Explaining the FERC Waiver

NOVEMBER 13, 2009

On November 12, 2009 the State of Alaska (State) petitioned the Federal Energy Regulatory Commission (FERC) asking the commission to waive a rule that could add risk to shippers when the State elects to receive gas in kind for instate use.

The state is entitled to receive a 12.5 percent royalty for natural gas produced on state land. The state can choose to receive this royalty as revenue ("royalty in value") or it can choose to receive the royalty as gas ("royalty in kind") for instate use.

The ability to receive gas in kind for instate use as our royalty payment is an important requirement of AGIA. However, the State's ability to switch to taking royalty in kind gas creates additional financial risk for shippers producing gas from state lands.

Under FERC rules, a shipper is charged for the cost of transporting its gas through a pipeline. This cost is commonly referred to as a reservation charge. The State's royalty share is 12.5 percent of the capacity that each shipper commits to transporting on a gas pipeline.

When the State chooses to receive its royalty in value (i.e. revenue), it receives the price of the gas at the destination market minus the cost of transporting that gas to market. This is commonly referred to as the "netback" wellhead value. When the state receives its royalty in value it pays a proportionate share of the cost of moving its royalty gas to market.

If the State elects to take its royalty gas in kind for instate use, under current FERC rules, the shipper may have to pay its full capacity transportation cost - even though the state has pulled its royalty gas share from the shipper's capacity. The shipper would be charged for the unused capacity. Unused capacity is referred to as "stranded capacity."

By obtaining a waiver from the FERC the State could offer to eliminate this risk by allowing shippers to release "stranded capacity" to the State when the State receives its royalty in kind. This arrangement is referred to as "capacity going with the gas."

Such an offer is being contemplated as part of the royalty regulations being developed for the upcoming Open Season for the Alaska Pipeline Project, licensed under AGIA. Obtaining the waiver could save the producers billions of dollars in stranded capacity costs and remove a significant impediment for committing to an Open Season.

There is precedent for this type of waiver so state officials were comfortable that this would be a reasonable request to present to the FERC. Congress recognizes that the Alaska project is uniquely in the national interest. Obtaining this waiver reduces both risk and a potential commercial roadblock for producers evaluating the economics of committing gas to any upcoming Open Season.

The state requested expedited consideration so that a decision could be made within 75 days, in time for the upcoming Alaska Pipeline Project and Denali Open Seasons. The waiver would apply to any proposed gas pipeline project that is ultimately sanctioned for development.

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