

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

April 14, 2003

3:32 p.m.

MEMBERS PRESENT

Senator Scott Ogan, Chair
Senator Thomas Wagoner, Vice Chair
Senator Ralph Seekins
Senator Kim Elton

MEMBERS ABSENT

Senator Fred Dyson
Senator Ben Stevens
Senator Georgianna Lincoln

COMMITTEE CALENDAR

SENATE BILL NO. 31

"An Act relating to a railroad utility corridor for extension of the Alaska Railroad to Canada and to extension of the Alaska Railroad to connect with the North American railroad system."

HEARD AND HELD

SENATE BILL NO. 151

"An Act relating to the regulation of natural gas pipelines under the Pipeline Act."

HEARD AND HELD

SENATE BILL NO. 50

"An Act amending the manner of determining the royalty received by the state on gas production as it relates to the manufacture of certain value-added products."

HEARD AND HELD

PREVIOUS ACTION

SB 31 - See Transportation minutes dated 2/11/03 and 3/27/03.

SB 151 - See Labor and Commerce minutes dated 3/27/03 and 4/1/03.

SB 50 - See Resources minutes dated 3/26/03 and 4/11/03.

WITNESS REGISTER

Mr. Richard Schmitz
Staff to Senator Cowdery
Alaska State Capitol
Juneau, AK 99801-1182

POSITION STATEMENT: Testified for the sponsor of SB 31

Mr. Pat Gamble
Alaska Railroad Corporation
PO Box 107500
Anchorage, AK 99510-7500

POSITION STATEMENT: ARRC stands ready to make the [SB 31
railroad extension] project work

Mr. Bob Loeffler
Division of Land, Mining and Water
Department of Natural Resources
400 Willoughby Ave.
Juneau, AK 99801-1724

POSITION STATEMENT: Supports SB 31

Ms. Mary Jackson
Staff to Senator Wagoner
Alaska State Capitol
Juneau, AK 99801-1182

POSITION STATEMENT: Presented SB 151 for the sponsor

Mr. Ben Schoffmann
Marathon Oil Company
PO Box 196168
Anchorage, AK 99519

POSITION STATEMENT: Supports SB 151

Mr. Jim Strandberg
Regulatory Commission of Alaska
701 W Eighth Ave Ste 300
Anchorage, AK 99501

POSITION STATEMENT: The RCA has no position on SB 151 and does
not believe it will have any fiscal impact on the agency

Mr. Mark Myers, Director
Division of Oil and Gas
Department of Natural Resources
550 W 7th Ave.
Anchorage, AK 99501

POSITION STATEMENT: DNR has no position on SB 151

Mr. Anthony Scott
Division of Oil and Gas
Department of Natural Resources
550 W 7th Ave.
Anchorage, AK 99501

POSITION STATEMENT: Answered questions related to SB 151

ACTION NARRATIVE

TAPE 03-28, SIDE A

CHAIR SCOTT OGAN called the Senate Resources Committee meeting to order at 3:32 p.m. Senators Wagoner, Seekins, Elton and Chair Ogan were present. The committee took a brief at-ease. Upon reconvening, Senator Dyson arrived. The first order of business to come before the committee was SB 31.

#SB31

SB 31-RAILROAD UTILITY CORRIDOR TO & IN CANADA

MR. RICHARD SCHMITZ, staff to Senator Cowdery, gave the following explanation of SB 31.

SB 31 allows the Alaska Railroad Corporation (ARRC) to extend its tracks from Eielson Air Force Base to the Canadian border. It also allows ARRC to explore the possibility of extending its tracks as far as the North American rail system to connect at Fort Nelson, British Columbia. The bill does not provide any funding for this project but it allows ARRC to pursue financing wherever possible. The state land for the railroad corridor would be granted to ARRC, fee simple title, after a specific process is underway.

Former Representative Jeanette James introduced SB 31 last year. It was not enacted because of concerns about the corridor and the natural gas pipeline. Senator Cowdery reintroduced the identical bill this year and, during a Senate Transportation Committee hearing, a discussion took place with Administration officials and ARRC officials about the work Governor Murkowski did on the Rails to Resources Act when he was a member of the U.S. Senate. The goal [of the discussion] was to find language that everyone could agree to that addressed the circumstances under which ARRC would get land. Some of that language was incorporated into a Senate Transportation Committee substitute (CS) beginning on page 2, line 4. That language contains a list of parameters. He deferred to ARRC staff to explain why those parameters were chosen.

MR. SCHMITZ told members he provided background material for members that contains tourism and engineering reports, geological information, and maps showing the route from Eielson Air Force Base to the Canadian border and to British Columbia. The actual gap to be covered equals about 1,000 miles. Governor Murkowski and Senator Cowdery believe in order for Alaska's economy to grow, better transportation is necessary. Railroads can carry heavy, bulk items over long distances very cheaply. Senator Cowdery also believes it is important to build the rail connection because of the gas pipeline. Trucks will be unable to ship the steel pipe but rail could. In addition, it might be possible to build the railroad and pipeline simultaneously.

MR. SCHMITZ told members the railroad corridor covers some of the richest mineral land in Alaska and the Yukon Territory. A geological formation, the Tintina Trench, is particularly rich in the platinum group of metals and gold.

CHAIR OGAN informed members that Phyllis Johnson, Wendy Lindskoog, Pat Gamble and James Blasingame of the Alaska Railroad Corporation were available via teleconference to answer questions. He then announced that Senators Dyson, Lincoln and Stevens joined the committee a while ago. He asked Mr. Schmitz to review the changes made in the Senate Transportation Committee substitute for members.

MR. SCHMITZ said the original bill would have given ARRC the state land via fee simple title. ARRC wanted a 500-foot corridor for safety reasons; DNR was concerned about locking up that much land unnecessarily. Also, some practical issues arose about a 500-foot corridor in communities such as Delta. The CS provides DNR with more flexibility when the corridor is delineated. ARRC will have to follow a process to obtain state land that requires it to be in a position to begin construction. Therefore, no land would be transferred unless project financing was obtained.

CHAIR OGAN asked the width of the current right-of-way on the existing railroad corridor.

MR. SCHMITZ said he believes it varies from 100 to 500 feet.

MR. PAT GAMBLE, President of the Alaska Railroad Corporation, informed members that Phyllis Johnson, Bob Loeffler and Joe Joiner were also present to answer questions. He told Chair Ogan the current average right-of-way is 200 feet.

CHAIR OGAN asked why ARRC wants so much land.

MR. GAMBLE said that was the nature of the compromise when ARRC talked to DNR. The state wanted a corridor for transportation, communications and a possible pipeline. ARRC wanted an exclusive right-of-way for control of the rail line, as it has on its existing rail line. The compromise was to survey a 500-foot corridor for the state and within it embed a 200-foot right-of-way for the railroad.

CHAIR OGAN commented that SB 31 will give ARRC a 500-foot right-of-way, the rights of eminent domain, and subsurface rights, which will have a big impact on private landowners. He asked if any private landowners have voiced an opinion on this change.

MR. GAMBLE clarified that ARRC will not have subsurface rights.

CHAIR OGAN referred to a provision in SB 31 on page 3, line 26, that says the state shall convey the state's entire interest in the land. He assumed that would include subsurface rights.

3:42 p.m.

MR. BOB LOEFFLER, Director of the Division of Mining, Land and Water, DNR, explained that DNR would convey the state's entire interest except "(a) the interest required by AS 38.05.125", which is the subsurface interest. So, in fact, DNR would reserve oil and gas rights and the other things associated with a mineral estate.

SENATOR ELTON referred to the draft sectional analysis, which says that DNR will retain any revenues arising from use of the land. He assumed any revenues would also include revenues from fiber optic cable rights-of-way or other things that generate revenue for ARRC.

MR. LOEFFLER explained that before the railroad is ready to construct, DNR will remain as the land manager and retain the revenues. Once the railroad is ready to construct a portion of the rail line, ARRC will get those revenues within its right-of-way on that portion. Therefore, DNR will retain the revenues while it manages the land and, when it transfers the management authority for each portion, the revenue for that portion will be transferred with it.

SENATOR ELTON asked if that includes the subsurface rights.

MR. LOEFFLER said DNR will retain the subsurface rights.

SENATOR SEEKINS asked what safety issues might be involved in putting a 54-inch high-pressure gas pipeline within 300 feet of a railroad.

MR. GAMBLE said he is not an expert on the safety radius from the pipeline but that is one reason a 500-foot corridor was attractive. He said more work needs to be done as the entire route is reviewed to maintain that safety buffer. That might require special engineering solutions depending on the topography.

CHAIR OGAN pointed out that language on page 4 reads:

If the [Alaska Railroad] corporation provides a survey alignment to the department, the department may not authorize construction of the natural gas pipeline within a 200-foot-wide corridor centered on the survey alignment unless the department does not find a feasible and prudent alternative for the route of the pipeline.

He assumed that language refers to safety issues. He asked how much of an area a typical train wreck covers and whether it is more than 200 feet.

MR. GAMBLE said the wreckage can cover more than 200 feet if the train is moving fast. He said it depends on several factors such as speed, topography, train length and others.

CHAIR OGAN commented that on a visit to Florida two years ago, he was amazed to see how fast the trains travel through towns.

SENATOR SEEKINS said he assumes the 200-foot railroad corridor would be on one side or the other of the 500-foot corridor rather than down the middle. He asked if that is addressed in the bill.

MR. LOEFFLER said a 500-foot corridor was chosen for several reasons, one to allow ARRC to move the railroad base around a little bit when it is ready to begin construction and another to allow DNR to retain additional land as a transportation corridor for other complementary uses. After the construction is done, DNR could adjust the corridor. Any unusable remnants would probably be turned back to general domain state land.

SENATOR SEEKINS said his concern is that a transportation corridor that includes a natural gas pipeline will need a safety buffer.

MR. LOEFFLER said he believes the natural gas pipeline will have a separate right-of-way. The 500-foot corridor is not expected to be the only right-of-way for both, but it doesn't rule that possibility out.

SENATOR LINCOLN referred to the provision about subsurface rights in the last paragraph of page 3, which says, "subject to the existing valid rights." She asked whether the state or the railroad will reserve the valid existing subsurface rights if private lands are bought.

MR. LOEFFLER replied DNR cannot convey what it does not own so the state's conveyance to the railroad will not include any rights it does not own. DNR will reserve the subsurface rights. Where the subsurface is owned by the state and a corporation might have a surface right, one would assume they would buy the surface right. He cannot imagine [the railroad] having a reason to acquire the subsurface rights unless it is to buy out a placer miner to get that person out of the way.

SENATOR LINCOLN said she is specifically thinking of the Native corporations that own surface and subsurface rights. She asked Mr. Loeffler if the state or railroad will have no need for the subsurface rights so would only purchase the surface rights and leave the subsurface rights with the private owner.

MR. LOEFFLER said that is his expectation but he deferred to ARRC representatives to answer for the railroad.

CHAIR OGAN suggested the legislature does not want ARRC to do any open pit mining underneath the railroad. He then clarified that the bill is silent on the issue of private property.

SENATOR LINCOLN said that is because it applies to the valid existing rights.

CHAIR OGAN pointed out the subsurface rights were conveyed with the Native lands. He asked Mr. Loeffler whether eminent domain could be used to claim only the surface rights. He commented that if he were a private landowner, he would favor a railroad crossing his land as it would provide access to that land.

SENATOR ELTON said a couple of phrases, beginning on page 4, line 20, suggest to him the bill's first priority is a railroad and the second priority is a gas pipeline. That language reads:

If the corporation provides a survey alignment to the department, the department may not authorize construction of the natural gas pipeline within the 200-foot wide corridor centered on the survey alignment.... The department shall consult with the corporation before authorizing construction of a natural gas pipeline in order to minimize effects on the potential rail route....

He said that language could be problematic if the pipeline is prioritized above a railroad extension, which he favors.

MR. LOEFFLER said [DNR] has not prioritized a railroad above a gas pipeline and that was not the intent. He hopes that is not how this section operates. DNR tried to include language to ensure complementary action and avoid a conflict. The bill is not about the pipeline; it's about the railroad so all language modifies [activities of] the railroad.

MR. LOEFFLER explained:

Here's how we think it works. If there is an existing application or right-of-way, that is a valid existing right that gets dropped from - it doesn't get conveyed to the railroad. If we've already identified a 500-foot corridor and a pipeline says, gee, we're really ready to go through there, then what we say is, well the pipeline typically - railroads are more topographically limited. They have trouble going up hills and things like that than in fact a pipeline. So what we do is we say, look railroad, we're going to give you a chance to stake the centerline. You know where it's most important for you and then we'll make that decision. And we make that decision in the best interest of the state and if we can find a feasible and prudent alternative, and that is reasonably general language, which gives us the flexibility to take economics and the best interest of the state into account. Our expectation is not to give a priority to the railroad, but it does require consultation with the railroad. And, of course, the consultation would go the other way as well with any applicants but this

language was really directed to the railroad. I hope that answers the question.

SENATOR ELTON said it does. He is hearing that is not DNR's expectation. He asked if DNR attorneys have looked at that language.

MR. LOEFFLER said they have, but not with that specific question in mind. He offered to do that and get back to Senator Elton with a specific answer.

CHAIR OGAN said he shares that concern and plans to hold the bill in committee today.

SENATOR WAGONER said a primary reason given for the need to build the railroad is that a gas pipeline will be built with 80-foot sections of pipe. He said he has talked to several of the major companies that would be involved in the construction of a pipeline who say they would use 40-foot sections. They asked whether a railroad will be built to the North Slope to handle 80-foot sections there. He would like to see a company that will build this pipeline verify what length of pipe it will use. He surmised if the pipe can be transported via truck, transporting the pipe should not be used as justification to build this railroad.

MR. SCHMITZ replied there is no guarantee that 80-foot joints will be used but, when the pipeline is built, it will be competing with other natural gas around the world. Using 80-foot sections will require half the number of welds than 40-foot sections. That cost savings could make the difference in the project's feasibility.

SENATOR WAGONER said he is not aware of any company that can roll an 80-foot length of pipe right now.

SENATOR SEEKINS said he was in the Interior when the oil pipeline was built. At that time, 40-foot joints were brought into Fairbanks by truck in 80-foot lengths. A tremendous additional cost was associated with the double jointing process, which also caused safety concerns. He said he would imagine a company hired to build 2,000 miles of pipe could find the technology. He favors a railroad extension for a number of reasons, one being commerce. Alaska should do its best to try to connect to the Lower 48 states by railroad for commerce, national defense, and resource development. Building an instate

railroad will help but it will not provide the flexibility the state needs.

CHAIR OGAN commented that the state cannot wait until a railroad is built to build a gas line.

SENATOR SEEKINS agreed but said the state needs to move forward with the right-of-way and work with the Canadians to do likewise. He said he supports SB 31 regardless of the rationalizations.

SENATOR LINCOLN asked if the Canadian government has officially supported the railroad extension.

MR. SCHMITZ said that some of the Yukon communities have passed resolutions in support.

SENATOR DYSON said he visited the Yukon a week ago and found the Yukoners to be actively in favor. That is one reason language was added to the bill to make sure the Canadian and Alaskan routes come together. The huge mineral rich trench extends across the Yukon and British Columbia borders. If necessary, he could get resolutions from both governments.

CHAIR OGAN referred to a sentence on page 6, lines 9 through 12:

A corporation may acquire land or interests in land in Canada as the corporation considers appropriate for the development, construction and operation of an extension of the Alaska Railroad to connect with the North American railroad system.

He questioned why ARRC would want to acquire interest in land in Canada.

MR. SCHMITZ said when the bill was introduced last year, it would have allowed the extension of the railroad to the Canadian border and stopped there. After discussing the issue, Representative James decided to authorize the railroad to look into a further extension using bonds or an appropriation to purchase land to connect to an existing rail line. He pointed out the White Pass Railroad obtained a right-of-way into the United States.

CHAIR OGAN asked if Canadian railways own rights-of-way in the United States and vice versa.

MR. SCHMITZ said he would imagine so. He said the private corporations do.

CHAIR OGAN asked Mr. Gamble if he supports that language and anticipates acquiring land and interests in Canada to expand the railroad.

MR. GAMBLE said he understood that language to offer flexibility to address the eventuality of having to deal with the other side of the border in unforeseen ways. However, at this time, ARRC has no concrete plans to acquire land in Canada. Representative James talked to ARRC about the flexibility that language would provide and ARRC acknowledges the purpose of that language.

SENATOR SEEKINS said he could envision many reasons the railroad might want to acquire land or interest in land in Canada simply in terms of support. ARRC may need to have office space for the administration of the railroad between Alaska and the Lower 48 states or for housing and warehouse space. He thinks it is wise to include that language in the bill even though the legislature may have to address how ARRC will get funds to acquire that land later.

CHAIR OGAN asked Mr. Loeffler if he wished to testify.

MR. LOEFFLER said DNR supports the bill.

MR. GAMBLE said, from a strategic point of view, ARRC's perspective on the extension from Fairbanks to the Delta area differs from its perspective on the extension from Delta to the border. The first leg of that extension could provide an opportunity to look at how to fund the operations and maintenance of the railroad by hooking up to the requirement to move goods and services back and forth from Fairbanks to Delta. Beyond that, this bill offers the potential to get at the kind of plan the current administration wants to pursue, in terms of development. Development is within ARRC's mission so it stands ready, when the time and conditions are right, to make this project work.

CHAIR OGAN asked Senator Lincoln if she is aware of the position of the Native corporations.

SENATOR LINCOLN said she spoke with several individuals who felt it was a little premature to comment on this bill until the project has progressed further - maybe when the actual corridor route is discussed.

SENATOR ELTON asked if ARRC pays property taxes to the organized boroughs through which it passes.

CHAIR OGAN said ARRC is on government property.

SENATOR ELTON said he asked because it has been suggested that a portion of that area join an organized borough.

MR. SCHMITZ commented the Army surveyed a right-of-way in the 1940s for a rail route and a rail corridor from the border to Fairbanks is in statute. Therefore, regarding questions of eminent domain and private property, an undefined railroad right-of-way does exist.

CHAIR OGAN assumed an environmental impact statement (EIS) would have to be done. He then announced he would await an answer from DNR to Senator Elton's question and planned to move the bill from committee on Wednesday. He announced a brief at-ease.

SB 151-REGULATION OF NATURAL GAS PIPELINES

MS. MARY JACKSON, staff to Senator Tom Wagoner, sponsor of SB 151, told members this legislation is a housekeeping measure and provided the following background.

In 2000, the legislature amended the Alaska Pipeline Act. In there we stuck in this term, 'North Slope' because, at that time, that was the only natural gas pipeline that we ever saw on the horizon. We didn't anticipate another pipeline to come along. Since then, another pipeline has come along and, in fact, it's the only one that we have and it's on the Kenai Peninsula - it's the Kenai Kachemak Pipeline - we call it the KKPL. It was initially going to go from the Kachemak Bay area back to Kenai. What they drilled at the far end of the Peninsula didn't pan out so it actually now goes from Ninilchik up to the Kenai area.... It's being constructed right now and that's why there's an immediate effective date on the bill.

What happened is they went to the RCA to ask for the authority to provide for their carriage in the pipeline and the RCA said, well, it just says North Slope natural gas pipeline and we're not frankly sure whether or not we can do that. So this bill takes out North Slope and leaves it natural gas pipeline so it's

throughout the state of Alaska. And that's why it is a housekeeping measure. There are people, I believe, online from Marathon to speak to how they're going to go about doing it but it's a pretty straightforward bill.

Regarding the fiscal notes, MS. JACKSON said the RCA submitted two zero fiscal notes. The DNR fiscal note amount is indeterminate; the last line of the analysis explains why, "For the Kenai Kachemak pipeline these dynamics are unlikely as only 63 percent of the line's total capacity has been contracted for."

CHAIR OGAN said he begs to differ that this legislation is merely a housekeeping measure because the state has common carrier pipelines. The legislature made an exception for the gas line to the Lower 48 because the producers would own the pipeline. He expressed concern that if the legislature shifts away from a policy of common carrier pipelines, it could have the unintended consequence of inhibiting development. He explained that pipeline owners would control who can transport gas in that line and the open seasons based on when their development is planned to come on line, in effect, eliminating other users and stranding gas.

MS. JACKSON said she understands that concern. An alternative was discussed and that was to specifically name KKPL in the legislation so that it would only apply to the North Slope and KKPL. She pointed out the length of the KKPL pipeline is 30 miles.

TAPE 03-28, SIDE B

CHAIR OGAN said he has been told there are shallow gas leases on the Kenai Peninsula. His concern is that SB 151 could lock out and discourage other development.

MS. JACKSON referred to minutes from a House Resources Committee hearing in which Mr. Schoffmann of Marathon Oil talked about support from Aurora Gas, Forest Oil and Evergreen, smaller producers.

CHAIR OGAN noted he has not heard from the smaller producers.

SENATOR ELTON said his understanding is that without this bill, the only company allowed to use the pipeline would be Marathon

Oil because it could not contract to others for firm or interruptible service.

CHAIR OGAN said his understanding is that if SB 151 does not pass, the pipeline will be a common carrier pipeline. In that case, if there is more gas than the pipeline can carry, the gas will be prorated. SB 151 would allow companies to contract for space in the pipeline, whether or not that space is used.

SENATOR ELTON asked if the RCA would regulate whose gas is carried in the common carrier pipeline.

CHAIR OGAN said that is correct.

MR. BEN SCHOFFMANN told members he is employed by Marathon Oil and is the Vice President of KKPL, which is jointly owned by Marathon and Unocal. He told members he provided background information on this bill to the committee [in writing]. He asked to address some of the members' previous questions.

He told members the modifications proposed to the pipeline act are to the common carrier section of that act. SB 151 would allow, under the common carrier section, a pipeline to offer both firm and interruptible service. However, that full offering of service is still under the purview of the RCA. The RCA is authorized to ensure that the process of accessing that pipeline is fair and balanced and that no party is favored. In the event the RCA finds that companies are being excluded, it has the ability to direct the pipeline to expand capacity to make room for others who want to ship gas.

Most pipelines in Alaska have been built by producer affiliates. They have the capital and incentive to do so. Building pipelines spurs investment activity by majors and by independents. Aurora Gas has written a letter in support of SB 151, part of which says:

Aurora Gas would not avoid exploring and developing acreage in the vicinity of producer owner pipelines. However, Aurora can and would substantially discount the value of exploring and developing acreage with no infrastructure whatsoever.

He said he believes the pipeline would spur investments and, rather than shutting out smaller independents, they seem to say they will look for gas where there is infrastructure.

Furthermore, the RCA has the authority to ensure the process is executed fairly.

SENATOR SEEKINS said his understanding is that the owner of a gas field who knows how much gas will be produced can get a firm commitment to transfer that gas through this pipeline. That is considered to be non-interruptible gas. However, if the gas field's potential is unknown, the owner could contract on an interruptible basis if there is capacity within the pipeline, which would give him the opportunity to start producing the field. If, at a later time, he found the parameters of that field were great enough to overcome the capacity of this pipeline, he would have the option of building his own pipeline or entering into a non-interruptible contract. He asked if his understanding is correct.

SENATOR WAGONER said that is correct to a point. The carrying capacity of the pipeline can be increased with additional compression.

SENATOR SEEKINS said that at least allows the owner to get his product into the market on an interruptible basis. However, because the pipeline does not have infinite capacity, there would come a point where he would have to build his own pipeline if his supply was large enough.

CHAIR OGAN asked Mr. Strandberg if Alaska has any regulations on open seasons.

MR. STRANDBERG, Regulatory Commissioner of Alaska (RCA), said the RCA does not currently have a regulation that speaks to the open season process.

CHAIR OGAN asked if that is by virtue of the fact that pipelines are either utility or common carrier pipelines.

MR. STRANDBERG said that is correct. Currently two gas pipelines are in operation in Alaska, the Beluga pipeline and Enstar's pipeline. Those are both certificated under the public utilities statute.

CHAIR OGAN asked Mr. Strandberg if the RCA intends to promulgate regulations to regulate open seasons if pipelines offer firm transportation.

MR. STRANDBERG thought the RCA has the ability to promulgate regulations through its own motion or through a petition. He

said it is unclear whether the state immediately needs open season regulations at this time. However, if pipeline companies see a need for them, they could petition the RCA and it would get involved in a regulation project.

CHAIR OGAN asked if open season is not an issue now because Alaska does not have any pipelines built that require them.

MR. STRANDBERG said that is correct and a lot of it has to do with the responsibility of the company conducting offerings. He said he believes the RCA considered open seasons on the KKPL project.

CHAIR OGAN asked if a producer-owned pipeline company purchased all of the available capacity on a line to reserve it for the future, whether the RCA has the authority to require that capacity to be released to a party that needs it now.

MR. STRANDBERG said the RCA believes it has that authority under the existing statute. The RCA regards the proposed contract carriage statute language to embed itself in the overriding common carrier language of the Alaska Pipeline Act. The RCA believes it has the flexibility, even with these changes, to regulate in the public interest.

CHAIR OGAN asked if an independent shipper wanted the RCA to order capacity expansion, but the producer-affiliated pipeline did not want to expand, which party would have the burden of proof before the RCA.

MR. STRANDBERG said that is a difficult question. The RCA has to look at the specific circumstances to establish where the burden of proof lies. Some of the considerations are who has the information, whether the party is a utility that is required to prove something is in the public interest, and who is the moving party. He noted the RCA employs some rules of thumb but it has to look at each specific case.

CHAIR OGAN asked if the RCA has a position on the bill.

MR. STRANDBERG replied, "We take no position other than to note that there's a zero fiscal note and we feel we can certainly accommodate the statute changes within our current statute."

SENATOR LINCOLN referred to the fiscal note from the Department of Community and Economic Development and read from the analysis:

There are no fiscal impacts on RCA for this bill.... However, it is expected that where producers elect to own and operate a pipeline, which is allowed, the contract carriage with service under these statutory terms will be proposed to RCA in a pipeline tariff filing.

She asked Mr. Strandberg to elaborate on that statement.

MR. STRANDBERG said perhaps the "however" is slightly misplaced. The RCA does not foresee any fiscal impact from the bill. A company may petition the RCA for the contract carriage but that would be considered part of the RCA's normal course of business. The RCA expects that the cost would be absorbed in its current budget through the regulatory cost charge.

CHAIR OGAN asked why Alaska disallowed contract carriage in the past.

MR. STRANDBERG said that is a good question. He said he has learned from some of the corporate memory within the RCA the Pipeline Act and Right-of-Way Leasing Act were passed together in 1972. The Legislature wanted to establish a policy of equal and unfettered access to oil and gas in Alaska. At that time, the common carrier mechanism appeared to be an excellent vehicle to use to avoid any discrimination. He pointed out that act pre-dates the TransAlaska Pipeline Act. He said he believes, in terms of the specific circumstances surrounding the need to assure delivery, a contract carriage approach does not establish that discrimination will occur. He believes offering the choice of either vehicle that a pipeline company can approach this under is effective. It is important that the RCA consider each application or proposal for contract carriage in the public interest.

SENATOR ELTON commented that he finds it bothersome that the RCA does not have a preference and takes no position on the bill. He said it almost sounds as though Mr. Strandberg's argument is an argument for the common carrier approach. He remarked that SB 151 addresses a fairly significant public policy issue.

MR. STRANDBERG said he was attempting to give the committee the best factual information about possible outcomes. He said when pressed, he would say the RCA does have a position. It feels these statute changes will still allow the RCA to protect the public interest and to accommodate and work with the pipeline

companies to certificate and bring pipelines into operation under either contract or common carriage.

SENATOR SEEKINS asked Mr. Strandberg if the RCA sees any downside to the proposed legislation in terms of the public interest.

4:45 p.m.

MR. STRANDBERG said he sees no downside to this legislation with the caveat that the RCA can continue to discharge its responsibility to look at each application and its specific circumstances and determine how that particular application works within its statute.

SENATOR SEEKINS asked if SB 151 will help the state get its resources to market sooner and more efficiently. He then asked, if no downside exists in terms of the public interest, what the upside is.

MR. STRANDBERG told members the RCA's mission is to regulate for the public interest. Implicit in that mission is providing an environment to make the investment climate as good as possible and to protect ratepayer interests. He said the dynamics of a gas pipeline under the common carrier portion of the act does not allow a definite commitment for the conveyance of gas. As a commodity, gas is time-sensitive. He said he spoke earlier about the need for having the ability to fulfill a production contract. He believes the upside of this legislation is that it will increase surety for investors in a pipeline. They will know that a pipeline company will be able to comply with the terms of the contract it signs for the delivery of gas.

SENATOR SEEKINS commented that the upside to SB 151 is that it encourages development and increases surety for those who put up the capital to build the line and there is no foreseeable downside.

CHAIR OGAN asked Mr. Schoffmann to give his presentation.

MR. BEN SCHOFFMANN, Vice-President of KKPL, gave a PowerPoint presentation and offered the following highlights.

SB 151 will provide an additional option to offer firm or interruptible service. It allows other pipelines to operate under the same methods provided to the North Slope gas line during the 2000 legislative session. SB 151 is consistent with

policy elsewhere in the United States, where the Federal Energy Regulatory Commission (FERC), since deregulation, has been very accustomed to granting firm and interruptible transportation or contract carriage. This issue has not arisen in Alaska because there has not been pipeline construction here.

The difference between firm and interruptible service is as follows. For firm service, the shipper agrees to pay a monthly reservation charge for a set level of capacity, which is due and payable whether or not that capacity is used. The pipeline, in turn, agrees to make that capacity available. The shipper only pays interruptible service if and when the service is used, and the pipeline makes best efforts to provide capacity.

MR. SCHOFFMANN told members SB 151 has two important benefits. It will give pipeline investors the opportunity to see the demand for the services, thereby reducing the risk. It also helps to establish a minimum level of what people are willing to pay.

Prospective shippers will be able to choose the type of gas transportation service which best aligns their gas supplies and customer contracts. Gas contracts are typically entered into between producers and end users on a firm or interruptible basis. Those with firm gas sales contracts may be more likely to want firm transportation and be willing to pay for that transportation. Those with interruptible supply contracts would be more likely to be biased toward selecting interruptible transportation services. The key word associated with SB 151 is "alignment." It allows companies to align gas contracts with transportation services.

SB 151 does not change the open access status of pipelines under the Pipeline Act. He agreed with Mr. Strandberg that the RCA will still act in the public interest to make sure that suppliers have access to the system either through open season or forced expansion. SB 151 will not have an adverse fiscal impact on the state or on smaller shippers. The smaller shippers like the idea of building pipelines because they will be assured that if their exploration efforts are successful, they will be able to transport that gas. He told members he is speaking on behalf of Aurora Gas and Forest Oil. He added that the RCA will be looking at individual situations to make sure the smaller producers do not get locked out. Maximizing throughput is advantageous to smaller companies. There is no incentive for them to artificially constrain throughput. He said other agencies do not seem to have a concern with producer

affiliation. FERC has not prohibited that sort of situation, nor did the 2000 amendments to AS 42.06. Two entities have built pipelines in Alaska: the public utilities (Enstar) and the producers. Those entities have the capital, resources and incentives. He believes SB 151 will accelerate investments by allowing firm and interruptible transportation services.

KKPL's contention is that pipelines are good for business. It believes SB 151 will spur activity. It will give pipeline investors more assurance that their investments will be efficiently utilized and in demand. It will give the producers and gas suppliers the assurance that if they have firm gas sale commitments, they can transport that gas to market to meet their contracts. KKPL has two tentative contracts for firm shipment of gas. It would like to offer that service as the pipeline goes into operation later this year. This is a timely issue for KKPL but it believes SB 151 will also encourage pipeline investment and development activities.

CHAIR OGAN asked Mr. Schoffmann why KKPL needs contract carriage if it is already a producer and owns the gas it wants to ship on the pipeline.

MR. SCHOFFMANN said Marathon and Unocal have formed a separate pipeline entity, Kenai Kachemak Pipeline (KKPC), whose sole business is to own and operate this pipeline so it is a stand-alone business venture that will be regulated by the RCA. He stated:

It is in our interest to make sure that that pipeline company we created is not a loser of money but is financially viable in its own right. So, we have attempted to conduct the open season and set up the pipeline tariffs treating everyone equally, inviting other people to nominate gas or book for services, but the real issue is, because of a variety of reasons, it made the most business sense to set up a separate company for this aspect and that company would like to be - have some financial underpinning to it.

CHAIR OGAN commented that is a moot point if KKPL had an open season and invited participation but no one else had gas.

MR. SCHOFFMANN said KKPL anticipated that others might have gas. Others with leases had the opportunity to express interest or make commitments. The open season at least helped KKPL identify the minimum size line. KKPL wants to be financially stable but,

in addition, the producers, Marathon and Unocal, have commitments to ship firm gas to various supply contracts. They want to be assured they have the ability to do so and are willing to pay for it.

CHAIR OGAN commented that one cannot nominate gas if there are no "bookable" reserves.

MR. SCHOFFMANN said in this instance, other investments are tied to the old development program - the Ninilchik gas discovery. Millions of dollars are being spent. It is incumbent upon the suppliers to ensure that money spent will result in their ability to ship the gas they believe they are in the process of proving up and deliver as early as the end of this year.

CHAIR OGAN asked if the KKPL pipeline is contracted for 100 percent capacity at this point.

MR. SCHOFFMANN said it is not. He explained the gas line will not come on stream at full capacity. The gas supplies will ramp up to a certain level and then begin to decline. At its peak rate, the anticipated throughput that has been contracted is 90 million cubic feet. Under a reasonable operating scenario, that being the inlet pressure of about 1,050 pounds and the outlet pressure of about 750 pounds, the gas line capacity would be in the neighborhood of 120 to 130 million cubic feet per day. On that basis, at the peak, there will be about 25 percent excess capacity that is not contracted for. The line could be expanded if other supplies are proved up and firm commitments are made.

CHAIR OGAN asked if the pipeline would be expanded by compression or looping.

MR. SCHOFFMANN said it would be expanded by compression or changing the inlet or outlet conditions. The compression could be put at the beginning, middle or end. Looping would be the last resort but it is possible.

5:03 p.m.

SENATOR SEEKINS noted that Mr. Schoffmann said this is a common scenario in other states and asked how common.

MR. SCHOFFMANN clarified that he said this is commonly used by FERC in the Lower 48 states. KKPL did look at what other gas producing states, notably Oklahoma, Texas, and Louisiana, are doing. They each have slightly different statutory schemes but

they all permit gas to be transported on a firm and interruptible basis.

SENATOR SEEKINS asked if KKPL is building some flexibility into its pipeline to allow other producers a structured rate process that may help them get their product on line.

MR. SCHOFFMANN said that is essentially correct with the caveat that under the common carrier regulations, the RCA is concerned about two things: making sure the pipeline has enough capacity to let others in while making sure it is not too big. He explained the nature of pipeline design being what it is, a change in pipeline size creates a large amount of incremental capacity. He noted that an increase of one diameter size can create an increase in capacity of 50 to 100 percent. Pipeline capacity is the function of a lot of factors, but an increase in diameter from 8 inches to 12 inches almost doubles the capacity.

SENATOR SEEKINS asked Mr. Schoffmann if anything in the proposed rate structure in SB 151 would put a potential competitor with either Marathon or Unocal at a disadvantage.

MR. SCHOFFMANN said he does not see how that would result. Everyone has been offered the same two options, firm or interruptible transportation. The RCA will be ruling on a tariff, assuming SB 151 passes, that sets the rates for each form of transportation. Everyone will know what those rates are in advance. The rates will not discriminate between producers and independents. Therefore, Marathon and Unocal will have to contract with KKPL under the same exact terms as others.

CHAIR OGAN said that is assuming no one finds more quantities of gas than they can ship through the excess capacity.

MR. SCHOFFMANN said at the point extra capacity is needed, there would be a new RCA rate case to determine the cost, how that capacity will be provided, and who will pay for it.

CHAIR OGAN said he hopes that happens. He then asked Mr. Myers to testify.

MR. MARK MYERS, Director of the Division of Oil and Gas, DNR, told members that Kevin Banks and Anthony Scott were with him and available to answer questions.

SENATOR ELTON asked Mr. Myers if DNR has taken a position on SB 151.

MR. MYERS said DNR has taken no position on SB 151.

SENATOR SEEKINS asked Mr. Myers his view of the downside and upside of SB 151.

MR. MYERS said he believes contract carriage can provide more certainty, which helps with financing. The downside is that an affiliated pipeline may not have the same motivations as an independent pipeline. An independent pipeline will always want to expand. An affiliated pipeline owner could find itself in a competitive situation for the gas market with a company with a new discovery. He said affiliation can be an issue but, in this case, the RCA can compel expansion, help allocate production, work out clear rule making and put together rules for conducting open seasons. The RCA has more authority than FERC. He said some contract carriage pipelines might be built that would not be built under common carrier so the infrastructure will be there. However, one's ability to get into that infrastructure will not be as clear as it would be in a non-affiliated pipeline that might want to expand. He is not saying that anti-competitive behavior will happen, but there is concern that those who make the initial investment have priority in the market place. He repeated Alaska has more protection with the RCA. On the federal side, the Minerals Management Service has had some problems with access to offshore pipelines. They are more akin to the Alaska situation than Oklahoma or Texas, where there are a lot of competing pipelines.

SENATOR SEEKINS asked, "If this was not an affiliated pipeline, if this was simply a common contract carrier, do you think they would be looking for the same kind of flexibility that this pipeline is?"

MR. MYERS said he does. He added that contract carriage is a "take or pay" contract. He explained in an affiliated producer built pipeline, the producer has a good idea of the amount of gas going into the line and understands the market, and the pipeline is self financed. However, in the case of someone else going to the market to try to get financing, the fact that contracts are locked in for a long period of time would be helpful.

SENATOR SEEKINS asked if it is a good flexibility component in general so, by looking at it as an affiliated pipeline, the legislature may be reading more into it than just seeing this as

a common procedure used in other places and a better way to get gas to market.

TAPE 03-29, SIDE A

MR. MYERS said that is basically correct. He said affiliation could create a problem when there are no alternatives, but he is not saying that is the case with KKPL. He said when there is a single pipeline coming out of a basin and no one knows how much gas is in that basin, there could potentially be more demand than that pipeline can deliver and it will require expansion. Regarding the point of expansion, if the burden of demonstrating the need not to expand is on the pipeline company, that is one thing. If the burden to show the need to expand is on the explorer, that places more risk on the explorer. He said a lot depends on how the RCA weighs the evidence as far as mandating expansion.

CHAIR OGAN asked Mr. Myers if he would suggest clarifying in the statutes where the burden of proof should fall.

MR. MYERS said he is not qualified to say whether that should be in the RCA rule making or in statute. He deferred to Anthony Scott for an answer.

MR. ANTHONY SCOTT, Division of Oil and Gas, DNR, told members that Commissioner Strandberg mentioned if the RCA had the authority to weigh these matters on a case-by-case basis, it would be able to protect the public interest. He said he thinks rule making could potentially be quite useful.

CHAIR OGAN referred to DNR's fiscal note analysis and quoted the following sentence:

Meanwhile, contract carriage on a pipeline owned by an affiliated producer could potentially be used to impede pipeline access for non-affiliated producers. This could hinder natural gas exploration and development and ultimately result in a negative fiscal impact for the State. For the Kenai-Kachemak pipeline, however, these dynamics are unlikely, as only 63 percent of the line's total capacity has been contracted for.

He said he is trying to reconcile that with Mr. Myers' earlier comment that there could be more supply than capacity sometime

in the future. He then asked if the legislature should consider narrowing this legislation to this specific pipeline.

MR. MYERS said that is a policy call. He said if the RCA has the ability to mandate expansion and the burden of proof lies on the pipeline company, he thinks it's okay. He said since this applies to all pipelines, there is the potential for pipelines to be built for a specific project with a limited amount of capacity. The RCA could mandate expansion but explorers would have to go to the RCA and take the risk they would or would not succeed. In that case, there is additional risk but there is still a remedy. He said affiliation is not a huge issue in his mind but he had to bring the committee's attention to the fact that affiliation could change pipeline behaviors.

CHAIR OGAN announced he would hold the bill in committee until Wednesday. He then announced a brief at-ease.

SB 50-ROYALTY GAS CONTRACTS

CHAIR OGAN announced a committee substitute (CS) had been prepared, labeled Version Q. He informed members that a lot of committee members' questions and concerns were addressed in the CS but a few additional amendments need to be considered. He said because this CS is new, he would hold it in committee to give members time to review it.

SENATOR WAGONER moved to adopt Version Q as the working document of the committee.

CHAIR OGAN announced that without objection, Version Q was adopted.

SENATOR WAGONER moved to adopt an amendment with the following changes:

On page 2, line 31, change "shall" to "may"

On page 3, line 17, change "and" to "or"

On page 3, line 20, change "and" to "or"

CHAIR OGAN noted without objection, the amendment was adopted. He then said SB 50 would be taken up on Wednesday and adjourned the meeting at 5:20 p.m.