

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

April 24, 2003

3:16 p.m.

MEMBERS PRESENT

Representative Vic Kohring, Chair
Representative Hugh Fate
Representative Jim Holm
Representative Lesil McGuire
Representative Harry Crawford
Representative Beth Kerttula

MEMBERS ABSENT

Representative Norman Rokeberg

COMMITTEE CALENDAR

HOUSE BILL NO. 277

"An Act relating to the powers of the Regulatory Commission of Alaska in regard to intrastate pipeline transportation services and pipeline facilities, to the rate of interest for funds to be paid by pipeline shippers or carriers at the end of a suspension of tariff filing, and to the prospective application of increased standards on regulated pipeline utilities; allowing the commission to accept rates set in conformity with a settlement agreement between the state and one or more pipeline carriers and to enforce the terms of a settlement agreement in regard to intrastate rates; and providing for an effective date."

- HEARD AND HELD

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 198

"An Act providing for a reduction of royalty on certain oil produced from Cook Inlet submerged land."

- MOVED CSSSHB 198(O&G) OUT OF COMMITTEE

HOUSE BILL NO. 267

"An Act relating to the Alaska Railroad; authorizing the Alaska Railroad Corporation to provide financing for the acquisition, construction, improvement, maintenance, equipping, or operation of facilities for the transportation of natural gas resources within and outside the state by others; authorizing the Alaska

Railroad Corporation to issue bonds to finance those facilities; and providing for an effective date."

- MOVED HB 267 OUT OF COMMITTEE

HOUSE BILL NO. 246

"An Act relating to the limitation on upland acreage that a person may take or hold under oil and gas leases; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

PREVIOUS ACTION

BILL: HB 277

SHORT TITLE: PIPELINE UTILITIES REGULATION

SPONSOR(S): REPRESENTATIVE(S) DAHLSTROM

Jrn-Date	Jrn-Page		Action
04/17/03	1026	(H)	READ THE FIRST TIME - REFERRALS
04/17/03	1026	(H)	O&G, L&C
04/22/03		(H)	O&G AT 3:15 PM CAPITOL 124
04/22/03		(H)	-- Meeting Canceled --
04/23/03	1081	(H)	COSPONSOR(S): KOHRING
04/24/03	1108	(H)	RES REFERRAL ADDED AFTER O&G
04/24/03		(H)	O&G AT 3:15 PM CAPITOL 124

BILL: HB 198

SHORT TITLE: ROYALTY REDUCTION ON CERTAIN OIL

SPONSOR(S): REPRESENTATIVE(S) KOHRING

Jrn-Date	Jrn-Page		Action
03/17/03	0560	(H)	READ THE FIRST TIME - REFERRALS
03/17/03	0560	(H)	O&G, RES, FIN
03/26/03	0654	(H)	COSPONSOR(S): CHENAULT
04/03/03		(H)	O&G AT 3:15 PM CAPITOL 124
04/03/03		(H)	-- Meeting Canceled --
04/10/03		(H)	O&G AT 3:15 PM CAPITOL 124
04/10/03		(H)	-- Meeting Canceled --
04/24/03	1093	(H)	SPONSOR SUBSTITUTE INTRODUCED
04/24/03	1093	(H)	READ THE FIRST TIME - REFERRALS
04/24/03	1093	(H)	O&G, RES, FIN
04/24/03	1111	(H)	COSPONSOR(S): WOLF
04/24/03		(H)	O&G AT 3:15 PM CAPITOL 124

BILL: HB 267

SHORT TITLE: AK RAILROAD BONDS FOR NAT. GAS TRANSPORT

SPONSOR(S): REPRESENTATIVE(S) KOHRING

Jrn-Date	Jrn-Page		Action
04/15/03	0985	(H)	READ THE FIRST TIME - REFERRALS
04/15/03	0985	(H)	O&G, RES, FIN
04/16/03	1018	(H)	COSPONSOR(S): CRAWFORD
04/24/03		(H)	O&G AT 3:15 PM CAPITOL 124

WITNESS REGISTER

REPRESENTATIVE NANCY DAHLSTROM

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as sponsor of HB 277.

GARY CARLSON, Senior Vice President

Forest Oil Corporation

Anchorage, Alaska

POSITION STATEMENT: Testified in support of SSHB 198 as a requestor of the legislation.

MARK MYERS, Director

Division of Oil & Gas

Department of Natural Resources (DNR)

Anchorage, Alaska

POSITION STATEMENT: Testified on SSHB 198, calling it a very good, direct incentive; explained DNR's fiscal note for the original bill version; proposed technical amendments that were adopted.

PAUL FUHS, Lobbyist

for Yukon Pacific Corporation (YPC)

Anchorage, Alaska

POSITION STATEMENT: Testified that HB 267 is an important tool, but asked that members be aware of the potential for a pipeline to Valdez; answered questions.

WENDY KING, Director of External Strategies

ConocoPhillips

Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 267, stating support for having as many tools as possible.

ROGER MARKS, Petroleum Economist
Economic Research Section
Tax Division
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: During hearing on HB 267, said the department would support this as a way of moving the project forward; answered questions.

TOMAS H. BOUTIN, Deputy Commissioner
Office of the Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Answered questions pertaining to HB 267.

WENDY LINDSKOOG, Director of External Affairs
Alaska Railroad Corporation (ARRC)
Department of Community & Economic Development
Anchorage, Alaska

POSITION STATEMENT: During hearing on HB 267, testified that ARRC supports use of its tax-exempt bonding authority for a gas pipeline and believes it fits within ARRC's mission to support economic development for the state.

BILL O'LEARY, Vice President, Finance
Alaska Railroad Corporation
Anchorage, Alaska

POSITION STATEMENT: Answering questions on HB 267, discussed the timeline for issuance of the bonds and ARRC's fiscal note.

ACTION NARRATIVE

TAPE 03-18, SIDE A
Number 0001

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at 3:16 p.m. Representatives Kohring, Holm, and Fate were present at the call to order. Representatives Kerttula, Crawford, and McGuire arrived as the meeting was in progress.

CHAIR KOHRING announced that Representative Holm had agreed to serve in the [unofficial] capacity of vice chair if someone were needed to chair the committee in his absence.

HB 277-PIPELINE UTILITIES REGULATION

Number 0109

CHAIR KOHRING announced that the first order of business would be HOUSE BILL NO. 277, "An Act relating to the powers of the Regulatory Commission of Alaska in regard to intrastate pipeline transportation services and pipeline facilities, to the rate of interest for funds to be paid by pipeline shippers or carriers at the end of a suspension of tariff filing, and to the prospective application of increased standards on regulated pipeline utilities; allowing the commission to accept rates set in conformity with a settlement agreement between the state and one or more pipeline carriers and to enforce the terms of a settlement agreement in regard to intrastate rates; and providing for an effective date."

CHAIR KOHRING explained that the legislation would be presented by the sponsor and held over. He asked members to look at testimony provided in writing.

Number 0196

REPRESENTATIVE NANCY DAHLSTROM, Alaska State Legislature, sponsor of HB 277, explained that the bill addresses concerns related to pipeline utility regulation. She said the legislative branch is given sole authority [with the exception of the people, through initiatives] to write law, whereas the executive branch and state boards and commissions are authorized to act in accordance with those laws. In that context, she indicated HB 277 addresses issues brought forward by some who are involved in exploration, development, and delivery of oil and gas [who have concerns about the regulatory authority over that process].

REPRESENTATIVE DAHLSTROM said the goal of HB 277 is to clarify what jurisdiction the Regulatory Commission of Alaska (RCA) has over interstate and intrastate rates. The legislation addresses RCA's jurisdiction over state right-of-way leases; strives to clarify RCA's authority over dismantlement, removal, and restoration (DR&R); proposes that the RCA support rate methodologies agreed to in settlement agreements with the state; and addresses changes to the applicable interest rate charged under RCA orders so that it conforms with the interest rate applied in "other, similar matters." Characterizing it as a starting point, she indicated she would work with committee members, the administration, and members of the oil and gas industry to come up with a good piece of legislation that she would present at the next hearing.

Number 0379

CHAIR KOHRING apologized to those hoping to testify and informed listeners that testimony would be taken at the next hearing after some issues were worked out. [HB 277 was held over.]

HB 198-ROYALTY REDUCTION ON CERTAIN OIL

Number 0463

CHAIR KOHRING announced that the next order of business would be SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 198, "An Act providing for a reduction of royalty on certain oil produced from Cook Inlet submerged land."

CHAIR KOHRING, sponsor of SSHB 198, explained that he'd been approached by people who own and operate facilities in Cook Inlet, where most platforms were constructed in the 1960s. Production is declining significantly; two facilities out of thirteen have been mothballed, and others may be shut down because they aren't economically feasible. He told members that the intent is to help those platforms specifically. This bill provides a royalty break on those platforms if their production drops below 1,200 barrels a day. It lowers the state's royalty share, now 12.5 percent, down to as low as 5 percent, on a sliding-scale basis. If production were 750 barrels a day or less, for example, it would be 5 percent, and it would rise approximately 1 percent for every additional 100 barrels, up to the 12.5 percent.

CHAIR KOHRING offered the expectation that with this provision, production on those platforms would be extended up to an additional 14 months. He called upon Mr. Carlson of Forest Oil Corporation, who he indicated had requested the legislation.

Number 0789

GARY CARLSON, Senior Vice President, Forest Oil Corporation, noted that his corporation has been a major investor in Cook Inlet for five years. He told members his testimony would focus on the maintenance of critical and scarce infrastructure associated with mature oil fields in Cook Inlet. He said:

Platforms, associated pipelines, and related onshore facilities represent irreplaceable infrastructure which may facilitate the exploration, discovery, and

development ... of as-yet undiscovered reserves if their useful lives can be extended. Any delay in abandoning or ... decommissioning of this infrastructure will provide opportunities to the industry to develop smaller-scale oil and gas prospects that won't stand the economics if new infrastructure needed to be developed.

As the mature fields approach [the] end of their economic life, the operators need to get creative and manage costs carefully, which [includes] changes in the way they operate and the need for cooperation with their vendors and contractors to share in these efforts. I believe that it is ... appropriate for the state to step in as a partner also. This bill provides a way for the state to do its part.

Keeping the current Cook Inlet oil fields on line a few more years will maintain good jobs, provide local taxes and the possibility of new development that could easily exceed the anticipated future shortfall in state revenues resulting from any reduction of the state's royalty. I want to commend the chair and Representatives Rokeberg and Chenault for their leadership on this bill, and to the administration for supporting their efforts.

Number 0902

REPRESENTATIVE HOLM asked whether Mr. Carlson maintains that in order to use the resource to its final depletion, it is in the state's best interest to lower the royalty [so companies like his can continue to pump oil economically]. He also mentioned current versus future technology that may allow extraction more economically and thus provide better value for the resource.

MR. CARLSON replied:

I think the key to keeping interest by the operators in maintaining this infrastructure and continuing to operate it would be to fully understand what their costs are going to be. And some of those costs are associated with personnel and logistics, but some of them are actually ... the money that's pulled off the top and given to the state as a result of ... the state's ownership.

MR. CARLSON suggested that extending the life of these platforms may help develop other possible projects; if additional work or discoveries occur from the platforms, their lives can be extended and there will be a higher recovery. He suggested the formula devised by the state in the bill protects the state's interests; if for some reason the rates from these depleting platforms were to increase, the royalty would return to 12.5 percent. He pointed out that Forest Oil Corporation isn't currently an operator of any of these facilities, but is active in Cook Inlet and very concerned about losing infrastructure that may be available to bring new discoveries to another platform, instead of having to build platforms to accept further production.

Number 1095

REPRESENTATIVE HOLM said he isn't knowledgeable enough about this area to know where the law of diminishing return comes into play. As a legislator, he offered his belief that it is his fiduciary responsibility to try to protect the state's resources and extract the highest value possible, keeping in mind the desire to retain the producers as partners in order to extract them expeditiously. He pointed out that the fiscal note intimates that the State of Alaska will lose \$2.5 million in proposed royalty payments over the next five or six years, and questioned the urgency of this action.

Number 1171

MR. CARLSON responded that he believes maintaining that infrastructure and keeping the fields producing - for what could be one to three years, depending on what can be done to maintain the rate - could easily offset the fiscal note estimate. If there were a discovery that only could be developed by using some of that infrastructure, he suggested the return to the state would be many times that amount.

Number 1318

CHAIR KOHRING conveyed his belief that encouraging the continued production of these facilities creates potential for the state to generate even more money in the future because these existing facilities represent millions of dollars' worth of critical infrastructure from which further exploration can be done in the future. Even though there is no guarantee, there is that potential to use these facilities to engage in directional drilling and find additional oil reservoirs.

MR. CARLSON concurred. With regard to urgency, he said one platform has been shut in, and another is scheduled for that soon; therefore, he feels there is a sense of urgency to do something before it's too late.

CHAIR KOHRING asked Mr. Myers, in addition to his testimony on behalf of the division, to address Representative Holm's concerns and whether the amount lost will be gained in other ways.

Number 1356

MARK MYERS, Director, Division of Oil & Gas, Department of Natural Resources (DNR), advised members that a key goal for "incentivizing" oil and gas ought to be looking at incentives that are efficient and effective, and that hopefully are direct and measurable. He offered his belief that SSHB 198 meets those criteria. He explained that the Cook Inlet platforms have been producing for a long time; the state has a lot of good data, a good understanding of the reserve base, and a good understanding of the productions costs. In that light, he said, when the thresholds for royalty reduction were chosen, [DNR] worked carefully with data from Union Oil Company of California (Unocal) and Forest Oil Corporation, as well as internal data including DNR data and Department of Revenue (DOR) data that could be shared.

MR. MYERS said this was modeled accurately, using long-term production trends. Two different trends were found with regard to when the economic limit for particular platforms is reached. Thus there are two clusters of platforms. The first has platforms where the wells produce lots of water that must be separated out and that use significant water flood. They have more expensive operating costs and, therefore, an economic threshold of production such that operating costs exceed the value of the oil production; more barrels [of oil] are needed to justify their operating costs. The second has platforms that have a limited amount of water and water handling, and little water injection; those have cheaper costs.

MR. MYERS told members the bill therefore was designed by looking at those factors and at clustered fields. Appropriately, it lists individual fields, but it's truly based on economic clusters of data, not just targeting those particular fields. He said it was easier to name the fields,

but those fields represent certain characteristics of production and inherent reservoir characteristics.

Number 1491

MR. MYERS remarked that this is a case when it can be argued that royalty reduction is a very appropriate mechanism to extend field life. He went on to say royalty reduction is generally asymmetrical and explained, "Because your production is declining from the field, the period of time in which you ... actively affect the economics of the field and bring it up on line - when you're only talking about a 7.5 percent differential in the amount of production - is limited." He also pointed out that if the desire is to use this as an incentive to keep production going longer and possibly to get additional investment in the platforms, the relief should be given slightly before it is absolutely, critically needed. He added, "Plus, then, you're projecting on certain oil prices to project the economic threshold."

Number 1532

MR. MYERS continued:

We used a pretty middle-of-the-road calculation for netback oil price and then ran a bunch of scenarios ... on the platform, and came up with this cluster of data. So we feel pretty good that our fiscal [note] accurately reflects the loss in royalty, which, again, we think is relatively small. ... The first year, it's about \$220,000, going up to nearly \$600,000 in 2007. Those are relatively small numbers compared to the value of that infrastructure.

One of our concerns is, once you start pulling out multiple platforms out of the inlet, there's a synergy between the platforms. There's piping that goes between the platforms. There's common use of onshore facilities. All those additional costs of rerouting those pipes for existing platforms ... would cause additional costs, as well as a lesser throughput to those existing production facilities on shore would raise the cost. ... There's an interlinked interdependency of facilities in the inlet, and we want to make sure as much of that [as possible] keeps producing as long as it can.

Number 1585

MR. MYERS expressed optimism about the exploration potential and said:

We know of multiple prospects that exist off these existing platforms, and sometimes a current operator isn't desirable of expending the money to do the exploration, but a new operator might. So we're buying time ... in case there's sale or trade [of] the platforms, et cetera - other opportunities.

So while we lose some direct revenue, it's very quantifiable. It's relatively minimal on the scale of the potential benefit of that infrastructure, and we're hoping that the upside does exist. In the meantime, you have preserved jobs and you have preserved that oil going to the refineries ... on the Kenai [Peninsula], which are important to the state's economy.

Number 1622

REPRESENTATIVE McGUIRE asked how 5 percent was arrived at.

MR. MYERS answered that there's an historical precedent for using 5 percent, which the state uses for discovery royalty. It's in existing statute for six fields in Cook Inlet that weren't producing. It also leaves enough direct economic benefit to the state. If it's set much lower or at zero, then the fiscal note becomes bigger. He offered his belief that 5 percent royalty isn't a substantial burden on the project. "We might extend it a few months more by going lower, but this is a good number," he added.

MR. MYERS also pointed out that if these numbers don't work, an applicant [can seek] royalty reduction under the current royalty reduction statute; that can go down to 3 percent and is based on need, using technical data. He also mentioned royalty reduction under HB 28 if that bill passes. He added that this [5 percent in SSHB 198] is a "pretty good, standard threshold, we feel, that we still are getting direct revenue from the platforms as well as we're affecting the economics."

Number 1726

REPRESENTATIVE CRAWFORD asked what happens to platforms after they get shut in. For example, can they be reconditioned and shipped elsewhere?

MR. MYERS answered that it is uncharted territory as to what the state would do. Initially, production would be suspended; there are a few platforms where that has happened. He further explained:

Initially, that would just be plugging back the wells, cleaning the surfaces, keeping, usually, a manned presence or in some cases unmanned, if they go to a total cleaning and monitoring system. And then there's a period of time. At some period of time where there really isn't any additional economic potential, then the wells will be cemented in via AOGCC [Alaska Oil and Gas Conservation Commission] requirements, permanently abandoned, and the facility will have to be abandoned. ...

That process of what is done with the facility is truly going to be a public process, with multiple agencies looking at it and, I assume, with stakeholder influence from ... all sorts of other outside, nongovernmental organizations. The "highest and best use" question, I think, will really be put there: Do you want to keep the facility there? ... Can it be reused? There are certainly options to cut the legs off of the platforms if you bring in a (indisc.), move it over to another facility. ... So there's potential to use them. There's potential for various dismantlement and [removal], actually ... moving them out of the inlet, et cetera.

So, to the extent of the final abandonment requirements for a platform, we haven't gone there yet. It is something the state will have to face in the future. And certainly DNR will play a role in that, but other agencies will as well. The federal Coast Guard navigation issues will occur, et cetera. You can get a long list ... of potential actions that would have to be taking place.

Number 1830

MR. MYERS continued:

We're studying the issue. We sent some folks to a conference in California - where they're looking at abandoning some offshore platforms - the MMS [Minerals Management Service] sponsored. So we have models to go by from the federal [government] and ... folks in the Gulf of Mexico and offshore California. So we're looking [at] that, but we have not yet totally integrated what needs to be done.

Number 1852

MR. MYERS, in response to Representative Kerttula, indicated the fields listed in the bill are the older, existing platforms, rather than newer fields like Redoubt Shoals. He added that there is one onshore field, West McArthur [River] field, and said, "It's onshore facilities but offshore fields." He said although all the fields are named, the bill isn't designed to be name-specific, but is an easier, simpler way to look at the actual characteristics and economic criteria. "Again, we found the data clustered nicely around two types of platforms," he added. "And when you use a general bill like this, unless you wanted to [have] specific royalty reduction for each platform, you had to use ... an amount." He concluded by saying that the names are there because it targets certain characteristics, and that it is inclusive of all those platforms in Cook Inlet that have those characteristics.

Number 1938

REPRESENTATIVE FATE asked what the average daily production was at midlife for these fields.

MR. MYERS said he didn't know, but estimated perhaps 15,000 to 20,000 barrels a day; he suggested Mr. Carlson might have those figures. At the peak, Cook Inlet production was an order of magnitude larger than it is now, he said. "So we're really down near the end, ... and Redoubt Shoals, of course, is a great success, and that's going to help bring us up," he added. Mr. Myers said there is some other exploration going on; the hope is that it will lead to new production to substantially revive the inlet. Except for that, however, these platforms and reservoirs are largely expended. He pointed out that one challenge for companies is that they'll spend the money to drill a directional well; if successful, they may increase production, but it's marginal. "If this tips the scale, we'll all benefit," he concluded.

Number 2025

REPRESENTATIVE FATE referred to [AS 31.05] and recalled looking at royalty reduction specific to Cook Inlet a year ago, with the idea of perhaps broadening it statewide, for example, and making it self-limiting with a sunset date. He asked whether this current bill "will stimulate the kind of exploration for more oil in that area, which will take advantage of this royalty reduction, above and beyond what we thought it would."

MR. MYERS responded:

We have multiple programs, but I think the program we're referring to is the discovery royalty program, which gives 5 percent royalties to new discoveries. This program, I guess, is more certain, because you have all the production data. So this extends the life of infrastructure; that greatly improves the economics of future exploration. So I think this is actually ... one of our more positive moves that's clearly a direct, effective incentive, and will, ... if explorers are out there, ... give them more opportunity and more time. This buys us time with existing infrastructure, ... because once some of this infrastructure goes away, it's not going to be replaceable ... unless they find very large accumulations, which increases exploration risk because they need to find very large fields, then, to build ... the infrastructure in the inlet.

Generally, in the inlet, to put a new platform, people typically need probably around ... 30 or 40 million barrels of recoverable reserves. So you need a pretty substantial discovery for the inlet, though certainly the prospects are there to find more of those. But when you chance-risk it, it's nice if that number goes down a little bit because there's an existing platform for development. ... If you could use an existing platform, you might save a lot of money on the development, in which case, then, your limit for exploration size might shrink down by 5 or 10 million barrels, leaving you to drill a lot more different types of prospects, or lowering your risks.

Number 2134

MR. MYERS emphasized the synergies. He said one of Cook Inlet's real advantages is the existing infrastructure, which probably results in a much higher netback per barrel than on the North Slope. He added:

We want to keep that advantage there with this existing infrastructure. And, again, that will get more people drilling. We've seen a lot of good "independent action," as you've seen, particularly on the gas side, with independents in the inlet. There may be some swapping of platforms or selling of platforms, we hope, in the future with folks that might be a little more aggressive on exploration, say.

MR. MYERS concluded by saying this is truly a very good, direct incentive because "we can quantify the amount, and we can see the direct effects of it."

Number 2174

CHAIR KOHRING expressed appreciation to Mr. Myers for his work on the legislation and for working with the owners of the platforms on this.

Number 2197

MR. MYERS informed the committee of the following [technical changes] needed in the bill. On page 2, line 2, he said the phrase "field or" should be removed because it is specific to those platforms. On page 3, line 7, "XTO.B" should read "XTO.C". On page 3, subparagraph (E) is talking about a field in this one case; therefore, "platform" should be deleted on line 26 and replaced with "field", and the words "or platform" should be removed on line 29.

Number 2272

REPRESENTATIVE HOLM moved to adopt the foregoing as a [conceptual] amendment. There being no objection, it was so ordered.

Number 2287

REPRESENTATIVE FATE moved to report [SSHB 198, as amended] out of committee with individual recommendations and the accompanying fiscal note(s). There being no objection,

CSSSHB 198(O&G) was reported from the House Special Committee on Oil and Gas.

The committee took an at-ease from 3:50 p.m. to 3:51 p.m.

HB 267-AK RAILROAD BONDS FOR NAT.GAS TRANSPORT

Number 2339

CHAIR KOHRING announced that the final order of business would be HOUSE BILL NO. 267, "An Act relating to the Alaska Railroad; authorizing the Alaska Railroad Corporation to provide financing for the acquisition, construction, improvement, maintenance, equipping, or operation of facilities for the transportation of natural gas resources within and outside the state by others; authorizing the Alaska Railroad Corporation to issue bonds to finance those facilities; and providing for an effective date."

CHAIR KOHRING, sponsor of HB 267, pointed out the work of others on this legislation and described himself as a facilitator. Explaining that the bill provides a tool for potential constructors of the gas pipeline and is intended to provide a financing option, he thanked Representative Fate for work on other legislation pertaining to stranded gas. He noted that the Alaska Railroad Corporation (ARRC) has bonding capability and a very good bond rating, and thus can access capital at cheap rates. This bill asks ARRC to issue bonds in order to make money available for potential constructors of a natural gas pipeline, who would work out a contractual arrangement. The bill provides for up to \$17 billion in bonds, whereas Chair Kohring said he's been told constructing a pipeline would take as much as \$20 billion. He characterized this as an important piece of the package to make the gas pipeline a reality.

Number 2506

PAUL FUHS, Lobbyist for Yukon Pacific Corporation (YPC), began by listing his experience with bonding issues and entities. He told members this important tool has always been seen as "nonrecourse bonding": if ARRC issues these bonds, it would be conduit financing, with no recourse of any lender "to the state general obligation bonding - the permanent fund, the railroad, or any of the other assets." He said this "peculiar piece of tax law" came across as the railroad was transferred to the state, and is included in the federal railroad transfer Act.

MR. FUHS emphasized YPC's desire that the committee be aware of the potential for a pipeline to Valdez. He noted that the Canadian pipeline project is dependent on federal subsidies that may or may not be received, for instance.

Number 2583

MR. FUHS drew attention to documents he'd provided [a letter from Representative Harris to Ward Whitmore of YPC dated December 24, 2002; a letter in response; and a six-page document entitled "Yukon Pacific Corporation: Trans-Alaska Gas System"]. He suggested these contain the most detailed information provided by any project sponsor in terms of numbers, including capital costs of about \$12 million and delivered prices of liquefied natural gas (LNG) at \$3.50 in Asia and \$3.25 on the U.S. West Coast, and gas delivered in Alaska at \$2.50, leaving a wellhead value to the producers of about \$1.00, which he suggested is in the range talked about. As to whether there is a market, he said California has expressed interest and that LNG will be a critical part of that state's energy mix.

MR. FUHS also alluded to an e-mail in packets with regard to discussions with Mr. Kim, vice president of Korea Gas Corporation (KOGAS), to whom this information was presented. Mr. Fuhs noted that Representative Fate was at that meeting as well and also had heard that when the price of \$3.50 was mentioned to [Mr. Kim], he pulled a piece of paper from his pocket and said the lowest price they'd been offered was \$4.00, with the highest being \$5.17 for the gas that they were looking for. Regardless of generic comments that this project isn't economical, Mr. Fuhs said, these numbers show a viable project that doesn't even need subsidies.

MR. FUHS also drew attention to [letters between John Urbina of George K. Baum & Company ("George K. Baum") and Representative Harris]. He noted that Representative Harris had asked that company - which has sold about \$2 billion worth of bonds in Alaska in the last 10 years - to look at the numbers provided by YPC to see whether George K. Baum believes the bonds could be sold and what impact the ARRC bonds would have.

Number 2704

MR. FUHS pointed out that [page 2 of Mr. Urbina's letter] says, based on the information supplied by YPC, that the project can be financed in the bond market if the ARRC vehicle is available. Mr. Fuhs called this a pretty strong statement from a bonding

company on the importance of the railroad bonds. Highlighting "Chart A," an attachment to Mr. Urbina's letter, Mr. Fuhs noted that it shows almost a 2 percent difference in the rate of return if ARRC bonds are used, with a projected return to the State of Alaska of \$500 million to \$1 billion a year. He characterized this as the only project seen so far that comes close to meeting the governor's goal of addressing the state's budget deficit through resource development.

Number 2758

REPRESENTATIVE HOLM asked whether there are any U.S.-built tanker hulls available today that could haul LNG between U.S. ports.

MR. FUHS said no. He added that the world's LNG tankers are 100 percent utilized at this time and are on contract. Thus tankers will have to be built. If they go into the U.S. [from Alaska], they'll have to comply with the federal Jones Act. For Baja California, additionally, he said it would be U.S. tankers. The most interesting development in LNG is offshore platforms; the first is being applied for 130 miles offshore in the Gulf of Mexico, with the gasification facilities being on the ship. That helps to solve some of the siting problems. He said he wasn't sure whether something 20 miles offshore would require compliance with the Jones Act, but specified that vessels going into a U.S. port would have to comply with the Jones Act.

Number 2843

WENDY KING, Director of External Strategies, ConocoPhillips, informed members that she works in the "ANS [Alaska North Slope] gas commercialization group." She told the committee:

ConocoPhillips supports House Bill 267, which could provide, but would not require, an Alaska natural gas pipeline to potentially utilize an Alaska Railroad Corporation bond financing mechanism.

As mentioned before in previous testimony, ConocoPhillips has a three-pronged strategy to make a gas pipeline through Alaska and Canada a reality. The first is two distinctly different pieces of federal legislation. The first one is focusing on ... streamlining the permitting process. And the second is fiscal legislation which would provide insurance against the risk of extreme price volatility. The

third item is state fiscal certainty and clarity, which will be progressing with the recently passed House Bill 16, which reauthorized the [Alaska] Stranded Gas Development Act.

If ConocoPhillips is successful with securing these three items, we plan to continue moving forward on this project. Financing this potentially \$20-billion project will be a significant activity for any company that pursues the Alaska pipeline project. And we support having as many tools as possible to choose from, when that time comes. While it's too early to select specific financing [vehicles], if this vehicle proves workable it might add a potentially valuable option.

In conclusion, we support the passage of ... House Bill 267 and appreciate the legislature for addressing the financing options for the gas pipeline project.

Number 2922

CHAIR KOHRING emphasized the goal of providing a tool that potentially can be used to finance construction of that gas pipeline, and acknowledged that it won't automatically be used by any company. He then asked Mr. Marks of the Department of Revenue to address feasibility during his testimony.

Number 2951

ROGER MARKS, Petroleum Economist, Economic Research Section, Tax Division, Department of Revenue, said [the department] has done quite a bit of detailed modeling of this financing mechanism just to see what kind of potential effect it could have on project viability.

TAPE 03-18, SIDE B

Number 2973

MR. MARKS pointed out that the first step is making sure there is a good project [economically], regardless of financing. However, if this mechanism were available and project sponsors decided to use it, he estimated the range of savings would be from zero up to \$4 billion in financing charges, depending on the degree it was used because of the tax-free treatment. He said the Department of Revenue would support HB 267 as a way of moving this project forward.

Number 2915

REPRESENTATIVE KERTTULA referred to the analysis section of ARRC's fiscal note and asked who bears the liability for the bonds and who will hold them.

MR. MARKS answered that these "nonrecourse bonds" would be paid directly from project revenues. The corporations financing the project would be liable. He suggested that Mr. Boutin or someone from ARRC could discuss this in detail.

Number 2842

TOMAS H. BOUTIN, Deputy Commissioner, Office of the Commissioner, Department of Revenue, responded that as the structure has been explained to him, ARRC would be the "nominal issuer," a role state agencies or municipalities often have; there wouldn't be implications for the state, including ARRC. He said it isn't an uncommon structure in public financing.

REPRESENTATIVE KERTTULA related her understanding that although ARRC would basically be passing it through, the corporations themselves ultimately would be liable. She surmised that people who'd be buying these bonds would know that.

MR. BOUTIN said typically there would be a feasibility consultant with specific expertise in gas pipeline projects; this would be an important component, and the credit-rating agencies and so forth would use the consultant in addition to doing their own "due diligence" to determine that the revenues would be adequate to repay the bond debt.

REPRESENTATIVE KERTTULA asked whether bonds using ARRC as a conduit could be sold for any purpose or just for a gas pipeline.

MR. BOUTIN suggested Ms. Lindskoog of ARRC could answer better, but said because of tax-code changes, primarily in the 1980s, ARRC has a singular ability with regard to tax-exempt debt.

Number 2671

MR. MARKS pointed out that the federal legislation that transferred the Alaska Railroad to the state says the intent was to confer upon the railroad all the business opportunities available to comparable railroads. There is a long record of

gas pipelines tied to railroads in the Lower 48, he noted, with examples of railroads that have owned, operated, and financed gas pipelines. He suggested this might apply some boundaries with regard to what this mechanism could be used for.

Number 2646

REPRESENTATIVE KERTTULA asked about risk to the state.

MR. MARKS replied that he believes there is no risk or a very, very low risk.

CHAIR KOHRING asked whether ARRC supports the bill.

Number 2596

WENDY LINDSKOOG, Director of External Affairs, Alaska Railroad Corporation, Department of Community & Economic Development, informed members that ARRC supports the use of its tax-exempt bonding authority for a gas pipeline and believes it fits within ARRC's mission to support economic development for the state. She said this obviously is an important tool that could be used to help lower the cost of the project. She deferred to Bill O'Leary or Phyllis Johnson to answer further questions.

Number 2547

REPRESENTATIVE FATE asked what the process will be and when bonds will be issued. He pointed out that even though this is a pass-through, there is a lot of money involved.

Number 2441

BILL O'LEARY, Vice President, Finance; Alaska Railroad Corporation, noted that he is ARRC's chief financial officer. In answer to Representative Fate's question, he said it would be solely dependent upon having someone such as the [current oil] producers first agree that the project is viable, with a wish to proceed. If the other steps including passage of this legislation were in place, ARRC would lay out a timeline for the particular bond issuance or issuances that would take place. He said it is driven by the producers' coming forward and saying, "Yes, we want to do this."

REPRESENTATIVE FATE asked whether [the producers' statement] would be "Yes, we want to do this" or "Yes, we want to participate in the financing of this," or both. He said it

seems a lot of groundwork must be laid before issuance of those bonds. Although he said he didn't have a concern, Representative Fate specified that he wanted to know whether there is a timeline "that you are concerned about here."

MR. O'LEARY reiterated that the timeline is dependent upon the producers' coming forward and saying they wish to use the financing mechanism through ARRC. From that point, the game plan would be figured out with respect to when the [bond] issuances would take place. He said until that point is reached, it is tough to lay out anything more than that.

Number 2342

MR. FUHS added:

It may be the producers. It may be a pipeline group. It may be the state development authority. It may be a combination of -- I think Korea Gas [Corporation] said they would look at 5 to 10 percent equity investment. So it could be any one of a number of potential sponsors.

But the best information on this is contained in this report by George K. Baum. And what they did is, they modeled also the bonding for this. It's about an 80-page report, and I can make it available to you. And what they do is, they start from a possible project sanction - when you have the go-ahead. And then you've got a certain amount of final engineering that has to be done, and other things, before you start issuing those bonds.

Now, George K. Baum recommended three trains of bonds, because you're not going to go borrow all the money at once. You don't need it all at once. So you only borrow as much as you need, because during your construction period is your highest interest rate - the interim financing during construction, just like a house or building or anything else. So you want to stretch that out as far as possible. And ... I can share that [report] with you, and you can see that [it's] about over a five-year period that you're actually issuing those bonds, ... and they just recommended that because it reduces the cost of the project by doing it that way.

REPRESENTATIVE FATE requested that Mr. Fuhs supply the 80-page document he'd just referenced.

MR. FUHS agreed, noting that this could be used as a model, even though it was based on the project to Valdez.

Number 2261

REPRESENTATIVE CRAWFORD asked whether it would be good to take advantage of the current low interest rates all at once, rather than spacing this out over five years and having interest rates perhaps climb.

MR. FUHS said no. He pointed out that once those loans are taken out, payments must be made, regardless of whether that money is actually being used, and that there will be five years of building the project before any revenues come in. Referring to last year's HB 423 with regard to the Alaska Housing Finance Corporation, Mr. Fuhs said there might be the ability to arbitrage these bonds and even generate some revenues for the State of Alaska. Although more complicated, he said, it potentially exists once a project is actually going forward.

Number 2194

REPRESENTATIVE CRAWFORD suggested those bonds might be virtually free if current low interest rates were taken advantage of [and if it were leveraged well].

MR. FUHS replied, "Yes, sir, but there's also some potential risk for that." He added that for the George K. Baum model, interest rates were about 5.6 percent, an extremely good interest rate for a project of this type.

Number 2160

REPRESENTATIVE HOLM referred to ARRC's fiscal note and observed that it shows a cost of \$163 million for fiscal year 2006 (FY 06). He requested an explanation from Mr. O'Leary.

MR. O'LEARY responded:

The fiscal note in front of you does show, in 2006, a \$163-million expense funded through the bond proceeds. And this is an estimate of the bond issuance costs - what it would actually cost to issue these bonds. And, of course, this is based on a number of

assumptions. ... It's important to realize that the model for this fiscal note is based upon the work that was done last year by the Department of Revenue and Goldman Sachs when this issue sort of came to light about a year or 15 months ago. So this fiscal note, again, is based on that model and shows in 2006, ... when the initial [issuance] would certainly be, that [this] would be our best estimate of what the costs of issuance would be.

Those costs would be funded through the bond proceeds themselves. So to your question about impact to the state, there would be ... certainly no general fund impact.

Number 2061

CHAIR KOHRING asked whether there was further discussion and thanked participants.

Number 2022

REPRESENTATIVE FATE moved to report HB 267 out of committee with individual recommendations and the accompanying fiscal note. There being no objection, HB 267 was reported from the House Special Committee on Oil and Gas.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 4:25 p.m.