

ALASKA STATE LEGISLATURE
HOUSE RULES STANDING COMMITTEE

February 26, 2002
11:05 a.m.

MEMBERS PRESENT

Representative Pete Kott, Chair
Representative Brian Porter
Representative Vic Kohring
Representative Carl Morgan
Representative Lesil McGuire
Representative Ethan Berkowitz
Representative Reggie Joule

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE BILL NO. 206

"An Act relating to a vessel-based commercial fisheries limited entry system, to management of offshore fisheries, and to the definition of 'person' for purposes of the commercial fisheries entry program; and providing for an effective date."

- MOVED CSHB 206(RLS) OUT OF COMMITTEE

OVERVIEW: UPDATE ON HCR 17 & NETRICITY'S ROLE IN ALASKA

PREVIOUS ACTION

BILL: HB 206

SHORT TITLE: LIMITED ENTRY FOR COMM. FISHERIES

SPONSOR(S): RESOURCES

Jrn-Date	Jrn-Page		Action
03/22/01	0691	(H)	READ THE FIRST TIME - REFERRALS
03/22/01	0691	(H)	FSH, RES
04/02/01		(H)	FSH AT 5:00 PM CAPITOL 124
04/02/01		(H)	Moved Out of Committee
04/02/01		(H)	MINUTE(FSH)
04/03/01	0826	(H)	FSH RPT 2DP 4NR
04/03/01	0827	(H)	DP: SCALZI, WILSON; NR:

04/03/01	0827	(H)	DYSON, COGHILL, KERTTULA, STEVENS
04/03/01	0827	(H)	FN1: ZERO(DFG)
04/04/01		(H)	RES AT 1:00 PM CAPITOL 124
04/04/01		(H)	Heard & Held
04/04/01		(H)	MINUTE(RES)
04/09/01		(H)	RES AT 1:00 PM CAPITOL 124
04/09/01		(H)	Scheduled But Not Heard
04/10/01		(H)	MINUTE(RES)
04/10/01		(H)	RES AT 5:30 PM CAPITOL 124
04/10/01		(H)	Moved CSHB 206(RES) Out of Committee MINUTE(RES)
04/11/01	0952	(H)	RES RPT CS(RES) NT 7DP 1NR
04/11/01	0953	(H)	DP: FATE, MCGUIRE, GREEN, CHENAULT,
04/11/01	0953	(H)	KERTTULA, STEVENS, SCALZI; NR: MASEK
04/11/01	0953	(H)	FN1: ZERO(DFG)
01/23/02	2053	(H)	RETURNED TO RES COMMITTEE
02/08/02		(H)	RES AT 1:00 PM CAPITOL 124
02/08/02		(H)	Moved CSHB 206(2d RES) Out of Committee MINUTE(RES)
02/08/02		(H)	MINUTE(RES)
02/13/02	2221	(H)	RES RPT CS(2D RES) NT 4DP 1NR
02/13/02	2222	(H)	DP: CHENAULT, STEVENS, FATE, SCALZI;
02/13/02	2222	(H)	NR: MASEK
02/13/02	2222	(H)	FN2: ZERO(DFG)
02/26/02		(H)	RLS AT 11:00 AM BUTROVICH 205

WITNESS REGISTER

KRIS KNAUSS, Staff
to Representative Kott
House Rules Standing Committee
Alaska State Legislature
Capitol Building, Room 204
Juneau, Alaska 99801

POSITION STATEMENT: Reviewed the changes encompassed in Version W of HB 206.

REPRESENTATIVE DREW SCALZI
Alaska State Legislature
Capitol Building, Room 13
Juneau, Alaska 99801

POSITION STATEMENT: Testified on behalf of the House Resources Standing Committee, the sponsor of HB 206.

JIM DODSON

Netricity, L.L.C.

(No address provided)

POSITION STATEMENT: Provided an update of Netricity's project.

MIKE CASKEY

Netricity, L.L.C.

(No address provided)

POSITION STATEMENT: Provided an update of Netricity's project.

ACTION NARRATIVE

TAPE 02-3, SIDE A

Number 0001

CHAIR PETE KOTT called the House Rules Standing Committee meeting to order at 11:05 a.m. Representatives Kott, Porter, McGuire, and Berkowitz were present at the call to order. Representatives Kohring, Morgan, and Joule arrived as the meeting was in progress.

HB 206-VESSEL LIMITED ENTRY FOR COMM. FISHERIES

CHAIR KOTT announced that the first order of business would be HOUSE BILL NO. 206, "An Act relating to a vessel-based commercial fisheries limited entry system, to management of offshore fisheries, and to the definition of 'person' for purposes of the commercial fisheries entry program; and providing for an effective date."

KRIS KNAUSS, Staff to Representative Kott, House Rules Standing Committee, Alaska State Legislature, informed the committee of the changes encompassed in the proposed committee substitute (CS) [Version 22-LS0426\W, Utermohle, 2/21/02]. On page 3, line 28, after "recent" the language "and past" was inserted. The same was done on page 4, line 5. On page 4, line 9, the language "or recently was" was inserted. On page 4, line 10, "may" was changed to "shall".

Number 0138

REPRESENTATIVE MCGUIRE moved to adopt CSHB 206 [Version 22-LS0426\W, Utermohle, 2/21/02], as the working document. There being no objection, Version W was before the committee.

Number 0156

REPRESENTATIVE DREW SCALZI, Alaska State Legislature, informed the committee that he is carrying HB 206 at the request of the Commercial Fisheries Entry Commission (CFEC) who requested this of the legislature. A few years ago, the legislature discovered that a moratorium situation was coming in hair crab and scallop fisheries. Under the current limited entry system, [CFEC] was tasked with developing a program that would provide the aforementioned two fisheries with a limited entry. Under the current limited entry plan, a limited entry system must be devised such that the owner of the limited entry permit must be a person. Although this makes sense with the salmon and herring fisheries because of the small operations, under Bering Sea fisheries there are very large vessels that have multiple skippers. Therefore, if the CFEC considers a limited entry program, it must consider who is given the permit in relation to who operates the vessel. This legislation provides CFEC with a new tool, adoption of a limited entry system. By doing so, the limited entry, the initial recipient, would be attached to the vessel rather than to the person. In the next generation, the [limited entry permit] would revert back to a person. In other words, if the vessel permit was sold later, the permit would go to a person.

REPRESENTATIVE SCALZI posed an example in which CFEC used the current statutes to provide for a limited entry system. If there were seven vessels in the hair crab fishery and the desire was to provide a limited entry system, then "you" may have to increase to 20 permits. Therefore, the entire purpose of the moratorium would be circumvented because the number of participants would have been expanded.

Number 0407

REPRESENTATIVE SCALZI acknowledged that there has been some opposition to this bill because those people may not be initial recipients under [limited entry]. He emphasized that this merely provides a tool because the Limited Entry Commission still has to have public hearings and devise a limited entry plan. This legislation merely allows the permit of an initial recipient to go to a vessel. He recalled Representative McGuire's concern in regard to the possibility that [this limited entry] would short circuit [new] folks from entering into these fisheries. He pointed out that [the Bering Sea fishery] isn't an entry-level fishery.

REPRESENTATIVE SCALZI explained that originally HB 206 was going to be a generic tool applicable to all fisheries. However, there was opposition from various areas of the state and thus CFEC limited the legislation to the two species [hair crab and scallops]. In doing so, the next generation issue arose. Under the current limited entry system, the owner of the permit must be on the vessel fishing. However, these are large vessels and the owners are rarely on board. This legislation would allow the owner in the next generation of the permit to hire a skipper to run the boat, as is the current situation. Therefore, the current business practices wouldn't be changed.

Number 0633

MAX HULSE, Eagle River Seafoods, testified via teleconference. He reviewed the changes that he would recommend. He clarified that the changes on page 3, line 28, and page 4, lines 9-10, involve the qualifications for future permits issued in the scallop fisheries. On page 3, line 28, after "recent", he suggested inserting the language "and past". On page 4, line 9, he suggested changing "is" to "was" and insert "recent" between "a" and "moratorium". He also suggested changing "may" to "shall" on page 4, line 10. Mr. Hulse explained that if a vessel permit system is established in the future, those fishermen who benefit should be those who have historically been involved in the fishery. Therefore, [these changes would] tie the eligibility criteria to the receipt of a future permit.

Number 0840

JOE KYLE (ph) noted that he was representing the Korean Hair Crab fishers. He announced support of Mr. Hulse's suggested changes that are reflected in [Version W].

REPRESENTATIVE McGUIRE mentioned the debate regarding keeping these permits in the hands of Alaskans and Alaskan boats and workers. She inquired as to Mr. Kyle's opinion of that.

MR. KYLE answered that he believes the bill is in harmony with all the other things in place at the federal and state level in regard to keeping permits local. However, he noted that there are no guarantees.

CHAIR KOTT closed the public testimony.

Number 0908

REPRESENTATIVE McGUIRE moved to report CSHB 206 [Version 22-LS0426\W, Utermohle, 2/21/02], out of committee with individual recommendations and the accompanying zero fiscal notes. There being no objection, CSHB 206(RLS) was reported from the House Rules Standing Committee.

OVERVIEW: UPDATE ON HCR 17 & NETRICITY'S ROLE IN ALASKA

CHAIR KOTT announced that the next order of business would be an update from Netricity.

Number 0981

JIM DODSON, Netricity, L.L.C., informed the committee that Netricity began the project by trying to secure a gas supply for the project by approaching the Department of Natural Resources (DNR). He explained that he was informed that if the state was to sell Netricity gas, it would be subject to approval by the legislature. Therefore, Netricity was directed to the legislature in order to bring members up to speed on what Netricity is trying to do. In talking with the legislature, the project gained quite a bit of support. For instance, last year the House passed HCR 17, which called upon DNR to enter into some agreement to sell Netricity gas or respond to the legislature in regard to why such a contract couldn't be entered into. From that, a discussion within DNR ensued in regard to the rights of the state to sell gas from the Prudhoe Bay unit, for example, in the absence of severance of that gas from the mineral estate. The department's response was that the state's right to take gas in the absence of production by the producers is an open question. If the state could take gas, it would be going out of balance; that is [the state would] take its gas first out of the reserves. Furthermore, there is no gas balancing agreement or provisions under which the state could go out of balance. Therefore, the state isn't in a good position to attempt to sell Netricity gas. Hence, Netricity began working with the producers in order to purchase gas. Those negotiations are continuing; however, at this point the commercial terms of those negotiations are being kept confidential. Progress has been made, particularly in the last couple of months. However, there is no gas supply contract at this point.

CHAIR KOTT inquired as to why Netricity has identified the North Slope as the location for this operation.

MIKE CASKEY, Netricity, L.L.C., explained that the business Netricity wants to place on the North Slope takes all those things that prohibit business and uses them to the benefit of Netricity. Key to the location of Netricity on the North Slope is a readily available supply of natural gas, which Netricity hopes will be at a lesser [price] than that in the Lower 48. Additionally, the ambient temperature on the North Slope dramatically increases the heating and cooling efficiency. In a server farm context, the largest expense is in cooling the operation. In recent months, the security issue associated with catastrophe recovery of data has been highlighted. Therefore, the isolation of the North Slope has a tremendous of level of security that isn't available in the Lower 48.

MR. DODSON interjected that the lack of a gas market on the North Slope and the ability to create a gas market has really motivated Netricity. Mr. Dodson informed the committee that over the last five years approximately 90 percent of Netricity's incremental ability to generate electrical power has been based on natural gas; that trend is expected to continue. "Natural gas is the incremental power generating fuel," he stated. In reviewing the economics of building a 500 megawatt power plant in the Lower 48, it amounts to a \$350-\$400 million investment. A \$4 price averaged over 20 years would mean that the plant would burn between \$2.5-\$3 billion worth of fuel. Netricity is focusing on the cost of fuel over time and the security of fuel over time, which directly relates to the cost and liability of electricity over time. Mr. Dodson said, "To say you've got reliability in electricity supply right now in the Lower 48, I truly think means you're saying you have reliability in your natural gas supply." Furthermore, 50 percent of the natural gas in the Lower 48 is coming from wells that are three years old or younger. He said, "We are getting to adjust in time natural gas inventory situation." There is not a lot of surplus or overhang of natural gas supply. Moreover, the recent collapse of natural gas prices, which he believes is primarily due to a lot of gas being in storage, [correlates to] the collapse of the drilling rate. Therefore, it seems that the stage is set for a shortage of natural gas in the Lower 48, similar to what occurred in 2000-2001. Mr. Dodson also pointed out that "our" rate of decline and base rate of reduction continues to increase. He explained that if one enters the year with a certain amount of deliverability, at the end of the year there will be a certain percentage of that left. In 1990 the decline rate was between 18-19 percent and in 2001 it was between 25-27 percent. He

suggested that perhaps it would be as high as 29 percent this year. In order to arrive at a higher degree of reliability and lower cost of electricity with respect to natural gas, Mr. Dodson saw Alaska, the North Slope specifically, as the solution if one wants to remain in a country with political stability.

Number 1387

REPRESENTATIVE PORTER recognized the producers' concerns with regard to filling Netricity's gas. He asked if Mr. Dodson and Mr. Caskey gathered the impression from discussions with the producers that [the decision regarding the gas supply for] Netricity would come after the decision on the pipeline.

MR. CASKEY related his belief that in the effort to secure a fuel supply for this generation capacity, Netricity has said on the record that this gas will only be utilized on the North Slope; it won't be available for pipeline shipment. Therefore, this quantity of natural gas that will be utilized on the North Slope is being taken out of context relative to a pipeline mentality. This quantity of gas won't impact the current producers' ability to ship gas or realize the eventual value of that gas. In fact, Mr. Caskey remarked that he believes Netricity will be additive to the gas because the reserves Netricity is suggesting to produce and utilize will take place in the immediate future.

MR. DODSON informed the committee that Netricity is looking at a maximum of 125 million [gallons] a day in demand for natural gas in the North Slope Borough. Netricity's natural gas use would be relative to a 4.5 billion cubic feet (bcf) proposed pipeline. Mr. Dodson echoed Mr. Caskey's comments that Netricity is immaterial to a pipeline; Netricity isn't a volume that matters. Furthermore, Netricity doesn't need its gas processed for shipment; that is Netricity can use gas that has carbon dioxide in it. Therefore, the cost involved with processing gas in building a pipeline doesn't apply to Netricity. Mr. Dodson said that Netricity is something that is additive to a pipeline market. For example, if a 4.5 bcf a day pipeline came on line eight years from today, it would probably take at least 25-30 years to drain the known reserves. He specified that the discussion is in regard to taking year 33 or year 55 gas and using it in the nearer term and turning it into cash.

Number 1540

CHAIR KOTT asked whether there would be an impact on the price structure of selling gas on a future pipeline if the producers sold Netricity gas.

MR. CASKEY replied no. He reiterated that the volumes for Netricity are outside the volumes that would be put down a pipeline. From a gas marketing mentality, Mr. Caskey said Netricity wouldn't have any impact on a gas pipeline. However, the impact would be in relation to the value of bringing a state-of-the-art technology/business to an area with very limited alternatives. Netricity would utilize Alaska's resources to create an exportable product that doesn't weigh anything, is environmentally sound, and for which the infrastructure for the usage of that commodity is already available.

Number 1620

REPRESENTATIVE BERKOWITZ remarked that he is reviewing things in terms of a long-range fiscal plan, which has included discussion of \$100 million in additional revenue from the oil and gas industry. It seems that one opportunity to explore in this context would be to offer the producer an exemption from whatever additional charges that might result from a new revenue package.

MR. DODSON agreed that such would seem to be an incentive. Mr. Dodson pointed out that the benefits of this project to the state are different than those to the producers. The volumes Netricity is looking to utilize aren't massive, and aren't material relative to pipeline export volumes. However, the job creation would be beneficial to the state.

REPRESENTATIVE BERKOWITZ related his belief that his aforementioned incentive would benefit the producers in that it would generate cash flow that wouldn't otherwise be present. Furthermore, it's consistent with the Alaska Constitution, which says: "It's the policy of the state to encourage the development of its resources by making them available for maximum use consistent with the public interest." Representative Berkowitz noted that this legislature has been on record that what Netricity is attempting is consistent with the public interest.

Number 1726

REPRESENTATIVE McGUIRE recalled that a key issue is in regard to the state's right to overlift gas, which resulted in DNR's belief in the need to consult the producers. Therefore, the discussion seems to be at a point in which Netricity is dealing with the producers.

MR. DODSON replied yes.

REPRESENTATIVE McGUIRE inquired as to whether there is something that this legislature can do to help Netricity move forward.

MR. DODSON answered that there needs to be a change in the perception that Netricity is related to or tied to the pipeline or the netback price from the pipeline, although he wasn't sure if the legislature could help with that. Furthermore, he expressed the need to move away from the belief that there is a precedent-setting value. Mr. Dodson specified that the precedent is set only to the extent that the user says that the gas will only be used on the North Slope Borough and won't be exported, which is what Netricity is saying. To the extent that the legislature could forward that message, the legislature could be very helpful.

MR. DODSON turned to the notion that by the producers selling to Netricity, there is some precedential value to Netricity's price. In regard to whether the price the producers set with Netricity establishes the price for all sales from the North Slope, Mr. Dodson didn't believe so. To the extent the legislature could provide the producers with some assurance on the royalty valuation, it would be helpful. Mr. Dodson noted that the only public number in relation to producer expectations for pricing is the effort by Phillips for a \$1.25 minimum netback price, which would be in the form of tax credits that would bring the netback price up to \$1.25 if the netback is lower than that. Mr. Dodson expressed concern with being tied to the netback price in that it ties Netricity to a theoretical netback of a theoretical pipeline that may be built at some theoretical time in the future while asking for the netback now. Therefore, Netricity's pricing and supply needs to be divorced from the pipeline.

REPRESENTATIVE McGUIRE inquired as to the length of a contract with a fixed price in the gas.

MR. DODSON answered that Netricity is looking to have options, with the duration of those options being five years. Following

those five year options, Netricity would want at least a 20 year supply.

Number 1890

CHAIR KOTT requested that either witness refresh the committee's memory in regard to the economic impact of this project to the state.

MR. CASKEY answered that this project would increase taxes, job creation, and the vendor chains associated with support on the North Slope. This is potentially a billion dollar project. Mr. Caskey said, "It could feasibly be the single largest high visibility, high priority, data ... storage facility on earth." He reiterated that Netricity is a custom fit for the North Slope.

CHAIR KOTT pointed out that a year later, this project isn't any closer to fruition. Therefore, he inquired as to how much longer Netricity will continue to work on being in the North Slope before looking elsewhere.

MR. CASKEY remarked that the positives of doing this in Alaska have to be weighed against the risk of getting it done. Mr. Caskey acknowledged that there are other countries, although without the support of the U.S. Constitution, that have potential for a Netricity-type facility. Mr. Caskey stated, "It would be my last choice to move it out of the United States or move it out of Alaska because I think it truly is custom fit, but at some point in time we either have to say we will take our investment elsewhere"

Number 2021

REPRESENTATIVE BERKOWITZ returned to the concern regarding creating bad precedent. He asked if the producers have indicated to Netricity the sideboards that would be necessary.

MR. DODSON said that he hasn't heard any specific requirements from the producers. Mr. Dodson said that he understands fully the concern of the producers because Netricity is maybe 2-3 percent of the daily throughput of a major export gas pipeline. In regard to the guarantees the producers may want or need, Mr. Dodson guessed that the royalties would be high on the list. Additionally, he felt that there is an issue of precedent to the extent that selling to Netricity for use on the North Slope would establish a price for others. He pointed out that gas is

already sold to the utility on the North Slope, and that sale, like the one to Netricity, isn't precedent setting. In both cases, the gas would only be used within the franchise area.

Number 2126

REPRESENTATIVE MORGAN remarked that Netricity sounds like a wonderful concept. He related his belief that there should be value added before the oil is shipped. He recalled that the facility would utilize 500 megawatts.

MR. DODSON said that at full build-out he could see the market being 500 megawatts. Mr. Dodson explained that looking only at servers, the hope was that last year's server sales worldwide would come in at or above 4 million. Last year's server sales came in at 4.4 million. He posed a situation in which 1.4 million servers were replacement use and 3 million were new use. If one were to assume a 200 watt power demand to each of those servers, somewhere 600 megawatts of incremental power demand came on line in the world for those servers. The issue is that those servers tend to be installed in clumps and no one sees the aggregate electrical supply issue that is created. Mr. Dodson remarked that he believes there were significant disruptions in power in California because of the growth of the hi-tech industry in that area. All of those aggregate demands showed up in the entire power grid. Mr. Dodson related his opinion that there is a growing market for servers and backup data services for managed web hosting services. He further saw Alaska as being in a position to access North American and Asian markets. Mr. Dodson pointed out that from 1994-1999 web growth occurred largely with unlimited capital. In such an environment, there are few worries of cost. However, now those businesses have to operate like real businesses and thus must worry about cost. Mr. Dodson said that is where Netricity comes in. He pointed out that California just entered into a long-term power contract for \$.7-\$1.10 per kilowatt hour wholesale, and therefore at the entry point to the data center it amounts to about \$.10-\$0.12 per kilowatt hour. Additionally, a typical data center uses over half of its power for cooling, which is another energy budget. Therefore, by using the ambient cooling ability of the North Slope, Netricity can attack the total energy budget.

REPRESENTATIVE MORGAN remarked that the power plant alone would employ many people. He reiterated his belief that Netricity is a wonderful idea.

REPRESENTATIVE BERKOWITZ inquired as to whom the legislature needs to send another letter.

TAPE 02-3, SIDE B

Number 2292

REPRESENTATIVE McGUIRE recalled that the only concern of Netricity was in regard to shielding the facility from permafrost. She asked if that issue had been addressed.

MR. DODSON answered that Parsons Engineering, Texas, is working on the feasibility study of the actual physical plant. He explained that this particular firm was chosen because it has a tremendous amount of experience on the North Slope. This firm is also a contractor to AT&T for building data centers. Therefore, within one organization the physical plant for the power as well as the physical plant for the data can be engineered. Furthermore, this firm has gone to a modular concept for data centers for AT&T. If a data center is built on site versus in a factory, the ability to have ISO9001 certification as well as a lot of quality control is lost. A factory building modules can test all those modules before those modules leave the factory, which is significantly cheaper than trying to retrofit space not designed as data center space. In response to Representative McGuire, Mr. Dodson confirmed that this firm is reviewing the permafrost concern.

CHAIR KOTT thanked the presenters and expressed his hope that the next update will be in regard to the construction of the physical plant. Upon determining that Bonnie Robson, Deputy Director, Division of Oil & Gas, Department of Natural Resources, was not on teleconference, Chair Kott said that he was going to ask where the report is that the legislature requested by the first day of this session. That report was to focus on the state's role in the sale of gas on the North Slope. In closing, Chair Kott remarked that he and other members will try to develop something that will encourage the sale of gas in order to get this project moving.

ADJOURNMENT

There being no further business before the committee, the House Rules Standing Committee meeting was adjourned at 11:55 p.m.