

LEGAL SERVICES

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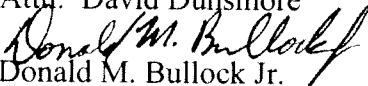
State Capitol
Juneau, Alaska 99801-1182
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MEMORANDUM

March 17, 2009

SUBJECT: Request by HCR 12 that the governor and the attorney general review and reevaluate the license issued under the Alaska Gasline Inducement Act (AS 43.90) (Work Order 26-LS0156\S)

TO: Representative Pete Petersen
Attn: David Dunsmore

FROM: 
Donald M. Bullock Jr.
Legislative Counsel

HCR 12 requests the governor and the attorney general to review and reevaluate the license issued to TransCanada Alaska Company, LLC and Foothills Pipe Lines, Ltd. (licensee) to determine whether the project proposed "maximizes the benefits to the people of the state and merits continuing the license[.]" You asked whether any authority exists for the state to unilaterally revoke or modify the terms for the license, whether the state would be exposed to any liability if the state unilaterally revoked or modified the license, and whether there are any other potential legal consequences of revoking or modifying the license.

The license issued under AS 43.90 (Alaska Gasline Inducement Act (AGIA)) is a contract between the state and the licensee. Under the contract, the state commits to make matching contributions of up to \$500,000,000 for qualified expenditures incurred by the licensee and to provide the benefits of the Alaska Gasline Inducement Act coordinator.¹ The state also granted the licensee the assurances in AS 43.90.440 that the inducements provided to the licensee would not also be given to a competing natural gas pipeline; if the state provides inducements to a competing pipe line, the licensee is entitled to the payment described in AS 43.90.440(a). In return for the state's commitment, the licensee agrees to the conditions and commitments in AS 43.90.130, the requirements generally referred to as the "must haves" during the consideration of AGIA. Because the license is a contract, if the state unilaterally revokes or modifies the contract, the state would be liable for damages resulting from the breach.

I will not speculate on the amount of the damages for which the state would be liable if the state breaks the contract. However, the amount of damages may be significant based on the fact that AS 43.90.440 entitles the licensee to a payment by the state of three times the total amount of the qualified expenditures incurred and paid by the licensee if the

¹ AS 43.90.110.

state violates the contract by providing inducements to a competing gas pipeline. If the state makes the payment under AS 43.90.440, the project is deemed to be abandoned under AS 43.90.240(d).

Within AGIA, there are provisions that allow for the abandonment of the license or a modification of the project. Under AS 43.90.240, the project may be abandoned if it is found to be uneconomic. AS 43.90.240(a) addresses the situation where the licensee and the commissioner of revenue and the commissioner of natural resources all agree that the project is uneconomic. That subsection reads as follows, with emphasis added:

*(a) If the commissioners and the licensee agree that the project is **uneconomic**, the project shall be abandoned, the inducement provided for in AS 43.90.110 shall be terminated, and, except for requirements imposed on the licensee under (e) of this section and AS 43.90.220, the state and the licensee no longer have an obligation under this chapter with respect to the license.*

AS 43.90.240(b) and (c) address the situation where the commissioners and the licensee disagree that the project is uneconomic. AS 43.90.240(b) and (c) read as follows, with emphasis added:

(b) If the commissioners or the licensee determines that the project is uneconomic and the other party disagrees, the disagreement shall be settled by arbitration administered by the American Arbitration Association under the substantive and procedural laws of this state, and judgment on the award rendered by the arbitrators may be entered in superior court in the state. In the event of arbitration, each party shall select an arbitrator from the American Arbitration Association's National Roster, and the two arbitrators shall appoint a third arbitrator from the American Arbitration Association's National Roster who shall serve as the chair of the three-member arbitration panel. If the arbitration panel determines that the project is

(1) uneconomic, the state and the licensee no longer have an obligation under this chapter with respect to the license, except for requirements imposed on the licensee under (e) of this section and AS 43.90.220; or

(2) not uneconomic, the obligations of the licensee and the state continue as provided under this chapter and the license.

(c) The arbitration panel in (b) of this section shall make a determination that the project is uneconomic only if the panel finds that the party claiming the project is uneconomic has proven by a preponderance of the evidence that the

(1) project does not have credit support sufficient to finance construction of the project through firm transportation commitments, government assistance, or other external sources of financing; and

(2) predicted costs of transportation at a 100 percent load factor, when deducted from predicted gas sales revenue using publicly available predictions of future gas prices, would result in a producer rate of return that is below the rate typically accepted by a prudent oil and gas exploration and production company for incremental upstream investment that is required to produce and deliver gas to the project.

As you can see, if the licensee and commissioners disagree on whether the project is uneconomic, the dispute is resolved through an arbitration process.

Many of the facts presented in HCR 12 relate to whether the project proposed by the licensee is uneconomic. The administration could avail itself of AS 43.90.240(a) - (c) and explore whether the project is uneconomic and decide its next course action.

The licensee also has the option of seeking an amendment or modification of its project plan under AS 43.90.210. That section reads as follows:

Subject to the approval of the commissioners, a licensee may amend or modify its project plan if the amendment or modification improves the net present value of the project to the state, is necessary because of an order or requirement by a regulatory agency with jurisdiction over the project or by the Alaska Oil and Gas Conservation Commission, or is necessary because of changed circumstances outside the licensee's control and not reasonably foreseeable before the license was issued. An amendment or modification approved under this section must be consistent with the requirements of AS 43.90.130 and, except for an amendment or modification required because of an order or requirement of a regulatory agency with jurisdiction over the project or by the Alaska Oil and Gas Conservation Commission, may not substantially diminish the value of the project to the state or the project's likelihood of success.

Although the grounds for modification or amendment are limited, the facts alleged in HCR 12 may constitute "changed circumstances outside the licensee's control and not reasonably foreseeable before the license was issued" that necessitate a change in the project. If so, the commissioners and the licensee could work together to reach agreement on acceptable modifications and amendments. This approach would not end the project and but would allow the project to continue with changes and modifications.

The requests to the governor and to the attorney general in HCR 12 do not address abandonment as uneconomic or modification of the project. Instead, the resolution asks the administration to reconsider the decision made by the commissioners before the licensee was recommended for approval to the legislature. Specifically, on page 4, lines 25 - 26, HCR 12 requests the governor and the attorney general to "determine whether the project proposed by the licensee sufficiently maximizes the benefits to the people of the state and merits continuing the license[.]" This provision could be read to encourage

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a unilateral revocation outside of the contract termination provisions within AGIA. If the contract is unilaterally terminated by the state, the state could be found by a court to be liable for damages to the licensee arising out of the state's breach.

If I may be of further assistance, please advise.

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