



UNITED STATES OF AMERICA  
DEPARTMENT OF ENERGY  
OFFICE OF FOSSIL ENERGY

In the Matter of: )  
)  
CONOCOPHILLIPS ALASKA )  
NATURAL GAS CORPORATION ) FE Docket No. 07-02-LNG  
and )  
MARATHON OIL COMPANY )  
\_\_\_\_\_ )

**REPLY COMMENTS OF THE STATE OF ALASKA**

Pursuant to the Department of Energy, Office of Fossil Energy’s (“FE” or “DOE”) June 5, 2007 Order, the State of Alaska (the “State”) submits the following Reply to the Applicants’ Answer.

**I. INTRODUCTION AND SUMMARY OF ARGUMENT**

The State supports a decision by FE to grant the LNG export application (the “Application”) subject to three conditions: ensuring local utility needs are met, taking steps to provide for replacement of reserves exported, and allowing for open access to unused capacity of the LNG plant by other producers. The State’s request for imposition of these three conditions is consistent with accepted economic principles, and tied directly to the FE’s objectives under Section 3 of the Natural Gas Act (“Section 3” or the “Act”).

First, the State has shown that local utilities serving the majority of Alaska’s population have no place else to go for gas, and have substantial unmet natural gas requirements during the proposed export extension term. Ensuring that these local

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2 needs are met *before* allowing LNG to be exported is a stated DOE/FE requirement.<sup>1</sup>  
3 Thus, the application can be approved on the condition that physical exports of LNG  
4 may occur only after local needs are met, which can be satisfied by the applicants and/or  
5 other suppliers in the local market.

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7 Second, in addition to ensuring energy security for Alaska, DOE's Section  
8 3 Guidelines state that in evaluating applications under the Act, "[t]he policy  
9 cornerstone of the public interest standard is competition."<sup>2</sup> The State's request for FE  
10 imposition of conditions requiring (1) reserves replacement and (2) open access are tied  
11 directly to these policy cornerstones. Requiring reserves replacement, in the form of  
12 measurable work commitments and an offer to sell geophysical and geological data to  
13 third-party gas explorers, will not only help ensure local needs are met, but will also  
14 serve as a platform for continued viability of the nation's only LNG export industry. At  
15 the same time, requiring open access to the LNG plant through purchases of gas from  
16 third-party suppliers under reasonable terms will promote development of competition  
17 in the local natural gas market by providing new producers a market to monetize their  
18 investment, a point the Applicants candidly admit.<sup>3</sup>

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22 <sup>1</sup> DOE/FE Opinion and Order 1473, at p. 13.

23 <sup>2</sup> 49 Fed. Reg. 6684, 6687 (February 22, 1984).

24 <sup>3</sup> Answer, page 28: "The pace of future investment will depend on  
25 balancing the timing of investment capital with expectations of when the resource can  
26 be sold."

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2 Each of these requested conditions are inherently reasonable and are  
3 consistent with DOE/FE's Section 3 mandate. The State's requested conditions have  
4 their foundations set in sound economic theory, are tied to ensuring the preservation of  
5 Alaska's energy security, and would, if implemented, foster creation of a true  
6 competitive market for natural gas production in the Cook Inlet.  
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8 The Applicants' response to the State's requests is not persuasive. The  
9 goal underlying the Applicants' Answer is preservation of the Applicants' market power  
10 by limiting open access, while concurrently allowing them to harvest remaining proved  
11 Cook Inlet reserves for export at the expense of the local needs of utilities that provide  
12 home heating and electric power generation for the vast majority of Alaskans.  
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14 Adhering to the Applicants' request for FE to reject the State's proposed  
15 conditions cannot be found to be consistent with DOE's policy under Section 3. FE  
16 should adopt the State's requested conditions in their entirety.

17 **I. ARGUMENT**

18 **A. THE FOUNDATION FOR THE APPLICANTS' ANSWER IS**  
19 **UNSUPPORTABLE**

20 The foundation for virtually every argument raised in the Applicants'  
21 Answer lies with their incorrect assertion that Cook Inlet presents a *normal* competitive  
22 market, and that imposition of the State's requested conditions would inappropriately  
23 interfere with its workings. This premise is patently incorrect.  
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2 The State's Motion to Intervene demonstrates that the Cook Inlet market  
3 is not competitive for suppliers.<sup>4</sup> Instead, it is dominated by only three producers  
4 (ConocoPhillips, Marathon and Chevron) who collectively control 95 percent of all gas  
5 sold from the Cook Inlet. Other than the LNG plant (to which only ConocoPhillips and  
6 Marathon currently have access), the only other local outlets for Cook Inlet gas  
7 produced are the local utility market, the Agrium fertilizer plant, and a few other small  
8 commercial users, such as the Tesoro refinery. The current Reserves-to-Production  
9 ("R/P") ratio is now below 9. Gas prices have doubled over the last three years. A  
10 Lerner Index analysis of this market shows the Applicants hold substantial market  
11 power<sup>5</sup> which carries with it both the specter and reality of oligopoly pricing  
12 capabilities.<sup>6</sup>  
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17 <sup>4</sup> State's Motion to Intervene, pages 14 – 15.

18 <sup>5</sup> References supported each of these facts are detailed in the State's Motion  
19 to Intervene, filed with DOE on April 9, 2007.

20 <sup>6</sup> An example of such oligopoly pricing is the recent APL-5 gas supply  
21 contract which was presented to the Regulatory Commission of Alaska ("RCA") by  
22 Marathon and Enstar. The RCA rejected this contract as being unreasonably priced.  
23 RCA Order U-06-02(15)(September 28, 2006). This determination is entitled to  
24 collateral estoppel effect by DOE/FE. *Astoria Federal Savings & Loan Ass'n. v.*  
25 *Solimino*, 501 U.S. 104, 108, 111 S.Ct. 2166 (1991). The Applicants choose to ignore  
26 this conclusive determination by referencing dissenting statements from the RCA Order  
that cannot, because of collateral estoppel, be given any weight as a matter of law. See  
Answer at pages 20 and 40.



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2 None of these facts are disputed in the Applicants' Answer. Instead, the  
3 Applicants proceed with their arguments wrongly assuming at a threshold level that the  
4 Cook Inlet market is "competitive" when it clearly is not.<sup>7</sup>

5 This flawed premise can be found threaded throughout the Applicants'  
6 entire Answer. For example, the Applicants claim that imposition of a condition  
7 requiring local public utility demand to be under contract would ". . . interfere with *the*  
8 *normal workings of a competitive market* by requiring an exporter to give contract  
9 priority to domestic customers."<sup>8</sup> They claim that "*reasonable, market-based*" pricing  
10 is the only incentive needed to encourage reserves replacement.<sup>9</sup> They claim granting  
11 the export Application "will not diminish the quantity or quality of energy available, nor  
12 should it increase the cost of energy in the market *assuming that the market is*

15 <sup>7</sup> The State recognizes that, in reality, markets rarely meet recognized  
16 economic criteria fitting a perfectly competitive model. In addition to a market  
17 structure that comports with the notion of price-taking buyers and sellers with ease of  
18 entry and exit, the perfectly competitive model assumes the existence of a perfectly  
19 divisible, homogeneous product, perfect information, no externalities, and no  
20 transaction costs. Here, however, the State views Cook Inlet, with its closed, highly  
21 concentrated structure of production that is clearly capable of dominating other factors,  
22 to represent special circumstances that justify governmental intervention. *See, D.*  
23 *Carleton and J. Perloff, Industrial Organization, (2<sup>nd</sup> Ed. 1994) at page 87.*

24 <sup>8</sup> Answer page 19: "DOE/FE has never found the public interest to require  
25 all utility demand to be under contract. In fact, DOE/FE has found that 'it is not in the  
26 public interest for DOE to interfere with the normal workings of a competitive market  
by requiring an exporter to give contract priority to domestic customers.'"

<sup>9</sup> Answer page 29: "There is no incentive to continue exploring for and  
developing resources when the market can be met for five to ten years into the future for  
those who are willing and able to buy natural gas at a reasonable, market-based price."

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2 *functioning properly.*<sup>10</sup> They claim local utility deliverability constraints should be  
3 ignored because “. . . *market forces* should be allowed to implement a natural gas supply  
4 system that specifically addresses base load, peak and needle peaking requirements.”<sup>11</sup>  
5 They claim that curtailed operations of local industry and a scramble by local utilities to  
6 secure gas supplies needed to provide vital services are not the result of a reduction in  
7 Cook Inlet’s proved reserves to historic lows, but instead “. . . *the market is sorting out*  
8 *which entities are economically viable* as the era of stranded gas comes to an end in  
9 Cook Inlet.”<sup>12</sup> They claim that “there is nothing to prevent local utilities, manufacturers  
10 or industrial users from negotiating with [the Applicants] . . . after the export  
11 authorization is approved.”<sup>13</sup> And they claim there is no need to impose a condition  
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16 <sup>10</sup> Answer page 14.

17 <sup>11</sup> Answer page 33: “Simply put, responsibility for fixing the system should  
18 not be demanded solely of Applicants. Instead, market forces should be allowed to  
19 implement a natural gas supply system that specifically addresses base load, peak and  
20 needle peaking requirements.”

21 <sup>12</sup> Answer page 36: “In reality, the market is sorting out which entities are  
22 economically viable as the era of stranded gas comes to an end in Cook Inlet. . . . Closer  
23 examination, however, shows that these results are reactions to economic factors, not  
24 indicators of natural gas shortages.”

25 <sup>13</sup> Answer page 5 – 6. “Nothing in the blanket authorization sought by  
26 Applicants will compel them to export all of the authorized volumes. Local utilities,  
manufactures or refiners are free to compete for the volumes associated with the export  
authorization as well as other natural gas available in the marketplace.”



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2 because “. . . exploration and production decisions should be influenced by *market*  
3 *forces*, not regulatory fiat.”<sup>14</sup>

4 As shown earlier, it is simply incorrect for the Applicants to ground their  
5 arguments on the assumption that the Cook Inlet market is either “normal” or  
6 “competitive” when it is neither. This fundamental flaw invalidates the Applicants’  
7 objections to the State’s conditions at a threshold level.  
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9 **B. THE APPLICANTS MISINTERPRET THE STANDARDS TO BE**  
10 **APPLIED TO THIS EXPORT APPLICATION**

11 The Applicants contend the State’s requested conditions are  
12 unprecedented.<sup>15</sup> From this baseline, they conclude these requested conditions are at  
13 odds with DOE precedent and guidelines. This leap in logic is unwarranted.

14 As a preliminary matter, it is not surprising that some issues presented in  
15 this Application can be called “unprecedented.” The Kenai LNG facility is the only  
16 LNG export facility in the United States. All other such facilities in the continental  
17 United States are used for LNG import. Thus, it is not surprising that some issues  
18 presented for FE consideration in this docket represent issues of first impression.<sup>16</sup>  
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21 <sup>14</sup> Answer page 39 – 40: “[E]xploration and production decisions should be  
22 influenced by market forces, not regulatory fiat. . . . [T]he Cook Inlet is a resource rich  
23 basin with more than enough proved, probable and potential natural gas reserves to  
24 service the needs of the basin for many years to come.”

25 <sup>15</sup> Answer, at pages 19, 38, and 41.

26 <sup>16</sup> Matters of first impression were also presented to FE in the Applicants’  
last export application proceeding. See DOE/FE Opinion and Order No. 1473, at page



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2 But merely because the State's requested conditions may be new does not  
3 make them either unreasonable or unlawful. Nor is there anything presented in the form  
4 of the State's requested conditions that is inconsistent with the policy considerations  
5 that guide FE in addressing this Application.

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7 DOE's Section 3 Guidelines recognize the need for flexibility to meet  
8 different considerations.<sup>17</sup> Although written to address gas imports, the policies  
9 advanced apply to exports as well.<sup>18</sup> These guidelines provide that FE "shall regulate  
10 exports (including the place of exit) based on a consideration of the domestic need for  
11 the gas to be exported and such other matters as the Administrator finds in the  
12 circumstances of a particular case to be appropriate."<sup>19</sup> Application of these flexible  
13 DOE guidelines supports each requested State condition.

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18 15 n. 48 ("In view of the geographic isolation of Alaska and the Cook Inlet area from  
19 the rest of the United States, the Applicants asserted the question of general domestic or  
20 national need was not relevant. No intervenor challenged this assertion, and DOE  
concurs in it. Therefore, regional need is the only relevant need consideration.")

21 <sup>17</sup> "The guidelines do not establish binding and inflexible rules." 49 CFR at  
22 6687. *See also* DOE/FE Opinion and Order 1473, at page 13: "[T]he plenary authority  
23 conferred on the Department by section 3 provides the administrative flexibility  
necessary to protect sometimes conflicting public interests."

24 <sup>18</sup> DOE/FE Opinion and Order 1473, at page 14.

25 <sup>19</sup> 49 CFR at 6690. [Delegation Order 0204-111].

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2           **1.    ENSURING UTILITY SUPPLIES ARE UNDER RCA-**  
3           **APPROVED CONTRACT BEFORE LNG MAY BE**  
4           **EXPORTED AS A CONDITION OF FE APPROVAL OF**  
5           **THE APPLICATION IS CONSISTENT WITH DOE**  
6           **GUIDELINES**

7                   Ensuring that local utilities have the gas they need *under contract* during  
8 the term of the proposed export license falls squarely within DOE’s domestic needs  
9 policy mandate. In fact, it is difficult to imagine a more compelling public policy  
10 purpose than this. The State has shown that Enstar and Chugach, who collectively  
11 supply natural gas for residential space heat and electric generation to most of Alaska’s  
12 population, do not have gas supplies under contract during the export term.<sup>20</sup> The RCA  
13 has a statutory mandate to protect the interests of captive consumers, and it does so by  
14 reviewing gas supply contracts between utilities and suppliers for reasonableness.  
15 Unless the producers present contractual opportunities to these utilities for gas supplies  
16 to meet their outstanding requirements, and do so under terms the RCA will approve,  
17 there can be no conclusion that local needs are met. Local needs are not met when  
18 proved reserves are not available.

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22                   <sup>20</sup> For Enstar, this fact is largely undisputed, which is addressed further  
23 below. For Chugach, the Applicants claim Chugach’s projected unmet needs are  
24 “highly speculative.” Answer page 22. These observations are nothing more than  
25 unsupported argument. The Applicants present no documentary evidence to support  
26 their claims. At best, they simply raise issues requiring further DOE proceedings to  
adjudicate.



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2 Requiring that these utility gas supplies be under RCA-approved contracts  
3 does not present some kind of “regulatory anomaly” as the Applicants claim.<sup>21</sup> This  
4 state regulatory requirement exists because virtually all states – and the federal  
5 government – permit commission review of utility contracts with third party suppliers  
6 that affect captive consumer rates. Indeed, authority for this type of commission review  
7 exists under the Natural Gas Act. 15 U.S.C. § 717d(a).<sup>22</sup> No “regulatory anomaly” can  
8 exist for DOE to recognize a condition which is already permitted under both federal  
9 and state law.<sup>23</sup>  
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11 There is also a very good reason why virtually all states and the federal  
12 government permit state commission review of gas supply contracts with public  
13 utilities, and why imposition of this condition should be adopted by FE. State  
14 commission review is necessary because most utilities are largely financially indifferent  
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16 <sup>21</sup> Answer page 20.

17 <sup>22</sup> “Whenever the Commission, after a hearing had upon its own motion or  
18 upon complaint of any State, municipality, State commission, or gas distributing  
19 company, shall find that any rate, charge, or classification demanded, observed,  
20 charged, or collected by any natural-gas company in connection with any transportation  
21 or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule,  
22 regulation, practice, or *contract affecting such rate, charge, or classification* is unjust,  
23 unreasonable, unduly discriminatory, or preferential, the Commission shall determine  
24 the just and reasonable rate, charge, classification, rule, regulation, practice, or contract  
25 to be thereafter observed and in force, and shall fix the same by order . . .” [Emphasis  
26 added].

<sup>23</sup> The Applicants’ claim of discrimination (Answer page 20) fails for the  
same reason. How can it be discriminatory for FE to impose a condition already  
allowed under state and federal law?



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2 to their purchased gas costs. As is the case in Alaska, these purchased gas costs are  
3 typically passed directly through to captive consumers on a dollar – for – dollar basis.  
4 Thus, the RCA – like other state commissions - is authorized to closely scrutinize such  
5 contracts for reasonableness.<sup>24</sup>

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7 The need to require RCA approval of these utility supply contracts as a  
8 condition before LNG may be exported is even more pronounced here. It is uncontested  
9 that the Applicants possess substantial market power and the capability to project  
10 oligopoly pricing.<sup>25</sup> The most recent demonstration of such oligopoly pricing was the  
11 recently rejected APL-5 gas supply contract.<sup>26</sup> As noted in the RCA’s majority

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16 <sup>24</sup> See C. Phillips, *The Regulation of Public Utilities* (2<sup>nd</sup> Ed. 1988), at page  
17 249 (“[Fuel adjustment clauses] reduce a utility’s incentive to minimize fuel costs.”).

18 <sup>25</sup> The Applicants ignore this market power in claiming “local utilities,  
19 manufacturers or refiners are free to compete for the volumes associated with the export  
20 authorization.” Answer page 6.

21 <sup>26</sup> The Applicants again ignore their market power when they suggest that  
22 the State’s request for utility needs be under RCA-approved contracts is a “desire to  
23 achieve artificially low natural gas cost for Alaskan consumers.” Answer page 19. This  
24 rhetoric is continued on page 40 where the Applicants’ claim “[r]ecent actions by the  
25 RCA have sent a signal to investors that Cook Inlet natural gas prices must be far below  
26 the opportunities elsewhere in the United States.” These inflammatory claims are  
wholly unwarranted and unsupportable. The need for RCA oversight exists because  
state law compels it to evaluate what price is fair, just and reasonable *for everyone* –  
consumers and suppliers alike, a fact demonstrated in the State’s opening motion at  
page 11. As noted earlier, federal law mirrors this reasonableness review requirement.

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2 decision, the contract was unreasonably priced.<sup>27</sup> This determination is entitled to  
3 collateral estoppel effect.<sup>28</sup>

4 The final point raised by the Applicants on this issue appears superfluous.  
5 The Applicants point to Enstar's existing supply contract with Chevron and note that  
6 "Chevron has the option to commit additional natural gas volumes to Enstar before any  
7 other supplier."<sup>29</sup> This observation is meaningless for purposes of the conditions

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<sup>27</sup> It is improper for the Applicants to complain in their Answer at page 21  
11 that it was unreasonable for Alaska's Attorney General to have opposed RCA adoption  
12 of the Enstar/Marathon APL-5 gas supply contract. The Attorney General is charged by  
13 state law to represent the public interest in proceedings before the RCA.  
14 AS 44.23.020(e). When the public interest compels the Attorney General to object to  
15 implementation of an unreasonable gas supply contract, state law grants the Attorney  
16 General the discretion to do so. In the case of APL-5, this discretion was exercised  
17 because the contract was unreasonably priced, a point with which the RCA agreed per  
18 RCA Order U-06-02(15).

19 It is also improper for the Applicants to complain about the length of time taken  
20 by the RCA to review proposed gas supply contracts. Proceedings before the RCA to  
21 review supply contracts are only protracted when unreasonable prices or other terms are  
22 demanded of consumers. If a reasonable supply contract is proposed, the Attorney  
23 General will not contest it. In fact, some gas supply contracts have been approved by  
24 the RCA without suspension, which is what happened recently for the Moquawkie gas  
25 supply agreement. RCA TA114-4, approved by RCA Letter Order No. L0000864 on  
26 September 19, 2000. However, to the extent FE wishes to consider the Applicants'  
complaints about regulatory lag before the RCA (Answer at pages 21 – 22), the RCA  
has the discretion to expedite adjudicatory proceedings when and if warranted. *See*  
RCA Order U-03-84(1)(September 18, 2003)(requiring a hearing to be held within 90  
days of filing a proposed gas supply agreement).

27 <sup>28</sup> *See* footnote 6, *supra*.

28 <sup>29</sup> Answer page 21.



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2 requested here.<sup>30</sup> An FE condition requiring Enstar's supply needs to be under RCA-  
3 approved contract would be met if Chevron eventually agrees to provide Enstar the gas  
4 it needs. It is difficult to understand why the Applicants would object to imposition of  
5 an FE condition that another supplier agrees to perform. But in any event, it is unknown  
6 if Chevron has uncommitted reserves available to meet Enstar's gas supply needs  
7 beginning in 2009. The State's requested condition cures this unknown by ensuring no  
8 LNG can be shipped if Enstar (and Chugach) have outstanding unmet requirements.  
9 Imposition of a condition providing coverage for this local utility need, from whatever  
10 supplier, is entirely consistent with the DOE's Section 3 mandate.  
11

12 **2. A REQUIREMENT FOR RESERVES REPLACEMENT AND**  
13 **OPEN ACCESS IS CONSISTENT WITH DOE'S**  
14 **GUIDELINES**

15 The lack of a "competitive" gas supply market in the Cook Inlet provides  
16 the conceptual framework upon which the State's other conditions is built. Requiring  
17 reserves replacement as an FE condition will not only help ensure local needs are met,  
18 an express DOE policy goal, but it will also serve as a platform for continued viability  
19 of the nation's only LNG export industry.<sup>31</sup> As noted in the State's opening motion, if  
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22 <sup>30</sup> This observation is also meaningless to Chugach, which has no such  
23 supply contract.

24 <sup>31</sup> The State recognizes that a blanket requirement to replace a certain  
25 quantity of proved reserves over a fixed period of time would be difficult for the  
26 Applicants to guarantee. The State intends that this condition merely require the  
Applicants undertake measurable work commitments that are designed to achieve the



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2 reserves are replaced, the Applicants will have every incentive to be back before DOE  
3 in the future seeking additional export authority while at the same time helping to  
4 perpetuate a natural gas supply for local utility consumption.

5           DOE's guidelines require consideration of "other matters . . . the  
6 Administrator finds appropriate." It is difficult to imagine how requiring reserves  
7 replacement under these circumstances would not be appropriate. By doing so, the FE  
8 will be acting to ensure the ongoing viability of domestic industry and employment, as  
9 well as the perpetuation of export activities during a time when the national balance of  
10 trade can use all of the help it can get.

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12           Likewise, requiring open access to the LNG facility will act to enhance  
13 supply competition, rather than stifle it, because it will offer a market for new  
14 production. The Applicants make no attempt to rebut this economic truism. Because  
15 the DOE guidelines observe that "the policy cornerstone of the public interest standard  
16 is competition"<sup>32</sup>, it is difficult - if not impossible - to fathom how imposition of a  
17 condition that will act to create competition in Cook Inlet gas supply can be inconsistent  
18 with Section 3 of the Act.

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22           goal of replacing proved gas reserves, subject to the normal degree of uncertainty  
23 associated with development activity in the Cook Inlet basin. The measurable work  
24 commitments include: (1) additional wells in existing fields; and (2) a provision to sell  
25 to interested third-parties geological and geophysical data owned by the Applicants on  
26 commercially reasonable terms.

32           49 Fed. Reg. at 6687.

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2 The Applicants' suggestion that *Hackenberry* (an LNG import case),  
3 should compel FE to reach a contrary conclusion on the open access condition is  
4 entirely misplaced.<sup>33</sup> FERC's goal in *Hackenberry* was to encourage development of  
5 new import facilities, and most important, to "[encourage] gas-on-gas competition by  
6 introducing new imported supplies of natural gas which will be accessible to all willing  
7 purchasers."<sup>34</sup> This is exactly the result that imposition of the State's conditions for  
8 reserves replacement and open access should achieve.  
9

10 Requiring open access for the Kenai LNG export facility will foster  
11 competition, rather than stifle it because new gas suppliers will have an incentive to  
12 enter the market due to the creation of new opportunities to monetize their investment.  
13 Since the premise of *Hackenberry* is a FERC desire to create the development of a  
14 competitive "gas-on-gas" market, and requiring open access for the Kenai facility will  
15 facilitate this result, *Hackenberry* actually supports the State's requested condition for  
16 open access.  
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18 DOE's policy guidelines observe that "it is the U.S. policy goal for gas  
19 imports [and presumably for gas exports as well] . . . to have a supply of natural gas . . .  
20 available on a market-responsive basis."<sup>35</sup> Because the Cook Inlet market is not  
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23 <sup>33</sup> Answer page 41.

24 <sup>34</sup> *Hackenberry LNG Terminal, L.L.C.*, 2002 WL 31975188 at \*\*6 (F.E.R.C.  
25 2002).

26 <sup>35</sup> 49 Fed. Reg. at 6687.

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2 currently competitive, remedies suggested by the State that will help cure this flawed  
3 market should be required. The State's requested conditions are designed to achieve  
4 this purpose. Reserves replacement and open access should be imposed as required  
5 conditions on this export application.

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7 **3. APPLICATION OF THE *YUKON PACIFIC* TEST ALSO  
8 SUPPORTS THE STATE'S REQUESTED CONDITIONS**

9 Both Enstar and the Applicants address a public interest analysis used by  
10 DOE/FE in *Yukon Pacific Corp.*, DOE Opinion and Order No. 350 (1989).<sup>36</sup> To the  
11 extent FE chooses to employ this public interest analysis, review of the State's  
12 requested conditions will result in the same conclusion.

13 The three prong analysis employed in *Yukon Pacific* requires  
14 consideration of (1) whether the export will cause a shortage; (2) whether the needs  
15 unmet by natural gas may be met more efficiently by alternative fuels; and (3) whether  
16 the export will reduce the quantity of energy available or increase the total cost of  
17 energy in the relevant market.

18 Imposition of the State's requested conditions dovetails with each prong  
19 of this test.<sup>37</sup> Gas shortage threats and upward price pressures evaporate because  
20 reserves replacement and open access will generate new supply and help encourage  
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23 <sup>36</sup> Answer pages 13 - 14.

24 <sup>37</sup> The Applicants understandably make no attempt to argue that "needs  
25 unmet by natural gas may be met more efficiently by alternative fuels." The conclusion  
26 on this issue is self evident because without natural gas, hundreds of thousands of  
Alaskan families will be required to convert their home furnaces to fuel oil.



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2 competitive pricing behavior. Thus, under any DOE test employed, *Yukon Pacific* or  
3 another, the State's requested conditions are necessary, reasonable and proper.

4 **C. THE APPLICANTS HAVE NOT DEMONSTRATED THAT**  
5 **LOCAL UTILITY NEEDS CAN BE MET**

6 A principal flaw in the Applicants' Answer is their entire failure to  
7 address the distinction between the supply estimates their studies present with any  
8 showing whatsoever that the reserves they claim exist are not already spoken for. In  
9 other words, since it is known that Enstar and Chugach have unmet needs for natural  
10 gas beginning in 2009, the Applicants must make some showing that *uncommitted*  
11 reserves actually exist to meet this local need during the export term.

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13 The Applicants do not address this issue at all. The closest they come is  
14 to cite the State's concerns at page 27 of their Answer, and then point again as rebuttal  
15 to the same "RD Report" studies that simply do not address this issue.

16 On one hand, the Applicants properly acknowledge that "DOE/FE has  
17 found regional need for natural gas in Southcentral Alaska to be the relevant inquiry for  
18 an export of LNG from Kenai."<sup>38</sup> Yet despite this acknowledgement, the Applicants  
19 ignore this maxim. They simply conclude the State's observation that the Applicants'  
20 studies do not show adequate *uncommitted* reserves exist, relates "to commercial issues  
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25 <sup>38</sup> Answer page 12.

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2 which are outside the scope of the NGA Section 3 public interest analysis.”<sup>39</sup> Not only  
3 is this statement unsupported by reference to any authority, but it is also illogical.

4 If the reserves the Applicants’ studies claim to exist are already under  
5 contract, they are not available to meet the local needs identified by Enstar and  
6 Chugach. To suggest otherwise is simply counterintuitive. This failure of proof is fatal  
7 to this Application *unless* a condition is imposed requiring these local utility natural gas  
8 needs be under RCA-approved contract *before* any LNG export can occur.

10 **D. LOCAL PUBLIC UTILITY DELIVERABILITY NEEDS SHOULD**  
11 **NOT BE IGNORED**

12 The Applicants claim FE should disregard local utility deliverability needs  
13 in evaluating their Application. As support, they point to language in DOE/FE Order  
14 No. 1473, which was issued over eight years ago.

15 Cook Inlet’s gas supply profile has changed substantially since 1999, and  
16 the DOE’s flexible guidelines do not require FE to ignore this fact. On this point, FE  
17 should consider:

- 18  
19 • Cook Inlet’s R/P ratio is now below 9.<sup>40</sup>

21  
22 <sup>39</sup> Answer page 27.

23 <sup>40</sup> The R/P ratio has declined from 24.1 in 1978 to 19.9 (1988), to 13.2  
24 (1998), and now to 8.5 (2006) according to data derived from various *Alaska Oil and*  
25 *Gas Annual Reports* published by the Alaska Department of Natural Resources,  
Division of Oil and Gas between 1979 and 2006 found at:  
<http://www.dog.dnr.state.ak.us/oil/products/publications/annual/report.htm>.



- The LNG plant has diverted supply into Enstar's system in order to meet peak utility winter needs.
- The Agrium urea plant is now subject to seasonal shutdowns, and runs substantially under capacity when operating.
- Winter gas supply utility needs on peak days have reached existing deliverability capacity even with industrial diversion and curtailment.
- The geographic isolation of Alaska and the Cook Inlet from any other sources of gas to meet winter peak demand is unlike that faced by any other region in the country.
- Unlike any other area in the contiguous United States, the Cook Inlet and the local utilities it serves are geographically isolated from any other pipeline infrastructure.
- Enstar's and Chugach's winter peaking needs must be met through existing Cook Inlet gas infrastructure. There is no other safety net available.
- Enstar and Chugach cannot call on gas from any other state, from Canada, or from imported LNG.
- There are no existing facilities that can backstop Cook Inlet's production.

The Applicants unreasonably suggest that FE should ignore these facts in evaluating the deliverability needs faced by local utilities. As pointed out in the State's opening motion, the public interest in addressing the deliverability needs of local utilities cannot be ignored. This is particularly critical in the Cook Inlet where the Applicants and one other producer control existing storage and the production capabilities necessary to meet this local need. It is simply wrong for the Applicants to

1  
2 claim “market forces” should be allowed to fix this issue<sup>41</sup>, when there is no  
3 functionally competitive market in the Cook Inlet. Thus, unless Enstar and Chugach  
4 have priority rights to gas during winter peaking periods, there can be no conclusion  
5 reached that local needs are being met during the proposed export term.

6  
7 **E. THE APPLICANTS’ QUESTIONS REGARDING THE SCOPE**  
8 **AND MECHANICS OF THE REQUEST FOR OPEN ACCESS ARE**  
9 **EASILY ADDRESSED**<sup>42</sup>

10 The State’s proposed open access requirement does not dictate the form  
11 that open access would take, but simply contemplates that an agreement to purchase  
12 third-party producer gas for export would be compatible with the interests of both the  
13 Applicants and the broader public. Given that the Applicants’ have extensive  
14 experience in marketing gas to the Pacific Rim as well as their ownership and control of  
15 the LNG plant, dock facilities and tankers, it is difficult to imagine a situation involving  
16 open access that would place the Applicants at a competitive disadvantage with other  
17 third-party producers interested in placing gas with the LNG facility. On the contrary, if  
18 the plant is operating below capacity levels authorized for export, it seems likely that

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22 <sup>41</sup> Answer page 33.

23 <sup>42</sup> The Applicants imply this open access condition should be addressed by  
24 FERC, rather than by DOE. Answer page 41. This implicit jurisdictional claim is  
25 misplaced. The State’s requested open access condition pertains to export activities, not  
26 to the construction, siting or domestic distribution of foreign gas. *See* 49 Fed. Reg. at  
6688. Imposition of this condition is not beyond DOE’s jurisdiction.



1  
2 the Applicants would welcome commercial opportunities with third party producers to  
3 increase plant and tanker loads.<sup>43</sup>

4 The State's request for an open access condition actually creates a win-  
5 win proposition. For the State, this exists by allowing for creation of a true competitive  
6 gas supply market. For the Applicants, this exists by allowing for their use of unused  
7 plant and tanker capacity authorized for export. Finally, for DOE/FE, this exists by  
8 enhancing creation of "gas-on-gas" competitive opportunities consistent with DOE's  
9 Section 3 mandate. These results are compatible with DOE's Section 3 Guidelines.

## 11 II. CONCLUSION

12 The State respectfully suggests that it has presented ample justification in  
13 its opening motion and in these reply comments justifying FE imposition of each State-  
14 requested condition.<sup>44</sup> In addition, the State has shown that the Applicants have entirely  
15 failed to address key factual issues that render their Application fatally defective unless  
16

17  
18 <sup>43</sup> The Applicants also question whether this open access requirement would  
19 compel them to "make available to third parties a portion of the volumes that Applicants  
20 are authorized to export." Answer page 41. The answer to this question is no. If open  
21 access is required by FE under commercially reasonable terms, new developers could  
22 either seek their own DOE export authority, or place gas by sale to the Applicants for  
23 export under reasonable commercial terms when the Kenai LNG plant is operating  
24 below levels authorized in the blanket export authorization.


25 <sup>44</sup> The State does not waive its request for additional procedures by not  
26 addressing this issue further at this time. Rather, the State incorporates by reference the  
27 questions of fact and policy identified in the State's opening motion that warrant  
28 additional procedures as though fully stated herein. A full evidentiary hearing  
29 addressing these issues would be warranted to the extent FE does not otherwise adopt  
30 the State's requested conditions in their entirety on the basis of the comments filed.

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the State's conditions are imposed. For these reasons, FE should condition the export Application as requested.

DATED this 25th day of June, 2007 at Anchorage, Alaska.

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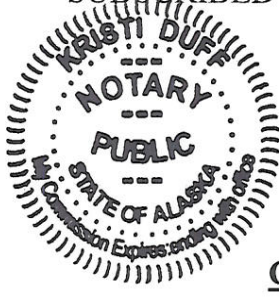
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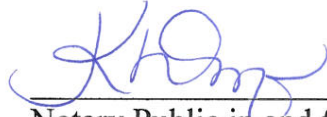
VERIFICATION

Steve DeVries, being first duly sworn, on oath states that he is an Assistant Attorney General for the State of Alaska and is authorized to make this verification; that he has prepared the forgoing document and that all allegations of fact stated therein are true and correct to the best of his knowledge, information and belief.

  
\_\_\_\_\_  
Steve DeVries

SUBSCRIBED AND SWORN to before me this 25th day of June, 2007.




  
\_\_\_\_\_  
Notary Public in and for Alaska  
My commission expires: with office

CERTIFICATE OF REPRESENTATIVE

Pursuant to 10 CFR 590.103(b), I hereby certify that I am a duly authorized representative of the STATE OF ALASKA and that I am authorized to sign and file with the Department of Energy, Office of Fossil Energy, the foregoing document.

DATED this 25th day of June, 2007 at Anchorage, Alaska.

TALIS J. COLBERG  
ATTORNEY GENERAL

By:   
\_\_\_\_\_  
Steve DeVries  
Assistant Attorney General

1  
2  
3 **CERTIFICATE OF SERVICE**

4 I hereby certify that on this 25th day of June, 2007, a true and correct copy  
5 of the REPLY COMMENTS OF THE STATE OF ALASKA and this CERTIFICATE  
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