

**UNITED STATES OF AMERICA
BEFORE THE
DEPARTMENT OF ENERGY
OFFICE OF FOSSIL ENERGY**

In the matter of:)
)
CONOCOPHILLIPS ALASKA)
NATURAL GAS CORPORATION)
and)
MARATHON OIL COMPANY)

Docket No. 07-02-LNG

APR 09 2007

**MOTION TO INTERVENE, COMMENTS AND PROTEST OF
AGRIUM U.S. INC.**

I. INTRODUCTION

On January 10, 2007, ConocoPhillips Alaska Natural Gas Corporation (ConocoPhillips) and Marathon Oil Company (Marathon) (collectively, Applicants) filed an application requesting a blanket authorization to export 99 TBtus of liquefied natural gas (LNG) from Alaska on a short-term or spot market basis to one or more countries on the Pacific Rim (Application).¹ In response to the notice issued by the Department of Energy's (DOE) Office of Fossil Energy (OFE) on March 8, 2007, with respect to the Application,² and pursuant to Sections 303 and 304 of the OFE's Administrative Procedures,³ Agrium U.S. Inc. (Agrium) respectfully submits this Motion to Intervene, Comments, and Protest in the above-captioned proceeding. In particular, Agrium respectfully:

- (1) moves for leave to intervene as an interested party;
- (2) submits comments to correct factual errors and omissions in the Application; and
- (3) protests the Application on the grounds that, without conditions assuring that domestic customer demand for Cook Inlet gas is satisfied, the proposed export is not in the public interest.

II. SERVICE

All correspondence and communications regarding this proceeding, including the service of pleadings and notices, should be directed to the following persons:

¹ Application for Blanket Authorization to Export Liquefied Natural Gas of ConocoPhillips Alaska Natural Gas Corporation and Marathon Oil Company, filed in Docket No. 07-02-LNG (Jan. 10, 2007) (*hereinafter*, Application).

² ConocoPhillips Alaska Natural Gas Corporation and Marathon Oil Company: Application for Blanket Authorization To Export Liquefied Natural Gas, 72 Fed. Reg. 10507 (Mar. 8, 2007).

³ 10 C.F.R. §§ 590.303 and 590.304 (2006).

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Agrium hereby certifies that the persons named above are duly authorized representatives of Agrium.

III. BACKGROUND

A. Agrium U.S. Inc.

With manufacturing, distribution, and retail facilities in over 25 states, Agrium U.S. Inc. has in excess of 4,500 employees throughout the United States who work at three main divisions: wholesale, retail and specialty products.

Agrium's wholesale division has nitrogen complexes in Kenai, Alaska and Borger, Texas. Agrium facilities that upgrade ammonia to other nitrogen products are located in Cincinnati, Ohio; Sacramento, California; and Kennewick, Washington. The company's phosphate mine operations are located in Soda Springs, Idaho. Agrium also has an extensive transportation, storage, blending and warehousing system throughout the continental United States.

Agrium is the largest fertilizer retailer in the United States with over 400 retail facilities throughout the country. As a major distributor of crop nutrients, seed processing, and crop protection products, the retail division operates under the name of Western Farm Service in the Western U.S. and Crop Production Services throughout the Corn Belt and eastern agricultural regions.

Headquartered in Sylacauga, Alabama, Agrium's Advanced Technologies division provides branded specialty fertilizer products with slow release technologies suitable for golf course turf, specialty crops, lawn care, and horticulture and sport field applications. Advanced Technologies also manufactures and markets the only polymer-coated, environmentally friendly, controlled release fertilizer available for board acre crops, ESN.

B. Agrium's Kenai Fertilizer Plant

Agrium owns and operates a fertilizer plant located on the east side of the Cook Inlet on the Kenai Peninsula in Alaska (Kenai Fertilizer Plant). The Kenai Fertilizer Plant, which has been in operation since 1968, manufactures anhydrous ammonia and urea fertilizer products. The Kenai Fertilizer Plant is immediately adjacent to the LNG export facility operated by the Applicants.

Natural gas is a key feedstock in fertilizer production. Anhydrous ammonia is manufactured by combining nitrogen from the atmosphere with hydrogen from natural gas and serves as the starting point for virtually all other nitrogen fertilizers. Urea is a white granular substance made by reacting carbon dioxide with ammonia. Urea is the highest volume nitrogen fertilizer in world trade. The vast majority of urea is consumed as a direct application fertilizer, with much smaller volumes being used for production of melamine, UF resins and downstream fertilizer production. The Kenai Fertilizer Plant is capable of annually manufacturing approximately 1.1 million tons of urea and approximately 600,000 tons of ammonia for sale. In order to manufacture these volumes, the Kenai Fertilizer Plant requires approximately 53 BCF (56 TBtus) of natural gas per year.

The Kenai Fertilizer Plant is one of Alaska's few major manufacturing operations and contributes significantly to Alaska's economy by adding value to Cook Inlet natural gas

production. For every one thousand cubic feet of Cook Inlet natural gas used at the Kenai Fertilizer Plant, “over \$9 in total Alaska economic output is generated.”⁴ At full production, the Kenai Fertilizer Plant is the United States’ second largest producer of ammonia and urea. In 2003, with a gas supply of 40 BCF, or 75% of capacity, the total economic output in Alaska attributable to the Kenai Fertilizer Plant was \$374 million.⁵ This figure includes the gross sale of Agrium’s production plus the impacts of company and employee spending in support of the Kenai Fertilizer Plant operations.

As a major manufacturer of nitrogen-based fertilizers, Agrium’s Kenai Fertilizer Plant is a significant domestic consumer of natural gas in Cook Inlet. Prior to 2002, when the Kenai Fertilizer Plant was running at full capacity, gas consumption was approximately 53 BCF per year. Due to gas supply shortages, gas consumption in 2002 was reduced to 47 BCF, a reduction of 11% from full capacity. From 2003 to 2005, gas consumption was further reduced to an annual average of approximately 40 BCF, a reduction of 25% from full capacity. Due to continued gas supply shortages, one of the two urea plants at the Kenai Fertilizer Plant had to be shut down in October 2004 and one of the two ammonia facilities at the Kenai Fertilizer Plant had to be shut down in November 2005. Both of these plants currently remain shut down. In 2006, gas consumption was further reduced to 21 BCF, a 60% reduction from full capacity.

Due to continuing and worsening gas supply shortages, the entire Kenai Fertilizer Plant was shut down on October 24, 2006, and currently remains shut down. Agrium anticipates restarting the plant, at reduced rates, later this month as limited, short-term gas supplies become available. However, while Agrium continues to try to work with all producers to arrange for a long-term supply of gas, its contracts currently end in October 2007. Agrium, therefore, has

⁴ The Economic Impact of Closing Agrium Kenai Nitrogen Operations, The McDowell Group Report at p. 1 (April 2004) (*hereinafter*, McDowell Group Report) (excerpts attached as Appendix A).

⁵ *Id.*

announced that operations will be suspended at that time unless further gas supplies can be found.

IV. MOTION TO INTERVENE

The Application requests blanket authority to export LNG from Applicants' existing Kenai LNG Facility (LNG Facility) in Alaska on a short-term or spot market basis up to the cumulative equivalent of 99 TBtus over a two-year period commencing April 1, 2009 and terminating March 31, 2011. Exporting 99 TBtus of natural gas over a two-year period is a significant volume under any circumstances;⁶ however, the significance of the requested export authority is heightened in this case because domestic natural gas users in Southcentral Alaska rely solely upon Cook Inlet gas to meet their own needs.

The Kenai Fertilizer Plant is one of the major Cook Inlet domestic gas consumers, and is the major industrial gas user in the area. It requires a substantial and consistent flow of Cook Inlet gas to operate the Kenai Fertilizer Plant. In fact, the Kenai Fertilizer Plant's viability is dependant on the availability of an adequate supply of natural gas.

For these reasons, Agrium has a direct, unique, and substantial interest in the outcome of this proceeding that cannot be adequately represented by any other party. Accordingly, it is both appropriate and in the public interest that Agrium be allowed to intervene as a party to these proceedings. Therefore, Agrium respectfully requests that OFE grant Agrium party status in these proceedings.

V. STANDARD OF REVIEW

Applicants filed their application under section 3 of the Natural Gas Act (NGA). Section 3 provides, in relevant part:

⁶ Applicants have asked for authorization to export 99 TBtus of LNG. Taking into account the natural gas that is used as fuel in the LNG liquefaction process, Applicants would need approximately 116 TBtus of natural gas to export 99 TBtus of LNG over the proposed two-year export period. Application at n. 5.

[N]o person shall export any natural gas from the United States to a foreign country or import any natural gas from a foreign country without first having secured an order of the [Secretary of Energy] authorizing it to do so. The [Secretary] shall issue such order upon application, unless, after opportunity for hearing, it finds that the proposed exportation or importation will not be consistent with the public interest. The [Secretary] may by [the Secretary's] order grant such application, in whole or part, with such modification and upon such terms and conditions as the [Secretary] may find necessary or appropriate.⁷

Thus, the question presented by the Application is whether the proposed exports are in the public interest.

One of the primary concerns of the NGA “is protection of American consumers.”⁸ A paramount consideration in evaluating the public interest under section 3 is whether the proposed export will leave domestic needs for gas unmet. The legislative history of section 3 indicates that one of Congress’ primary concerns with permitting the export of natural gas was to ensure against impairment of “the sufficiency of the supply of natural gas within the United States.”⁹ The Secretary of Energy’s delegation of section 3 authority to OFE designates domestic need for the natural gas proposed to be exported as an explicit criterion that must be considered in determining the public interest.¹⁰ As DOE has found, and Applicants concede, in view of the geographic isolation of Alaska and the Cook Inlet area from the rest of the United States, the domestic need consideration in this case must focus on the impacts on domestic users of Cook Inlet gas in Southcentral Alaska.¹¹ Accordingly, in these proceedings, OFE must consider the regional need for the gas proposed to be exported in determining whether the Applicants’ request is consistent with the public interest.

⁷ NGA § 3, 15 U.S.C. § 717b.

⁸ Yukon Pacific Corp., DOE/FE Opinion and Order No. 350, 1 FE ¶ 70,259 at section V(B)(1) (Nov. 16, 1989).

⁹ H.R. 11662, 74th Congress § 3 (1936).

¹⁰ Delegation Order No. 0204-211, 49 Fed. Reg. 6690 (Feb. 22, 1984). *See also* Delegation Order No. 0204-127, 54 Fed. Reg. 11436 (Mar. 20, 1989).

¹¹ Order Extending Authorization to Export Liquefied Natural Gas from Alaska, DOE/FE Opinion and Order No. 1473, at n. 48 (Apr. 2, 1999) (*hereinafter*, 1999 Authorization Order); Application at p. 7.

VI. COMMENTS

The Application contains important factual and analytical errors and omissions. In order to clarify the record so that OFE has a complete and accurate account of the issues involved in this case, Agrium submits the following comments. Taken together, the comments provided below indicate that OFE must give careful scrutiny to the factual assertions and analysis submitted in the Application.

A. Applicants Understate Natural Gas Demand Associated With The Kenai Fertilizer Plant

In assessing the regional need for the natural gas proposed to be exported, OFE must consider the regional demand for gas during the proposed export period. One of the principal domestic demands for natural gas in the Cook Inlet area is for industrial use, and in particular, demand for gas to operate Agrium's Kenai Fertilizer Plant. As discussed in greater detail below, one of the most significant flaws in the Application is a faulty assessment of the Kenai Fertilizer Plant's demand for Cook Inlet natural gas.

In their Application, Applicants stated that the Kenai Fertilizer Plant's natural gas use rate has been decreasing over the course of the past few years. Applicants stated that in 2003 and 2004, Agrium's historic natural gas use rate decreased by approximately 20%.¹² They further stated that, "[i]n 2005, Agrium shut down additional capacity at the plant, thereby reducing plant capacity to 50%. . . . On October 24, 2006, Agrium shut down its plant for winter 2006-2007."¹³ Quoting from a newspaper article, Applicants stated that the Kenai Fertilizer Plant would run through late 2007 at an estimated 75% of its already reduced level of operations.¹⁴

¹² Application at p. 13.

¹³ *Id.*

¹⁴ *Id.* at pp. 13-14.

Based on these figures, Applicants projected that the Agrium Kenai Fertilizer Plant will continue operations through late 2007, at which time the Kenai Fertilizer Plant would close. In their Expected Demand Case, Applicants estimated approximately 20 BCF in annual demand for Agrium in 2007, and then included no natural gas demand for the Kenai Fertilizer Plant in 2008-2011. Under their Stress Demand Case, Applicants assumed that, in the event the Kenai Fertilizer Plant continued operations, it would only continue at its current level of operations through the year 2011 (thus consuming only 20 BCF of natural gas annually).¹⁵

Applicants have made a fundamental error in assuming that Agrium's reduced *consumption* of natural gas in recent years reflects declining *demand*. As explained below, Agrium has not voluntarily reduced operations at its Kenai Fertilizer Plant. To the contrary, the only cause of Agrium's reduced natural gas use has been a lack of available supply of natural gas. The reduced consumption reflects insufficient gas supply to meet existing gas demand, not reduced demand for natural gas.

The Kenai Fertilizer Plant's demand for natural gas has consistently been, and remains, approximately 53 BCF annually – the volume of natural gas needed to operate at full capacity. Prior to 2002, the Kenai Fertilizer Plant operated at full capacity and its annual natural gas use rate was approximately 53 BCF per year. Between 2002 and the present, the Kenai Fertilizer Plant has been forced to significantly scale back its operations due to a lack of available natural gas supply.

The reduced gas usage at the Kenai Fertilizer Plant has occurred during a time when Agrium would have strongly preferred that the Kenai Fertilizer Plant was operating at its full capacity in order to take advantage of very high fertilizer product prices. However, Agrium has been unable to take advantage of this very profitable fertilizer market because it has not been

¹⁵ *Id.* at p. 14.

able to acquire sufficient gas to operate the Kenai Fertilizer Plant at full capacity. Because of lack of gas supply, and resultant reductions in output, Agrium was forced to take a financial impairment of \$140 million, after taxes, on the Kenai Fertilizer Plant in 2003.¹⁶

As a result of faulty assumptions about Agrium's gas demand, Applicants have significantly underestimated the domestic demand during the proposed export period. Agrium's demand for natural gas is, and has always been, approximately 53 BCF of natural gas annually. In the Expected Demand Case, for 2009, 2010, and 2011, Applicants estimate the domestic gas demand, not including LNG production, to be 83 BCF, 82.6 BCF, and 79.3 BCF, respectively.¹⁷ However, since Applicants assumed zero demand for the Kenai Fertilizer Plant for these years, they have underestimated the annual domestic demand by approximately 53 BCF. In the Stress Demand Case, Applicants assumed only 20 BCF demand for the Kenai Fertilizer Plant for 2009-2011,¹⁸ thereby underestimating the total annual domestic demand by 33 BCF. As is evident, Applicants' estimated domestic demand for natural gas is considerably lower than the actual demand.

B. The Kenai Fertilizer Plant Is A Key Domestic Industrial Consumer

Demand for Cook Inlet gas for the Kenai Fertilizer Plant must be included in the calculation of the overall domestic gas demand. The Kenai Fertilizer Plant manufactures two different fertilizer products -- ammonia and urea. While the majority of the output of the Kenai Fertilizer Plant is shipped to foreign markets, the Kenai Fertilizer Plant is the largest supplier of

¹⁶ Agrium purchased the Kenai Fertilizer Plant from Union Oil Company of California (Unocal) in 2000. (Agrium is a manufacturer and marketer of finished products, but, unlike Unocal, it does not participate in the upstream oil and gas business.) Agrium made this significant investment with the expectation of running the plant at full capacity on a long-term basis. Agrium did not intend to curtail production at the Kenai Fertilizer Plant a mere two years after making this significant purchase, nor did it intend on having to take such a significant financial impairment four years after purchasing the plant. These operational curtailments and financial impairments have been caused by an unanticipated inability to secure adequate gas supplies.

¹⁷ Marvin Feldman, *Economic Analysis of Kenai LNG Export*, January 2007, at p. 3-15 (*hereinafter*, RD Report).

¹⁸ *Id.* at p. 3-17.

urea for the Alaskan wholesale and industrial markets. In addition, the products manufactured at the Kenai Fertilizer Plant are used to supply markets in the western United States.

The Kenai Fertilizer Plant's demand for natural gas for manufacturing purposes should not be discounted simply because Agrium markets products manufactured at the Kenai Fertilizer Plant to foreign markets. DOE's precedent under the NGA section 3 public interest analysis does not suggest any basis for discounting domestic manufacturing demand associated with production of goods bound for export.¹⁹ Thus, the Kenai Fertilizer Plant's demand for Cook Inlet natural gas to manufacture products must be included in DOE's calculation of domestic gas demand.

C. Utilities Face Uncertain Natural Gas Supplies

Applicants stated that "regional demand for Cook Inlet natural gas attributable to the major Southcentral Alaska utilities for natural gas distribution and electricity generation purposes is largely contracted through 2011."²⁰ Thus, in their calculations, Applicants assumed that the utilities have no need for the natural gas volumes proposed to be exported, even in the event only limited new natural gas reserves are discovered and demand for natural gas rapidly increases.²¹ These statements and assumptions are incorrect.

In September 2006, the Regulatory Commission of Alaska (RCA) rejected a gas supply contract between ENSTAR Natural Gas Company (ENSTAR), which is a utility company in the Cook Inlet region, and one of the Applicants, Marathon.²² Subsequent to this decision, Marathon

¹⁹ The sale to foreign markets of products, such as fertilizer, that are manufactured domestically with natural gas inputs are not the equivalent of natural gas exports in the section 3 review process, and should not be considered as such. Section 3 of the Natural Gas Act itself distinguishes between exports of natural gas and exports of other products – it requires prior approval for exports only of natural gas (including LNG).

²⁰ Application at p. 11.

²¹ *Id.*

²² Order Rejecting TA139-4 as a Base Supply Contract Having the Effect of Increasing the Current Average Cost of System Gas Supply But Allowing TA139-4 to take Effect Immediately as a Base Supply Contract Having the Effect

clearly stated in a letter to ENSTAR that they understood the utility had unmet gas supply requirements starting in 2009.²³ Marathon's statement in this letter clearly shows that there are unfulfilled utility needs beginning in 2009, which is inconsistent with Applicants' claims in their Application that there is no apparent need for additional contracted utility gas during the 2009 – 2011 timeframe.²⁴

In addition, the Applicants' own actions demonstrate the utilities' need for natural gas. On January 9, 2007, due to local consumer demand in Southcentral Alaska, Applicants had to divert production from their LNG Facility for utility use in order to address supply shortfalls.²⁵

As these events demonstrate, Applicants' assertion that domestic utilities have no need for the gas proposed to be exported is simply incorrect. Even at the present time, there is a shortage of natural gas for consumer needs, such that Applicants had to temporarily divert production at their LNG Facility to meet local utility customer demands. Based on ENSTAR's stated shortfall of contracted gas beginning in 2009,²⁶ the shortage of natural gas supplies will only grow during the proposed export period.

of Decreasing the Current Average Cost of System Gas Supply and Requiring Filings, Regulatory Commission of Alaska, Order No. 15, U-06-2, (Sept. 28, 2006) (attached as Appendix B).

²³ January 3, 2007 letter from Marathon to ENSTAR, submitted to RCA by ENSTAR (Jan. 19, 2007) (attached as Appendix C).

²⁴ Application at p. 11.

²⁵ Regulatory Commission of Alaska, Public Meeting Transcript, *ENSTAR Natural Gas Company Winter Operations Update*, p. 68-69 (Jan. 24, 2007) (excerpts attached as Appendix D).

²⁶ *Cook Inlet Supply and the Impact of North Slope Natural Gas for Future Generations*, Presentation by ENSTAR Natural Gas Company to Alaska Governor Sarah Palin, at p. 8 (December 2006) (*hereinafter*, Presentation to Gov. Palin) (attached as Appendix E); *2006-2007 Winter Update to RCA*, Presentation by ENSTAR Natural Gas Company, at p. 9 (2007) (attached as Appendix F).

D. Use Of Gas At The Kenai Fertilizer Plant Produces More Benefits For Alaskan Economy Than LNG Exports

The Application includes a discussion of the benefits of the requested authorization to Alaskan interests. According to Applicants, among other benefits, their LNG Facility provides income and employment to Alaskan workers and economic benefits to suppliers and businesses in the area. In addition, Applicants stated that the proposed export will benefit the State of Alaska and its citizens through royalty payments and income tax revenue. Even assuming that the representations regarding the employment, economic and tax benefits of the LNG Facility operations are accurate, Applicants did not provide any discussion of the comparative benefits of alternative domestic uses – and in particular use at the Kenai Fertilizer Plant – of the natural gas proposed to be exported. As shown below, the public benefits offered by making sufficient natural gas available to operate the Kenai Fertilizer Plant at full capacity are far greater than those provided by devoting similar quantities of natural gas to LNG Facility operation.

On all of the measures of public benefit, gas supplied to the Kenai Fertilizer Plant produces more public benefit than gas supplied to the LNG Facility.²⁷ The Kenai Fertilizer Plant employs more people, spends more money in the community, and creates a manufactured product that has greater value than the LNG Facility with any given volume of natural gas.

The Kenai Fertilizer Plant, when it has sufficient natural gas to operate, provides income and employment to a greater number of people than the LNG Facility. While the LNG Facility provides full-time employment for 58 Alaskan workers at the plant, Agrium’s Kenai Fertilizer Plant currently employs 155 Alaskan workers. When running at full capacity, the Kenai Fertilizer Plant employs approximately 264 employees.²⁸ The Kenai Fertilizer Plant provides total direct and indirect employment for an estimated 685 Alaskans when operating at full

²⁷ Of course, if sufficient gas is available to operate both facilities, the benefits are additive.

²⁸ McDowell Group Report at pp. 1, 2, and 3.

capacity,²⁹ while the LNG Facility provides direct and indirect employment to an estimated 186 Alaskans.³⁰

Applicants stated that their facility generates approximately \$15.9 million dollars in personal income.³¹ The Kenai Fertilizer Plant, when running at full capacity, generated approximately \$42 million in personal income.³² According to the Applicants, local purchases of goods and services associated with exports from the LNG Facility provide a total of \$5 million in economic benefits to suppliers and businesses on an annual basis. The Kenai Fertilizer Plant, on the other hand, provided economic benefits to suppliers and businesses in Alaska totaling \$77 million in 2003 when the Kenai Fertilizer Plant was running at 75% capacity.³³ These benefits were even larger when the Kenai Fertilizer Plant was running at full capacity.

Agrium estimates that if the natural gas proposed to be exported were delivered to the Kenai Fertilizer Plant, the royalties paid to the State of Alaska would be significantly greater than those currently paid by Applicants. In addition, compared to the \$900,000 paid by Applicants in 2005 for property taxes,³⁴ Agrium paid approximately \$1 million in the same year. When the Kenai Fertilizer Plant was running at 75% capacity in 2003, it paid \$2 million in property taxes.

In addition to the benefits outlined above, the Kenai Fertilizer Plant is the largest supplier to the Alaskan wholesale and industrial market for urea, and supplied approximately 4,500 tons in 2006. This supply is extremely important to the farmers, companies and the State because the cost of purchasing the urea from the Kenai Fertilizer Plant is considerably less than if the urea

²⁹ *Id.* at pp. 1 and 2.

³⁰ Application at p. 24.

³¹ *Id.*

³² McDowell Group Report at pp. 1 and 2.

³³ *Id.* at pp. 1, 2, and 4.

³⁴ Application at p. 24.

were purchased in Canada or the Pacific Northwest. Purchasing urea from the Kenai Fertilizer Plant also allows certain customers to market their products with a “Made in Alaska” label. The Kenai Plant has supplied 342,000 metric tons of urea to Alaska and the western United States between 2001 and 2006.

Thus, Applicants’ statement that the State of Alaska would lose an array of claimed economic benefits if LNG exports from the LNG Facility were discontinued is misleading and incomplete. The table below summarizes the comparative benefits to the Alaska economy from operation of the LNG Facility and the Kenai Fertilizer Plant.

Summary Comparison of Benefits to Alaska from LNG Facility and Kenai Fertilizer Plant

	LNG Facility	Kenai Fertilizer Plant
Employment - Direct	58	264
Employment - Direct and Indirect	186	685
Personal Income generated	\$15.9 M	\$42 M
Alaska goods and services	\$5 M	\$77 M
Property Tax	\$0.9M	\$2 M

As explained above, use of gas at the Kenai Fertilizer Plant produces greater economic benefits for the State of Alaska than use of the same quantity of gas for LNG export. If there is not enough gas available for both uses, the local economy is better off if the limited supply is devoted to domestic manufacturing at the Kenai Fertilizer Plant.

E. Domestic Demand Is Sufficient To Avoid Shut In Of Gas Supplies

Applicants argue that a shut down of their LNG Facility could cause a shut-in of the flowing gas supplies, and, as a result, lost natural gas reserves and deliverability for local customers.³⁵ This conclusion is without justification. There is local demand for the natural gas proposed to be exported. In fact, Agrium’s unmet demand during the export period exceeds the proposed export volumes. Thus, if the Applicants’ request were denied, there would be an

³⁵ Application at pp. 25-26.

existing market for the natural gas. So in spite of the Applicants' suggested threats, there is no basis to assume that denial of the Application would cause a shut-in of the flowing gas supplies.

Moreover, it would be ironic indeed if a would-be exporter could simply assert that it would not continue producing gas if a requested export application were denied, and then successfully argue that the application would have no impact on domestic users of the gas, and thus should be granted, because the domestic users would not have access to such shut-in gas in any case.

F. Balancing And Reliability Function Can Be Provided By Kenai Fertilizer Plant

Applicants stated that “[t]he Kenai LNG Facility also serves an important reliability role in the supply and demand balance in the areas served by the major Southcentral Alaska utilities. ... The natural gas production associated with LNG exports is available in real time for diversion to heating and electricity generation.”³⁶ OFE should note that until gas supply shortages occurred in 2003, the Kenai Fertilizer Plant historically played the role of providing reliability in the area. If natural gas supplies are available for operation of the Kenai Fertilizer Plant, it can fulfill this balancing and reliability function in the future. Thus, should the Application be denied, this reliability service could continue to be provided by the Kenai Fertilizer Plant.

G. Coal Gasification Plant Is Not A Viable Alternative During Proposed Export Period

Applicants assumed that if Agrium's Kenai Fertilizer Plant reopens at a later date, it would utilize gas from a new coal gasification plant, and thus the Kenai Fertilizer Plant would have no impact on demand for Cook Inlet natural gas.³⁷ The sole reason Agrium is even investigating the viability of investing in a coal gasification plant is because of the lack of natural

³⁶ *Id.* at p. 25

³⁷ *Id.* at p. 14.

gas supply in the region. In fact, the availability of gas has been so limited that natural gas producers, including Applicants, have been unable to enter into long-term gas contracts with Agrium to allow the Kenai Fertilizer Plant to run at full capacity. Thus, Agrium has been forced to consider alternatives to natural gas – such as syngas manufactured from coal – as a basis for supplying its Kenai Fertilizer Plant.

Even though Agrium is considering investing in a coal gasification plant, the project plan is still tentative. At the present time, such a gasification plant is projected to cost in excess of \$2 billion, which would result in marginal economics for the project. Thus, the gasification plant's commercial development is by no means certain. In any case, even if the decision to build the gasification plant were made, the gasification plant could not be built and become operational until late in 2011 at the very earliest. This would be after the period of the proposed exports. Thus, any potential coal gasification project should not be considered as a viable alternative to the natural gas proposed to be exported from April 2009 through March 2011.

H. Potentially Discoverable Resources Are Not Relevant To Evaluating Sufficiency Of Supply During Proposed Export Period

Applicants place much emphasis on their claims that there are significant quantities of potentially discoverable gas resources in and around the Cook Inlet area.³⁸ Even if a significant portion of the resources could eventually be proven up and become reserves from which production could occur, it is unlikely that any of this would occur within the time frame of the requested authorization. Given the two-year time period of the requested authorization, and the fact that very little, if any, of the potentially discoverable gas resources could actually be used to satisfy natural gas demand during the request's time frame, OFE should not factor potentially discoverable gas resources into its supply and demand calculations.

³⁸ *Id.* at pp. 18-19.

I. “Other Energy Sources” Would Not Be Available During The Proposed Export Period

The Applicants included “other energy sources” as part of the supply to meet the regional demand.³⁹ The RD Report defines these sources as Alaska North Slope Gas, Coalbed Methane, Kenai Coal Gasification and LNG regasification.⁴⁰ All of these potential energy sources have significant challenges and it is unlikely that any of these could be available within the time frame of the requested authorization. Given the foregoing, the OFE should not factor any of the potential “other energy sources” into its supply and demand calculations.

J. Reserves Analyses Require Critical Review

The analysis of the various reserve estimates included in the Application are significantly different from the Alaska Department of Natural Resources (ADNR) estimates, and, thus, must be carefully examined by OFE. Applicants stated that, “the RD Report provides a comparison of the ADNR and NSAI reserve estimates. The small difference between the two reserve estimates can be attributable to interpretation of the data by ADNR and NSAI.”⁴¹ However, in so doing, they have tried to minimize the substantial differences between their consultant’s estimates and the estimates of the State of Alaska. While the total reserve estimates may be similar, there are significant differences between the reserve estimates for the various fields, as shown in the table below.

³⁹ *Id.* at p. 9.

⁴⁰ RD Report at pp. 2-3

⁴¹ Application at p. 18.

	<u>NSAI</u>		<u>DNR</u>		<u>Proven Variance</u>		<u>P1 + P2 Variance</u>	
	Proven	Proven + Probable	Proven	Proven + Probable	BCF	%	BCF	%
Beaver Creek	39.6	41.1	36.4	36.4	-3.2	(9%)	-4.7	(13%)
Beluga River	473.3	509.4	539.4	539.4	66.1	12%	30.0	6%
Cannery Loop	44.2	44.2	68.5	68.5	24.3	35%	24.3	35%
Kenai	98	173.2	140.4	140.4	42.4	30%	-32.8	(23%)
McArthur River	89.4	174.9	110.2	110.2	20.8	19%	-64.7	(59%)
Ninilchik	56.4	82.5	50.8	50.8	-5.6	(11%)	-31.7	(62%)
North Cook Inlet	350.3	610.2	320.8	320.8	-29.5	(9%)	-289.4	(90%)
Other	60.6	90.9	85.7	381.9	25.1	29%	291.0	76%
	1211.8	1726.4	1352.2	1648.4	140.4	10%	-78.0	(5%)

As the table above demonstrates, while the gross totals are similar, there are major variances in the analyses of individual resources, which indicate that there are significant differences between the two analyses used to develop these estimates.

VII. PROTEST

The proposed export is not in the public interest because there are unmet domestic needs for the gas proposed to be exported. Agrium urges that the Application be denied, or, in the alternative, that the Application be granted subject to a condition that exports are only permitted to the extent that domestic demand for Cook Inlet natural gas is also being satisfied. Agrium has no stake in preventing LNG exports if there is adequate gas supply for both domestic and export purposes. Agrium stresses that its only interest is in assuring adequate supplies are available to domestic users including the Kenai Fertilizer Plant.

A. The Applicants' Proposed Exports Are Not In The Public Interest Because There Is Unmet Domestic Demand For The Gas To Be Exported

Agrium's progressive shut down of its Kenai Fertilizer Plant is a direct indication of the domestic need for, and the shortage of supply of, natural gas in the Cook Inlet area. In fact, Agrium has not been able to secure sufficient natural gas supplies to operate its Kenai Fertilizer Plant at full capacity since 2002. Moreover, as discussed above, the utilities in the area have only been able to acquire resources on relatively short-term basis. ENSTAR, the largest gas

utility in Alaska, has not been able to fully contract its long-term natural gas supplies for 2009 and beyond.⁴² These facts lead to the fundamental conclusion that there is not enough gas to meet domestic demand at the present time, and this shortage can be expected to continue into the future.

The current gas supply shortage in the Cook Inlet market is not simply a theoretical scenario, based on a comparison of consultant studies of supply and demand – it is an observed fact. This is precisely the type of situation where it is not in the public interest to allow the export of natural gas. In this situation, there are demonstrable problems meeting domestic demand, and the gas supply shortages are exacerbated by LNG exports. If DOE were to find that further LNG exports are in the public interest in the face of persistent domestic supply shortages in Southcentral Alaska, then the public interest test would have been reduced to a meaningless formality – DOE would have effectively abdicated its duty under the Natural Gas Act to consider the public interest by applying a conclusive presumption that applicants can export natural gas if they wish to regardless of domestic circumstances. This is not what Congress had in mind in giving DOE the responsibility to make a public interest determination with respect to proposed natural gas exports.

As discussed above, one of the primary considerations in evaluating the public interest is to ensure an adequate domestic supply of gas. Without the needed supply of natural gas, Agrium's Kenai Fertilizer Plant will be forced to suspend operations entirely at the end of 2007. This result, however, should not be used by Applicants to justify an assumption of no demand on Agrium's part. To the contrary, Agrium's progressive shut down of its Kenai Fertilizer Plant is a concrete indication of both the need for, and the short supply of, natural gas in the Cook Inlet area.

⁴² Presentation to Gov. Palin at p. 8.

In addition, as the recent developments with respect to ENSTAR and the LNG Facility's diverted production demonstrate, Applicants' assertion that utilities have no need for the gas proposed to be exported is simply incorrect. These events further demonstrate the present and worsening shortage of gas supply in the Cook Inlet area. It would be contrary to the public interest to allow Applicants to export natural gas while domestic users struggle to find sufficient supplies.

Applicants' argument that their LNG Facility provides benefits to the State of Alaska that would be lost if the requested authorization were denied also fails. As is evident from the comments above, Agrium's Kenai Fertilizer Plant provides valuable benefits to the Alaskan economy that are lost if the gas necessary to operate the Kenai Fertilizer Plant is instead exported.⁴³ In fact, the benefits provided to the State of Alaska and its people by the Kenai Fertilizer Plant greatly exceed the benefits provided by Applicants' LNG Facility using the same volumes of gas. This comparison bolsters the conclusion that the public interest is not served by the export if domestic needs go unmet as a result.

While Applicants have attempted to argue that deliverability issues should not be considered when assessing regional supply and demand,⁴⁴ an evaluation of the supply in the Cook Inlet area based solely on reserves, without consideration of supply actually available to end use consumers, does not take into account the reality of the current situation. The actual supply of natural gas for domestic consumers is determined by deliverability constraints, and such issues should be considered in any assessment of supply in the area.

Any evaluation of supply that simply equates reserves to supply without accounting for actual production and deliveries is only theoretical in application, and does not take into

⁴³ See Section VI, D above.

⁴⁴ Application at p. 21.

consideration the practical realities regarding supply. For example, if there were plenty of reserves to cover domestic demand plus LNG exports, but all actual gas production was directed to LNG exports such that the utilities had no gas supply, DOE would surely find the LNG exports to be inconsistent with the public interest in assuring that domestic needs are met. DOE would be hard pressed to argue that it was not going to consider actual production and deliveries in its public interest evaluation of such a situation – the public benefits from actual domestic gas deliveries, not the theoretical adequacy of reserves and undeveloped resources that are not being produced, are the key to the public interest assessment. The current situation in Southcentral Alaska is little different – domestic consumers are unable to obtain sufficient supplies of natural gas. Thus, actual access to supply, not simply theoretical sufficiency of reserves, must be at the core of DOE’s public interest determination.

The requested export authorization is not consistent with the public interest because approval of the requested export will exacerbate existing shortages of natural gas supply for domestic users in Southcentral Alaska during the export period. Therefore, Agrium respectfully protests the Application and requests that OFE deny Applicants’ requested authorization.

B. If Granted, The Requested Authorization Should Be Conditioned So That Exports Are Permitted Only If Domestic Demand Is Being Met

In the alternative, Agrium requests that OFE condition any grant of the requested authorization upon a requirement that domestic demand for the natural gas be met before natural gas may be exported. Section 3 of the Natural Gas Act authorizes DOE to grant applications “in whole or part, with such modification and upon such terms and conditions as the [Secretary] may find necessary or appropriate.”⁴⁵ In the past, DOE has conditioned grants of export authority with such conditions as it found necessary and appropriate.

⁴⁵ NGA § 3, 15 U.S.C. § 717b.

In Yukon Pacific Corp., DOE conditioned the grant of the requested export authorization in order to minimize any detrimental effects on American consumers, the Alaska Natural Gas Transportation System (ANGTS), and the environment. Specifically, DOE required that no costs of the export project could be recovered from American consumers. In addition, DOE required that no action could be taken in connection with the export project that would impair the construction and operation of the ANGTS project. Finally, DOE conditioned the grant of the requested export authority on the requirement that all aspects of the export project must be undertaken in accordance with the appropriate environmental review process and must comply with any and all preventative and mitigative measures imposed by Federal or State agencies.⁴⁶

Consistent with this DOE precedent, Agrium requests that any grant of Applicants' request be conditioned on the requirement that domestic demand for the natural gas be met before the gas may be exported.⁴⁷ Such a condition will assure, and is necessary to assure, that any proposed exports are consistent with the public interest. Given Applicants' assurance that "there is no regional need for the volume of LNG for which the Applicants are requesting export authority during the two-year period terminating March 31, 2011,"⁴⁸ they should have no objection to such a condition.

⁴⁶ Yukon Pacific Corp. at section I. DOE also conditioned the export of natural gas in El Paso Natural Gas Co. DOE/ERA Opinion and Order No. 18, 1 ERA ¶ 70,513 (Aug. 21, 1980); *order on reh'g*, DOE/ERA Opinion and Order No. 18A, 1 ERA ¶ 70,514 (Sept. 4, 1980); Opinion and Order No. 18B, 1 ERA ¶ 70,515 (Sept. 19, 1980); DOE/ERA Opinion and Order No. 18C, 1 ERA ¶ 70,516 (Oct. 7, 1980); Opinion and Order No. 18D, 1 ERA ¶ 70,517 (Oct. 17, 1980); DOE/ERA Opinion and Order No. 18E (June 29, 1981).

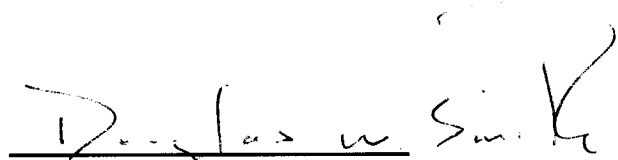
⁴⁷ The City of Kenai also passed a resolution stating that it endorsed Applicants' request "providing that Department of Energy review confirms that the gas being exported is in excess to that needed to meet local commercial, industrial and residential needs." City of Kenai Res. 2007-11, *A Resolution of the Council of the City of Kenai, Alaska, Supporting the Continued Operation of Natural Gas Industrial Facilities on the Kenai Peninsula* (2007) (attached as Appendix G).

⁴⁸ Application at p. 23.

VIII. CONCLUSION

WHEREFORE, Agrium respectfully requests that: (1) OFE grant Agrium's motion to intervene and grant Agrium party status in these proceedings; (2) OFE consider the comments provided above; and (3) for the reasons outlined above, OFE deny Applicants' requested export authorization or, in the alternative, condition the grant of the requested authorization such that domestic demands for the natural gas must be met before gas may be exported.

Respectfully submitted,



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Agrium U.S. Inc.
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907-776-3133

~~Douglas Smith~~
Mona Tandon
Van Ness Feldman, P.C.
1050 Thomas Jefferson St, NW
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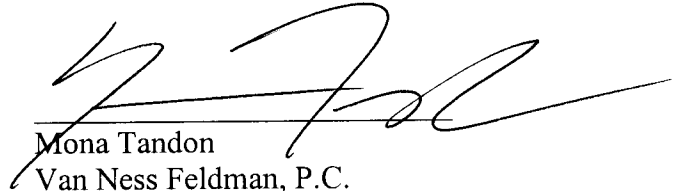
Attorneys for Agrium U.S. Inc.

Dated: April 9, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing Motion To Intervene, Comments, and Protest Of Agrium U.S. Inc. by first-class mail to all parties on the service list for this proceeding.

Dated at Washington, D.C., on this 9th day of April, 2007.

A handwritten signature in black ink, appearing to read 'Mona Tandon', is written over a horizontal line.

Mona Tandon
Van Ness Feldman, P.C.
1050 Thomas Jefferson St, NW
Washington, DC 20007
202-298-1800

APPENDIX

- APPENDIX A **The Economic Impact of Closing Agrium Kenai Nitrogen Operations, The McDowell Group Report (April 2004)**
- APPENDIX B **Order Rejecting TA139-4 as a Base Supply Contract Having the Effect of Increasing the Current Average Cost of System Gas Supply But Allowing TA139-4 to take Effect Immediately as a Base Supply Contract Having the Effect of Decreasing the Current Average Cost of System Gas Supply and Requiring Filings, Regulatory Commission of Alaska, Order No. 15, U-06-2 (Sept. 28, 2006)**
- APPENDIX C **January 3, 2007 Letter from Marathon to ENSTAR, submitted to RCA by ENSTAR (Jan. 19, 2007)**
- APPENDIX D **Regulatory Commission of Alaska, Public Meeting Transcript, *ENSTAR Natural Gas Company Winter Operations Update* (Jan. 24, 2007)**
- APPENDIX E ***Cook Inlet Supply and the Impact of North Slope Natural Gas for Future Generations*, Presentation by ENSTAR Natural Gas Company to Alaska Governor Sarah Palin (December 2006)**
- APPENDIX F ***2006-2007 Winter Update to RCA*, Presentation by ENSTAR Natural Gas Company (2007)**
- APPENDIX G ***City of Kenai Res. 2007-11, A Resolution of the Council of the City of Kenai, Alaska, Supporting the Continued Operation of Natural Gas Industrial Facilities on the Kenai Peninsula* (2007)**

APPENDIX A

The Economic Impact of Closing Agrium Kenai Nitrogen Operations

***PREPARED FOR:
Agrium U.S. Inc.***



Research-Based Consulting

Juneau
Anchorage

April 2004

Agrium U.S. Inc. contracted with McDowell Group, an Alaska research-based consulting firm, to quantify the economic impact of closing down Agrium Kenai Nitrogen Operations on the Kenai Peninsula Borough and the Alaska economy. This report details the study findings of the economic role of Agrium's production on the Kenai Peninsula and Alaska, and then assesses the impact if this production stopped and the plant closed.

Agrium Kenai Nitrogen Operations is one of Alaska's few major manufacturing operations and contributes significantly to Alaska's economy by adding value to Cook Inlet natural gas production. The Agrium complex is located near Nikiski on the Kenai Peninsula, 10 miles north of Kenai. In 2003, Agrium reported an average annual employment of 264. With a June 2003 downsizing, the plant's current employment is 230. The plant is the United States' second largest producer of ammonia and urea. It consists of two urea and two ammonia plants, a tidewater port facility, and a power cogeneration facility. In 2003, the Kenai plants produced 1.6 million metric tons of anhydrous ammonia and urea. The plant operated at 75 percent capacity, using approximately 110 million cubic feet of Cook Inlet natural gas daily (or 40 billion cubic feet annually). At capacity, the plant could use as much as 155 million cubic feet daily (or 53 billion cubic feet annually) of Cook Inlet natural gas. Virtually all of Agrium's Kenai production is destined for overseas markets. Agrium's total gross sales in 2003 were \$220 million.

Summary of Role in the Economy

Economic Output

- Total economic output in Alaska related to Agrium operations was \$374 million in 2003. Economic output is the gross sale of Agrium's production plus the impacts of company and employee spending in support of Agrium's operations.
- For every one thousand cubic feet (Mcf) of Cook Inlet natural gas used by Agrium for feedstock and power generation, over \$9 in total Alaska economic output is generated.
- In 2003, Agrium spent \$77 million on goods and services provided by almost 400 Alaska companies. Purchases were made from gas producers, construction contractors, engineering firms, environmental service firms, utility companies, retail and wholesale businesses, and other types of businesses.

Employment and Payroll

- Total Alaska impacts include 685 Alaska jobs (2003 average of 264 direct plus 421 indirect and induced jobs) and \$42 million in payroll (\$22 million in direct wages plus \$20 million in indirect and induced payroll).

- Agrium provides year-round, high-paying skilled manufacturing jobs.
- The Agrium operation also accounts - directly and indirectly - for an estimated 2 percent of the population, 4 percent of employment, and 7 percent of wage and salary income in the Kenai Peninsula Borough.
- Agrium's work force is virtually 100 percent resident in the Kenai Peninsula area. This fact, in turn, directs household spending locally, as opposed to other income sectors that have significant non-resident components. According to the Alaska Department of Labor and Workforce Development, in 2002, non-residents held 21 percent of the private sector jobs in the Kenai Peninsula Borough.

Community Involvement

- In 2003, Agrium contributed \$195,000 to 43 non-profit organizations or programs, most of them located in the Kenai area. Seven other organizations received in-kind support.
- Charitable giving was provided to local schools' athletic and academic programs, youth activities, community services and civic organizations, environmental programs, senior services, and other health and economic development programs.
- Agrium participated in 17 membership organizations, including industry and business support organizations.

Government Revenues

- The Kenai Peninsula Borough receives \$2 million in industrial property tax from Agrium, an estimated minimum of \$0.2 million in residential property tax from Agrium's employees' dwellings, and \$1 million in state funding support for Agrium family school-age children's education - a total of \$3 million in direct revenue.

Table 1
Summary of Statewide Agrium Kenai Nitrogen Operations
Economic Impacts, 2003

	Direct Impacts	Multiplier Effect	Indirect and Induced Impacts	Total Impacts
Economic Impacts				
Output	\$220 million	1.7	\$154 million	\$374 million
Economic value of Agrium production per MCF of natural gas feedstock				\$9.35/Mcf
Employment	264 jobs	2.6	421 jobs	685 jobs
Payroll	\$22 million	1.9	\$20 million	\$42 million
AK goods & services purchased	\$77 million			

(Table continues next page)

Table 2
Summary of Agrium's Economic Impacts on the
Kenai Peninsula Borough, 2003

	Direct Impacts	Multiplier Effect	Indirect and Induced Impacts	Total Impacts
Kenai Peninsula Borough Employment and Payroll				
KPB Employment	264 jobs	2.2	317 jobs	580 jobs
Employment (% of KPB 2002 total)				3%
Payroll	\$22 million	1.6	\$13 million	\$35 million
Wage and salary income (% of KPB 2002 total)				6%
Revenue to Kenai Peninsula Borough (KPB)				
Agrium industrial property tax	\$2.2 million			
Agrium employee property tax	\$0.2 million			
State revenue to KPB School District for Agrium dependents	\$1.1 million			
Total revenue to KPB	\$3.5 million			
Social Impacts				
Total population impacts (direct and indirect)				1,250 total 2.4% of KPB
Student enrollment (Agrium children as % of total KPB District enrollment)	2.5%			
Number of charities supported	50			

Economic Impacts of Agrium Closure

Alaska's Plant Closure Case Studies

Based on profiles of two Alaska communities - Ketchikan and Wrangell - that have lost important manufacturing facilities, a community in Alaska experiencing a similar loss can expect some or all of the following:

- Immediate loss of some of the community's highest paying, year-round jobs.
- Some immediate population loss, but also gradual, long-term population decline.
- Declining average wages as manufacturing jobs are not replaced in the local economy or are replaced by lower paying service sector jobs.
- Declining business sales and sales tax revenues.
- Declining property tax base that results in declining tax revenues.

- Increased tax burden on residents and businesses that remain and/or cuts in local government services.
- Economic consequences much greater than just the direct jobs lost with the closure if there is no growth elsewhere in the economy.

Kenai Peninsula Borough Impacts from Agrium's Closure

The Borough would experience both direct and indirect impacts on its economy. Based on current employment figures, estimates of direct impacts include:

- Immediate loss of 230 jobs and \$19 million in annual payroll.
- Borough-wide employment dropping by 1.3 percent and payroll by 3.2 percent.
- Average monthly wage for the Borough dropping by 1.9 percent.
- Immediate loss of \$2 million in property tax revenues, representing 5 percent of the Borough's total property tax revenues.
- 43 non-profit organizations losing \$195,000 in contributions, perhaps more when including contributions made directly by Agrium employees.
- Immediate loss of \$77 million in business sales.

Using multipliers for the Kenai Peninsula Borough (employment and payroll multipliers of 2.2 and 1.6 respectively), estimates of indirect impacts on the Borough include the potential loss of about 280 support sector jobs and \$11 million in annual support sector payroll.

APPENDIX B

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Kate Giard, Chairman
Dave Harbour
Mark K. Johnson
Anthony A. Price
Janis W. Wilson

In the Matter of the Gas Sales Agreement)
Between ENSTAR NATURAL GAS COMPANY,)
A DIVISION OF SEMCO ENERGY, INC. and)
MARATHON OIL COMPANY Filed as TA139-4)

U-06-2

ORDER NO. 15

**ORDER REJECTING TA139-4 AS A BASE SUPPLY CONTRACT
HAVING THE EFFECT OF INCREASING THE CURRENT AVERAGE
COST OF SYSTEM GAS SUPPLY BUT ALLOWING TA139-4 TO TAKE
EFFECT IMMEDIATELY AS A BASE SUPPLY CONTRACT HAVING
THE EFFECT OF DECREASING THE CURRENT AVERAGE COST OF
SYSTEM GAS SUPPLY AND REQUIRING FILINGS**

BY THE COMMISSION:

Summary

We reject Tariff Advice Letter 139-4 (TA139-4) which includes the gas supply contract, APL-5, because ENSTAR¹ did not meet its burden of demonstrating that gas supplies pledged under the contract are reliable and that the price is reasonable. We allow APL-5 to go into effect without our approval to the extent that APL-5 has the effect of decreasing the current average cost of system gas supply in any

¹ENSTAR Natural Gas Company is a division of SEMCO Energy, Inc. (SEMCO). Alaska Pipeline Company (APLC) is a wholly-owned subsidiary of SEMCO. APLC, not ENSTAR Natural Gas Company, is the actual party to APL-5. The commission has historically regulated APLC and ENSTAR as a single entity. The use of the name ENSTAR in this proceeding includes both APLC and ENSTAR.

1 year of its implementation subject to ENSTAR making supplemental filings addressing
2 Section 2.7.4 of APL-5.

3 Background

4 At issue in this proceeding is TA139-4 filed November 14, 2005, in which
5 ENSTAR requested our approval of a new gas supply contract, APL-5, with Marathon
6 Oil Company (Marathon) providing for deliveries beginning in 2009.² ENSTAR operates
7 under Certificate of Public Convenience and Necessity Nos. 4 and 141 as a natural gas
8 transmission and distribution utility in Southcentral Alaska. Marathon is a current
9 ENSTAR supplier under a Gas Purchase Agreement dated May 1, 1988.³

10 ENSTAR requested that the commission approve the addition of APL-5 as
11 a base supply contract to its tariff⁴ and also requested inclusion of all costs related to
12 the contract in the calculation of ENSTAR's Gas Cost Adjustment.⁵

13 ENSTAR's tariff requires we approve any gas sales agreements that
14 increase ENSTAR's current average cost of gas. Tariff Sheet 90, Section 708f,
15 provides:

16 Base Supply Contracts.

17 The base supply contracts are those contracts in effect on September 1,
18 1987. Additional contracts or revisions of base supply contracts having the
19 effect of increasing the current average cost of system gas supply will be
20 made, subject to Commission approval, by filing with the Commission, 45
21 days prior to the proposed effective date of such addition or revision, a copy
22 of such addition or revision. Additional contracts or revisions of base supply
contracts having the effect of decreasing the current average cost of system
gas supply become effective immediately without notification.

23 ²H-1 at 1.

24 ³T-9 at 5.

25 ⁴H1-C (Tariff Sheet Nos. 89 and 221).

26 ⁵*Id.*

1 ENSTAR believes that a secure supply of gas that is reliably available
2 when its customers most need it is the utility's absolute top priority.⁶ ENSTAR's gas
3 supply contracts require ENSTAR to provide an annual forecast of its needs and
4 supplies for the next ten years each October⁷ in its "Buyer's Annual Forecast."⁸
5 ENSTAR calculates its annual gas requirements based on existing supplier
6 commitments and identifies any year in which there may be a supply shortfall ("Buyers
7 Unmet Requirements").⁹ Under ENSTAR's contract with Unocal,¹⁰ Unocal has the right
8 to supply any projected shortfall for five years into the future, beginning October 10,
9 2004. ENSTAR may not take gas from any third party so long as Unocal's total
10 commitment of gas brings ENSTAR's unmet requirements to zero.¹¹

11 In October 2004, ENSTAR projected unmet requirements beginning in
12 2008 and 2009.¹² Unocal was unable to commit to provide all of the additional gas
13 needed for 2009.¹³ ENSTAR notified other Cook Inlet producers of its need for new gas
14 supplies. Marathon was the only gas producer that offered to meet ENSTAR's unmet
15 requirements, including its full swing requirements, beginning in 2009 and continuing for
16 a reasonable period.¹⁴

17
18
19 ⁶T-1 (Izzo) at 3.

20 ⁷T-7 (Dieckgraeff) at 19.

21 ⁸H-1B at 3.

22 ⁹H-1B at 4.

23 ¹⁰H-26 at 11.

24 ¹¹*Id.*

25 ¹²T-7 (Dieckgraeff) at 6.

26 ¹³*Id.*

¹⁴T-7 (Dieckgraeff) at 10.

1 ENSTAR's swing ratio is approximately 3.0, meaning its forecasted peak
2 winter demand can be three times greater than its average daily demand. Chugach¹⁵
3 and ML&P¹⁶ have swing ratios ranging from 1.4 to 1.6 because electricity usage does
4 not fluctuate as dramatically from season to season as does the demand for gas for
5 space heating purposes. The industrial plants operating on the Cook Inlet - Agrium, the
6 LNG¹⁷ plant, and the Tesoro Refinery - have virtually no swing. They consume a more
7 or less steady volume year-round.¹⁸

8 ENSTAR has elected not to develop storage to meet its deliverability
9 requirements. Rather, ENSTAR "subcontracts" this important service to its suppliers.¹⁹
10 Many gas distribution utilities in the Lower 48 use gas storage facilities to meet
11 deliverability. SEMCO, in Michigan, uses a combination of leased and company-owned
12 storage totaling 15.1 Bcf²⁰ to provide approximately 40 percent of its winter supply
13 requirements and 25 percent of its peak-day requirements.

14 ENSTAR has contractual commitments from a 1988 contract with
15 Marathon (APL-4), a 1982 contract with the Beluga producers (Chevron,
16 ConocoPhillips, and ML&P), a 2000 contract with Aurora (also called the Moquawkie
17 Contract), and a 2000 contract with Unocal.²¹

18
19
20
21 ¹⁵Chugach Electric Association, Inc. (Chugach).

22 ¹⁶Municipality of Anchorage d/b/a Municipal Light & Power (ML&P).

23 ¹⁷Liquefied natural gas (LNG).

24 ¹⁸T-1 (Izzo) at 13.

25 ¹⁹*Id.*

26 ²⁰One billion standard cubic feet (Bcf).

²¹T-7 (Dieckgraeff) at 6.

1 The committed volumes supplied by the Beluga, Moquawkie, and APL-4
 2 contracts are declining as illustrated by ENSTAR's 2005 Buyers Annual Forecast as
 3 follows.²²

EXHIBIT A

**TO THE OCTOBER 14, 2005 GAS SALES AGREEMENT BETWEEN
 MARATHON OIL COMPANY AND ALASKA PIPELINE COMPANY**

ARTICLE XIV BUYER'S ANNUAL FORECAST

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
<u>Buyer's Annual Gas Requirements (Bcf)</u>										
Total Annual Requirements	26.70	27.50	28.30	29.0	29.7	30.30	31.00	31.60	32.20	32.70
Existing Commitments:										
Beluga	1.10	0.80	0.70	0.60	0.00	0.00	0.00	0.00	0.00	0.00
Marathon APL4	13.00	11.00	9.00	7.00	5.00	5.00	5.00	5.00	5.00	5.00
Moquawkie	1.80	1.50	1.10	0.80	0.60	0.50	0.30	0.30	0.20	0.00
Unocal Commitments	10.80	14.20	17.50	19.00	16.00	13.00	10.00	7.00	4.00	1.00
Total Existing Commit.	26.70	27.50	28.30	27.40	21.60	18.50	15.30	12.30	9.20	6.00
Unocal Conditional Option	0.00	0.00	0.00	0.00	3.00	6.00	9.00	12.00	15.00	18.00
Marathon APL5 Initial										
Annual Commitment	0.00	0.00	0.00	1.60	5.10	5.80	6.70	7.30	8.00	8.70
Marathon APL5 Additional	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Commitment										
Total Marathon Commit.	0.00	0.00	0.00	1.60	5.10	5.80	6.70	7.30	8.00	8.70
Additional Third-Party										
Commitments	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Unmet Requirements*	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

16 Starting in the mid-1970s, ENSTAR's first gas supply contract (APL-I) had
 17 a portion of its price indexed on a component of the producer price index. The price
 18 adjustment term for the Marathon APL-4 contract and Beluga Contract is based on the
 19 NYMEX²³ oil futures. The price adjustment term for the Moquawkie contract is based
 20 on the Gross Domestic Product Implicit Price Deflator (GDPIPD), a national measure of
 21 inflation. In the Unocal and NorthStar²⁴ contracts, the price itself is based on a

23 ²²H-1A, Ex. A at 44-46.

24 ²³New York Mercantile Exchange (NYMEX).

25 ²⁴As of the hearing date, there were no volumes committed from the NorthStar
 26 contract.

1 36-month daily average Henry Hub natural gas futures.²⁵ We have attached an
2 appendix which illustrates the differing prices of ENSTAR's gas supply contracts.

3 ENSTAR presents its new supply contract with Marathon which "should
4 insure that ENSTAR has sufficient gas to meet all of its customers' requirements
5 through at least 2016."²⁶ Marathon provides all the gas needed by ENSTAR above that
6 which comes from fixed volume contracts. APL-5 is effective October 14, 2005, with the
7 full requirements provisions effective for Contract Years 2009 through 2016.²⁷
8 Marathon makes available 62.8 BCF of Proven Reserves to meet its Initial Annual
9 Commitment.²⁸ There are limits on Marathon's rights to sell gas produced from its
10 Proven Reserves if it can not meet its obligations under APL-5.²⁹ ENSTAR will have a
11 priority on Marathon's gas delivered into the Cook Inlet area, except for Marathon's
12 existing commitments;³⁰ and any subsequent contract entered into or any existing
13 contract modified by Marathon must recognize this priority.³¹

14 The contract price (Index Price) of gas under APL-5 is set annually in
15 October for the next year beginning January 1.³² The Index Price is calculated using
16 the simple daily average price of the NYMEX Henry Hub natural gas futures market
17 during the preceding twelve months ending September 30.³³

18
19 ²⁵T-7 (Dieckgraeff) at 16.

20 ²⁶H-1 at 2.

21 ²⁷H-1A at 1.

22 ²⁸*Id.*

23 ²⁹*Id.* at 2.

24 ³⁰H-1A, Ex. E.

25 ³¹T-7 (Dieckgraeff) at 15.

26 ³²H-1A at 2.

³³*Id.* at 3.

1 The Index Price is discounted as follows to determine the Contract Price
2 (defined in Section 3.1, p. 22 of APL-5) which is subject to a Floor and a Ceiling:

3 i. If the Index Price is \$6.00 per Mcf³⁴ or less, the Contract Price equals
4 the Index Price;

5 ii. If the Index Price is greater than \$6.00 per Mcf and equal to or less
6 than \$8.00 per Mcf, the Contract Price equals \$6.00 plus 80 percent of the
7 difference between the Index Price and \$6.00;

8 iii. If the Index Price is greater than \$8.00 per Mcf and less than or equal
9 to \$10.00 per Mcf, the Contract Price is \$7.60 plus 95 percent of the
10 difference between the Index Price and \$8.00;³⁵

11 iv. If the Index Price is greater than \$10.00 per Mcf, the Contract Price is
12 \$9.50 plus 85 percent of the difference between the Index Price and
13 \$10.00,³⁶

14 APL-5 has a floor price, the minimum price Marathon will receive from
15 ENSTAR, which is set at \$4.25 adjusted annually by one-half the annual rate of inflation
16 based on the GDPIPD.³⁷

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21 ³⁴One thousand standard cubic feet (Mcf)

22 ³⁵H-1B, Section 3.1(iii) at 23.

23 ³⁶H-1A at 3.

24 ³⁷H-1B, Section 3.3 at 23-24 - The Floor Price is equal to the initial price of \$4.25
25 times one plus the floor price adjuster divided by 2. The floor price adjuster is the
26 GDPIPD for the quarter ended June 30 of the year before the price is calculated,
divided by GDPIPD for the quarter ended June 30, 2006.

1 APL-5 also has a ceiling price of \$15.00 that is adjusted annually by one-
2 half the annual rate of inflation based on the GDPIPD; however, the cap cannot change
3 by more than 1.5 percent per year.³⁸

4 APL-5 requires ENSTAR to pay Marathon \$0.25 per Mcf as a gas
5 transportation fee to ship the gas to ENSTAR's pipelines. There is also an Excess
6 Peaking gas fee of \$2.50 per Mcf for gas that Marathon provides in excess of its
7 pro rata share of ENSTAR's peak day gas requirements. Additionally, APL-5 requires
8 ENSTAR to reimburse Marathon for all production taxes on gas purchased by
9 ENSTAR.³⁹

10 We have previously decided the ENSTAR-Unocal Gas Sales Agreement
11 (Unocal GSA)⁴⁰ and the ENSTAR-NorthStar Gas Sales Agreement (NorthStar GSA).⁴¹

12 Unocal Gas Sales Agreement

13 On October 25, 2001, we issued Order U-01-7(8) conditionally approving
14 a Unocal GSA between ENSTAR and Unocal. Unocal and ENSTAR characterized the
15 Unocal GSA as an exploration contract because the focus of the contract was

16 _____
17 ³⁸H-1B, Section 3.4 - The Ceiling Price is equal \$15.00 times one plus the ceiling
18 price adjuster divided by 2. The ceiling price adjuster is the GDPIPD for the quarter
19 ended June 30 of the Year before the Year for which the Price is calculated, divided by
20 GDPIPD for the quarter ended June 30 of the Year two years before the year the
21 Contract Price is calculated. However, the calculation of the ceiling price in any contract
22 year, the ceiling price adjuster used in such calculation will not be more than 1.0300.

23 ³⁹H-1B, Article V.

24 ⁴⁰Docket U-01-7, *In the Matter of the Gas Sales Agreement Between ALASKA
25 PIPELINE COMPANY, a Wholly-owned Subsidiary of SEMCO ENERGY, INC., of
26 Which the ENSTAR NATURAL GAS COMPANY is a Division, and the UNION OIL
COMPANY OF CALIFORNIA, Filed as TA117-4. TA117-4 was filed December 12,
2000.*

⁴¹Docket U-03-84, *In the Matter of the Gas Sales Agreement between ENSTAR
Natural Gas Company, a division of SEMCO ENERGY INC. and NORTHSTAR
ENERGY GROUP, INC. filed as TA125-4. TA125-4 was filed August 8, 2003.*

1 exploration for new gas sources.⁴² Under the contract Unocal committed to spend in
2 excess of \$10 million over two years looking for new gas fields.

3 The Unocal GSA was the first time we allowed a gas supply contract to be
4 priced to a market index, Henry Hub natural gas futures. We found that ENSTAR
5 needed to pay a competitive price to attract exploration capital and that a price tied to
6 Henry Hub with a floor of \$2.75 was a reasonable balance of the risks associated with
7 gas exploration and the need to assure an adequate supply of gas to ENSTAR.⁴³

8 Northstar Gas Sales Agreement

9 On March 23, 2004, we issued Order U-03-84(7), conditionally approving
10 a full requirements gas sales agreement between ENSTAR and Northstar to serve
11 Homer for twenty years beginning at the first delivery under the contract.⁴⁴

12 NorthStar stated it would spend between \$8 and \$12 million for expenses
13 associated with drilling, completing, and testing wells that target new gas reserves and
14 constructing a pipeline.⁴⁵ We found that the investment required of NorthStar prior to
15 the opportunity to sell gas, the requirement to prove additional reserves, and the
16 requirement to drill a second 'commercial quality gas field' well as justifications for
17 Henry Hub pricing.⁴⁶

18 Hearing Proceeding

19 We convened a hearing on APL-5. It began on July 6, 2006, and
20 continued through July 13, 2006, when it was recessed because Marathon refused to
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22 ⁴²Order U-01-7(8) at 8.

23 ⁴³*Id.* at 9.

24 ⁴⁴Order U-03-84(7) at 4

25 ⁴⁵*Id.* at 5.

26 ⁴⁶*Id.* at 10.

1 provide discovery we ordered. ENSTAR presented the testimony of Paul R. Carpenter
2 (Carpenter); Anthony M. Izzo (Izzo); Oliver Scott Goldsmith (Goldsmith), and Daniel M.
3 Dieckgraeff (Dieckgraeff).⁴⁷

4 The hearing resumed on August 22, 2006. Intervenor James L. Walker
5 (Walker) presented testimony and was cross-examined⁴⁸. Marathon presented the
6 testimony of Bruce B. Henning (Henning) and Catherine M. Elder (Elder).⁴⁹ The
7 Attorney General (AG) presented its witness Arlon R. Tussing (Tussing).⁵⁰ Tesoro
8 presented Benjamin Schlesinger (Schlesinger).⁵¹ The final witness was C. Les Webber
9 (Webber), sponsored by Marathon, who had previously been unavailable due to
10 scheduling conflicts.⁵² On Sunday, August 27, 2006, we heard closing argument by the
11 parties.⁵³ The positions of the parties are summarized below.

12 Positions of the Parties

13 ENSTAR

14 ENSTAR requests Commission approval for the addition of APL-5 to
15 Section 708 of ENSTAR's tariff as a base supply contract and for inclusion of all costs
16 related to the contract in the calculation of ENSTAR's Gas Cost Adjustment, including
17 Henry Hub pricing.

18 ENSTAR stated that it supports using a 12-month trailing average of the
19 Henry Hub Index (Trailing HHI) because it provides 240 data points of actual

20 ⁴⁷Tr. at 118-1261.

21 ⁴⁸Tr. at 1298-1399.

22 ⁴⁹Tr. at 1399-1656.

23 ⁵⁰Tr. at 1687-2050.

24 ⁵¹Tr. at 2052-2308.

25 ⁵²Tr. at 2318-2478.

26 ⁵³Tr. at 2054-2619.

1 transactions in a highly liquid, transparent, and competitive natural gas market.
2 ENSTAR added that the Trailing HHI reflects price changes more quickly than the 36-
3 month trailing average HHI used in Unocal GSA and NorthStar GSA. ENSTAR stated
4 that a 12-month trailing average in APL-5 buffers the Unocal GSA by reflecting falling
5 prices. An additional advantage of the Trailing HHI price is that it is market-responsive,
6 thereby mitigating the risk that, over the term of the contract, the price will be higher
7 than the HHI price.⁵⁴

8 ENSTAR asserted that the Henry Hub is a dominant market reference and
9 the commission twice sent signals to the market indicating that contracts with trailing
10 averages of Henry Hub represent a fair price. ENSTAR absolutely believes APL-5 is a
11 fair market price, and that ENSTAR got this gas for less than straight Henry Hub price
12 even with a ceiling. ENSTAR asserted that Cook Inlet gas is in scare supply and that
13 APL-5 diversifies ENSTAR's supply portfolio.

14 ENSTAR maintained that the purpose of the Henry Hub price was to
15 stimulate additional exploration and development of reserves in Cook Inlet. ENSTAR
16 added that the price needs to be high enough to attract investment capital to this market
17 compared to other markets. ENSTAR stated that the Henry Hub is what the
18 Department of Energy (DOE) uses as a comparative reference. ENSTAR stated that
19 two alternatives have been proposed, one on the West Coast and one in Alberta, but
20 points out that both those markets have a lot of supply. ENSTAR added that the supply
21 and demand balance in those markets is not the same as it is in the Cook Inlet market.
22 ENSTAR hoped that, over the long haul, the Cook Inlet market would come into some
23 sort of a balance.⁵⁵

24 ⁵⁴TA139-4 at 5.

25 ⁵⁵Tr. at 671-578.

1 ENSTAR proposed the \$4.25/Mcf price floor and the ceiling being capped
2 at \$15.00/Mcf, noting that the floor and cap are adjusted annually by one-half of
3 inflation, but the cap cannot change by more than 1.5 percent from year-to-year. The
4 purpose of the cap and floor is to force the price to fall within a relatively narrow range
5 and to avoid extreme swings in price.⁵⁶

6 ENSTAR explained that the floor and the ceiling were agreed to by the
7 parties as a mutual allocation of risk.⁵⁷ ENSTAR explained that the floor and ceiling
8 price were negotiated terms, and in its opinion, not arbitrary.⁵⁸

9 APL-5 requires ENSTAR to pay a transportation fee of \$0.25/Mcf to
10 Marathon for transportation of all gas provided to ENSTAR. The transportation fee is
11 intended to cover the construction, installation, and operation of Marathon's production,
12 gathering, treating, and processing facilities; and all pipelines necessary to deliver gas
13 to ENSTAR. The alternative, according to ENSTAR, would be to pay the actual tariff for
14 each pipeline, which creates risks that arise from the new regulation of most Cook Inlet
15 gas pipelines. ENSTAR added that the use of actual tariffs is also unworkable because
16 Marathon will have two contracts with ENSTAR; and gas will be delivered
17 simultaneously under both contracts starting in 2009, so there is no way to determine
18 which gas molecules are from APL-4 or APL-5. ENSTAR does not think it wise to
19 expose its customers to these risks and proposes a fixed rate as best for its
20 ratepayers.⁵⁹

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23 ⁵⁶TA139-4 at 5, Tr. 453.

24 ⁵⁷Tr. at 229.

25 ⁵⁸Tr. at 139.

26 ⁵⁹TA139-4 at 6.

1 ENSTAR asserted that there is no limitation to the transportation fee,
2 whether a pipeline is preexisting or constructed later.⁶⁰ ENSTAR added that Marathon
3 has not indicated from where it plans to ship the gas. ENSTAR further added that it is
4 conceivable that Marathon will be shipping gas through preexisting pipelines, newly-
5 constructed pipelines, and newly-regulated pipelines.⁶¹ ENSTAR stated that Marathon
6 indicated it may ship gas over the Kenai-Nikiski Pipe Line, Cook Inlet Gas Gathering
7 System, and Beluga, which are now regulated pipelines.⁶²

8 APL-5 requires ENSTAR to pay a peaking gas fee of \$2.50/Mcf, in
9 addition to the price of the gas for all gas delivered in excess of Marathon's pro rata
10 share of ENSTAR's peak day gas requirements. According to ENSTAR, the additional
11 charge of \$2.50/Mcf (in addition to the HHI price) was necessary, if ENSTAR requests
12 and Marathon provides gas (1) in excess of Marathon's pro-rata share of what it would
13 provide on the peak day or (2) in excess of the flow rate that if sustained for 24-hours
14 would cause Marathon to supply more than its pro-rata share of the peak day
15 requirement. However, if the reason for the request for excess gas is due to an
16 inaccurate forecast by ENSTAR of its estimated peak day requirement, the incremental
17 charge of \$2.50/Mcf is not applied and the price payable is the HHI price.⁶³

18 ENSTAR stated that the peaking fee contract provision supports the
19 notion that a full requirements contract with swing has a great deal of value. ENSTAR
20 continued that providing for swing is also costly for a producer not in a position to be
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23 ⁶⁰Tr. at 851.

24 ⁶¹Tr. at 852.

25 ⁶²Tr. at 853-854.

26 ⁶³TA139-4 at 6.

1 able to itself go to the spot market and pick up emergency supplies to backfill a contract.
2 ENSTAR stated that swing has value to a buyer and costs to a seller.⁶⁴

3 ENSTAR also reported awareness that Marathon provided peaking gas to
4 a third party at basically the same price as the peaking price under the Unocal contract.
5 ENSTAR stated that the price for the peaking gas in the Unocal contract price is base
6 price plus \$1.00 per Mcf. ENSTAR stated that the reason Marathon received the
7 \$2.50/Mcf peaking fee was that it was part of the overall contract negotiations.⁶⁵

8 APL-5 provides that ENSTAR will reimburse Marathon for all production
9 taxes. ENSTAR asserted that the price includes all royalties. ENSTAR added that
10 these provisions are essentially identical to the Unocal and NorthStar contracts.⁶⁶
11 ENSTAR added that the producers have insisted upon provisions for tax reimbursement
12 in all of ENSTAR's gas supply arrangements since the mid-1970s. ENSTAR stated that
13 no one needs to look further than the flurry of activity around production taxes in the
14 recent legislative session to understand why. ENSTAR added that under the current
15 statutory scheme, the provisions for oil production taxes also apply to gas production
16 taxes.⁶⁷

17 Marathon will be ENSTAR's full requirements supplier beginning in
18 contract year 2009 and ending in contract year 2016; however, Marathon may provide
19 gas into the future beyond 2018. ENSTAR added that APL-5 is a relatively short-term
20 contract compared to ENSTAR's other gas supply contracts. Further, Marathon has
21 committed to supply ENSTAR's unmet requirements through 2016 and Marathon has
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23 ⁶⁴Tr. at 283-286.

24 ⁶⁵Tr. 1179-1180.

25 ⁶⁶TA139-4 at 7.

26 ⁶⁷T-7 at 19.

1 no right to “put” additional gas to ENSTAR unless shortfalls occur for specified reasons
2 during those years. ENSTAR added that Marathon has an option to offer additional gas
3 to ENSTAR under various circumstances; however, ENSTAR has the option to take or
4 not take the optional gas. ENSTAR asserted the contract’s term balances the need for
5 an assured gas supply against the possibility that less expensive or alternative gas
6 supplies might become available from the North Slope or new Cook Inlet discoveries or
7 developments.⁶⁸

8 ENSTAR offered three reasons why APL-5 does not have a limitation on
9 the amount of gas that Marathon can purchase each year and resell. First, when gas is
10 scarce it is not desirable to make it more difficult to discover, produce, deliver, or to
11 otherwise limit the seller’s alternatives to procure gas to meet ENSTAR’s requirements.
12 Second, Marathon is not obligated to but may wish, in the future, to develop storage
13 facilities for meeting some of its commitments to ENSTAR. ENSTAR stated that
14 purchasing gas when it is available (typically during the summer) and putting it into
15 storage for the winter is very desirable because that maximizes the gas available for
16 ENSTAR. Third, the proposed APL-5 is relatively short-term and it would be beneficial if
17 Marathon can offer additional gas as a result of purchases. ENSTAR does not expect
18 that Marathon will purchase significant quantities of gas to meet its obligations, but
19 believes it unwise to constrain that option during the term of APL-5.⁶⁹

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⁶⁸TA139-4 at 4.

25 ⁶⁹TA139-4 at 5.

1 Marathon

2 Marathon supports APL-5 and offers its opinion that the agreement
3 satisfied the "public interest" standard adopted by the commission.⁷⁰ Marathon stated
4 that it invested significant amounts of capital to prove up and develop its gas reserves
5 so it can fully serve ENSTAR. As a result of its investment Marathon can now provide a
6 long term secure supply to ENSTAR and its customers.⁷¹ Marathon added that in the
7 contract negotiations it made significant concessions to benefit ENSTAR's customers
8 regarding the pricing of the gas and other key terms.⁷² Marathon stated that APL-5 was
9 carefully structured to satisfy the commission's public interest standard, as well as to
10 balance the needs of each of the parties and that in its opinion the public benefits from
11 approval of APL-5.⁷³ Marathon was the only gas producer that offered to meet specific
12 load-following needs of the ENSTAR customer base and is willing to also meet
13 ENSTAR's unmet requirements beginning in 2009 and for a reasonable period
14 thereafter.⁷⁴ In its role as an ENSTAR gas supplier meeting ENSTAR's considerable
15 swing and peak requirements, Marathon suggests that it will incur significantly more
16 cost than the cost of meeting the load of a customer who takes a relatively constant
17 daily volume of gas over an extended period.⁷⁵ Marathon witness Henning⁷⁶ stated this
18 contract has a very high likelihood of reducing ENSTAR's WACOG (weighted average
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20 ⁷⁰*Comments of Marathon Oil Company* filed December 22, 2005 in TA139-4,
21 at 1.

22 ⁷¹*Id.* at 2.

23 ⁷²*Id.* at 3.

24 ⁷³*Id.* at 4.

25 ⁷⁴*Id.* at 2.

26 ⁷⁵*Id.* at 4

⁷⁶T-14 (Henning) at 24.

1 cost of gas). Marathon also stated in closing argument there was an extraordinary
2 likelihood in this record that the result of APL-5 will be a decrease to ENSTAR's
3 WACOG.⁷⁷

4 Attorney General

5 The AG noted seventeen specific concerns with APL-5 and set them out in
6 his statement of issues and early filed comments.⁷⁸ The AG's principal concern is
7 whether the price of gas under APL-5 is unjust and unreasonable such that the pricing
8 provision of APL-5 should be rejected in its entirety.⁷⁹ The AG identified three
9 subcomponents of the price inquiry including:

- 10 (a) Whether it is appropriate to use the Henry Hub index (HHI) as a
11 pricing proxy under the facts presented in APL-5;
- 12 (b) Whether APL-5's use of a twelve-month HH average would be
13 prudent given HH market volatility and the resulting potential for
14 consumer rate shock;
- 15 (c) Whether the price floor (\$4.25/Mcf) and price cap (\$15.00/Mcf) in
16 APL-5 are reasonable.

17 The AG identified other concerns including such matters as the
18 opportunity for arbitrage, peaking fees, transportation fees, and production taxes. The
19 AG asked whether storage might render suspect Marathon's claim of high cost to meet
20 deliverability and suggested that approval of one or all of the pricing provisions will
21 require a determination of whether the inclusion of such term in APL-5 meets the
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23 ⁷⁷Tr. at 2529.

24 ⁷⁸*Attorney General's Statement of Issues*, filed June 28, 2006, and *Comments of*
25 *the Attorney General* filed in TA139-4 on December 22, 2005.

26 ⁷⁹*Comments of the Attorney General*, filed December 22, 2005, in TA139-4, at 2.

1 standard of fair, just, and reasonable.⁸⁰ The AG suggested that the APL-5 raises
2 significant public policy issues and would, if adopted, impact all of ENSTAR's captive
3 ratepayers.⁸¹

4 Intervenor Walker

5 Walker is a residential ratepayer who opposes APL-5.⁸² Walker asked
6 that the contract be rejected as the price terms are neither just nor reasonable.⁸³
7 Walker stated that the ENSTAR gas cost adjustment mechanism means ENSTAR's
8 captive ratepayers will bear all of the economic and supply risk under APL-5. ENSTAR
9 will bear no economic risk or supply risk at all if APL-5 is approved by the commission.⁸⁴
10 Walker added that public policy should encourage construction of gas storage facilities
11 to ensure the long-term provision of utility services necessary for the public convenience
12 and necessity.⁸⁵ Walker stated that the lack of gas production capability in Cook Inlet is
13 not solved by this contract.⁸⁶ Walker objected to allowing companies the opportunity to
14 take profits from Cook Inlet without requiring them to reinvest in Cook Inlet, thereby
15 ensuring a long term gas supply for Alaska consumers.⁸⁷

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19 ⁸⁰*Id.* at 2.

20 ⁸¹*Id.* at 3.

21 ⁸²*Comments of James L. Walker*, filed December 19, 2005, in TA139-4, at 1.

22 ⁸³*Id.* at 1.

23 ⁸⁴*Id.* at 1.

24 ⁸⁵Tr. 1384-1385 and *Comments of James L. Walker*, filed December 19, 2005, in
TA139-4 at 3.

25 ⁸⁶*Comments of James L. Walker*, filed December 19, 2005 at 1.

26 ⁸⁷*Id.* at 4

1 Intervenor Tesoro

2 Tesoro's primary concern with APL-5 is the objectionable pricing
3 mechanisms. Tesoro asserted that a price based on the 12-month trailing average of
4 Henry Hub prices is essentially a "straight Henry Hub" price and approval of straight
5 Henry Hub price will result in ENSTAR paying excessive prices for Cook Inlet natural
6 gas.⁸⁸ According to Tesoro, Cook Inlet natural gas is either used locally, used to
7 manufacture fertilizer for export along the Pacific Rim, or converted into LNG for export
8 to Japan,⁸⁹ and none of these uses is linked in any direct way to Henry Hub⁹⁰ pricing;
9 and therefore, a HHI price bears no logical relationship to the prices of Cook Inlet
10 natural gas.⁹¹ Tesoro stated that the only justification for using HHI pricing is as an
11 incentive for a commitment to explore for additional natural gas, such as in the Unocal
12 GSA.⁹² Tesoro asserted that because of the absence of an exploration obligation or
13 other undertakings on the part of Marathon, APL-5 lacks justification in support of the
14 proposed straight HHI pricing.⁹³ Tesoro is also concerned that the peaking and excess
15 volume price premiums to be paid by ENSTAR customers are excessive.⁹⁴

16 According to Tesoro, premiums for peaking gas are arguably built into the
17 HHI pricing structure, are reflective of seasonal supply and demand dynamics, and

20 ⁸⁸*Tesoro Alaska Company's Comments on Tariff Advice Letter 139-4 and Petition
to Intervene*, filed December 22, 2005, in TA139-4, at 3.

21 ⁸⁹*Id.*

22 ⁹⁰Henry Hub Index.

23 ⁹¹*Id.*

24 ⁹²*Id.* at 5.

25 ⁹³*Id.* at 6.

26 ⁹⁴*Id.* at 3 and 7.

1 appear to be inappropriate as premiums above HHI pricing.⁹⁵ Tesoro said that the
2 propriety of these price adjustments for premium services should be investigated by the
3 commission.⁹⁶ Tesoro is also concerned with the ability of Marathon to resell third-party
4 natural gas to ENSTAR at a premium above its acquisition cost without any restrictions
5 or constraints.⁹⁷ According to Tesoro, APL-5 puts Marathon in the position of a gas
6 broker, providing it with the opportunity to purchase gas at lower prices from others and
7 sell that same gas to ENSTAR under APL-5.⁹⁸

8 Intervenor Trading Bay

9 Trading Bay Energy Corporation (Trading Bay) was granted intervenor
10 status in the Docket proceeding but did not participate at the hearing.⁹⁹ Trading Bay is
11 an Alaska business that has as its goal establishing an Alaska owned and operated oil
12 and gas exploration and production company.¹⁰⁰ The company complained that a
13 “[c]onsistent stick in the spokes” as it has sought to grow its business and produce oil or
14 gas, is the lack of opportunity to sell newly discovered gas into the existing
15 marketplace.¹⁰¹ Trading Bay asked that the commission take steps to require that a set

16 ⁹⁵*Id.*

17 ⁹⁶*Id.*

18 ⁹⁷*Id.* at 8.

19 ⁹⁸*Id.*

20 ⁹⁹Order U-06-2(2), *Order Granting Motion for Leave to Accept Reply Filed by*
21 *Tesoro, Denying Motion for Leave to Accept Reply Filed by Agrium, Affirming Electronic*
22 *Ruling Granting Intervention to Marathon and Denying Intervention to Agrium, Vacating*
23 *Electronic Ruling Denying Intervention to Tesoro, Granting Petitions to Intervene Filed*
24 *by Walker and Trading Bay, Rejecting Reply by Trading Bay, Affirming Bench Ruling*
25 *and Adopting Procedural Schedule, and Granting Motion to Adopt Orders Governing*
26 *Discovery and Confidential Discovery Material*, dated March 23, 2006.

¹⁰⁰*Comments by Trading Bay Energy Corporation*, filed in TA139-4 on
December 27, 2005, at 1.

¹⁰¹*Id.* at 2.