. For example, in Massachusetts they'd been informed of opposition by public and state officials.

SENATOR STEDMAN said Senator Wilken's points about the report were good, but he'd read it more as "the window of opportunity is not going to stay open forever for Alaska, and we need to get our house in order and get to market before a competitor does." He suggested delays of three or four years would create an issue with that window of opportunity.

SENATOR THERRIAULT reported that his office had e-mailed to committee members several pages received from Dr. Tony Finizza of Econ One Research, Inc., this morning. That document talks about the window of opportunity, noting LNG and nonconventional gas - from tight sands and coal bed methane, for instance - fill the market differential, but likely would be the first gas pushed out of the market by other supplies, including the proposed Alaska project.

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MR. CUPINA pointed out although the open season is one first step, the report also mentions that the open season could take place after the FERC pre-filing process begins and during that process, which could save six months' time. The staff and commission could be active in developing the application and working with the stakeholders; that is where staff resources can really be brought to bear in helping to develop the project. Thus FERC sees the beginning of the pre-filing process as a more important milestone than completing the open season beforehand.

He explained, in response to Mr. Loeffler, that the aforementioned is in the regulations for LNG, but also in the guidelines at FERC.gov for pipeline projects. It is part of the process to identify issues as early as possible and try to resolve them up front, bringing all stakeholders in. Mr. Cupina reported good results from this, and said Congress saw fit to make it mandatory for LNG projects because of the level of public involvement. It is pre-filing, before the application. In further response, he indicated sponsors of gas pipeline projects are strongly encouraged to use this option. The goal is to cut the time and produce a better EIS, so everybody's concerns are addressed.

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MS. NEWMAN pointed out that, as a matter of law, contracting parties cannot confer jurisdiction on FERC if FERC doesn't have

it. She agreed with Mr. Keithley that FERC historically has accepted jurisdiction over facilities - even gathering facilities, exempt from its jurisdiction by statute - and then issued rates after concluding this was in connection with interstate transportation. However, a District of Columbia Circuit decision, written by now-Justice John Roberts, said although everyone had requested jurisdiction over certain facilities, it didn't exist and couldn't be asserted unless Congress changed the law.

She noted the question becomes whether some facilities fit within the letter of the law; this depends on what they are and how they're used, and a body of law defines which facilities are and aren't FERC-jurisdictional under the Natural Gas Act and/or ANGPA, if it confers something different. It isn't certain, just because FERC does it, that it will survive. As to who could or would challenge it, Ms. Newman didn't have the answer. It depends on who is bound by the commitment to go to FERC and request FERC jurisdiction; then it depends on whether FERC, in light of the recent District of Columbia Circuit decision, will assert jurisdiction over something it doesn't really have jurisdiction over. It will be a matter of law that decides it - not a matter of preference.

CHAIR SEEKINS asked what Ms. Newman proposed as a solution.

MS. NEWMAN suggested if everyone wants to confer jurisdiction on FERC over particular facilities, perhaps FERC should be asked for guidance as to whether facilities that can be adequately described at that point are FERC-jurisdictional, rather than waiting until the application is filed.

CHAIR SEEKINS asked: If the gas transmission lines weren't subject to FERC jurisdiction, would they be under jurisdiction of the Regulatory Commission of Alaska (RCA)?

MS. NEWMAN replied it would depend on Alaska Statutes.

MR. LOEFFLER noted it's a whole separate analysis.

MS. NEWMAN agreed, indicating if Alaska conferred jurisdiction to an Alaskan regulatory body over facilities used in the way these facilities would be used, the answer would be yes. If it didn't, the answer would be no. Then theoretically there would be no regulation.

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CHAIR SEEKINS acknowledged he isn't a lawyer, but remarked that from reading the law it appears they must be under some kind of regulation.

MS. NEWMAN responded that, as a practical matter, this isn't the case. Facilities fall between the cracks.

MR. LOEFFLER agreed with Ms. Newman, but pointed out that a lot of facts aren't known today.

CHAIR SEEKINS asked: Regardless of who owns the project, would the same questions arise at the same level?

MS. NEWMAN affirmed that, saying what dictates jurisdictional status is the nature of the facilities and how they are used.

CHAIR SEEKINS posed a situation in which the transmission lines are found not subject to FERC regulation. He surmised a company perhaps could charge whatever rate it wanted for access to those lines by any willing shipper.

MR. LOEFFLER emphasized "perhaps," noting they could be subject to regulation. There are divisions among field facilities, gathering lines, transmission lines and interstate transmission lines. It gets complicated.

CHAIR SEEKINS suggested if those were built by ConocoPhillips or BP, for instance, that company perhaps would determine whether there was access and at what cost, regardless of who the shipper downstream was.

MR. LOEFFLER replied, "Perhaps."

MS. NEWMAN, in response to Chair Seekins, agreed these jurisdictional issues aren't project-specific. She couldn't say right now, with the limited information she'd seen, whether or not the facilities linking the gathering system to the plant would be under FERC jurisdiction. Ms. Newman offered her belief that FERC has indicated, if there is a conditioning plant and the desire is for an unbundled rate, that there would still be the jurisdictional step of determining whether the conditioning plant itself is jurisdictional. "They may be very close to that, conceptually, already," she added.

CHAIR SEEKINS referred to testimony about strict rules against anticompetitive actions, and strict penalties if such activities are detected relating to facilities and pipes regulated by FERC.

MR. CUPINA noted those were covered by Mr. Pease with respect to EPAct authorities and FERC enforcement.

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SENATOR BEN STEVENS expressed concern about encroaching on an individual owner's right to operate a facility. One hypothetical example involved a unit owned by a consortium that doesn't want to invest in a pipeline to the GTP, but wants to go to FERC and request mandatory access to a pipeline built by owners of three other units. He voiced concern that even if FERC didn't have jurisdiction, someone could petition for it, to obtain access control or to circumvent the need to invest in one's own facilities to get to the GTP. He said it's either FERC-regulated or owner-operated; if the latter, they don't have to give access to anyone unless there is a negotiated agreement.

MS. NEWMAN acknowledged that.

MR. LOEFFLER explained that if it is a unit facility, a pipeline within a unit, FERC usually doesn't touch it. Although there have been historic questions about access to unit facilities by smaller parties, the contract doesn't touch that or intend to do so. If a company builds a pipeline to ship just its own gas and it isn't FERC-jurisdictional, to his understanding, RCA's view has been this: If it isn't offered to someone else, "you can keep it to yourself." Even that area of law with respect to RCA is evolving, however. Mr. Loeffler surmised a 100-mile pipeline feeding into the main line and going out of state would be FERC-jurisdictional, and then the open season and access requirements would apply.

MR. KEITHLEY added that BP - and probably the other parties to the proposed contract - looked at the lines from the unit to the GTP and onward, under applicable FERC law, and concluded they are validly FERC-jurisdictional. They aren't saying FERC has jurisdiction simply because all the parties agree, and they aren't proposing that FERC take jurisdiction over something questionable. Mr. Keithley said he didn't want to get into future lines that may or may not be FERC-jurisdictional.

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CHAIR SEEKINS highlighted the concern of not wanting an anticompetitive situation, but also not wanting it to be punitive towards someone who already made the investment.

MS. NEWMAN raised the question of the rate structure and what happens if the capital structure changes tomorrow, for instance. She explained that the FERC process works through a series of sections in the Natural Gas Act. Section 7 establishes the initial rate for the service to be offered, in this case the pipeline. The second step is that FERC usually conditions a brand-new facility on its coming in, in three years, for a rate justification; this affects a tariff rate, but not a negotiated rate under a contract with shippers.

She noted the next step is a possible rate-increase filing by the pipeline under Section 4. However, pipelines in the U.S. for the last 15-20 years haven't filed rate cases. Ms. Newman said the only alternate is Section 5, a complaint process filed by FERC or a shipper; providing prospective relief only, it is rare, though seen in the past year because pipeline rates have gotten so out of whack. Once the rates are set in a certificate case and go through the rate justification, they are only likely to change if the pipeline makes a filing. Since FERC doesn't review things as a matter of course to see if there is over-earning, someone must take initiative to trigger the proceeding.

CHAIR SEEKINS asked whether there were further questions or clarifications. Hearing none, he thanked participants and held SB 3001 and SB 3002 over.

There being no further business to come before the committee, Chair Seekins adjourned the Senate Special Committee on Natural Gas Development meeting at [12:58:43 PM](#).