

# How AGIA Addresses Competitive Issues Raised by a Producer-Owned Pipeline

The Palin-Parnell Administration presents

# AGIA

The Alaska Gasline Inducement Act

**Presentation to the Alaska Legislature**

**Senate Judiciary Committee**

**May 11, 2007**

**Kenneth M. Minesinger**

**Greenberg Traurig LLP**

# Overview



- Testimony addresses 3 competitive issues
  - Competitive problems associated with a producer-owned pipeline
  - How AGIA addresses those problems
  - Failure by producers (Exxon, BP, Conoco) to bid in an open season

# Qualifications/ Experience



- Have represented several major interstate natural gas pipelines and other clients before the FERC, including in
  - Rate proceedings
  - Certificate proceedings
  - Market power cases
- Have also served as Chairman of the Antitrust Committee of the Energy Bar Association
- Have worked on numerous antitrust matters involving natural gas pipelines and other energy companies

# Competitive Problems Raised by a Producer-Owned Pipeline



- Issue addressed in Dec. 21, 2006 memorandum on LB&A website
- Main competitive issue: **vertical market power**
  - Producer-owned pipeline would have an incentive *not* to ship gas produced by competing producers
- This disincentive could manifest itself as follows:
  - **Expansion:** Refusing to expand to ship competing gas, or delaying expansion
  - **Access/Discrimination:**
    - Raising the tariff rate paid by competing producers
    - Other means of restricting/denying access, including subtle forms of discrimination that are difficult for regulators to detect
  - Producer incentive to **delay** project so as not to undermine other projects (LNG) or other gas sales in the Lower 48
  - Vertical relationship could also facilitate **collusion**

# Competitive Problems Raised by a Producer-Owned Pipeline



- **Vertical market power issue:** addressed by U.S. DOJ in 1977
  - **Expansion:** The U.S. Attorney General concluded that
    - “it will be in the interest of producer-owners to resist future expansion and thus discourage future entry into Alaskan gas production” ... because the producers’ market power “could be reduced by discovery and development of new fields by other producers”
  - **Access/Discrimination:** U.S. Attorney General also stated:
    - Producer-owned pipeline “would seek to restrict access and throughput to take monopoly profits.”
- DOJ recommended a complete ban on producer-ownership
- Reagan Administration: conditional waiver
- FERC Chairman in 2005: antitrust issues “are still valid and will be addressed” by FERC in certificate proceeding

# Competitive Problems Raised by a Producer-Owned Pipeline



- FTC, DOJ and FERC precedent confirms that the competitive concerns raised by DOJ in 1977 about a producer-owned pipeline are still valid:
  - FTC/DOJ vertical merger cases in energy industry: “raising rivals costs”
  - Major FERC orders addressing vertical market power issues over past two decades, including Order Nos. 436, 497, 636, 637, 2000, 2004, 2005

# How AGIA Addresses Competitive Problems Raised by a Producer-Owned Pipeline



- Unlike 1977 DOJ opinion, AGIA does not advocate a ban on producer ownership of the pipeline
- Instead, AGIA:
  - Invites applications by producers and by independent pipelines
  - Attempts to ameliorate or eliminate competitive problems raised by a producer-owned pipeline

# How AGIA Seeks to Address Competitive Problems Raised by a Producer-Owned Pipeline



- **Problem: Incentive Not To Expand**
  - AGIA requires expansion on reasonable terms:
    - The applicant must “commit to expand the proposed project in reasonable engineering increments and on commercially reasonable terms that encourage exploration and development of gas resources in this state”

# How AGIA Seeks to Address Competitive Problems Raised by a Producer-Owned Pipeline



- **Problem: Incentive Not To Expand**
  - AGIA also addresses producer/expansion issue by requiring pipeline to hold open seasons for expansion capacity every two years:
    - The applicant must “commit that after the first binding open season, the applicant will assess the market demand for additional pipeline capacity at least every two years through public non-binding solicitations or similar means”

# How AGIA Seeks to Address Competitive Problems Raised by a Producer-Owned Pipeline



- **Problem: Refusal To Expand Except on Terms That Deter Exploration**
  - AGIA requires applicant to propose rolled-in rate treatment of expansion costs, up to a 15 percent increase in existing rates
    - The 15 percent roll-in requirement counteracts a producer-owned pipeline's incentive to discourage expansion by proposing incremental rates
    - Rolled-in rates are consistent with FERC policy (rebuttable presumption of roll-in) and federal law (ANGPA) mandating rate criteria which promote exploration, development and production of Alaska gas

# How AGIA Seeks to Address Competitive Problems Raised by a Producer-Owned Pipeline



- **Problem: Discrimination/Access**
  - For example, a producer-pipeline is indifferent to high tariff rates, with regard to their own gas, because the money they spend on rates just goes from one pocket to another
  - AGIA requires applicants to commit to low tariff rates, by:
    - committing to a “capital structure for rate-making that consists of no less than 70 percent debt”
    - competing via proposals to manage cost overruns and “provide low transportation rates”
  - These provisions give the State an opportunity to avoid some of the problems experienced with TAPS
    - High tariff rates have reportedly caused some competitors to exit

# How AGIA Seeks to Address Competitive Problems Raised by a Producer-Owned Pipeline



- **Problem: Delaying the Project**
  - AGIA requires open season within 36 months, initiation of FERC pre-filing process by a date certain, and filing of certificate application by a date certain
  - Producer-pipeline required to sanction project within one year of FERC certificate because they have the gas supply that would underwrite FT commitments (credit support)
  - AGIA would not permit a producer-owned pipeline to unduly delay project development based, for example, on concerns that:
    - Alaska pipeline could adversely affect producers' investment in worldwide LNG projects
    - Alaska pipeline could adversely affect producers' sales of other gas in Lower 48

# How AGIA Seeks to Address Competitive Problems Raised by a Producer-Owned Pipeline



- **Level playing field:**
  - AGIA establishes competitive process open to all applicants, including producers and independent pipelines
  - Allows producers to compete by proposing additional ways of remedying the vertical market power problem, including proposals to:
    - Divest ownership after construction
    - Hire independent third-party to operate the pipeline
    - Establish market monitor

# AGIA's "Must Haves" Are Critically Important



- State has an opportunity to provide an additional line of defense against competitive problems
- TAPS: State has already seen what can happen when a producer-owned pipeline lacks the normal incentives to expand, increase throughout and serve other shippers
  - Reduced competition, exit by explorers that do not own pipeline
- AGIA's "Must Haves" regarding expansions, open seasons, etc., provide important, additional protections that would not otherwise exist

# Open Season



- **What if the producers fail to bid in an open season?**
  - Premature: need to wait and see whether there is a failure to bid, and the facts associated with that failure
  - State and other interested parties can then determine based on the facts whether any antitrust, FERC or other issues have been raised by a failure to bid or a withholding of gas supplies from the market

# Conclusion



- AGIA charts a middle ground between (A) banning producer-ownership of the pipeline and (B) negotiating exclusively with the producers
- Instead of banning producer-ownership, AGIA:
  - Attempts to fix the competitive problems
  - Invites producers to build the pipeline on terms consistent with the State's interest in promoting exploration and development of North Slope gas resources