

The Palin-Parnell Administration presents

AGIA

The Alaska Gasline Inducement Act

**House Finance
4/30/07**

Overview of “FERC issues”



- FERC’s new mandatory expansion authority
 - Not a panacea
- AGIA’s rolled in rate provisions
 - In harmony with FERC policy
- “Negotiated” versus “Recourse” rates
 - AGIA requires that negotiated rates do not thwart the possibility of rolled-in rates, and helps foster meaningful pipeline access

FERC's authority to order expansions is problematic



ANGPA Sec. 105—FERC can mandate expansion only if FERC finds that several criteria are first met, including:

- 1) No “rate subsidy”
- 2) No adverse effect on “financial or economic viability” of project
- 3) No adverse effect on “overall operations” of project
- 4) Cannot diminish the “contract rights of existing shippers to previously subscribed certificated capacity
- 5) Find that adequate downstream capacity exists or will exist

Section 105 provisions invite litigation



- The statute is unprecedented and has not been tested in court.
- The Section 105 criteria are ambiguous, and fertile ground for litigation.
- Litigation necessarily involves:
 - 1) Delay
 - 2) Uncertainty
- The duration of delay is likely to be measured in years, not months

AGIA avoids Section 105



- AGIA requires the licensee to:
 - 1) Regularly test the market for new capacity;
 - 2) Expand in reasonable engineering increments;
 - 3) Expand under commercially reasonable terms
- AGIA thus avoids uncertainty/delay of litigation.

FERC Rolled-in Rate Policy In Alaska



- 2004 ANGPA mandate to FERC:
 - Open season regulations should: “promote competition in the exploration, development and production of Alaska natural gas.” (§103(e)(2)(b)).
- FERC’s implementation of that directive:
 - “incremental pricing of expansion could put expansion shippers at a significant rate disadvantage compared with initial shippers, and accordingly could discourage exploration, development and production of Alaska natural gas.” (Order 2005 at ¶ 123)

FERC Rolled-in Rate Policy In Alaska



- FERC’s Open Season regulations provide a rebuttable presumption in favor of rolled-in rates.
- This departure from lower-48 policy was in recognition of Alaska’s unique circumstances.
 - “Our existing lower-48 states policy favoring incremental rates for expansions does not apply in the case of an Alaska natural gas project. There is likely to be only one Alaska pipeline so there will be little or no opportunity for competition between pipelines.” (Order 2005 at ¶ 123).

FERC Rolled-in Rate Policy In Alaska



- A rate increase is not necessarily a subsidy.
(see, order 2005-A at ¶ 50).
“An alternative ...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.” (Order 2005-A at ¶ 49)
- FERC left open the question of whether to allow rolled-in rates to a level that is no higher than the initial rate with subsidies.
- Total Government contributions (“built in subsidies”) reduce rates by more than 15%

Government Rate Contributions: Summary



- Government contributions total about 25¢, and reduce initial rates from \$2.25 to \$2.00
- Initial rates are therefore subsidized by government by about 12.5%
- But owners of Gas Treatment Plant also get a Federal Investment Tax Credit
- If this subsidy is included then total government subsidies exceed 15%

FERC Process



“A pipeline company

PROPOSES

But the FERC

DISPOSES.”

(an old industry adage)

FERC Process



- AGIA does not intrude on FERC's authority
- AGIA requires the licensee to **PROPOSE** rolled-in rates
- AGIA prevents Producers from negotiating rates with themselves that preclude rolled-in rates
- FERC will **DISPOSE**

“Negotiated” versus “Recourse” rates



Recourse rates:

Old fashioned, cost-based, just and reasonable rates established in FERC rate proceedings.

All shippers must have access to recourse rates as an alternative to negotiated rates (*i.e.*, recourse rates are a “lifeline”).

“Negotiated” versus “Recourse” rates



Negotiated Rates

Negotiate rates are just that: Negotiated

Virtually anything can be negotiated

Negotiated rates are now the norm for new pipeline capacity in the Lower-48

FERC regulates recourse rates, not negotiated rates



FERC sets recourse rates through regulatory process

Shipper and pipeline set negotiated rates through commercial process

AGIA's restrictions on negotiated rates



AGIA requires commitment by licensee not to enter negotiated rate contracts that preclude rate increases due to roll-in of expansion costs up to 15% above original negotiated rates.

By spreading expansion costs over all billing determinants, AGIA ensures that rolled-in rate treatment can – as a practical matter – be offered to expansion shippers.

Appendix
Negotiated rate example
(Rockies Express)



Rockies Express Open Season Notice:

1. Estimated “recourse rate:” \$1.427 (end-to-end).
2. Negot. rate (fixed rate, non-Anchor shipper): \$1.094 (end-to-end)
3. Negot. rate (adjustable, non-Anchor shipper): From \$1.04 to \$1.14 (depending on price of steel)

Appendix
Negotiated rate example
(Rockies Express)



Negotiated rates are for life of contract.

No risk of rate change due to cost overruns, changes in volume commitments, cost of capital, etc.

Appendix

Breakdown of Effects of Government Contributions on Rates



- **Base rate:** All government contributions included
 - For a pipeline into Alberta, tariff = **\$2.00**
- **Federal loan guarantee:** reduces cost of debt
 - Without loan guarantee, tariff rises to **\$2.10**
- **Accelerated depreciation:** 7-year vs. 15-year
 - With 15-year depreciation tariff rises to **\$2.19**
- **AGIA contribution:** \$500 million reduces rate base
 - Without AGIA contribution, tariff rises to **\$2.25**

Appendix Base Case Assumptions for Rates to Alberta



- Base rate assumes the following government subsidies:
 - Federal loan guarantee (assumed here to reduce debt costs by 0.75%)
 - Accelerated 7-year tax depreciation (part of Federal enabling legislation)
 - AGIA contribution of \$500 million (50% until open season, 80% after)
- And assumes further:
 - 70/30 debt/equity ratio
 - 14% ROE
 - 6.5% cost of debt
 - 30 year depreciation schedule
 - 25-year FT contracts
 - Cost input price escalation at 2%/year
 - Pipeline cost to Alberta of \$20.5 billion (\$2007)
 - Rates calculated on a levelized cost of service basis

Appendix Federal Loan Guarantee: Value is Scenario-dependent



Alaska Natural Gas Pipeline

Value of [federal] loan guarantee offers significant benefits

150-200 bp savings

Presentation from Goldman Sachs to State of Alaska on June 3, 2004
“Partnering and Risk Allocation Strategies for the Alaska Natural Gas Pipeline”
Assumes creative use of loan guarantees to achieve maximum benefits

- Federal Loan Guarantee could reduce taxable yields by approximately 50 basis points.

Presentation from JP Morgan to Legislative Budget and Analysis Committee, June 16, 2004
“Interim Hearings: Alaska Natural Gas Pipeline Issues”
Assumes underlying credit rating of A, at most 60% debt

“...application of the DOE Guarantees to Alaska LLC’s debt will probably lower the cost of borrowing with respect to such debt by approximately 50 to 100 basis points, depending on market conditions.”

Dept. of Revenue, SGDA Contract FIF