

**ALASKA STATE LEGISLATURE  
SENATE RESOURCES STANDING COMMITTEE**

February 5, 2007

4:13 p.m.

**MEMBERS PRESENT**

Senator Charlie Huggins, Chair  
Senator Bert Stedman, Vice Chair  
Senator Lyda Green  
Senator Gary Stevens  
Senator Lesil McGuire

**MEMBERS ABSENT**

Senator Bill Wielechowski  
Senator Thomas Wagoner

**OTHER LEGISLATORS PRESENT**

Senator Fred Dyson  
Senator Joe Thomas

**COMMITTEE CALENDAR**

Regulatory Commission of Alaska  
Natural Gas Contracts

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

KATE GIARD, Chair  
Regulatory Commission of Alaska (RCA)  
Department of Commerce, Community & Economic Development  
Anchorage, Alaska

**POSITION STATEMENT:** Presented information on natural gas contracts and pricing.

**ACTION NARRATIVE**

**CHAIR CHARLIE HUGGINS** called the Senate Resources Standing Committee meeting to order at [4:12:59 PM](#). Senators Huggins, Stevens, Stedman, Green, and McGuire were present at the call to order. Senators Dyson and Thomas were also in attendance. Chair

Huggins said it will be an educational session. Cook Inlet natural gas is the parameter of interest, he noted.

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### **Overview-Regulatory Commission of Alaska**

KATE GIARD, Chair, Regulatory Commission of Alaska (RCA), said Tony Price, RCA commissioner, was also with her. She will speak to the increases in the price of natural gas in Cook Inlet and Southcentral Alaska and on RCA's recent rejection of Enstar's contract with Marathon. "We come today to talk to you about what has happened in Cook Inlet that has both contributed to the increase in costs that your constituents are bearing and our ultimate decision to reject the Marathon contract." She said she will touch upon all gas users and suppliers in Cook Inlet because Enstar contracts touch upon the very issues of supply and demand. The RCA hearing process is different from legislative hearings, she explained. "We take a record and have experts come to us, but they're also cross examined by different parties." The experts are cross examined by someone with a different financial interest, so it is like civil court, she stated. Commissioners also have the ability to ask questions. The process creates a record that has been subject to scrutiny, "and that's the record we base our decisions on."

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MS. GIARD provided the names and backgrounds of the commissioners of the RCA. She said the commission is highly accredited.

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MS. GIARD said the RCA statutory authority includes telecommunications, oil and gas pipelines, electric utilities, natural gas utilities, water and waste water utilities, provisionally certificated utilities, garbage utilities, and Power Cost Equalization program administration.

SENATOR DYSON asked which gas pipelines are regulated.

MS. GIARD said RCA regulates all gas pipelines in Cook Inlet. The RCA recently accepted a stipulation on the Cook Inlet gas gathering system to come under regulation, "and that means that by now we have regulated, I believe, all but one." She said RCA will regulate the spur line and intrastate shipments on oil or gas pipelines. Inter-unit lines are not regulated by the RCA-

"those are gathering lines and so we do not regulate those. We also regulate TAPS [Trans Alaska Pipeline System]."

SENATOR DYSON asked if the RCA will regulate any pipelines that are constructed in the future that will take care of the state's royalty share for instate use.

MS. GIARD said the RCA will regulate any intrastate shipments.

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MS. GIARD said the RCA regulates the contracts that Enstar negotiates through its tariff sheet 90. The operating rules require that a base supply contract that increases the average cost of gas to the consumer will need approval from the RCA, and a contract that will decrease the cost of gas can be put into effect immediately.

SENATOR GREEN said she has never seen a presentation like this. "And I just want to confirm that we're not going to get into anything that's going to put us, then, listening to the people who are before you and retrying this at this committee. I'm very concerned about the agenda." She said she will defer to Ms. Giard's comfort level that the hearing will not create a floodgate of the two entities coming in to explain each side.

MS. GIARD said she believes that it is a good idea for the committee to have any kind of public conversation with Enstar and Marathon, because it is good public policy. The materials that she will present are public information and they resulted from the hearing that RCA held. She said she can't promise that Enstar, Unocal or Marathon won't come before the committee.

CHAIR HUGGINS said he prefers not to go through "the bowels of contract negotiations and all the ramifications."

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MS. GIARD said advance approval of contracts is unusual compared with other states. Normally a gas utility will engage with a supplier and then the regulator commission looks at it in arrears to see if the gas contract was reasonable. She stated that the RCA has always approved Enstar's gas contracts in advance. Enstar's focus is to secure supply, and that is a critical point. Enstar does not have a direct impact on the price of the contracts; they secure supply but the price flows through to the ratepayer. The ratepayers pay all costs associated with the negotiation, "so they'll pay the costs of Enstar engaging in the negotiation; they'll come to us for

approval of those costs as well." She suggested it was similar to a neighbor finding a vehicle as a favor to someone. "They're going to go out and do their best getting you a vehicle, but they're going to bring it home and put it in your driveway...and you're going to pay." To have Enstar have a financial commitment to pay for the gas is something that is not done anywhere in the country, she said. "It's all flown through." She added that someone needs to look to make sure they are reasonable when they're flowing through the price to the consumers.

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MS. GIARD said Enstar is very knowledgeable about the operations of the Cook Inlet producers, but they don't have information that is not publicly available. Enstar does not have the kind of information the producers have when negotiating a contract, so Enstar frequently has been in a challenging position, which has been described by Richard Barnes who is a former president of Enstar. She said Enstar frequently feels it doesn't have control over future gas supplies because of the industrial use of these supplies. Enstar presents a ten-year forecast to RCA as justification for its contracts. It has recently modified its projection because of warming weather.

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MS. GIARD said Enstar is not that far off in its projections. The approval process consists of the contract being filed with the RCA, which takes public comment and investigates to see if the price is reasonable for secure supply. Other parties with financial interest intervene, she said. In the Unocal contract, Marathon intervened to oppose it and the attorney general intervened on the behalf of the ratepayers. She said Tesoro intervened with Marathon in this contract, and a ratepayer intervened. These parties develop their own case to present to the RCA. The hearing requires that Enstar meets its burden of proof of reasonable pricing terms for the secure supply. Then the RCA adjudicates and makes a final decision. It is a standard method for approval of any matter before the RCA. The RCA is charged with making a balanced decision, and the attorney general intervenes in the interest of the Alaskan ratepayer.

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MS. GIARD said she will now discuss Enstar's current contracts and the cost of gas to its customers. Gas prices have increased by almost 81 percent over the last three years, she noted.

CHAIR HUGGINS asked if that price was for Cook Inlet and Enstar.

MS. GIARD said it is the gas price for a residential user. Enstar makes annual calculations and presents what an average family will pay. A chart showed family costs of gas over time. A family who paid \$854 annually for gas in 2004 will pay \$1,547.59 in 2007. This is the reason there have been "conversations from your constituents," she stated.

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MS. GIARD said the change in price is from several factors. Enstar has several different contracts with different pricing mechanisms, she stated. "They have one contract, APL-4, which is priced on a base price. In 1988 it had a base price of \$1.55, and it was adjusted annually for the last many years based on the change in the price of oil." When the contract began, the price of oil was \$18, and it recently went over \$70. Marathon's APL-4 contract has a limiter on the price increase, she noted.

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MS. GIARD said the Beluga contract is similar to the Marathon contract, but it doesn't have a limiter. The Henry Hub is a three-year Henry Hub pricing mechanism, she said, "which is a 36-month trailing average of the Henry Hub's futures contract."

SENATOR DYSON asked if the difference between the Henry Hub and prices allowed by the RCA is the transportation cost.

MS. GIARD said, "The price that you receive is a weighted average price, so these prices are what Unocal paid--\$7.98, that includes transportation and taxes, for the gas that it provides, the volumes that it provides to Enstar. Beluga is the same; I think it provides 3 million." She said they are paid according to the volumes they provide and then Enstar does a weighting calculation and it gets a weighted average price, "and that's the \$7.02 that your ratepayers are paying this year."

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MS. GIARD said the increase in price is a product of multiple factors. Aurora's Moquawkie gas was relatively inexpensively-priced gas, and "these volumes have stopped." The contract is in litigation because Aurora said it is uneconomic. "The Beluga is the \$6.33 price that you've seen, but it's got pretty small volumes." The Unocal contract has the highest price--the three-year Henry Hub--and has exceeded the Marathon contract in volume. Ratepayers see such a significant increase in gas prices because the Henry Hub price is increasing and it is now the main supplier. As years go by, as the trend continues, the change won't be as significant, she surmised.

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MS. GIARD said the pricing models have changed.

SENATOR McGUIRE asked about the limiter boundaries. She asked, "If a company enters into a gas contract where that rate is significantly lower than the Henry Hub for a period of years, is that something that RCA takes into account as opposed to simply reflecting on the Henry Hub price?"

MS. GIARD said the Marathon contract is limited to no higher than 20 percent to protect the ratepayers from strong jumps.

SENATOR McGUIRE said the difference in the Henry Hub price is a result of hurricane Katrina that didn't affect Alaska. "So does RCA look at Henry Hub price index even if...Enstar or another company supplying gas had a gas contract in place with a set dollar amount that they were getting that gas at that was significantly lower than the Henry Hub price, is there a consideration on the part of RCA for that?"

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MS. GIARD showed the committee a 36-month Henry Hub chart, which was provided by Enstar. It showed the impact of the 2005 hurricanes. She said RCA would not modify the Henry Hub for those "acts of god." She said the contract allows a 36-month trailing calculation, and that is the calculation that went into effect on January 1, 2000. She said she is not sure of others having gas available at a lower fixed price. She noted that Enstar has contracts with big producers, and the only small producer was Aurora. Many others would like to provide gas to Enstar, including Trading Bay. Trading Bay asked the RCA to allow 10 percent of the gas to be used by smaller utilities. She said the commission did not address that issue.

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MS. GIARD asked if that is enough information to answer constituents.

SENATOR DYSON said he has heard that one reason there has not been an increase in exploration in Cook Inlet is because of price. There has been pressure to allow the gas price to float with the Henry Hub to encourage further development.

MS. GIARD said when Enstar agreed to the contract with Unocal, "what Enstar was looking for was a new provider; Marathon in 1995, and that's why...the history of Enstar's negotiations in

Cook Inlet is very interesting." Marathon had a contract with Enstar, and in 1995 Enstar asked Marathon for 400 billion cubic feet (bcf) of gas--about 17 years worth of gas. Enstar's president said Marathon told Enstar it was going to sell the gas to Japan and for Enstar to look for other suppliers. Enstar analyzes data of supply and demand when it looks for suppliers, she said. She showed a graph that indicates a decline in reserves in Cook Inlet. Enstar was told to find another provider, and it was concerned because it negotiates without much information from the producers; Enstar only knew that reserves were declining. So Enstar wanted to encourage exploration, and in order to encourage exploration it said that it needed to pay prices that were competitive with the lower 48, Ms. Giard explained. Enstar turned to the lower 48 market, probably with help from the producers it was negotiating with, she stated. The producers needed to tell their owners in the lower 48 that they could get competitive prices, and that was the genesis for the Henry Hub. The attorney general did not support the use of the Henry Hub, she said. His recommendation was a well-head price, primarily because the Henry Hub includes transportation and taxes already in the price. "So one of the reasons we rejected the Marathon contract this time was because, again, we said Henry Hub has transportation and taxes included and we're not going to ask Alaska ratepayers to pay over and above. So, at the time, the attorney general recommended the well-head price, the U.S. average well-head price."

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MS. GIARD said the RCA found that Enstar had met its burden of proof and their case was persuasive, so RCA allowed the contract to go forward under Henry Hub.

SENATOR DYSON said there was hope that an increased price would encourage more development.

MS. GIARD said the record showed no noticeable increase in the reserves as a result of the Henry Hub contract. The finding was based on testimony that said net reserves were still going down. She said the RCA looked at if the Henry Hub was the right market. There is no net increase in reserves, she noted. The 2004 study provides a hypothesis of what drives exploration and development in Cook Inlet. She said it was interesting that in the history of supply and demand in Cook Inlet, there were only three times when sizeable reserves were added, and one was substantial: 1.4 trillion cubic feet (tcf). The increases happened when the LNG export license was up for renewal. The RCA

had to compare the benefit and detriment of the Henry Hub, she said.

SENATOR STEDMAN asked if that will happen again during the next renegotiation.

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MS. GIARD said that is an appropriate question to ask ConocoPhillips and Marathon. The evidence is that Marathon has been engaged in exploration and development activity since 2002. Marathon provided, in the confidential record, indications of reserves; they had to provide that to Enstar, she said. Those are not questions in RCA's record, and the only information she can provide to the committee is information that RCA bases its decisions on. "That will provide you with some information to make your own decisions on what the proper market is for the pricing of Enstar's natural gas contracts."

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SENATOR McGUIRE said the concern is the shortage of supply that is declining significantly. She asked if there is a message to Enstar for future negotiations. She asked what the company could do to negotiate some gas sale contracts that are going to work.

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MS. GIARD said the RCA did not provide specific guidance to Enstar as to how to price its future contract. They sought guidance, but RCA declined to give it to them because RCA needs to be able to make a decision on whatever Enstar brings forward. The dissenting and concurring statements will provide information to Enstar, she said. There is more information that leads to why those increases likely occurred, and there has been much discussion on how to determine what market benchmarks to use for Cook Inlet. How does it set prices to attract local producers to sell to Enstar and the utilities as compared to other alternatives? She explained:

When you settle down in your own market, and you understand some of the drivers of that market, you realize, well, we didn't lose 400 bcf to Henry Hub; they didn't take it away from us. They didn't negotiate better than we were able to negotiate. What you find is that the market driver is very much...and Marathon's alternative source of revenue is the export of LNG, so you settle in your own market and you understand and you look at that. Enstar's ratepayers can't afford to pay the highest cost of gas that any

one pays in this market. And as long as whatever they pay is reasonable in relation to what the alternatives are for this market, then the ratepayers can understand the connection. What we hear and why one of the reasons we could not support the Henry Hub contract, is that there's really no connection between the lower 48 Henry Hub and Alaska. There are no connections. The gas can't go there. The gas goes across the North Pacific Ocean to Japan.

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If Marathon is going to sell gas to an alternative to the utilities, it's going to be to the LNG market. So that, at the end of the day, is the market that Enstar needs to turn to. And they know that. Ex-president Barnes knew that. That he had to be competitive with that market or he was going to lose volumes.

CHAIR HUGGINS asked about storage of gas and the role of RCA.

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MS. GIARD said the RCA does not regulate storage of gas in Cook Inlet. Storage may be considered a total system of pipe, and the RCA has jurisdiction of a total system of pipe. Storage is regulated in the lower 48, she told the committee. But RCA has not exercised jurisdiction over storage facilities in Cook Inlet. The Unocal contract was presented to the RCA with storage embedded in the pricing. She said one of the reasons that the Unocal contract was attractive was because Unocal was going to provide storage to meet Enstar's winter needs.

SENATOR DYSON asked if LNG export is a market that is comparable to Henry Hub prices less transportation.

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MS. GIARD said the Japanese contract that ConocoPhillips and Marathon have is tied to the world oil prices in Japan. The prices of LNG delivered from Cook Inlet are available from the Department of Energy. The prices are the delivered price of Cook Inlet natural gas converted to LNG and shipped, and there is no direct relationship between those prices and the Henry Hub.

SENATOR DYSON said the inference is that Enstar has to compete with what ConocoPhillips and Unocal could sell to the Japanese, so that market is the default floor of Alaska's gas market.

MS. GIARD said only for Marathon and ConocoPhillips, and that is only through the evidence that was presented by Mr. Barnes in the last hearing.

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MS. GIARD said constituents can contact the RCA. There is a wealth of information on Cook Inlet on the Department of Energy website. She said it is helpful to look at Cook Inlet as it compares to the lower 48. The comparison will give an interesting perspective. She noted that the information is accessible to the Department of Natural Resources (DNR). She said the RCA rejected the Marathon contract because it did not find that the Henry Hub price was reasonable. The contract had a \$15 cap, and she showed a graph of what that would cost an average family annually [\$2,870.16]. "The world in the lower 48 would need to come apart, hopefully, before gas ever rose to \$15 per mcf [million cubic feet]; nevertheless, you cannot look at a contract for Alaska that has that price capability compared to what the alternatives are for the Alaska market."

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SENATOR DYSON said it is important to know what the proven and potential reserves are in the area. The inference he derived is that it is not known, and there are no economic drivers to get the explorers out there to find out. Before investing in a spur line or a bullet line, "getting a handle around what are the potential reserves in Cook Inlet, at what gas price and how long they will last us...all of us need to know."

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CHAIR HUGGINS said DNR is the lead for getting a gas pipeline for Alaska; "they also hold the answers to the questions that Senator Dyson was talking about: the reserves in Cook Inlet." Before making huge investments, he wants a better feel for what is in Cook Inlet.

MS. GIARD said the RCA position is to comment on materials from the record. The information from today is really a distillation of the evidence that's been filed before it. "I wish you well in your task, but our house is a bit smaller than that. We really are focused on the jurisdictional areas of gas utilities."

The Senate Resources Standing Committee adjourned at [5:03:59 PM](#).