UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

In the Matter of

Docket No. __-_______

The State of Alaska

PETITION OF THE STATE OF ALASKA
FOR EXPEDITED GRANT OF LIMITED WAIVER

Pursuant to Rule 207(a)(5) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission"), and Section 103(h)(1) of the Alaska Natural Gas Pipeline Act of 2004 ("ANGPA"), the State of Alaska ("State") petitions the Commission for the grant of a limited waiver of its capacity release regulations and related rules. The requested waiver will help effectuate, in a manner that does not put commercial risk on shippers or their producer affiliates who hold State leases ("Producers/Shippers"), the State's right under oil and gas production leases to elect periodically to receive its natural gas royalties either in kind ("RIK") or in value ("RIV"). A portion of the State's royalty gas would likely be used to serve local consumption needs within Alaska, as contemplated by ANGPA. A limited waiver is needed in these unique, Alaska-specific circumstances so the State can obtain released capacity to transport its royalty gas, while helping to eliminate the associated risk of stranded capacity for the Producer/Shippers that will continue to hold the firm capacity when the State elects the RIV option. The requested waiver will apply to any Alaska gas pipeline system the Commission ultimately authorizes ("Alaska Gas Pipeline Project"). By granting this Petition, the Commission will help advance the Alaska Gas Pipeline Project, consistent with the determination of Congress that the Project is in the national interest.

IDENTITY OF PETITIONER

Petitioner is the State of Alaska ("State").

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EXECUTIVE SUMMARY

With two projects now in the Commission's pre-filing process, significant progress has been made toward the goal of successfully developing the Alaska Gas Pipeline Project. This Petition presents the Commission with a unique opportunity to build on that progress by issuing a limited waiver of its capacity release regulations as they apply to the Alaska Gas Pipeline Project.

The need for a waiver is straight-forward yet unique to the Alaska Gas Pipeline Project. The State has leased to various producers the right to produce natural gas from the prolific natural gas reserves on the North Slope of Alaska. Under those leases, the State has the right to take its royalties either in kind ("RIK"), where the State would receive a portion of the gas produced that would then need to be shipped by the State through the pipeline, or in value ("RIV"), where the State would receive a monetary payment based on the market value of a portion of the gas produced and shipped by the Producer/Shippers through the pipeline. In the event the State elects the RIK option, it would likely be for the purpose of using RIK gas to serve in-state needs by shipping the gas through the pipeline to delivery points located in Alaska (although the State may choose periodically to sell the gas at other delivery points). Under the terms of its oil and gas leases with the producers, the State also has the right, and may exercise that right, to switch back and forth between the RIK and RIV options from time to time, depending on the need to supply local Alaska gas demands and other factors.

The purpose of this requested waiver is to ensure that the necessary transportation capacity "follows" the royalty gas. During periods in which the State elects the RIK option, it will need to transport its RIK gas on the Alaska Gas Pipeline Project. Some parties may prefer the State to contract for firm capacity directly with the pipeline, and nothing in this Petition precludes that outcome. However, the State currently anticipates the initial Producer/Shippers will hold all or most of the initial capacity of the Alaska system, including capacity needed to transport volumes that are equivalent to the royalty share of the produced natural gas, and at negotiated rates that differ from the recourse rate. When the State elects the RIV option, the Producer/Shipper would be responsible for holding capacity sufficient to transport these royalty volumes. However, when the State elects the RIK option, the Producer/Shipper will not need the portion of its capacity associated with the royalty gas. During those periods when the State elects the RIK option, it will benefit each of the Producer/Shippers to permit them to enter into a pre-arranged capacity release to the State of the capacity necessary to transport the RIK volumes.[1] The capacity would revert back to the affected Producer/Shipper when the State switches back to the RIV option.

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[1] The State notes, however, that nothing in this proposed limited waiver, or in the State's leases, compels producers to enter into such a pre-arranged deal. The State seeks a waiver so that it may make a

For the reasons discussed later in this Petition, the Commission's current capacity release regulations do not appear to permit this type of release on a pre-arranged basis without posting and bidding. Absent a waiver of those regulations to permit a pre-arranged release not subject to posting and bidding, the Producer/Shippers on the pipeline would bear a significant risk of stranded capacity. Specifically, to the extent the State can obtain capacity for its RIK volumes by turning to alternative sources of capacity, including interruptible transportation, releases from other shippers, or an expansion, a Producer/Shipper will be exposed to the risk it will be left with stranded royalty gas capacity that the Producer/Shipper will otherwise need when the State elects RIV. Given the massive financial scope of the Alaska pipeline project and the large reservation charges that a firm capacity commitment entails -- total reservation charges for capacity allocable to RIK gas could top $6 billion over a 25-year period -- this stranded capacity risk threatens to dissuade potential bidders participating in any open season to be held pursuant to the Commission's regulations[2] or, at least, to condition their open season bids on the satisfactory resolution of this issue.

To enable the State to eliminate the Producer/Shippers' risk of stranded capacity arising from the State's RIK/RIV switching option, the State requests a waiver of the Commission's regulations to allow the State to obtain, on a pre-arranged basis, capacity temporarily released by the Producer/Shipper that produced the RIK gas, without requiring the capacity to be posted for bidding by third-parties.[3] The release would be at the same rate the Producer/Shipper pays the pipeline. The requested waiver will apply when the State's lessees, in their posture as firm

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commercial offer to the lessees that reduces the stranded capacity risk that they would otherwise face.

[2] *See* 18 C.F.R. § 157.33(a).

[3] *See* 18 C.F.R. § 284.8. The posting and bidding requirements appear in subsections (c) through (e) of Section 284.8.

shippers on the Alaska system, temporarily release capacity to the State to the extent necessary to transport RIK gas when the State so elects. The releases will likely occur intermittently throughout the term of the initial Producer/Shippers' firm contracts, with the capacity reverting back to the Producer/Shippers when the State elects the RIV option.

The waiver should, at a minimum, apply to any capacity release to the State for RIK gas by any Producer/Shipper that obtains its capacity in the initial open seasons to be held by the projects now undergoing the pre-filing process or by pre-subscription. However, the Commission will best serve ANGPA's policies if the waiver extends to releases of capacity for the State's RIK volumes under any firm transportation contract on the Alaska Gas Pipeline Project, including expansions of that system, held by a shipper that produces gas under a lease with the State that permits switching between RIK and RIV. Furthermore, the waiver should apply to either system that is now in the Commission's pre-filing procedures, or to any other Alaska project that may ultimately be built, including any pipeline capacity associated with a liquefied natural gas ("LNG") project. In addition, and as discussed later, the waiver should also apply to capacity releases from the State to the affected Producer/Shipper, in the unlikely event the State acquires short-haul capacity directly from the pipeline in the open season to ship its RIK gas for in-state needs and then subsequently elects the RIV option.[4]

For the reasons discussed in this Petition, prompt Commission action is essential. Accordingly, the State requests the Commission to grant this Petition within 75 days from the date the Commission issues notice of the Petition to ensure the waiver is in place prior to the

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4 However, because it is unlikely the State will acquire capacity in the open season given commercial realities, for ease of discussion the text of this waiver request largely focuses on the more likely scenario, *i.e.*, a release of capacity from the Producer/Shipper to the State.

time the Commission receives "a detailed plan for conducting an open season" as contemplated by the Commission's regulations.[5]

In summary, granting this Petition will help the prospects for the Alaska Gas Pipeline Project and any upcoming open seasons, and is necessary to eliminate a significant risk associated with making a firm transportation commitment. A waiver is also consistent with ANGPA's determination that this unique project is in the national interest.[6] In addition, granting the requested waiver will be consistent with prior waivers granted by the Commission and implement the specific authority ANGPA granted the Commission to remove regulatory barriers when necessary to permit the State to meet the needs of natural gas consumers within Alaska with the State's royalty gas.[7] Finally, it is important to note that other issues Producer/Shippers may have with the State's fiscal and royalty system can be dealt with separately by the State, if the Producer/Shippers demonstrate a convincing need for any changes; however, the existence of any such issues does not provide any barrier to or detract from the ultimate need for granting the requested waiver.

BACKGROUND

A. Alaska Natural Gas Pipeline Act

Considerable progress has been made in recent years to develop an Alaska natural gas pipeline project to the U.S. market. In 2004, Congress passed the Alaska Natural Gas Pipeline Act ("ANGPA"). In ANGPA, Congress took the unique and important step of declaring an

5 *See* 18 C.F.R. § 157.38.

6 *See* Section 103(b)(2) of ANGPA, 15 U.S.C. § 720a(b)(2) (in acting on an application for a certificate for the Alaska gas pipeline project, the Commission shall presume that public need for the proposal exists).

7 *See* Section 103(h)(1) of ANGPA, 15 U.S.C. § 720a(h).

Alaska natural gas pipeline project to be in the national interest.[8] Consistent with that determination, ANGPA includes several provisions intended to help advance the project, including an expedited timeline for issuance of necessary federal authorizations, appointment of a federal coordinator to help manage the expedited federal agency review of the project, and federal loan guarantees.

In addition, ANGPA includes a provision that specifically addresses the issue of the State's royalty gas and in-state needs within Alaska. Section 103(h)(1) of ANGPA states that, so long as the rates of existing shippers are not increased as a result, the Commission, after a request by the State, may "*provide for reasonable access to the Alaska natural gas transportation project by the State (or State designee) for the transportation of royalty gas of the State for the purpose of meeting local consumption needs within the State*."[9]

B. Progress Towards an Alaska Natural Gas Transportation System

Following the passage of ANGPA, there have been at least four major developments concerning the Alaska Gas Pipeline Project. First, in 2007 the State passed the Alaska Gasline Inducement Act ("AGIA"), Alaska Stat. §§ 43.90.010, *et seq.*, to encourage a project to file for a FERC certificate. Under AGIA, the State can award a qualified project sponsor an exclusive and enforceable license.[10] The AGIA licensee is thus entitled to, among other things, matching contributions from the State of up to $500 million for expenditures during the planning and preparation of a FERC certificate application and related permits for the construction of the Project.[11] In exchange, the licensee must agree to various State requirements, including several

8 *See* ANGPA Sec. 114, 15 U.S.C. § 720*l*.

9 15 U.S.C. § 720a(h)(1) (emphasis added).

10 *See id.* § 43.90.190.

11 *See id.* § 43.90.110(1).

intended to maximize the exploration and development of the North Slope (which also is one of the goals of ANGPA).[12] The licensee also has the obligation to apply to the Commission for a certificate of public convenience and necessity by a date certain and without regard to the outcome of the initial open season the licensee will hold.[13]

Second, in November 2007, TransCanada Alaska Company, LLC and Foothills Pipe Lines, Ltd., affiliates of TransCanada Corporation (jointly "TransCanada"), submitted an application for the AGIA license. TransCanada has committed to seek Commission authorization, and related authorizations, to construct a pipeline with a capacity of up to 4.5 Bcf/day from the North Slope to Alberta, or a 3 Bcf/day project to a projected LNG terminal in Valdez, depending on market support. In 2008, the State issued the AGIA license to TransCanada.[14]

Third, in March 2008, following the passage of AGIA and the submission by TransCanada of its AGIA application, two of the major North Slope leaseholders, BP and ConocoPhillips, formed the Denali partnership. Denali proposes to construct a natural gas pipeline with a capacity of up to 4.0 Bcf/day from the North Slope to Alberta. Denali has initiated the FERC pre-filing process and has stated that it intends to initiate an open season by the end of 2010.[15]

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12 *See, e.g., id.* § 43.90.130(5)-(7), (10)-(13). *Cf* ANGPA section 103(e)(2)(B) (which, similar to AGIA, requires regulations that "promote competition in the exploration, development, and production of Alaska natural gas").

13 *See* Alaska Stat. § 43.90.130(4)(B).

14 *See Written Findings and Determination by the Commissioners of Natural Resources and Revenue for Issuance of a License under the Alaska Gasline Inducement Act (AGIA)* ("AGIA Findings") (May 27, 2008).

15 *See Denali-Alaska Gas Pipeline, LLC*, Docket No. PF08-26, June 25, 2008 (letter of Director, Office of Energy Projects, FERC, granting approval of request to use pre-filing process for proposed Alaska gas transportation system).

Fourth, in June 2009, TransCanada and ExxonMobil, the largest holder of discovered North Slope natural gas reserves, announced they reached agreement to jointly advance the AGIA pipeline project.[16] TransCanada, which has also initiated the FERC pre-filing process,[17] plans to file its open season plan with the Commission by February 1, 2010, and, assuming timely Commission approval of that plan, hold an open season that will conclude by July 31, 2010.[18] TransCanada has committed under AGIA to apply for a FERC certificate by a date certain (October 2012), regardless of the outcome of the initial open season.

Pertinent to the instant Petition for a waiver, AGIA also provides that the State will issue regulations that provide certainty on the RIK/RIV switching issue to any producer that commits to a binding firm transportation contract in the first open season of the AGIA gas pipeline project. Specifically, AGIA provides that, prior to the start of the first binding open season to be conducted by the AGIA licensee, the State shall adopt regulations that "establish terms under which the state will exercise its right to switch between taking its royalty in value or in kind for gas committed for firm transportation in the first binding open season of the project . . . ."[19] The regulations must ensure the State's actions "do not unreasonably (A) cause the lessee or other person to bear disproportionate transportation costs with respect to the state's royalty gas; [or] (B) interfere with the lessee's or other person's long-term marketing of its production."[20]

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16 TransCanada News Release, *TransCanada and ExxonMobil to Work Together on Alaska Pipeline Project* (June 11, 2009) ("June 11 TransCanada News Release").

17 *See TransCanada Alaska Company LLC*, Docket No. PF09-11, May 1, 2009 (letter of Director, Office of Energy Projects, FERC, granting approval of request to use pre-filing process for proposed Alaska gas transportation system).

18 June 11, 2009 TransCanada News Release.

19 Alaska Stat. § 43.90.310(a).

20 *Id.* § 43.90.310(a)(3)(A) & (B). The waiver requested in this Petition will complement the State's AGIA royalty regulations and eliminate the stranded capacity risk stemming from the State's right to elect RIK that Producer/Shippers will otherwise bear. This, in turn, will improve the prospects that the open season process will reach a successful conclusion. Because AGIA requires the State to promulgate these

C. Royalty Issues That Implicate the Commission's Capacity Release Rules

The North Slope of Alaska, including areas in addition to Prudhoe Bay and Point Thomson, is a major potential source of supply for the U.S. market, with estimated economically recoverable natural gas reserves of approximately 137 trillion cubic feet.[21] Known North Slope reserves in existing fields total around 35 trillion cubic feet; these reserves will anchor the pipeline system that ANGPA contemplates.

The State has leased the right to explore for and produce natural gas from State-owned land to oil and gas companies, including ExxonMobil, BP and ConocoPhillips. In exchange, the State is entitled to a royalty percentage of production. By virtue of its royalty interests, the State is among the largest holders of the natural gas reserves that will be transported on any project contemplated by Section 103(b) of ANGPA.[22] Under these leases, the State has the right to take its royalty gas in two ways, either in kind, where the State will receive a portion of the gas produced, or in value, where the State will collect a monetary payment based on the market value of a portion of the gas produced. The State's royalty share, under either the RIK option or the RIV option, is typically 12.5 percent. This share, however, varies depending on the property involved.

In the event the State elects the RIK option, it can elect to sell the royalty gas for delivery to points outside of Alaska. However, the principal reason for an RIK election would likely be so that the State can use a portion of its RIK gas to serve in-state needs.[23] Ensuring the adequacy of natural gas supplies for local consumption is an issue of paramount importance to the State.

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regulations no later than the beginning of the first binding open season to be held by the TransCanada project, *see id.* § 43.90.310(a), time is of the essence.

21 AGIA Findings at 3-40 to -41.

22 15 U.S.C. § 720a(b).

23 The State has from time to time taken its royalty oil in kind; it has used essentially all such RIK

It is anticipated that, to obtain financing, the Alaska Gas Pipeline Project will be fully subscribed (or largely so) at the time it goes into service by the North Slope producers, including affiliates of ExxonMobil, BP and ConocoPhillips, and potentially other producers and explorers. (It is possible, but unlikely, that the State would decide to subscribe for a portion of the project's initial capacity to transport its RIK gas.) Thus, if at some point the State exercises its right to switch from the RIV option to the RIK option (thus receiving its gas in kind), the State will need to obtain capacity for its RIK volumes.

The State's exercise of its right to switch from one method to the other will create an issue concerning the release of transportation capacity on the Alaska Gas Pipeline Project. If the State elects the RIK option, it will need transportation capacity on the pipeline to ship its gas to market. To obtain capacity, the State would have several options. First, the State could obtain released capacity from the Producer/Shipper that would be providing the RIK gas to the State, preferably on a pre-arranged, non-biddable basis, provided the State can do so in a manner consistent with the Commission's capacity release regulations. Second, the State could obtain released capacity from some other Producer/Shipper, to the extent capacity from that Producer/Shipper is available. Third, the State could rely on interruptible transportation.[24] Fourth, the State could obtain expansion capacity or, in lieu of an expansion, acquire turnback capacity from existing shippers through a reverse open season where existing shippers would be given the opportunity to shed capacity.[25]

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oil to provide for in-state refined product needs.

24 It is likely that interruptible service would be available, because when the State elects RIK the shippers that were responsible for shipping RIV volumes would now have capacity to move royalty gas that they no longer need during the period of the RIK election.

25 The State thus has several options to secure the necessary capacity. Absent the requested waiver, the State would pursue these avenues. A Producer/Shipper thus cannot count on a continuous or effectively permanent RIV election by the State. Accordingly, regardless of whether the State can

For the reasons discussed below, the first option -- obtaining a pre-arranged, non-biddable release of capacity from the Producer/Shipper that would be providing the royalty gas -- is the option that is in the best interests of all parties impacted by the State's RIK/RIV switching, including consumers within and outside of Alaska, Producer/Shippers, and the State.

DISCUSSION

A. A Pre-Arranged, Non-Biddable Capacity Release Is the Best Option for all Parties To Effectuate the State's RIK Election.

The optimal, most efficient arrangement to address the State's need to ship its RIK gas is for the State, as replacement shipper, to secure the needed capacity from the Producer/Shipper that is impacted by the State's RIK election. Under this scenario, the capacity for State royalty volumes would simply "go with the gas." Although the State has other options by which to obtain capacity to ship its RIK gas, those options pose substantial risks for parties contemplating making commitments to acquire firm transportation. As explained below, if the State were forced to rely on such options, they could place additional significant obstacles in the path of the Alaska Gas Pipeline Project.

Initially, it is important to recall the unique character and massive scope of the Alaska Gas Pipeline Project. Although production costs for the project's anchor fields (particularly Prudhoe Bay) are low relative to many other natural gas sources (including shale gas), project cost estimates for a pipeline from the North Slope to the AECO Hub in Alberta range from approximately $26 billion to in excess of $40 billion.[26] Correspondingly, a shipper's decision to

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reliably secure the needed transportation service by capacity release as contemplated in this Petition, the Producer/Shippers cannot sell the royalty-related portion of their production on a long-term basis to purchasers in Alberta or elsewhere. In other words, granting the State the relief that this petition requests will not diminish the value of the royalty-related portion of the producers' gas.

[26] AGIA Findings at 3-52, Appendix F, Exhibit D, at 7. The costs of an Alaska LNG project would be even greater. *See* AGIA Findings at Ch. 4.

reserve firm capacity will require a substantial financial commitment. The proposals currently contemplate a system capacity from 4.0 to 4.5 Bcf/day. With only three major initial shippers, each Producer/Shipper will likely hold more than 1.0 Bcf/day of capacity.[27]

The risks associated with these commitments will be unnecessarily increased if the State is forced to obtain capacity for its RIK volumes by acquiring capacity from some party other than the Producer/Shipper that holds the firm capacity for the production that includes the royalty volumes. During periods when the State elects the RIV option, the Producer/Shipper will need all of its capacity because, in that scenario, the State has not elected to take its royalty in kind, and the Producer/Shipper will ship the RIV gas using its own capacity. However, when the State elects the RIK option, the Producer/Shipper will not need the portion of its contracted capacity associated with the RIK volumes. It would reduce a shipper's risk to allow that shipper to temporarily release that capacity to the State, thus allowing the capacity to "go with the gas". If the State were to elect to take RIK and, for the purpose of moving its RIK volumes, acquire interruptible transportation, released capacity from some other shipper, or capacity from a pipeline expansion, then the Producer/Shipper from which the State took its RIK volumes would be left holding a portion of its capacity that would essentially be stranded for an uncertain period of time. This would effectively force the Producer/Shipper to pay stranded demand charges on at least one-eighth of its capacity, in the typical case, until the State switches back to RIV.

The potential cost of stranded capacity associated with this issue is substantial. One estimate, using currently projected data, is that the value of pipeline capacity allocable to a 12.5 percent RIK share tops $6 billion.[28] Thus, the potential cost of stranded capacity associated with

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27 Alternatively, the producers could sell gas at the wellhead to other purchasers who hold capacity, such as a marketer.

28 This calculation assumes a $1.21 per Dth rate over a contract term of 25 years on a 4.5 Bcf/day

RIK volumes poses a significant risk, unique particularly when one considers that the primary term of a firm transportation contract on this project is likely to be in the range of 20-25 years.[29]

B. The Need for a Waiver To Effectuate a Pre-Arranged RIK Capacity Release Under the Commission's Capacity Release Regulations

Under the Commission's capacity release regulations, an entity that wishes to release firm capacity generally must post the capacity for competitive bidding by potential replacement shippers, subject to several limited exceptions. The exceptions to the posting and bidding requirements for capacity release are as follows:

(i) A release of capacity to an asset manager as defined in the regulations;

(ii) A release of capacity to a marketer participating in a state-regulated retail access program as defined in the regulations;

(iii) A release for more than one year at the maximum tariff rate; and

(iv) A release for any period of 31 days or less.[30]

None of these exceptions will reliably encompass a pre-arranged release of capacity from the Producer/Shipper to the State for the purpose of transporting RIK volumes when the State so elects. Put another way, none of these exceptions is a vehicle for ensuring that, when the State elects RIK, the capacity will "follow the gas."

First, while the State's RIK election bears some resemblance to an asset management agreement ("AMA"), there also appear to be certain technical and definitional differences. For example, if the State were to attempt to qualify as an "asset manager" under an AMA, the

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system. This calculation does not include costs for the gas treatment plant (including any facilities upstream of the plant) or for any facilities downstream of the Alaska-Canada border.

[29] The State does not believe a similar waiver is needed for the Canadian portion of any Alaska gas pipeline, but plans to work with shippers on a contractual solution to mitigate the risk of stranded capacity associated with RIK/RIV switching on that portion of the project as well.

[30] 18 C.F.R. § 284.8(h)(1) (2009).

regulations require that the State stand ready to "purchase" from the releasing Producer/Shipper, for defined minimum periods, a quantity of gas equal to the daily contract demand of the released capacity.[31] Here, as the lessor, the State actually owns the royalty gas that it would have transported with the released capacity, and thus would not and could not "purchase" the gas from the Producer/Shipper.[32] Thus, the AMA exception to the capacity release rules does not appear to be a feasible means for the State to ship RIK gas.

Second, at this juncture, the RIK-related capacity releases will not occur in connection with a state-regulated retail access program even though it is likely that some of the RIK gas could be used for in-State retail gas markets. Thus, that exception to the capacity release rules offers no avenue to the State.

Third, some of the RIK-related capacity releases will likely be for a term of one year or less, and at a rate either below or above the maximum recourse rate, depending on the terms of the Producer/Shipper's negotiated rate agreement with the pipeline and the timing of the RIK election. It is anticipated that, similar to other new gas pipeline projects, all of the initial firm transportation agreements on the Alaska Gas Pipeline Project will likely be negotiated rate agreements that are initially lower than the maximum recourse rate. Thus, it is unlikely that the exception for capacity releases of more than one year at the maximum tariff rate will apply.[33]

Fourth, some of the RIK-related releases will likely be for a term greater than 31 days, making this exception inapplicable as well.[34]

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31 *See id.* § 284.8(h)(3).

32 *See Jicarilla Apache Tribe v. FERC,* 578 F.2d 289, 292 (10th Cir. 1978).

33 *See* 18 C.F.R. § 284.8(h)(1)(iii). In the event the shipper is paying a negotiated rate higher than the maximum recourse rate (which may be the case at certain times), the State also is seeking a waiver of the maximum rate ceiling to permit the State to pay the same rate the shipper must pay to the pipeline under its contract.

34 *See id.* § 284.8(h)(1)(iv).

Accordingly, absent a waiver of these capacity release regulations, the State and a Producer/Shipper will be prohibited from entering into a pre-arranged capacity release by the shipper to the State for the transportation of royalty volumes that is not subject to bidding by other parties, even if the release is at the same rate set forth in the shipper's firm contract with the pipeline. The State is thus seeking a waiver of the posting and bidding requirements of the Commission's regulations to the extent those requirements would otherwise prevent a pre-arranged non-biddable temporary release of capacity from the Producer/Shipper to the State for the purpose of transporting RIK gas produced by that Producer/Shipper.

Of course, neither the waiver itself nor the State's leases compel any "deal" between the State and a Producer/Shipper concerning a pre-arranged capacity release. However, a waiver is a necessary condition for the State and its lessees to arrive at an equitable agreement for cost responsibility associated with capacity for moving State royalty gas. Assuming that the State and its lessees reach a commercial accommodation, this waiver would apply when the State elects RIK, which will likely occur at various times during the term of each affected Producer/Shipper's firm contract. Similarly, should the State "re-elect" the RIV option, then the temporarily released capacity would, of course, revert back to the original shipper so that the shipper has sufficient capacity to transport the RIV volumes.

The State is not requesting the Commission to extend the proposed waiver to marketers or other sellers of gas that may hold capacity on the Alaska system and will not transport gas from leases with the State that provide for the switching option between RIK and RIV. Because these parties will not face the risk of stranded capacity stemming from the RIK election, they are not similarly situated with the Producers/Shippers that do face that risk.

In addition, the State believes the related prohibition against "tying", which provides that a releasing Producer/Shipper cannot tie the release of its capacity to any extraneous conditions, may also apply absent a waiver. This too could hinder a straightforward commercial accommodation concerning cost responsibility for capacity associated with State royalty gas. The Commission has previously ruled that "*all* terms and conditions for capacity release must be posted and nondiscriminatory, and must relate solely to the details of acquiring transportation on the interstate pipelines. Release of pipeline capacity cannot be tied to any other conditions."[35] To effectuate a capacity release as this Petition contemplates, it will be necessary for the releasing shipper to condition its temporary release of capacity to the State on the State's agreement to use that capacity for the RIK volumes associated with the releasing Producer/Shipper's capacity; similarly, the Producer/Shipper would need to agree reciprocally to take back the released capacity upon the State's election to take RIV. The State is willing to agree to this condition, to lessen the burden of RIK/RIV switching and the risk of stranded RIK capacity on the releasing Producer/Shipper. However, to the extent such a condition by the Producer/Shipper constitutes the tying of the release to "extraneous conditions", the parties will need (and the State hereby requests) a waiver of the tying prohibition before entering into the transaction.

C. The Requested Waiver Is Consistent with ANGPA, the National Interest in Advancing an Alaska Natural Gas Pipeline Project, and FERC Precedent.

Several considerations compel the conclusion that the Commission should promptly waive its capacity release regulations, the related tying prohibition, and any other regulations and policies to the extent necessary to permit the pre-arranged release of capacity to the State for

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[35] *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636-A, 57 Fed. Reg. 36,128, 36,149 (1992) (subsequent history omitted; emphasis in original).

transportation of RIK volumes. First, a waiver will help advance a project Congress has determined is in the national interest. The importance of this unique project was recognized in the Commission's first report to Congress submitted pursuant to section 1810 of the Energy Policy Act of 2005.[36] In its first report, the Commission stated:

> Recognizing the importance of Alaska natural gas resources in meeting the rapidly rising demand for natural gas, Congress enacted ANGPA, which became law on October 13, 2004. The objective of this Act is to facilitate the timely development of an Alaska natural gas transportation project to bring Alaskan natural gas to markets in Alaska and the lower 48 states to meet increasing demand.[37]

Granting a waiver will provide greater certainty to shippers on the Alaska system by eliminating one of the risks of holding firm capacity. This should facilitate the submission of bids for firm capacity in any open season required by the Commission's regulations. The waiver will thus "facilitate the timely development of an Alaskan natural gas transportation project", consistent with Congressional intent as reflected in ANGPA. Given the unique circumstances that exist in this context, it is necessary as a practical matter for both the State and the affected Producer/Shippers to have the up-front certainty that capacity acquired for the royalty gas will be released to the State when it elects RIK.

Second, the requested waiver is consistent with the provision in ANGPA that provides for the State to obtain transportation capacity on the project to meet local consumption needs in Alaska with its royalty gas. As noted earlier, Section 103(h)(1) of ANGPA authorizes the Commission, after a request by the State and so long as the rates of existing shippers are not increased as a result, to "*provide for reasonable access to the Alaska natural gas transportation*

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[36] Pub. L. No. 109–58, 119 Stat. 594, 1126 (codified at 42 U.S.C. § 16523).

[37] *Report to Congress on Progress Made in Licensing and Constructing the Alaska Natural Gas Pipeline* at 2 (February 1, 2006) (footnote omitted). As noted earlier, ANGPA also provides that the Commission "shall presume that . . . a public need exists to construct and operate the proposed Alaska natural gas transportation project". ANGPA Section 103(b)(2)(A), 15 U.S.C. § 720a(b)(2)(A).

project by the State (or State designee) for the transportation of royalty gas of the State for the purpose of meeting local consumption needs within the State."[38] The requested waiver will carry out the intent of Congress that the State be assured of reasonable access to the project for the transportation of the State's royalty gas.

Third, the waiver requested here by the State is consistent with Commission precedent granting waivers in other situations. For example, in *North Baja Pipeline, LLC*,[39] the Commission granted a limited waiver of the posting and bidding requirements to allow a permanent transfer of firm pipeline capacity from two Mexican electric generating plants including, in one case, only a portion of the generating plant's pipeline capacity, to an American shipper. The Commission found that the waiver gave "financial certainty" to the pipeline, the releasing shippers and the replacement shipper. Also, the waiver would facilitate transportation of gas from LNG terminals in Baja California, reduce the need for pipeline construction, and help advance the development of energy infrastructure in the Southwestern United States. Lastly, granting the waiver would be consistent with a letter of intent between the Chairman of the Commission and his Mexican counterpart.[40]

The *North Baja* situation is similar in several respects to the situation here. The requested waiver will allow a transfer to the State of a portion of the Producer/Shipper's capacity at the same rate the Producer/Shipper will pay, providing a solution to the stranded capacity risk associated with RIV/RIK switching for the entire term of the firm transportation contract. Thus, the State, the Producer/Shipper, and the Alaska Gas Pipeline Project will all enjoy enhanced

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38 15 U.S.C. § 720a(h)(1) (emphasis added).

39 111 FERC ¶ 61,119 (2005).

40 *See id.* at P 6. To the same effect are *North Baja Pipeline, LLC*, 109 FERC ¶ 61,269 (2004), and *North Baja Pipeline, LLC*, 111 FERC ¶ 61,435 (2005).

financial certainty. In addition, the State's requested waiver will apply to only a portion of the Producer/Shipper's capacity – a portion equivalent to the royalty percentage during the term of the Producer/Shipper's firm transportation contract – during periods when the State elects RIK. As indicated above, it did not appear to concern the Commission that one of the waivers in *North Baja* applied to only a portion of the releasing shipper's capacity. The Commission granted that requested waiver along with the waiver that applied to the entire capacity of the releasing shipper.

Furthermore, analogous to *North Baja*, the waiver will reduce the need for additional construction of capacity to accommodate State RIK gas.[41] The waiver will also serve the Congressional purpose of facilitating the development of energy infrastructure in Alaska.

In another recent case also involving North Baja ("*North Baja II*"),[42] the Commission acted upon other requests for waivers of its posting and bidding requirements for releases, one permanent, the other temporary, to Gazprom Marketing & Trading USA, Inc. of two portions of capacity held by Shell Energy North America (US), L.P. under a 20-year, negotiated "levelized" rate contract. The Commission granted the waiver for the permanent release but denied the waiver for the temporary release. In the case of the permanent release, the Commission observed that, absent the waiver: "[B]idders could not offer to pay the existing negotiated rate for the entire term of the release because such a rate could violate the maximum rate during future periods."[43]

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41 Absent the requested waiver, recall that if the State switches from RIV to RIK, it could obtain capacity from an expansion to move RIK volumes.

42 *North Baja Pipeline, LLC*, 128 FERC ¶ 61,082 (2009).

43 *Id.* at P 14.

The temporary release stood on a different footing. According to the Commission, "[b]ecause the release is on a temporary basis, it is clear that Shell North America is not transferring capacity that it no longer needs."[44] Also, the Commission observed that "[t]he petitioners have not explained why the capacity cannot be submitted for posting and bidding, and awarded to the bidder who values it most."[45]

The concerns that gave the Commission pause with respect to the temporary release in *North Baja II* are not present in the release to the State for transportation of RIK gas. The release is ostensibly temporary in that the capacity would, whenever the State elects RIV, remain with the Producer/Shipper. Despite this, the release will have a stronger permanent character than the situation in *North Baja II* because the State's need for capacity, and the corresponding need for the Producer/Shipperto shed the capacity, will last as long as the State has the right to elect RIK, which is for the life of each lease. Perhaps more significantly, the release cannot be posted for bidding without exposing Producer/Shippers to a unique risk of stranded capacity on the Alaska project, which stems from the State's RIV/RIK switching rights. *North Baja II* is also distinguishable because posting for bidding will threaten to deprive the State of capacity necessary to transport its royalty gas which, particularly in the case of gas for in-state needs, is contrary to the Alaska-specific Congressional policy expressed in Section 103(h)(1) of ANGPA.

Furthermore, other parties that wish to acquire capacity on the Alaska system will have other alternatives. These options include expansions, other sources of released capacity, and interruptible service.

It is also worth noting that, to the extent other parties seek capacity, during the life of the project there are likely to be Producer/Shippers in subsequent years with production in new fields

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44 *Id.* at P 15.

45 *Id.*

on State land that is subject to the same RIV/RIK switching issue and stranded capacity problem discussed here. Thus, these parties, and the consumers that would benefit from the additional gas supplies they make available, are also likely to be beneficiaries of the requested waiver.

The Commission has also previously recognized the need for unique regulatory treatment of government RIK rights. For example, in 2006 the Commission approved a firm contract allowing for MMS RIK volumes to receive special negotiated rate treatment on the Rockies Express pipeline.[46] In addition, in 2000, the Commission granted a limited waiver of its "buy-sell prohibition" to participants in the MMS RIK program.[47] There, the Commission rejected a broader request by a marketer (Williams) for a declaratory order that the prohibition on buy-sell transactions did not apply to any transactions on the entire Outer Continental Shelf ("OCS"), out of a concern (not present here) that the marketer's request was anticompetitive.[48] However, the Commission found there were public benefits associated with the MMS RIK program which, according to the MMS, would promote efficient exploration and development of the OCS, reduce the cost of royalty collection, and benefit the Federal treasury. Accordingly, the Commission concluded it was appropriate to grant a waiver of its buy-sell and capacity release regulations with respect to the RIK program. The waiver was expressly limited to transactions

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[46] *Cf. Rockies Express Pipeline LLC*, 116 FERC ¶ 61,272 at 62,114, P 75 (2006) (approving non-conforming provisions in precedent agreements including an agreement with the MMS providing that if "MMS receives RIK gas from a well in which it has in-kind royalty rights from an Anchor or Foundation Shipper and that gas otherwise would have been transported under the Anchor or Foundation Shipper's [firm transportation agreement], then MMS shall receive the same rate for such RIK volumes as the corresponding Anchor or Foundation Shipper.").

[47] *Williams Energy Marketing and Trading Company,* 92 FERC ¶ 61,219 (2000). Under the MMS RIK program, MMS sought buyers for its RIK volumes at the offshore platforms who would tender equivalent volumes to the MMS at market locations on-shore. *See id.* at 61,715.

[48] The "buy-sell" prohibition related to transactions where a party buys gas on behalf of another and ships it to the ultimate buyer using the party's firm pipeline capacity and then sells the gas at the delivery end of the transaction. *See id.* at 61,720. That prohibition is not implicated by the State's exercise of its right to switch between RIV and RIK.

performed directly in connection with the MMS RIK program. It was also limited in duration (one year) inasmuch as the MMS was then seeking budget authority that would allow it to acquire capacity for transportation of RIK volumes.[49]

The policy reasons underlying the waiver in *Williams* of the buy-sell and capacity release regulations with respect to the MMS RIK program support granting the State's request for a waiver to facilitate transportation of its RIK gas volumes. Like the waiver in *Williams,* which facilitated an MMS program, the waiver requested here will directly benefit a governmental entity, and also will benefit consumers of natural gas within Alaska. Just as the waiver in *Williams* promoted exploration and development of the OCS, the waiver requested here will promote the Alaska Gas Pipeline Project and the exploration and development of the North Slope. If anything, given the Congressional determinations in ANGPA, the policy considerations in this case militate even more strongly for a waiver than in *Williams.*

The State's proposal also seeks to reduce the risks to Producer/Shippers of holding firm capacity on the Alaska Gas Pipeline Project, in a way that the MMS program did not. Unlike the MMS situation, the State is not seeking to profit from the ability to obtain less expensive interruptible capacity to transport its RIK volumes. Instead, through its willingness to obtain released firm capacity from the affected Producer/Shippers at contract rates, the State is willing to forego potential opportunities to obtain capacity at rates significantly below those of the original shippers' contracts.[50] For this reason as well, the case for a waiver here is even more compelling than in the *Williams* case.

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49 *Id.* at 61,721.

50 While the State intends to avail itself of capacity release to secure the necessary transportation service if the Commission approves this requested waiver (and thus the State will pass up capacity that may be cheaper at the time of the RIK election), the State reserves the right to participate in the upcoming open seasons and to acquire capacity in its own name for its RIK gas. At this point, however, the State believes that is unlikely.

It is also important to note that granting the proposed waiver will not diminish the ability of other market participants to obtain capacity. The State has confined its waiver request to capacity needed to transport State royalty gas. The State's lessees are in effect obligated to ensure that RIV volumes are transported and sold. If the waiver request were denied, and the State believed it could not otherwise obtain capacity from another source to transport RIK, then the State simply could elect not to take RIK and, instead, remain with RIV. However, the State's RIV election would not make any additional capacity available in the secondary market. Accordingly, the granting of the waiver for temporary release of capacity to effectuate RIK gas transportation will not diminish the capacity that would otherwise be available to other market participants. They will still be able to obtain capacity directly from the pipeline, or from other potential sources of released capacity, to the same extent as prior to the waiver.

Finally, the State would note that in several other cases, the Commission has also granted waivers of the posting and bidding requirements, and the related prohibitions on tying and exceeding the maximum rate ceiling.[51] These cases generally involved a shipper's attempt to achieve a permanent exit from the natural gas business in a rational and orderly fashion and to turn transportation capacity over to a successor at the same rate the shipper was paying under its firm contract with the pipeline.[52] The State asks for no relaxation of this policy. Because the State will pay the same rate the Producer/Shipper will pay, neither the releasing Producer/Shipper nor any other party will profit from the release. Also, although the requested

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[51] *See, e.g., Macquarie Cook Energy, LLC,* 126 FERC ¶ 61,160 (2009); *Northwest Pipeline Corp.*, 109 FERC ¶ 61,044 (2004).

[52] *See Louis Dreyfus Energy Services, L.P.*, 114 FERC ¶ 61,246, at P16 (2006) ("[T]he waivers the Commission has granted have been limited to permitting the releasing shipper to release at a rate up to the rate it was paying the pipeline; the Commission has not permitted the releasing shipper to profit from release of capacity by allowing it to release capacity at a rate higher than the rate it was paying the pipeline." (footnote omitted)).

waiver for the RIK gas volume does not involve any shipper's permanent exit from the business, the requested waiver is based on Alaska-specific reasons that mitigate the capacity risks arising from switching between RIK and RIV.

D. Scope of the Requested Waiver and Need for Prompt Action

The State believes the Commission will best serve the policies Congress set out in ANGPA if the Commission approves the requested waiver of the above-referenced regulations and policies with respect to all temporary capacity releases to the State for transporting RIK gas associated with production by any Producer/Shipper that holds firm capacity at any time on an "Alaska natural gas transportation project" as defined in Section 102(2) of ANGPA.[53] At a minimum, this waiver should apply to capacity releases to the State for transporting RIK gas by any firm shipper if the shipper acquired its capacity in a project's initial open season required by Section 157.33(a) of the Commission's regulations or by pre-subscription as contemplated by Section 157.33(b). However, Producer/Shippers that produce gas under leases with the State but acquire capacity after the initial binding open season, including after the system begins operation, will also benefit from the requested waiver if the Commission extends the waiver to them. These Producer/Shippers, if they produce gas under a lease that provides the State with RIK/RIV switching rights, also face the risk of stranded capacity if the State elects RIK. Thus, the State believes the waiver should encompass any capacity on the Alaska Gas Pipeline Project, including expansions of that system, if that capacity is allocated to production from State leases. Placing all firm shippers of production from State leases within the scope of the waiver generally improves the risk profile for the Alaska Gas Pipeline Project, and thereby improves the likelihood that it will be timely constructed.

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[53] 15 U.S.C. § 720(2). The State envisions that the waiver would apply to any project facilities that are subject to FERC's jurisdiction under ANGPA.

In addition, to provide the necessary certainty to Producer/Shippers, the waiver should apply for the full term of a Producer/Shipper's firm transportation contract. Potential Producer/Shippers will benefit from knowing that they can bid for capacity without the risk that capacity will be stranded at any time during the term of the firm contract due to the State's right to switch between RIV and RIK.

The State also requests that the waiver apply to capacity releases (as described above) to the State or to the State's designee. This would allow the State to choose to transport its RIK gas itself using the released capacity, or to sell its RIK gas at the wellhead with released capacity under this waiver going to the purchaser of the royalty gas as designated by the State. Fashioning the waiver in this manner will further the intent of ANGPA, under which the Commission may provide for reasonable access to the project by "the State (or State designee)", for the purpose of meeting local consumption needs.[54]

Likewise, the State also requests that the waiver request apply to capacity releases to the Producer/Shipper from the State for the transportation of RIK gas. The State does not currently plan to acquire short-haul firm capacity from the pipeline in the initial open season to transport its RIK gas for in-state needs, and believes that is an unlikely scenario given commercial realities. However, in the event the State decides to hold short-haul capacity for its RIK gas under a firm transportation contract with the pipeline, it would then seek to release that capacity to the affected producer during periods when the State elects to switch to RIV (subject to the producer's agreement to enter into such a release). The waiver requested here would also apply to that situation as well.

[54] 15 U.S.C. § 720a(h)(1).

Finally, there should be no "economic leakage" resulting from the State's decision to switch between RIV/RIK switching. As a result, the State seeks a waiver of the maximum rate ceiling to permit the releasing shipper to be paid consistent with the terms of its firm transportation contract with the pipeline.

Prompt Commission action on this request is essential. Given the fact that one of the Alaska Gas Pipeline Projects will file its proposed open season plan with the Commission in early 2010, and hold its open season shortly thereafter, the State urges the Commission to grant this waiver request within 75 days. The State has also briefed all the principally affected Producer/Shippers on the features of this proposal (including providing advance drafts of the waiver request), and thus believes that no more than a 30-day comment period on the proposed waiver is needed for parties to provide their views to the Commission in writing. The State would also not object if the Commission believes a rulemaking proceeding is needed to effectuate the requested relief, if a rulemaking can be completed and made effective prior to January 31, 2010.[55] However, if the Commission anticipates that a rulemaking would take longer than that to complete, then the State requests the Commission to issue the waiver first before holding a subsequent rulemaking proceeding to codify the substance of the waiver as part of its regulations.

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[55] In the rulemaking provisions of the Administrative Procedure Act, Congress expressly contemplated and provided for speedy agency action in the very circumstances that the State's petition presents. *See* 5 U.S.C. § 553(d)(1) & (3) (prescribed thirty day notice period not applicable to "a substantive rule which *grants or recognizes an exemption or relieves a restriction*; . . . or . . . as otherwise provided by the agency for good cause found and published with the rule." (emphasis added)).

CONCLUSION

This waiver petition presents the Commission with the opportunity to help further the goal of an Alaska natural gas pipeline project as mandated in ANGPA. By providing a waiver, the Commission will eliminate a risk faced by potential Producer/Shippers in connection with the need to release capacity associated with the State's RIK volumes. At the same time, a waiver will ensure that the State has "reasonable access" for in-state use of RIK gas, as required by ANGPA. In addition, the requested waiver will facilitate bidding for the firm capacity in the upcoming open seasons. While the requested waiver does not and is not intended to address every issue the producers may have with the State's fiscal and royalty system, a waiver would address the significant issue of RIK/RIV switching, while other issues can be dealt with separately by the State and the producers if the producers demonstrate a need for any changes to the State's system. Accordingly, and as more fully discussed in this Petition, the State respectfully requests the Commission to waive, in part, its regulations and related rules as requested herein to permit the pre-arranged, non-biddable release to the State of firm transportation capacity associated with the State's RIK volumes.

Respectfully submitted,

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