SCOMM

148:7

The Palin-Parnell Administration presents

AGIA

The Alaska Gasline Inducement Act

Last Updated: March 12th, 2007

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The Alaska Gasline Inducement Act

Introduction

Presentation 1

Need for the AGIA approach
State value for the $500M (Part I)

Presentation 2

State value for the $500M (Part II)
Increasing Resource Owner Predictability

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Need for the AGIA Approach

Overview of AGIA principals

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- Get project built, quickly
- Open the North Slope gas basin
- Open and competitive process
- Low tariffs
- Gas for Alaska
- Jobs for Alaska
- Reduce uncertainties for the Producers

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State Value for $500 million

- Project moves forward
- Lower tariffs
- Expansion Commitments
- Rolled-in rates

Prototype Pipeline Model

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Economic analyses based on:

- 4.3 Bcf/day to Alberta
- 70/30 debt to equity, 14% ROE
- Current PPT tax structure (no GTP credit)
- Pipeline cost of $20.5B ($2007)
- 30 year project life
- Gas flow 2016-2046
- Oil to Gas ratio = 7 (fixed)
- Oil price of $36.50 fixed real for project life
- $ values increase at 2%/yr

State Value for $500 million

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1. Project moves forward quicker

Losses to State For Each Year Delay

Discounted at 5% per Year

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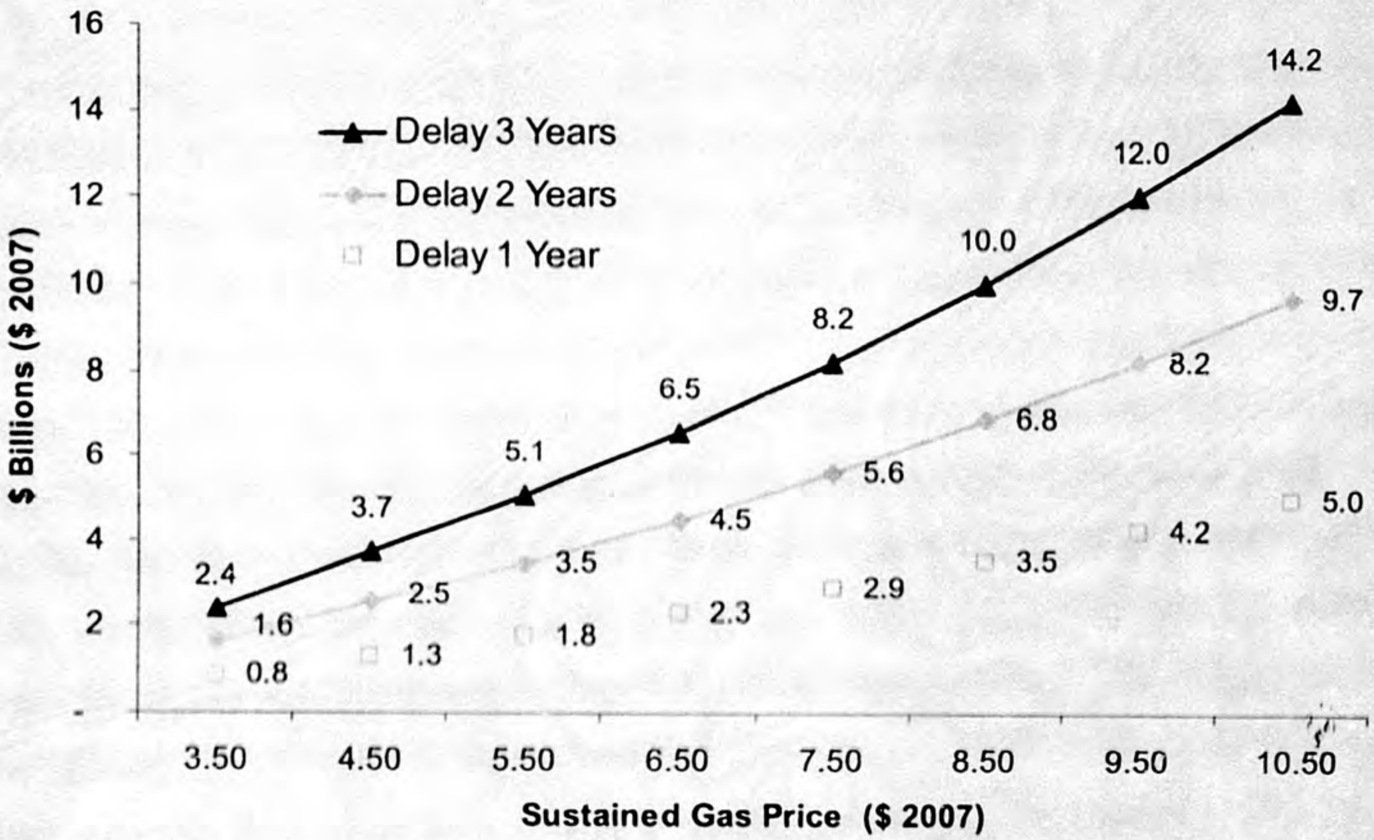

Timeline

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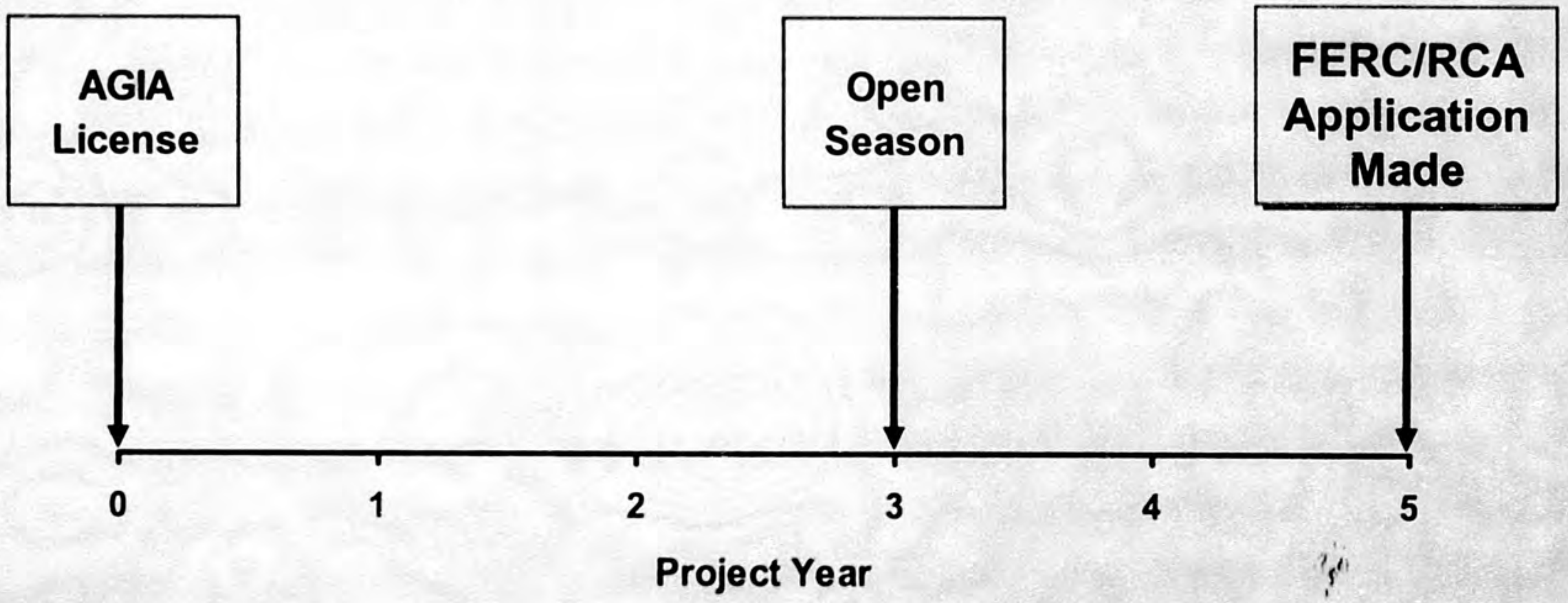
AGIA Timeline



Declining Oil Revenue

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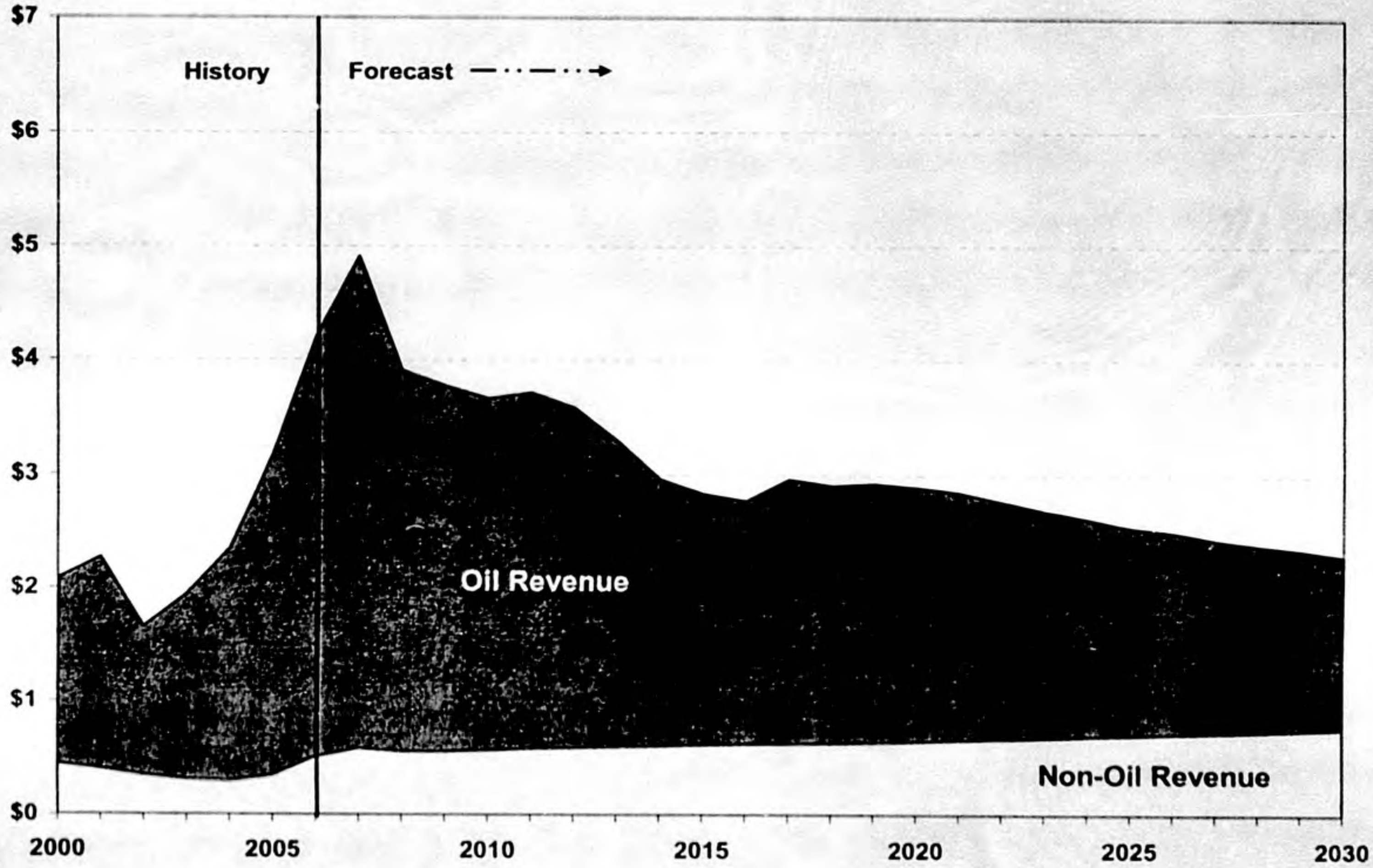
Alaska General Fund Unrestricted Revenue, Billions of Dollars



Source: Fall 2006 *Revenue Sources Book*, includes Cook Inlet

US Need for Alaska Gas

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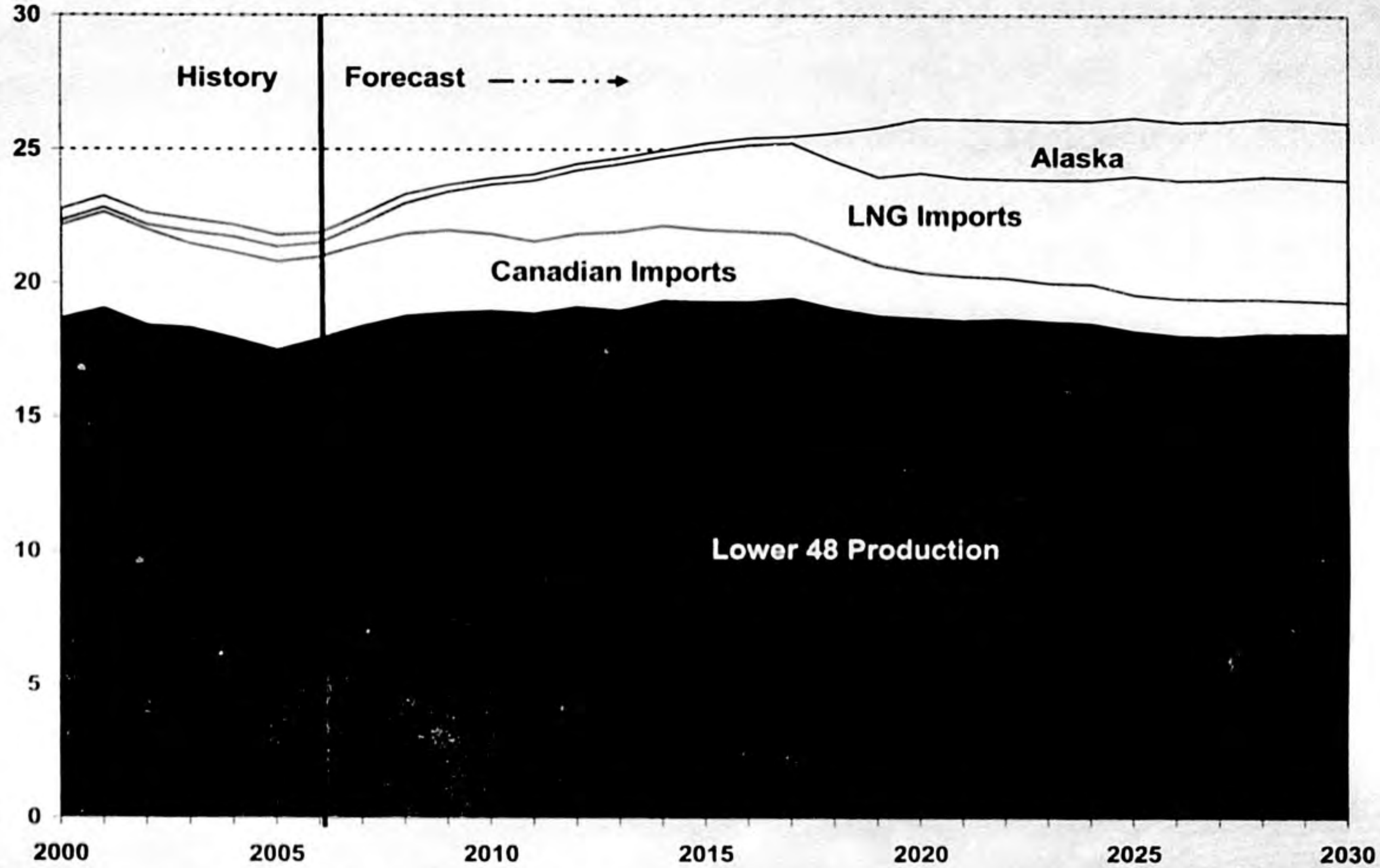
US Demand, Trillions of Cubic Feet per Year



Source: US Department of Energy, Energy Information Administration, *Annual Energy Outlook 2007*, February 2007.

State Value for $500 million

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2. Lower tariffs

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How Transportation Charges Affect State Royalty and Production Tax - Hypothetical

Destination Price		**$6.25**
Transportation Charges		
Gas Treatment Plant	**$0.49**	
Pipeline Alaska-Canada	**$1.65**	
Subtotal	**$2.14**	
Netback Value of Gas		**$4.11**

- **A 1¢ change in the pipeline tariff is worth $45 million in cumulative royalty and production tax proceeds to the State over project life.**

Payback from reduced tariffs:

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- Reduces pipeline tariff by 4-6¢ for next 30 years
- A 1¢ change in the tariff is worth $45M in royalty and production tax to the state over project life
- At 5% discount rate, state receives 70% back

State Co-Pay Reduces Rate Base Elements by More than $500 mm

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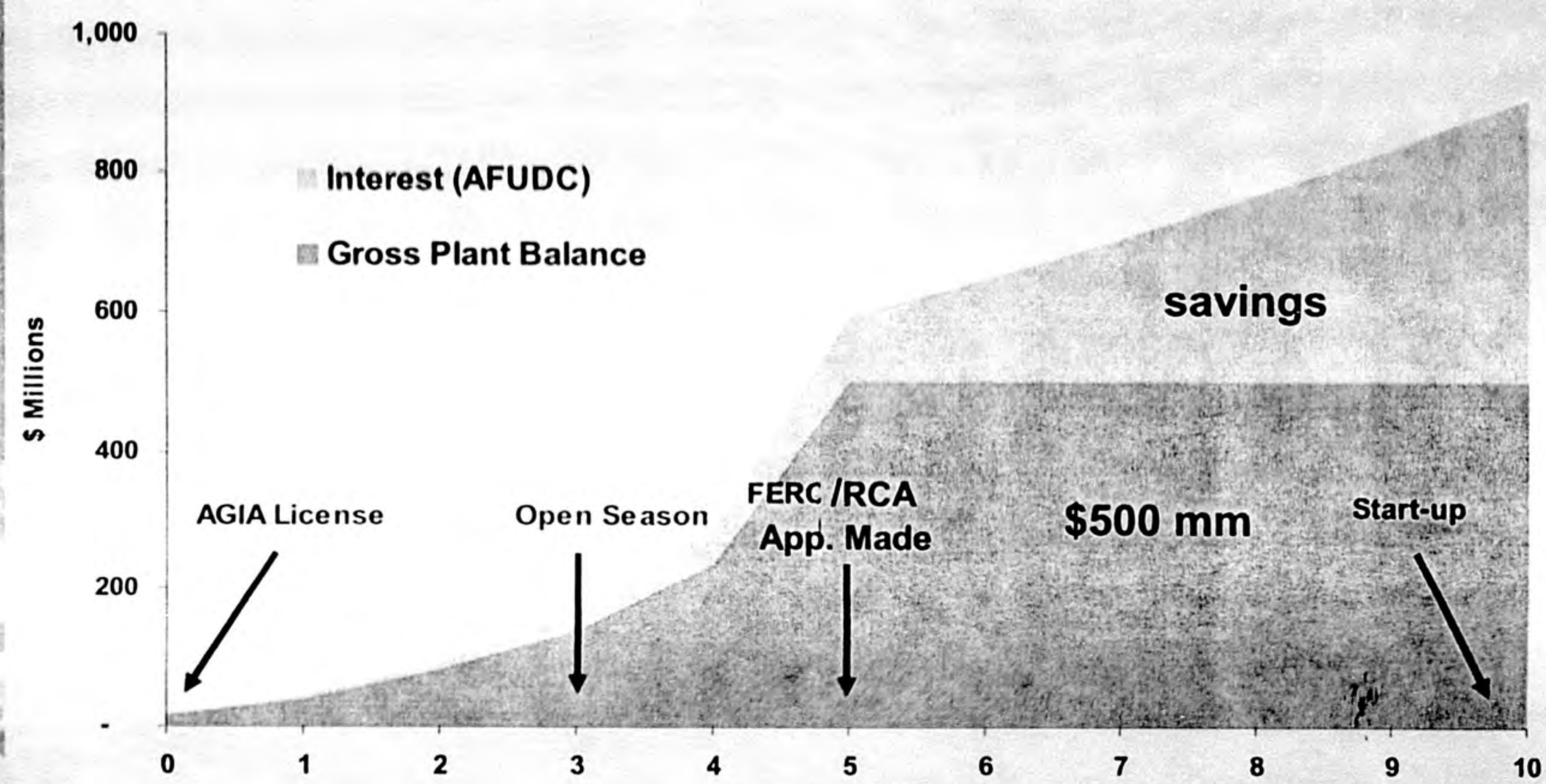

Capital Structure Requirements Reasonable, Provide Protection

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- FERC has approved 70/30 capital structure for eight of fifteen recent major new-build or expansion projects
- Three projects had 75/25 capital structures
- Three had 50 percent equity or more, with one having 65 percent equity.

Tariff and State Revenue Effects of Debt-Equity Structure

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Debt%	Equity%	Tariff	Present Value State Revenue $ Billions
80%	20%	$1.47	37.4
75%	25%	$1.56	36.9
70%	30%	$1.65	36.3
65%	35%	$1.74	35.7
60%	40%	$1.84	35.1
55%	45%	$1.95	34.5
50%	50%	$2.06	33.8
45%	55%	$2.18	33.1

AGIA protects the states interest in low tariffs. It ensures that no less than 70/30 will be used rather than 50/50, with associated tariff benefits of 41 cents and state revenue benefits of $2.5 billion.

State Value for $500 million

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3. Expansion commitments

Access Delay Prevents Exploration

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- FERC mandatory expansion process requires shippers to make capacity commitment
- Capacity commitment requires gas
- Getting gas requires investment in seismic, exploration drilling, and delineation drilling
- After investment, each year of delay in pipeline access reduces NPV of prospect by millions $
- Threat of delay will cause explorer not to invest.

Cost-of-Delay To Explorer

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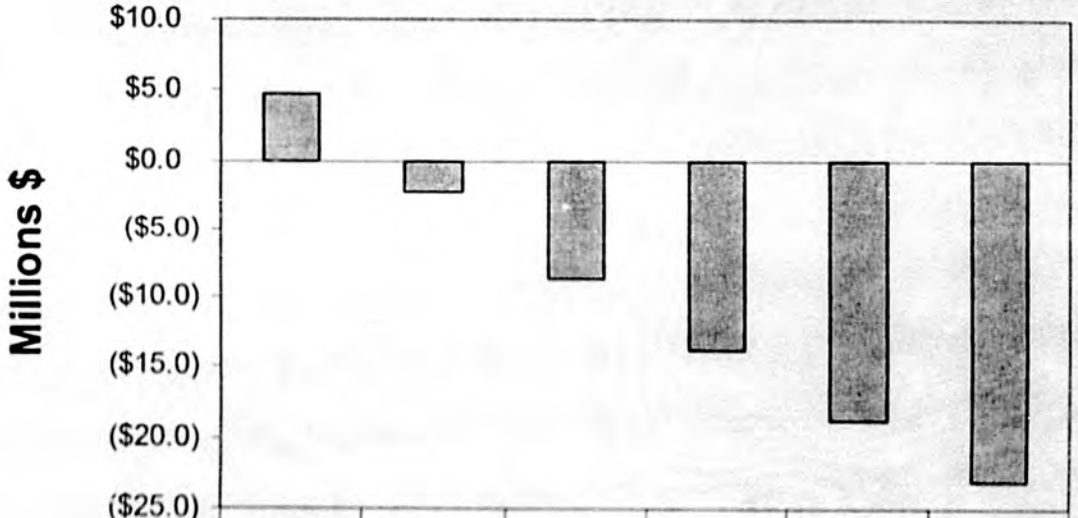
Expected Net Present Value (NPV 12)

Generic North Slope Prospect



	0	1	2	3	4	5
Operator's NPV	$4.7	($2.3)	($8.7)	($13.8)	($18.7)	($23.1)

Years Delay to First-Production

State Value for $500 million

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4. Rolled-in Rates

Rolled-in Rates for Expansions

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- Foster exploration and development
  - Expansion shippers pay lower rates, increasing likelihood of exploration
  - All shippers pay the same rate
  - Incremental rates result in some shippers paying more than other shippers

What Rolled-in Rates Are

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Initial Cost	Throughput	Initial Toll
$100	100	$100/100 = **$1.00/unit**
Expansion Cost	**Exp. Throughput**	**Rolled in Toll**
$30	18	$(100+30)/(100+18) = **$1.10/unit**
Expansion Cost	**Exp. Throughput**	**Increment. Toll**
$30	18	$30/18 unit = **$1.67/unit**

Rolled-in Rates for Expansions Encourage Exploration

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- Rolled-in rates make exploration prospects economic, which would not be economic under incremental rate treatment

- The expected value of an exploration project is greater with rolled-in rates

- This is true for both explorers and producer

Rolled-in Rates for Expansions Encourage Exploration

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IMPACTS ON PROSPECT VALUE

1ST expansion: Add 1 Bcf/day with compression (from 4.5 to 5.5 Bcf/day)

Rolled-in	*Incremental*
\$6.0 million	**\$6.5 million**

2nd expansion: Add 1 Bcf/day with compression (from 5.5 to 6.5 Bcf/day)

Rolled-in	*Incremental*
\$4.3 million	**-\$5.4 million**

3rd expansion: Add 700 MMcf/day with looping (from 6.8 to 7.5 Bcf/day)

Rolled-in	*Incremental*
\$ .9 million	**-\$25.5 million**

Rolled-in Rates for Expansions – Tariff Effects

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1st expansion
Add 1 Bcf/day with compression (from 4.5 to 5.5 Bcf/day)

	Incremental	*Rolled-in*
Existing Shippers		
Rate/Fuel Use	**$1.62 / 2.7%**	**$1.47/4.3%**
Expansion Shippers		
Rate/Fuel Use	**$1.07 / 11.6%**	**$1.47/4.3%**

2nd expansion
Add 1 Bcf/day with compression (from 5.5 to 6.5 Bcf/day)

	Incremental	*Rolled-in*
Existing Shippers		
Rate/Fuel Use	**$1.47 / 4.3%**	**$1.51 / 5.6%**
Expansion Shippers		
Rate/Fuel Use	**$1.73 / 13.3%**	**$1.51 / 5.6%**

3rd expansion
Add 700 MMcf/day with looping (from 6.8 to 7.5 Bcf/day)

	Incremental	*Rolled-in*
Existing Shippers		
Rate/Fuel Use	**$1.57 / 6.1%**	**$1.71 / 5.5%**
Expansion Shippers		
Rate/Fuel Use	**$3.25 / 5.5%**	**$1.71 / 5.5%**

Incremental State Revenue 1 Bcfd Expansion[1] in 2021

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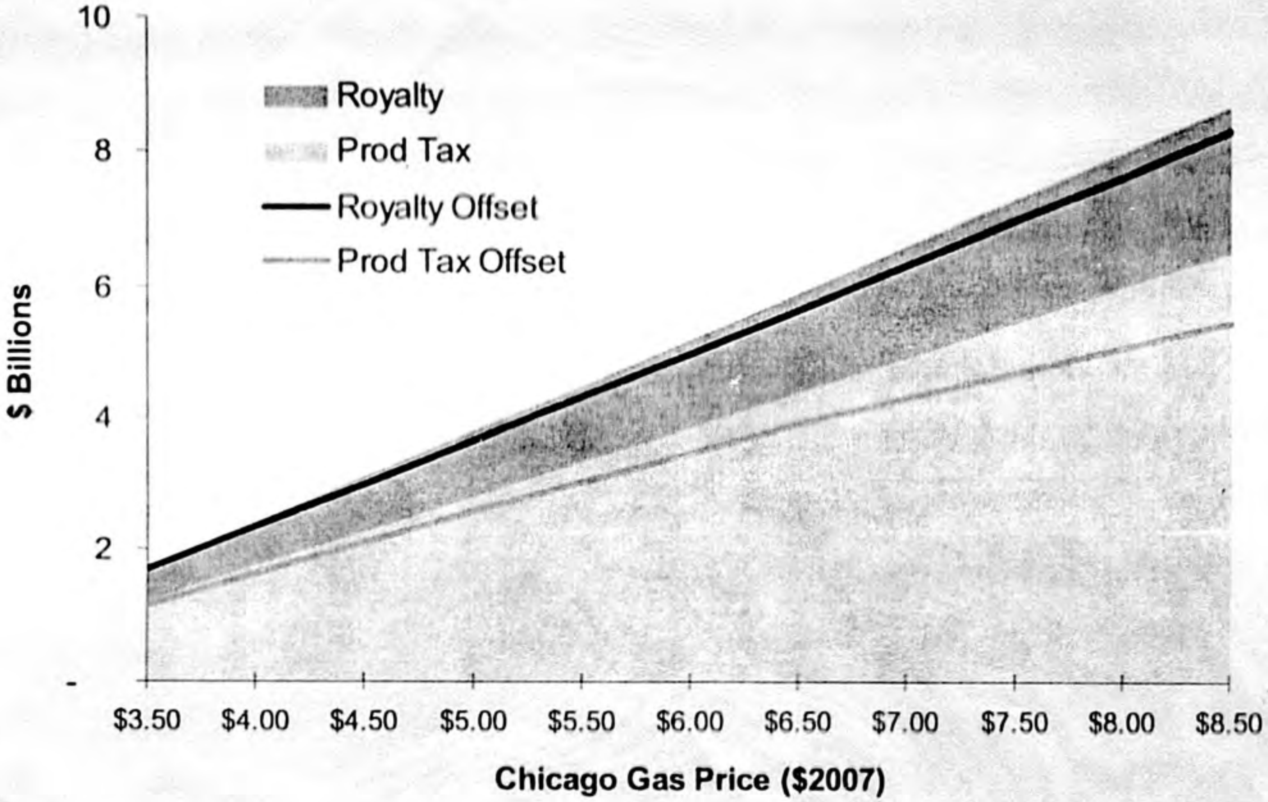

[1] Expansion through in-fill compression.

Incremental State Revenue, 700 mmcfd Looping Expansion in 2023

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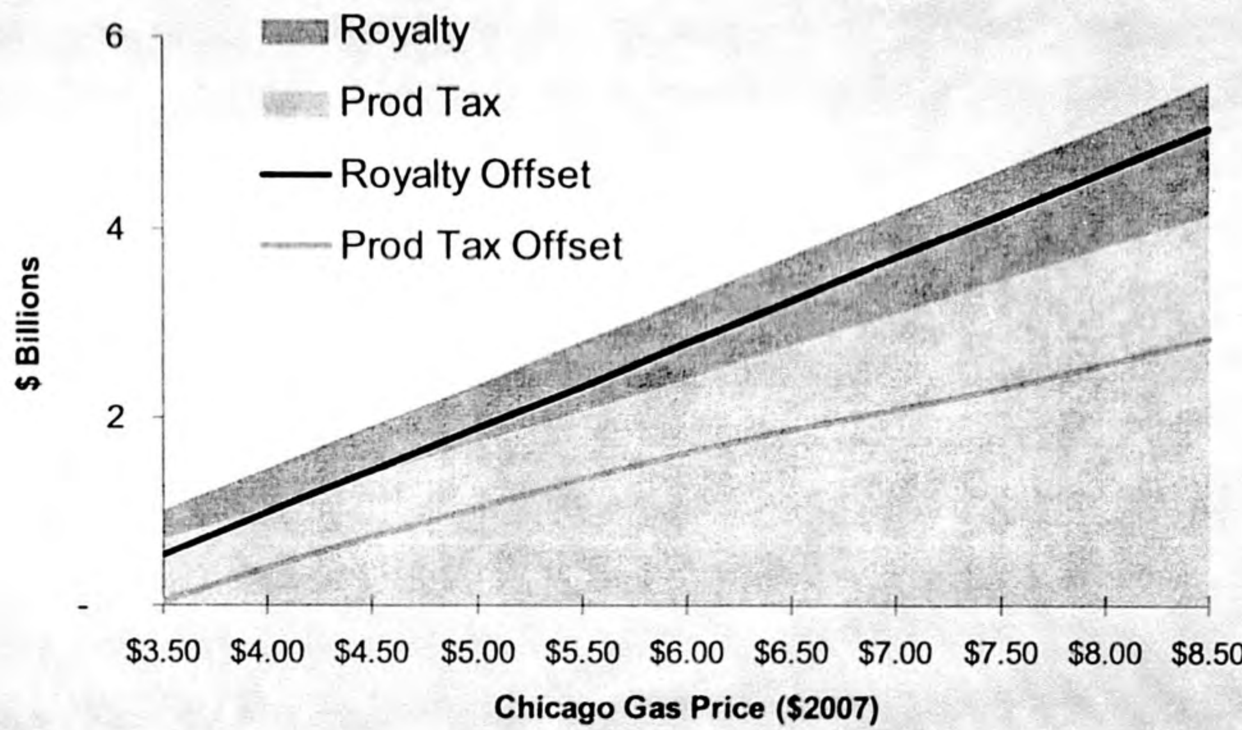

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Presentation two

Last Updated: March 13th, 2007

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Introduction

State value for the $500M (Part 2)
Evaluation Criteria and Process
Increasing Predictability for Producers
Getting Gas for the Pipeline

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State Value for $500 million

Presentation 1:

- Project moves forward faster
- Lower tariffs
- Expansion Commitments
- Rolled-in rates

Presentation 2:

- In-State Use

State Value for $500 million

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In-State Use

- 5 off-take points
- Distance sensitive rates
- Expansion provisions

Distance sensitive rates

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Hypothetical: Gas Off-take in Fairbanks

- Off-take volume to meet heating needs only
- Main pipeline sized at 4.3 BCF/D delivered to Alberta
- Main pipeline cost $20.5B
- Main Pipeline has 70% debt financing at 14% ROE

Full Tariff from NS to AK/Canada border = 72¢

Mileage-based rate from NS to Fairbanks = 46¢

Distance sensitive rates

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Fairbanks Gas Prices if capacity acquired at initial or subsequent Open Season

With distance sensitive rates:

$5.50 Alberta Gas price
minus $2.14 pipeline (Alaskan + Canadian) and GTP costs
= $3.36 North Slope netback value
+ 49¢ GTP fee
+ 47¢ tariff to Fairbanks
= $4.32 Fairbanks price

Without distance sensitive rates:

$3.35 North Slope netback value
+ 49¢ GTP fee
+ 72¢ tariff to Fairbanks
= $4.62 Fairbanks price

Distance sensitive rates

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Fairbanks Gas Prices if no capacity available through expansion

If in-state entities are not ready to subscribe for capacity in the initial open season, and if there are no expansions, then benefits of distance sensitive rates are not enjoyed.

Illustration:

$5.50 Alberta Gas price
- $2.14 pipeline and GTP costs
= $3.36 North Slope netback value
+ $2.14 pipeline and GTP costs
= $5.50 Fairbanks gas price

Evaluation Criteria

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Value to State:

- Timing
- Cost overrun mitigation
- Favorable tariffs
- Initial capacity and expansion
- State match after open season

Likelihood of Success:

- Feasibility of work plan and budget
- Financial strength
- Technical expertise
- Track Record

Evaluation Process

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1) Applications made public

2) Public review and comment - 60 days

3) Commissioners select licensee and make findings.

4) Legislative review, opportunity to disapprove

- Review of published applications
- Review of Commissioners' finding- 30 days

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Increasing Predictability for Producers

1. Royalty predictability
   - "Higher-of" Provision
   - RIV vs. RIK

2. Production tax exemption
   - Description of tax exemption structure
   - Constitutionality

Increasing Predictability for Producers

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Royalty Predictability

- Minimize retroactive adjustments
- Use public price indices
- RIK/RIV switching

Increasing Predictability for Producers

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Production tax predictability

- Tax Exemption = gas production tax obligation (current year) minus gas production tax obligation (open season year)
- Available only on gas shipped in capacity acquired in first binding open season
- Available first ten years of gas flow

Increasing Predictability for Producers

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Production tax exemption

Constitutionality

Constitution of Alaska

Article 9 - Finance and Taxation

§ 1. Taxing Power

The power of taxation shall never be surrendered. This power shall not be suspended or contracted away, <u>except as provided in this article.</u>

Increasing Predictability for Producers

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Constitution of Alaska

Article 9 - § 4. Exemptions

The real and personal property of the State or its political subdivisions shall be exempt from taxation …. [P]roperty used exclusively for non-profit religious, charitable, cemetery, or educational purposes, … shall be exempt from taxation. <u>Other exemptions of like or different kind may be granted by general law.</u> All valid existing exemptions shall be retained until otherwise provided by law.

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Getting Gas for the Pipeline

- How Much is Needed?
- Prudhoe Bay
  - AOGCC off-take study
- Point Thomson
- New exploration

18 C.F.R. § 157.34

(c) Contents of notice. Notice of the open season required in paragraph (a) of this section, shall contain at least the following information; however, to the extent that any item of such information is not known or determined at the time the notice is issued, the prospective applicant shall make a good faith estimate based on the best information available of all such unknown or undetermined items of required information and further, must identify the source of information relied on, explain why such information is not presently known, and update the information when and if it is later determined during the open season period:

(8) Based on the In-State Study and the delivery points within the State of Alaska identified in paragraph (c)(1) of this section, there must be an estimated transportation rate for such deliveries, based on the amount of in-state needs shown in the study. Such estimated transportation rate must be based on the costs to make such in-state deliveries and shall not include costs to make deliveries outside the State of Alaska;

Code of Federal Regulations Currentness
Title 18. Conservation of Power and Water Resources
Chapter I. Federal Energy Regulatory Commission, Department of Energy
Subchapter E. Regulations Under Natural Gas Act
Part 157. Applications for Certificates of Public Convenience and Necessity and for Orders Permitting and Approving Abandonment Under Section 7 of the Natural Gas Act (Refs & Annos)
→ Subpart B. Open Seasons for Alaska Natural Gas Transportation Projects (Refs & Annos)

§ 157.30 Purpose.

This subpart establishes the procedures for conducting open seasons for the purpose of making binding commitments for the acquisition of initial or voluntary expansion capacity on Alaska natural gas transportation projects, as defined herein.

§ 157.31 Definitions.

(a) "Alaska natural gas transportation project" means any natural gas pipeline system that carries Alaska natural gas to the international border between Alaska and Canada (including related facilities subject to the jurisdiction of the Commission) that is authorized under the Alaska Natural Gas Transportation Act of 1976 or section 103 of the Alaska Natural Gas Pipeline Act.

(b) "Commission" means the Federal Energy Regulatory Commission.

(c) "Voluntary expansion" means any expansion in capacity of an Alaska natural gas transportation project above the initial certificated capacity, including any increase in mainline capacity, any extension of mainline pipeline facilities, and any lateral pipeline facilities beyond those certificated in the initial certificate order, voluntarily made by the pipeline. An expansion done pursuant to section 105 of the Alaska Natural Gas Pipeline Act is not a voluntary expansion.

§ 157.32 Applicability.

These regulations shall apply to any application to the Commission for a certificate of public convenience and necessity or other authorization for an Alaska natural gas transportation project, whether filed pursuant to the Natural Gas Act, the Alaska Natural Gas Transportation Act of 1976, or the Alaska Natural Gas Pipeline Act, and to applications for expansion of such projects. Absent a Commission order to the contrary, these regulations are not applicable in the case of an expansion ordered by the Commission pursuant to section 105 of the Alaska Natural Gas Pipeline Act.

§ 157.33 Requirement for open season.

(a) Any application for a certificate of public convenience and necessity or other authorization for a proposed Alaska natural gas transportation project must include a demonstration that the applicant has conducted an open season for capacity on its proposed project, in accordance with the requirements of this subpart. Failure to provide the requisite demonstration will result in an application being rejected as incomplete.

(b) Initial capacity on a proposed Alaska natural gas transportation project may be acquired prior to an open season through pre-subscription agreements, provided that in any open season as required in paragraph (a) of this section, capacity is offered to all prospective bidders at the same rates and on the same terms and conditions as contained in the pre-subscription agreements. All pre-subscription agreements shall be made public by posting on Internet websites and press releases within ten days of their execution. In the event there is more than one such agreement, all prospective bidders shall be allowed the option of selecting among the several agreements all of the rates, terms and conditions contained in any one such agreement.

§ 157.34 Notice of open season.

(a) Notice. A prospective applicant must provide reasonable public notice of an open season through methods including postings on Internet Web sites, press releases, direct mail solicitations, and other advertising. In addition, a prospective applicant must provide actual notice of an open season to the State of Alaska and to the Federal Coordinator for Alaska Natural Gas Transportation Projects.

(b) In-State Needs Study. A prospective applicant must conduct or adopt a study of gas consumption needs and prospective points of delivery within the State of Alaska and rely upon such study to develop the contents of the notice required in paragraph (a) of this section. Such study shall be identified in the notice and if practicable, shall include or consist of a study conducted, approved, or otherwise sanctioned by an appropriate governmental agency, office or commission of the State of Alaska. In its open season proposal, a prospective applicant shall include an estimate based upon the study, of how much capacity will be used in-state.

(c) Contents of notice. Notice of the open season required in paragraph (a) of this section, shall contain at least the following information; however, to the extent that any item of such information is not known or determined at the time the notice is issued, the prospective applicant shall make a good faith estimate based on the best information available of all such unknown or undetermined items of required information and further, must identify the source of information relied on, explain why such information is not presently known, and update the information when and if it is later determined during the open season period:

(1) The general route of the proposed project, including receipt and delivery points, and any alternative routes under consideration; delivery points must include those within the State of Alaska as determined by the In-State Study in paragraph (b) of this section.

(2) Size and design capacity (including proposed certificate capacity at the delivery points named in paragraph (c)(1) of this section to the extent that it differs from design capacity), a description of possible designs for expanded capacity beyond initial capacity, together with any estimated date when such expansions designs may be considered;

(3) Maximum allowable operating pressure and expected actual operating pressure;

(4) Delivery pressure at all delivery points named in paragraph (c)(1) of this section;

(5) Projected in-service date;

(6) An estimated unbundled transportation rate for each delivery point named in paragraph (c)(1) of this section, stated on a volumetric or thermal basis, for each service offered, including reservation rates for pipeline capacity, interruptible transportation rates, usage rates, fuel retention percentages, and other applicable charges, or surcharges, such as the Annual Charge Adjustment (ACA); (if rates are estimated on a volumetric basis then the notice must inform bidders that final pro forma service agreements and the sponsor's proposed FERC tariff will have to be submitted with rates based on a thermal basis.)

(7) The estimated cost of service (i.e., estimated cost of facilities, depreciation, rate of return and capitalization, taxes and operational and maintenance expenses), and estimated cost allocations, rate design volumes and rate design;

(8) Based on the In-State Study and the delivery points within the State of Alaska identified in paragraph (c)(1) of this section, there must be an estimated transportation rate for such deliveries, based on the amount of in-state needs shown in the study. Such estimated transportation rate must be based on the costs to make such in-state deliveries and shall not include costs to make deliveries outside the State of Alaska;

(9) Negotiated rate and other rate options under consideration, including any rates and terms of any precedent agreements with prospective anchor shippers that have been negotiated or agreed to outside of the open season process prescribed in this section;

(10) Quality specifications and any other requirements applicable to gas to be delivered to the project; provided that a prospective applicant shall not require that potential shippers process or treat their gas at any designated plant or facility;

(11) Terms and conditions for each service offered;

(12) Creditworthiness standards to be applied to, and any collateral requirements for, prospective shippers;

(13) The date, if any, by which potential shippers and the prospective applicant must execute precedent agreements;

(14) A detailed methodology for determining the value of bids for deliveries within the State of Alaska and for deliveries outside the State of Alaska;

(15) The methodology by which capacity will be awarded, in the case of over-subscription, clearly stating all terms that will be considered, except that if any capacity is acquired through pre-subscription agreements as provided in § 157.33(b) and the prospective applicant does not redesign the project to accommodate all capacity requests, only that capacity that was acquired through pre-subscription or was bid in the open season on the same rates, terms, and conditions as any one of the pre-subscription agreements shall be allocated on a pro rata basis and no other capacity acquired through the open season shall be allocated.

(16) Required bid information, whether bids are binding or non-binding, receipt and delivery point requirements, the form of a precedent agreement and time of execution of the precedent agreement, definition and treatment of non-conforming bids;

(17) The projected date for filing an application with the Commission;

(18) All information that the prospective applicant has in its possession pertaining to the proposed service to be offered, projected pipeline capacity and design, proposed tariff provisions, and cost projections, or that the prospective applicant has made available to, or obtained from, any potential shipper, including any affiliates of the project sponsor and any shippers with pre-subscribed capacity, prior to the issuance of the public notice of open season;

(19) A list of the names and addresses of the prospective applicant's affiliated sales and marketing units and Energy Affiliates involved in the production of natural gas in the State of Alaska. Affiliated unit means "Affiliate" as applicably defined in § 358.3(b) of this chapter. Energy Affiliate means "Energy Affiliate" as applicably defined in § 358.3(d) of this chapter;

(20) A comprehensive organizational charts showing:

(i) The organizational structure of the prospective applicant's parent corporation(s) with the relative position in the corporate structure of marketing and sales units and any Energy Affiliates involved in the production of natural gas in the State of Alaska.

(ii) The job titles and descriptions, and chain of command for all officers and directors of the prospective applicant's marketing and sales units and any Energy Affiliates involved in the production of natural gas in the State of Alaska; and

(21) A statement that any officers and directors of the of the prospective applicant's affiliated sales and marketing units and Energy Affiliates involved in the production of natural gas in the State of Alaska named in paragraph (c)(19) of this section will be prohibited from obtaining information about the conduct of the open season or allocation of capacity that is not posted on the "open season" Internet website or that is not otherwise also available to the general public or other participants in the open season.

(d) Timing.

(1) A prospective applicant must provide prospective shippers at least 90 days from the date on which notice of the open season is given within which to submit requests for transportation services. No bid shall be rejected because a prospective shipper has submitted another bid in another open season conducted under this subpart.

(2) A prospective applicant must consider any bids tendered after the expiration of the open season by qualifying bidders and may reject them only if they cannot be accommodated due to economic, engineering, design, capacity or operational constraints, or accommodating the request would otherwise adversely impact the timely development of the project, and a detailed explanation must accompany the rejection. Any bids tendered after the expiration of the open season must contain a good faith showing, including a statement of the circumstances which prevented the late bidder from tendering a timely bid and how those circumstances have changed. If a prospective applicant determines at any time that, based on the criteria stated in this paragraph, no further late bids for capacity can be accommodated, it may request Commission approval to summarily reject any further requests.

(3) Within 10 days after precedent agreements have been executed for capacity allocated in the open season, the prospective applicant shall make public on the Internet and through press releases the results of the open season, at least including the name of the prospective shipper, amount of capacity awarded, and term of agreement.

(4) Within 20 days after precedent agreements have been executed for capacity allocated in the open season, the prospective applicant must submit copies of all such precedent agreements to the Commission and copies of any relevant correspondence with bidders for capacity who were not allocated capacity that identifies why such bids were not accepted (all documents identified in this paragraph (d)(4) may be filed under confidential treatment pursuant to § 388.112 of this chapter if desired.

§ 157.35 Undue discrimination or preference.

(a) All binding open seasons shall be conducted without undue discrimination or preference in the rates, terms or conditions of service and all capacity allocated as a result of any open season shall be awarded without undue discrimination or preference of any kind.

(b) Any complaint filed pursuant to § 385.206 of this chapter alleging non-compliance with any of the requirements of this subpart shall be processed under the Commission's Fast Track Processing procedures contained in § 385.206(h).

(c) Each prospective applicant conducting an open season under this subpart must function independent of the other divisions of the prospective applicant as well as the prospective applicant's Marketing and Energy affiliates as those terms are defined in § 358.3(d) and (k) of the Commission's regulations. In instances in which the prospective applicant is not an entity created specifically to conduct an open season under this subpart, the prospective applicant must create or designate a unit or division to conduct the open season that must function independent of the other divisions of the project applicant as well as the project applicant's Marketing and Energy affiliates as those terms are defined in § 358.3(d) and (k) of the Commission's regulations.

(d) Each project applicant conducting an open season under this subpart that is not otherwise subject to the provisions of part 358 of this chapter must comply with the following sections of that part: Sections 358.4(a)(1) and (3); 358.4(e)(3), (4), (5), and (6); 358.5(a), (b), (c)(3) and (5); and 358.5(d). The exemptions from § 358.4(a)(1) and (3) set forth in § 358.4(a)(4), (5), and (6) of this chapter also apply to each project applicant conducting an open season under this subpart.

§ 157.36 Open seasons for expansions.

Any open season for capacity exceeding the initial capacity of an Alaska natural gas transportation project must provide the opportunity for the transportation of gas other than Prudhoe Bay or Point Thomson production. In considering a proposed voluntary expansion of an Alaska natural gas pipeline project, the Commission will consider the extent to which the expansion will be utilized by shippers other than those who are the initial shippers on the project and, in order to promote competition and open access to the project, may require design changes to ensure that some portion of the expansion capacity be allocated to new shippers willing to sign long-term firm transportation contracts, including shippers seeking to transport natural gas from areas other than Prudhoe Bay and Point Thomson.

§ 157.37 Project design.

In reviewing any application for an Alaska natural gas pipeline project, the Commission will consider the extent to which a proposed project has been designed to accommodate the needs of shippers who have made conforming bids during an open season, as well as the extent to which the project can accommodate low-cost expansion, and may require changes in project design necessity to promote competition and offer a reasonable opportunity for access to the project.

§ 157.38 Pre-approval procedures.

No later than 90 days prior to providing the notice of open season required by § 157.34(a), a prospective applicant must file, for Commission approval, a detailed plan for conducting an open season in conformance with this subpart. The prospective applicant's plan shall include the proposed notice of open season. Upon receipt of a request for such a determination, the Secretary of the Commission shall issue a notice of the request, which will then be published in the Federal Register. The notice shall establish a date on which comments from interested persons are due and a date, which shall be within 60 days of receipt of the prospective applicant's request unless otherwise directed by the Commission, by which the Commission will act on the proposed plan.

§ 157.39 Rate treatment of pipeline expansions.

There shall be a rebuttable presumption that rates for any expansion of an Alaska natural gas transportation project shall be determined on a rolled-in basis.

Current through February 22, 2007; 72 FR 7933
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Effective: November 17, 2005

Code of Federal Regulations Currentness
Title 18. Conservation of Power and Water Resources
Chapter I. Federal Energy Regulatory Commission, Department of Energy
Subchapter E. Regulations Under Natural Gas Act
Part 157. Applications for Certificates of Public Convenience and Necessity and for Orders Permitting and Approving Abandonment Under Section 7 of the Natural Gas Act (Refs & Annos)
Subpart A. Applications for Certificates of Public Convenience and Necessity and for Orders Permitting and Approving Abandonment Under Section 7 of the Natural Gas Act, as Amended, Concerning Any Operation, Sales, Service, Construction, Extension, Acquisition or Abandonment

→§ 157.21 Pre-filing procedures and review process for LNG terminal facilities and other natural gas facilities prior to filing of applications.

(a) LNG terminal facilities and related jurisdictional natural gas facilities. A prospective applicant for authorization to site, construct and operate facilities included within the definition of "LNG terminal," as defined in § 153.2(d), and any prospective applicant for related jurisdictional natural gas facilities must comply with this section's pre-filing procedures and review process. These mandatory pre-filing procedures also shall apply when the Director finds in accordance with paragraph (e)(2) of this section that prospective modifications to an existing LNG terminal are modifications that involve significant state and local safety considerations that have not been previously addressed. Examples of such modifications include, but are not limited to, the addition of LNG storage tanks; increasing throughput requiring additional tanker arrivals or the use of larger vessels; or changing the purpose of the facility from peaking to base load. When a prospective applicant is required by this paragraph to comply with this section's pre-filing procedures:

(1) The prospective applicant must make a filing containing the material identified in paragraph (d) of this section and concurrently file a Letter of Intent pursuant to 33 U.S.C. 127.007, and a Preliminary Waterway Suitability Assessment (WSA) with the U.S. Coast Guard (Captain of the Port/Federal Maritime Security Coordinator). The latest information concerning the documents to be filed with the Coast Guard should be requested from the U.S. Coast Guard. For modifications to an existing or approved LNG terminal, this requirement can be satisfied by the prospective applicant's certifying that the U.S. Coast Guard did not require such information.

(2) An application:

(i) Shall not be filed until at least 180 days after the date that the Director issues notice pursuant to paragraph (e) of this section of the commencement of the prospective applicant's pre-filing process; and

(ii) Shall contain all the information specified by the Commission staff after reviewing the draft materials filed by the prospective applicant during the pre-filing process, including required environmental material in accordance with the provisions of part 380 of this chapter, "Regulations Implementing the National Environmental Policy Act."

(3) The prospective applicant must provide sufficient information for the pre-filing review of any pipeline or other natural gas facilities, including facilities not subject to the Commission's Natural Gas Act jurisdiction, which are necessary to transport regassified LNG from the subject LNG terminal facilities to the existing natural gas pipeline infrastructure.

(b) Other natural gas facilities. When a prospective applicant for authorization for natural gas facilities is not required by paragraph (a) of this section to comply with this section's pre-filing procedures, the prospective applicant may file a request seeking approval to use the pre-filing procedures.

(1) A request to use the pre-filing procedures must contain the material identified in paragraph (d) of this section unless otherwise specified by the Director as a result of the Initial Consultation required pursuant to paragraph (c) of this subsection; and

(2) If a prospective applicant for non-LNG terminal facilities is approved to use this section's pre-filing procedures:

(i) The application will normally not be filed until at least 180 days after the date that the Director issues notice pursuant to paragraph (e)(3) of this section approving the prospective applicant's request to use the pre-filing procedures under this section and commencing the prospective applicant's pre-filing process. However, a prospective applicant approved by the Director pursuant to paragraph (e)(3) of this section to undertake the pre-filing process is not prohibited from filing an application at an earlier date, if necessary; and

(ii) The application shall contain all the information specified by the Commission staff after reviewing the draft materials filed by the prospective applicant during the pre-filing process, including required environmental material in accordance with the provisions of part 380 of this chapter, "Regulations Implementing the National Environmental Policy Act."

(c) Initial consultation. A prospective applicant required or potentially required or requesting to use the pre-filing process must first consult with the Director on the nature of the project, the content of the pre-filing request, and the status of the prospective applicant's progress toward obtaining the information required for the pre-filing request described in paragraph (d) of this section. This consultation will also include discussion of the specifications for the applicant's solicitation for prospective third-party contractors to prepare the environmental documentation for the project, and whether a third-party contractor is likely to be needed for the project.

(d) Contents of the initial filing. A prospective applicant's initial filing pursuant to paragraph (a)(1) of the section for LNG terminal facilities and related jurisdictional natural gas facilities or paragraph (b)(1) of this section for other natural gas facilities shall include the following information:

(1) A description of the schedule desired for the project including the expected application filing date and the desired date for Commission approval.

(2) For LNG terminal facilities, a description of the zoning and availability of the proposed site and marine facility location.

(3) For natural gas facilities other than LNG terminal facilities and related jurisdictional natural gas facilities, an explanation of why the prospective applicant is requesting to use the pre-filing process under this section.

(4) A detailed description of the project, including location maps and plot plans to scale showing all major plant components, that will serve as the initial discussion point for stakeholder review.

(5) A list of the relevant federal and state agencies in the project area with permitting requirements. For LNG terminal facilities, the list shall identify the agency designated by the governor of the state in which the project will be located to consult with the Commission regarding state and local safety considerations. The filing shall include a statement indicating:

(i) That those agencies are aware of the prospective applicant's intention to use the pre-filing process (including contact names and telephone numbers);

(ii) Whether the agencies have agreed to participate in the process;

(iii) How the applicant has accounted for agency schedules for issuance of federal authorizations; and

(iv) When the applicant proposes to file with these agencies for their respective permits or other authorizations.

(6) A list and description of the interest of other persons and organizations who have been contacted about the project (including contact names and telephone numbers).

(7) A description of what work has already been done, e.g., contacting stakeholders, agency consultations, project engineering, route planning, environmental and engineering contractor engagement, environmental surveys/studies, and open houses. This description shall also include the identification of the environmental and engineering firms and sub-contractors under contract to develop the project.

(8) For LNG terminal projects, proposals for at least three prospective third-party contractors from which Commission staff may make a selection to assist in the preparation of the requisite NEPA document.

(9) For natural gas facilities other than LNG terminal facilities and related jurisdictional natural gas facilities, proposals for at least three prospective third-party contractors from which Commission staff may make a selection to assist in the preparation of the requisite NEPA document, or a proposal for the submission of an applicant-prepared draft Environmental Assessment as determined during the initial consultation described in paragraph (c) of this section.

(10) Acknowledgement that a complete Environmental Report and complete application are required at the time of filing.

(11) A description of a Public Participation Plan which identifies specific tools and actions to facilitate stakeholder communications and public information, including a project website and a single point of contact. This plan shall also describe how the applicant intends to respond to requests for information from federal and state permitting agencies, including, if applicable, the governor's designated agency for consultation regarding state and local safety considerations with respect to LNG facilities.

(12) Certification that a Letter of Intent and a Preliminary WSA have been submitted to the U.S. Coast Guard or, for modifications to an existing or approved LNG terminal, that the U.S. Coast Guard did not require such information.

(e) Director's notices.

(1) When the Director finds that a prospective applicant for authority to site and construct a new LNG terminal has adequately addressed the requirements of paragraphs (a), (c) and (d) of this section, the Director shall issue a notice of such finding. Such notice shall designate the third-party contractor. The pre-filing process shall be deemed to have commenced on the date of the Director's notice, and the date of such notice shall be used in determining whether the date an application is filed is at least 180 days after commencement of the pre-filing process.

(2) When the Director finds that a prospective applicant for authority to make modifications to an existing or approved LNG terminal has adequately addressed the requirements of paragraphs (a), (c) and (d) of this section, the Director shall issue a notice making a determination whether prospective modifications to an existing LNG terminal shall be subject to this section's pre-filing procedures and review process. Such notice shall designate the third-party contractor, if appropriate. If the Director determines that the prospective modifications are significant modifications that involve state and local safety considerations, the Director's notice will state that the pre-filing procedures shall apply, and the pre-filing process shall be deemed to have commenced on the date of the Director's notice in determining whether the date an application is filed is at least 180 days after commencement of the pre-filing process.

(3) When a prospective applicant requests to use this section's pre-filing procedures and review for facilities not potentially subject to this section's mandatory requirements, the Director shall issue a notice approving or disapproving use of the pre-filing procedures of this section and determining whether the prospective applicant has adequately addressed the requirements of paragraphs (b), (c) and (d) of this section. Such notice shall designate the third-party contractor, if appropriate. The pre-filing process shall be deemed to have commenced on the date of the Director's notice, and the date of such notice shall be used in determining whether the date an application is filed is at least 180 days after commencement of the pre-filing process.

(f) Upon the Director's issuance of a notice commencing a prospective applicant's pre-filing process, the prospective applicant must:

(1) Within seven days and after consultation with Commission staff, establish the dates and locations at which the prospective applicant will conduct open houses and meetings with stakeholders (including agencies) and Commission staff.

(2) Within 14 days, conclude the contract with the selected third-party contractor.

(3) Within 14 days, contact all stakeholders not already informed about the project, including all affected landowners as defined in paragraph § 157.6(d)(2) of this section.

(4) Within 30 days, submit a stakeholder mailing list to Commission staff.

(5) Within 30 days, file a draft of Resource Report 1, in accordance with § 380.12(c), and a summary of the alternatives considered or under consideration.

(6) On a monthly basis, file status reports detailing the applicant's project activities including surveys, stakeholder communications, and agency meetings.

(7) Be prepared to provide a description of the proposed project and to answer questions from the public at the scoping meetings held by OEP staff.

(8) Be prepared to attend site visits and other stakeholder and agency meetings arranged by the Commission staff, as required.

(9) Within 14 days of the end of the scoping comment period, respond to issues raised during scoping.

(10) Within 60 days of the end of the scoping comment period, file draft Resource Reports 1 through 12.

(11) At least 60 days prior to filing an application, file revised draft Resource Reports 1 through 12, if requested by Commission staff.

(12) At least 90 days prior to filing an application, file draft Resource Report 13 (for LNG terminal facilities).

(13) Certify that a Follow-on WSA will be submitted to the U.S. Coast Guard no later than the filing of an application with the Commission (for LNG terminal facilities and modifications thereto, if appropriate). The applicant shall certify that the U.S. Coast Guard has indicated that a Follow-On WSA is not required, if appropriate.

(g) Commission staff and third-party contractor involvement during the pre-filing process will be designed to fit each project and will include some or all of the following:

(1) Assisting the prospective applicant in developing initial information about the proposal and identifying affected parties (including landowners, agencies, and other interested parties).

(2) Issuing an environmental scoping notice and conducting such scoping for the proposal.

(3) Facilitating issue identification and resolution.

(4) Conducting site visits, examining alternatives, meeting with agencies and stakeholders,

and participating in the prospective applicant's public information meetings.

(5) Reviewing draft Resource Reports.

(6) Initiating the preparation of a preliminary Environmental Assessment or Draft Environmental Impact Statement, the preparation of which may involve cooperating agency review.

(h) A prospective applicant using the pre-filing procedures of this section shall comply with the procedures in § 388.112 for the submission of documents containing critical energy infrastructure information, as defined in § 388.113.

[Order 665, 70 FR 60440, Oct. 18, 2005]

SOURCE: 50 FR 42487, Oct. 18, 1985; 51 FR 9186, March 7, 1986; 51 FR 22218, June 18, 1986; 52 FR 47910, Dec. 17, 1987; 53 FR 4133, Feb. 12, 1988; 53 FR 15028, April 27, 1988; 53 FR 15381, April 29, 1988; 56 FR 50245, Oct. 4, 1991; 57 FR 21893, May 26, 1992; Order 2005-A, 70 FR 35026, June 16, 2005, unless otherwise noted.

AUTHORITY: 15 U.S.C. 717-717w.

18 C. F. R. § 157.21, **18 CFR § 157.21**

Current through February 22, 2007; 72 FR 7933

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IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

FIRST JUDICIAL DISTRICT AT JUNEAU

STATE OF ALASKA, Plaintiff, COMMISSIONER OF NATURAL RESOURCES, and DIRECTOR OF THE DIVISION OF LANDS, STATE OF ALASKA, Involuntary Plaintiffs, vs. AMERADA HESS CORPORATION; ATLANTIC RICHFIELD COMPANY; BP ALASKA INC.; BP ALASKA EXPLORATION INC.; EXXON CORPORATION; GETTY OIL COMPANY; HUNT INDUSTRIES; CAROLINE HUNT TRUST ESTATE; LAMAR HUNT TRUST ESTATE; WILLIAM HERBERT HUNT TRUST ESTATE; N. B. HUNT; THE LOUISIANA LAND AND EXPLORATION COMPANY; MARATHON OIL COMPANY; MOBIL OIL CORPORATION; SOHIO PETROLEUM COMPANY; CHEVRON U.S.A. INC.; PLACID OIL COMPANY; and PHILLIPS PETROLEUM COMPANY, Defendants.	Civil Action No. 77-847 SETTLEMENT AGREEMENT

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THIS AGREEMENT, dated April 1, 1980, for reference purposes only, entered into by and among the STATE OF ALASKA, acting by and through its Attorney General under the authority conferred by AS 44.23.020, AS 09.50.300, AS 22.20.050(a) and common law, the COMMISSIONER OF NATURAL RESOURCES, STATE OF ALASKA (the "Commissioner") and the DIRECTOR OF THE DIVISION OF LANDS, STATE OF ALASKA (the "Director") (the foregoing parties being hereinafter collectively referred to as the "State" except where otherwise indicated), and each of the following defendants in the above-entitled action:

AMERADA HESS CORPORATION,

ATLANTIC RICHFIELD COMPANY,

BP ALASKA INC.,

BP ALASKA EXPLORATION INC.,

EXXON CORPORATION,

GETTY OIL COMPANY,

HUNT INDUSTRIES,

CAROLINE HUNT TRUST ESTATE,

LAMAR HUNT TRUST ESTATE,

WILLIAM HERBERT HUNT TRUST ESTATE,

N. B. HUNT,

THE LOUISIANA LAND AND EXPLORATION COMPANY,

MARATHON OIL COMPANY,

MOBIL OIL CORPORATION,

SOHIO ALASKA PETROLEUM COMPANY, formerly known as Sohio Petroleum Company,

CHEVRON U.S.A. INC.,

PLACID OIL COMPANY,

and

PHILLIPS PETROLEUM COMPANY

(said defendants being hereinafter referred to as the "Lessees" except where otherwise indicated),

W I T N E S S E T H

THAT, WHEREAS, the Lessees are the present holders of certain oil and gas leases (said leases being hereinafter referred to as the "Leases") issued by the State covering those certain lands, in the vicinity of Prudhoe Bay, more particularly described in Exhibit A to the Prudhoe Bay Unit Agreement (said agreement, as amended from time to time, being hereinafter referred to as the "Unit Agreement"); and

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WHEREAS, the Lessees entered into the Unit Agreement effective as of April 1, 1977, with the agreement and approval of the State; and

WHEREAS, several disputes have arisen between the State and the Lessees concerning their respective rights and duties under the provisions of AS 38.05.180(a), AS 31.05.110, the Leases and the Unit Agreement; and

WHEREAS, the State, on September 2, 1977, commenced the above-captioned action in the Superior Court for the State of Alaska, First Judicial District at Juneau (hereinafter, the "Court"), seeking a judgment declaring the rights and duties of the parties with respect to "in value" royalty payments to the State on oil produced from lands governed by the Unit Agreement; and

WHEREAS, the Lessees, on October 13, 1977, answered the State's complaint and filed a counterclaim seeking a judgment declaring the rights and duties of the parties with respect to both "in value" and "in kind" royalty payments to the State on both oil and gas produced from lands governed by the Unit Agreement; and

WHEREAS, the State and the Lessees, recognizing that there is substantial doubt as to the ultimate outcome of this litigation, and considering the many difficulties and delays inherent in this highly complex litigation, agree that the continuing economic uncertainty, great expense and other detriment to all parties which would result from the prolongation of this litigation are undesirable; and

WHEREAS, the State and each of the Lessees have therefore concluded that a settlement of this litigation in the manner and upon the terms and conditions hereinafter set forth is in the best interests of all parties; and

WHEREAS, the Commissioner has determined that the settlement of this litigation upon the terms and conditions set forth in this Agreement is necessary and proper to secure the proper protection of the public interest by, among other things, facilitating the exercise by the State of its option under the Leases and under the Unit Agreement to take its royalty "in kind."

NOW, THEREFORE, in consideration of the foregoing and in consideration of the various covenants hereinafter contained, the State and each of the Lessees agree and covenant as follows:

ARTICLE 1: DEFINITIONS

As used in this Agreement:

1.1 Previously Defined Terms. Each of the terms "Commissioner," "Director," "State," "Lessees," "Leases," "Unit Agreement" and "Court" shall have the meaning given to it on the preceding pages.

1.2 Effective Date shall have the meaning given to it in Section 5.2.

1.3 Field Cost Allowance shall mean:

(a) with respect to Royalty Oil, the amount per barrel thereof determined in accordance with Section 2.6.

(b) with respect to Royalty Gas, the amount per MCF thereof determined in accordance with Section 3.7.

1.4 Interim PPI for a particular year shall have the meaning given to it in Section 1.5.

1.5 PPI for a particular calendar month shall mean the Producer Price Index for Industrial Commodities (or its successor index) for said month as determined and reported by the U.S. Department of Labor, or by such other agency of the United States government as may, from time to time, determine and report such index if the U.S. Department of Labor ceases to do so. If the method by which the PPI is determined or the base thereof is changed, the successor index or base shall, to the extent practicable, be correlated with the previously applicable index or base so that the amounts determined by the formulae hereinafter set forth shall not be changed by reason of the substitution of such successor index or base. References herein to the PPI for a particular year shall mean the PPI for the month of December of that year. Unless otherwise specified, all calculations hereunder which require use of the PPI shall be made using the PPI as finally determined and reported; provided, however, that if the PPI for a particular year has not been finally determined and reported prior to the date on which a particular calculation pursuant to Subsection 2.6.2, Subsection 3.7.2, or Subsection 3.8.3 must be made, then such calculation shall be made, and the amounts of all payments or deductions based on such calculation shall be determined, using the PPI for said year as then most recently determined and reported (such index being hereinafter referred to as the "Interim PPI" for said year), subject, however, to the provisions of Sections 2.7 and 3.14. The parties agree that the Producer Price Index for Industrial Commodities (1967 = 100.0 base) for June 1977 is 194.7.

1.6 RIK Gas shall mean any Royalty Gas taken by the State "in kind."

1.7 RIK Oil shall mean any Royalty Oil taken by the State "in kind."

1.8 RIV Gas shall mean any Royalty Gas for which the State is to be compensated "in value."

1.9 RIV Oil shall mean any Royalty Oil for which the State is to be compensated "in value."

1.10 Royalty Gas shall mean any gas, other than gas which is conditioned in the Field Fuel Gas Unit (a part of Shared Group 19, as defined in Exhibit 32A of the Prudhoe Bay Unit Operating Agreement), included in the State's royalty share of gas produced from the Unit Area, regardless of the condition or form (e.g., wet gas, sales quality residue gas, gas plant liquids, et cetera) in which said gas may exist at the point of taking, in the case of RIK Gas, or at the Intermediate Valuation Point (as defined in Subsection 3.2.15), in the case of RIV Gas.

1.11 Royalty Oil shall mean any oil included in the State's royalty share of oil produced from the Unit Area, regardless of the condition or form in which said oil may exist at the point of taking, in the case of RIK Oil, or at the LACT Meter (as defined in Subsection 2.2.2), in the case of RIV Oil.

1.12 TAPS shall mean the Trans Alaska Pipeline System.

1.13 Unit Area shall mean the land described by Tracts in Exhibit A to the Unit Agreement and shown on Exhibit B to the

Unit Agreement as of the Effective Date of this Agreement and, in addition, all other land to which the Unit Agreement may hereafter be extended as therein provided (it being expressly understood and agreed that the term "Unit Area" shall encompass, at any particular time, all land as to which the Unit Agreement has previously become effective, regardless of whether the Unit Agreement then remains effective as to such land).

1.14 Upstream Cost Allowance shall mean the amount per MCF of Royalty Gas determined in accordance with Section 3.6.

1.15 Year Of Production shall mean, with respect to particular oil or gas, the calendar year during which the volume of said oil or gas is measured for royalty purposes.

ARTICLE 2: SETTLEMENT OF OIL ROYALTY ISSUES

2.1 Scope. The provisions of this Article are applicable to all royalties accruing to the State on oil produced from the Unit Area on or after June 20, 1977, the date of first production into TAPS.

2.2 Definitions. As used in this Article and Article 4:

2.2.1 Field Costs shall mean, with respect to particular Royalty Oil, any and all costs (including, without limiting the generality of the foregoing, gathering, separation, cleaning, dehydration and other field handling costs) incurred by the Lessees with respect to such oil upstream of the LACT Meter for such oil, other than costs (including, but not limited to, chilling costs) incurred by the Lessees with respect to such oil downstream of a Separation Facility (as defined in the Prudhoe Bay Unit Operating Agreement) in order to blend with such oil any liquid hydrocarbons extracted from gas for the purpose of transporting said gas liquids off the North Slope of Alaska with said oil (the latter type of costs being hereinafter referred to as "Oil-NGL Blending Costs").

2.2.2 LACT Meter shall mean, with respect to particular oil, the particular meter at which the volume of said oil is initially measured for royalty purposes. (At the date of this Agreement, with respect to all oil other than that taken by a Lessee at the Arco/Exxon Prudhoe Bay Crude Oil Topping Plant, "LACT Meter" means the custody transfer meters into TAPS.)

2.2.3 LACT Meter Value shall mean, with respect to particular Royalty Oil, the value of said oil at the LACT meters into TAPS. With respect to particular Royalty Oil measured for royalty purposes at a LACT Meter other than a LACT meter into TAPS, LACT Meter Value shall mean the value at the LACT meters into TAPS of oil of like grade and gravity (e.g., with respect to Royalty Oil taken by a Lessee at the Arco/Exxon Prudhoe Bay Crude Oil Topping Plant, the value at the LACT meters into TAPS of oil of the same grade and gravity as oil at the inlet LACT meter to said plant).

2.3 Settled RIK Oil Taking Issue. As used herein, the term "Settled RIK Oil Taking Issue" shall mean the issue of where and in what condition the Lessees are obligated to deliver RIK Oil to the State. In full and final settlement of the respective claims and contentions of the State and each of the Lessees with respect to the Settled RIK Oil Taking Issue, the State and each of the Lessees agree that all RIK Oil taken as royalty from a particular Lessee at a particular time shall be delivered to the State at the custody transfer meters into TAPS in the same condition as oil generally available for taking or other disposition by said Lessee at said point at the time at which said RIK Oil is taken by the State.

2.4 Settled Upstream RIK Oil Issue. As used herein, the term "Settled Upstream RIK Oil Issue" shall mean the issue of whether, with respect to RIK Oil taken by the State as royalty from a particular Lessee, the State is liable to each Lessee for reimbursement of all or any portion of the Field Costs incurred by said Lessee with respect to said oil. In full and final settlement of the respective claims and contentions of the State and each of the Lessees with respect to the Settled Upstream RIK Oil Issue, the State and each of the Lessees agree that with respect to each barrel of RIK Oil taken as royalty from a particular Lessee the State shall be liable to that Lessee for an amount equal to the Field Cost Allowance with respect to said oil, determined in accordance with Section 2.6.

2.5 Settled Upstream RIV Oil Issue. As used herein, the term "Settled Upstream RIV Oil Issue" shall mean the issue of whether, in computing the value of Royalty Oil for the purpose of making royalty payments "in value" on oil produced from the Unit Area, each Lessee may deduct from the LACT Meter Value of said oil all or any portion of the Field Costs incurred by said Lessee with respect to said oil. In full and final settlement of the respective claims and contentions of the State and each of the Lessees with respect to the Settled Upstream RIV Oil Issue, the State and each of the Lessees agree that, in computing the value for royalty purposes of each barrel of RIV Oil for which a particular Lessee makes settlement, said Lessee may deduct from the LACT Meter Value of said oil an amount equal to the Field Cost Allowance with respect to said oil, determined in accordance with Section 2.6.

2.6 Field Cost Allowance for Royalty Oil. Each Lessee shall be entitled to a Field Cost Allowance with respect to Royalty Oil, determined as follows:

2.6.1 Pre-1980. With respect to Royalty Oil measured for royalty purposes on or before December 31, 1979, the Field Cost Allowance shall be 42 cents per barrel.

2.6.2 Thereafter. With respect to Royalty Oil measured for royalty purposes on or after January 1, 1980, the Field Cost Allowance shall be the amount determined by using the following formula:

$$\text{Field Cost Allowance per barrel} = 42 \text{ cents} \times \frac{\text{PPI for the year prior to the Year Of Production}}{\text{PPI for June 1977}}.$$

2.7 Payment of PPI Adjustment Differential. If, in accordance with Section 1.5, the Field Cost Allowance for particular Royalty Oil is calculated using the Interim PPI for the year prior to the Year Of Production for said oil and, as a result, any Lessee:

(i) receives an amount pursuant to Section 2.4 with respect to said oil, if said oil is RIK Oil, or

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(ii) deducts an amount pursuant to Section 2.5 with respect to said oil, if said oil is RIV Oil

(such amount so received, if RIK Oil, or deducted, if RIV Oil, being referred to in this Section as the "Interim Amount" for said oil), which amount is greater than or less than the amount that would have been so received or deducted by said Lessee with respect to said oil had said allowance been calculated using the PPI for said year as finally determined and reported (such amount calculated using said finally determined PPI being referred to in this Section as the "Redetermined Amount" for said oil), then:

(a) Refund to State. If the Interim Amount received or deducted with respect to said oil is greater than the Redetermined Amount for said oil, said Lessee shall pay to the State, within sixty days after the PPI for said year is finally determined and reported, an amount equal to the difference between said Interim Amount and said Redetermined Amount.

(b) Payment of Balance Due Lessee. If the Interim Amount deducted or received with respect to said oil is less than the Redetermined Amount for said oil, the State shall pay to said Lessee an amount equal to the difference between said Redetermined Amount and said Interim Amount. Such payment shall be made promptly (within sixty days, if possible) after receipt by the State of said Lessee's invoice therefor.

2.8 Payment of Pre-Effective Date Oil Royalties Differential. To the extent that any Lessee, prior to the Effective Date, has taken a greater or lesser deduction in computing the value of particular RIV Oil, or has received a greater or lesser amount as compensation for Field Costs incurred with respect to particular RIK Oil, than the Field Cost Allowance for such oil determined in accordance with Section 2.6, such Lessee, in the case of a greater deduction or amount, or the State, in the case of a lesser deduction or amount, shall pay the difference to the party entitled thereto, together with interest thereon, computed with respect to said oil from the last day of the calendar month following the calendar month during which said oil was measured for royalty purposes until the date said difference is paid, at the rate of eight percent (8%) per annum (which the parties agree is the legal rate of prejudgment and post-judgment interest to which the prevailing party would have been entitled had the above entitled action been litigated to its conclusion). Each Lessee from whom the State is entitled to receive payment pursuant to this Section shall pay such sum to the State within sixty days after the Effective Date, such payment to be made by wire transfer if in excess of $50,000. Any obligation of the State to make payment to any Lessee pursuant to this Section shall be satisfied by offsetting the amount owed to said Lessee by the State against amounts then or thereafter due from said Lessee to the State as royalty on RIV Oil; provided, however, that any amount not so offset within six months after the Effective Date shall be paid to said Lessee by the State promptly (within thirty days, if possible) after receipt by the State of an invoice therefor.

ARTICLE 3: SETTLEMENT OF GAS ROYALTY ISSUES

3.1 Scope. The provisions of this Article are applicable to all royalties accruing to the State on gas produced from the Unit Area and measured for royalty purposes after Major Gas sale other than royalties, if any, on gas which is conditioned in the Field Fuel Gas Unit (a part of Shared Group 19, as defined in Exhibit 32A of the Unit Operating Agreement).

3.2 Definitions. As used in this Article, Article 4 and in the Exhibits to this Agreement:

3.2.1 Affiliate of a particular Lessee shall mean any company that is owned or controlled by that Lessee. For the purpose of this definition, ownership or control of any company exists if fifty percent (50%) or more of the stock of such company that has the right to vote for directors is owned or controlled, directly or indirectly, by the particular Lessee. The stock owned or controlled by a Lessee shall be deemed to include all stock owned or controlled, directly or indirectly, by any other company that is owned or controlled by that Lessee. Affiliate of a particular Lessee also includes any parent company that owns or controls, directly or indirectly, fifty percent (50%) or more of the stock having the right to vote for directors of such Lessee, and any company of which said parent company owns or controls, directly or indirectly, more than fifty percent (50%) of the stock having the right to vote for directors of such company.

3.2.2 Base Amount shall mean, with respect to a particular Gas Conditioning Plant, the amount per MCF of Royalty Gas determined in accordance with Subsection 3.8.2 for said plant.

3.2.3 Base Period shall mean, with respect to a particular Gas Conditioning Plant, the calendar year following the Initial Period for said plant.

3.2.4 Calculated Conditioning Cost shall mean, with respect to a particular Gas Conditioning Plant and particular Royalty Gas, the amount per MCF of said gas determined in accordance with Section 3.8 for said plant and gas.

3.2.5 Conditioning (or "to Condition," "to cause to be Conditioned," et cetera) shall refer to the conditioning or treating of gas to meet sales gas specifications of a major gas pipeline for transportation off the North Slope of Alaska, the disposal of byproducts of such conditioning or treating, and any transportation of conditioned gas to said pipeline. Conditioning shall include, without limiting the generality of the foregoing, hydrocarbon dewpoint control, NGL fractionation, water dewpoint control, CO_2 removal, compression and chilling; but shall include neither (i) any conditioning or treating which occurs in a Separation Facility (as defined in the Unit Operating Agreement), nor (ii) the blending, with oil, of liquid hydrocarbons extracted from gas for the purpose of transporting said gas liquids off the North Slope of Alaska with such oil. If part, but not all, of the process of Conditioning occurs in a particular Gas Conditioning Plant, the term "Conditioning," with respect to that plant, refers to the portion of the entire Conditioning process that occurs in said plant (including the disposal of byproducts therefrom, whether or not such disposal occurs in said plant).

3.2.6 Divided Plant shall have the meaning given to it in Subsection 3.9.1.

3.2.7 Downstream Conditioning Allowance shall mean, with respect to a particular Lessee, Gas Conditioning Plant and calendar month, the amount per MCF of Royalty Gas determined in accordance with Subsection 3.11.2 for said Lessee, plant and month.

3.2.8 Effective Rate Of Interest for a specified calendar month shall mean a monthly rate of interest equal to one hundred twenty-five percent (125%) of one-twelfth of the Citibank, N.A. (or its successors) annual base interest rate in effect for substantial, responsible commercial borrowers (commonly referred to as the "prime rate") on the first day of such month. Effective Rate Of Interest for a period longer than one month shall mean the product of (i) the arithmetic average of the Effective Rate Of Interest for each calendar month occurring during said period, multiplied by (ii) the number of calendar months in said period.

3.2.9 Field Costs shall mean, with respect to particular Royalty Gas, any and all costs (including, without limiting the generality of the foregoing, gathering, separation, cleaning, dehydration, compression and other field handling costs) incurred by the Lessees with respect to such gas upstream of the Intermediate Valuation Point for such gas, in the case of RIV Gas, and upstream of the point of taking, in the case of RIK Gas, other than (i) costs incurred by the Lessees in Conditioning such gas, and (ii) costs incurred by the Lessees with respect to such gas in an extraction plant, the primary purpose of which is to extract liquid hydrocarbons from gas that is injected back into any formation underlying the Unit Area (such costs incurred in such a plant being hereinafter referred to as "Cycling Plant Costs").

3.2.10 Gas Conditioning Plant shall mean an assemblage of facilities, located in or near the Unit Area and owned in common by one or more persons, which facilities are designed or used (i) to Condition gas produced from the Unit Area, or (ii) to support, directly or indirectly, the construction or operations of facilities designed or used to Condition such gas; provided, however, that in the case of a Unit Plant, the term "Gas Conditioning Plant" shall not include Support Facilities. If any gas produced from the Unit Area is Conditioned in one such assemblage prior to further Conditioning in another such assemblage, then each such assemblage shall be deemed to be a separate Gas Conditioning Plant. If Support Facilities are used in connection with the construction or operation of a Unit Plant, a portion of the costs attributable to such Support Facilities shall be included in computing certain costs with respect to said Gas Conditioning Plant, as more particularly provided in Subsection 3.2.24. For purposes of illustration only, a functional description of one possible design for a Gas Conditioning Plant is contained in Exhibit A. A Gas Conditioning Plant may ultimately be constructed which differs from that described in Exhibit A.

3.2.11 Heating Value of particular gas shall mean the gross number of BTU's per standard cubic foot of said gas at a pressure of 14.65 psia and a temperature of 60° Fahrenheit.

3.2.12 Initial Amount shall mean, with respect to a particular Gas Conditioning Plant, the amount per MCF of Royalty Gas determined in accordance with Subsection 3.8.1.

3.2.13 Initial Period, except as provided in Subsection 3.8.4, shall mean, with respect to a particular Gas Conditioning Plant, the period beginning at 12:01 A.M. on the first day of the calendar month following the calendar month during which Major Gas Sale occurs and ending at the end of the calendar year following the calendar year during which Major Gas Sale occurs. For example, if Major Gas Sale occurs on January 15, 1985, the term "Initial Period" (except as provided in Subsection 3.8.4) shall mean the period beginning on February 1, 1985, and ending on December 31, 1986.

3.2.14 Interest During Construction shall mean, with respect to a particular Gas Conditioning Plant, the cumulative total of all Construction Interest calculations for said plant. "Construction Interest" for each Gas Conditioning Plant shall be calculated for each calendar month starting with the month during which the Federal Energy Regulatory Commission issues a final certificate of public convenience and necessity with respect to a major gas pipeline for transporting gas off the North Slope of Alaska (or, if no such certificate is required, starting with the month during which the final permit, certificate or approval necessary to begin construction of such a pipeline is obtained) and ending with the month during which Major Gas Sale occurs. "Construction Interest" for a particular Gas Conditioning Plant shall be determined by multiplying the Relevant Sum for said plant for a particular calendar month by the Effective Pate Of Interest for that month. The "Relevant Sum" for a particular Gas Conditioning Plant for a particular calendar month shall be the cumulative total amount of Investments for said plant (excluding expenditures attributable to Support Facilities) paid and recorded or approved for payment through the last day of that month, plus the cumulative total of all previous Construction Interest calculations for said plant.

3.2.15 Intermediate Valuation Point shall mean:

(a) with respect to RIV Gas delivered for Conditioning to a Unit Plant, the outlet of said plant.

(b) with respect to RIV Gas delivered for Conditioning to a Non-Unit Plant (other than RIV Gas described in Paragraph 3.2.15(a)), the inlet of said plant. If particular RIV Gas produced from the Unit Area is first Conditioned in a Non-Unit Plant prior to further Conditioning in another Non-Unit Plant, the Intermediate Valuation Point for such gas shall be the inlet of the first such Non-Unit Plant.

(c) with respect to RIV Gas never delivered to a Gas Conditioning Plant for Conditioning, the meter at which the volume of said gas is measured for royalty purposes.

3.2.16 Intermediate Value shall mean, with respect to particular Royalty Gas, the value of said gas at the Intermediate Valuation Point for said gas.

3.2.17 Investments shall mean, with respect to a particular Gas Conditioning Plant, the total of all costs, in dollars actually spent (not escalated), attributable to the engineering, design, acquisition, construction, transportation, erection, expansion, alteration, start-up, commissioning and replacement (including unreimbursed costs associated with a catastrophic loss) of said Gas Conditioning Plant, minus the salvage value of equipment removed from said plant if the cost of such equipment was previously included in Investments. "Investments" for said plant shall also include a portion of the total of such types of costs, in dollars actually spent (not escalated), incurred with respect to Support Facilities, if any, for said plant, allocated on the basis set forth in Subsection 3.2.24, but shall not include any expenditure made after Major Gas Sale which is attributable to the Conditioning of gas produced from outside the Unit Area. If all or any portion of the facilities presently constituting the Central Injection Plant (a part of Non-Shared Group C, as defined in Exhibit 32B of the Unit Operating Agreement) are used to provide sales boost compression for said Gas Conditioning Plant (and thus constitute a part of said Gas Conditioning Plant), but said facilities remain available for the injection of gas back into the Unit Area when not being used for sales boost compression, "Investments" for said plant shall include ninety-eight percent (98%) of all of the aforesaid types of costs, in dollars actually spent (not escalated), incurred with respect to those Central Injection Plant facilities capable of being used both for sales boost compression and for gas injection.

3.2.18 <u>Major Gas Sale</u> shall mean 12:01 A.M. on the day on which the first delivery of gas produced from the Unit Area is made to a major gas pipeline for transportation off the North Slope of Alaska for any purpose other than, or in addition to, use or consumption as fuel for TAPS.

3.2.19 <u>Majority Owned Plant</u> shall have the meaning given to it in Subsection 3.9.2.

3.2.20 Minority Owned Plant shall have the meaning given to it in Subsection 3.9.3.

3.2.21 Non-Unit Plant shall mean a Gas Conditioning Plant that is not Unit Equipment.

3.2.22 Plant Investment Costs shall mean, with respect to a particular Gas Conditioning Plant, the sum of Investments for said plant plus Interest During Construction for said plant.

3.2.23 Regulated Plant shall have the meaning given to it in Subsection 3.9.4.

3.2.24 Support Facilities shall mean those items of Unit Equipment which are used both (i) to support (whether directly or indirectly) the construction or operations of a Unit Plant and (ii) to support other Unit Operations; provided, however, that Support Facilities shall not include such portion, if any, of those facilities presently constituting the Central Injection Plant (a part of Non-Shared Group C, as defined in Exhibit 32B of the Unit Operating Agreement) as are used to provide sales boost compression for said Gas Conditioning Plant. Support Facilities may include, but are not limited to, facilities of the types listed in Exhibit B. Except as otherwise expressly provided in this Agreement, in computing Investments, Plant O&M Costs (as defined in Subparagraph 3.8.1(a)(2)) and Ad Valorem Taxes (as defined in Subparagraph 3.8.1(a)(1)) for the purpose of calculating the Calculated Conditioning Cost for said plant, an allocated portion of, respectively, the investment costs, operating and maintenance costs and ad valorem taxes attributable to the Support Facilities, if any, for said plant shall also be included in such computations as though such allocated portion were incurred directly with respect to said plant. The basis for allocating to said plant a portion of such costs attributable to certain types of Support Facilities is shown in Exhibit B. As used in Exhibit B, allocation by "Investment Ratio" shall mean allocation in the same proportion as the ratio of total Plant Investment Costs for said plant (excluding costs attributable to Support Facilities) to total investment costs in the Unit (excluding costs attributable to Support Facilities) at the end of the Initial Period; and allocation by "Percentage Based on Usage" shall mean allocation in the same proportion as the ratio of usage of the particular facility by or in support of said plant to total usage of the facility during the Initial Period. If Support Facilities of a type not shown in Exhibit B are used to support said plant, the investment costs, operating and maintenance costs and ad valorem taxes attributable thereto shall be allocated between said plant and the other facilities supported by such Support Facilities in accordance with generally accepted accounting principles.

3.2.25 Total Plant Throughput for a particular period shall mean:

(a) with respect to a particular Unit Plant, the total volume (measured at the outlet of said plant and expressed in MCF) of all tailgate residue gas and other products and byproducts discharged from said plant during that period minus any portion of said total volume that is Used In Unit Operations.

(b) with respect to a particular Non-Unit Plant, the total volume (measured at the inlet of said plant and expressed in MCF) of all gas produced from the Unit Area and delivered to said plant during that period (hereinafter, "Delivered Gas") minus the volume determined by multiplying (i) the total volume (measured at the outlet of said plant and expressed in MCF) of any portion of the tailgate residue gas and other products and byproducts yielded from Delivered Gas that is Used In Unit Operations (hereinafter, "Returned Gas"), by (ii) the ratio determined by dividing (A) the volume weighted average Heating Value (measured at the outlet of said plant) of Returned Gas, by (B) the volume weighted average Heating Value (measured at the inlet of said plant) of Delivered Gas.

3.2.26 Unit Equipment shall have the meaning given to it in the Unit Agreement.

3.2.27 Unit Operating Agreement shall have the meaning given to it in the Unit Agreement.

3.2.28 Unit Operations shall have the meaning given to it in the Unit Agreement.

3.2.29 Unit Partial Conditioning Plant shall mean a Unit Plant in which gas produced from the Unit Area is Conditioned prior to further Conditioning in a Non-Unit Plant.

3.2.30 Unit Plant shall mean a Gas Conditioning Plant that is Unit Equipment.

3.2.31 Used In Unit Operations shall have the meaning given to it in Subsection 3.15.1.

3.3 Settled RIK Gas Taking Issue. As used herein, the term "Settled RIK Gas Taking Issue" shall mean the issue of where and in what condition the Lessees are obligated to deliver RIK Gas to the State. In full and final settlement of the respective claims and contentions of the State and each of the Lessees with respect to the Settled RIK Gas Taking Issue, the State and each of the Lessees agree as follows:

3.3.1 Unit Plant. If there is a Unit Plant, then all RIK Gas shall be taken by the State at the outlet of said plant.

3.3.2 Non-Unit Plant. If there is a Non-Unit Plant and there is no Unit Plant, then all RIK Gas shall be taken by the State upstream of said Non-Unit Plant at a single point located within the Unit Area and mutually agreed upon by the State and the Lessees.

3.3.3 No Plant. If there is no Gas Conditioning Plant, then all RIK Gas shall be taken by the State at a single point located within the Unit Area and mutually agreed upon by the State and the Lessees.

3.3.4 Condition at Point of Taking. All RIK Gas taken as royalty from a particular Lessee at a particular time shall be delivered to the State in the same condition as gas generally available for taking or other disposition by said Lessee at the time and point at which said RIK Gas is taken by the State.

3.4 Settled Upstream RIK Gas Issue. As used herein, the term "Settled Upstream RIK Gas Issue" shall mean the issue of whether, with respect to RIK Gas taken by the State as royalty from a particular Lessee, the State is liable to said Lessee for reimbursement of (i) all or any portion of the Field Costs incurred by said Lessee with respect to said gas, and (ii) all or any portion of any Conditioning costs incurred by said Lessee with respect to said gas upstream of the point of taking. In full and final settlement of the respective claims and contentions of the State and each of the Lessees with respect to the Settled Upstream RIK Gas Issue, the State and each of the Lessees agree that, with respect to each MCF of RIK Gas taken as royalty from a particular Lessee, the State shall be liable to that Lessee for an amount equal to the Upstream Cost Allowance with respect to said gas, determined in accordance with Section 3.6.

3.5 Settled Upstream RIV Gas Issue. As used herein, the term "Settled Upstream RIV Gas Issue" shall mean the issue of whether, in computing the value of Royalty Gas for the purpose of making royalty payments "in value" on gas produced from the Unit Area, each Lessee may deduct from the Intermediate Value of said gas (i) all or any portion of the Field Costs incurred by said Lessee with respect to said gas, and (ii) all or any portion of any Conditioning costs incurred by said Lessee with respect to said gas in a Gas Conditioning Plant located upstream of the Intermediate Valuation Point for said gas. In full and final settlement of the respective claims and contentions of the State and each of the Lessees with respect to the Settled Upstream RIV Gas Issue, the State and each of the Lessees agree that, in computing the value for royalty purposes of each MCF of RIV Gas for which a particular Lessee makes settlement, said Lessee may deduct from the Intermediate Value of said gas an amount equal to the Upstream Cost Allowance with respect to said gas, determined in accordance with Section 3.6.

3.6 Upstream Cost Allowance. Each Lessee shall be entitled to an Upstream Cost Allowance with respect to Royalty Gas, determined as follows:

3.6.1 Gas Conditioned by Unit Plant. The Upstream Cost Allowance for Royalty Gas that is discharged from a Unit Plant and measured for royalty purposes during a particular calendar month shall be an amount per MCF (measured at the outlet of said plant) equal to the sum of: (i) the Field Cost Allowance determined for said month in accordance with Section 3.7, plus (ii) the Calculated Conditioning Cost determined for said plant and said gas in accordance with Section 3.8.

3.6.2 Other Royalty Gas. The Upstream Cost Allowance for Royalty Gas measured for royalty purposes during a particular calendar month, other than Royalty Gas described in Subsection 3.6.1, shall be an amount per MCF (measured at the point of taking in the case of RIK Gas and at the Intermediate Valuation Point in the case of RIV Gas) equal to the Field Cost Allowance determined for said month in accordance with Section 3.7, whether or not there is a Unit Plant.

3.7 Field Cost Allowance. The Field Cost Allowance for Royalty Gas shall be determined as follows:

3.7.1 Pre-1986. The Field Cost Allowance with respect to Royalty Gas, if any, measured for royalty purposes after

Major Gas Sale and on or before December 31, 1985, shall be 15.5 cents per MCF.

3.7.2 Thereafter. The Field Cost Allowance with respect to Royalty Gas measured for royalty purposes after Major Gas Sale and on or after January 1, 1986, shall be the amount per MCF determined by using the following formula:

$$\text{Field Cost Allowance per MCF} = 15.5 \text{ cents} \times \frac{\text{PPI for the year prior to the Year Of Production}}{\text{PPI for 1984.}}$$

3.7.3 Upstream Gas Facilities. A functional description of facilities used to clean, dehydrate and transport gas is contained in Exhibit C.

3.8 Calculated Conditioning Cost. The Calculated Conditioning Cost for a particular Gas Conditioning Plant and particular Royalty Gas shall be determined as follows:

3.8.1 Initial Amount

(a) Formula. With respect to Royalty Gas measured for royalty purposes during a particular calendar month after Major Gas Sale and prior to the end of the calendar month during which the Commissioner is notified of the Base Amount pursuant to Paragraph 3.8.2(b), the Calculated Conditioning Cost shall be the amount per MCF (hereinafter, the "Initial Amount") determined by using the following formula:

$$\text{Initial Amount per MCF} = \text{An estimate of the Base Investment Component} + \text{An estimate of the Base O\&M Component,}$$

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where:

(1) "Base Investment Component" is the per MCF amount determined by adding:

(i) "Interest on Plant Investment Costs" (the amount determined by multiplying Plant Investment Costs as of the end of the Initial Period by the Effective Rate Of Interest for the Initial Period); plus

(ii) Depreciation" (the amount determined by dividing Plant Investment Costs as of the end of the Initial Period by 300 and then multiplying by the number of months in the Initial Period) (this represents depreciation calculated on a 25-year straight line basis); plus

(iii) "Ad Valorem Taxes" (the amount determined by multiplying one-twelfth of all ad valorem taxes applicable to the Gas Conditioning Plant for the last calendar year of the Initial Period, plus a portion of the total of all ad valorem taxes applicable to all Support Facilities for such calendar year (allocated on the basis set forth in Subsection 3.2.24) by the number of calendar months in the Initial Period);

and then dividing said sum by Total Plant Throughput for the Initial Period; and

(2) "Base O&M Component" is the per MCF amount determined by dividing:

(i) "Plant O&M Costs" (the total of: (A) all costs, other than ad valorem taxes, attributable to operating, maintaining and repairing the Gas Conditioning Plant during the Initial Period (including overhead and, in the case of a Non-Unit Plant, the cost of plant fuel), plus (B) (i) in the case of a Unit Plant, a portion of all such costs for Support Facilities during the Initial Period, allocated on the basis set forth in Subsection 3.2.24, or (ii) in the case of a Non-Unit Plant, the value of any gas contributed in kind to said plant during the Initial Period for use as plant fuel,

by:

(ii) Total Plant Throughput for the Initial Period; and

(3) said estimates of the Base Investment Component and the Base O&M Component are determined in accordance with Paragraph 3.8.1(b).

(b) <u>Procedure</u>. Lessees who own an interest (or whose Affiliates own an interest) in a Gas Conditioning Plant shall cause the operator of such plant (or, if he fails to do so, the Lessee who owns (or whose Affiliate owns) the greatest interest in said plant) to estimate the Base Investment Component and Base O&M Component; to calculate the Initial Amount using the formula prescribed in Paragraph 3.8.1(a); and to furnish to said Lessees a worksheet showing said amount, the manner in which said amount was calculated and the projections and estimates used in calculating said amount (including the estimated Total Plant Throughput for each calendar month occurring prior to the end of the Initial Period). Said Lessees shall notify the Commissioner of the Initial Amount prior to the end of the calendar month during which Major Gas Sale occurs.

3.8.2 Base Amount.

(a) Formula. With respect to Royalty Gas measured for royalty purposes during a particular calendar month after the end of the calendar month during which the Commissioner is notified of the Base Amount and prior to the end of the Base Period, the Calculated Conditioning Cost shall be the amount per MCF (hereinafter, the "Base Amount") determined by using the following formula:

$$\text{Base Amount per MCF} = \text{Base Investment Component} + \text{Base O\&M Component},$$

where:

(1) "Base Investment Component" is the per MCF amount determined as provided in Subparagraph 3.8.1(a)(1); and

(2) "Base O&M Component" is the per MCF amount determined as provided in Subparagraph 3.8.1(a)(2).

(b) Procedure. Lessees who own an interest (or whose Affiliates own an interest) in a Gas Conditioning Plant shall cause the operator of such plant (or, if he fails to do so, the Lessee who owns (or whose Affiliate owns) the greatest interest in said plant) to calculate the Base Amount using the formula prescribed in Paragraph 3.8.2(a), and to furnish to said Lessees a worksheet showing said amount, the manner in which said amount was calculated and the figures from which each component in said formula was derived. Said Lessees shall notify the Commissioner of the Base Amount not later than sixty days after the end of the Initial Period.

3.8.3. Adjusted Amount.

(a) Formula. With respect to Royalty Gas measured for royalty purposes during any calendar month of a particular calendar year after the end of the Base Period, the Calculated Conditioning Cost shall be the amount per MCF (hereinafter, the "Adjusted Amount") determined by using the following formula:

$$\text{Adjusted Amount per MCF} = \text{Adjusted Investment Component} + \text{Adjusted O\&M Component},$$

where:

(1) "Adjusted Investment Component" is the per MCF amount determined by using the following formula:

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$$\text{Adjusted Investment Component} = \text{Base Investment Component} \times \frac{\text{Plant Investment Costs as of December 31 of the year prior to the Year Of Production}}{\text{Plant Investment Costs as of the end of the Initial Period}},$$

where: "Base Investment Component" is the per MCF amount determined as provided in Subparagraph 3.8.1(a)(1);

and

(2) "Adjusted O&M Component" is the per MCF amount determined by using the following formula:

$$\text{Adjusted O\&M Component} = \text{Base O\&M Component} \times \frac{\text{PPI for the year prior to the Year Of Production}}{\text{PPI for the year following the calendar year during which Major Gas Sale occurs}},$$

where: "Base O&M Component" is the per MCF amount determined as provided in Subparagraph 3.8.1(a)(2).

(b) Procedure. After the end of the Base Period, Lessees who own an interest (or whose Affiliates own an interest) in a Gas Conditioning Plant shall cause the operator of such plant (or, if he fails to do so, the Lessee who owns (or whose Affiliate owns) the greatest interest in said plant) to calculate the Adjusted Amount yearly using the formula prescribed in Paragraph 3.8.3(a), and to furnish to said Lessees a worksheet showing said amount, the manner in which said amount was calculated and the figures from which each component in said formula was derived. Said Lessees shall notify the Commissioner of the Adjusted Amount not later than the last day of February of the calendar year during which such Adjusted Amount applies.

3.8.4. Significant Throughput Deviation.

(a) Phased Plant Startup. If, at Major Gas Sale, the estimate furnished to Lessees pursuant to Paragraph 3.8.1(b) of Total Plant Throughput for a particular Gas Conditioning Plant for the first six calendar months after the calendar month during which Major Gas Sale occurs is less than ninety percent (90%) of the estimate (so furnished) of Total Plant Throughput for said plant for the last six calendar months of the calendar year after the calendar year during which Major Gas Sale occurs, then, notwithstanding the definition given in Subsection 3.2.13, the term "Initial Period" shall, for all purposes under this Agreement with respect to said plant, have the meaning set forth in Paragraph 3.8.4(c).

(b) Plant Throughput Shortfall. If, at the end of the calendar year following the calendar year during which Major Gas Sale occurs, a Plant Throughput Shortfall (as hereinafter defined) is deemed to have occurred with respect to a particular Gas Conditioning Plant:

(1) each Lessee who owns an interest (or whose Affiliate owns an interest) in said plant shall notify the Commissioner of the existence of such shortfall within thirty days thereafter; and

(2) the term "Initial Period", for all purposes under this Agreement with respect to said plant, shall have

the meaning set forth in Paragraph 3.8.4(c), except that, in such event, the previously calculated "Initial Amount" shall not be recalculated and shall continue to be used as the Calculated Conditioning Cost for that plant with respect to Royalty Gas measured for royalty purposes prior to the end of the calendar month during which the Commissioner is notified of the Base Amount for that plant pursuant to Paragraph 3.8.2(b).

As used in this Paragraph 3.8.4(b), a "Plant Throughput Shortfall" shall be deemed to have occurred with respect to a particular Gas Conditioning Plant if Total Plant Throughput for said plant for the period beginning at 12:01 A.M. on the first day of the calendar month following the calendar month during which Major Gas Sale occurs and ending at the end of the calendar year following the calendar year during which Major Gas Sale occurs is less than ninety percent (90%) of the estimate furnished to Lessees pursuant to Paragraph 3.8.1(b) of Total Plant Throughput for that same plant and period.

(c) Initial Period Redefined. In those instances specified in Paragraphs 3.8.4(a) and (b), the term "Initial Period" shall mean the period beginning at 12:01 A.M. on the first day of January of the second calendar year following the calendar year during which Major Gas Sale occurs and ending at the end of said second calendar year.

3.8.5 Accounting Procedure. For the purpose of determining Investments (as defined in Subsection 3.2.17) and Plant O&M Costs (as defined in Subparagraph 3.8.1(a)(2)), all expenditures, both direct and indirect (including overhead), shall be accounted for in accordance with the Accounting Procedure attached as Exhibit I to the Unit Operating Areement; provided, however, that if a particular Gas Conditioning Plant is not Unit Equipment governed by said Exhibit I, or if expenditures with respect thereto are not accounted for by the plant owners in accordance with said Exhibit I, then, for the purpose of this Agreement, such expenditures shall be accounted for in accordance with the accounting procedure established for that plant; and provided further that neither Investments nor Plant O&M Costs shall include either of the following types of expenditures: (i) oil and gas lease rentals or royalties paid to the State; (ii) legal expenses incurred by any person in connection with litigation or claims with respect to which the State is an adverse party. Each Lessee who owns an interest (or whose Affiliate owns an interest) in a Gas Conditioning Plant shall use its best efforts to provide for an accounting procedure for expenditures with respect to said plant not substantially different from the Accounting Procedure attached as Exhibit I to the Unit Operating Agreement, modified as hereinabove provided.

3.9 <u>Characterization of Non-Unit Plants</u>. As used in this Article and the Exhibits to this Agreement:

3.9.1 <u>Divided Plant</u> shall mean a Non-Unit Plant that is owned by more than one owner if: (i) gas may be tendered for Conditioning to any one of the several owners and (ii) the owner to whom particular gas is tendered for Conditioning establishes, independently of the other owners of said plant, the charge which shall be paid for the Conditioning of such gas (or, if such plant is a Regulated Plant, said charge is regulated or established individually with respect to each such owner).

3.9.2 Majority Owned Plant shall mean a Non-Unit Plant in which Lessees (or Affiliates thereof, or any combination of Lessees and their Affiliates) own a majority interest.

3.9.3 Minority Owned Plant shall mean a Non-Unit Plant that is not a Majority Owned Plant.

3.9.4 Regulated Plant shall mean a Non-Unit Plant that Conditions gas produced from the Unit Area for a charge established or regulated by governmental authority.

3.9.5 Adjectives. The term "Undivided" refers to a Non-Unit Plant that is not a Divided Plant. The term "Unregulated" refers to a Non-Unit Plant that is not a Regulated Plant.

3.10 Settled Downstream RIK Gas Issue. As used herein, the term "Settled Downstream RIK Gas Issue" shall mean the issue of whether and, if so, the extent to which and for what price, any Lessee is required to condition or otherwise treat all or any portion of the gas produced from the Unit Area and taken by the State as royalty "in kind." In full and final settlement of the respective claims and contentions of the State and each of the Lessees with respect to the Settled Downstream RIK Gas Issue, the State and each of the Lessees agree that:

3.10.1 Unregulated Divided and Unregulated Majority Owned Plants. Each Lessee who owns an interest (or whose Affiliate owns an interest) in an Unregulated Divided Plant or an Unregulated Majority Owned Plant shall, if so requested by the State, Condition or cause to be Conditioned in said plant, during a particular calendar month, the portion of the RIK Gas taken as royalty from said Lessee having a volume equal to the lesser of:

(i) the volume (measured at the inlet of said plant and expressed in MCF) of RIK Gas taken as royalty from said Lessee and tendered by the State (or, if all or any portion of the rights of the State under this Section 3.10 have been assigned in accordance with this Section 3.10 to one or more persons (hereinafter, "Assignees"), the aggregate volume of such RIK Gas tendered by the State and all of the Assignees) during that month for Conditioning in said plant; or

(ii) the volume equal to the product of (A) Total Plant Throughput for that month, multiplied by (B) said Lessee's percentage of ownership in said Gas Conditioning Plant (or, if an Affiliate of said Lessee owns an interest in said plant, the aggregate percentage owned by said Lessee and all of its Affiliates), multiplied by (C) twelve and one-half percent (12-1/2%), multiplied by (D) the percentage of Royalty Gas for that month which the State has taken "in kind" during that month;

for which Conditioning the State, for each MCF (measured at the inlet of said plant) of said RIK Gas tendered by the State for Conditioning in said plant pursuant to this Subsection 3.10.1, and each Assignee, for each MCF (measured at the inlet of said plant) of said RIK Gas so tendered by said Assignee, shall pay to said Lessee a Conditioning charge equal to the Calculated Conditioning Cost determined for said plant and gas in accordance with Section 3.8, plus any amount due to said Lessee with respect to said gas pursuant to Paragraph 3.13.2(b) or Paragraph 3.14.2(b), as applicable; provided, however, that if, prior to said month, the State has elected to abandon the Calculated Conditioning Cost with respect to said Lessee and plant in accordance with the provisions of Section 3.12, then this Subsection 3.10.1 shall be inapplicable to, and no obligation under this Subsection 3.10.1 to the State or any Assignee shall arise on the part of, said Lessee with respect to said plant.

3.10.2 Regulated Plants. Each Lessee who owns an interest (or whose Affiliate owns an interest) in a Regulated Plant shall, if so requested by the State, Condition or cause to be Conditioned in said plant, during a particular calendar month, the portion of the RIK Gas taken as royalty from said Lessee having a volume equal to the lesser of:

(i) the volume (measured at the inlet of said plant and expressed in MCF) of RIK Gas taken as royalty from said Lessee and tendered by the State (or, if all or any portion of the rights of the State under this Section 3.10 have been assigned in accordance with this Section 3.10 to one or more Assignees, the aggregate volume of such RIK Gas tendered by the State and all of the Assignees) during that month for Conditioning in said plant; or

(ii) the volume equal to the product of (A) Total Plant Throughput for that month, multiplied by (B) said Lessee' percentage of ownership in said Gas Conditioning Plant (or, if an Affiliate of said Lessee owns an interest in said plant, the aggregate percentage owned by said Lessee and all of its Affiliates), multiplied by (C) twelve and one-half percent (12-1/2%), multiplied by (D) the percentage of Royalty Gas for that month which the State has taken "in kind" during that month;

for which Conditioning the State, for each MCF (measured at the inlet of said plant) of said RIK Gas tendered by the State for Conditioning in said plant pursuant to this Subsection 3.10.2, and each Assignee, for each MCF (measured at the inlet of said plant) of said RIK Gas so tendered by said Assignee, shall pay to said Lessee a Conditioning charge equal to the applicable tariff rate or charge (per MCF measured at the inlet of said plant) established for such Conditioning (or, if the applicable tariff rate or charge encompasses services in addition to Conditioning, the portion of such rate or charge attributable to such Conditioning) (it being understood and agreed that the term "applicable tariff rate or charge" as used in this Subsection shall mean the entire tariff rate or charge payable for such Conditioning).

3.10.3 <u>Conditioning Contract</u>. Prior to tendering RIK Gas for Conditioning pursuant to Subsection 3.10.1 or Subsection 3.10.2 to a Lessee who owns an interest (or whose Affiliate owns an interest) in a Gas Conditioning Plant, the State (or, with respect to rights under this Section 3.10 assigned by the State, the Assignee of such rights) shall have entered into a conditioning contract with the owners of said plant (or, in the case of a Divided Plant, with said Lessee or its Affiliate who owns an interest in said plant), which contract shall set forth the terms and conditions (not inconsistent with those provided for herein) on which such gas shall be Conditioned. The entry by the State (or Assignee, as the case may be) into such a contract and the performance by the State (or Assignee) of all of its obligations thereunder shall be conditions precedent to the obligations of such Lessee under Subsection 3.10.1 and Subsection 3.10.2.

3.10.4 Assignment by State. The State may assign its rights under this Section 3.10 with respect to RIK Gas taken from a particular Lessee during a particular month to any person purchasing all or any portion of said RIK Gas from the State if said gas is to be delivered to such person by the State at the point of taking provided for in Section 3.3 hereof; provided, however, that the volume of said RIK Gas which a particular Assignee may require said Lessee to Condition in a particular Gas Conditioning Plant pursuant to Subsection 3.10.1 or Subsection 3.10.2, as applicable, shall in no event exceed the volume determined by multiplying (i) the volume of RIK Gas taken as royalty from said Lessee during said month that the State and all Assignees may require said Lessee to Condition in said plant pursuant to said Subsection, by (ii) the ratio determined by dividing (A) the volume of RIK Gas taken as royalty from said Lessee during said month and purchased from the State by said Assignee, by (B) the total volume of RIK Gas taken as royalty from said Lessee during said month; and provided further, that no such assignment shall be effective as to or binding upon any Lessee unless and until: (1) there shall have been delivered to said Lessee the instrument (or a duplicate original thereof) by which such assignment is made, duly executed and acknowledged by the State and the Assignee, obligating said Assignee, for the benefit of said Lessee, to pay the respective share of the charges due to said Lessee for Conditioning RIK Gas sold by the State to said Assignee (including any amount then or thereafter due to said Lessee pursuant to Section 3.13) and to keep and perform and be bound by each and all of the other covenants, conditions, restrictions and other provisions hereof on the part of the State with respect to said RIK Gas, which assignment shall expressly provide that it is made subject to all of such covenants, conditions, restrictions and provisions; and (2) said Assignee has entered into a conditioning contract with the owners of the Gas Conditioning Plant in which said Lessee (or its Affiliate) owns an interest setting forth the terms and conditions on which such gas shall be Conditioned in said plant. No Assignee may further assign any rights under this Agreement without, in each instance, the prior written consent of each Lessee who owns (or whose Affiliate owns) an interest in a Gas Conditioning Plant, and any assignment made without such prior consent shall be null and void. No assignment by the State pursuant to this Subsection 3.10.4 shall affect or reduce any obligation of the State or right of any Lessee hereunder, and all obligations of the State hereunder shall continue in full force and effect as the obligations of a principal, and not of a guarantor or surety, to the same extent as though no assignment had been made (it being expressly understood and agreed that the foregoing shall not obligate the State to pay, and the State shall not be liable hereunder for, any costs or charges incurred by an Assignee for Conditioning gas in a Non-Unit Plant). Nothing in this Subsection 3.10.4 shall be construed as permitting the State to assign its right to abandon the

Calculated Conditioning Cost with respect to any Lessee and Gas Conditioning Plant. Except as permitted by this Subsection 3.10.4, the State shall not assign, in whole or in part, any of its rights under this Agreement, and all assignments of rights under this Agreement other than those permitted by and made in accordance with this Subsection 3.10.4 shall be null and void.

3.10.5 No Other Obligation. Except as otherwise expressly provided in this Section 3.10, no Lessee shall be obligated to Condition or otherwise treat Royalty Gas; provided, however, that this Subsection 3.10.5 shall not be construed as a waiver by the State of any of its rights under federal law.

3.11 Settled Downstream RIV Gas Issue. As used herein, the term "Settled Downstream RIV Gas Issue" shall mean the issue of how, in determining the Intermediate Value of RIV Gas delivered during a particular calendar month to a particular Non-Unit Plant (from which Intermediate Value the Upstream Cost Allowance may be deducted by a Lessee, pursuant to Section 3.5, in making settlement for such RIV Gas), a Lessee is to compute the value at the inlet of said plant of the RIV Gas portion of said Lessee's Inlet Gas for said plant and month (as a function of the value of the tailgate residue gas and other products and byproducts yielded from said Inlet Gas) in those instances in which said Lessee Bears Conditioning Costs with respect to the RIV Gas portion of said Lessee's Inlet Gas for said plant and month. For purposes of this Section 3.11 and Section 3.13:

(a) with respect to a particular Lessee, Gas Conditioning Plant and calendar month, the term "Inlet Gas" shall mean all gas, other than RIK Gas, that is (i) produced from the Unit Area, (ii) allocated to said Lessee, and (iii) delivered to said plant during said month; and

(b) a particular Lessee "Bears Conditioning Costs" with respect to the RIV Gas portion of said Lessee's Inlet Gas for a particular Non-Unit Plant and month if and only if said Lessee either (i) owns an interest in said plant, or (ii) incurs (with or without right of reimbursement) any of the cost of Conditioning said Inlet Gas in said plant other than the cost of disposing of any of the products or byproducts yielded from said gas.

In full and final settlement of the respective claims and contentions of the State and each of the Lessees with respect to the Settled Downstream RIV Gas Issue, the State and each of the Lessees agree that:

3.11.1 Intermediate Value of Certain RIV Gas. In those instances in which a particular Lessee Bears Conditioning Costs with respect to the RIV Gas portion of said Lessee's Inlet Gas for a particular Non-Unit Plant and particular calendar month, for the purpose of determining the Intermediate Value of each MCF of said RIV Gas, the value at the inlet of said plant of each MCF of said RIV Gas shall be the amount determined by using the following formula:

$$\text{Inlet Value per MCF} = \frac{\text{Lessee's Net Outlet Value}}{\text{Lessee's Net Inlet Volume}} - \text{Downstream Conditioning Allowance per MCF},$$

where:

(1) "Lessee's Net Outlet Value" is the total value of the tailgate residue gas and other products and byproducts yielded from all of said Lessee's Inlet Gas for said plant and month other than any portion of said tailgate residue gas and other products and byproducts which is Used In Unit Operations (which total value shall be determined at the outlet of said plant; or, with respect to any portion of said tailgate residue gas and other products and byproducts yielded from said Inlet Gas which is contributed in kind to said plant for use as fuel in said plant, determined at the point of consumption); and

(2) "Lessee's Net Inlet Volume" is the total volume (measured at the inlet of said plant) of said Lessee's Inlet Gas for said plant and month minus the volume determined by multiplying (i) the total volume (measured at the outlet of said plant and expressed in MCF) of any portion of the tailgate residue gas and other products and byproducts yielded from said Inlet Gas which is Used In Unit Operations (hereinafter, "Lessee's Returned Gas"), by (ii) the ratio determined by dividing (A) the volume weighted average Heating Value (measured at the outlet of said plant) of Lessee's Returned Gas, by (B) the volume weighted average Heating Value (measured at the inlet of said plant) of said Inlet Gas; and

(3) "Downstream Conditioning Allowance" is the per MCF amount determined for said plant and said RIV Gas in accordance with Subsection 3.11.2.

3.11.2 Downstream Conditioning Allowance. For the purposes of this Section 3.11, the Downstream Conditioning Allowance for RIV Gas shall be determined as follows:

(a) Lessee-Owner of Regulated Plant. With respect to RIV Gas for which a particular Lessee who owns an interest (or whose Affiliate owns an interest) in a Regulated Plant makes settlement, the Downstream Conditioning Allowance for said plant with respect to each MCF of said RIV Gas measured during a particular calendar month at the inlet of said plant shall be equal to the applicable tariff rate or charge per MCF (measured at the inlet of said plant) established for Conditioning said Lessee's Inlet Gas in said plant during said month (or if the applicable tariff rate or charge encompasses services in addition to such Conditioning, the portion of said rate or charge attributable to such Conditioning). If said Regulated Plant is a Divided Plant, the "applicable tariff rate or charge" shall be the tariff rate or charge established with respect to gas tendered during that month to said Lessee for such Conditioning (or if said Lessee does not own an interest in said plant, so tendered to said Lessee's Affiliate who owns an interest in said plant).

(b) Lessee-Owner of Unregulated Majority Owned Plant or Unregulated Divided Plant. With respect to RIV Gas for which a particular Lessee who owns an interest (or whose Affiliate owns an interest) in an Unregulated Majority Owned Plant or in an Unregulated Divided Plant makes settlement, the Downstream Conditioning Allowance for said plant with respect to each MCF of said RIV Gas measured during a particular calendar month at the inlet of said plant shall be determined as follows:

(1) With respect to the portion of said RIV Gas having a volume equal to the lesser of:

(A) the total volume (expressed in MCF) of said RIV Gas measured during said calendar month at the inlet of said plant; or

(B) the volume (expressed in MCF) equal to the product of (i) Total Plant Throughput for that month, multiplied by (ii) said Lessee's percentage of ownership in said Gas Conditioning Plant (or, if an Affiliate of said Lessee owns an interest in said plant, the aggregate percentage owned by said Lessee and all of its Affiliates), multiplied by (iii) twelve and one-half percent (12-1/2%), multiplied by (iv) the percentage of Royalty Gas for that month which the State did not take "in kind" during that month;

the Downstream Conditioning Allowance (per MCF of said RIV Gas measured at the inlet of said plant) shall be equal to the Calculated Conditioning Cost (per MCF measured at the inlet of said plant) determined for said plant and gas in accordance with Section 3.8; provided, however, that if, prior to said month, the State has elected to abandon the Calculated Conditioning Cost with respect to said Lessee and plant in accordance with the provisions of Section 3.12, then the Calculated Conditioning Cost shall not apply with respect to any of said RIV Gas and the Downstream Conditioning Allowance with respect to said RIV Gas shall be determined in accordance with Subparagraph 3.11.2(b)(2).

(2) With respect to the remainder, if any, of said RIV Gas (or if, prior to said month, the State has elected to abandon the Calculated Conditioning Cost with respect to said Lessee and plant in accordance with the provisions of Section 3.12, then with respect to all of said RIV Gas), the Downstream Conditioning Allowance (per MCF measured at the inlet of said plant) shall be equal to:

(A) if said plant is an Undivided Gas Conditioning Plant, the tariff rate or charge (per MCF measured at the inlet of said plant) established by the owners of said plant for Conditioning said Lessee's Inlet Gas in said plant during said month; or, if no such tariff rate or charge is established, the volume weighted average tariff rate or charge (per MCF measured at the inlet of said plant) paid for Conditioning in said plant during said month gas of the same kind and quality as said Lessee's Inlet Gas.

(B) if said plant is a Divided Plant, the tariff rate or charge (per MCF measured at the inlet of said plant) established by said Lessee (or, if said Lessee does not own an interest in said plant, established by said Lessee's Affiliate who owns an interest in said plant) for Conditioning in said plant during said month gas of the same kind and quality as said Lessee's Inlet Gas for said plant and month; or, if no such tariff rate or charge is so established, the volume weighted average tariff rate or charge (per MCF measured at the inlet of said plant) paid for such Conditioning with respect to gas tendered during that month to said Lessee (or, if said Lessee does not own an interest in said plant, so tendered to said Lessee's Affiliate) for Conditioning in said plant.

(c) <u>Lessee-Owner of Unregulated, Undivided Minority Owned Plant</u>. With respect to RIV Gas for which a particular Lessee who owns an interest (or whose Affiliate owns an interest) in an Unregulated Undivided Minority Owned Plant makes settlement, the Downstream Conditioning Allowance for said plant with respect to each MCF of said RIV Gas measured during a particular calendar month at the inlet of said plant shall be equal to the tariff rate or charge (per MCF measured at the inlet of said plant) established by the owners of said plant for Conditioning said Lessee's Inlet Gas in said plant during said month; or, if no such tariff rate or charge is established, the volume weighted average tariff rate or charge (per MCF measured at the inlet of said plant) paid for such Conditioning occurring in said plant during said month.

(d) <u>Non-Owner Lessee</u>. With respect to any RIV Gas for which a particular Lessee makes settlement, which gas is delivered during a particular calendar month to a Gas Conditioning Plant in which neither said Lessee nor any Affiliate of said Lessee owns an interest, the Downstream Conditioning Allowance for said plant with respect to each

MCF (measured at the inlet of said plant) of said RIV Gas shall be equal to the sum of (i) the volume weighted average amount, if any, (per MCF measured at the inlet of said plant) paid to the owners of said plant by said Lessee for Conditioning in said plant during said month, plus (ii) the volume weighted average amount, if any, (per MCF measured at the inlet of said plant) paid to the owners of said plant by the purchasers of said RIV Gas for such Conditioning.

(e) <u>In Kind Charges</u>. As used in this Subsection 3.11.2 and in Paragraph 3.13.1(c), the term "tariff rate or charge" (and, with respect to Paragraph 3.11.2(d), the term "amount") shall mean, with respect to particular gas and a particular Gas Conditioning Plant, the sum of (i) the entire monetary amount, if any, established (or, in the case of Paragraph 3.11.2(d), paid) for Conditioning said gas in said plant, plus (ii) the value of any gas contributed in kind to said plant as payment, in whole or in part, for such Conditioning, regardless of the form or condition in which such gas is contributed.

3.12 <u>Election to Abandon Calculated Conditioning Cost</u>. With respect to each Gas Conditioning Plant, the State may elect, for the purpose of Sections 3.10, 3.11 and 3.13, to abandon the Calculated Conditioning Cost with respect to any or all Lessees (regardless of whether the Calculated Conditioning Cost then applies to a particular Gas Conditioning Plant and Lessee with respect to which such election is made) by dispatching written notice of such election to each Lessee affected thereby, such notice to be dispatched with respect to a particular Gas Conditioning Plant within one hundred fifty days after the end of the Initial Period for said plant. Each such notice shall be dispatched by registered mail, return receipt requested, to the address for such Lessee set forth in the Unit Agreement or at such other address as said Lessee shall hereafter specify for such purpose. Any such election shall be irrevocable. The right of the State to make the election provided for in this Section 3.12 with respect to a particular Gas Conditioning Plant shall expire with respect to all Lessees one hundred fifty days after the end of the Initial Period for said plant and no attempt to make such an election with respect to any Gas Conditioning Plant or Lessee after said one hundred fiftieth day shall be effective for any purpose; provided, however, that if, as of the sixtieth day following the end of the Initial Period for a particular Gas Conditioning Plant in which one or more Lessees (or their Affiliates) then own an interest, the Commissioner has not been notified of the Base Amount for said plant if such notice is required by Paragraph 3.8.2(b), then, with respect to all Lessees, the time within which the State may make such an election with respect to said plant shall be extended through the end of the ninetieth day after the Commissioner is first notified of the Base Amount for said plant. The election rights provided for in this Section 3.12 shall not be assigned by the State and any assignment by the State of all or any portion of said rights shall be null and void.

3.13 <u>Payment of Initial Amount/Established Amount Differential</u>.

3.13.1 <u>Definitions</u>. As used in this Section 3.13:

(a) <u>Bears Conditioning Costs</u> shall, with respect to particular RIV Gas, have the meaning given to it in Section 3.11.

(b) Differential Amount Per MCF for a particular Lessee, particular Gas Conditioning Plant and particular Royalty Gas shall mean an amount equal to the difference between the Calculated Conditioning Cost for said plant and gas and the Established Amount for said Lessee, plant and gas.

(c) Established Amount for a particular Lessee, particular Gas Conditioning Plant and particular Royalty Gas shall mean an amount equal to the Base Amount for said plant determined in accordance with Subsection 3.8.2; provided, however, that if the State has made the election provided for in Section 3.12 with respect to a particular Lessee and a particular Gas Conditioning Plant, then, with respect to said Lessee and plant, the term "Established Amount" for Royalty Gas measured for royalty purposes during any calendar month when said plant was an Unregulated Undivided Majority Owned Plant or an Unregulated Divided Plant shall mean an amount equal to:

(1) if said plant was an Unregulated Undivided Majority Owned Plant during a particular calendar month, the tariff rate or charge (as defined in Paragraph 3.11.2(e)) (per MCF measured at the inlet of said plant) established by the owners of said plant for Conditioning said Lessee's Inlet Gas in said plant during said month; or, if no such tariff rate or charge is established, the volume weighted average tariff rate or charge (per MCF measured at the inlet of said plant) paid for Conditioning in said plant during said month gas of the same kind and quality as said Lessee's Inlet Gas.

(2) if said plant was an Unregulated Divided Plant during a particular calendar month, the tariff rate or charge (as defined in Paragraph 3.11.2(e)) (per MCF measured at the inlet of said plant) established by said Lessee (or, if said Lessee does not own an interest in said plant, established by said Lessee's Affiliate who owns an interest in said plant) for Conditioning in said plant during said month gas of the same kind and quality as said Lessee's Inlet Gas for said plant and month; or, if no such tariff rate or charge is so established, the volume weighted average tariff or charge (per MCF measured at the inlet of said plant) paid for such Conditioning with respect to gas tendered during that month to said Lessee (or, if said Lessee does not own an interest in said plant, so tendered to said Lessee's Affiliate) for Conditioning in said plant.

(d) Election Date shall mean, with respect to a particular Lessee and a particular Gas Conditioning Plant, the date on which the State elects to abandon the Calculated Conditioning Cost with respect to said Lessee and plant in accordance with the provisions of Section 3.12; provided, however, that if the State does not so elect, then with respect to said Lessee and plant, "Election Date" shall mean the date on which the State's right so to elect expires under Section 3.12.

(e) Inlet Gas of a particular Lessee shall, with respect to a particular Non-Unit Plant and a particular calendar month, have the meaning given to it in Section 3.11.

3.13.2 Obligation.

(a) Royalty Gas, Unit Plant. With respect to each MCF of Royalty Gas (i) discharged from a particular Unit Plant prior to the end of the calendar month during which the Commissioner is notified of the Base Amount for said plant pursuant to Paragraph 3.8.2(b), and (ii) taken as royalty from a particular Lessee (in the case of RIK Gas) or for which a particular Lessee makes or is obligated to make royalty settlement "in value" (in the case of RIV Gas):

(1) if the Established Amount for said Lessee, plant and gas is less than the Calculated Conditioning Cost for said plant and gas, then said Lessee shall pay the Differential Amount Per MCF for said Lessee, plant and gas to the State within forty-five days after the Commissioner is notified of the Base Amount for said plant pursuant to Paragraph 3.8.2(b).

(2) if the Established Amount for said Lessee, plant and gas is greater than the Calculated Conditioning Cost for said plant and gas, then the State shall pay the Differential Amount Per MCF for said Lessee, plant and gas to said Lessee promptly (within forty-five days, if possible) after the Commissioner is notified of the Base Amount for said plant pursuant to Paragraph 3.8.2(b). Each Lessee whom any payment will be due under this Subparagraph 3.13.2(a)(2) shall invoice the Commissioner for the total amount due to said Lessee within fifteen days after the Commissioner is so notified of said Base Amount.

(b) RIK Gas, Non-Unit Plant. With respect to each MCF of RIK Gas that is taken from a particular Lessee as royalty and tendered pursuant to Subsection 3.10.1 for Conditioning in a particular Unregulated Undivided Majority Owned Plant or Unregulated Divided Plant prior to the end of the calendar month during which the Election Date occurs with respect to said Lessee and plant:

(1) if the Established Amount for said Lessee, plant and gas is less than the Calculated Conditioning Cost for said plant and gas, then said Lessee shall pay the Differential Amount Per MCF for said Lessee, plant and gas to the person who tendered said gas for Conditioning in said plant pursuant to Subsection 3.10.1.

(2) if the Established Amount for said Lessee, plant and gas is greater than the Calculated Conditioning Cost for said plant and gas, then the person who tendered said gas for Conditioning in said plant pursuant to Subsection 3.10.1 shall pay the Differential Amount Per MCF for said Lessee, plant and gas to said Lessee.

Unless otherwise provided in the contract entered into pursuant to Subsection 3.10.3 with respect to the Conditioning of said gas, such payments shall be made on or before the forty-fifth day after the end of the calendar month during which said Election Date occurs.

(c) RIV Gas, Non-Unit Plant. With respect to each MCF of RIV Gas (i) that is delivered to a particular Unregulated Undivided Majority Owned Plant or Unregulated Divided Plant prior to the end of the calendar month during which the Election Date occurs with respect to said Lessee and plant, and (ii) for which a particular Lessee both Bears Conditioning Costs and makes (or is obligated to make) royalty settlement "in value":

(1) if the Established Amount for said Lessee, plant and gas is less than the Calculated Conditioning Cost for said plant and gas, then said Lessee shall pay the Differential Amount Per MCF for said Lessee, plant and gas to the State within forty-five days after the end of the calendar month during which said Election Date occurs.

(2) if the Established Amount for said Lessee, plant and gas is greater than the Calculated Conditioning Cost for said plant and gas, then the State shall pay the Differential Amount Per MCF for said Lessee, plant and gas to said Lessee promptly (within forty-five days, if possible) after the end of the calendar month during which said Election Date occurs. Each Lessee to whom any payment will be due under this Subparagraph 3.13.2(c)(2) shall invoice the Commissioner for the total amount due to said Lessee within fifteen days after the end of the calendar month during which said Election Date occurs.

3.14 <u>Payment of PPI Adjustment Differential</u>.

3.14.1 <u>All Royalty Gas</u>. If, in accordance with Section 1.5, either the Upstream Cost Allowance or, with respect to a particular Non-Unit Plant, the Downstream Conditioning Allowance, or both such allowances, for particular Royalty

Gas are calculated using the Interim PPI for the year prior to the Year Of Production for said gas and, as a result, any Lessee:

(i) receives an amount pursuant to Section 3.4 with respect to said gas, if said gas is RIK Gas, or

(ii) deducts an amount pursuant to Section 3.5, or Subsection 3.11.1, or both, with respect to said gas, if said gas is RIV Gas

(such amount so received, if RIK Gas, or deducted, if RIV Gas, being referred to in this Subsection 3.14.1 as the "Interim Amount" with respect to said gas), which amount is greater than or less than the amount that would have been so deducted or received by said Lessee with respect to said gas had said allowance been calculated using the PPI for said year as finally determined and reported (such amount calculated using said finally determined PPI being referred to in this Subsection as the "Redetermined Amount" with respect to said gas), then:

(a) Refund to State. If the Interim Amount received or deducted with respect to said gas is greater than the Redetermined Amount with respect to said gas, said Lessee shall pay to the State, within thirty days after the PPI for said year is finally determined and reported, an amount equal to the difference between said Interim Amount and said Redetermined Amount.

(b) Payment of Balances Due Lessee. If the Interim Amount deducted or received with respect to said gas is less than the Redetermined Amount with respect to said gas, the State shall pay to said Lessee an amount equal to the difference between said Redetermined Amount and said Interim Amount promptly (within thirty days, if possible) after receipt by the State of said Lessee's invoice therefor.

3.14.2 <u>RIK Gas Tendered Under § 3.10.1</u>. If, in accordance with Section 1.5, the Calculated Conditioning Cost for a particular Non-Unit Plant and particular RIK Gas tendered for Conditioning in said plant pursuant to Subsection 3.10.1 is calculated using the Interim PPI for the year prior to the Year Of Production for said gas and, as a result, any Lessee

(i) receives any amount pursuant to Subsection 3.10.1 with respect to said gas (hereinafter, the "Interim Amount Received" with respect to said gas), which amount is greater than the amount that would have been so received by said Lessee, or

(ii) charges an amount pursuant to Subsection 3.10.1 with respect to said gas (hereinafter, the "Interim Amount Charged" with respect to said gas), which amount is less than the amount that would have been so charged by said Lessee,

if said Calculated Conditioning Cost had been calculated using the PPI for said year as finally determined and reported (such amount calculated using the PPI for said year as finally determined and reported being referred to in this Subsection 3.14.2 as the "Redetermined Amount" with respect to said gas), then:

(a) Refund to Person Tendering Gas. If the Interim Amount Received with respect to said gas is greater than the Redetermined Amount with respect to said gas, said Lessee shall pay to the person who tendered said gas for Conditioning in said plant pursuant to Subsection 3.10.1, within thirty days after the PPI for said year is finally determined and reported, an amount equal to the difference between said Interim Amount Received and said Redetermined Amount.

(b) Payment by Person Tendering Gas. If the Interim Amount Charged with respect to said gas is less than the Redetermined Amount with respect to said gas, the person who tendered said gas for Conditioning in said plant pursuant to Subsection 3.10.1 shall pay to said Lessee, within thirty days after the PPI for said year is finally determined and reported, an amount equal to the difference between said Interim Amount Charged and said Redetermined Amount.

3.15 Settled Returned Gas Royalty Issue. As used herein, the term "Settled Returned Gas Royalty Issue" shall mean the issue of whether any royalty obligation accrues with respect to gas that is (i) produced from the Unit Area, (ii) delivered to a Non-Unit Plant, and (iii) thereafter Used In Unit Operations. In full and final settlement of the respective claims and contentions of the State and each of the Lessees with respect to the Settled Returned Gas Royalty Issue, the State and each of the Lessees agree that:

3.15.1 Returned Gas Used In Unit Operations. No royalty obligation, "in kind" or "in value," shall accrue with respect to any gas that is (i) produced from the Unit Area, (ii) delivered to a Gas Conditioning Plant (whether or not such plant is Unit Equipment), and (iii) thereafter Used In Unit Operations, regardless of whether or not said Gas Conditioning Plant is located within the boundaries of the Unit Area (it being expressly understood and agreed that no royalty obligation shall accrue with respect to gas produced from the Unit Area, allocated to a particular Lessee and sold by said Lessee at or upstream of the inlet of said plant if and to the extent that said previously sold gas or an equivalent amount of gas produced from the Unit Area is subsequently purchased by said Lessee and contributed in kind by said Lessee to be Used In Unit Operations). As used herein, gas which is "Used In Unit Operations" shall mean gas that is used, unavoidably lost, stored or consumed in Unit Operations or otherwise exempt from royalty (including, without limiting the generality of the foregoing, gas that is used or consumed in Unit Equipment and gas that is injected into any formation underlying the Unit Area), regardless of the form or condition in which such gas is Used In Unit Operations.

3.15.2 Calculation Re Non-Unit Plant. The volume of gas that is (i) produced from the Unit Area, (ii) delivered during a particular period to a Non-Unit Plant, and (iii) thereafter returned for the account of a particular Lessee to be Used In Unit Operations (hereinafter, "Lessee's Returned Gas"), with respect to which gas no royalty obligation, "in kind" or "in value," shall accrue, shall be determined by multiplying (1) the volume (measured at the outlet of said plant and expressed in MCF) of Lessee's Returned Gas, by (2) the ratio determined by dividing (A) the volume weighted average Heating Value (measured at the outlet of said plant) of Lessee's Returned Gas, by (B) the volume weighted average

Heating Value (measured at the inlet of said plant) of all gas produced from the Unit Area, allocated to said Lessee and delivered to said plant during that period.

3.15.3 Proviso. Nothing in this Section 3.15 shall be construed as limiting the royalty exemptions set forth in Article 7 of the Unit Agreement and Paragraph 11 of the Leases, or either of them.

3.16 Plant Design Information. Each Lessee who owns an interest in a Gas Conditioning Plant shall use its best efforts to inform the Commissioner of significant developments relating to the engineering design and the physical aspects of construction of that Gas Conditioning Plant during the period prior to Major Gas Sale; provided, however, that no Lessee shall be required to furnish any data or information which said Lessee is required by contract or by law to keep confidential (hereinafter, "Trade Secrets"). If the State so requests, such Lessee (or Lessee's designated representative) shall, upon reasonable notice, meet informally with the Commissioner (or a designated member of his professional staff) to discuss such matters, other than Trade Secrets. Any such meeting shall be held at such place as the Commissioner and such Lessee shall mutually agree.

3.17 Examples. Exhibits D, E and F hereto illustrate the application of portions of this Article 3 in certain instances. In the event of any conflict between the provisions of Article 3 and said Exhibits, the text of Article 3 shall control.

ARTICLE 4: GENERAL PROVISIONS

4.1 Use of Agreement. This Agreement effects the settlement and compromise of claims and contentions which are disputed. The rights granted to and duties imposed upon the parties hereto by the covenants contained herein are recognized and accepted for purposes of this settlement only and in compromise of the disputes being settled among the parties hereto. Neither the above-captioned litigation nor this Agreement shall be introduced into evidence or otherwise referred to by any party to this Agreement in any action or administrative proceeding to which the State and any of the Lessees are parties unless such action or proceeding concerns a State-issued oil and gas lease to which this Agreement applies. In the event of any dispute concerning the meaning or application of any of the terms of any lease to which this Agreement applies, or of the Unit Agreement, this Agreement shall govern where applicable.

4.2 Several Obligations. This Agreement shall be treated for all purposes as though the State had entered into a separate agreement upon the terms and conditions contained herein with each of the respective individual Lessees. All of the Lessees' obligations hereunder shall be the several obligations of the individual Lessees and nothing herein shall be construed as imposing joint liability upon the Lessees for satisfaction of any obligation hereunder. Unless otherwise specified, each and every one of the State's obligations hereunder shall be deemed to be a separate obligation with respect to each Lessee and shall not be deemed to be an obligation to all of the Lessees jointly. This Agreement may be modified, amended or supplemented, in accordance with the terms of Section 4.10 of this Agreement, with respect to a particular Lessee or Lessees without the consent of any Lessee not affected by said modification, amendment or supplement.

4.3 Primary Liability of State. From time to time, the State may arrange for one or more purchasers of RIK Oil or RIK Gas to make payment to the respective Lessees of all or any portion of the sums for which the State is liable hereunder. Neither the agreement or acquiescence by any Lessee in such an arrangement nor the acceptance by any Lessee of payment from any such purchaser shall relieve the State of its primary liability for the satisfaction of the State's obligations hereunder. The State shall in all cases remain primarily liable for the satisfaction of all of its obligations under this Agreement.

4.4 Payments.

4.4.1 Invoices. If the State takes Royalty Oil or Royalty Gas "in kind" during a particular month, each Lessee shall send, or cause to be sent, to the State, on or before the last day of the following month, an invoice for (i) the Field Cost Allowance with respect to such oil taken from said Lessee, (ii) the Upstream Cost Allowance with respect to such gas taken from said Lessee, and (iii) the Conditioning charge due to said Lessee with respect to any such gas Conditioned for the State pursuant to Subsection 3.10.1 or Subsection 3.10.2 in a Gas Conditioning Plant in which said Lessee (or an Affiliate of said Lessee) has an ownership interest. (Amounts due with respect to Royalty Gas taken from a Lessee as royalty "in kind" prior to the Effective Date shall be invoiced within sixty days after the Effective Date.) The State shall pay, or cause to be paid, each invoice rendered for such allowances and charges promptly (within thirty days, if possible) from the date of such invoice. [Procedures for payment of amounts due with respect to RIK Oil taken by the State prior to the Effective Date and with respect to RIV Oil for which royalty settlement has been made prior to the Effective Date are set forth in Section 2.8.]

4.4.2 Failure to Pay. If the State fails to pay, or to cause to be paid, to a Lessee, within thirty days of the date of the invoice therefor, any amount which the State is obligated to pay to such Lessee under this Agreement, such Lessee may:

(a) offset all or any portion thereof remaining unpaid at the time of such offset against any obligation then or thereafter due from said Lessee to the State under the Leases, the Unit Agreement, this Agreement, or any one or more of them; provided, however, that, prior to any such offset, the Lessee shall give the State fifteen days' written notice specifying the amount unpaid and the amount and nature of the particular obligation against which the Lessee intends to offset; or

(b) demand that the State cause such unpaid amount to be paid by its purchasers of RIK Oil or RIK Gas (hereinafter, individually and collectively, "RIK Hydrocarbons"), from sums then or thereafter otherwise due to the State for RIK Hydrocarbons, in accordance with the following provisions of this Paragraph 4.4.2(b):

(1) the State, upon receiving such a demand from a Lessee, shall direct each purchaser to whom it has

sold any RIK Hydrocarbons with respect to which all or any portion of said unpaid amount accrued to pay to said Lessee, as the State's nominee payee, the amount next due to the State from said purchaser for RIK Hydrocarbons sold by the State to said purchaser (or so much thereof as is necessary to satisfy the portion of the State's unpaid obligation to said Lessee which accrued with respect to RIK Hydrocarbons theretofore sold by the State to said purchaser), and the State shall direct each such purchaser to continue to make payment for RIK Hydrocarbons in this manner until the portion of the State's obligation to said Lessee which accrued with respect to said RIK Hydrocarbons is paid in full; and

(2) if, for any reason whatever, the State's obligation to said Lessee with respect to RIK Hydrocarbons sold to said purchaser is not so satisfied by said purchaser within ninety days after receipt by the State of the demand first described in this Paragraph 4.4.2(b), the State, upon receipt of a further demand from said Lessee, shall (unless prohibited by contractual obligation binding upon the State both on the date first set forth above and at the time such demand is made) direct such other purchasers of RIK Hydrocarbons as the State shall elect to pay to said Lessee, as the State's nominee payee, such amounts, then or thereafter due to the State for RIK Hydrocarbons sold to such other purchasers, as are necessary to satisfy promptly the State's unpaid obligation to said Lessee; or

(c) offset a portion of said unpaid obligation pursuant to Paragraph 4.4.2(a) and demand payment of a portion thereof pursuant to Paragraph 4.4.2(b); and

(d) in addition to the foregoing, or, at the option of said Lessee, in lieu thereof, pursue any and all other remedies which said Lessee may have against the State or against any other person for failure to make timely payment of any amount due to said Lessee under this Agreement (it being understood and agreed that no action taken by said Lessee in accordance with the provisions of this Section 4.4 shall be construed or treated for any purposes as a waiver of or election not to pursue any other remedies which said Lessee may have against the State or any other person for failure to make timely payment).

4.5 Audits. Upon reasonable notice to Lessees in writing and at reasonable times within the thirty-six month period following the end of a particular calendar year, the Commissioner shall have the right to audit each Lessee's accounts and records relating to the costs used in determining the allowances, charges and deductions for Royalty Oil and Royalty Gas provided for in this Agreement for said calendar year. Upon reasonable notice and at reasonable times during any such audit, the Commissioner shall have access to such accounting records and supporting documentation as are reasonably necessary to determine whether such allowances, charges and deductions have been accurately and correctly calculated; provided, however, that nothing herein shall require a Lessee to retain documents and records for more than thirty-six months after the end of the calendar year during which such documents and records were prepared. Audits shall be conducted in a manner which will result in a minimum of inconvenience to the

Lessees, who shall bear no portion of the State's costs incurred for such audits.

4.6 Confidentiality of Information. The Commissioner shall not be required to keep confidential particular information furnished to him by or on behalf of any Lessee pursuant to this Agreement unless (i) the information constitutes trade secrets, or (ii) the information, if publicly disclosed, would likely result in appreciable competitive or other economic harm to said Lessee. Upon request by or on behalf of said Lessee, such information shall be kept confidential by the Commissioner unless (i) such information is or becomes part of the public knowledge or literature other than through the fault of or unauthorized disclosure by an officer or employee of the State; or (ii) such information is or becomes available to the Commissioner from a source (other than said Lessee) having the legal right to disclose such information to the Commissioner and said source did not request that the Commissioner keep such information confidential; or (iii) said Lessee notifies the Commissioner that such information no longer need be kept confidential. All documents containing information to be kept confidential shall be clearly marked "confidential" and shall be filed separately from those records of the Department of Natural Resources which are available to persons other than employees of, and legal counsel to, said Department. The foregoing notwithstanding, if the Commissioner receives a request from or on behalf of any Lessee that particular information furnished to the Commissioner by or on behalf of said Lessee be kept confidential, the Commissioner shall give said Lessee thirty days' advance written notice prior to any disclosure of said information, which notice shall specify the grounds for the Commissioner's good faith belief that he is not obligated by the terms of this Section 4.6 to keep said information confidential. Any Lessee, upon reasonable notice from the Commissioner, shall review confidential information previously furnished to the Commissioner by said Lessee to determine whether such information no longer need be kept confidential by the Commissioner. If confidential information furnished to the Commissioner by a Lessee pursuant to this Agreement could be publicly disclosed without appreciable competitive or economic harm or other damage to said Lessee, said Lessee, upon reasonable request by the Commissioner, shall notify the Commissioner that such information no longer need be kept confidential.

4.7 Construction of Agreement. Each of the parties hereto acknowledges that it is entering into this Agreement without reliance in any way upon any statement, representation, action or other matter not specifically set forth herein; and that the Field Cost Allowances and Calculated Conditioning Cost provided for herein shall be calculated in the manner set forth in, respectively, Sections 2.6, 3.7 and 3.8, and applied as provided in this Agreement, without regard to Field Costs (as defined in Subsections 2.2.1 and 3.2.9, respectively) and gas Conditioning costs actually incurred by any Lessee. The language in all parts of this Agreement shall, in all cases, be construed according to its fair meaning and not strictly for or against any of the parties hereto. Headings at the beginning of Articles, Sections and other subparts of this Agreement are (except in the case of Article 1, Sections 2.2, 3.2 and 3.9 and Subsection 3.13.1) solely for the convenience of the parties and are not a part of this Agreement. When required by the context, whenever the singular number is used in this Agreement, the same shall include the plural, and the plural shall include the singular; the masculine gender shall include the feminine and neuter genders and vice versa; the word "person" shall include individuals, governmental agencies, departments and entities, and corporations, partnerships and other forms of business association, as the case may be. As used in this Agreement: to the extent practicable, "measured" shall mean a metered volume corrected for metering error; the "meter" at which the volume of particular oil or gas is "measured for royalty purposes" shall mean, in the case of Royalty Oil and Royalty Gas produced from lands as to which the Unit Agreement is then effective, the custody transfer meter or other point at which one of the Unit Operators (as defined in the Unit Agreement) relinquishes custody of said oil as Unit Operator; the date on which particular oil or gas is "measured for royalty purposes" shall mean: (i) with respect to particular oil, the date on which said oil reaches the LACT Meter for said oil, regardless of the date on which royalty settlement is made therefor; (ii) with respect to particular RIK Gas, the date on which said gas is taken by the State as royalty "in kind"; and (iii) with respect to particular RIV Gas, the date on which said gas reaches the Intermediate Valuation Point for said gas, regardless of the date on which royalty settlement is made therefor. The quantity of the tailgate residue gas and other products and byproducts yielded from a particular quantity of gas produced from the Unit Area, allocated to a Lessee under the Unit Agreement and delivered to a Gas Conditioning Plant shall be determined in accordance with the Unit Operating Agreement.

4.8 Units of Measurement. As used in this Agreement, the word "barrel" shall mean a stock tank barrel of 42 standard U.S. gallons measured at or corrected to a pressure of 14.65 pounds per square inch absolute ("psia") and a temperature of 60° Fahrenheit; "MCF" shall mean 1000 standard cubic feet of gas measured at or corrected to a pressure of 14.65 psia and a temperature of 60° Fahrenheit; and "BTU" shall mean British Thermal Unit. Whenever a volume, value or rate necessary to make a calculation provided for herein is stated in a different unit of measurement or with respect to a different point of measurement from that required to complete said calculation, then the volume, value or rate shall be converted, in accordance with good engineering practices consistently applied, to one which is stated in the required units or at the required point of measurement. Volumes of natural gas liquids (NGL's) measured in liquid form shall be converted to MCF units of measurement for purpose of this Agreement by applying the appropriate component conversion factors as shown in the column entitled "cu ft gas/gal liquid" in Figure 16-1 (Physical Constants of Hydrocarbons) in the 1979 edition of the Engineering Data Book published by the Gas Processors Suppliers Association (GPSA).

4.9 Allocation of RIK Oil and RIK Gas. For the purposes of this Agreement, any RIK Oil or RIK Gas taken by the State under the Unit Agreement during a particular calendar month shall be deemed to have been taken as royalty from each of the respective Lessees in the same proportions as all RIV Oil or RIV Gas, as the case may be, was allocated for that month under the Unit Agreement to each of the respective Lessees for settlement (or, if the State took all its Royalty Oil or Royalty Gas "in kind" during said month, in the same proportions as all such Royalty Oil or Royalty Gas would have been allocated for that month in the absence of any taking "in kind" by the State).

4.10 Amendment. This Agreement may be modified, amended or supplemented only by a written instrument or instruments executed by the party to be charged with such modification, amendment or supplement.

4.11 Successors and Assigns. Except as otherwise provided herein, this Agreement shall be binding upon and shall inure to the benefit of each of the parties hereto and their respective heirs, devisees, legal representatives, successors and assigns, and shall constitute a covenant running with the lands, leases and interests covered by this Agreement.

4.12 Severability. If any provision of this Agreement or the application of such provision to any party or circumstance shall be finally determined by a court of competent jurisdiction to be invalid or unenforceable, the party materially disadvantaged by said determination may, in its sole discretion, either (i) terminate this Agreement (as between the State and any Lessee with respect to which the State is materially disadvantaged by said determination, if the State is the party materially disadvantaged thereby; or, if a Lessee is the party materially disadvantaged thereby, as between said Lessee and the State), as of the date of said determination, or (ii) continue the remainder of this Agreement in full force and effect.

4.13 Execution in Counterparts. This Agreement may be executed in counterparts, each of which shall be deemed to be an original for all purposes, and all of which shall, together, be construed as one and the same instrument. Executed signature pages signed by one or more of the parties hereto may be affixed to one or more copies of the Agreement and, subject to Section 4.2, each such copy shall also constitute a duplicate original of this Agreement as between the State and each of the other parties who executed such copy. One or more duplicate originals hereof may be filed in the Superior Court for the State of Alaska, First Judicial District at Juneau.

4.14 Reservation of Other Disputes. Neither this Agreement nor the payment or acceptance of any sums pursuant to this Agreement nor the performance of any act hereunder shall prejudice any claims or contentions of any of the parties hereto with respect to any issues other than those settled or resolved by the terms of this Agreement. Issues not settled or resolved by the terms of this Agreement include, *inter alia*, the following:

(a) The issue of whether, in computing the value of Royalty Oil for the purpose of making royalty payments "in value" on oil produced from the Unit Area, each Lessee may deduct from the LACT Meter Value of said oil all or any portion of any Oil-NGL Blending Costs (as defined in Subsection 2.2.1) incurred by said Lessee with respect to said oil.

(b) The issue of how, in determining the LACT Meter Value of RIV Oil (from which LACT Meter Value the Field Cost Allowance with respect to said oil may be deducted by a Lessee, pursuant to Section 2.5, in making royalty settlement for said oil), a Lessee is to compute the value of said oil at the LACT meters into TAPS.

(c) The issue of whether, with respect to gas produced from the Unit Area and taken by the State as royalty "in kind," the State is liable to each Lessee for reimbursement of all or any portion of any Cycling Plant Costs (as defined in Subsection 3.2.9) incurred by said Lessee with respect to said gas.

(d) The issue of whether, in computing the value of Royalty Gas for the purpose of making royalty payments "in value" on gas produced from the Unit Area, each Lessee may deduct from the Intermediate Value of said gas all or any portion of any Cycling Plant Costs (as defined in Subsection 3.2.9) incurred by said Lessee with respect to said gas.

(e) The issue of how, in determining the Intermediate Value of RIV Gas delivered during a particular calendar month to a particular Non-Unit Plant (from which Intermediate Value the Upstream Cost Allowance may be deducted by a Lessee, pursuant to Section 3.5, in making royalty settlement for said gas), in those instances in which a Lessee Bears Conditioning Costs (as defined in Paragraph 3.11(b)) with respect to the RIV Gas portion of said Lessee's Inlet Gas (as defined in Paragraph 3.11(a)) for said plant and month, said Lessee is to compute said Lessee's Net Outlet Value (as defined in Subsection 3.11.1) for said plant and month.

(f) The issue of how, in determining the Intermediate Value of RIV Gas delivered during a particular calendar month to a particular Non-Unit Plant (from which Intermediate Value the Upstream Cost Allowance may be deducted by a Lessee, pursuant to Section 3.5, in making royalty settlement for said gas), a Lessee is to compute the value at the inlet of said plant of the RIV Gas portion of said Lessee's Inlet Gas (as defined in Paragraph 3.11(a)) for said plant and month in those instances in which said Lessee does not Bear Conditioning Costs (as defined in Paragraph 3.11(b)) with respect to said gas, plant and month.

(g) The issue of where and in what condition the Lessees are obligated to deliver to the State any royalties "in kind" accruing with respect to gas that is produced from the Unit Area, conditioned in the Field Fuel Gas Unit (a part of

Shared Group 19, as defined in Exhibit 32A of the Unit Operating Agreement) (hereinafter, the "FFGU"), and not Used In Unit Operations. Nothing herein shall be construed as obligating any Lessee to deliver gas conditioned in the FFGU to the State as royalty "in kind," or as an admission that any Lessee is so obligated independent of this Agreement.

(h) The issue of whether, with respect to any gas produced from the Unit Area and taken as royalty "in kind" that is either (i) measured for royalty purposes prior to Major Gas Sale, or (ii) measured for royalty purposes after Major Gas Sale and conditioned in the FFGU, the State is liable to each Lessee for reimbursement of (1) all of the gathering, separation, cleaning, dehydration, compression and other field handling costs incurred by said Lessee with respect to said gas, and (2) all conditioning and treating costs, if any, incurred by said Lessee with respect to said gas in the FFGU. Nothing herein shall be construed as obligating any Lessee to deliver gas conditioned in the FFGU to the State as royalty "in kind," or as an admission that any Lessee is so obligated independent of this Agreement.

(i) The issue of how the value of the State's royalty share of gas that is produced from the Unit Area and either (i) measured for royalty purposes prior to Major Gas Sale, or (ii) measured for royalty purposes after Major Gas Sale and conditioned in the FFGU, shall be computed for the purpose of making royalty payments "in value."

ARTICLE 5: ENTRY OF FINAL JUDGMENT

5.1 Final Judgment. The State and each of the Lessees hereby consent to, and agree to request the Court to make and enter, a Final Judgment in the above-captioned action approving this Agreement.

5.2 Effective Date. Sections 4.10, 4.11, 4.13, 5.1 and 5.2 of this Agreement shall become effective upon the execution of this Agreement by all parties hereto. The entire Agreement shall become effective upon the date on which a Final Judgment approving this Settlement Agreement becomes final under Alaska law (herein referred to as the "Effective Date").

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the dates opposite their respective signatures.

STATE OF ALASKA:

ATTORNEY GENERAL,
STATE OF ALASKA

By______________________ Date: 8 August 80

COMMISSIONER OF NATURAL RESOURCES,
STATE OF ALASKA

By______________________ Date: 8 August 1980

DIRECTOR OF THE DIVISION OF LANDS,
STATE OF ALASKA

By______________________ Date: 8/11/80

EXHIBIT A

FUNCTIONAL DESCRIPTION OF POSSIBLE GAS CONDITIONING PLANT DESIGN

The principal function of a Gas Conditioning Plant will be to condition gas to meet sales gas specifications of a major gas pipeline for transportation of gas off the North Slope of Alaska. The final pipeline specifications are as yet unresolved. Currently proposed pipeline specifications include a hydrocarbon dew point of -10°F at 1000 psig (pounds per square inch gauge), a CO_2 content of 1%, an inlet pressure of 1260 psig, and an inlet temperature of 25°F. Based on these assumed pipeline specifications, the R.M. Parsons Company developed a preliminary design for a gas conditioning plant, which design is commonly referred to as the "September 1978 Parsons Study Report." Although the final design of a Gas Conditioning Plant may differ from this preliminary design, facilities required to condition Prudhoe Bay gas to meet pipeline specifications can be illustrated by reference to the Parsons design. The facilities in the Parsons design are divided by function into three main categories:

(a) Hydrocarbon dew point control and NGL fractionation;
(b) CO_2 Removal; and
(c) Compression and Chilling.

Hydrocarbon dew point is controlled to pipeline specifications by lowering the temperature of the incoming gas to condense the heavier hydrocarbon components for removal from the gas stream.

The CO_2 content of the gas is reduced by contact with SELEXOL solvent, which absorbs the CO_2.

The gas is then compressed from approximately 500 psig to pipeline pressure, and chilled by mechanical refrigeration from 90°F to 25°F.

Current plans envision a "stand-alone" plant; i.e., all facilities such as power, utilities, flare systems, communications systems, etc. used to support the plant will be incorporated into the plant design and therefore will be considered to be part of the plant regardless of where such facilities are physically located. If the plant that is ultimately constructed utilizes existing or future Support Facilities, a share of the costs attributable to such Support Facilities shall be included in computing the Calculated Conditioning Cost.

EXHIBIT B

PARTIAL LIST OF POTENTIAL SUPPORT FACILITIES

TYPE OF FACILITY	ALLOCATION BASIS
Flares	Investment Ratio
Utilities	Investment Ratio
Supervisory Controls	Investment Ratio
Communications	Investment Ratio
Roads and Bridges	Investment Ratio
Central Power System	Percentage Based on Usage
Field Fuel Gas Unit	Percentage Based on Usage
Construction Related Facilities	Investment Ratio
Operations Related Facilities	Investment Ratio

EXHIBIT C

FUNCTIONAL DESCRIPTION OF UPSTREAM GAS FACILITIES

Upstream gas facilities include all direct and support equipment necessary to clean, dehydrate and transport gas between the outlets of the gas/oil separators and the inlet of the Gas Conditioning Plant or, if there is no Gas Conditioning Plant, the inlet of a major gas pipeline for transportation of gas off the North Slope of Alaska. The facilities are divided by function into three main categories:

(a) Compression;
(b) Dehydration; and
(c) Gathering.

Separation of natural gas from crude oil at the flow stations/gathering centers is currently accomplished at four pressure levels: high pressure separators at 650 psig, intermediate pressure separators at 85 psig, treaters at 25 psig, and oil surge tanks at 1.5 psig. The function of the upstream gas facilities is to compress and dehydrate the gas streams from gas/oil separators for delivery through the gas gathering lines to the Gas Conditioning Plant (or major gas pipeline). Compressors take suction from gas/oil separators and are required to provide the necessary pressure to transport gas from separators through the gathering system. The gas is dehydrated by contact with glycol prior to being transported in gathering lines.

EXHIBIT D

DETERMINATION OF CALCULATED CONDITIONING COST

This Exhibit illustrates the manner in which the Calculated Conditioning Cost (per MCF) is to be determined pursuant to Section 3.8 for a particular Gas Conditioning Plant, whether or not such plant is Unit Equipment.

Assumptions:[1]

(A) "Major Gas Sale" occurs on July 20, 1986.

(B) The "Initial Period" begins at 12:01 A.M. on August 1, 1986 and ends at the end of 1987.

(C) The "Base Period" is 1988.

(D) The Commissioner is notified of the amount of the Base Amount on February 26, 1988.

Calculate:

(1) Initial Amount (the Calculated Conditioning Cost for Royalty Gas measured for royalty purposes after Major Gas Sale and prior to the end of the calendar month during which the Commissioner is notified of the Base Amount (July 20, 1986, through February 29, 1988, given the foregoing assumptions) (§ 3.8.1):

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[1]The assumptions in this Exhibit are fictitious and are made only for the purpose of illustrating the application of Section 3.8. No party is entering into this Agreement in reliance on any of these assumptions or conclusions drawn therefrom.

(a) Initial Amount = $IC_E + OMC_E$.

(b) IC_E = an estimate of IC_B, made in accordance with § 3.8.1(b).

(c) OMC_E = an estimate of OMC_B, made in accordance with § 3.8.1(b).

(d) $IC_B = \frac{I + D + AVT}{TPT_{IP}}$.

(e) $OMC_B = \frac{O\&M_{IP}}{TPT_{IP}}$.

(f) $I = (PIC_{IP}) \times (R_{IP})$.

(g) $D = (\frac{1}{300}) \times (PIC_{IP}) \times (M)$.

(h) $AVT = (\frac{1}{12}) \times (AV) \times (M)$.

Therefore, Initial Amount = an estimate of:

$$\frac{(PIC_{IP})x(R_{IP}) + (\frac{1}{300})x(PIC_{IP})x(M) + (\frac{1}{12})x(AV)x(M) + O\&M_{IP}}{TPT_{IP}},$$

Where:

IC_B = Base Investment Component (§ 3.8.1(a)(1)).

OMC_B = Base O&M Component (§ 3.8.1(a)(2)).

I = Interest on Plant Investment Costs (§ 3.8.1(a)(1)).

D = Depreciation (§ 3.8.1(a)(1)).

AVT = Ad Valorem Taxes (§ 3.8.1(a)(1)).

TPT_{IP} = Total Plant Throughput for the Initial Period (§ 3.2.25).

$O\&M_{IP}$ = Plant O&M Costs for the Initial Period (§ 3.8.1(a)(2)).

PIC_{IP} = Plant Investment Costs as of the end of the Initial Period (§ 3.2.22).

R_{IP} = Effective Rate Of Interest for the Initial Period (§ 3.2.8).

M = Number of months in the Initial Period (§ 3.2.13) (Given the foregoing assumptions, M = 17).

AV = All ad valorem taxes applicable to the Gas Conditioning Plant for the last year of the Initial Period, plus a portion of the total of all ad valorem taxes applicable to all Support Facilities for such year (allocated on the basis set forth in Subsection 3.2.24) (§ 3.8.1(a)(1)).

(2) <u>Base Amount</u> (the Calculated Conditioning Cost for Royalty Gas measured for royalty purposes after the end of the calendar month during which the Commissioner is notified of the Base Amount and prior to the end of the Base Period (March 1,

1988, through December 31, 1988, given the foregoing assumptions) (§ 3.8.2)):

Base Amount = $IC_B + OMC_B$.

<u>Therefore</u>, Base Amount =

$$\frac{(PIC_{IP}) \times (R_{IP}) + (\frac{1}{300}) \times (PIC_{IP}) \times (M) + (\frac{1}{12}) \times (AV) \times (M) + O\&M_{IP}}{TPT_{IP}},$$

Where: All terms have the meaning given to them in (1) above.

(3) Adjusted Amount (the Calculated Conditioning Cost for Royalty Gas measured for royalty purposes during a particular calendar year after the end of the Base Period (1989 and thereafter, given the foregoing assumptions) (§ 3.8.3)):

(a) Adjusted Amount = $IC_A + OMC_A$.

(b) $IC_A = (IC_B) \times (\frac{PIC_N}{PIC_{IP}})$.

(c) $OMC_A = (OMC_B) \times (\frac{PPI_N}{PPI_{IP}})$.

<u>Therefore</u>, Adjusted Amount =

$$(IC_B) \times (\frac{PIC_N}{PIC_{IP}}) + (OMC_B) \times (\frac{PPI_N}{PPI_{IP}}),$$

Where:

IC_A = Adjusted Investment Component.

OMC_A = Adjusted O&M Component.

PIC_N = Plant Investment Costs as of December 31 of the year prior to the Year Of Production with respect to the particular Royalty Gas for which the Calculated Conditioning Cost is being calculated (§ 3.2.22).

PPI_N = PPI for the year prior to the Year Of Production with respect to the particular Royalty Gas for which the Calculated Conditioning Cost is being calculated (§ 1.5).

PPI_{IP} = PPI for the last month of the Initial Period (§ 1.5).

All other terms have the meaning given to them in (1) above.

EXHIBIT E

DETERMINATION OF THE VOLUME OF RIK GAS TO WHICH THE CALCULATED CONDITIONING COST APPLIES

This Exhibit illustrates, with respect to RIK Gas for a particular calendar month taken as royalty from a particular Lessee ("Lessee Y") and tendered during that calendar month to a particular Gas Conditioning Plant that is either an Unregulated Divided Plant (§§ 3.9.1, 3.9.5) or an Unregulated Majority Owned Plant (§§ 3.9.2, 3.9.5), the manner in which one calculates the volume of the portion of said gas that Lessee Y is obligated, pursuant to Subsection 3.10.1, to Condition for a Conditioning charge equal to the Calculated Conditioning Cost (§ 3.8).

Assumptions:[1]

(A) There is only one Gas Conditioning Plant.

(B) The Gas Conditioning Plant is either an Unregulated Majority Owned Plant or an Unregulated Divided Plant (§ 3.9).

(C) Lessee Y owns a 40% interest in the Gas Conditioning Plant.

(D) The State has not elected to abandon the Calculated Conditioning Cost with respect to Lessee Y (§ 3.12).

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[1]The assumptions in this Exhibit are fictitious and are made only for the purpose of illustrating the application of Subsection 3.10.1. No party is entering into this Agreement in reliance on any of these assumptions or conclusions drawn therefrom.

(E) During the month in question the State has taken 70% of its Royalty Gas for said month "in kind".

(F) Total Plant Throughput for the month in question is 75,000,000 MCF.

(G) The volume of RIK Gas tendered during the month in question by the State and all of its Assignees for Conditioning in the Gas Conditioning Plant is 2,100,000 MCF.

<u>Calculate</u>:

(1) The volume described in § 3.10.1(i) (hereinafter, "Volume (i)"):

Volume (i) = the total volume of RIK Gas for the month in question that is taken as royalty from Lessee Y and tendered during said calendar month by the State and all of its Assignees for Conditioning in the Gas Conditioning Plant.

= 2,100,000 MCF.

(2) The volume described in § 3.10.1(ii) (hereinafter, "Volume (ii)"):

$$\text{Volume (ii)} = (TPT_M)x(POP_Y)x(12.5\%)(PTIK_M)$$
$$= (75{,}000{,}000\ MCF)x(40\%)x(12.5\%)x(70\%)$$
$$= 2{,}625{,}000\ MCF.$$

Where:

TPT_M = Total Plant Throughput for the calendar month in question (§ 3.2.25).

POP_Y = Lessee Y's percentage of ownership in the Gas Conditioning Plant.

$PTIK_M$ = The percentage of Royalty Gas for the calendar month in question which the State has taken "in kind" during said month.

(3) The volume of the portion of the RIK Gas tendered during the month in question by the State and all of its Assignees for Conditioning in a particular Gas Conditioning Plant to which the Calculated Conditioning Cost applies (hereinafter, "CCC Volume"):

(a) CCC Volume = Lesser of Volume (i) or Volume (ii).

(b) 2,100,000 MCF is less than 2,625,000 MCF.

Therefore, CCC Volume = 2,100,000 MCF.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects

Docket No. RM05-1-001

ORDER NO. 2005-A

ORDER ON REHEARING AND CLARIFICATION

(Issued June 1, 2005)

1. On February 9, 2005, the Federal Energy Regulatory Commission (Commission) issued a Final Rule, Order No. 2005,[1] amending its regulations by adding Subpart B to Part 157 to establish requirements governing the conduct of open seasons for capacity on proposals to construct Alaska natural gas transportation projects. Order No. 2005 fulfilled the Commission's responsibilities to issue open season regulations under section 103 of the Alaska Natural Gas Pipeline Act (ANGPA or the Act), enacted on October 13, 2004. Section 103(e)(1) of the Act directs the Commission, within 120 days from enactment of the Act, to promulgate regulations governing the conduct of open seasons for Alaska natural gas transportation projects, including procedures for allocation of capacity. As required by section 103(e)(2) of the Act, the regulations promulgated in Order No. 2005 (1) include the criteria for and timing of any open season, (2) promote competition in the exploration, development, and production of Alaska natural gas, and (3) for any open seasons for capacity exceeding the initial capacity, provide for the

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[1] *Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects*, RM05-1-000, Order No. 2005, FERC Stats. and Regs. ¶ 31,174 (2005).

opportunity for the transportation of natural gas other than from the Prudhoe Bay and Point Thomson units.

2. The Commission affirms here the legal and policy conclusions on which Order No. 2005 was based. As stated in Order No. 2005, the goal of the open season regulations is to design an open season process that provides non-discriminatory access to capacity on any Alaska natural gas transportation project and, at the same time, allows sufficient economic certainty to support the construction of the pipeline and thereby provide a stimulus for exploration, development, and production of Alaska natural gas. We find that Order No. 2005's open season rules as revised and clarified herein, satisfy that goal and, therefore, are in the public interest.

Background

3. ANGPA mandates the expedited processing by the Commission of any application for an Alaska natural gas transportation project. To this end, as stated above, section 103(e)(1) of the Act specifically directs the Commission to prescribe the rules which shall apply to any open season held for the purpose of soliciting interest in, or making binding commitments to the acquisition of capacity on, any Alaska natural gas transportation project, including the criteria for allocating capacity among competing bidders. In this regard, Congress instructed the Commission to include in its regulations the criteria for, and timing of, any open season, and to design its open season regulations to promote competition in the exploration, development, and production of Alaska natural gas and, as to any open season for the voluntary expansion[2] of the initial capacity of any Alaska natural gas transportation project, to specifically provide the opportunity for gas other than Prudhoe Bay and Point Thomson production to have access to the pipeline.

4. In response to the Act's directive, on November 15, 2004, the Commission issued in Docket No. RM05-1-000 a Notice of Proposed Rulemaking (NOPR) in this proceeding

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[2] Excluded from the scope of the open season rules are expansions compelled by the Commission pursuant to section 105 of the Act. Section 105 authorizes the Commission to order these "involuntary" expansions upon the request of one or more persons, and upon the satisfaction of certain statutory criteria.

<u>FOR FURTHER INFORMATION CONTACT</u>:

Whit Holden, Office of the General Counsel, (202) 502-80[illegible]9, edwin.holden@ferc.gov;

Richard Foley, Office of Energy Projects, (202) 502-8955, richard.foley@ferc.gov;

Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426

<u>SUPLEMENTARY INFORMATION</u>:

containing the Commission's proposed Alaska natural gas transportation project open season regulations. Also, the Commission held a public technical conference in Anchorage, Alaska on December 3, 2004 to develop a record in this proceeding. The Commission received 25 comments in response to the NOPR.

5. On February 9, 2005, the Commission issued Order No. 2005. The open season regulations contained in Order No. 2005 apply to any application for a certificate or other Commission authorization for an Alaska natural gas transportation project, whether filed pursuant to the NGA, the Alaska Natural Gas Transportation Act of 1976, or ANGPA, as well as to any voluntary applications for expansions of such a project.

6. The Final Rule adopted the NOPR's proposed requirements that the applicant provide a 30-day prior public notice containing extensive information intended to allow all interested persons to decide whether to participate in the open season, followed by an actual open season period of at least 90 days. The regulations in the Final Rule also adopted the NOPR's approach of allowing prospective applicants to develop and state in detail the methodologies for determining the value of bids and for allocating capacity, subject to the requirement that all capacity be awarded without undue discrimination or preference of any kind. In addition, the Final Rule required that at least 90 days prior to providing the open season notice, the prospective applicant must file its open season plan with the Commission for approval, and that the Commission will act on the plan within 60 days of its filing.

7. The Final Rule provided that prospective applicants must conduct or adopt a study of Alaska's in-state needs, and use the study results to design capacity needs for use within the state, and design in-state delivery points and in-state transportation rates as part of an open season. Moreover, bidding on in-state capacity must be conducted independent of out-of-state deliveries during a prospective applicant's open season.

8. In order to further the Commission's goal of a non-discriminatory open season, the Final Rule applied certain of the Standards of Conduct requirements of Order No. 2004, including the establishment of an independent, functionally-separate unit to conduct the open season. In addition, the open season notice must identify the prospective applicant's affiliates involved in the production of natural gas in the state of Alaska, and all information about the open season disclosed to any potential shippers must be made available to all potential shippers.

9. The Final Rule permitted pre-subscription by anchor shippers, limited to initial capacity only, in order to facilitate the development of an Alaska pipeline project. However, to ensure that all other potential shippers have an equal opportunity to obtain

access to capacity on the project in the open season, all pre-subscription agreements must be made public within ten days of their execution, and capacity on the proposed project must be offered to all prospective qualifying shippers under the same terms and conditions and at the same rates as the pre-subscription agreements. In addition, if capacity is oversubscribed in the open season and it is not feasible to redesign the proposed project to meet both the pre-subscription shippers' and the open season shippers' capacity needs, then capacity bid for in the open season will not be reduced, but all capacity subject to the terms and conditions of pre-subscription agreements will be allocated pro rata.

10. In an effort to allow as many potential shippers as possible the opportunity to acquire capacity in the initial open season, the Final Rule required that the project sponsor must consider any qualifying bids tendered after the expiration of the open season, and reject them only if they cannot be accommodated due to economic, engineering, or operational constraints.

11. The Final Rule stated that, within ten days after precedent agreements have been executed for capacity acquired in the open season, the prospective applicant shall make public the results of the open season, including the names of the prospective shippers, amount of capacity awarded, and the terms of the agreements. Within 20 days after precedent agreements have been executed, copies of all precedent agreements, as well as copies of any correspondence with bidders whose bids were not accepted, must be filed with the Commission.

12. In another provision, the Final Rule stated that, as a part of the Commission's review of any application for an Alaska natural gas transportation project, it will consider the extent to which the proposed project has been designed to accommodate the needs of shippers who have made conforming bids during an open season, as well as the extent to which the project can accommodate low-cost expansion, and the Commission may require changes in the project's design necessary to promote competition and offer a reasonable opportunity for access to the project.

13. Finally, to provide guidance to interested parties on the important subject of expansion rate treatment, the Final Rule establishes a presumption in favor of rolled-in pricing for expansions up to the point that it would cause there to be a subsidy of expansion shippers by initial shippers.

14. Requests for rehearing and/or clarification were filed jointly by BP Exploration (Alaska), Inc., ConocoPhillips Company and Exxon Mobile Corporation (the North Slope Producers), by Enbridge, Inc. (Enbridge), by ChevronTexaco Natural Gas, a division of

Chevron U.S.A. Inc. (ChevronTexaco), and by the State of Alaska. In addition, Anadarko Petroleum Corporation (Anadarko) and the Legislative Budget and Audit Committee of the Alaska State Legislature (Alaska Legislators) filed responses to the rehearing requests.[3]

Discussion

I. Mandating Pipeline Design

A. The Final Rule - §§ 157.36 and 157.37

15. Section 157.36 requires that any open season for expansion capacity of an Alaska natural gas transportation project must provide the opportunity for the transportation of gas other than Prudhoe Bay or Point Thomson production, and that the Commission, in considering any proposed voluntary expansion of an Alaska natural gas pipeline project, "may require design changes to ensure that all who are willing to sign long-term firm transportation contracts that some portion of the expansion capacity be allocated to new shippers or shippers seeking to transport natural gas from areas other than Prudhoe Bay and Point Thomson." Section 157.37 states that, in reviewing any application for an Alaska natural gas pipeline project, the Commission "may require changes in the project design necess[ary] to promote competition and offer a reasonable opportunity for access

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[3] Under Rule 213 of the Commission's Rules of Practice and Procedure, answers to rehearing requests are not permitted. However, the Commission has discretion to waive this rule when it finds that the answers will help provide a complete record in the proceeding or allow a better understanding of the issues. This proceeding involves the establishment of open season rules for capacity on an Alaska natural gas transportation project, and is critical to the development of Alaska's vast natural gas resources to meet anticipated national demand for natural gas, thereby enhancing national security. The Commission finds that the answers will provide necessary information to provide a full and complete record, which will assist the Commission in addressing the issues on rehearing pertaining to the complex and unique circumstances surrounding the development of an Alaska natural gas transportation project. Therefore, Anadarko's and the State of Alaska's answers to the rehearing requests are accepted. *See* 18 C.F.R § 385.213 (2004).

to the project, taking into account the extent to which the proposed project design accommodates the open season's conforming bids as well as low-cost expansion."[4] These provisions were included in the Final Rule in response to concerns of non-North Slope producers that they have access to capacity on an Alaska natural gas transportation project when their potential gas reserves are commercially developed.

B. Rehearing/clarification requests

16. The North Slope Producers and ChevronTexaco object to the provisions contained in sections 157.36 and 157.37 to the extent that they authorize the Commission to require changes in the design of an Alaska natural gas transportation project. The North Slope Producers object to these provisions on a number of grounds. First, they contend that it is beyond the Commission's NGA authority to mandate changes in the design of a pipeline, either to provide additional capacity or to enhance future expandability. The North Slope Producers contend that, in either case, the result is a mandatory expansion of the project, which according to section 7(a) of the NGA, is outside the Commission's authority to require.[5] The North Slope Producers maintain that this limitation on the Commission's authority is reflected in the Commission's regulations providing that open access pipelines are "not required to provide any requested transportation service for which capacity is not available or that would require the construction or acquisition of any new facilities,"[6] and in judicial precedent.[7] According to the North Slope Producers, the Commission has acted unreasonably in "morphing" ANGPA's vague and undefined open

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[4] "Necessity" in section 157.37 is revised to read "necessary."

[5] Section 7(a) of the NGA provides "[t]hat the Commission shall have no authority to compel the enlargement of transportation facilities…" 15 U.S.C. 717f(a).

[6] 18 C.F.R. §284.7(f).

[7] The North Slope Producers cite *Panhandle Eastern Pipe Line Co.*, 204 F.2d 675 (3rd Cir. 1953) in which the court stated that "[i]n light of Section 7(a) we are compelled to conclude that Congress meant to leave the question whether to employ additional capital in the enlargement of its pipeline facilities to the unfettered judgment of the stockholders and directors of each natural gas company involved." 204 F.2d at 680.

season requirements pertaining to competition in the exploration, development, and production of Alaska gas and sufficient opportunity for future access for the transportation of non-Prudhoe Bay/Point Thomson gas into factors to be considered by the Commission in its NGA section 7 review of a certificate applications for Alaska natural gas transportation projects.

17. Second, the North Slope Producers assert that ANGPA section 105 further limits the Commission's authority to require an expansion of an Alaska natural gas transportation project sections. The North Slope Producers state that before an involuntary expansion can be ordered by the Commission, section 105 lists a number of statutory requirements that must be met which are designed to balance potential future shippers' interests with the need to protect the pipeline and existing shippers and to protect against uneconomic overbuilding. The North Slope Producers state that none of these statutory requirements are referenced in or satisfied by section 157.36 or 157.37.

18. Third, the North Slope Producers argue that the Commission appears to mistakenly "assume that a pipeline can, in all circumstances, be efficiently designed to accommodate all qualifying bids." The North Slope Producers assert that the most efficient and economic pipeline design might not be one which can accommodate 100 percent of the capacity bid for in the open season. In fact, according to the North Slope Producers, it is possible that a pipeline designed to accommodate all the capacity bid in the open season "could result in a design that is inefficient and/or negatively impacts future expansion design alternatives."

19. Fourth, the North Slope Producers maintain that to the extent that it authorizes a set-aside of capacity, section 157.36 violates the Order No. 636's goal of eliminating impediments to the transmission of proper pricing signals between producers and consumers, as well as the Commission's non-discrimination policies. The North Slope Producers point to the second sentence of section 157.36, which states:

> "In considering a proposed voluntary expansion of an Alaska natural gas pipeline project, the Commission will consider the extent to which the expansion will be utilized by shippers other than those who are the initial shippers on the project, and in order to promote competition and open access on the project, *may require design changes to ensure that all who are willing to sign long-term firm transportation contracts to some portion of the expansion capacity be allocated to new shippers or shipper s seeking to transport natural gas from areas other than Prudhoe Bay and Point Thomson.*" (Emphasis added).

The North Slope Producers assert that if this "indecipherable" language is intended to set aside capacity for new shippers or shippers of gas from areas other than Prudhoe Bay and Point Thomson, then the Commission is favoring one shipper's bid over another bid that otherwise meets all of the bid criteria. The North Slope Producers assert that ANGPA's section 103(e)(2)(C) requirement that open season regulations for voluntary expansions are to "provide an opportunity for the transportation of gas other than Prudhoe Bay and Point Thomson gas" does not support section 157.36's apparent set-aside or preference. The North Slope Producers state that not only is such a preference inconsistent with the Commission's open access policies, it is patently discriminatory and anti-competitive and unlawful under the NGA. The North Slope Producers contend that allocating pipeline capacity in an open season to customers who value it most, *i.e.*, through the use of the Commission-favored net present value capacity allocation methodology, ensures pipelines and shippers that capacity will be allocated in a non-discriminatory and economically efficient manner. The North Slope Producers also assert that development of multi-owner fields could be delayed or hampered if one group of shipper/owners had a competitive advantage over another shipper/owner group due to a capacity allocation advantage or preference.

20. Finally, the North Slope Producers maintain that sections 157.36 and 157.37 are contrary to the Commission's reliance on market forces, on which its existing policies are based. Specifically, the North Slope Producers claim that Order No. 2005 fails to reconcile Subparts 157.36 and 157.37 with current Commission policies in favor of "facilitate[ing] the unimpeded operation of market forces to stimulate the production of natural gas,"[8] and against the subsidization of new services by existing shippers. The North Slope Producers state that it would be unreasonable to expect that the pipeline sponsors would simply assume the financial risk for significant amounts of uncontracted capacity on such an enormous project, yet Order No. 2005 fails to address cost recovery issues associated with any mandated design changes that might be ordered.

21. ChevronTexaco claims that the regulations promulgated in Order No. 2005 apply to open seasons for initial or voluntary expansion capacity; therefore, the idea of post-open season Commission-mandated design changes is inconsistent with and outside the

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[8] Order No. 636, FERC Stats. and Regs. ¶ 30,939 at 30,393 (1992), *quoting* S.Rep. No. 30 9, 101st Cong., 1st Sess. at p.2 (1989).

scope of this rulemaking. Moreover, ChevronTexaco asserts that the design change provisions of sections 157.36 and 157.37 should be deleted from the open season regulations because the subject was not included in the Notice of Proposed Rulemaking. ChevronTexaco states that absent removing sections 157.36 and 157.37 from the open season regulations, the Commission should provide that it would not require project design changes if doing so would negatively impact the rates, terms or conditions of service for initial shippers or otherwise adversely affect pipeline operations of efficiency.

22. In its response to the rehearing requests, Anadarko argues that ANGPA and the NGA provide the Commission with ample authority to require changes in the design of an initial or expanded Alaska natural gas transportation project necessary to meet the statutory objectives of promoting competition and provide a reasonable opportunity for access to all shippers who have made conforming bids during the open season. Anadarko states that clearly there is interplay between the NGA and ANGPA. Specifically, states Anadarko, section 7(e) of the NGA provides that a "certificate shall be issued ... if it is found that proposed service, sale, operation, construction... to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity." Anadarko states that the Commission considers many factors in making this public convenience and necessity finding, and, in the case of an Alaska natural gas transportation project, should consider the requirements of ANGPA.

23. Anadarko asserts that the Commission often imposes conditions to its certificates requiring routing or design modifications in order to support a finding that a particular project is in the public convenience and necessity. In any event, sections 157.36 and 157.37 do not mandate an expansion, according to Anadarko, because the applicant may choose not to accept a certificate that requires that the project be redesigned. Anadarko states that the regulations merely put the applicant on notice that its proposed project design might be rejected as failing to meet the objectives of ANGPA, and consequently, not being required by the public convenience and necessity.

24. In response to the North Slope Producers' charge that section 157.36 provides for discriminatory reallocation of capacity contrary to existing Commission policy, Anadarko contends that the Commission is merely following the mandate of ANGPA section 103(e)(2)(C). Anadarko states that under section 103(e)(2)(C), the Commission's regulations must ensure that any open season for expansion capacity provides the opportunity for the transportation of natural gas other than from Prudhoe Bay/Point Thomson, and section 157.36 seeks to do just that.

25. Anadarko also disputes the North Slope Producers' claim that parties were not adequately notified in the NOPR that pipeline design would be a subject of the

rulemaking. Anadarko maintains that the regulations contained in sections 157.36 and 157.37 reasonably respond to many concerns expressed throughout the rulemaking process.[9] Anadarko contends that under the Administrative Procedure Act (APA), the Commission was required in this informal rulemaking proceeding to provide either the terms or substance of the proposed rule or a description of the subjects and issues involved.[10] Moreover, Anadarko points out that the courts have held that "even if the final rule deviates from the proposed rule,'[s]o long as the final rule promulgated by the agency is a 'logical outgrowth' of the proposed rule… the purposes of the notice and comment have been adequately served ."[11] Anadarko states that Order No. 2005's pipeline design provisions were a "logical outgrowth" of the NOPR and the issues discussed therein, *e.g.*, the major goals of ANGPA, concerns over potential discrimination, producer/sponsor preferences, the role of pre-subscriptions, and tensions between ANGPA's goals and the application of existing policies to an Alaska project.

26. Lastly, Anadarko contends that the Commission provided ample support for not following current Commission policies that favor reliance on market forces. Anadarko states that the rulemaking record in Order No. 2005 thoroughly discusses the conditions and circumstances in Alaska that are much different than those found in the lower 48 states, requiring the appropriate regulatory action taken in sections 157.36 and 157.37. In conclusion, Anadarko disagrees that 157.36 is "indecipherable" as claimed by the North Slope Producers.

27. The Alaska Legislators maintain that sections 157.36 and 157.37 are well within the Commission's broad power to attach to certificates any conditions that may be found to be required by the public convenience and necessity. They claim that the "forced expansion" argument fails to acknowledge that ANGPA has injected into the public convenience and necessity standard of the NGA a new statutory standard, *i.e.*, the promotion of competition in the exploration, development and production of Alaska

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[9] Anadarko identifies comments addressing pipeline size both at the technical conference and written. *See* Anadarko's March 29, 2005 response at 15 -16.

[10] *See* 5 U.S.C.A. 553(b)(3).

[11] *Appalachian Power Co. v. EPA,* 135 F.3d 791, 804 n.22 (D.C. Cir. 1998).

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[11] *Appalachian Power Co. v. EPA*, 135 F.3d 791, 804 n.22 (D.C. Cir. 1998).

natural gas with respect to Alaska natural gas transportation projects. Moreover, the Alaska Legislators contend that the Commission's pipeline design concerns are required not only by the mandate of ANGPA, but also by the economic realities in Alaska, where virtually all of the proven reserves are held by the North Slope Producers. The Alaska Legislators state that the Commission is simply announcing in sections 157.36 and 157.37 that it may condition the approval of the certificate upon the applicant's making necessary design changes required to satisfy the public convenience and necessity standard, including the "promote competition" standard, which is uniquely applicable to an Alaska natural gas transportation project.

28. Addressing the North Slope Producers' claim that section 157.36 provides for an unduly discriminatory set aside of capacity for non-North Slope shippers, the Alaska Legislators agree with Anadarko that ANGPA mandates that in the case of an expansion of an Alaska natural gas transportation project, the Commission must provide an opportunity for the transportation of natural gas other than from Prudhoe Bay and Point Thomson units in its open season rules. Alaska Legislators state that section 157.36 is consistent with that mandate.

29. The Alaska Legislators also defend the Commission's "proactive" approach through which it fashioned the open season rules in recognition of the recognized differences between competitive forces in the lower 48 states and the lack of competition in Alaska. Given these differences, the Alaska Legislators maintain that the Commission was right to depart from existing Commission policy. They assert that the fact that Congress required the Commission to promulgate the Alaska open season rules in place of the Commission's long-standing policy of evaluating open seasons on a case-by-case, after-the-fact basis, is an illustration of the need for different approach based on the unique circumstances surrounding an Alaska pipeline. The Alaska Legislators conclude that, unlike the situation in the lower 48 states, there is no existing or foreseeable competitive environment in Alaska, where the North Slope Produces not only control all the known gas reserves, but also may become the sponsors of the Alaska pipeline. Therefore, the Commission was right to not rely on market forces in Alaska to ensure the development, routing, sizing and timing of an Alaska pipeline.

30. Finally, the State of Alaska suggests that section 157.36 be expanded to better reflect its intent. According to the State of Alaska, section 157.36 should read:

> "In considering a proposed voluntary expansion of an Alaska natural gas transportation project, the Commission will consider the extent to which the expansion will be utilized by shippers other than those who are the initial shippers on the project and, in order to promote competition and open

> access to the project, may require design changes to ensure that new shippers willing to sign long-term firm transportation contracts or shippers
>
> seeking to transport natural gas from areas other than Prudhoe Bay or Point Thomson who are willing to sign long-term contracts can have access to some portion of the expansion capacity."

C. <u>Commission Response</u>

31. The North Slope Producers' assertion that the Commission has no authority under the NGA to require changes in the design of an proposed Alaska natural gas transportation project in connection with an application for authorization either to construct the project, or to expand the project is inconsistent with law and precedent. At the outset, we reject the notion that any design change that might be required under either section 157.36 or 157.37 would constitute a mandatory expansion of the project. First, in every case in which the section 7(a) limitation has been addressed, the facilities involved were existing facilities subject to existing certificate authorization. The reasoning behind this limitation is clear. Once a natural gas company accepts a certificate and in reliance thereof expends resources to construct the facilities authorized therein, the pipeline and its customers should have the right to rely on the authorizations contained in that certificate. It is quite another thing where the Commission tells a certificate applicant that unless it agrees to certain changes (including cost allocations and the design of initial service rates), its proposal will not be found to be in the public convenience and necessity. In such case, if the applicant does not want to change its proposed project design, it is not required to accept the certificate. Furthermore, because design changes under either 157.36 or 157.37 would not constitute a mandatory project expansion, the statutory requirements of ANGPA section 105 have no application.

32. In considering an application for a certificate of public convenience and necessity under section 7 of the NGA, the Commission has the authority to consider all factors

bearing on the public interest,[12] and in particular, the Commission "certainly has the right to consider a congressional expression of fundamental national policy as bearing upon the question whether a particular certificate is required by the public convenience and necessity."[13] In the case of an Alaska natural gas transportation project, these factors would properly include the requirements of ANGPA, including the statutory objectives of promoting competition and provide a reasonable opportunity for access to all shippers who have made conforming bids during the open season.

33. The Commission has authority under NGA section 7(e) to attach to a certificate of public convenience and necessity any conditions it deems necessary to meet the public interest.[14] The Commission has exercised this conditioning authority to require routing or design modifications in order to support a finding that a particular project is in the public convenience and necessity.[15] Sections 157.36 and 157.37 merely codify our existing authority and practice.

34. The North Slope Producers' claim that sections 157.36 and 157.37 are predicated on the Commission's erroneous assumption "that a pipeline can, in all circumstances, be efficiently designed to accommodate all qualifying bids." This is inaccurate. We noted in Order No. 2005 that both the North Slope Producers and Enbridge maintained that an Alaska pipeline could be designed and built with sufficient capacity to accommodate the

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[12] *See, e.g., FPC v.Transcontinental Gas Pipe Line Corporation*, 365 U.S. 1, 81 S.Ct. 435 (1961); *Office of Consumers' Counsel v. FERC*, 655 F.2d 1132, 210 U.S.App. D.C. 315 (1980).

[13] *City of Pittsburgh v. FPC*, 237 F.2d 741 at 754 (D.C. Cir. 1965).

[14] *See, e.g., FPC v. Hunt*, 376 U.S. 515, 525 -527, 84 S.Ct. 861 (1964); *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378 (1959).

[15] *See, e.g., Vector Pipeline, L.P.*, 87 FERC ¶ 61,225 at 61,892-893 (1999); *Maritimes & Northeast Pipelines, L.L.C.*, 80 FERC ¶ 61,345 (1997); *NE Hub Partners, L.P.*, 83 FERC ¶ 61,043 (1998); *see also, Transcontinental Gas Pipe Line Corp v. FERC*, 589 F.2d 186 (5^{th} Cir.), cert. denied , 445 U.S. 915 (1979).

needs of every qualified shipper.[16] Our expectation is that an Alaska natural gas transportation project will be designed and built, to the extent possible, to accommodate all qualified shippers who are ready to sign firm transportation agreements. Nonetheless, in Order No. 2005 we certainly did not rule out the possibility that a project, with or without pre-subscription agreements, might be oversubscribed.[17] On this note, we should emphasize that in our review of any application for initial Alaska project or any expansion thereof, our consideration of the project design will be driven by our need to find that the proposal is in the public convenience and necessity. Any conditions we impose must be required by the public interest, and be based on substantial evidence.

35. The North Slope Producers' claim that section 157.36 provides for an unduly discriminatory set-aside of capacity for non-North Slope shippers discounts, if not ignores, the Congressional mandate of ANGPA section 103(e)(2)(C) that requires our open season regulations to ensure that any open season for expansion capacity provides the opportunity for the transportation of natural gas other than from Prudhoe Bay/Point Thomson. Section 157.36 does so in a reasonable manner. In any event, our regulations do not require that an expansion proposal must, regardless of economic and technical considerations, provide transportation of gas other than Prudhoe Bay/Point Thomson volumes. The regulations simply require that an opportunity for such transportation be provided.

36. As pointed out elsewhere in this order, and throughout Order No. 2005, a number of existing Commission policies predicated on competitive conditions in the lower 48 states are ill-suited for application in the case of an Alaska natural gas transportation project, particularly in view of ANGPA's directives. As we stated in Order No. 2005, a successful Alaska natural gas transportation project will have to overcome a variety of significant obstacles, including unique and complex competitive conditions. Those competitive conditions, we said, are intensified by the generally agreed-upon fact that

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[16] *See, e.g.*, Order No. 2005 at P 29, 37, and 88.

[17] *See id.* at P 37; *see also* § 157.34(c)(15).

there will be only one such Alaska pipeline for the foreseeable future.[18] Against that backdrop, we affirm the conclusions of Order No. 2005, which serve as the underpinnings of the Final Rule's regulations, including the need in certain instances to accommodate existing Commission policy to the unique circumstances surrounding the exploration, production, development, and transportation to market of Alaska natural gas.

37. Finally, while due process and the APA impose an obligation on agencies to provide adequate notice of issues to be considered,[19] that obligation is satisfied in this informal rulemaking by providing either the terms or substance of the proposed rule or a description of the subjects and issues involved.[20] Order No. 2005's pipeline design provisions were a logical outgrowth of the NOPR and the issues discussed therein, *e.g.*, major goals of ANGPA, concerns over potential discrimination, producer/sponsor preferences, potential role of pre-subscriptions, tensions between ANGPA's goals, and application of existing policies to the circumstances of an Alaska project. Indeed, the critical importance of properly sizing the pipeline was a recurring theme throughout this proceeding, and was raised by several parties at the technical conference, and in later comments and reply comments.[21] Thus, Order No. 2005 does not unduly change the scope of this proceeding. In any event, the parties' ability to seek rehearing resolves any due process issues.

38. Although the North Slope Producers describe section 157.36 to be "indecipherable," their comments demonstrate that they understand its intent.

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[18] The North Slope Producers, in their rehearing request, claim that it is too early to conclude that only one Alaska pipeline will ever be built. We find nothing in the record to support a contrary conclusion.

[19] *Public Service Commission of the Commonwealth of Kentucky v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005), *citing Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54 (D.C. Cir. 1999); *see* 5 U.S.C. § 554(b)(3).

[20] *See* 5 U.S.C. 553(b)(3).

[21] *See* n. 8, *supra*.

Section 157.36 is intended to provide that the Commission may require design changes necessary to ensure that some portion of a proposed voluntary expansion will be allocated to new shippers or shippers seeking to transport gas from areas other than Prudhoe Bay or Point Thomson, provided such shippers are willing to sign qualifying long-term firm transportation agreements. To ensure clarity, we will revise section 157.36 to read as follows:

> "In considering a proposed voluntary expansion of an Alaska natural gas transportation project, the Commission will consider the extent to which the expansion will be utilized by shippers other than those who are the initial shippers on the project and, in order to promote competition and open access to the project, may require design changes to ensure that some portion of the expansion capacity will be allocated to new shippers willing to sign qualifying long-term firm transportation contracts, including shippers seeking to transport natural gas from areas other than Prudhoe Bay or Point Thomson."

II. Presumption of Rolled-in Rates for Expansions

A. Final Rule - § 157.39

39. Section 157.39 states that "[t]here shall be a rebuttable presumption that rates for any expansion of an Alaska natural gas transportation project shall be determined on a rolled-in basis." The Commission stated in Order No. 2005 that by providing for this presumption, the Commission is advising potential shippers, in advance of any initial Alaska natural gas transportation project open season, of its intention to harmonize the objective of rate predictability for initial shippers with the objective of reducing barriers to future exploration and production in designing rates for future expansions of any Alaska natural gas transportation project. The Commission concluded in Order No. 2005 that section 157.39 is consistent with "our guiding principle that competition favors all of the Commission's customers, as well as with the objectives of the Act, to adopt rolled-in rate treatment up to the point that would cause there to be a subsidy of expansion shippers by initial shippers, if any subsidy were to be found."

B. Rehearing/Clarification Requests

40. The North Slope Producers, Enbridge, and ChevronTexaco assert that the presumption in favor of rolled-in rates for voluntary expansions established in section 157.39 creates uncertainty for shippers and project sponsors, and, therefore, section 157.39 should be eliminated from the regulations or substantially revised. The

North Slope Producers and Enbridge claim that prospective initial shippers, fearing that in the future their rates may be increased to subsidize the cost of expansion facilities, will be less willing to make the long-term commitments necessary to support an Alaska project. This uncertainty, they predict, will discourage rather than advance the development of an Alaska pipeline or any voluntary expansion thereof – a result clearly inconsistent with ANGPA's primary goal. Moreover, the North Slope Producers and Enbridge suggest that mandatory expansions pursuant to ANGPA section 105 will become more attractive than voluntary expansions because of the explicit rate protection for existing shippers in section 105.

41. The North Slope Producers contend that section 157.39 is unjustifiably inconsistent with the Commission's current policy regarding rate treatment of expansions, which is to discourage uneconomic expansions and assure that expansions will not be subsidized by existing shippers. They assert that even if, as claimed by the Commission, only one pipeline will be built in Alaska, that distinction does not justify deviating from the Commission's current policy.

42. The North Slope Producers charge that the Commission acted arbitrarily and capriciously in relying on ANGPA section 103(e) to justify its conclusion to provide for a presumption of rolled-in rates for expansions. Although the North Slope Producers concede that the Commission clearly has the authority under ANGPA and the NGA to approve rates for Alaska natural gas transportation projects, they claim that ANGPA section 103(e) has nothing to do with rate regulation. Furthermore, state the North Slope Producers, even if section 103 could be read to give the Commission authority to include rate regulations in its open season rules, the proper course would be to remove section 157.39 from the open season rules and instead address rate policy issues only after the parties have the opportunity of developing a complete factual record. Failing this, the North Slope Producers state that the Commission should revise section 157.39 to provide that the Commission's current rate policies will apply to Alaska projects.

43. Enbridge also argues that the Commission acted arbitrarily and capriciously by imposing a rebuttable rolled-in presumption, even where rolled-in pricing would increase existing shippers' rates. According to Enbridge, Order No. 2005 identifies two considerations, namely the Commission's disfavor of existing shippers subsidizing the rates of new shippers, and the Commission's reluctance to authorize an expansion rate that would have an unduly negative impact on the exploration and development of Alaska reserves. Enbridge contends that the presumption should be "scaled back" to apply only to cases where expansion rates are no higher than pre-existing rates. Enbridge points to the Commission's acknowledgement in Order No. 2005 that it "cannot at this point, without a specific project proposal or the facts surrounding a proposed expansion before

us, define exactly what will be required to overcome the presumption." Enbridge contends that the Commission's inability to explain how the presumption can be rebutted renders rolled-in pricing mandatory, leaving the question of whether a rolled-in expansion rate that is higher than original rates is a subsidy to be resolved in a future NGA section 7 filing.

44. ChevronTexaco stresses that because the text of Order No. 2005 recognizes that "without a specific project proposal or the facts surrounding a proposed expansion" the Commission cannot determine what is needed to overcome the presumption favoring rolled-in rates, the Commission should defer any determination of rate treatment for expansions until a record can be developed after a specific proposal is made. According to ChevronTexaco, this inability to articulate when the presumption will be applied creates uncertainty that inhibits the development of any Alaska project.

45. ChevronTexaco states that inconsistency between the text of order and the text of the regulations creates further uncertainty. ChevronTexaco states that while the regulations state that the presumption applies to "any expansion," Order No. 2005's text, at paragraphs 124 and 125, suggests that rolled-in rates are appropriate only if there is no increase in rates for existing shippers. ChevronTexaco urges the Commission to clarify section 157.39 to state that no cross-subsidy is intended. Otherwise, the Commission should consider issuing, in lieu of a regulation, a policy statement which outlines the general direction that the Commission intends to take.

46. The Alaska Legislators and Anadarko contend that rolled-in pricing is essential and justified. Anadarko asserts that the Commission clearly has the statutory authority to establish a presumption of rolled-in pricing for future expansions in the open season regulations. Both Anadarko and the Alaska Legislators contend that the significant differences identified in the record between an Alaskan pipeline project and a pipeline in the lower 48 states provide ample justification for departing from the current pricing policy. The Alaska Legislators contend that even if there were some factual reason for applying the current policy, that policy cannot be reconciled with the policy considerations stated in ANGPA. Both Anadarko and the Alaska Legislators state that incremental pricing of expansions cannot be reconciled with ANGPA's goals of promoting competition in the exploration, development, and production of Alaska natural gas, and providing for the transportation of natural gas other than from the Prudhoe Bay and Point Thomson units in any expansions of the Alaska pipeline facilities. The Alaska Legislators estimate that expanding a pipeline, through looping, to a capacity of 7 billion cubic feet (Bcf), would result in an expansion rate 50 percent higher than existing rates if incrementally priced. Anadarko predicts that incremental pricing of expansions of an Alaskan pipeline beyond 6 Bcf would cause the pipeline to be capped at 6 Bcf.

C. Commission Response

47. ANGPA section 103(i) gives the Commission broad authority to establish "such regulations as are necessary" for the conduct of open seasons. In this regard, the Commission believes that it is appropriate to establish rate criteria that will assist potential shippers to make informed open season bids, and will promote competition, as required by ANGPA. As discussed in detail in Order No. 2005, these criteria include projected rates for in-state deliveries of gas, as well as a presumption for rolled-in rate treatment for future pipeline expansions.

48. In adopting the presumption for rolled-in rate treatment, the Commission balanced rate predictability for initial shippers with the objective of reducing barriers to future exploration, development and production of Alaska natural gas. The Commission was concerned that the prospect of high incremental transportation rates might increase risks to Alaskan producers and serve as a disincentive to future exploration and development of potentially valuable natural gas resources. On the other hand, the Commission does not wish to discourage voluntary capacity expansions.

49. The rolled-in rate presumption was not an abandonment of our current policy of not favoring rate subsidization by existing customers of capacity expansions as suggested in the requests for rehearing. The Commission did, however, suggest that because of the likelihood of a single Alaskan pipeline project, it would consider alternatives to our current policy on how to define or quantify subsidization by current customers. Current policy primarily considers whether the expansion project will result in a rate higher than the existing transportation rate for existing customers. An alternative consideration or definition of subsidization could be whether the expansion rate is no higher than the actual initial rate or of an initial rate without built-in subsidies. The Commission believed and continues to believe that the appropriate place to review this issue is in the context of a future NGA section 7 filing. In such a proceeding, if the pipeline owners can show that the initial pipeline was sized appropriately, *i.e.,* it was uneconomic or inefficient to build a larger capacity pipeline, the Commission would consider this in overcoming the rolled-in rate presumption.

50. The text of Order No. 2005 referred to by ChevronTexaco does not simply state that rolled-in rates are appropriate only if there is no increase in rates for existing shippers; it suggests that a rolled-in expansion rate that is higher than the original rate is not necessarily a subsidy. As noted above, we will determine whether a particular rate amounts to a subsidy when the issue is presented to us.

51. Nothing in the requests for rehearing causes us to question our conclusion that a rebuttal presumption of rolled-in treatment for the expansion of an Alaska Project is a reasonable approach to the difficult issues we, and prospective pipeline proponents and shippers, may face on the future. We think that the signal we are sending is a positive one that will help spur natural gas exploration and development in Alaska. At the same time, we have not prejudged how we will resolve future proceedings, and all parties will have the opportunity to convince us of appropriate rate treatment if and when expansion proposals for an Alaska project are developed. We therefore will not change the rule on this matter.

III. Late Bids

A. The Final Rule - § 157.34(d)(2)

52. Order No. 2005 added a new provision in the Final Rule, section 157.34(d)(2), that a project sponsor must consider any bids tendered after the expiration of the open season by qualified bidders, and may reject them only if they cannot be accommodated due to economic, engineering, or operational constraints, in which case the project sponsor must provide a detailed explanation for the rejection. The Commission explained that this requirement is designed to allow reasonable access to those shippers who may not be ready to participate during the established open season period, and at the same time provide the sponsor with flexibility in the timing of its open season.

B. Rehearing/Clarification Requests

53. The North Slope Producers and Enbridge contend that it is important for the timely development of any project that the project sponsors be able to rely on an open season that has a definite term. They state that the open season results are needed to permit the project sponsor to gauge demand and in turn finalize pipeline design. They assert that the late bid provisions of section 157.34(d)(2) will result in unreasonable risks and costs to the project sponsor by creating a never-ending, open-ended open season in which the project sponsor will be required, for each and every late bid received, to divert resources and incur additional costs to evaluate whether bid can be accommodated. In addition, they state that there is tremendous potential for delay at each step of the development of the project, if the project sponsor must stop and make design changes at every stage to accommodate a late bid. Thus, they state, section 157.34(d)(2) would frustrate the Commission's stated goal of adopting open season regulations that ensure sufficient economic certainty to support the construction of a pipeline.

54. The North Slope Producers add that financing cannot be secured until pipeline design and development costs are known and precedent agreements are in place. Consequently, they claim, the prospect of having to make changes to key project components to accommodate late bids jeopardizes the project sponsor's ability to obtain financing in a timely manner.

55. Both Enbridge and the North Slope Producers also state that section 157.34(d)(2) fails to provide a clear standard under which the project sponsor must evaluate late bids. This failure, they claim, presents another risk of uncertainty and delay. Enbridge argues that, even if it is necessary to significantly re-design a project in order to satisfy a late bid, the regulation would require that such a bid be accepted if the re-designed project remains feasible from an "economic, engineering or operational" perspective.

56. The North Slope Producers state that another effect of the late bid provision is that potential shippers will be discouraged from participating in an open season if they can submit a late bid. They worry that this would diminish the open season's ability to accurately demonstrate the demand for pipeline capacity. Enbridge also claims that, absent a good faith requirement in connection with submitting late bids, section 157.34(d)(2) permits such gamesmanship. Enbridge states that at a minimum, section 157.34(d)(2) should put "the burden on the bidder to demonstrate compelling circumstances that prevented participation in open season, and that the bid can be accommodated without changing system design, requiring capacity to be allocated away from other shippers, or otherwise adversely impacting the project's development and timing." In this regard, the State of Alaska maintains the Commission should include language in section 157.34(d)(2) that requires late bidders to provide adequate justification for their late bids.

57. Additionally, the North Slope Producers assert that, to the extent a project sponsor would be required to expand the project to accommodate late bids, the Commission is in effect ordering an expansion of the pipeline. In such a case, section 157.34(d)(2) raises the same issues regarding forced expansions as are raised by sections 157.36 and 157.37. The North Slope Producers contend that whereas the Commission may require an expansion under section 105, that section places the burden on the party seeking such expansion to establish that specific conditions are met, section 157.34(d)(2) appears to place the burden on the pipeline to justify why it cannot expand the project to accommodate a late bid.

58. Enbridge states that in any event there is little or no reason for section 157.34(d)(2) "given the other measures instituted by Order No. 2005 to protect the interests of late developing shippers." Specifically, Enbridge refers to the

unprecedented level of information required in the open season notice on which bidders will be able to base their long-term capacity decisions, Order No. 2005's emphasis on requiring that the project's design demonstrate a capability for low-cost expansion, and, finally, the mandatory expansion provisions of ANGPA 105. Enbridge contends that to the extent late bids can be accommodated without adversely impacting the project's development, it is in the project sponsor's economic interests to do so.

59. ChevronTexaco requests that the Commission clarify that project sponsors will be required to consider late bids only if there is excess capacity after capacity is allocated to those open who bid in the open season. ChevronTexaco states that one of the major purposes of the open season is provide a level playing field for all participants, thereby eliminating the advantages of possessing superior or advance information. ChevronTexaco cannot understand the Commission's reasoning in giving special consideration to one specific parameter of a conforming bid, namely, the timing of the bid. According to ChevronTexaco, late bidders should not be allowed to put new burdens on the project or to adversely affect timely open season bidders.

60. Anadarko states that section 157.34(d)(2) is a reasonable compromise balancing concerns that the open season could be held prematurely with a project sponsor's desire to control open season timing. Anadarko also states that it is possible to accommodate all qualified bidders up to the time the pipeline design is finalized.

C. Commission Response

61. Under the Commission's open access policy and rules, all operating interstate pipelines have an obligation to receive and respond to new requests for service, even if no capacity is available. All operating pipelines have provisions in their FERC tariffs governing the procedures that the pipeline will use in evaluating requests for service. Absent an expansion,[22] capacity could still be made available to a prospective shipper via capacity release or the capacity turnback provisions of an interstate pipeline's FERC

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[22] Interstate pipelines, other than an Alaska pipeline, cannot be required to expand their systems, but pipelines are required to respond to those who request service, even when none is available.

tariff. During the several years between the time that the open season ends and an Alaskan pipeline goes into service, there will be no tariff with provisions like those described above in effect for that pipeline. Without the late bidder provisions of section 157.34(d), late-developing prospective shippers would have no formal way of seeking capacity on the pipeline after the open season ends. As revised herein, the Commission believes that the late bidder provision is a fair and necessary addition to the open season process for an Alaska natural gas transportation project.

62. The project sponsor's obligation under section 157.34(d)(2) is not "unbounded" or "open-ended," as North Slope Producers contend. We added this requirement in recognition of the possibility that an appreciable amount of time might pass between the close of the open season and the project sponsor's finalizing the details of the proposed pipeline design and associated development costs, given the size and scope of an Alaska natural gas pipeline project. During that time, it is possible that producers of Alaska natural gas who were not in a position to commit to long-term capacity commitments during the open season, might then be in a position to request capacity consistent with the open season notice (except, of course, that the bid is tendered out of time). We felt it proper to require the project sponsor to consider such a request. At the same time, we appreciated that at some point in time, either before or after the proposed pipeline design is finalized, the project sponsor might not be able to accommodate reasonably a late request. For that reason, we provided that late requests could be rejected on the basis of "economic, engineering or operational constraints." This is far from an unbounded, open-ended obligation. Indeed, as noted above, Enbridge points out that to the extent that late bids can be accommodated without adversely impacting the project's development, it is in the project sponsor's economic interest to do so. We see no harm in requiring that result.

63. We will however, revise the requirements of section 157.34(d)(2) in response to the complaints that the "economic, engineering or operational constraints" standard for rejecting late bids is too vague. Specifically, we are clarifying the criteria for rejecting late bids in section 157.34(d)(2) to be "economic, engineering, design, capacity or operational constraints, or accommodating the request would otherwise adversely impact

the timely development of the project."[23] Additionally, we are adding a provision to the section which will enable the project sponsor, at the appropriate time in the development of its project and subject to Commission approval, to determine, based on the above criteria, that no further bids can be accepted. We will also revise section 157.34(d)(2) to provide that any bid tendered after the expiration of an open season must contain a good faith showing, including a statement of the circumstances which prevented the bidder from tendering a timely bid, and how those circumstances have changed. This requirement is consistent with the underlying premise of section 157.34(d)(2) in the Final Rule, and should serve to protect against "gamesmanship." With these revisions and clarifications, we believe that the late bid provision will permit late-developing shippers to obtain capacity after the expiration of the open season, while also providing the prospective applicant the assurance that it will be able to design and develop its project according to its own schedule.

V. Mandatory Pre-Approval

A. The Final Rule - § 157.38

64. Section 157.38 requires that, at least 90 days prior to providing its notice of open season, an applicant must file, for Commission approval, a detailed plan for conducting the open season in conformance with the regulations. The Commission will establish a date by which comments on the request for approval are due, and the Commission, unless it directs otherwise, will act on the request within 60 days of its filing. The Commission concluded in Order No. 2005 that this requirement would allow for the resolution of disputes or dissatisfaction with an open season at the earliest possible time, thereby reducing the risk of having to require a second remedial open season because the first one did not conform to the regulations.

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[23] We are retaining the requirement that the prospective applicant must provide a detailed explanation for its rejection, at least until such time as it has determined, subject to Commission approval, that no further late bids can be accepted. We find that, based on the prospective applicant's position, it is easier for it to evaluate why a late bid cannot be accepted, than it is for a later bidder to explain why its bid can be accommodated.

B. Rehearing/Clarification Requests

65. The North Slope Producers and Enbridge urge the Commission to eliminate the mandatory pre-review process set out in section 157.38, calculating that with the addition of this mandatory review, the open season process will take at least 210 days, instead of the 120-day open season period proposed in the NOPR and established in section 157.34. They state that this additional 90 days does not include further delays that could result from disputes arising during the pre-review process, including the need to consider requests for rehearing of any orders pre-approving an open season or the Commission's inability to adhere to its 90-day window. The result, they claim, is that the open season process will be delayed, not expedited. Enbridge states that the 210-day period is longer than the 180-day open season period which the Commission rejected as inconsistent with Congress' sense of urgency, as well as the Commission's conclusion in Order No. 2005 that "timing is of the essence."

66. The North Slope Producers maintain that the Commission's justification for this requirement is that a successful open season is more likely to occur if issues are identified and resolved at the earliest time. The North Slope Producers disagree, claiming that, instead of reducing the chance of post-bid disputes, this layer of review will provide those who would gain commercial leverage by delaying the open season process "with an additional bite at the apple, first by objecting to the bid package, then by objecting to the results of the open season."

67. Both the North Slope Producers and Enbridge contend that the mandatory pre-review process is unnecessary and duplicative of other protections provided in Order No. 2005, including the transparency and specificity of the open season information, the 30-day prior notice requirement, the prohibition against undue discrimination or preference in rates, terms or conditions of service, and the imposition of Order No. 2004 standards of conduct. They contend that the effects of any delay of the open season can be profound, due to narrow, seasonal windows for environmental studies and preliminary field work, which cannot take place until the open season has been held. These risks, they claim, far outweigh any utility of a mandatory pre-review. In conclusion, the North Slope Producers contend that any pre-review of the open season notice should be voluntary, shortened, and that the Commission decision on the sufficiency should be deemed a pre-decisional, non-reviewable determination, similar to the Commission's action in rejecting a deficient certificate application under section 157.8 of the Commission's regulations.

68. Anadarko defends the mandatory pre-review requirement as striking an "appropriate balance between granting project sponsors flexibility in designing open seasons and providing regulatory supervision to potential bidders by requiring project sponsors to file and obtain approval of the open season plan." Anadarko and the Alaska Legislators state that pre-approval will reduce any risk of having to hold a second open season to correct one done improperly. Anadarko states that this will, as the Commission believes, promote rather than hinder a timely and successful open season. The Alaska Legislators agree with this assessment, contending that adding 90 days to the front end of the open season process, even with the prospect of a rehearing, is better than having an open season called back by an order on rehearing or on appeal from the results of an open season, and then having to hold another open season. Moreover, they state that once the open season is approved, parties may rely on those terms being controlling throughout the bidding and contracting process.

C. <u>Commission Response</u>

69. The North Slope Producers and Enbridge correctly state that, by virtue of the mandatory pre-approval established in section 157.38, the minimum duration of the whole open season process would be 210 days. However, the concept of a mandatory pre-approval and the attendant additional time that such review will add is not inconsistent with our concern that "time is of the essence" that caused us to reject a 180-day open season period, and instead provide for a 120-day open season.[24] Our focus in establishing this 120-day period was to arrive at a time period such that all prospective bidders reasonably could review the open season information and evaluate whether to make multi-year capacity commitments, thereby leveling the playing field.

70. When discussing the duration of the whole "open season process," we must consider the potential for delays due to disputes arising during the open season. In this regard, we found in Order No. 2005 that pre-approval of open season procedures would "allow issues to be identified and resolved at the earliest possible time and, ideally, reduce the possibility of dissatisfaction with open seasons, as well as the risk that the

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[24] The 120 days consists of the 30-day prior notice period (section 157.34(a)), followed by a 90-day open season (section 157.34(d)(1)).

Commission will have to require that deficient open seasons be conducted again."[25] The North Slope Producers' and Enbridge's disagreement with this assessment is based on arguments that the transparency and specificity of the information required in the open season and other protections provided in the open season rules render pre-approval unnecessary, and that the pre-approval process itself invites delay.

71. We are not as optimistic as the North Slope Producers and Enbridge that there is little likelihood that disputes might arise over the conduct of an open season and its conformance with the open season rules. While the transparency and specificity of the open season rules might lead to a clearer identification of any issues in dispute, they do not change the fact that in any open season there will be a universe of potential bidders with starkly different, competing needs and interests, and the potential for dispute is real. We continue to believe that getting it right the first time is the best approach.

72. Nonetheless, in revisiting the requirement for mandatory pre-approval as a result of these rehearing requests, we find that it is appropriate to make some changes. First, we are revising section 157.38 to make clear that the plan to be filed by a prospective applicant shall include the information required in a notice of open season under section 157.34. Second, we are eliminating the 30-day prior notice requirement in section 157.34(a). Since the public will have actual notice of a prospective applicant proposed open season notice at least 90 days prior to the open season, there is no reason to provide for an additional prior notice period. By this change, we are reducing the 210-day period to 180 days. It also our conclusion that, given the fact that participants in an open season will have the opportunity to object to the conduct of the open season after a certificate application is filed, as is our current practice, as well as the ability to seek rehearing and obtain appellate review of any Commission certificate orders, orders approving open season procedures will be interlocutory and not subject to rehearing.

V. <u>In-State Study</u>

A. <u>The Final Rule - §157.34(b)</u>

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[25] Order No. 2005 at P 109.

73. In response to concerns expressed by Alaska entities and in recognition of Congress' mandate that Alaska in-state needs be given due consideration, the Final Rule added in section 157.34(b) a requirement not contained in the proposed regulations that the open season information include an assessment of Alaska's in-state needs and prospective points of delivery within the State of Alaska, based to the extent possible on any available study performed or otherwise approved by an appropriate Alaska governmental entity.

B. Rehearing/Clarification Requests

74. While the North Slope Producers find reasonable a requirement that a study of in-state needs be completed prior to any open season, they object to section 157.34(b)'s requirement that the contents of the open season notice rely on an in-state study, if practicable. They assert that ANGPA does not require a pipeline sponsor's study to "include or consist' of a state-sanctioned study. The North Slope Producers contend that this requirement invites disputes as to whether it is "practicable" to include a state study, or whether "appropriate" state officials were involved. Consequently, the North Slope Producers request that the Commission revise section 157.34(b) to require that a project sponsor consult with the State regarding the study for in-state needs.

75. The Alaska Legislators state that the Commission has avoided the problem of "dueling studies" by deferring the study to the State of Alaska. In this regard, the Alaska legislators advise the Commission that the State of Alaska has undertaken to designate an appropriate agency to conduct or sanction the required study, and the Alaska House of Representatives has passed a resolution urging the Administration to conduct, approve, or sanction the required study prior to the effective date of the opens season rules.

C. Commission Response

76. Section 157.34(b) does not mandate the use of a particular study but rather is premised on the common-sense notion that information provided by the State of Alaska likely will be valuable to potential shippers. We trust that the State and prospective pipeline applicants can agree on the manner in which such information can be provided. If questions arise as to the extent to which it is possible to include a state study, we will resolve them. Our regulations offer several options that the prospective applicant and the State of Alaska could take to ensure the adequate involvement of the State. Accordingly, we will not revise section 157.34(b).

VI. In-State Rates

A. The Final Rule - § 157.34 (c)(8)

77. In addition to the requirement that in-state gas needs be addressed in the open season, the Commission also required, in section 157.34(c)(8), that, based on in-state needs and the delivery points identified in the study, open season information include a proposed in-state transportation rate, based on the costs of providing that service.

B. Rehearing/Clarification Requests

78. The North Slope Producers ask the Commission to clarify that estimating rates for in-state service does not create a requirement to offer such a service at that rate (or at all) if the open season does not yield firm commitments for in-State deliveries. They assert that the ultimate indicator of any market for in-state service is the willingness of shippers to make firm commitments to purchase capacity for in-state use during the open season, not a study. They also request that the Commission clarify that the estimated in-state service rates are merely illustrative and subject to adjustment.

79. Enbridge requests that the Commission make clear that the "estimated transportation rate" referred to in section 157.34 (c)(8) is one based on project sponsor's estimated costs to make in-state deliveries, not upon any rates assumed by the study. Additionally, Enbridge states that the Commission clarify that bids for in-state service should be subjected to the same requirements for creditworthiness, collateral and execution of binding contractual commitments as apply to any other open season bidder.

80. The State of Alaska asks the Commission to clearly state that the in-state rates are to be distance-sensitive in order to ensure that the cost of in-state service is calculated properly.

C. Commission Response

81. During the open season process, qualified bidders must successfully bid upon and arrange to consummate service agreements for transportation service. Projected rates for in-state deliveries must be based on estimates of costs for providing service to the in-state delivery points. While prospective applicants will estimate rates during an open season, the Commission's review of proposed rates will be guided by section 284.10(c)(3) of our regulations, which states in part that "[a]ny rate filed for service … must reasonably reflect any material variation in the cost of providing the service due to … the distance over which the transportation is provided."

82. All shippers on any new interstate pipeline have a right to pay only the initial rate on file as approved in the NGA section 7 certificate of public convenience and necessity. Those initial rates, approved under section 7 as part of the certificate, would be paid unless changed under section 4 or 5 of the NGA after appropriate regulatory proceedings and upon the Commission's order. However, under the Commission's negotiated rate policy,[26] pipelines and shippers are free to make an agreement to "dispense with cost-of-service regulation" and agree to any mutually agreeable rate. A recourse rate found in the pipeline's tariff would be available for those shippers preferring traditional cost-of-service rates. Thus, if an in-state service is successfully bid upon, filed for and approved, an in-state cost-of-service recourse rate would be set in an Alaskan pipeline's tariff, but in-state shippers would also be free to seek a negotiated in-state rate with an Alaskan pipeline. Negotiated rates can be used to lock in transportation costs and pipeline revenues to the mutual benefit of both the shippers and the pipeline, without the risks of later changes to rates and revenues under the NGA.

83. If there are no successful bids for in-state service, the prospective applicant would nonetheless have to include the in-state service as part of its proposed initial tariff. An opportunity to have in-state service might arise if the pipeline voluntarily accepts a request for it at a later time, or if the Commission acts under section 103(h) of ANGPA and section 5 of the NGA to require the pipeline to make such in-state deliveries. The actual in-state rate for in-state service would be an issue for such future proceedings. Based on the foregoing, we see no need to further clarify the regulations.

VII. Tying Arrangements

A. The Final Rule - §§ 157.34(c)(6), 157.34(c)(10), and 157.35(a)

84. The Commission addressed the matter of tying access to pipeline capacity on an Alaska project to ancillary services in two sections of the Final Rule. First, section 157.34(c)(6) requires that the open season notice must contain an unbundled

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[26] Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, Docket No. RM95-6-000, Regulation of Negotiated Transportation Services of Natural Gas Pipelines, Docket No. RM96-7-000, 74 FERC ¶ 61,076, (Jan. 31, 1996).

transportation rate. Second, section 157.34 (c)(10) prohibits a prospective applicant from requiring prospective shippers to process or treat their gas at any designated facility. We explained elsewhere in Order No. 2005 "that [we] can address any other discriminatory conduct in connection with gas quality requirements or other ancillary services through the provisions of section 157.35 in conjunction with existing Commission policies and procedures." Relevant to this explanation, section 157.35(a) provides that '[a]ll binding open seasons shall be conducted without undue discrimination or preference in the rates, terms, or conditions of service and all capacity awarded as a result of any open season shall be awarded without undue discrimination or preference of any kind."

B. Rehearing/Clarification Requests

85. The State of Alaska states that the Commission should more explicitly explain the prohibition against tying arrangements, and explain how the open season rules will apply to gas treatment plants. The State believes that the open season rules should do more than require an applicant to use an unbundled transportation rate, prohibit tying of capacity on the pipeline to the use of a designated plant or facility, and merely refer to the existing regulations and policies prohibiting undue discrimination or preference. Rather, Alaska states that the open season rules should make clear that any tying arrangements will be subject to an exacting inquiry by the Commission and will require a compelling justification, and even offers recommended language to this end.

86. Alaska also states that since ANGPA includes gas treatment plants in its definition of an Alaska natural gas transportation project,[27] treatment plants should be subject to the open season regulations. Alaska points out that the effect of the unbundling requirement of section 157.34(c)(6) is to exclude gas treatment plants from the requirements of the open season. As a possible solution, Alaska suggests that the open season rules be clarified to provide that the applicant must separately offer gas treatment plant capacity and pipeline capacity in the open season notice, and give bidders an opportunity to bid on

[27] ANGPA §102(2) defines the term 'Alaska natural gas transportation project' as "any natural gas pipeline system that caries Alaska natural gas to the border between Alaska and Canada (including related facilities subject to the jurisdiction of the Commission) ..."

either or both, as they choose. ChevronTexaco contends that because gas treatment plants are jurisdictional facilities,[28] Order No. 2005's approach of deferring consideration of any discriminatory conduct as to necessary such ancillary facilities and services to a later day does not satisfy the requirements of the ANGPA. Chevron Texaco maintains that it is particularly important that access to treatment facilities be subject to the same open season, non-discriminatory requirement as the pipeline because pipeline capacity without access to gas treatment facilities that maybe a part of the pipeline system is meaningless.

C. Commission Response

87. The Commission did not intend to preclude the inclusion of jurisdictional natural gas conditioning facilities from the open season. If, pursuant to ANGPA section 103, a project sponsor intends to file an application under section 7 of the NGA for authorization of a project that includes a jurisdictional natural gas conditioning service, we will review the open season plan and notice to ensure that such service is offered in its open season notice, subject to the same requirements as apply to transportation service. However, the prospective applicant must offer a separate rate for the gas treatment service and separate rate for the transportation service. Furthermore, the prospective applicant can neither require bidders to bid on both services, nor evaluate the bids based on whether bidders requested one or both services. Moreover, while the prospective applicant can require specific natural gas quality specifications such as would be met by using the conditioning services offered, it cannot reject an otherwise qualified bidder that states that it will deliver to the pipeline facilities gas that meets the stated quality specifications.

88. On the other hand, if a prospective applicant is proposing to apply to revise the Alaska Natural Gas Transportation System (ANGTS) application now held in abeyance, then a conditioning service will have to be included as a part of the open season but again, with all services offered priced separately. Specifically, in 1981, President Reagan submitted a Waiver of Law to Congress for the purpose of clearing away certain government-imposed obstacles to the private financing of the ANGTS. The Commission

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[28] *See Venice Gathering Co.*, 97 FERC ¶ 61,045 at 61,255 (2001) (Treatment of gas to enhance its safe and efficient transportation is subject to Commission jurisdiction).

implemented that portion of the Presidential waiver that required the Commission to include within the ANGTS the gas conditioning plant at Prudhoe Bay.[29]

VIII. Pre-Subscribed Capacity

A. The Final Rule - §§ 157.33(b) and 157.34(c)(15)

89. Under section 157.33(b), pre-subscription agreements for initial capacity on a proposed Alaska natural gas transportation project are permitted, provided that capacity is offered to all open season prospective bidders at the same rates and on the same terms and conditions as contained in the pre-subscription agreements. In addition, if there is more than one pre-subscription agreement, open season prospective bidders are given the option of selecting the rates, terms and conditions contained in any one of the several agreements. However, section 157.34(c)(15) states that "[i]f capacity is oversubscribed and the prospective applicant does not redesign the project to accommodate all capacity requests, only capacity that has been acquired through pre-subscription shall be subject to allocation on a *pro rata* basis; no capacity acquired through the open season shall be allocated."

B. Rehearing/Clarification Requests

90. The North Slope Producers assert that the provision in section 157.34(c)(15) subjecting only presubscribed capacity to *pro rata* allocation, will dissuade any shippers from signing up for the presubscribed capacity, thereby "wholly negating" the recognized benefits of allowing pre-subscription agreements to facilitate the development of an Alaska natural gas transportation project. They predict that prospective shippers would rather wait for the open season than risk proration. The North Slope Producers maintain that this selective proration unduly discriminates against those shippers who are willing to make early commitments for firm capacity in order to support the project, in violation

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[29] *See Alaskan Northwest Natural Gas Transportation Co.*, 18 FERC ¶ 61,002 (1982).

of the NGA and Commission policy. They add that since section 157.33(b) allows all open season participants to enjoy the same benefits as contained in the pre-subscription agreements, such discrimination is particularly unjustified. The North Slope Producers add that this is another example where the Commission is attempting to compel the project sponsor to make design changes in order to accommodate all bids.

91. The North Slope Producers also state that the final clause of section 157.34(c)(15) is not consistent with the Commission's presumed intent not to foreclose proration among open season bidders where there is no presubscribed capacity. They suggest that the final clause of that provision, which states "no capacity acquired through the open season shall be allocated," should be clarified.

92. In addition to agreeing that proration renders pre-subscription an unattractive option for prospective shippers, Enbridge adds that the additional requirement that the terms and conditions of any pre-subscription agreements be made public prior to the open season notice renders pre-subscription even less desirable because it put anchors shippers at a competitive disadvantage to open season bidders who would have prior knowledge of the pre-subscription bids. At the same time, Enbridge concedes that it would be highly unlikely that project would not be re-designed to accommodate capacity of all qualified bids at the incipient, open season stage.

93. Enbridge raises again the claim that the "numerous and overlapping protections" of Order No. 2005, in particular the level of information provided in open season notice and measures provided to ensure against discrimination, are sufficient to ensure a fair, open and non-discriminatory open season process. Enbridge also states that the Commission should clarify that open season shippers who in the open season elect to select the terms and conditions of a pre-subscription agreement may not cherry-pick" terms and conditions from several agreements but must accept any one agreement in its entirety.

94. The State of Alaska seeks clarification that, in the case of capacity allocation on an oversubscribed pipeline that cannot reasonably be redesigned, both presubscribed capacity and capacity later acquired on the same rates, terms and conditions will be subject to allocation, for the reason that the final words of section 157.34 (c)(15) stating that "no capacity acquired through the open season shall be allocated," suggests otherwise.

95. ChevronTexaco maintains that the Commission failed to consider and provide for the various circumstances that could trigger the pro-rationing of pre-subscribed capacity. ChevronTexaco states that bidders in the open season could outbid pre-subscribing

shippers on the basis of any of the qualifying conditions: for instance, an open season bidder might outbid pre-subscribing shippers whose agreements are at less than maximum rates, or whose agreements are of shorter terms. ChevronTexaco is concerned that pre-subscribing shippers might lose their capacity to open season bidders who outbid them because they know the salient terms of the pre-subscription agreements. Therefore, ChevronTexaco submits that the Commission should expand the requirement of pro-rationing by establishing that all bids eligible to be allocated capacity in an open season where pre-subscribing shippers will be prorated should be treated as having equal value to the pre-subscription precedent agreement for purposes of pro-rationing. In this way, later qualifying bidders would be prevented from outbidding pre-subscribing shippers.

96. In response to the claims on rehearing that the capacity allocation provisions of section 157.34(c)(15) are counterproductive because they will deter potential anchor shippers from entering into pre-subscription agreements, Anadarko contends that the Commission's finding that the North Slope Producers' unique position of control over pipeline design amply justifies putting the consequences of any decision not to redesign pipeline to accommodate all bidders on them. Anadarko also questions the importance placed on pre-subscription agreements in connection with an Alaska pipeline project. According to Anadarko, the only justification for a pre-subscription agreement is to facilitate financing and to provide the project sponsor with assurances that it has the commitments to justify development and construction expenses. However, states Anadarko, there is little doubt that any Alaska natural gas transportation project will be fully committed, even without pre-subscription agreements.

97. The Alaska Legislators support the pre-subscription rules of Order No. 2005, claiming that the rules make sense given the unique nature and circumstances of an Alaska natural gas transportation project and the need to balance concerns "that pre-subscription is essential to finance the pipeline with concerns of those who feared that such arrangements would favor affiliates of the pipeline or otherwise undermine the objectives of conducting public open seasons for capacity."

C. Commission Response

98. Although we allowed pre-subscription agreements in the belief that they could have utility in facilitating the development of an Alaska natural gas transportation project, we cannot quantify how beneficial such arrangements are. Our paramount consideration in allowing pre-subscription was that it should not impact in any way the capacity obtained through the open season process. For this reason, we provided that any capacity acquired by reason of agreements entered into prior to the open season would have to yield to capacity bid for in the open season in the case of oversubscription We

believe our reasons for this selective proration, as stated in Order No. 2005 and reaffirmed here, are sound.

99. The argument that anchor shippers will be dissuaded from entering into pre-subscription agreements if they risk losing capacity as a result of open season bidding, and that the "recognized benefits" of pre-subscription will be lost, is unpersuasive. The North Slope producers and other potential project sponsors have developed a plethora of information in recent years regarding the viability of an Alaska project. They are fully capable of deciding whether they wish to execute pre-subscription agreements. If they do not, capacity will be allocated in an open season. There has been no showing that an Alaska project cannot be financed, as are many major projects, based on commitments made in an open season. While we have concluded that the public interest permits pre-subscription, under the conditions established by the rule, we do not find that the public interest requires pre-subscription. It does require competition and open-access. We leave it to potential project sponsors and shippers whether pre-subscription makes sense to them.

100. We will, however, clarify section 157.34(c)(15) in two respects, first to eliminate confusion over the last sentence of that section which concludes "no capacity acquired through the open season shall be allocated," and second to make clear that in the event there is more than one pre-subscription agreement, bidders in the open season may not cherry-pick among the provisions of the several agreements. The North Slope Producers contend that the last clause of section 157.34(c)(15) might be read to provide that proration is foreclosed among open season bidders even where there is no presubscribed capacity. We will clarify the language of the rule to avoid such a misreading. Capacity bid for in the open season is exempt from allocation only in a case where there is also presubscribed capacity, as explained in the text of Order No. 2005. The State of Alaska reads that clause to suggest that capacity acquired by bidders in the open season who elect to acquire their capacity on the same rates, terms and conditions as contained in a pre-subscription agreement will not be subject to pro rata allocation along with the pre-subscription shippers. Such an interpretation also misreads the intent of section 157.34(c)(15),and we will clarify the language of the rule accordingly. Finally, we will clarify section 157.33 to make clear that open season bidders may not cherry pick among the provisions of several precedent agreements, as was our intent in the Final Rule.

IX. <u>Other Issues</u>

101. The North Slope Producers request that the open season rules be clarified in certain respects. First, they request that the Commission clarify the open season

regulations by replacing references to "prospective points of delivery within the State of Alaska" or "delivery points" in several subsections of the regulation with the term "tie-in points."[30] The North Slope Producers assert that the term "delivery point" implies an obligation that the pipeline will be finally designed to deliver gas all the way to in-State markets and that ANGPA does not contemplate or impose such an obligation.

102. The Commission understands the terms "prospective points of delivery within the State of Alaska" or "delivery points" to mean those points on the interstate Alaskan pipeline where custody of the gas would be transferred to the facilities of an intrastate pipeline, local distribution company, or end-user whose facilities are not otherwise under the Commission's jurisdiction, assuming that shippers on an Alaska pipeline requested such deliveries. The term "tie-in points" as used only once in ANGPA is used in reference to the study of in-state needs in section 103(g) and as a familiar natural gas industry phrase is not as familiar to the Commission as the terms "points of delivery" or "delivery points." [31]

103. As part of the open season, the prospective applicant is in fact obligated to offer to deliver gas at least at certain prospective in-state delivery points identified in the study of in-state needs. However, the open season notice's initial design of the pipeline need only match the prospective applicant's open season business proposal to deliver at least the amount of gas identified in the study of in-state needs at those prospective in-state delivery points. Bidders may seek alternative delivery points (such as ones closer to their market) as part of their bids, and as part of the open season the prospective applicant may consider building additional facilities to such alternate points, but has no obligation to do so as long as it treats similar requests the same. As discussed above, if the open season ends without any successful bids for in-state deliveries, then there is a continuing obligation for the prospective applicant to leave provision for such in-state service available in its tariff, but it would not have to voluntarily propose such service as part of its initial application. Also, as used in section 157.34, the term "delivery point(s)" also refers to the location at the border between Alaska and Canada where presumably

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[30] These sections include §§ 157.34(b) and 157.34(c)(1), (2), (3), (6), (8), and (16).

[31] Although tie-in point is used in some Commission documents, the most common use is to identify the point where a pipeline's loop ties back into the mainline.

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prospective bidders will seek to have their volumes delivered. If would be much more confusing if the regulations were revised to refer to "tie-in points" for points inside Alaska and "delivery points" for locations at the border between Alaska and Canada. Therefore, we will not clarify the rules as requested by the North Slope Producers in this regard.

104. Second, the North Slope Producers state that the "catch-all" language in section 157.34(c)(18) was not scaled back enough from the language proposed in the NOPR. Specifically, they state that as written, the final regulation requires a pipeline applicant to provide all bidders, not only with information the applicant has provided to any bidder, but also with information "in the hands of" any bidder. The North Slope Producers claim that the applicant cannot know what information identified in section 157.34(c)(18) is "in the hands of a potential shipper." Moreover, they contend that while the text of Order No. 2005 does not discuss the intent of this subsection, the Commission's press release and the Commission staff's PowerPoint presentation at the February 9, 2005 Commission Open Meeting presentation refer to information that the applicant has in some way made available to a potential shipper, and the regulations should be clarified to be consistent with this intent. The North Slope Producers add that, read literally, this language would call for protected information. Enbridge, on the other hand, claims that section 15734(c)(18) should be eliminated as unnecessary due to the transparency assured by the rest of the numbered subsections of section 157.34(c).

105. Anadarko objects to this requested clarification, pointing out that the North Slope Producers are likely already to possess relevant project-related information as a result of discussions with other possible project sponsors, and if the North Slope Producers becomes the project sponsor, this information is already in their hands and was not made available to them by an applicant.

106. The "catchall" provision addresses the difficult issue of separation of functions between a prospective applicant and its affiliates who produce, sell or market Alaska gas, and as such are potential bidders for capacity on an Alaska natural gas transportation project. It has been targeted as a problem since it appeared in the NOPR and it was discussed extensively in the Final Rule.[32] The North Slope Producers have undertaken

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[32] *See* Order No. 2005 at P 72 -83.

millions of dollars of due diligence "homework" on the design, cost, operation and feasibility of an Alaska pipeline. If they are not affiliated with the prospective applicant for an Alaska pipeline, then all that knowledge and information is theirs and, presumably, would give them an informational advantage in the open season bidding. However, if the North Slope Producers are affiliated with the prospective applicant, then the Commission and other potential bidders must be assured that any relevant information about the design, cost, operation and feasibility of an Alaska pipeline that the North Slope Producers transfers to an affiliated prospective applicant is available to everyone. The Commission desires to make this very important part of the Final Rule as clear as possible. Thus, we will revise section 157.34(c)(18) to read as follows:

> All information *that the prospective applicant has in its possession* pertaining to the proposed service to be offered, projected pipeline capacity and design, proposed tariff provisions, and cost projections, *or that the prospective applicant has* made available to, *or obtained from, any potential shipper*, including any affiliates of the project sponsor and any shippers with pre-subscribed capacity, prior to the issuance of the public notice of open season;

The Commission understands that the scope of this information is extensive. Therefore, we will not require that the contents of the open season notice to be published by the prospective applicant must contain copies of all the documents which would be covered under section 157.34(c)(18), but that the notice identify a "public reading room" where such information is available, for copying at the reader's expense. Further, as the North Slope Producers point out, dealing with potential "protected information" will have to be addressed as it is in any commercial situation. The Commission expects that all parties will cooperate in dealing with "protected information," but as in all matters pertaining to the open season process, the Commission and its staff stand ready to assist in resolving any disputes.

107. Third, the North Slope Producers request that the Commission clarify the requirement in section 157.35(c) that the project applicant "create or designate a unit or division to conduct the open season that must function independent of the other divisions of the project applicant as well as the applicant's Marketing and Energy affiliates." They claim that they intend to create a separate entity to be the project sponsor and to conduct the open season, and that this section would require them to establish yet another separate entity to conduct the opens season, and that section 157.35(c) should be revised to reflect that this is sufficient. Specifically, the North Slope Producers propose to delete from the regulations the language requiring that a project applicant must designate a separate unit

or division to conduct the open season. Anadarko claims that this requested clarification would largely nullify the purpose of section 157.35(c).

108. The Commission denies the North Slope Producers' proposed change to section 157.35(c). However, the Commission will amend the section to take into account situations in which a project applicant is an entity that has been separately created for the purpose of conducting an open season. In such cases, the separate entity would comply with the provisions of section 157.35(c) if that project applicant functioned and operated independently from the project applicant's Marketing and Energy Affiliates, as well as the other divisions of the project applicant. The purpose of section 157.35(c) is to ensure that the project applicant conducting the open season is independent of, and does not favor, its affiliates. If the project applicant was created to comply with section 157.35(c) and does, in fact, comply with the regulation, the project applicant is not required to create a further subdivision to achieve compliance.

109. The North Slope Producers identify several other non-substantive clarifications to the regulatory language that should be made to avoid confusion.[33] These corrections will be made.

110. Enbridge argues that since the open season regulations require that the project design criteria include a requirement that the project be capable of "low-cost expansion,"[34] the Commission should explain that the threshold for satisfying the low-cost expansion" standard is any expansion that does not increase rates to initial shippers. However, as Enbridge recognizes, any certificate application for an Alaska natural gas

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[33] These include typographical errors in section 157.35(d) (references to sections 258.4(a)(1) and (3) should be to sections 358.4(a)(1) and (3)), Order No. 2005, P 74 (should cite to §§ 358.5(d) and 358.4(e)(3) rather than §§ 358.4(d) and 358.(b)(e)(3)); section 157.34(c)(9) ("proscribed" should be changed to "prescribed"); and section 157.33(b) ("terms, rates, terms and conditions" should be changed to "duration, rates, terms and conditions"). The North Slope Producers also suggest that the term "rate amounts" in section 157.34(c)(9) should be changed to "rates" as the latter term is more commonly used in the industry.

[34] *See, e.g.*, Order No. 2005 at P 82; section 157.37.

transportation project might provide detail regarding several expansion scenarios depending on and in response to the results of the open season. The project design review that the Commission will undertake focuses on the proposed project's ability to accommodate the capacity bid for in the open season, as well as the extent to which the project can accommodate "low-cost" expansion. All expansions will involve cost. Obviously, as recognized by virtually all stakeholders, capacity that can be gained by compression alone would typically be the lowest-cost expansion. At the other end of the spectrum would be a pipeline that has no compression-only expansion potential, necessitating the need for looping in the first instance. The operative word in connection with any "low-cost" standard in section 157.37, is the *extent* of the design's expandability, and that standard is not tied to the cost impact of a given expansion. Consequently we will not clarify section 157.37 as requested by Enbridge.

111. ChevronTexaco claims that the Final Rule contains a conflict about how the contract term might be used by the prospective applicant in establishing its methodologies for the evaluation of bids and the allocation of capacity due to oversubscription, should that be necessary. It states that this confusion is caused because contract term is not mentioned in section 157.34(c)(14) regarding evaluation of bids, but is mentioned in section 157.34(c)(15) regarding allocation of capacity due to oversubscription. ChevronTexaco also complains that the Commission's stated intention to rely on after the fact enforcement of issues that might be caused by unusual contract terms, rather than set a cap on contract term for the purpose of bidding and allocation review methodologies, does not satisfy ANGPA's mandate that the Commission's open season rules are fully prescriptive. ChevronTexaco requests that the Commission clarify the open season regulations to require that open season notices to include a cap on the contract term for capacity bids.

112. First, our intention to rely on after-the-fact enforcement of open season issues that might be caused by unusual contract terms, or by any other aspect of the open season process that is not specifically enumerated in the open season regulations, completely satisfies the intent of Congress as stated in ANGPA. Moreover, as explained in Order No. 2005, it is consistent with our existing policy. However, we do agree that the discrepancy in language between section 157.34(c)(14) and section 157.34(c)(15) should be clarified to provide consistency between the methodologies for the evaluation of bids and the allocation of capacity due to oversubscription. To be consistent and avoid confusion, we will delete the phrase "including price and contract term" from section 157.34(c)(15). Furthermore, we will look carefully at this issue in our review of any open season plan and notice under section 157.38.

113. ChevronTexaco claims that the only way to assure that an open season was conducted fairly and in accordance with the open season rules is by making the precedent agreements publicly available. Therefore, ChevronTexaco objects to the provision in section 157.34(d)(4) which provides that all precedent agreements and correspondence with bidders who were not allocated capacity must be filed with the Commission, but that they may be filed under a request for confidential treatment pursuant to section 388.112 of the Commission's regulations. ChevronTexaco claims that since precedent agreements will become agreements that will appear in a pro forma tariff or an effective tariff, there is little chance that the information in the precedent agreements should be confidential for any prolonged period of time, or that any of the information would fall under a Freedom of Information Act exemption. ChevronTexaco states that the precedent agreements could be filed in a public and non-public version in the event parts of the agreements do contain protected information.

114. We deny ChevronTexaco's request. Under section 388.112 of the Commission's regulations, any person submitting a document to the Commission may request privileged treatment by claiming that some or all other information is exempt from the Freedom of Information Act's disclosure requirements. We are nor conferring any special confidential status to the agreements. The party requesting privileged treatment must support that claim. It may be, as ChevronTexaco claims, that precedent agreements are not likely to be exempt from disclosure. Neither section 157.35(d)(4) nor section 388.112 predetermines whether privileged treatment will be granted.

Document Availability

115. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page (http://www.ferc.gov) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington D.C. 20426.

116. From FERC's Home Page on the Internet, this information is available in the Federal Energy Regulatory Records Information System (FERRIS). The full text of this document is available on FERRIS in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in FERRIS, type the docket number excluding the last three digits of this document in the docket number field.

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Effective Date

118. These regulations are effective as of the date of publication in the FEDERAL REGISTER.

List of subjects in 18 CFR Part 157

Administrative practice and procedure; natural gas; reporting and recordkeeping requirements

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

In consideration of the foregoing, the Commission amends Part 157, Chapter I, Title 18, Code of Federal Regulations, as follows.

PART 157 - APPLICATIONS FOR CERTIFICTES OF PUBLIC CONVENIENCE AND NECESSITY AND FOR ORDERS PERMITTING AND APPROVING ABANDONMENT UNDER SECTION 7 OF THE NATURAL GAS ACT

1. The authority citation for Part 157 continues to read as follows:

AUTHORITY: 15 U.S.C. §§ 717 -717w.

SUBPART B – OPEN SEASONS FOR ALASKA NATURAL GAS TRANSPORTION PROJECTS

2. In section § 157.33, paragraph (b) is revised to read as follows:

§ 157.33 Requirements for Open Seasons.

(a) * * *

(b) Initial capacity on a proposed Alaska natural gas transportation project may be acquired prior to an open season through pre-subscription agreements, provided that in any open season as required in (a) above, capacity is offered to all prospective bidders at the same rates and on the same terms and conditions as contained in the pre-subscription agreements. All pre-subscription agreements shall be made public by posting on Internet websites and press releases within ten days of their execution. In the event there is more than one such agreement, all prospective bidders shall be allowed the option of selecting among the several agreements all of the rates, terms and conditions contained in any one such agreement.

3. In section 157.34, paragraphs (a), (c)(9), (c)(15) and (c)(18), and (d)(2) are revised to read as follows:

§ 157.34 Notice of open season.

(a) Notice. A prospective applicant must provide reasonable public notice of an open season through methods including postings on Internet websites, press releases, direct mail solicitations, and other advertising. In addition, a prospective applicant must provide actual notice of an open season to the State of Alaska and to the Federal

In consideration of the foregoing, the Commission amends Part 157, Chapter I, Title 18, Code of Federal Regulations, as follows.

PART 157 - APPLICATIONS FOR CERTIFICTES OF PUBLIC CONVENIENCE AND NECESSITY AND FOR ORDERS PERMITTING AND APPROVING ABANDONMENT UNDER SECTION 7 OF THE NATURAL GAS ACT

1. The authority citation for Part 157 continues to read as follows:

AUTHORITY: 15 U.S.C. §§ 717 -717w.

SUBPART B – OPEN SEASONS FOR ALASKA NATURAL GAS TRANSPORTION PROJECTS

2. In section § 157.33, paragraph (b) is revised to read as follows:

§ 157.33 Requirements for Open Seasons.

(a) * * *

(b) Initial capacity on a proposed Alaska natural gas transportation project may be acquired prior to an open season through pre-subscription agreements, provided that in any open season as required in (a) above, capacity is offered to all prospective bidders at the same rates and on the same terms and conditions as contained in the pre-subscription agreements. All pre-subscription agreements shall be made public by posting on Internet websites and press releases within ten days of their execution. In the event there is more than one such agreement, all prospective bidders shall be allowed the option of selecting among the several agreements all of the rates, terms and conditions contained in any one such agreement.

3. In section 157.34, paragraphs (a), (c)(9), (c)(15) and (c)(18), and (d)(2) are revised to read as follows:

§ 157.34 Notice of open season.

(a) Notice. A prospective applicant must provide reasonable public notice of an open season through methods including postings on Internet websites, press releases, direct mail solicitations, and other advertising. In addition, a prospective applicant must provide actual notice of an open season to the State of Alaska and to the Federal

Coordinator for Alaska Natural Gas Transportation Projects.

* * * * * * * *

(c) * * *

(9) Negotiated rate and other rate options under consideration, including any rates and terms of any precedent agreements with prospective anchor shippers that have been negotiated or agreed to outside of the open season process prescribed herein;

* * * * * * * *

(15) The methodology by which capacity will be awarded, in the case of over-subscription, clearly stating all terms that will be considered, except that if any capacity is acquired through pre-subscription agreements as provided in §157.33(b) above and the prospective applicant does not redesign the project to accommodate all capacity requests, only that capacity that was acquired through pre-subscription or was bid in the open season on the same rates, terms, and conditions as any one of the pre-subscription agreements shall be allocated on a pro rata basis and no other capacity acquired through the open season shall be allocated.

* * * * * * * *

(18) All information that the prospective applicant has in its possession pertaining to the proposed service to be offered, projected pipeline capacity and design, proposed tariff provisions, and cost projections, or that the prospective applicant has made available to, or obtained from, any potential shipper, including any affiliates of the project sponsor and any shippers with pre-subscribed capacity, prior to the issuance of the public notice of open season;

* * * * * * * *

(d) * * *

(2) A prospective applicant must consider any bids tendered after the expiration of the open season by qualifying bidders and may reject them only if they cannot be accommodated due to economic, engineering, design, capacity or operational constraints, or accommodating the request would otherwise adversely impact the timely development of the project, and a detailed explanation must accompany the rejection. Any bids tendered after the expiration of the open season must contain a good faith showing, including a statement of the circumstances which prevented the late bidder from

tendering a timely bid and how those circumstances have changed. If a prospective applicant determines at any time that, based on the criteria stated above, no further late bids for capacity can be accommodated, it may request Commission approval to summarily reject any further requests.

* * * * * * * *

4. In section 157.35, paragraph (c) is revised to read as follows and paragraph (d), the word "258.4(a)(1)" is removed and the word "358.4(a)(1)" is inserted in its place.

§ 157.35 Undue Discrimination or Preference.

(a) * * *

(b) * * *

(c) Each prospective applicant conducting an open season under this subpart must function independent of the other divisions of the prospective applicant as well as the prospective applicant's Marketing and Energy affiliates as those terms are defined in §§ 358.3(d) and (k) of the Commission's regulations. In instances in which the prospective applicant is not an entity created specifically to conduct an open season under this Subpart, the prospective applicant must create or designate a unit or division to conduct the open season that must function independent of the other divisions of the project applicant as well as the project applicant's Marketing and Energy affiliates as those terms are defined in sections 358.3(d) and (k) of the Commission's regulations.

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5. Section 157.36 is revised to read as follows:

§ 157.36 Open seasons for expansions.

Any open season for capacity exceeding the initial capacity of an Alaska natural gas transportation project must provide the opportunity for the transportation of gas other than Prudhoe Bay or Point Thomson production. In considering a proposed voluntary expansion of an Alaska natural gas pipeline project, the Commission will consider the extent to which the expansion will be utilized by shippers other than those who are the initial shippers on the project and, in order to promote competition and open access to the project, may require design changes to ensure that some portion of the expansion capacity be allocated to new shippers willing to sign long-term firm transportation contracts, including shippers seeking to transport natural gas from areas other than Prudhoe Bay and Point Thomson.

6. Section 157.38 is revised to read as follows:

§ 157.38 Pre-Approval Procedures.

No later than 90 days prior to providing the notice of open season required by section 157.34(a), a prospective applicant must file, for Commission approval, a detailed plan for conducting an open season in conformance with these regulations. The prospective applicant's plan shall include the proposed notice of open season. Upon receipt of a request for such a determination, the Secretary of the Commission shall issue a notice of the request, which will then be published in the Federal Register. The notice shall establish a date on which comments from interested persons are due and a date, which shall be within 60 days of receipt of the prospective applicant's request unless otherwise directed by the Commission, by which the Commission will act on the proposed plan.