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VIA E-Mail
Alaska State Legislature
Budget & Audit Committee
State Capitol, Room 514
Juneau, Alaska 99801

Re: The Alaska LNG Project

We have been asked to advise the State of Alaska ("State") on whether there are risks, and ways to minimize any such risks, under the federal antitrust laws in connection with the proposal for the State and four others to create a joint venture that would transport gas and produce LNG for consumption within Alaska and for export by ship to other markets.

In rendering this advice, we are primarily relying on information contained in (i) the Heads of Agreement dated January 14, 2014, among the State, the Alaska Gasline Development Corporation ("AGDC"), TransCanada Alaska Development Inc., ExxonMobil Alaska Production Inc., ConocoPhillips Alaska, Inc., and BP Exploration (Alaska) Inc. ("HOA"); (ii) the Memorandum of Understanding among the State, the TransCanada Alaska Company, LLC, Foothills Pipe Lines Ltd. and TransCanada Alaska Development Inc.; (iii) House Bill No. 277, introduced January 24, 2014; and (iv) the Senate Bill No. 138, also originally introduced January 24, 2014, but apparently subsequently modified.

Under the Heads of Agreement and HB 277, the Legislature is proposing to create a new a new AGDC subsidiary, AGDCS, to explore the feasibility of, and to develop, a large diameter gas pipeline from the North Slope and a LNG production plant in Southern Alaska.[1] Like its parent, AGDCS would be "a public corporation and government instrumentality for administrative purposes of the corporation, but having a legal existence separate from the state." [SB Section 7; HB Section 7] The Board of Directors would consist of the corporation's chairman, two state commissioners, and four public members selected by the Governor and

[1] We understand that a prior version of SB 138 also contemplated that AGDC would incorporate a new subsidiary. That feature is not contained in the current version of the Senate Bill. In any case, the existence of a separate subsidiary to AGDC does not affect the analysis contained herein.

serving at his pleasure. AGDCS would be one of the five corporate participants in the project; the other four are TransCanada Alaska Development Inc., ExxonMobile Alaska Production, Inc., ConocoPhillips Alaska, Inc., and BP Exploration (Alaska) Inc. (the latter three collectively "the Producers") (*see* HOA).[2]

This project is generated by the need for the State and the Producers to respond to the changing market for natural gas in North America, largely as a result of the recent economical development of significant gas reserves from shale. This development has substantially increased the amount of gas already being supplied in the United States, and thereby made it uneconomic to build the previously planned Canadian natural gas pipeline from the North Slope to the Lower 48 US states. The Producers have large reserves of natural gas, and the State shares their strong interest in finding markets for it. This reality has led the State to join with the producers to develop the concept of (i) an 800 mile joint venture pipeline from the North Slope to southern Alaska and (ii) a large scale LNG plant and related facilities to convert the gas into a form that could be exported by ship, while also providing for distribution to Alaska residents in the more populous southern part of the State.

We believe that this large-scale, capital intensive project can be justified by applying the normal antitrust analysis contained in the Sherman and Clayton Acts; and any antitrust risks that remained could be eliminated by strengthening the legislative mandate to be sure that whole LNG project could be qualified for immunity under the so-called "state action" doctrine.

Antitrust Issues Related to the Creation of the LNG Joint Venture

There are generally two sets of antitrust questions that must be examined when a joint venture is being created: (1) Is the joint venture undertaking an activity that its members could not perform efficiently on an individual basis? (2) Is the size of the venture appropriate to its goals? In the case of the proposed Alaska LNG joint venture, the answers to these questions are clearly "yes".

Where the joint venture is performing what the members have previously done on an individual basis, it may be treated as a de facto merger and hence struck down if it encompasses an unnecessarily high proportion of market participants. See, e.g., *United States v. Columbia*

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2 We note that, to the extent that AGDC/AGDCS would become an owner of a newly created entity or otherwise acquire interests in an entity to develop, own or operate an LNG plant, the acquisition of such interests could potentially implicate the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended. 15 U.S.C. § 7a. This statute is a notification statute which requires parties involved in certain acquisitions of voting securities or assets to notify the federal government before consummating such acquisition. At present, we do not seem to have sufficient information to advise the State on whether any such notification would be required, or if an exemption from such notification would be available.

Pictures Industries, Inc., 507 F. Supp. 412 (S.D.N.Y. 1980), *aff'd mem.* No 81-6003 (2d Cir. 1981). Alternatively, it may be treated as a thinly-veneered cartel, engaged in joint price fixing or market division. See *Timken Roller Bearing Co. v. United States,* 341 US 593 (1951); *United States v. Dynalectric Co.*, 859 F.2d 1559 (11th Cir. 1988). This problem does not appear with regard to the Alaska LNG joint venture. Pipelines and LNG production plants are subject to very large economies of scale. We are not aware of any evidence that any entity has plans to build a pipeline and LNG production plant on their own. And, given the regulatory approvals required for such a project, there appears to be no efficient way to meet the need to transport the gas except via a very large diameter pipeline that is being proposed. It would seem highly unlikely that the State (or the federal government) would approve for environmental and other reasons the building of multiple pipelines and LNG plants. Thus, single, larger scale facilities are perhaps the only practicable alternative to transport and market the North Slope gas.

The situation is quite different if a joint venture among some competitors is performing a necessary and efficient function, and the existing members exclude their rivals from access to the venture. Then the joint venture may be found to have engaged in a form of illegal boycott under Section 1 of the Sherman Act. See *United States v. Terminal RR Assn. of St. Louis*, 224 US 383 (1912); *Associated Press v. United States*, 326 US 1 (1945); *United States v. Realty Multi-List*, 629 F.2d F.2d 1351 (5th Cir. 1980). In these cases, the normal remedy is compulsory access for the non-member competitors. But this problem does not appear present with proposed Alaska LNG joint venture either. The Producers are major sources of natural gas from the North Slope and there is no evidence that there is any other gas producer who has been denied participation in the project. As long as the joint venture pipeline is willing to transport the gas of any smaller producers on reasonable terms, there is simply no antitrust issue with basic creation of the LNG joint venture. Such conditions appear to be reflected in the HOA where it specifically states that the State share of capacity would be owned and operated "on terms that would provide access for third-parties." HOA, ¶ 6.3b.

1. Antitrust Issues Concerning Operational Rules of a Joint Venture

There has been a lot more antitrust litigation over how joint ventures actually operate than over their creation. A rule or decision of a joint venture will be treated as an "agreement" among its participating members and therefore subjection to more stringent antitrust scrutiny under Section 1 of the Sherman Act than a single firm monopolist would be for doing the same thing. *See American Needle v. NFL*, 130 S.Ct. 2201 (2010). However, it has become clear that, where the joint venture is performing a function that involves some plausible efficiencies, that its rules and decisions will be adjudicated under fact-intensive balancing process embodied in the so-called "rule of reason", rather than a per se prohibition. *See NCAA v. Board of Regents,* 468 US 85 (1984). Thus the joint venture can set the prices and terms when it is offering a product that is based on competitively produced inputs from its members. *See Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.,* 441 US 1 (1979).

Reviewing the terms of the proposed joint venture among the State and the Producers, we do not see any rules that cause us immediate antitrust concern. The joint venture, as we understand it, will be the producer of the LNG gas for export and the seller of natural gas to the utilities serving consumers in Alaska. It will be free to set prices, quantities and terms for delivery without facing unusual antitrust risks. *Texaco Inc. v. Dagher*, 547 U.S. 1. In addition, the prices at which gas will be delivered to the venture will apparently be discussed/submitted to the Federal Energy Regulatory Commission for review and approval. *See* HOA, ¶ 6.4a. Such prices will therefore be considered regulated and will be essentially free from challenge under the so-called "filed rate doctrine" which prohibits antitrust damage actions in situations where rates were submitted/authorized by an agency with authority to determine whether the rate was appropriate. *Keogh v. Chicago & Northwestern Railway Co.*, 260 U.S. 156 (1922); *Wah Chang v. Duke Energy Trading and Mktg. LLC,* 507 F.3d 1222, 1226 (9th Cir. 2007).

We have reviewed Appendix A (entitled "Pro-Expansion Principles") to the Heads of Agreement. We believe this has been done in a particularly effective way to avoid antitrust risks. A periodic problem occurs in a monopoly joint venture among competitors if one or more partners can veto expansion as a way to restrict supply and thereby generated supply shortages and higher prices in the downstream market. *See United States v. Pan American World Airways, Inc.,* 193 F. Supp. 18 (S.D.N.Y. 1961), *rev'd on other grounds,* 371 U.S. 296 (1963).

However, in Appendix A, it is made clear that any partner (including the State) may cause an expansion of the pipeline or the LNG plant so long as the Expansion Party will finance the addition and certain other conditions are met. The fact the State is a full partner makes this safeguard even stronger. Assume for some reason that the Producers wanted to hold down the pipeline capacity because they believed that resulting shortfall would result in higher prices for themselves. In these circumstances, the State could still exercise its right to be an Expansion Party, and thereby protect the consumer interests of its residents and voters.

2. Further Reducing Any Antitrust Risks by Enhancing the Legislative Mandate

As we have indicated, we do not see significant antitrust risks being generated by LNG joint venture's creation or proposed operation. However, we have also had considerable experience where antitrust claims were made against a joint venture for tactical or anti-competitive reasons. The objector will formulate a "price fixing" or "boycott claim" which may be disruptive and expensive to defend. Because of the substantial expense of defending antitrust litigation, the trouble-making plaintiff can impose serious costs on a joint venture and thus sometimes even cause it to abandon its preferred course.[3]

It is for the purpose of reducing any such risks that we make the following comments on how the proposed legislation *could be* modified to ensure that the LNG joint venture could gain the ability to make a strong "state action" exemption defense if sued by a troublemaking plaintiff or class of alleged victims assembled by some opportunistic lawyers.

First recognised in *Parker v. Brown,* 317 U.S. 341 (1943), the state action doctrine is a judicially-created exemption to the application of the federal antitrust laws where a state has imposed a restraint on competition. The state action doctrine immunizes anti-competitive conduct by private parties if a two-part test can be satisfied: (1) the challenged restraint must be one "clearly articulated and affirmatively expressed as state policy" and (2) policy must be "actively supervised" by the state itself. For entities that are considered the "state" for the doctrine's purpose, the second prong need not be established because the state presumably supervises itself.

Stated another way, in the absence of clear intent by the federal government to the contrary, the state action doctrine specifically allows a state to withdraw a sector of the economy from the competitive forces of the marketplace. As one court of appeals explained, "[w]hile individual anti-competitive acts of state governments may be considered unwise or counterproductive, the decision to make such choices lies within the sovereign power of the states. Congress did not intend to override important state interests in passing the Sherman Act." *A.D. Bedell Wholesale Co. v. Philip Morris Inc.,* 263 F.3d 239, 255 (3d Cir. 2001).

Here, the State of Alaska could make clear that, whatever its other goals and the antitrust risks of the Alaska LNG venture may be, it intends that its legislation and the subsequent operation of AGDC/AGDCS to displace the role of competition in the development and marketing of Alaska North Slope gas.[4] For example, it could make somewhat clearer that the State's ultimate goal in passing HB No. 277 and SB No. 138 is to maximize the revenues from

[3] *See, e.g.,* Robert H. Bork, THE ANTITRUST PARADOX (1978) ("Litigation can be a particularly effective form of predation. Litigation can often be framed so the expenses to each party will be about the same....Expenses in complex business litigation can be enormous, not merely direct legal fees and costs but in diversion of executive time and effort and in the disruption of the organization's regular activities.") The incentives here may be modified somewhat by Alaska Rule of Civil Procedure 82 which incorporates a prevailing party attorneys' fee rule.

[4] While we do not opine on existing Alaska law, we note that we did not come across a provision in existing legislation that makes clear that the State wants to displace market-based competition with its own market and/or regulatory structure with regard to the marketing of ANS gas.

the production of sale of ANS gas, consistent with the presumed goals of the producers. *But see Alaska Gasline Port Auth. v. ExxonMobil Corp.,* 2006-1 Trade Cas. (CCH) ¶ 75,312 (D. Alaska 2006) (Port Authority could not maintain action against gas producers for failing to supply gas to pipeline because, among other things, of apparent preemption of such actions by Stranded Gas Development Act, Alaska Stat. § 43.82.010, *et seq.*).

By making such goals clear in the legislation, Alaska would virtually eliminate (what we believe in any event is minimal) antitrust risk to AGDC and AGDCS in participating in such a venture. It has the virtue of allowing the state to determine if it also wants to extend such protection to the private parties participating in the Project because to do so, Alaska would need to establish some mechanism to "actively supervise" their activities within the Project to ensure that those activities are consistent with the State's goals in authorizing the Project in the first instance. Such a role could be played by the Board of AGDC/AGDCS, which is comprised of, among others, state officials and public citizens appointed by the governor, or another agency or entity of the State of Alaska, if the State so desires it.

We trust that this letter is helpful in explaining the apparent federal antitrust law treatment of the proposed Alaska LNG Project and related legislation. We would be pleased to expand upon on our analysis should the Legislature or the Committee so desire or to address any specific questions that the Legislature or the Committee may have.

Sincerely,

W. Todd Miller
Donald I. Baker