



STATE OF ALASKA
DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT

Sean Parnell, Governor
Susan K. Bell, Commissioner
T.W. Patch, Chairman

Regulatory Commission of Alaska

Date: September 11, 2013

File: TA242-4

RE: LO # L1300428


Correction regarding Description of Statement by Commissioner Norman Rokeberg

You are hereby informed that Commissioner Norman Rokeberg's separate statement issued on September 9, 2013 and appended to LO # L1300428 is not a dissent as to the form and content of the letter order.

The Commission corrects page nine of its letter order and hereby provides you a complete new order and a corrected page nine. Please destroy the earlier version of the order transmitted to you electronically on September 9, 2013.

Sincerely,

REGULATORY COMMISSION OF ALASKA


T.W. Patch
Chairman

Attachment: Corrected Page Nine - LO # L1300428



STATE OF ALASKA
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ECONOMIC DEVELOPMENT

Sean Parnell, Governor
Susan K. Bell, Commissioner
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Regulatory Commission of Alaska

September 9, 2013

In Reply: Tariff Section
Docket: TA242-4
Letter Order No.: L1300428

Colleen Starring
President
ENSTAR Natural Gas Company,
A Division of SEMCO Energy, Inc.
PO Box 190288
Anchorage, AK 995019-0288

Subject: TA242-4 Gas Sales Agreement Between Alaska Pipeline Company and Hilcorp Alaska, LLC

We approve the proposed Gas Sale and Purchase Agreement between Alaska Pipeline Company and Hilcorp Alaska, LLC, filed in TA242-4. We approve the inclusion of the costs of gas purchased under the Gas Sale and Purchase Agreement in the calculation of the Gas Cost Adjustment. We approve Tariff Sheet Nos. 89 and 221, filed in TA242-4 on July 24, 2013, with an effective date of September 9, 2013.

Background

ENSTAR Natural Gas Company (ENSTAR) filed TA242-4, requesting our approval of a gas sale and purchase agreement (GSA) between Alaska Pipeline Company (APC)¹ and Hilcorp Alaska, LLC (APL-12 GSA). ENSTAR requests that we approve the proposed APL-12 GSA for firm natural gas deliveries beginning April 1, 2014 and continuing through March 31, 2018. ENSTAR also requests that we approve the APL-12 GSA as a base gas supply agreement, and include all costs incurred under the GSA in the calculation of its gas cost adjustment.² ENSTAR filed revised Tariff Sheets Nos. 89 and 221 and requested an effective date of September 9, 2013.³

We issued notice of TA242-4 on July 26, 2013, with a comment period ending August 22, 2013. Cook Inlet Energy; Buccaneer Alaska, LLC; and Furie Operating Alaska, LLC, filed comments critical of the APL-12 GSA. ENSTAR filed a reply to those comments along with a motion to accept the reply comments.

¹The Commission has historically regulated Alaska Pipeline Company and ENSTAR Natural Gas Company as a single entity.

²TA242-4 at 1.

³ENSTAR requested an effective date of the end of the standard notice and review period. TA242-4 at 10.

Discussion

Consent Decree

The State of Alaska entered into a Consent Decree with Hilcorp Alaska, LLC (Hilcorp) to resolve competitive concerns with Hilcorp's acquisition of Marathon Oil Company's Cook Inlet assets.⁴ The Consent Decree was approved by the Superior Court on January 17, 2013.⁵ The APL-12 GSA includes provisions that follow the terms and conditions⁶ of the Consent Decree, including pricing, gas disposition, negotiable costs (transportation, excess taxes, and excess royalties), Hilcorp non recoverable costs, (royalties and taxes, gas dehydration, gas treatment, facilities O&M), and RCA approval.

ENSTAR's Projected Gas Supply as of July 8, 2013

ENSTAR provided a forecast showing the gas supply requirements of its customers from January 2014 through March 2018, including the volumes to be delivered under the APL-12 GSA. The volumes supplied under the APL-12 GSA will meet the remaining requirements of ENSTAR's customers through March 31, 2018.⁷

Term

Purchases under the APL-12 GSA commence on April 1, 2014, and terminate on March 31, 2018.⁸ Year 1 of the contract is April 1, 2014, to March 31, 2015; Year 2 is April 1, 2015, through March 31, 2016; Year 3 is April 1, 2016, through March 31, 2017; and Year 4 is April 1, 2017, through March 31, 2018.

Gas Supply Volumes

Annual Contract Quantity

ENSTAR committed to a firm annual contract quantity of 10,000 MMcf for Year 1 of the contract. For Years 2 through 4, ENSTAR must provide Hilcorp with preliminary estimated annual contract quantities, final estimated annual contract quantities, and firm annual contract quantities. Within the contract quantities provisions, ENSTAR may adjust its contractual volumes up or down within a specified band to account for changes in customers demands.

ENSTAR provided Hilcorp preliminary estimated annual contract quantities of 15,000 MMcf for Year 2; 17,000 MMcf for Year 3; and 21,500 MMcf for Year 4. On March 1, 2014, ENSTAR will provide Hilcorp with an updated preliminary estimated annual contract quantity for Year 4. ENSTAR provided final estimated annual contract quantities of 15,000 MMcf for year 2. On March 1, 2014, ENSTAR must provide Hilcorp the final estimated annual contract quantity for Year 3, and on March 1, 2015, ENSTAR must provide Hilcorp with a final estimated annual contract quantity for Year 4. ENSTAR must provide Hilcorp firm annual contract quantities for Year 2, by March 1, 2014, for Year 3 by March 1, 2015, and for Year 4 by March 1, 2016.⁹

⁴<http://www.law.state.ak.us/press/releases/2012/110712-PricingProtection.html>

⁵See *State of Alaska vs. Hilcorp Alaska, LLC et. al*, 3AN-12-10858CI, Consent Decree, dated January 17, 2013.

⁶Consent Decree at 10-12.

⁷TA242-4 at 8.

⁸APL-12 GSA at §4.

⁹APL-12 GSA at §2.3(A), (B), Exhibit D, Exhibit E.

Daily Contract Quantity

The APL-12 GSA provides for different delivery periods for which Hilcorp will increase daily deliveries during the winter to accommodate increased demand. For Year 1 of the contract, Hilcorp will deliver, and ENSTAR will buy and receive, gas on each day according to the following delivery profile (daily contract quantity):

- April 1 through April 30, 2014: 24 MMcf per day;
- May 1, 2014, through September 30, 2014: 19 MMcf per day;
- October 1, 2014, through December 31, 2014: 34 MMcf per day; and
- January 1, 2015, through March 31, 2015: 38 MMcf per day.

ENSTAR will provide Hilcorp with its requested delivery rates for each subsequent contract year approximately 13 months prior to the start of the contract year. On or before March 1, 2014, ENSTAR will provide Hilcorp its daily contract quantity for year 2. On or before March 1, 2015, ENSTAR will provide Hilcorp its daily contract quantity for year 3. On or before March 1, 2016, ENSTAR will provide Hilcorp its daily contract quantity for year 4.¹⁰

Base Load and Swing Load Gas

Base load gas is the volume of gas delivered on a day of the contract year which is less than or equal to the average daily contract quantity.¹¹ The average daily contract quantity is the average of the volume of gas which would be sold on any given day during a contract year if the applicable contract year were delivered evenly on each day throughout the contract year (volumes divided by 365).¹² For any month, the volume of gas that Hilcorp delivers and ENSTAR receives up to the sum of the average daily contract quantities for that month will constitute base load gas volumes.¹³ Swing load gas is the volume of gas sold to ENSTAR on any given day in excess of the base load gas.

Emergency Load Gas

Emergency load gas is the gas sold to ENSTAR in excess of the base load gas and swing load gas to meet short term (less than one month) extraordinary or emergency gas supply needs.¹⁴ At any time during the term of the APL-12 GSA, ENSTAR may notify Hilcorp, via an Operational Notice, that it has an extraordinary or emergency gas supply need and request a specific volume of emergency load gas to be delivered. The Operational Notice must specify the nature and anticipated duration of the extraordinary or emergency situation which forms the basis of the need for additional gas. Hilcorp will promptly notify ENSTAR if it has the gas available. Emergency load gas transactions are not included in the annual contract quantity or daily contract quantities and shall not be included in the calculations of base load gas and swing load gas.¹⁵

Additional Summer Storage Gas

ENSTAR may purchase up to 1 Bcf of additional summer gas to be placed into storage in CINGSA between April 1 and September 30 of the upcoming contract year. ENSTAR must notify Hilcorp on or before March 1 of each contract year of the amount

¹⁰APL-12 GSA at §2.3(D).

¹¹APL-12 GSA at 2.

¹²APL-12 GSA at 2.

¹³APL-12 GSA at 7, §7.1(B), Exhibit H.

¹⁴APL-12 GSA at 5.

¹⁵APL-12 GSA at §2.3(F).

of additional summer gas it wants delivered and Hilcorp is obligated to deliver the gas. The additional summer storage gas is added to the firm annual contract quantity volumes and the base load gas and swing load gas volumes are recalculated. Hilcorp will make reasonable efforts to deliver the gas in such a way that it will be priced at the base load gas price.¹⁶

Discretionary Gas

ENSTAR may request discretionary gas, which is defined as gas other than emergency load gas that ENSTAR may request to purchase from Hilcorp in ENSTAR's sole discretion and which Hilcorp may sell to ENSTAR in Hilcorp's sole discretion.¹⁷ This provision allows ENSTAR to request gas beyond the contracted volumes established by the process in Section 2.3(A) and (B)(1)-(5) (and Hilcorp to provide that gas, if it is willing) at times and for reasons that are not the result of an "emergency" (as set out in the Consent Decree), and thus would not be billed as "Emergency Load Gas." This provision allows occasional additional gas purchases throughout the contract year in response to non-emergency needs.¹⁸ Volumes purchased as discretionary gas are added to the daily contract quantity for the day it was delivered and the total volume delivered on that day will be sold at the sales price in effect during the month in which it is delivered.¹⁹ Because the parties anticipate that the provision will be used intermittently in a manner that does not allow for planning like the contracted adjustability in the prior subsections, the provision does not provide for adjustments to the annual contract quantity.²⁰

Market Out and Market Return

The GSA recognizes the possibility that during the term of the contract commercial gas sales customers may buy gas from a third party sellers who would transport the gas to those customers over the ENSTAR system. Under the GSA ENSTAR may reduce the Annual Contract Quantity and the Daily Contract Quantity by the amount of gas sales lost. If commercial customers who buy gas from third party sellers again become gas sales customers of ENSTAR, ENSTAR will contact Hilcorp to purchase the increased volumes needed to serve the returning customers. There is no requirement that Hilcorp supply increased volumes but, if Hilcorp agrees to supply the additional gas, the Annual Contract Quantity and Daily Contract Quantity will be increased by the amount of gas needed by the returning customers.

¹⁶ APL-12 GSA §2.3(B)(5); Correspondence from D. Dieckgraeff, filed August 9, 2013.

¹⁷ APL-12 GSA at 5.

¹⁸ Supplemental Filing, filed August 13, 2013.

¹⁹ APL-12 GSA at §2.3(B)(6).

²⁰ Supplemental Filing, filed August 13, 2013.

Price

Gas purchased between 2014 and 2017 under the APL-12 GSA is priced at the cap set in the Consent Decree.²¹ To establish the price for gas purchased in 2018, Hilcorp and ENSTAR agreed to use the 4% price escalator contained in the Consent Decree.²² The table below provides the sales price of the base load gas, swing load gas, and emergency gas for each contract year.²³

Contract Year	Pricing Period	Base Load Gas	Swing Load Gas	Emergency Load Gas
1	4/01/2014 through 12/31/2014	\$6.86	\$8.58	\$10.29
	1/01/2015 through 3/31/2015	\$7.13	\$8.91	\$10.70
2	4/01/2015 through 12/31/2015	\$7.13	\$8.91	\$10.70
	1/01/2016 through 3/31/2016	\$7.42	\$9.28	\$11.13
3	4/01/2016 through 12/31/2016	\$7.42	\$9.28	\$11.13
	1/01/2017 through 3/31/2017	\$7.72	\$9.65	\$11.58
4	4/01/2017 through 12/31/2017	\$7.72	\$9.65	\$11.58
	1/01/2018 through 3/31/2018	\$8.03	\$10.04	\$12.05

Cover Gas

The APL-12 GSA provides “cover” as a remedy for certain failures to perform under the terms of the GSA.²⁴ Cover means that if there is failure to deliver or take any quantities of gas pursuant to the GSA, the performing party shall use commercially reasonable efforts as follows: (i) if ENSTAR is the performing party, obtain replacement gas (including gas from its contracted storage inventory in CINGSA or, if gas is not available from storage, gas obtained by calling on electric utilities to alter their generation to allow ENSTAR access to additional gas), or (ii) If Hilcorp is the performing party, sell the untaken gas or, in Hilcorp’s sole discretion, inject some or all of the untaken gas into Hilcorp’s storage facilities and thereafter seek to sell the untaken gas injected into storage. The price or cost of the elected alternative must be reasonable for the Cook Inlet Area consistent with the amount of notice provided by the nonperforming party, the immediacy of ENSTAR’s gas consumption needs or Hilcorp’s gas sales requirements, as applicable, the quantities involved, the availability of storage and stored gas considering the amount of gas in storage and the time of year, and the anticipated length of failure by the nonperforming party.²⁵

Delivery Shortfall

If Hilcorp fails to sell and deliver (or make available for delivery) the applicable daily contract quantity, as provided for in Sections 2.3(D)(1) and 2.5, for such day (nominated volume) and such failure is not permitted by the GSA, the difference between the nominated value and the amount of gas actually delivered (or made

²¹Consent Decree at 11.

²²TA242-8 at 6, n.8.

²³APL-12 GSA at §7.1(A).

²⁴APL-12 GSA at §2.4.

²⁵APL-12 GSA at 3.

available for delivery) is called the delivery shortfall volume.²⁶

If Hilcorp fails to deliver gas, ENSTAR is entitled to cover for the shortfall amount by either: (1) purchasing the gas from a third party; (2) withdrawing additional gas from CINGSA and then later replacing that storage gas through purchases from a third party (if such gas is available); or (3) invoking the Gas Emergency Agreement which permits ENSTAR to ask electric generators to alter their generation strategy to make additional gas available to ENSTAR.²⁷

If ENSTAR purchases the gas from a third party, Hilcorp will reimburse ENSTAR the positive difference, if any, between the weighted average cost of the purchased gas and the sales price for the base load gas price for that year, times the volumes of cover gas purchased. The positive difference is limited to the base load gas price for the applicable year.

If ENSTAR withdraws the gas from storage, Hilcorp will reimburse ENSTAR the positive difference, if any, between the cost of gas withdrawn from storage and the sales price for the base load gas price for that year, times the volumes of cover gas purchased. If ENSTAR purchases gas from a third party to replace the gas it withdrew from storage, Hilcorp will reimburse ENSTAR the positive difference, if any, between the storage replacement gas and the sales price for the base load gas price for that year, times the volumes of cover gas purchased. The positive difference is limited to the base load gas price for the applicable year.

If ENSTAR calls on electric utilities for gas, Hilcorp will reimburse ENSTAR the positive difference, if any, between the costs of the interruption gas itself plus any interruption expenses, and the sales price for the base load gas price for that year, times the volumes of cover gas purchased. The positive difference is limited to the base load gas price for the applicable year.

If ENSTAR is not able to replace the delivery shortfall volumes within two months, Hilcorp will pay ENSTAR the base load gas sales price times the volumes of delivery shortfall gas that was not replaced through cover.²⁸

²⁶APL-12 GSA at §2.4(C).

²⁷TA242-4 at 5-6.

²⁸APL-12 GSA at §2.4(C); Supplemental Filing, filed August 2, 2013.

Exhibit F of the PL-12 GSA provides several examples, in narrative format, of cover gas if a delivery shortfall occurs.

Receipt Shortfall

If ENSTAR fails to purchase and take the applicable daily contract quantity, as provided for in Sections 2.3(D)(1) and 2.5, for such day (nominated volume) and such failure is not excused or permitted by the GSA, the difference between the nominated value and the amount of gas actually taken is called the receipt shortfall volume.²⁹

Should ENSTAR fail to purchase gas, Hilcorp's cover remedy is to make commercially reasonable efforts to sell the untaken gas, either by selling it immediately or by injecting it into its proprietary storage facilities, and trying to sell the gas later. Hilcorp may recover from ENSTAR the positive difference, if any, between the weighted average sales price received by Hilcorp for such gas and the sales price for base load gas applicable that year, multiplied by the volume of replacement gas sold, up to the price for base gas applicable that year. If Hilcorp is not able to sell the receipt shortfall volumes within two months, ENSTAR will reimburse Hilcorp the base load gas sales price times the amount volumes of receipt shortfall not delivered through cover.³⁰ Exhibit G of the APL-12 GSA provides several examples, in narrative format, of cover gas if a receipt shortfall occurs.

Transportation

ENSTAR is responsible for transportation to, at, from, and after delivery to a delivery point, including reimbursement for transportation costs initially paid by Hilcorp.³¹

Public Interest

ENSTAR³² asserts that the Alaska Legislature articulated the standard for review of gas supply contracts in AS 42.05.141(d), which is as follows:

When considering whether the approval of a rate or a gas supply contract proposed by a utility to provide a reliable supply of gas for a reasonable price is in the public interest, the commission shall:

(1) recognize the public benefits of allowing a utility to negotiate different pricing mechanisms with different gas suppliers and to maintain a diversified portfolio of gas supply contracts to protect customers from the risks of inadequate supply or excessive cost that may arise from a single pricing mechanism; and

(2) consider whether a utility could meet its responsibility to the public in a timely manner and without undue risk to the public if the commission fails to approve a rate or a gas supply contract proposed by the utility.

ENSTAR argues that approval of the GSA is in the public interest for a number of reasons. First, approval would allow ENSTAR to purchase a reliable supply of gas. Second, it would that gas purchased by ENSTAR is at a reasonable price. Third, it would satisfy the remaining unmet need of ENSTAR's customers over four years. And fourth, the pricing terms of the GSA meets the diversified portfolio with different pricing mechanisms. ENSTAR presented each of these arguments as follows:

²⁹APL-12 GSA at §2.4(D).

³⁰TA 242-4 at 6 and APL-12 GSA at §2.4(D).

³¹APL-12 GSA at §7.3(A).

³²TA242-4 at 8.

- 1) *Afford ENSTAR the opportunity to purchase a newly discovered supply of gas at a reasonable price.* While Hilcorp is a relatively recent entrant in the Cook Inlet market, it has proven to be a reasonable and reliable supplier of natural gas to ENSTAR. ENSTAR has purchased natural gas supplied by Hilcorp under several contracts (APL-4, APL-8, APL-9, APL-10, and the Union contract) since Hilcorp first began its Cook Inlet operations in December 2011. ENSTAR's customers have benefited from reliable deliveries by Hilcorp under those contracts. Hilcorp is the third-largest privately held exploration and production company in the United States and is an established producer with a history of performance in the Inlet that indicates it is qualified to undertake and meet the obligations contained in the GSA.
- 2) *Ensures that ENSTAR's customers will enjoy a reasonable price.* The Superior Court approved the Consent Decree in January 2013. The Consent Decree includes price caps on "Base Load," "Swing Load," and "Emergency Load" Gas. The proposed GSA pricing strictly adheres to the terms of the Consent Decree and as a result, ENSTAR argues that these prices are reasonable.
- 3) *Satisfies the unmet needs of ENSTAR's customers.* The proposed GSA is intended to meet all of ENSTAR's outstanding gas requirements through the first quarter of 2018, and to do so in a way that ensures the flexibility to adapt to changes in ENSTAR's customers' demand due to weather or any Market Out volumes. If the Commission approves the APL-12 GSA, as well as the other two multi-year contracts currently under review in TA239-4 and 241-4, ENSTAR will have contracted for all of its gas supply needs through the first quarter of 2018. In the intervening years, ENSTAR will closely monitor Cook Inlet production and seek appropriate sources for gas supply beyond 2018.
- 4) *The pricing terms of the GSA meets the diversified portfolio with different pricing mechanisms.* As noted in several places in the TA Letter, the GSA's pricing is governed by the Consent Decree, which sets prices for Base Load Gas, Swing Load Gas and Emergency Gas and uses a four percent per year escalator over five years. The majority of ENSTAR's other gas is priced using energy-based indices. APL-4, which makes up approximately 15 percent of ENSTAR's projected purchases during the term of APL-12, is priced using an oil-based index. The "legacy" Hilcorp (Unocal) contract, which makes up approximately 25 percent of ENSTAR's projected purchases during the term of APL-12, is priced using a Henry Hub natural gas-based index. Further, as noted on page 3 of the TA Letter, ENSTAR issued a Request for Proposals ("RFP") to ten local producers, potential producers, and potential manufacturers soliciting their interest in and ability to meet ENSTAR's near-term gas supply needs. The three other supply contracts with two different gas suppliers that ENSTAR has recently submitted to the RCA for approval demonstrate ENSTAR's attempt to further diversify its gas portfolio. In the case of APL-12, no other supplier was able to provide the proven reserves³³ behind pipe and the deliverability ENSTAR required in these years to meet the needs of its customers.³⁴

The Consent Decree provides that Hilcorp will use commercially reasonable efforts to increase the production and development of natural gas from Hilcorp's Cook Inlet Basin Properties. As such, approval of the GSA allows for what appears to be a reliable source of gas from a well-established credible producer. The GSA also satisfies ENSTAR's unmet needs through the first quarter of 2018. The addition of the APL-12 GSA allows ENSTAR to maintain a somewhat diversified portfolio of gas supply

³³Supplemental Filing, filed August 8, 2013.

³⁴TA242-4 at 9-10; Supplemental Filing, filed August 12, 2013.

contracts, as it currently has long term GSAs with other producers (Anchor Point Energy, Buccaneer, and ConocoPhillips) which also contain different pricing mechanisms. Most important to our consideration, without our approval of the APL-12 GSA ENSTAR's customers could potentially be at risk of inadequate supply. For these reasons we believe that it is in the public interest to approve the APL-12 GSA. Also important to us, the GSA allows ENSTAR to reduce the quantity it is required to buy from Hilcorp by the amount ENSTAR's demand is reduced if some commercial customers cease to buy gas from ENSTAR. Our review and approval of the GSA rests in part on our understanding that a reduction in contract quantities due to loss of commercial gas sales customers is not restricted by the percent limitations on contract quantities specified in sections 2.3(A) and (B) of the GSA. On the point, ENSTAR observed in its TA Letter (pg.4), that it can reduce its annual and daily quantities if market out considerations develop. Hilcorp did not comment on ENSTAR's TA letter.

Tariff Sheets

ENSTAR filed revised Tariff Sheet Nos. 89 and 221, adding a line for the APL-12 GSA. We approve Tariff Sheet Nos. 89 and 221, both with an effective date of September 9, 2013.

Conclusion

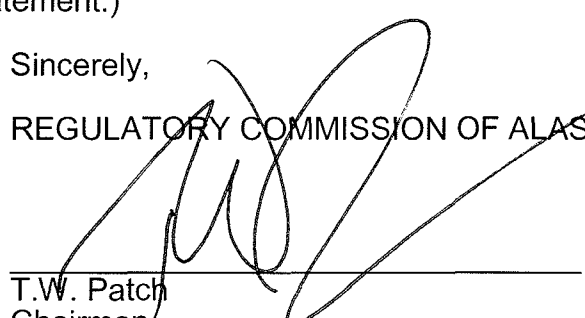
We grant the motion to accept reply comments. We find that approval of the APL-12 GSA is in the public interest. We approve the APL-12 GSA, approve the inclusion of the cost of gas purchased under the APL-12 GSA in the calculation of ENSTAR's gas cost adjustment, and approve Tariff Sheet Nos. 89 and 221 filed in TA242-4. In the event the parties to this contract agree to an amendment, the contract as amended shall be submitted to the commission for review and approval not later than 30 days after execution of any amendment. Enclosed is a validated copy of the APL-12 GSA. Also enclosed are validated copies of Tariff Sheet Nos. 89 and 221, filed in TA242-4 on July 24, 2013.

BY DIRECTION THE COMMISSION

Commissioner Norman Rokeberg concurs in the decision to approve this gas supply contract and makes a separate statement.)

Sincerely,

REGULATORY COMMISSION OF ALASKA



T.W. Patch
Chairman