Report

Submitted to the

United States Congress

by the Federal Energy Regulatory Commission

Third Report to Congress on Progress Made in Licensing

and Constructing the Alaska Natural Gas Pipeline

January 31, 2007

Third Report to Congress on the Alaska Pipeline

I. Executive Summary

This report by the Federal Energy Regulatory Commission (Commission) is submitted pursuant to section 1810 of the Energy Policy Act of 2005 (EPAct 2005).[1] Section 1810 of EPAct 2005 provides that within 180 days of the date of enactment, and every 180 days thereafter until the Alaska natural gas pipeline commences operation, the Commission shall submit to Congress a report describing the progress made in licensing and constructing the Alaska natural gas pipeline and any impediments thereto.

This report describes the events and the progress that have transpired since the Commission's Second Report on July 10, 2006. During the period covered by this report, the following key events have occurred: the President's nominee for Federal Coordinator for Alaska Natural Gas Transportation Projects was confirmed by the U.S. Senate and the Federal Coordinator's office was opened; oral argument was held in the U.S. Court of Appeals for the District of Columbia Circuit on the petition for review of the Commission's Open Season regulations; negotiations between certain project sponsors and the State of Alaska on a fiscal contract ended without approval by the Alaskan legislature; and a new Alaska governor was elected in November and sworn into office on December 4, 2006.

II. Status Report

A. Status of Three Potential Projects

The three potential projects described in the Commission's first two reports are still being pursued by the project sponsors. One of these potential projects is the Alaska Natural Gas Transportation System (ANGTS) which is supported by the TransCanada Corporation. This project is proposed pursuant to the Alaska Natural Gas Transportation Act of 1976 (ANGTA), Canada's Northern Pipeline Act (1978) and a 1977 Agreement on Principles between the United States and Canada. The ANGTS consists of a pipeline that would parallel the Trans-Alaska Oil Pipeline System (TAPS) from Prudhoe Bay to the Canadian border and continue through Canada to the Alberta hub. In Alberta, the pipeline would split into two legs: the eastern leg terminates near Chicago and the western leg terminates near Antioch, California. The second potential project is the Trans-Alaska Gas System (TAGS), a liquefied natural gas (LNG) export project which is being promoted by the Alaska Gasline Port Authority. The TAGS proposal calls for a pipeline to parallel the TAPS from Prudhoe Bay to Anderson Bay near Valdez, Alaska, where an LNG liquefaction plant would be built to ship the LNG to worldwide markets, including the lower 48 states. The third potential project involves an entirely new

[1] P.L. 109-58, 119 Stat. 594 (2005), 42 U.S.C § 15801 *et seq.*

pipeline project which would be authorized pursuant to the provisions of section 103 of the Alaska Natural Gas Pipeline Act (ANGPA)[2] and section 7 of the Natural Gas Act (NGA).[3] The sponsor of this third project is the Producer Group, which is composed of BP, ConocoPhillips, and ExxonMobil. The conceptual proposal of the Producer Group consists of a pipeline that would generally parallel the TAPS from Prudhoe Bay to Delta Junction, Alaska, then follow the Alaska Highway to the Alaska-Yukon/Canadian border and continue through Canada to the Alberta hub and, ultimately, to markets in the lower 48 states.

B. Progress on Alaska Stranded Gas Development Act Agreement Negotiations and Related Executive, Legislative and Judicial Activity

1. Proposed Alaska Stranded Gas Development Act Agreement

As discussed in the Second Report, Governor Frank Murkowski announced on February 21, 2006, that the State of Alaska and the Producer Group had reached agreement on the major components of an Alaska Stranded Gas Development Act fiscal contract. The Producer Group has indicated that it will only begin to develop an application for its project once it has established fiscal certainty in Alaska. On May 10, 2006, Governor Murkowski provided the draft fiscal contract to the Alaska legislature for its review. The release of the proposed contract was also followed by a series of statewide public hearings. However, this agreement was not approved by the Alaskan legislature during its regular legislative session and additional special sessions called by Governor Murkowski during 2006.

Later, Governor Murkowski failed to win an August 2006 primary election for the gubernatorial nomination of his party. Another candidate, Sarah Palin, received the party's nomination in August and was elected in November 2006. On November 29, 2006, the Alaska Supreme Court turned down a request by Governor Murkowski to reconsider a lower court decision that blocked him from signing a gas pipeline contract without approval from the state legislature. Thus, the election of the new governor and the court ruling prevented further approval of the agreement with the Producer Group.

Governor Palin has stated that she intends to reexamine all aspects of the state's role in fostering an Alaska natural gas pipeline. Governor Palin was sworn in on December 4, 2006 and during the first two days of her term she and her top advisors met with many of the key stakeholders in an effort to get an Alaska natural gas pipeline project underway again. Governor Palin has appointed new state agency commissioners

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[2] P.L. 108-324, 118 Stat. 1220 (2004), 15 U.S.C § 719.

[3] 15 U.S.C. § 717(f) (2000).

and other top level state agency officials who will be responsible for continuing the State of Alaska's efforts concerning proposed Alaska natural gas pipeline projects.

In January 2007, the Alaska Gasline Port Authority and the Alaska Natural Gas Development Authority (both state voter-approved entities) signed a memorandum of understanding. The agreement is designed to allow the two groups to work cooperatively on developing a natural gas pipeline in Alaska, including the sharing of confidential information and cost estimates.

Governor Palin and her gas team have met with at least 12 potential project sponsors. She announced her plans to introduce a new gas pipeline bill in her January 17, 2007 State of the State address at the beginning of the 2007 Alaska legislative session (which began on January 16, 2007). According to her State of the State address, Governor Palin's new bill, entitled the Alaska Gasline Inducement Act, would replace the Alaska Stranded Gas Development Act as the vehicle for inducing construction of the Alaska natural gas pipeline Governor Palin's proposed new law (the Alaska Gasline Inducement Act) would spell out what incentives the state was willing to offer and what it would demand in return. According to Governor Palin, this new law would clearly spell out Alaska's requirements for a gas pipeline and create a transparent and competitive process, open to all, for the selection of a project that meets those needs. Any company interested in building a pipeline would be able to submit a proposal, and the state would pick the best one. Under the new law, Governor Palin said, the state would offer incentives that could include a "substantial" contribution of state funds. In turn, an applicant would have to meet requirements relating to in-state use of gas, jobs for Alaskans, and project "benchmarks."[4]

2. Oil tax revision

On May 24, 2006, Governor Murkowski announced that state and industry negotiators had reached agreement on the oil fiscal certainty portion of the gas pipeline contract. The governor introduced oil tax-reform/modernization legislation designed to link taxes to the oil companies' Alaska profits. In August 2006, after adding certain changes to the legislation proposed by Governor Murkowski, the Alaska State Legislature approved the revised oil tax structure dealing with the adoption of the Oil and Gas Petroleum Profits Tax (PPT) and amendments to Oil and Gas Properties Production Tax and Governor Murkowski signed these oil tax revisions into law. According to the Producer Group, oil fiscal certainty was a pre-requisite to a gas pipeline contract. Governor Palin indicated in her State of the State address that if the results of the PPT, when implemented, are not satisfactory, the production tax issue would be revisited.

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[4] See *A New Approach to Gas Line*, by Stefan Milkowski, Published January 18, 2007 in the Fairbanks News Miner and *New governor overhauls plans for Alaska pipeline*, Gas Daily, January 19, 2007.

In Alaska's November 2006 general election, Ballot Measure 2 asked voters to approve taxing large North Slope gas reserves every year until a pipeline is built to carry the gas to the Lower 48. This referendum was defeated with 65 percent of the voters opposing the measure.

3. Termination of the Point Thomson Unit

On November 27, 2006, the Alaska Department of Natural Resources (Alaska DNR) announced that the state is terminating the Point Thomson unit on the North Slope and taking back oil and gas leases since the unit operator, Exxon Mobil, failed to meet obligations for development.[5] The Point Thomson unit, formed in 1977 but never developed, covered 106,000 acres and held an estimated nine trillion cubic feet of natural gas and 300,000 million barrels of gas condensate and oil. Because the Point Thomson unit is located north of 64 degrees north latitude, any production from that unit would be Alaska natural gas subject to the Commission's open season rules for capacity on the Alaska natural gas pipeline. Exxon Mobil, along with other parties, may seek further legal action or could re-apply to the Alaska DNR for permission to develop the Point Thomson natural gas reserves.

C. Federal Interagency Memorandum of Understanding

As discussed in the Second Report, in June 2006 the Federal Interagency Memorandum of Understanding for the Alaska Natural Gas Transportation Project (MOU) was fully signed and executed by senior executives and heads from 15 federal departments and agencies. The signing of an MOU by this large number of agencies demonstrates that the federal agencies are prepared to work together to expedite the permitting and construction of an Alaska natural gas pipeline project.

D. Installation of the Federal Coordinator

On June 12, 2006, President Bush nominated Drue Pearce, of Alaska, to be Federal Coordinator for Alaska Natural Gas Transportation Projects, for a term ending one year following the completion of the Alaska Natural Gas Transportation Project. On August 3, 2006, Ms. Pearce's nomination was confirmed by the U.S. Senate. On December 13, 2006, Vice President Cheney presided over a swearing in ceremony for Ms. Pearce attended by Chairman Kelliher and other federal officials. Her official appointment date was established as November 13, 2006. The Federal Coordinator has begun meeting with stakeholders for the Alaska natural gas transportation project in both Alaska and Canada.

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[5] The announcement upholds an administrative decision made by the Alaska DNR on September 30, 2005, as amended on October 27, 2005.

In accordance with the section 106 of ANGPA, the Federal Coordinator will head the Office of the Federal Coordinator for Alaska Natural Gas Transportation Projects. [6] The Federal Coordinator is responsible for: (1) coordinating the expeditious actions of all Federal agencies regarding an Alaska natural gas transportation project; and (2) ensuring the compliance of Federal agencies with the provisions and deadlines of ANGPA.

E. U.S. Department of Energy Activities

The U.S. Department of Energy's (DOE) program office for the federal loan guarantee process for the Alaskan natural gas transportation project is monitoring the progress of commercial negotiations with the State of Alaska and the bills before the Alaska state legislature. When a commercial project emerges, DOE will proceed with structuring the loan guarantee process.

F. Commission's Activities

1. Open Season Regulations

ANGPA directed the Commission to issue regulations governing the conduct of open seasons for Alaska natural gas transportation projects, including procedures for allocation of capacity. The orders which the Commission issued promulgating regulations governing the conduct of open seasons for Alaska natural gas transportation projects, including procedures for allocation of capacity, are under review in the U.S. States Court of Appeals for the District of Columbia Circuit.[7]

The regulations issued pursuant to these orders, codified at 18 C.F.R. 57.30-157.39, sought to balance the ANGPA's dual objectives of (1) facilitating the timely development of an Alaska natural gas transportation project; and (2) encouraging the exploration for new gas reserves by assuring competitive access to the pipeline.

On appeal, the North Slope Producer Group has challenged one specific aspect of the Commission's Alaska natural gas transportation regulations adopted at 18 C.F.R.

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[6] It is our understanding that the Office of the Federal Coordinator for Alaska Natural Gas Transportation Projects has no stand-alone funding.

[7] Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects, FERC Stats. & Regs., Regs. Preambles ¶ 31,174 (February. 9, 2005); 70 Fed. Reg. 8,269 (February 18, 2005) ("Order No. 2005") and Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects, FERC Stats. & Regs., Regs. Preambles ¶ 31,187 (June 1, 2005); 70 Fed. Reg. 35,011 (June 16, 2005) ("Order No. 2005-A")

157.36 and 157.37.[8] These regulations allow the Commission, upon a review of the record, to condition its granting of a pipeline certificate by requiring project design changes if necessary to advance the ANGPA's competition and access goals. The case was argued before the court on December 5, 2006, and the matter is now pending with the court.

2. Environmental Review - Update

As described in the preceding two Reports to Congress, the Commission is actively preparing to fulfill its National Environmental Policy Act of 1969 and certificate application responsibilities. Since the Second Report, the Commission staff traveled the Dalton Highway touring the route of the northern segment of the pipeline and continued its discussions with the Department of the Interior regarding resource and training needs for the eventual environmental impact statement and project permitting.

Throughout the summer and fall of 2006, the Producer Group worked with Governor Murkowski's administration making changes to the draft fiscal contract in response to public comments; however, no changes were made to its schedule for planning, permitting, and constructing the project. The Producer Group continues to estimate a period of 10 years from the beginning of formal project planning activities to the date of first gas deliveries. Although it is not known which project sponsor or design will move forward, the Producer Group's conceptual schedule remains valid for a project of this complexity and magnitude.

G. Developments in Canada

The Mackenzie Gas Project continues to be under consideration by the Government of Canada. Hearings conducted by Canada's Joint Review Panel[9] are scheduled throughout the first quarter of 2007. The Mackenzie Gas Project includes development of natural gas fields, gathering lines, and processing facilities in the Mackenzie River Delta of Canada's Northwest Territories, and a transportation pipeline along the Mackenzie River Valley to deliver the natural gas to market.

III. Conclusion

Alaska offers a reliable continental source of natural gas for the Lower 48 States that will help the U.S. economy to grow and thrive, and also contribute to the economic

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[8] *Exxon Mobil Corporation, et al. v. FERC*, Case Nos. 05-1299, 05-1300, & 05-1301 (consolidated).

[9] The Joint Review Panel for the Mackenzie Gas Project is a seven-member, independent body that will evaluate the potential impacts of the project on the environment and lives of the people in the project area.

well being of the State of Alaska. Since the Second Report was submitted to Congress, the Federal Coordinator for Alaska Natural Gas Transportation Projects has been appointed and confirmed; Commission staff has toured the route of the northern segment of the pipeline; Commission and Department of Interior staff have begun working together regarding resource and training needs in connection with the eventual environmental impact statement and project permitting; and the 15 federal agencies with responsibilities regarding the permitting and construction of an Alaska natural gas pipeline project remain prepared to assist in the development of an application through the Commission's pre-filing process and work together expeditiously once authorization to construct the project is sought. The federal government is ready to act. However, no pipeline application has been developed, and the prospects of an application are more remote than a year ago. Over the past year, the schedule for an Alaska gas pipeline has slipped considerably.

The main obstacle to progress on an Alaskan gas pipeline is the failure to resolve state issues necessary before a project sponsor will commit to go forward. The fresh competitive approach announced by the new governor must be successful if Alaska gas is to be part of the nation's energy supply solution anytime in the coming years.