

**ALASKA STATE LEGISLATURE**  
**SENATE SPECIAL COMMITTEE ON NATURAL GAS DEVELOPMENT**

June 4, 2006

2:13 p.m.

**MEMBERS PRESENT**

Senator Ralph Seekins, Chair  
Senator Lyda Green  
Senator Gary Wilken  
Senator Con Bunde  
Senator Fred Dyson  
Senator Bert Stedman  
Senator Lyman Hoffman  
Senator Donny Olson  
Senator Thomas Wagoner  
Senator Ben Stevens  
Senator Kim Elton  
Senator Albert Kookesh

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Senator Gary Stevens  
Senator Hollis French  
Senator Johnny Ellis  
Senator Gene Therriault

**COMMITTEE CALENDAR**

SENATE BILL NO. 2003

"An Act establishing the Alaska Natural Gas Pipeline Corporation to finance, own, and manage the state's interest in the Alaska North Slope natural gas pipeline project and relating to that corporation and to subsidiary entities of that corporation; relating to owner entities of the Alaska North Slope natural gas pipeline project, including provisions concerning Alaska North Slope natural gas pipeline project indemnities; establishing the gas pipeline project cash reserves fund in the corporation and establishing the Alaska natural gas pipeline construction loan fund in the Department of Revenue; making conforming amendments; and providing for an effective date."

HEARD AND HELD

SENATE BILL NO. 2004

"An Act relating to the Alaska Stranded Gas Development Act, including clarifications or provision of additional authority for the development of stranded gas fiscal contract terms; making a conforming amendment to the Revised Uniform Arbitration Act; relating to municipal impact money received under the terms of a stranded gas fiscal contract; and providing for an effective date."

HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SB2003

SHORT TITLE: NATURAL GAS PIPELINE CORPORATION

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

05/31/06	(S)	READ THE FIRST TIME - HELD ON SECY'S DESK
06/01/06	(S)	REFERRALS - NGD
06/01/06	(S)	NGD AT 1:30 PM SENATE FINANCE 532
06/01/06	(S)	Heard & Held
06/01/06	(S)	MINUTE(NGD)
06/02/06	(S)	NGD AT 11:15 AM SENATE FINANCE 532
06/02/06	(S)	Heard & Held
06/02/06	(S)	MINUTE(NGD)
06/03/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
06/03/06	(S)	Heard & Held
06/03/06	(S)	MINUTE(NGD)
06/04/06	(S)	NGD AT 2:00 PM SENATE FINANCE 532

BILL: SB2004

SHORT TITLE: STRANDED GAS DEVELOPMENT ACT AMENDMENTS

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

05/31/06	(S)	READ THE FIRST TIME - HELD ON SECY'S DESK
06/01/06	(S)	REFERRALS - NGD
06/01/06	(S)	NGD AT 1:30 PM SENATE FINANCE 532
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06/03/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
06/03/06	(S)	Heard & Held
06/03/06	(S)	MINUTE(NGD)
06/04/06	(S)	NGD AT 2:00 PM SENATE FINANCE 532

**WITNESS REGISTER**

JOSEPH K. DONOHUE  
Preston Gates & Ellis  
Counsel to the Governor  
Office of the Governor  
PO Box 110001  
Juneau, AK 99811-0001

**POSITION STATEMENT:** Answered questions during hearing on SB 2003 and SB 2004.

SENATOR GENE THERRIAULT  
Alaska State Legislature  
Alaska State Capitol  
Juneau, AK 99801-1182

**POSITION STATEMENT:** Commented on Amendment 4 to SB 2004.

KEN KONRAD, Senior Vice President - Gas  
BP

**POSITION STATEMENT:** Testified during hearing on SB 2003 and SB 2004; opposed Amendment 4 to SB 2004.

BRIAN WENZEL, Vice President  
Finance and Administration  
ConocoPhillips Alaska, Inc.

**POSITION STATEMENT:** Testified during hearing on SB 2003 and SB 2004; opposed Amendment 4 to SB 2004.

WENDY KING, Director of External Strategies  
ANS Gas Development Team  
ConocoPhillips Alaska, Inc.  
PO Box 100360  
Anchorage, AK 99510

**POSITION STATEMENT:** Testified during hearing on SB 2003 and SB 2004; opposed Amendment 9 to SB 2004.

JIM BALDWIN  
Counsel to the Office of the Attorney General  
Department of Law  
PO Box 110300  
Juneau, AK 99811-0300

**POSITION STATEMENT:** Answered questions on amendments to SB 2004.

DONALD SHEPLER  
Greenberg Traurig, LLP

Consultant to the Legislature

**POSITION STATEMENT:** Answered questions on amendments to SB 2004.

BOB LOEFFLER

Morrison & Foerster  
Counsel to the Governor  
Office of the Governor  
PO Box 110001  
Juneau, AK 99811-0001

**POSITION STATEMENT:** Testified on Amendment 9 to SB 2004.

PETE FROST, Director of Regulator Affairs  
ConocoPhillips  
Washington, DC

**POSITION STATEMENT:** Testified on Amendment 9 to SB 2004.

#### **ACTION NARRATIVE**

**CHAIR RALPH SEEKINS** called the Senate Special Committee on Natural Gas Development meeting to order at [2:13:31 PM](#). Present at the call to order were Senators Lyda Green, Gary Wilken, Con Bunde, Fred Dyson, Bert Stedman, Lyman Hoffman, Donny Olson, Thomas Wagoner, Ben Stevens, Kim Elton, Albert Kookesh and Chair Ralph Seekins. Also in attendance were Senators Gary Stevens, Hollis French, Johnny Ellis and Gene Therriault.

#### **SB 2003-NATURAL GAS PIPELINE CORPORATION** **SB 2004-STRANDED GAS DEVELOPMENT ACT AMENDMENTS**

CHAIR SEEKINS announced SB 2003 and SB 2004 to be up for consideration. Pending was a motion to adopt Amendment 4 to SB 2004, which had been discussed the previous day.

[2:13:55 PM](#)

CHAIR SEEKINS informed members there was an updated version of Amendment 4, labeled 24-GS2046\A.12, Bailey, 6/3/06, which read:

#### **A M E N D M E N T 4**

OFFERED IN THE SENATE BY SENATOR BEN STEVENS  
TO: SB 2004

Page 6, following line 8:

Insert a new bill section to read:

\* **Sec. 10. AS 43.82** is amended by adding a new section to read:

**Sec. 43.82.255. Terms of contract provisions related to oil.** (a) The provisions of this section apply to a contract developed under AS 43.82.020 that provides for periodic payment in lieu of taxes on oil under AS 43.55.

(b) For the part of the contract term beginning immediately after the date of full project funding or the date of issuance of a certificate of public convenience and necessity for construction and initial operation of the Alaska Natural Gas Pipeline, whichever date is later, and ending 14 years after that date, the commissioner may develop a term for the contract that provides for payments in lieu of the taxes on oil set out in AS 43.55. For the part of the contract term covered by this subsection, the payments in lieu of taxes may be established with as much certainty as the Constitution of the State of Alaska allows.

(c) For the part of the contract term beginning immediately after the period described in (b) of this section, and ending on a date not later than 25 years after the effective date of the contract, the amount of the payment in lieu of tax on oil under AS 43.55 must be equal to the amount of the tax levied by law. However, the commissioner may develop a contract term that, in the event of a material change in the taxes enacted after the effective date of the contract, establishes a procedure for restoring the parties to substantially the same economic position they had as of the end of the period described in (b) of this section immediately before the change.

(d) Implementation of a contract provision authorized in this section may be made subject to the dispute resolution procedures of the contract."

Renumber the following bill sections accordingly.

Page 10, line 23:

Delete "Sections 1 - 12, 15, 16, and 18"  
Insert "Sections 1 - 13, 16, 17, and 19"

Page 10, line 25:

Delete "Section 17"  
Insert "Section 18"

SENATOR BEN STEVENS told members the words were identical to previous Amendment 4, except for language added to renumber the bill sections. He thanked Senator Wilken for providing a related handout labeled "Oil Tax Certainty." He asked for unanimous consent for the adoption of Amendment 4.

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SENATOR ELTON began discussion that led to Amendment 1 to Amendment 4. He reiterated his question of the previous day relating to the dispute resolution language in subsection (d) of the amendment. He read the phrase, "Implementation of a contract provision authorized in this section", and asked what its net effect would be on subsection (b).

SENATOR BEN STEVENS gave his view that the only new contract provision would relate to lines 18-19 of the amendment, subsection (c), "However, the commissioner may develop a contract term ... in the event of a material change". He said that takes place in the third component of the timeline. He noted the provision that would be challenged in court is mentioned on lines 13-14, subsection (b), which talks about "as much certainty as the Constitution of the State of Alaska allows." He highlighted this as a term in the contract that already is subject to the dispute resolution procedure. This just says that if a new provision under a fiscal-balancing scenario is developed, it also shall be under the dispute resolution scenario, he added.

SENATOR ELTON offered an example, reading from the first sentence in (b). He said this seems to be a contract term subject to arbitration, rather than a court decision; a determination as to when the 14-year clock would start running could be highly important.

SENATOR BEN STEVENS responded that the aforementioned isn't a contract term. It would be in statute, not the contract. He indicated this doesn't affect any term of the contract, but adds timelines as to whether the legislature will agree not to change AS 43.55, which would affect the contract; subsection (d) implements a contract provision authorized by this section, which is mentioned on lines 18-19, subsection (c).

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SENATOR BEN STEVENS suggested replacing "contract term" with "contract provision" in (c), on line 19, because in this instance it isn't talking about a time period.

CHAIR SEEKINS proposed adding "(c) of" to subsection (d), line 23, so it would read: "a contract provision authorized in (c) of this section".

SENATOR BEN STEVENS indicated the above could be done if necessary for clarification, or as an alternative.

SENATOR DYSON agreed with the need for clarification, since "term" has different meanings. He suggested hearing from a legal expert.

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JOSEPH K. DONOHUE, Preston Gates & Ellis, Counsel to the Administration, opined that "term" is used properly within the context of the Alaska Stranded Gas Development Act ("Stranded Gas Act"). He gave an example. To the extent Amendment 4 deals with a specific contract provision, he suggested "contract term" is appropriately used. He indicated, however, that consistency would be attained by amending (d) as proposed by Chair Seekins, adding "(c) of" so that line 23 would read "in (c) of this section".

[2:24:37 PM](#)

SENATOR BEN STEVENS suggested "in section (c)" for simplicity.

CHAIR SEEKINS asked whether "provision" should be changed to "term" on line 23 for consistency.

MR. DONOHUE related his belief that within the context of Section 10 of the bill, "contract provision authorized in section (c)" would be as clear as "contract term authorized in this section".

SENATOR DYSON highlighted the unclear meaning of the various uses of "term" and "terms". For example, does "the part of the contract term" refer to the extent of time during which the contract is in place? Does "contract term" on line 15, subsection (c), deal with the length of the contract in force? Does "terms" in the title, line 4 of the amendment, refer to both the length of time that the contract is in force and the individual provisions within the contract?

MR. DONOHUE announced he was changing his mind. He acknowledged the potential for ambiguity and said he needed time to think about the appropriate language to clarify the distinction.

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SENATOR BEN STEVENS said he appreciated attempts to clarify the intention, but brought attention to the title, "Terms of contract provisions related to oil", as well as subsection (d). He said the question that brought them to this point is the creation of a new provision in the contract that is authorized by this amendment. It is the only mention of the development of a new provision; all other "terms of the contract" already exist. He acknowledged "terms" could mean either provisions or periods of time.

CHAIR SEEKINS opined that the amendment was pretty clear, except for line 23.

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CHAIR SEEKINS requested a motion to delete the word "this" on line 23 after "in" and then add "(c)" after "section". In response to staff, he said he'd have no objection to "(c) of this section". Thus it would read in part: "(d) Implementation of a contract provision authorized in (c) of this section".

SENATOR GREEN moved to adopt the foregoing as Amendment 1 to Amendment 4. There being no objection, it was so ordered.

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SENATOR ELTON requested a legal opinion as to whether the last sentence of (b) affects issues relating to legal standing. For example, does it change who has standing? Does it preclude going to court until a lockdown on taxes begins?

MR. DONOHUE replied that as he understands Amendment 4, a term in the contract that is authorized at the conclusion of this process would lay out this proposal. It would say the producers agree there is no fiscal certainty with respect to oil until such-and-such a time, and they'd agree to fiscal certainty for the middle period, and to a balancing for the third period. There would be standing to challenge whether fiscal certainty is authorized by the state constitution. In addition, the basic theory of providing fiscal certainty associated with all the other provisions - including tax rates for gas and so forth - would be at issue and resolved. Even if there were an argument that this issue needed to await the mid-phase agreement, the constitutional question would be addressed.

CHAIR SEEKINS added that under SB 2002, which passed the Senate that afternoon, the constitutional challenge would have to be

brought within 120 days of execution of the contract as an original action in the Alaska Supreme Court.

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SENATOR DYSON began discussion that led to Amendment 2 to Amendment 4. Returning to the meaning of "term" in Amendment 4, he interpreted it to always refer to periods when the contract is in force.

CHAIR SEEKINS compared line 19, subsection (c), with language in the Stranded Gas Act set out in SB 2004 on page 3, line 3. He indicated he read "contract term" on line 19 to mean "contract provision," but otherwise thought Senator Dyson was correct.

SENATOR DYSON suggested that if the foregoing was correct, perhaps it should be plural: "the commissioner may develop contract terms". He said more than one component of the contract might need alteration, and thus it wouldn't be good to limit the commissioner to only one provision. He deferred to Chair Seekins to propose an amendment, if appropriate.

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SENATOR GREEN suggested leaving the language as is. She noted that "contract term" is linked to the phrase "establishes a procedure" on line 20 of the amendment.

MR. DONOHUE said it was fairly clear, but he didn't believe making it plural would either help or hurt. He then noted that both (b) and (c) begin, "For the part of the contract term beginning". He recommended perhaps citing AS 43.82.250, where the statute says "the term of the contract"; there, however, it means length of time. He pointed out "term" is used in both senses in the statute, as well as in Amendment 4.

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CHAIR SEEKINS informed members that his own notes said, "For the period of the contract term".

MR. DONOHUE agreed that would provide clarity.

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SENATOR GREEN moved to adopt the aforementioned as Amendment 2 to Amendment 4, to change "part" to "period" on lines 7 and 15, at the beginning of subsections (b) and (c).

SENATOR DYSON proposed the same change on line 12, in subsection (b), where it says, "For the part of the contract term".

SENATOR GREEN incorporated that change to line 12; thus revised Amendment 2 to Amendment 4 would change "part" to "period" on lines 7, 12 and 15. There being no objection, it was so ordered.

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SENATOR WAGONER requested confirmation of his understanding: after year 18 so, after capital-cost recovery, there'd be a "reopener," except a future legislature couldn't increase the tax without a compensating reaction as far as oil tax versus gas tax; that would happen if there were a material change, more than 3 percent up or down. He asked why they were even considering having a reopener there, because he could see no advantage to the legislature.

SENATOR BEN STEVENS pointed out that line 19 in (c) says the commissioner "may" develop a contract term. He said he'd agree with Senator Wagoner only if it said "shall". He referred to the previous day's discussion about uncertainty and discretion given to the commissioner to develop a contract term if a material change occurred as a result of an effective change in the tax. He said it leaves flexibility for a legislature to force a reopener, but also gives discretion to the commissioner and the sponsor group to say this likely will end up in dispute resolution. He concluded that "shall" would provide a mandatory reopener and rebalancing. However, "may" leaves it to the discretion of the participants 18 years in the future.

SENATOR WAGONER asked what the point is of giving the legislature a chance to reopen the tax structure for oil in year 18, for instance, if the final result is a rebalancing by decreasing taxes on gas - which he suggested the companies would propose and the commissioner may concur with.

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SENATOR BEN STEVENS replied that it doesn't say anything about the terms with regard to gas; rather, it talks about "substantially the same economic position", which he called a "distribution of the economic rents." He indicated that if the legislature reacted to a change in market conditions, "may" would give the commissioner flexibility if he or she didn't believe there was a need for rebalancing.

SENATOR DYSON surmised Senator Wagoner's point linked to his own concern voiced yesterday: Even if the commissioner decided to go ahead, the net cost to the producers couldn't change very

much - within 3 percent up or down, as discussed yesterday. The net government take under (c) would have to be substantially the same as what was in effect in (b) after the commissioner's decision, even if net profits were low and the companies were going broke.

SENATOR WAGONER clarified his concern: Because of how this is constructed, why are they even looking at an opportunity for the legislature to revisit this?

SENATOR BUNDE suggested it costs nothing and yet provides some flexibility for future situations that the legislature may not be aware of.

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SENATOR BEN STEVENS, in response to Chair Seekins, specified the intent that it be left open, not locking in a change at year 18, but locking in the ability to make a change if so required, with flexibility.

CHAIR SEEKINS expressed concern that the language may authorize that term to be negotiated in the contract from day one.

SENATOR BEN STEVENS opined it was pretty clear. He read portions of (c). Proposing that members think theoretically, he said the contract has provisions locked in for 14 years, and a future legislature, in year 15, could change the rate that would become effective immediately after year 18; thus it could be changed before the time.

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SENATOR BEN STEVENS, in further response, said the intent of (c) is to leave it flexible; to not make it part of the contract now; and to say that the terms to be locked in at sanction will be firm until the end of the cost-recovery period, at which time there would be "flexibility and opportunity." He said if the situation posed by Senator Dyson were to come into effect, there will be opportunity. He specified that it isn't intended that the terms from years 18-25, give or take, be negotiated now.

CHAIR SEEKINS highlighted the need to ensure that the language clearly says this is an option to be exercised at a future date, rather than negotiated into the contract from day one.

SENATOR BEN STEVENS added there is certainty in (c), lines 17-18, which says the amount of the payment in lieu of taxes (PILT) on oil must equal the amount of tax levied by law.

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SENATOR DYSON asked whether he meant to imply that "must be equal to the amount of tax levied by law" includes changes that the legislature might make in the law at that time.

SENATOR BEN STEVENS replied he thinks that's inherent and imbedded in it, because it speaks of that period of time. He read from the first sentence of (c): "beginning immediately after the period described in (b)". He remarked, "Beginning at that point, whatever is law then, ... the production value tax calculated under 43.55 must equal the PILT payment, or the PILT payment must equal that."

He said he wasn't trying to trigger an automatic change in taxes, but also wasn't trying to say that if future legislatures see the need for a change, the PILT shall equal it. If there is a material change in the distribution of economic rent as a result, however, the commissioner may go in with the sponsors and make the modifications. This is so far over the horizon that the economic conditions are unknown. Referring to his testimony the previous day, he highlighted the desire to create a stable taxation rate during the period of firm transportation (FT) commitments, to provide a mechanism for stability if required, as well as to provide the legislature with an opportunity for change. He said that's the purpose of that section.

SENATOR DYSON asked, however, whether lines 19-21 in (c) say that whatever those changes are, they must balance with some other changes in order to leave the parties in the same position as they were before.

SENATOR BEN STEVENS agreed that's what it says, but opined that subsection (c) pivots on "may" versus "shall". He specified that he intentionally chose "may" to leave flexibility.

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SENATOR ELTON proposed that not having (c) at all would provide maximum flexibility, leaving it to the legislature at that time, after 14 years, to determine tax rates or anything else. However, (c) seems to cede some current legislative powers to the commissioner; it suggests the legislature can increase a tax, but if it's a material change - defined the previous day as plus or minus 3 percent - then the commissioner has the ability to keep the other parties whole by making economic adjustments that would essentially change the government take. Suggesting

it gets back to Senator Wagoner's point, he spoke in favor of maximum flexibility for the legislature, which would mean removing (c).

SENATOR HOFFMAN agreed the aforementioned would be optimum for the legislature, but suggested also looking at the position of the oil companies in order to get their commitment to build the gas pipeline. Stating his belief that the consensus of the majority of legislators is that the contract is too long, and referring to Senator Wagoner's previous discussion, Senator Hoffman classified this as an opener - the legislature would have the option, at that point, to evaluate the economic conditions in the market and make a change accordingly.

2:59:01 PM

SENATOR WAGONER remarked that with Senator Ben Stevens' definition of "material change" the previous day, it provides flexibility; he mentioned 3 percent.

SENATOR BEN STEVENS said material change is incorporated in a generally accepted accounting principles (GAAP) or Financial Accounting Standards Board (FASB) terminology that he believes is plus or minus 3 percent.

CHAIR SEEKINS surmised it would be around \$90 million.

SENATOR WAGONER said it depends.

CHAIR SEEKINS offered his understanding that the reason for this is to cover the period through the first shipping commitments, to ensure the project economics aren't altered materially during that time.

SENATOR BEN STEVENS affirmed that. He suggested Senator Wilken's chart defines it best. During that time, phase three is meant to provide stabilization. As Senator Hoffman accurately described it, Senator Ben Stevens said, there is opportunity for the legislature to modify it, if justified by conditions at that point. However, it isn't mandatory.

SENATOR GREEN thanked Senator Ben Stevens for bringing forward such an amendment, which addresses two main issues heard about from the producers and the administration. While the idea of certainty is important, the public perspective is that 30 years is too long. She surmised the public would find the idea behind this amendment reasonable, since it provides a future opportunity to look at it.

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SENATOR BEN STEVENS wrapped up his discussion of Amendment 4, suggesting it is the legislature's answer to concerns about fiscal certainty relating to oil and its relationship to moving this gas project forward. He emphasized that the terms and concept weren't provided by consultants; it is a legislative solution.

CHAIR SEEKINS added, "With as much certainty as the Constitution of the State of Alaska allows."

[3:04:09 PM](#)

SENATOR OLSON referred to the 14 years on line 10, in (b). If the supreme court determines there is only a 2-year period for certainty, he asked, does it change the flavor of Amendment 4, since 2 years is the period of a legislature, and one legislature's binding another may not be what they have in mind?

SENATOR BEN STEVENS replied he didn't have the answer, but it would dilute the amendment because the supreme court would say that certainty couldn't be provided under the constitution.

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SENATOR DYSON offered his belief that the House had amended this to 12 years instead of 14. He also recalled hearing from Senator Ben Stevens yesterday that the 14 years was an approximation of what was appropriate. Senator Dyson asked how he'd feel about amending this to 12 years.

SENATOR BEN STEVENS opposed the concept, saying the period of project sanction to first gas is the uncertain period of time. There could be delays because of a shortage of steel, for instance; thus he'd "erred with that in mind."

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SENATOR DYSON asked whether language had been considered saying this period ends when cost recovery is complete. He recalled hearing that once the gas pipeline is largely full, costs would be recovered in about 6 years.

SENATOR BEN STEVENS said he had considered it. A hard date was chosen instead of capital-cost recovery, however, because disputes would arise from trying to account for all expenditures and determine when they began.

CHAIR SEEKINS invited Senator Therriault to comment.

[3:08:19 PM](#)

SENATOR GENE THERRIAULT, Alaska State Legislature, expressed pleasure that the portion up to project sanction isn't locked in. However, he offered his understanding that if construction was thought to last 4 years, there'd been past testimony - which probably needed to be updated - that the recovery period would be fairly quick for capital outlay, 5 or 6 years. Thus 14 years seems overly generous for recapturing the investment, since the rate of return should be substantial. Referring to Senator Elton's discussion of (c) and the House's action, he also questioned whether any legislature would adjust the oil tax once they were past the construction and cost recovery for oil, despite the "may", since they'd have to give back dollar-for-dollar on the gas side. He said it's a mixed bag.

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SENATOR BUNDE surmised that if, for some reason, North Slope oil became like Cook Inlet production and there was a desire to lower oil taxes, then the state would benefit from an increased take on gas. He said it seems it should work both ways, even though such a scenario is unlikely. He asked whether his understanding was correct.

SENATOR BEN STEVENS replied yes.

CHAIR SEEKINS said that's how he reads it too: it restores the parties, and the state is a party. He asked whether Mr. Donohue wished to comment.

[3:11:55 PM](#)

MR. DONOHUE noted he wasn't authorized to address policy issues from the administration's standpoint, since he was outside counsel to the administration. He did point out, though, that this is a significantly different approach from the "oil fiscal term" in the proposed contract, and is likely problematic from the producers' standpoint; however, the producers could speak for themselves. Noting a legal concern, he said he'd initially read it to have a term at the outset perhaps not locking in rates, but creating parameters for the "reopener" conditions. If this is merely an agreement to agree in the future, however, there'd be a question of whether anyone would want to agree to that from the producers' perspective.

CHAIR SEEKINS invited further testimony on Amendment 4.

[3:13:26 PM](#)

KEN KONRAD, Senior Vice President - Gas, BP, began by addressing fiscal stability in general. He said sovereign governments around the world enter into contracts that specify government take for very large energy projects. They do it to attract expertise and capital investment, which creates wealth and vital economic activity for their countries. Similarly, U.S. states and municipalities negotiate contractual PILTs to attract investment for factories, for example, which can create long-term economic benefits for citizens. Although the projects are smaller than the proposed Alaskan gas project, the principle is the same. Mr. Konrad noted similar contractual tax-stability concepts were employed in Alaska over 40 years ago to attract the investment necessary to build large gas facilities on the Kenai Peninsula; Alaska still benefits from those.

He said in all these cases, governments working with industry have proactively encouraged investment, providing clear and certain rules, to the mutual benefit of both. While benefits to Alaska from a gas project would span generations and be enormous, risks for investors also would be quite large, given the massive investments and the production timeframe. The largest cost for this project, by far, is not the \$25 billion in capital costs; rather, it is the payments that will be made to Alaska. Thus it's important to know what the rules are.

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MR. KONRAD addressed stability relating to oil and gas. He suggested fiscal certainty as introduced in SB 2004 isn't a new concept; it was a key purpose when the Stranded Gas Act was enacted in 1998 and reenacted in 2003 with strong support from the legislature. Although the original bill provided for replacing both oil and gas production taxes with PILTs in AS 43.82.210, it's worth ensuring that this intent is made very clear, he told members.

He said SB 2004, as originally written, clearly extends PILTs to both oil and gas. This is of critical importance in letting the project advance. The economics of oil and gas are inextricably linked on the North Slope: oil and gas are formed together underground, co-exist in the same reservoirs, are produced through the same wells, flow through the same flow lines and are processed in the same facilities. This linkage is recognized by governments and investors around the world, Mr. Konrad noted; royalty contracts cover both oil and gas, as do international production-sharing contracts, although the terms may not be identical.

He advised members that this linkage is particularly acute in Alaska in the mature basin on the North Slope. Building a gas pipeline is effectively a commitment by the major producers to maintain the vital North Slope infrastructure for 40 to 50 years. Unless all the oil and gas infrastructure is maintained, the gas pipeline cannot be supplied with gas. Thus it's a 40- to 50-year commitment to keep the machinery operating in its entirety. Mr. Konrad highlighted protecting investors from after-the-fact tax increases. Once the gas pipeline is up and running, there is no choice but to produce in order to recover the investment; that is why these large energy investments around the world have fiscal-stability parameters for both oil and gas.

[3:19:13 PM](#)

MR. KONRAD cited the Caspian region as a germane example; he provided details, saying BP wants the same results for the Alaskan gas pipeline project. Knowing the rules for both oil and gas is of key importance, and fiscal stability on gas but not oil is close to having no fiscal stability at all. Changes to the oil taxes could more than offset the benefits from the gas pipeline project, he said. That's why sovereign governments such as in the Caspian region offer fiscal stability for both oil and gas.

He suggested SB 2004 makes this inextricable linkage between oil and gas very clear. Recognizing that the legislature is carefully considering options, he discounted the idea that decisions regarding the duration and nature of fiscal stability should be made now. The contract details were only released two weeks ago, he said, and public review is underway. The ultimate decision on any contract and its duration by this legislature should be taken at the appropriate time, after the legislature understands the benefits and attributes of the project. Mr. Konrad questioned the benefits to anyone of significantly altering or foreclosing a fundamental, underpinning concept at this juncture, in what he said feels like a bit of a rushed fashion.

He told members SB 2004 as originally written provided the necessary framework for the legislature to either approve or not approve the proposed contract - in its current form or a modified form - at some point in the future, following a public comment period and full legislative review. For that reason and other important attributes of fiscal stability, he voiced opposition to this type of amendment, which would foreclose

fiscal-stability provisions. "We just don't believe it's appropriate right now," Mr. Konrad concluded.

3:23:20 PM

SENATOR BUNDE pointed out that the total project cost won't be known for many years. Noting Mr. Konrad had spoken of \$25 billion, he asked whether this was a conscious effort to use a more accurate figure than the ballpark number of \$18 billion to \$20 billion he'd heard earlier.

MR. KONRAD indicated BP hadn't done a reestimate since the work done in 2001, discussed the previous day. If the project were done today, however, it certainly would cost a lot more. Steel prices have doubled, for instance; the Canadian dollar is stronger; and there is inflation because of the current boom. Although the price of steel five years from now isn't known, the general cost environment is measurably higher than in 2001 and so prices are expected to be higher.

3:25:20 PM

BRIAN WENZEL, Vice President, Finance and Administration, ConocoPhillips Alaska, Inc., began by saying he would echo many of Mr. Konrad's comments. In addition, he noted the bill provides instructions and a toolkit for the administration to use in developing a contract with the producers to provide a gas pipeline. However, an amendment like this removes tools, limiting the degrees of freedom provided to the administration to negotiate a contract - a philosophy Mr. Wenzel said he wasn't sure he understood. He expressed concern that this amendment reduces the administration's ability to bring in a viable project for consideration by the legislature, and also increases project risk to be borne by the producers, since it reduces the amount of fiscal stability available to them.

3:28:24 PM

MR. WENZEL referred to testimony about capital-cost recovery, saying he wasn't sure he understood the definition of that term as discussed by the committee. He discounted the idea that this project could have a reasonable payout in 5 years, barring very high prices. He cautioned members to consider this when looking at the definition.

He agreed with Senator Ben Stevens that this amendment attempts to deal with legislator's concerns about the duration of oil fiscal stability proposed in the contract. However, Mr. Wenzel reported hearing previously from legislators that they were looking to the petroleum production tax (PPT) bill to counteract

this, expecting or requiring a higher rate on the base tax rate as the mechanism. He said he didn't support this amendment, but expressed hope that removing the fiscal stability would also remove the need for such a "premium" in the PPT base tax rate.

[3:31:30 PM](#)

SENATOR DYSON asked what a reasonable period would be to expect that a project would pay for its capital construction costs.

MR. WENZEL replied that he didn't have exact numbers with him, but his point is that just paying off the capital investment isn't sufficient. There are operating costs and other costs. Simply paying off capital costs is by no means recognizing the risks for the producers, and their expected returns.

SENATOR DYSON said he understood that and wanted the producers to be rewarded for their risks. He asked, generally speaking, how quickly construction costs are amortized on mega-projects like this.

MR. WENZEL replied that from an economic-return standpoint, it's not about how long accounting principles or tax principles allow amortizing particular costs. Rather, it's about how long it takes to get to the expected return, which is much longer.

SENATOR DYSON said he'd thought there'd be some basis on which there was an expectation to recover the money put into building a project. He expressed disappointment that Mr. Wenzel hadn't answered that.

[3:33:31 PM](#)

SENATOR STEDMAN spoke in support of Amendment 4. He said some legislators would argue that the PPT is at a discount, while others would argue it's at a premium. Clearly, there is discomfort around the state as the gas line project and oil taxes are looked at. He lauded the amendment's strong points, saying it leaves flexibility to ensure that the oil tax in place at the end of year 4 is in the best interests of the industry and the state, in order to have a long-term working relationship through the next several decades.

He pointed out that legislators work to come up with a balance in order to move tough issues forward. He said he thinks this is a good amendment and certainly helps to protect the people of the state, who own the resources, and it helps ensure that the industry won't be put at a disadvantage in the future. He surmised operating in Alaska, where there is stability and where

the tax structure isn't changed arbitrarily, is more beneficial than in Bolivia or possibly the Caspian region.

[3:35:30 PM](#)

SENATOR BEN STEVENS clarified that "capital cost recovery" is used to say "total revenues equals total expenditures." He told Mr. Wenzel it's by no means intended to be when payout begins on the project or when debt is retired. It's not mentioned in the amendment because it has different interpretations and would take a long effort to describe in statute, he explained, saying that methodology had been used to come up with a timeline.

[3:36:30 PM](#)

SENATOR BUNDE remarked that he respects the industry's point of view. However, one "given" for him is that unless the general public has reasonable comfort with the contract's major provisions - including this issue of certainty, which currently causes discomfort - the contract won't pass. If this amendment increases the public's comfort level, which is unknown at this point, then it's a positive step forward.

[3:38:10 PM](#)

SENATOR WAGONER concurred, noting he has often heard concern from constituents about locking in fiscal certainty for 35 years. Calling it a good compromise, he specified that he supported the amendment.

CHAIR SEEKINS asked Mr. Wenzel whether he'd seen the chart provided by Senator Wilken.

MR. WENZEL said yes.

CHAIR SEEKINS pointed out that the first section is plus or minus 4 years, up to project sanction. He asked whether that is a reasonable time.

MR. WENZEL deferred to Wendy King.

[3:39:20 PM](#)

WENDY KING, Director of External Strategies, ANS Gas Development Team, ConocoPhillips Alaska, Inc., noted there is a publicly available version of the project summary. She explained:

In that project summary, in our success-based case, it is anticipated that we would take roughly 1 year for project planning, have an additional year of permit-application work, and then another couple years of

permit application, ... the actual submission of the applications. So this 4-year timeframe would be consistent with the current anticipated schedule.

And, as we've highlighted in a number of our discussions with individuals, the provisions that are currently within Article 5, the work commitment section with a diligence standard, were specifically crafted to allow us to use industry best practices on gated decision making, to help us to be able to adjust schedule if it's deemed appropriate at that point in time, subject to that diligence standard. So, yes, this is consistent with what we would know about the schedule today, to have 4 years to project sanction.

CHAIR SEEKINS asked about a reasonable estimate of the time from project sanction to first gas.

MS. KING replied that the publicly available schedule has an estimate of 9 years to first gas, with an additional year of ramp-up to get to full project volumes. She referred to testimony from Mr. Konrad and emphasized it's an estimate, not a guaranteed date to first gas delivery.

[3:41:37 PM](#)

CHAIR SEEKINS returned to the chart, noting it shows about 18 years to get to "capital cost recovery complete." He asked whether Ms. King was saying that, after first gas, it would be approximately 8 years more to get to that point, with the same disclaimers.

MS. KING affirmed that.

CHAIR SEEKINS asked whether 8 years after first gas is a reasonable timeframe for capital-cost recovery.

MS. KING replied:

I'll reiterate a point that Mr. Wenzel made earlier: We do not know what payout will be, and I do not know for sure what capital-cost recovery will be for this project. We do not know what the actual costs of this project are going to be. We do not know what the natural gas prices are going to be. We do not know how long it will take to actually deliver the project. So we would not have an estimate for capital-cost

recovery or payout, because I can't predict what the prices of gas would be.

CHAIR SEEKINS asked about rules of thumb or a target.

MS. KING answered:

We will look at a wide range of uncertainties, and we will carry a wide range of what this project will deliver going forward. And that range would be substantially wide for a project that has a cost estimate associated with this project of \$20 billion, ... which Mr. Konrad very eloquently spoke to, that there's large uncertainties already with that cost estimate. We could provide a range, but that range would be very, very large because of the uncertainties associated with this project.

[3:44:11 PM](#)

SENATOR BEN STEVENS reiterated that capital-cost recovery isn't mentioned in statute. He said what is meant by that period of time is "when total revenues minus corporate income tax equals total costs." He added, "That is the timeframe that we used in saying total costs may be 6 years, 8 years; total revenues may occur in 6 years or 8 years - we don't know." He emphasized that by no means does he want Amendment 4 to be interpreted as saying this project will reach payout in 5 years.

CHAIR SEEKINS remarked that many people he has talked with don't mind having some kind of certainty, as long as it doesn't negatively affect the economics of the deal. But how do they know when that point in time is reached? Even in his own business, he cannot make those kinds of predictions with a high degree of certainty, he noted.

[3:45:47 PM](#)

MR. WENZEL apologized and clarified that the estimate Senator Dyson had asked for earlier, on capital-cost recovery, isn't something his company tracks; it isn't how they determine returns. Thus he didn't know the answer.

SENATOR DYSON said he appreciated that. He recalled that in the years he worked for BP, the general manager would say that if a desired project wouldn't start making money in 3 years, they wouldn't do it. Senator Dyson surmised he now understood what Senator Ben Stevens was talking about: 14 years after project

sanction, the expectation would be that the producers would begin to make money. He asked whether that's a bad assumption.

MR. WENZEL offered his understanding of Senator Ben Stevens' intention: after 14 years, capital costs would be recovered, but not necessarily operating costs or any return. "So it's not the point we start first making money, in my mind," he said, adding that it's an interim point which he doesn't believe is relevant.

SENATOR DYSON thanked Mr. Wenzel, but expressed confusion.

[3:48:04 PM](#)

SENATOR ELTON objected to Amendment 4 as amended. He explained that he was uncomfortable handcuffing future legislatures with respect to the power of taxation. He agreed with producers' testimony that it seems extremely difficult to make decisions like this before the public comment period has ended. He also pointed out that this is legislators' opportunity to decide what they want the contract to look like; once they get the contract, it will be an "up or down" vote. He specified his reason for opposing the amendment wasn't because of an issue of when fiscal stability begins or ends, but related to the constitution and the legislature's power of taxation.

SENATOR BEN STEVENS removed his objection.

[3:50:17 PM](#)

A roll call vote of 11 yeas and 1 nay proved Amendment 4 as amended passed, with Senators Stedman, Bunde, Olson, Dyson, Wilken, Hoffman, Kookesh, Ben Stevens, Green, Wagoner and Seekins voting yea and Senator Elton voting nay.

The committee took an at-ease from [3:50:54 PM](#) until [4:10:39 PM](#).

The committee took an at-ease from [4:11:04 PM](#) until [4:13:02 PM](#).

SENATOR DYSON moved to adopt Amendment 5 to SB 2004. With original language, spelling and punctuation, as well as line numbers relating to the previous day's Amendment 4, it read:

**A M E N D M E N T 5**

**OFFERED BY:** Senator Fred Dyson

Subparagraph (b), lines 5 and 6:

Delete [DEVELOP A TERM FOR THE CONTRACT T]

Insert "modify those terms of the contract relating to"

Subparagraph (c), line 4: After "equal to" insert:  
Delete [EQUAL TO THE AMOUNT OF THE TAX LEVIED BY LAW.]  
Insert "equal to or greater than the amount of the tax then levied by law."

Subparagraph (c), lines 4 through 9: Replace last sentence with the following:  
"In the event taxes levied by law have changed, and remain in effect, in excess of three percentage points from those taxes in effect at the end of the period described in (b) of this section, the commissioner may develop contract provisions for payment in lieu of tax equivalent to the taxes in effect at the end of the period described in (b) of this section."

SENATOR DYSON objected for discussion purposes. He explained that he'd discussed this with Senator Ben Stevens, who he believed was fine with the first two portions. Senator Dyson suggested the need to either divide the amendment or do more work on the third portion.

SENATOR BEN STEVENS pointed out that the line references in Amendment 5 relate to yesterday's version of Amendment 4. Thus the first portion, amending (b), relates to line 11 of today's version of Amendment 4; the second portion, amending (c), relates to line 18 of today's version. He agreed with dividing the amendment.

[4:15:46 PM](#)

SENATOR DYSON moved to divide Amendment 5, with Amendment 5A including all but the third portion. There being no objection, it was so ordered.

[4:16:04 PM](#)

SENATOR DYSON moved to adopt Amendment 5A to SB 2004. With original language, spelling and punctuation, as well as line numbers relating to the previous day's Amendment 4, it read:

**A M E N D M E N T 5A**

**OFFERED BY:** Senator Fred Dyson

Subparagraph (b), lines 5 and 6:  
Delete [DEVELOP A TERM FOR THE CONTRACT T]

Insert "modify those terms of the contract relating to"

Subparagraph (c), line 4: After "equal to" insert:

Delete [EQUAL TO THE AMOUNT OF THE TAX LEVIED BY LAW.]

Insert "equal to or greater than the amount of the tax then levied by law."

CHAIR SEEKINS objected for discussion purposes. He surmised the first part of Amendment 5A would cause the beginning sentence in (b) to end as follows: "the commissioner may modify those terms of the contract relating to payments in lieu of the taxes on oil set out in AS 43.55." The second part would cause the beginning sentence of (c) to end as follows: "the amount of the payment in lieu of tax on oil under AS 43.55 must be equal to or greater than the amount of the tax then levied by law."

[4:17:49 PM](#)

SENATOR BEN STEVENS said after seeing how it fits in, he wasn't sure it would achieve what Senator Bunde had mentioned in the discussion relating to Amendment 4. This way, it would only be one-sided. He asked whether that was Senator Dyson's intention.

SENATOR DYSON responded yes, but indicated he'd understood Senator Ben Stevens to say that after the time in (b), the legislature could change the tax laws. As he understood this amendment, inserting "then" indicates it would be whatever the law had become at that point. It allows the legislature to adopt a tax rate up or down, but doesn't give the commissioner discretion to have the PILT be lower than what the legislature, in its wisdom, has decided. Senator Dyson indicated that was his intention.

[4:19:39 PM](#)

SENATOR GREEN asked whether this is designed so the commissioner would develop a contract term and subsequently it would come to the legislature for approval. She then asked whether this is designed to be only a one-way street, that only the state would have to receive more, as she read the proposed amendment.

SENATOR DYSON reiterated his understanding of what Senator Ben Stevens had said, that after the (b) portion of the contract period is over, in the period of capital-cost recovery and so forth, then the legislature is free to adjust oil taxes up or down. This wording change would only say that the commissioner could not modify the PILT below what the legislature had, by its actions, put in place. In further response, he said the

commissioner could only go up or down in putting in place a payment in lieu of taxes. So whatever was in statute, or that the legislature decided, would be the basis on which the commissioner could exercise discretion in applying a PILT.

4:21:34 PM

SENATOR BUNDE expressed concern about letting the commissioner raise taxes, but not lower them.

SENATOR DYSON answered that the constitutional role of imposing taxes is within the legislature's purview. When getting into this business of authorizing a payment in lieu of taxes, however, it authorizes the commissioner, in this contract, to have a PILT, but not to ignore what the legislature has done in statute.

SENATOR BUNDE replied, "Unless you raise them; then you can ignore it."

SENATOR DYSON responded, "Well, sure. And we would trust that he would be doing that for good public purposes and so on."

SENATOR BUNDE said he'd trust the commissioner would lower them for good public purposes as well.

SENATOR DYSON replied, "And then I don't believe that we want to give away that constitutional mandate that establishing taxes is our purview."

SENATOR BUNDE responded, "Raising it is giving away our right. I don't see how that's any different than lowering."

SENATOR DYSON said he didn't see it as giving it away. If the administration wants a surcharge, it would still be subject to contract negotiations. Furthermore, with Amendment 4 the commissioner can put in changes to other parts of the agreement to bring it back to "the net that's not a substantial modification to what was in place before."

4:23:44 PM

SENATOR BEN STEVENS, in response to Chair Seekins, interpreted the second part of Amendment 5A to say the commissioner can modify the PILT, not the taxes, and could only change the PILT to be a greater amount. He asked whether that is correct.

SENATOR DYSON affirmed that as his understanding.

SENATOR GREEN asked how that differs from surrendering the right of the legislature. She also asked whether this is how it's done currently.

SENATOR BEN STEVENS, in response to Senator Green and Chair Seekins, alluded to (c) of Amendment 4. He clarified that this amendment is confined to the PILT as determined on oil, not gas. He surmised Senator Dyson's intention was to maintain that, so the PILT on oil couldn't be adjusted downward from the amount due under the calculation under the oil tax.

[4:26:29 PM](#)

SENATOR HOFFMAN said it must be equal under the existing language.

CHAIR SEEKINS asked how something can be taken in lieu of something that isn't due.

SENATOR BEN STEVENS suggested that may be an issue for dispute resolution.

CHAIR SEEKINS observed that, in effect, there would be a PILT greater than the taxes due; it would equate to a tax increase.

SENATOR DYSON responded, "We are willing to give this one up."

[4:27:34 PM](#)

SENATOR BEN STEVENS moved to amend Amendment 5A by deleting the second portion, relating to (c). There being no objection, it was so ordered.

[4:27:58 PM](#)

CHAIR SEEKINS asked whether there was any objection to adopting Amendment 5A as amended. There being no objection, it was so ordered.

[4:28:15 PM](#)

SENATOR DYSON moved to adopt Amendment 5B to SB 2004. With original language and punctuation, as well as line numbers relating to the previous day's Amendment 4, it read:

**A M E N D M E N T 5B**

**OFFERED BY:** Senator Fred Dyson

Subparagraph (c), lines 4 through 9: Replace last sentence with the following:

"In the event taxes levied by law have changed, and remain in effect, in excess of three percentage points from those taxes in effect at the end of the period described in (b) of this section, the commissioner may develop contract provisions for payment in lieu of tax equivalent to the taxes in effect at the end of the period described in (b) of this section."

SENATOR DYSON objected for discussion purposes. Noting this adds a definition to "material change", he said Senator Ben Stevens told him during the recess that "we didn't quite get it done because we were talking about the tax rate, not the effective tax rate." He indicated the effective state government take needs to be defined as being in excess of 3 percent, but asked Senator Ben Stevens whether that was right.

SENATOR BEN STEVENS said he believed the issues revolve around the definition of materiality and what is a material change. There are two issues: the material change in revenues and the material change in the government take or distribution of economic rent.

SENATOR DYSON concurred.

SENATOR BEN STEVENS highlighted the need for deliberation. He said the intent of the original amendment was to say a material change as defined by GAAP or FASB, which he interpreted to be a plus-or-minus-3-percent change on revenues. After giving it more thought, however, that wouldn't trigger a distribution change in the economic rents. He suggested Senator Dyson had pointed out a deficiency because of the lack of definition, saying "we need to have a material change in distribution of economic rents, which would be plus or minus 3 percent." Senator Ben Stevens said the question in his mind, though, is whether to apply that to revenue or to the percentage of government take. He suggested that a 1 percent change in government take would be a material change in funds or revenue. He urged caution.

[4:31:34 PM](#)

SENATOR DYSON asked whether Mr. Donohue or someone else had a good way to resolve this. Otherwise, he said, he'd withdraw the amendment and work on it.

MR. DONOHUE said one possible approach is to add to (c) a definition that gets at these concepts of economic rent, beginning with "For purposes of this subsection, a material

change in the taxes means ..."; however, those are sophisticated notions and would take some time to develop. Hence he suggested a simpler approach: go to the effective tax rate at the time under AS 43.55, which might be a shorthand for some of the "economic notions that you're driving at in this measure."

[4:32:58 PM](#)

SENATOR STEDMAN asked what effect a change in the federal tax rate would have, since it would affect economic rent. Would that put the state in a position of having to lower its share to achieve balance?

SENATOR BEN STEVENS answered that in developing the amendment, there wasn't consideration that a change in a tax structure over which the state has no authority would initiate a change by the commissioner; he wasn't sure whether the contract had that provision. Returning to Mr. Donohue's definition of material change, he agreed with the concept, but cautioned to use care in crafting it. He reiterated his belief that a 1 percent change in tax rate would have a material impact on project economics.

MR. DONOHUE concurred, indicating these issues should be discussed with state economists, for instance.

[4:34:54 PM](#)

SENATOR DYSON committed to work on the aforementioned with Mr. Donohue and Senator Ben Stevens if the bill wasn't moving from committee that day.

CHAIR SEEKINS set aside Amendment 5B to SB 2004.

[4:35:24 PM](#)

SENATOR DYSON moved to adopt Amendment 6 to SB 2004, labeled 24-GS2046\A.8, Bailey, 6/4/06, which read:

**A M E N D M E N T 6**

OFFERED IN THE SENATE BY SENATOR DYSON  
TO: SB 2004

Page 3, line 28, following "waiver":  
Insert "on a case-by-case basis"

Page 3, line 28, following "general":  
Insert "and the consent of the legislature"

CHAIR SEEKINS objected for discussion purposes.

SENATOR DYSON said this is to provide clarity on page 3, line 28, of the bill with regard to waivers. It also adds the consent of the legislature in the process, in addition to the attorney general.

[4:37:11 PM](#)

SENATOR GREEN asked Mr. Baldwin how it affects the arbitration and alternate dispute resolution setup if the legislature is thrown into it. Also, if waivers are done on a case-by-case basis, will the standard vary according to the person or incident?

[4:37:53 PM](#)

JIM BALDWIN, Counsel to the Office of the Attorney General, Department of Law, surmised this to be in reaction to "our testimony the other day" that said the waiver would be effected on a one-time basis only, when the attorney general signs the agreement. He also surmised that with "case-by-case basis" this intends that each time there is an intent to waive sovereign immunity for a specific action, it would need to be a separate waiver.

CHAIR SEEKINS recalled that the discussion had included whether this allowed the attorney general to negotiate into the contract a blanket ability to use arbitration as an alternate dispute resolution process. He asked whether that was what Mr. Baldwin was saying here, that this amendment would change it to be on a case-by-case basis and to require legislative approval to do so.

MR. BALDWIN affirmed that and elaborated:

What we're intending to do here, really, is to obtain the legislature's consent on a one-time basis to be able to agree ... to waive the sovereign immunity. And so what this would do, as I read it, would be to say that we cannot do it on a one-time basis, and that if we're going to do it, we have to go back to the legislature each time to obtain the legislature's consent, ... which really kind of leaves us where we are today, which is, we can't waive sovereign immunity unless we have specific authority from the legislature to do it. So this is really leaving us where we are today, basically, I think. And I'm not sure that's what the maker of the amendment is intending, but that's how I'm reading it.

[4:40:04 PM](#)

SENATOR GREEN asked whether inserting the legislature into the process creates a separation-of-powers issue.

MR. BALDWIN answered, "When we need to or want to waive our immunity as a state, we have to get authority from the legislature to do that."

SENATOR GREEN requested confirmation that this happens currently.

MR. BALDWIN replied:

We currently must do that, particularly in dealing in federal court, if we're going to subject ourselves to the jurisdiction of the federal court. And the way we're acting here is, we believe we need to do a similar thing in order to subject ourselves to jurisdiction of ... another state's court. So ... we're asking for this statutory authority so that we can agree to that.

And so that's why I'm saying I think it leaves us kind of where we are today, without this authority. ... We wouldn't be gaining much ... if Senator Dyson's amendment were to be accepted. I'm not sure that's what he intends, but ... I'm starting to assume maybe that is what he intends.

[4:41:30 PM](#)

SENATOR DYSON indicated the drafters in Legislative Legal Services had alerted him to a potential separation-of-powers issue on this.

CHAIR SEEKINS related his understanding that the intent of the waiver of sovereign immunity is basically to put the state on an equal footing with the other partners, the producers. If the state is going to act as a partner in an organization, it needs to act as if it were a corporation, rather than a sovereign state. Otherwise, the state could sue the producers without their permission, but the producers couldn't sue the state without its permission. He asked whether that is correct.

MR. BALDWIN said the partners are not on an equal footing with the state, which as a sovereign entity can avoid suit in distant jurisdictions. In order to equalize their remedies - from their viewpoint - the producers are asking that the state's ability to

agree to a waiver of sovereign immunity be incorporated into the Stranded Gas Act.

CHAIR SEEKINS asked whether there is a blanket waiver under contract for sovereign immunity.

MR. BALDWIN answered that AS 09.50 says that under certain circumstances, for actions in tort or contract, the state consents to be sued as a general matter.

CHAIR SEEKINS suggested that is basically what is being said here, that in terms of enforcement of this contract, the state is allowing the other parties to sue the state as if it were a corporation, rather than a state.

MR. BALDWIN replied it adds the element of "in distant jurisdictions." The consent referred to in Title 9 is in the state courts.

CHAIR SEEKINS surmised this lowers the state's position, so to speak, to be on an equal basis with the other parties, as is done already in contract or tort.

MR. BALDWIN responded, "Yes, in our jurisdiction." He said the legislature has made that policy decision, and it's up to the legislature to make the further policy decision as to "what we would do in district courts."

SENATOR DYSON withdrew Amendment 6 to SB 2004.

[4:45:15 PM](#)

SENATOR DYSON moved to adopt Amendment 7 to SB 2004, labeled 24-GS2046\A.9, Bailey, 6/3/06, which read:

**A M E N D M E N T 7**

OFFERED IN THE SENATE

BY SENATOR DYSON

TO: SB 2004

Page 3, line 31:

Delete "state"

Insert "project"

CHAIR SEEKINS objected for discussion purposes.

SENATOR DYSON offered his belief that this clarifies what was understood from the previous day's discussion.

MR. DONOHUE opined it would be incorrect to substitute the concept of "project" for the concept of "state" in this amendment and in Section 4 of the bill. He explained:

We are talking about allowing the producers, in a dispute, to pursue the state in other jurisdictions, but it's limited to jurisdictions ... where the state is doing business or otherwise has assets or what have you. So that state court has to have jurisdiction over the State of Alaska. If that fact exists, then the state is ... waiving sovereign immunity pursuant to this provision. So I believe, if I understand the concern, maybe the amendment would be "that has jurisdiction over the State of Alaska."

SENATOR DYSON said those were words he'd penciled in during yesterday's discussion. He asked Mr. Donohue to explain, under the federal constitution, how any other state has jurisdiction over the State of Alaska.

[4:48:45 PM](#)

MR. DONOHUE replied the issue may arise when states engage in a proprietary activity in other states. For example, the Alaska Marine Highway System uses facilities and wharves in Washington State that are owned or leased by the State of Alaska. There could be accidents and so forth, and those issues probably would be resolved initially in Washington State. Thus the sovereign immunity of the State of Alaska does not automatically translate into sovereign immunity in another jurisdiction when the state is acting in a proprietary capacity.

[4:49:42 PM](#)

CHAIR SEEKINS asked whether it made sense to say "over the State of Alaska related to this project".

SENATOR DYSON proposed "or a portion of this project that is happening" or something that is related to this project.

CHAIR SEEKINS asked about "on matters related to this project".

MR. DONOHUE replied the jurisdiction that this section tries to clarify arises when there is an enforcement action against the State of Alaska that hasn't been satisfied by either the recoupment provisions in Article 22 of the fiscal contract or by an appropriation from the state legislature. So it wouldn't

necessarily be project assets or jurisdiction related to this project itself.

CHAIR SEEKINS asked about "or to the contract" or "matters related to ... the fiscal contract". He surmised Senator Dyson was saying it's only when there is jurisdiction over the state in matters related to this particular project or contract.

MR. DONOHUE replied by giving the example that if the State of Alaska were engaged in an enforcement action to collect a significant amount of revenues from the producers, and for whatever reason the producers' assets in the state were insufficient to satisfy the judgment entered after arbitration, the State of Alaska would be pursuing the producers in other states such as Texas or Colorado; those assets may or may not have anything to do with the project. Thus the producers here are seeking reciprocal rights, essentially.

SENATOR DYSON said this is what he was trying to get at, because he'd thought of what the State of Alaska might be pursuing in other states. For example, a module might be built in Louisiana, or the organization from which the state sought a remedy might have a bank account in Massachusetts. He said it would be a place where some of the assets related to this project reside when the state seeks a remedy.

[4:52:03 PM](#)

MR. DONOHUE pointed out that someone engaging in an enforcement activity would be looking for highly liquid assets, and probably not going after assets that are under construction and related to this project.

CHAIR SEEKINS asked whether an enforcement action would be filed for collection of a judgment wherever the money was; for example, the state may have money in a Boston bank. He asked whether that is a common practice among states.

MR. DONOHUE replied it is a common practice among private parties pursuing each other when there is an unpaid judgment. It is relatively uncommon, however, for a state to waive sovereign immunity to allow itself to be sued in other jurisdictions. But this is a very uncommon and historic fiscal contract under consideration, he noted, and so the state and the producers have incorporated this provision to create more equal footing.

SENATOR DYSON announced he was now convinced that the language in the bill was probably okay.

[4:54:11 PM](#)

SENATOR DYSON moved to amend Amendment 7, leaving "state" and inserting "of Alaska" following that. Thus it would clarify which state it is talking about, especially for lay readers. There being no objection, it was so ordered.

[4:54:57 PM](#)

SENATOR GREEN referred to the top of page 4, line 2, of the bill. He asked Mr. Donohue whether that refers to any state in which the litigation occurs or refers to the State of Alaska.

MR. DONOHUE answered it is only after the initial arbitration award is entered in superior court; there is an enforcement action sought in Alaska Superior Court.

CHAIR SEEKINS said he hadn't read it that way. He asked whether it is an arbitration award and they would have tried to collect in the Alaska Superior Court.

MR. DONOHUE affirmed that.

CHAIR SEEKINS first proposed saying "of Alaska", but then said it was all right with him either way.

[4:55:58 PM](#)

CHAIR SEEKINS removed his objection and asked whether there was any further objection to adopting Amendment 7 to SB 2004 as amended. There being no objection, it was so ordered.

SENATOR ELTON requested that Mr. Donohue confirm his understanding: If there is an arbitration award and the state doesn't pay, a private partner first must go to Alaska Superior Court; if the court doesn't agree and enforce the arbitration award, the partner can then go to another state. He asked what happens if the Alaska Superior Court enters an enforcement order, but the legislature refuses to appropriate the funds. Could the partner still go to another state to seek relief?

[4:57:01 PM](#)

MR. DONOHUE answered there are two categories of arbitration awards within the fiscal contract. One is for a class of indemnification-type obligations, which are limited to enforcement in Alaska, seeking appropriations from the state legislature; he mentioned the recoupment and offset provisions

in Article 22 of the fiscal contract. Other types of arbitration awards, relating to other issues and obligations of the state within the contract, would then go through this process and would go to the state legislature for an appropriation; without an appropriation, they would be authorized to seek enforcement in other states.

He noted Article 26 also provides that if, for some reason, the superior court didn't act to confirm an arbitration award of this other category of obligations that don't relate to the indemnification provisions under the contract, then they would be free to pursue state assets and enforce the judgment in other states. Mr. Donohue said this is unlikely, however, because once an arbitration award has been decided, it's usually an administrative act for the court to enter and confirm that award and enter judgment.

[4:59:06 PM](#)

SENATOR WAGONER asked how this applies to the limited liability companies (LLCs) that will be created. Would it be the same application even if the LLC was registered in Delaware, or would the Delaware court take precedence over the Alaska court?

MR. DONOHUE offered his understanding that these provisions relate only to the fiscal contract terms; they don't necessarily dictate what will happen under the LLC agreement. The LLC being negotiated has mandatory arbitration requirements; those obligations and disputes would be resolved under Delaware law.

SENATOR OLSON asked: If there is a pipeline to Chicago and there are sales agreements or gas reserves in some other states, are those counted as assets that allow the State of Alaska to be sued there?

MR. DONOHUE replied, generally speaking, that is correct if the state is doing business. He noted the state would be doing business through LLCs; generally, the asset to be pursued would be the state's ownership interest in the LLC, but "on the sales side" there could be assets available as well.

SENATOR OLSON asked: Anywhere we're selling gas, that jurisdiction prevails?

MR. DONOHUE answered that the rules of that jurisdiction can vary by state. One reason the contract calls for a waiver of sovereign immunity is to make it more certain that the state

cannot assert sovereign immunity, in these other jurisdictions, as a defense against a judgment in an enforcement action.

[5:02:18 PM](#)

CHAIR SEEKINS again asked whether there was any objection to adopting Amendment 7 to SB 2004 as amended. There being no objection, it was so ordered.

[5:02:41 PM](#)

SENATOR DYSON moved to adopt Amendment 8 to SB 2004, labeled 24-GS2046\A.10, Bailey, 6/3/06, which read:

**A M E N D M E N T 8**

OFFERED IN THE SENATE BY SENATOR DYSON  
TO: SB 2004

Page 9, line 14, following "section.":

Insert "Before making a final determination of the grants to be awarded, the commissioner shall submit recommendations for annual grant allocations to the Legislative Budget and Audit Committee for approval. The Legislative Budget and Audit Committee shall approve or modify the commissioner's recommendations within 10 days after receipt from the commissioner. If the Legislative Budget and Audit Committee does not respond to the commissioner within 10 days, the commissioner may proceed with grant payments as recommended."

SENATOR DYSON objected for discussion purposes. Recalling that yesterday Senator Wilken had expressed concern about the ability of the Department of Commerce, Community and Economic Development (DCCED) to award grants without oversight, Senator Dyson said it seemed that could be improved upon. Notice to the legislature wouldn't be given until the first 10 days of the regular session, which occurs after the fact. Thus this amendment requires the department to solicit the approval of the Legislative Budget and Audit Committee for these grants, inserting the legislature into the approval process. He noted Legislative Legal Services had suggested this may raise a separation-of-powers issue.

CHAIR SEEKINS asked Mr. Baldwin to respond. He also noted the Department of Revenue (DOR) wished to comment on Amendment 10, but Steve Porter wasn't available.

MR. BALDWIN agreed this raises separation-of-powers issues in that it would have a legislative committee executing the law by being able to declare who were the approved grantees under this program. It would not be the legislature itself, the 60 members; rather, the committee would be attempting to act in a lawmaking capacity, if it could be characterized as such. While saying he could understand why the legislature would like to have that oversight role for the grant-making process, Mr. Baldwin opined that it is a rather severe legal problem.

[5:05:56 PM](#)

SENATOR WILKEN welcomed what Senator Dyson was trying to do with the added scrutiny, but recognized the separation-of-powers problem. He asked Mr. Baldwin: If this grant process goes off track and the legislature gets the report in the first 10 days, couldn't the legislature affect the grant process through the budgeting process each year?

MR. BALDWIN answered that as it's set up, the money is appropriated into the fund - as almost all grant programs are - in advance of the fiscal year. The legislature has exceedingly broad powers, the "power of the purse," to deal with agencies that aren't administering funds in the appropriate way; the powers of oversight and audit are potent legislative powers that the agencies are mindful of and responsive to.

He surmised, however, that the suggestion was the ability to go in and amend those grants after they are made. Mr. Baldwin said it depends on how those grants are being administered by the agencies. Altering the grant through the capital-budget process might be possible if the money isn't fully expended; otherwise, options are somewhat limited. Generally, though, this department doesn't just disburse the whole amount, but will disburse a percentage and then pay on invoices, on a rolling basis. Thus the money wouldn't be all out the door, and the legislature could exercise its power of appropriation in the way Senator Wilken had suggested. Mr. Baldwin characterized it as a blunt instrument, but one that's available.

[5:08:30 PM](#)

SENATOR DYSON withdrew Amendment 8 to SB 2004.

[5:09:00 PM](#)

SENATOR HOFFMAN moved to adopt Amendment 9 to SB 2004, labeled 24-GS2046\A.7, Bailey, 6/4/06, which read:

**A M E N D M E N T 9**

OFFERED IN THE SENATE

TO: SB 2004

Page 3, line 26:

Delete "a new subsection"

Insert "new subsections"

Page 4, following line 2:

Insert a new subsection to read:

"(c) The commissioner shall include in any contract developed under this chapter gas pipeline "rolled in" expansion pricing to provide for expansion of the pipeline that encourages further gas exploration."

CHAIR SEEKINS objected for discussion purposes.

SENATOR HOFFMAN requested that a related two-page handout be distributed. He then indicated Amendment 9 would add the following requirement under Section 3 of the bill, which amends the "Contract development" section of the Stranded Gas Act: the commissioner shall include a "rolled-in" expansion to provide for expansion of the pipeline, which encourages further gas exploration. He offered his understanding that this language doesn't presently exist in the Stranded Gas Act.

He referred to the page of his handout labeled "Quotes from the FERC (The Federal Energy Regulatory Commission) Briefing Paper Nov. 9 2004." Calling it the most telling from that sheet, Senator Hoffman read from the last paragraph, which stated:

Under incremental pricing there will almost certainly be no competition after the less expensive capacity goes into service. Expansion, priced incrementally, will virtually preclude new exploration programs by companies other than the preexisting holders of pipeline capacity.

He noted the other page explains the difference between incremental pricing and rolled-in pricing.

[5:11:16 PM](#)

SENATOR BUNDE said this is focused on "independents" finding more gas. He asked whether it would also apply to consumers, or whether a provision already does that. For example, would the people of Fairbanks be subject to rolled-in pricing if the

people of Valdez wanted a spur line, and thus the Fairbanks residents would help pay for it?

SENATOR HOFFMAN said he didn't believe that would be the case, but deferred to an expert to answer.

SENATOR WILKEN suggested the answer was provided yesterday, when it was said that all gas sales have to be commercial gas sales, which would indicate they're sold at market value.

CHAIR SEEKINS noted the discussion often arises with regard to the North Pole refinery.

SENATOR GREEN recalled discussion at Centennial Hall that spur lines and offshoot lines would be a totally different network, under the Regulatory Commission of Alaska (RCA), whereas the others are under FERC.

CHAIR SEEKINS asked whether anyone could comment on whether rolled-in pricing would have a positive or negative effect.

[5:13:17 PM](#)

SENATOR BUNDE said he'd like to state for the record that this would apply only to producers, not to consumers.

CHAIR SEEKINS said that was his understanding, but asked whether it was correct.

SENATOR STEDMAN related his understanding that this amendment precludes FERC from allowing an incremental-pricing scenario, and that "all expansions would then go into the rolled-in, so ... we'd be controlling FERC's action." He also asked whether FERC normally tries to do rolled-in pricing to keep competition in the marketplace.

SENATOR HOFFMAN said he didn't know.

SENATOR BEN STEVENS opined that the tariffs and authority to demand the rolled-in or incremental pricing lie not with the state's commissioner, but with FERC; it is an interstate commerce project, and the state doesn't have jurisdiction. While respecting the Senator Hoffman's attempt, he suggested the need to find out the answer.

SENATOR WAGONER pointed out that Mr. Shepler, a FERC attorney with 30 years' experience, was in town. Noting he himself had

an amendment, Senator Wagoner expressed hope that Mr. Shepler would be available for that as well.

The committee took an at-ease from [5:16:08 PM](#) to [5:26:31 PM](#).

DONALD SHEPLER, Greenberg Traurig, LLP, Consultant to the Legislature, introduced himself.

SENATOR STEDMAN explained that the question goes to rolled-in pricing versus incremental pricing and the relative roles of FERC and the state. Specifically, can FERC's decision be preempted legislatively by requiring that FERC use rolled-in pricing instead of incremental pricing? And when FERC looks at situations similar to what Alaska is facing, does it normally include either rolled-in pricing or incremental pricing as a preferred alternative?

MR. SHEPLER answered that, first, the state probably couldn't dictate to FERC how to require pipeline expansion to be priced. However, FERC has said, in its order following the 2004 federal legislation, that it would establish a rebuttable presumption in favor of any expansion of the Alaskan pipeline being priced on a rolled-in basis, which is a departure from the policy FERC has applied in pipeline cases in the Lower 48. Up until the mid-1990s, to his recollection, FERC's policy was that it would approve rolled-in pricing for an expansion if it caused a rate increase of less than 5 percent to existing shippers.

He surmised members were familiar with the concept of rolled-in pricing. Mr. Shepler said in the mid-1990s or so, FERC reassessed its policy if circumstances included one pipeline company competing against another to serve a particular market or to expand a pipeline to attach to new market areas. To promote a level playing field, current FERC policy for Lower 48 pipelines is that any pipeline expansion which will result in a rate increase to an existing shipper has to be priced on an incremental basis.

He noted, however, that in Order 2005 FERC made a 180-degree change: in the context of the unique circumstances, FERC ruled that the presumption going forward for an Alaskan pipeline - regardless of whether there was an increase to existing shippers' rates - would still be in favor of rolling in the cost of an expansion, on the theory that, at some point, the expansions would get incrementally so expensive that they wouldn't be economic and thus wouldn't take place. Mr. Shepler said the increase that an existing shipper would bear in the

context of rolled-in pricing would be some unknown rate impact, but certainly the increase to the existing shipper would be much less than if the new shipper had to pay an incremental rate, which may be two times what the existing shipper was paying. In response to Senator Ben Stevens, Mr. Shepler noted he'd just been given a copy of Amendment 9.

5:33:02 PM

SENATOR BEN STEVENS referred to line 7 of Amendment 9, the beginning of proposed subsection (c). He asked whether the DOR commissioner has the power to mandate rolled-in pricing in this project.

MR. SHEPLER answered he thinks so, if it's put into the contract.

SENATOR BEN STEVENS countered with his understanding, under rolled-in pricing, that the rates are determined by FERC.

MR. SHEPLER agreed, but said they're determined based on filings and applications made by the pipeline company, which has to propose a rate either under rolled-in or incremental treatment; FERC then disposes of it. He said as he read what he'd just been handed, the contract for the gas pipeline would require the pipeline company to file for rolled-in treatment; as to whether FERC would approve it, however, he agreed it wasn't certain.

SENATOR BEN STEVENS said that wasn't how he read it. He suggested the need to perhaps modify the amendment so it states what Mr. Shepler said, that the intention is to say "the contract shall include rolled-in pricing in applications for rate-setting methodology at FERC."

CHAIR SEEKINS interpreted the foregoing to be that the contract requires the parties to agree to apply for rolled-in pricing on expansion.

SENATOR BEN STEVENS concurred. He offered his understanding that FERC has the authority to tell the participants in a ratemaking case what they believe should happen when they adjudicate the tariffs, whether or not there is an application for rolled-in pricing or for incremental pricing.

MR. SHEPLER agreed. At the same time, however - as he believed Mr. Loeffler had explained previously - in the gas pipeline context the applicant goes to FERC and makes an application for a certificate, including the tariff and all supporting

materials; FERC makes a decision and issues an order, and requires some sort of rate treatment; and then the applicant can accept or reject that certificate. Thus while FERC would make a ruling regardless of what the applicant proposed, the pipeline company could accept or reject it.

SENATOR BEN STEVENS asked: If the legislature mandates rolled-in pricing must be in the contract, and if FERC then determines otherwise, is the contract in violation and thus there would be no contract? He said he doesn't want to set up a trapdoor that jettisons the contract based on a decision by FERC.

MR. SHEPLER replied he didn't have an answer. Returning to what Chair Seekins had said, Mr. Shepler opined that if the amendment were to have the effect of obligating the pipeline company to file for and support rolled-in pricing, that would probably be as far as the State of Alaska could go; the ball would then be in the commission's court to adjudicate that filing and either accept the rolled-in pricing or not.

[5:38:19 PM](#)

SENATOR BUNDE asked whether FERC would tend to accept or reject certain portions of a contract or the whole contract.

MR. SHEPLER replied the contract itself wouldn't go to FERC, to his understanding; rather, it would be an application for a certificate, containing the company's proposal. Frequently, or almost universally in pipeline certificate cases, FERC grants approval contingent on attached conditions. At that point, the company can decide whether to accept those conditions.

CHAIR SEEKINS surmised the contract would have a severability clause so the whole contract wouldn't be voided.

[5:40:08 PM](#)

SENATOR STEDMAN recalled that FERC had looked at the cost of this proposed pipeline and challenged that the smaller firms could come in and use a portion at some future date; incremental pricing would put them at a disadvantage because of the magnitude of this project, whereas rolled-in pricing would be preferable from their perspective.

MR. SHEPLER said he believed that was right; it was the rationale, at least, presented to FERC as to why rolled-in pricing was a necessary condition for this pipeline to be expanded at some point. Although there may be one or two expansions where rolled-in pricing wouldn't matter to the new

shippers, at some point they'd face paying for the expensive looping expansions, which would be cost-prohibitive because they'd be paying far more than the existing shippers. Either everyone, including the existing shippers, would have to pay a dime more or else the incremental shipper may have to pay a dollar more; that's the problem FERC, with its presumption, is trying to avoid.

SENATOR STEDMAN posed a situation in which smaller players want to expand the pipeline and FERC wants rolled-in pricing as a policy, but the four pipeline owners want incremental pricing. He asked whether those four could be forced by FERC to do rolled-in pricing.

MR. SHEPLER answered they always have the power to reject the certificate. If they filed for and tried to pursue incremental pricing, and if FERC approved the application except for saying they must do rolled-in pricing, then the pipeline company - the producers and the state - would have to decide whether to accept that certificate; if they chose not to, then that expansion couldn't be built.

[5:43:24 PM](#)

SENATOR HOFFMAN spoke for Amendment 9. He pointed out the dilemma because included are provisions for credits for oil companies to explore. There is a desire to extend use of the gas pipeline for 30-50 years, but if the explorers can't get into the line, then the life of the contract won't be stretched out. He again read from his handout on FERC, which stated:

Under incremental pricing there will almost certainly be no competition after the less expensive capacity goes into service. Expansion, priced incrementally, will virtually preclude new exploration programs by companies other than the preexisting holders of pipeline capacity.

He remarked that this is the crux of the problem, and asked why that door should be left open. Instead, he said, it seems the rolled-in basis should be required in order to fulfill the original intention: to stretch this out and have new explorers. To accomplish that, he suggested, this amendment must pass. Otherwise, it defeats the purpose of offering all the credits in the first place.

[5:45:07 PM](#)

SENATOR BUNDE suggested the amendment could be passed as an expression of interest or will. He said, however, that he'd understood Mr. Shepler to say the decision would be made by FERC. Thus he questioned whether it would accomplish much.

MR. SHEPLER first offered the following clarification for Senator Hoffman:

The pipeline applicant has to file a proposal. They have to propose ... and pursue and defend a rate structure as part of their certificate application. So if the contract obligates the pipeline company to file on a particular basis, in this case, rolled-in, then the pipeline company would have to file on that basis. ... In the absence of such a requirement, the pipeline company would presumably be free to file on whatever basis it thought made sense at the time, which might or might not be rolled-in. But the pipeline company has the obligation in the first instance to make a proposal.

He then opined, in response to Senator Bunde, that putting into the contract what the pipeline company has to file at FERC is significant, because the pipeline company has the burden initially to propose something.

SENATOR BUNDE replied that even if the company didn't request a rolled-in basis, however, FERC could ask for it, if it believed it was in everyone's best interest - regardless of whether the pipeline company had applied for it.

MR. SHEPLER agreed, but noted the pipeline company would decide then whether to accept the certificate with that condition.

[5:48:11 PM](#)

SENATOR ELTON spoke in support of Amendment 9. He recalled that Mr. Shepler's memo said rolled-in pricing is crucial for two reasons: it provides for expansion, and it is the best way for the state to commercialize its resource. He further recalled Mr. Shepler had noted that after FERC decided to have the presumption be rolled-in pricing for expansion, some of the private partners in the proposed contract argued against that presumption, and continue to argue against it.

He said he is comfortable inserting this in the contract because rolled-in pricing, which aids in expansion and commercializing the resource, should be something the state gets in return for

the tax and royalty concessions in the contract in other places. It makes sense that the state would want this option to have the request for expansion include rolled-in pricing; perhaps, he suggested, the only way to get it is through the contract, since the state will be a minority partner in the mainline entity.

SENATOR DYSON said he appreciated those remarks. He noted that the independents, which he surmised will be the future of exploration in Alaska, feel strongly about rolled-in pricing.

BOB LOEFFLER, Morrison & Foerster, Counsel to the Governor, began by voicing general agreement with what Mr. Shepler had said. First, he emphasized, the applicants can request rolled-in pricing, but a future FERC will do whatever it decides is in the public interest; without a federal statute, FERC cannot be forced to deliver rolled-in pricing, even if it is perhaps possible to force an application for it. Second, there is no guarantee the capacity will be given to the independents, whether rolled-in or incremental pricing is used. Capacity is put out for an open season. If a major producer bids for the capacity, it could receive it. So while rolled-in pricing can be requested, the results cannot be promised.

He said, third, the pipeline can be expanded easily from 4.3 to about 5.9 billion cubic feet (Bcf) a day; this is cheap expansion of almost 50 percent. Rolled-in pricing actually doesn't help there; it is a disadvantage to the independents because the cheap capacity is rolled in with the original capacity. Only when there is more than a roughly 50 percent increase in the project that looping happens, which is more expensive. Mr. Loeffler told members he has talked to engineers about it. It starts out more expensive, but depending on "how far out you go" may end up less expensive. Noting the picture is more complicated than people think, Mr. Loeffler said FERC has done all it could, and has established rolled-in pricing as a rebuttable presumption for the future.

He opined Amendment 9 would create a major hurdle for getting the contract through, from what he'd seen of the negotiations on expansion. Furthermore, it wouldn't provide the absolute assurance hoped for.

[5:56:07 PM](#)

MS. KING of ConocoPhillips noted Pete Frost was on teleconference. Saying she has an engineering degree but isn't a pipeline engineer, Ms. King began by emphasizing that a one-size-fits-all treatment can't be prescribed for expansions. The

large expansion being discussed is about 1 Bcf a day, but there are other types of expansions including line looping. She pointed out that this is the largest pipeline she has been exposed to, and thus line looping seems a significant feat in its own right, considering how much gas would be needed to justify it; however, she couldn't predict how much gas would be discovered.

She highlighted that first it is critical to get a fiscal contract and a pipeline project. Then multiple mechanisms exist for any explorer in Alaska wanting to deliver new volumes. These include: 1) voluntary expansion, because any shipper can approach the pipeline and request an expansion, and pipelines are motivated to expand if a party is willing to pay to ship; 2) the unprecedented federal provisions passed by FERC in the mandated-expansion provisions; and 3) in the contract, a term Ms. King suggested the legislature will want to assess, Article 8.7, to her belief, the state-initiated-expansion provision that provides another mechanism for the state to represent an explorer with respect to expansion.

She emphasized that ConocoPhillips, the largest explorer in Alaska, has a unique perspective. The company continually tries to explore and find additional gas each year to put into this pipeline. Ms. King said ConocoPhillips is comfortable that FERC will play a role in adjudicating the rates and mechanisms for expansion on this pipeline. That is FERC's role, and her company believes FERC is the appropriate adjudicator, given that this is an interstate-commerce pipeline. Stating opposition to this amendment for a number of those reasons, Ms. King reiterated that there are provisions and mechanisms for explorers to pursue and gain access to this pipeline.

PETE FROST, Director of Regulator Affairs, ConocoPhillips, added that voluntary expansions of pipelines are the result of negotiations. The pipeline and potential shippers come together long before an open season is conducted. They have discussions about the shippers' needs and the ability of the pipeline to provide that service, and the parties come together and voluntarily propose an expansion to FERC. A predetermination of any aspect of that negotiation, particularly the rate design, can create unintended consequences. For instance, some expansions are uneconomic; the negotiating parties could have an expansion imposed upon them that isn't in the best interest of either the pipeline or the shippers.

He cautioned, therefore, about imposing conditions on what is normally a voluntary process. Mr. Frost also noted there is an unprecedented opportunity here that isn't available to any other party under FERC jurisdiction in the Lower 48: if voluntary expansion and negotiation by the parties isn't successful, then the parties have the ability, under federal law, to approach FERC and require the pipeline to expand.

6:02:36 PM

SENATOR OLSON said he'd been working under the premise of encouraging more exploration. He asked why they would preclude one of the avenues with respect to rolled-in expansion, which is the essence of the amendment.

MS. KING offered her reading of the amendment, that rolled-in treatment would be required for any expansion of the pipeline. "That is something that we do not have control over," she said, noting FERC would control the rates for the pipeline.

SENATOR OLSON replied that the alternative he sees is incremental pricing, which would make it cost-prohibitive. He asked whether that is true.

MS. KING returned to her point that each expansion is different. She explained that she has seen "multiple runs of expansions" where incremental pricing would create different combinations of either increased rates or lower rates for incremental shippers. There are multiple factors - not just the rate, but also what happens to the fuel associated with an incremental expansion. In addition, she has seen rolled-in rates increase the total rate for all shippers, but also where they might decrease the rate for all. It depends on what the actual expansion is.

She gave her understanding: The pipeline would propose treatment for a specific expansion proposed by an "expansion shipper," and then FERC would look at that in relation to the particular rules it has already outlined in Order 2005, with a rebuttable presumption of rolled-in rates. Thus she suggested protections already exist within Order 2005 to let FERC decide the appropriate rate for each particular expansion as it comes forward over the next 50 years.

6:06:30 PM

MR. SHEPLER agreed that FERC decides, but emphasized that the pipeline company first must make a proposal to FERC; then FERC would decide; and, subsequently, the pipeline company would decide whether to accept that decision. He also agreed that

expansions come in different sizes. At some point, though, incremental pricing will put new shippers at a huge disadvantage. Rolled-in pricing has the effect of creating a level playing field, he added.

SENATOR OLSON asked whether Mr. Shepler's view of Amendment 9 was positive or negative.

MR. SHEPLER said positive.

The committee took an at-ease from [6:08:32 PM](#) to [6:16:04 PM](#).

CHAIR SEEKINS noted members had all received a chart.

SENATOR BEN STEVENS recalled that this chart arrived during the week of May 10 in a packet from Mr. Loeffler. He opined it illustrates what Mr. Loeffler had labeled "cheap capacity expansion" and that the rolled-in tariff is more expensive. Mentioning "the difference between 4.5 and 5.9," he said he believed he'd heard the original line in the contract is at 4.3, not 4.5. He asked Ms. King whether that's correct.

CHAIR SEEKINS noted Mr. Loeffler used 4.3 in his testimony today.

MS. KING explained there are slightly different numbers because sometimes people talk about what goes into the gas treatment plant (GTP) versus what comes out of it; there are assumptions too. "In our actual Stranded Gas Act application, we just used approximately 4 Bcf," she added. "But that's usually the distinction between 4.5 and 4.3."

SENATOR BEN STEVENS thanked Ms. King for the clarification. He made the point that the difference between 5.9 and 4.3 is 37 percent. He indicated he'd distributed the information from Mr. Loeffler as a reminder of what federal law mandates, and to outline what was mentioned in the state-initiated expansion, as well as to highlight what is in Article 8.7.

[6:19:03 PM](#)

SENATOR WILKEN recalled the aforementioned chart from the Centennial Hall presentations. He expressed concern that a 4.5 Bcf system could be put into place today, followed by a 37 percent increase in capacity, "cheap incremental." However, at 5.9 Bcf there would be a major leap for anyone trying to gain access to the pipeline.

He pointed out today a big impediment on the North Slope is the inability to get into the Trans-Alaska Pipeline System (TAPS); of the three oil producers, one is actively exploring, discovering and producing, but one is doing nothing but harvesting. With respect to a gas line, Senator Wilken voiced concern that the cheap expansion would be done by the three producers, and that 10-15 years after first gas there would be a similar situation: three producers of gas, but no incentive for companies such as Anadarko to explore for gas because it would be too expensive. Therefore, Senator Wilken spoke in favor of at least sending to FERC an expression of support for rolled-in rates along with applications for expansion.

SENATOR HOFFMAN withdrew Amendment 9, given the testimony that it would pose a major hurdle in building the gas pipeline. He indicated he'd requested that Legislative Legal Services draft two similar amendments, one saying "shall" and the other being permissive.

[6:22:19 PM](#)

SENATOR HOFFMAN moved to adopt Amendment 12 to SB 2004, labeled 24-GS2046\A.14, Bailey, 6/4/06, which read:

**A M E N D M E N T 12**

OFFERED IN THE SENATE  
TO: SB 2004

Page 1, line 12, following "state":  
Insert ", including gas pipeline pricing that encourages further gas exploration"

He explained that Amendment 12 has permissive language on "roll-ins" and goes in the purposes section of the bill.

SENATOR WILKEN referred to his notes from 5/21/06 indicating Mr. Shepler had said there was one item pending in a FERC decision, on expansion due to a new discovery. He asked whether that relates to this.

MR. SHEPLER said he didn't recall it. There is a pending producer appeal of a requirement FERC set forth in its order with respect to evaluating the initial pipeline sizing. If they found it hadn't been sized optimally to facilitate expansion, they reserved the right to order a design change.

CHAIR SEEKINS asked if Amendment 12 is talking about tariff pricing.

SENATOR HOFFMAN reiterated that he'd asked the drafters for two amendments: one that required rolled-in pricing, and one that had it as a preference.

[6:24:35 PM](#)

CHAIR SEEKINS asked whether there was any objection to adopting Amendment 12 to SB 2004. There being no objection, it was so ordered.

The committee took an at-ease from [6:25:19 PM](#) to [6:29:33 PM](#).

CHAIR SEEKINS informed members another amendment was being broken into individual segments for tomorrow, and there would be further amendments as well. He announced he would recess the meeting until 7 a.m. and the regularly scheduled meeting would occur at 9 a.m.

SENATOR WILKEN pointed out Mr. Harper and Mr. Shepler were in town for a few days. He asked, since 12 of the 20 Senators are members, whether this committee could be used as a forum for discussion.

CHAIR SEEKINS requested that members speak with him about this. He held SB 2003 and SB 2004 over.

CHAIR SEEKINS recessed the Senate Special Committee on Natural Gas Development meeting at [6:31:16 PM](#).