ALASKA STATE LEGISLATURE
SENATE SPECIAL COMMITTEE ON NATURAL GAS DEVELOPMENT
June 6, 2006
9:15 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Senator Lyda Green

OTHER LEGISLATORS PRESENT

Senator Gary Stevens
Senator Gene Therriault
Senator Hollis French
Senator Charlie Huggins
Representative Beth Kerttula
Representative John Coghill
Representative Les Gara
Representative Carl Gatto
Representative David Guttenberg
Representative Jay Ramras
Representative Mike Kelly
Representative Paul Seaton
Representative Harry Crawford
Representative Ethan Berkowitz
Representative Jim Holm

COMMITTEE CALENDAR

Roundtable Questions and Answers with Legislative Consultants:
Issues Related to Gas Development

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."

SCHEDULED BUT NOT HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

JAMES BARNES
Barnes & Cascio LLP
Consultant to the Legislature
Houston, TX
POSITION STATEMENT: Gave PowerPoint presentation

RICK HARPER
Econ One Research, Inc.
Consultant to the Legislature
Three Allen Center, Suite 2825
333 Clay Street
Houston, TX 77002
POSITION STATEMENT: Contributed to Round Table Discussion

JIM EASON, Consultant
Legislative Budget and Audit Committee
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Contributed to Round Table Discussion

KEN GRIFFIN, Deputy Commissioner
Department of Natural Resources
400 Willoughby Ave.
Juneau, AK 99801-1724
POSITION STATEMENT: Responded to questions from committee members

PHILLIP GILDAN

Greenburg Traurig, LLP
Consultant to the Legislative Budget and Audit Committee
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Contributed to Round Table Discussion

DAN DICKINSON, CPA
Consultant to the Governor
Office of the Governor
PO Box 110001
Juneau, AK 99811-0001
POSITION STATEMENT: Contributed to Round Table Discussion

ACTION NARRATIVE

CHAIR RALPH SEEKINS called the Senate Special Committee on Natural Gas Development meeting to order at 9:15:01 AM. Present at the call to order were Senators Tom Wagoner, Gary Wilken, Bert Stedman, Fred Dyson, Albert Kookesh, Kim Elton, Lyman Hoffman and Chair Ralph Seekins; Senator Donny Olson arrived soon thereafter, and Senators Con Bunde and Ben Stevens arrived as the meeting was in progress. Also in attendance were Senators Gary Stevens, Gene Therriault, Hollis French and Charlie Huggins, and Representatives Beth Kerttula, John Coghill, Carl Gatto, Les Gara, David Guttenberg, Jay Ramras, Mike Kelly, Paul Seaton, Harry Crawford, Ethan Berkowitz and Jim Holm.

Roundtable Questions and Answers with Legislative Consultants: Issues Related to Gas Development

CHAIR RALPH SEEKINS announced there would be a roundtable discussion of issues related to gas development. This would allow legislative members to talk with consultants in an open forum style. He introduced James Barnes, Jim Eason, and Rick Harper and invited them to seat themselves at the table.

9:19:21 AM
JAMES BARNES, Barnes & Cascio LLP, Legislative Budget and Audit Consultant, informed the committee that he was with the law firm Barnes & Cascio and that they represent oil and gas companies primarily in international transactions. He gave a PowerPoint presentation that focused on the May 10, 2006 draft of the contract. The presentation does not reflect the changes set forth in the May 24, 2006 draft. The SGDA serves to encourage development of stranded gas, establish new fiscal terms for new investment without affecting tax on the existing structure, tailor the new fiscal terms to the project economics, establish

new fiscal terms, and maximize the benefits to the people of the State of Alaska.

9:20:11 AM
Senator Donny Olson joined the meeting.

MR. BARNES added Alaska is unique in the regard that the tax royalty jurisdiction does provide fiscal stability while others do not and so comparisons will be against Nigeria, Angola, Azerbaijan, Kazakhstan, and Russia. His comments would reflect his experience in the international arena and how production-sharing arrangements in different countries compare.

PowerPoint Presentation

9:21:26 AM
Work Commitment – Article 5 of the fiscal contract.
The commitment as stated is to begin project planning activities within 90 days, advance project activities with diligence, and to conclude project planning activities when participants have decided whether to begin preparation of regulatory applications and planning for an open season. The project plan is not publicly available but there is a summary generated by the producers, which is available on Governor Frank Murkowski's website. It is a description of the work to be done along with a corresponding timeframe.

MR. BARNES directed the committee's attention to the timeline and aired disappointment that the work commitment ends prior to other components that are necessary to get to the point of project sanction. Collection of field data, feed studies and the EIS preparation portions are missing from the work commitment. He recollected that the fiscal interest findings indicated that the economic analysis was based on old data and that needs to be updated. Some of the things that the work program encompasses are preparing the work scope staffing plan for the next phase, selecting contractors, developing plans for access and permanent applications, and establishing commercial structure and principles to guide the project through development.

The phrase "proceed with diligence" is defined as "prudence under the circumstances." If the State feels that the participants are not meeting that standard it could terminate the fiscal contract through arbitration. There is a written presumption that the contract will continue; the State's presumption of deference is waived; the State has the burden of proof to demonstrate that the participants are not acting with diligence and that the lack of such planning has resulted in

adverse impact to the project. The State may not consider any errors in judgment, unwillingness of any participant to enter into a contract or suspension of the planning party's activities.

By comparison with Azerbaijan or other nations it is recommended that the State facilitate a firmer work commitment, as the goal is to design a work commitment so that investors are able to make an investment decision. Parties might consider inserting completion dates for things such as filing the certificate of convenience and necessity within two years so that there are independent drivers for the State to be able to prove due diligence that the parties are moving on a committed timeline.

Another possibility is that the State could endeavor to align party interests so that the benefits flowing from the fiscal contract accrue to the participants from the outset. The State might also consider postponement of vesting of the components until the project sanction decision is made. This was most likely discussed already in the negotiations and discarded but it is seen in the international contracts. The State is in a position to manage the running timeline of the project and so if a milestone is not met or extended, the fiscal contract would end.

9:32:10 AM
State participation:
The fiscal contract contemplates that an Alaska entity would own an interest in each separate project entity that stems from the main. So the State would own approximately 20 percent interest in the gas transmission lines, gas treatment plant, mainline, AK-AECO Pipeline, natural gas liquids plant and AECO-Chicago pipeline. "Ship-or-pay" commitments would be the basis for financing. The marketing arrangements are unknown as well as the Governor's agreements with the project entities.

9:34:13 AM
Unknown components:
A coordinated agreement between the project entities will be necessary. Whether or not parties use federal guarantee the financing will be based on ship-or-pay and marketing arrangements. Affiliates of the producers will handle their own ship-or-pay commitments and the State would be well advised to prepare for how it is going to handle the liabilities associated with the ship-or-pay commitment.

Financing arrangements among project and State entities are unknown and there are probably “credit-worthiness” issues so some kind of financial guarantee should be required. The regulatory process will be above the level of the project entities so coordination between parties so that they don’t cross purposes with one another is advised.

9:36:58 AM
MR. BARNES referred to a chart that reflects what is known and not known and asked committee members to refer to it. The producers and their marketing affiliates exist but the entities are unknown.

9:38:50 AM
There are too many unknowns at this point and since the State is acting like a board of directors it is standard to have transparency and accountability. They are hallmarks of what a board should expect and the SGDA requires it.

9:40:02 AM
Regulatory Regime:
There are some indications that the RCA jurisdiction may be limited in the event FERC doesn’t take jurisdiction of one or more components of the project. Under certain conditions the State must reimburse the other participants for losses due to RCA jurisdiction. The State is waiving entitlements to deference and presumption of correctness with regard to interpretation of its regulations. All leases, agreements, regulations, rules orders and decisions to contract must conform to the contract. All disputes will be resolved by either baseball or traditional arbitration. The presentation concluded.

9:42:17 AM
SENATOR Con Bunde joined the meeting.
MR. BARNES offered to answer questions.

9:43:34 AM
SENATOR GARY WILKEN asked Mr. Barnes the components under Sarbanes-Oxley.

MR. BARNES replied he is not a Sarbanes-Oxley expert but he understands that it applies to the entire structure and includes other entities.

SENATOR BERT STEDMAN asked Mr. Barnes whether he planned on updating his memo to reflect changes in the contract.

MR. BARNES replied yes.

SENATOR STEDMAN referred to page 5 and asked whether it was advisable to require hard and fast timelines for the work commitments or whether it was better to remain more flexible.

MR. BARNES suggested that the parties should spend as much time in the planning phase as possible to come up with a realistic timeline and then follow that plan. Based on the SGDA it appears that the State is offering fiscal certainty in return for getting a pipeline developed. Putting the contract in place ought to lead to the point where the parties have sufficient information to make a decision about whether to sanction the project or not. That is what the work program does under most international contracts. Four years into the project the parties would have completed the studies, done the open season, and would be at a point to make a project sanction decision. If something gets delayed, the State has the ability to change the milestones.

SENATOR GENE THERRIAULT noted that Dr. van Meurs said the contract contained the strongest work commitments language he had seen. He asked whether it wasn't true that the clock starts ticking once the title to certain acreage is acquired and so that would motivate the company to keep moving forward on the project. If there were something that caused the project to be delayed then the State could consider an extension on the timeline but the burden of proof would be on the company to prove that the project was moving forward at an acceptable rate. He asked Mr. Barnes to speak of the burden of proof in relation to the work commitment.

MR. BARNES replied the full statement of the work to be done goes beyond project sanction. He has not seen the full project plan but said he understands that in the international regime there is some description of a work obligation and corresponding financial commitment. There is a time period and it is tied with a relinquishment obligation in portions. At the end of the primary term, any portion not being held for development must be relinquished. The detailed plan has to be approved by the investors and the State so production-sharing contracts do have that mechanism, which is a significant driver. It is not much different than the present leases between the producers and the State except that those leases are all tied to oil development, not gas.

9:56:36 AM

MR. BARNES added the State should have a driver for gas development and that should be a date independent on its own.

CHAIR SEEKINS noted the committee is talking about production agreements.

MR. BARNES said he was asked to talk about international comparisons, but the fiscal contract is not being converted to a production-sharing agreement.

9:58:13 AM
CHAIR SEEKINS asked Mr. Barnes whether they were considering a production-sharing agreement.

MR. BARNES said no but the State would use some elements of the oil-type leases.

CHAIR SEEKINS asked Mr. Barnes to define "production-sharing agreement."

MR. BARNES advised it would be a brief summary and continued. It is a grant of contract right, not an ownership interest in land, such as a lease. Typically it is between a state entity and the investors. It is an undertaking by the investor and in return to risking their capital, they are entitled to a share of production. The State owns the production in the ground until the point of fiscalization or the metering point. There are three basic components; the State first takes a royalty and then the balance is split. A portion goes to the investor to recover costs. Over time the investor will draw down its cost account and then something will have to be done with the cost oil. Then there is the profit oil. The State and the producers will both take a share of it. There is an income tax levied on the producers and it varies from jurisdiction to jurisdiction.

Generally the profit share and cost recovery account are usually given to the investor on the front end to ensure rapid recovery of cost. Over time, the investor's share of profit oil decreases and the State's share increases. The investors will also have fewer costs to recover and so more cost oil will be split off into profit oil so a large portion at the back end of the project would get allocated to the State. The State can decide whether to get its share at the end and let the investors pay down on their debt more quickly.

CHAIR SEEKINS noted Alaska has a different arrangement in the lease in that if there is a property right it ends up being with the lessee.

MR. BARNES added at the point of capture the lessee must produce the oil as it moves through the system.

10:05:15 AM
CHAIR SEEKINS mentioned that Senator Wilken organized a chart based on SB 2004, which he passed on to members.

SENATOR THERRIAULT asked Mr. Barnes whether baseball arbitration was common for these types of agreements.

MR. BARNES responded baseball arbitration is applicable when an entity has to choose between two numbers but it isn't used very often. He deferred the question to Mr. Harper.

10:07:01 AM
CHAIR SEEKINS asked Mr. Harper to respond to Senator Therriault's question.

RICK HARPER, Econ One Research, Inc., Consultant to the Legislature, introduced himself and listed his credentials. He advised that baseball arbitration is used in a very limited manner in the oil industry. In this instance it would be applied anytime that numerical amounts are involved, such as dollars, amounts, and quality. In the case of baseball arbitration, each party presents a final offer and the arbitrators must pick between the two offers. They are not free to craft their own remedy.

CHAIR SEEKINS noted that ConocoPhillips does not want to use baseball arbitration with the State of Alaska.

MR. HARPER agreed and said certain companies have carved that out in their contracts, such as British Petroleum. It is used for disputes of a numerical amount such as actual damages, volumes or value.

10:12:38 AM
SENATOR STEDMAN asked whether it would be a disadvantage or an advantage for the state to select baseball arbitration.

MR. HARPER responded it would make a significant difference depending on the situation. It greatly restricts how arbitration can be conducted. For instance there can only be three requests

for production of discovery documents and the maximum number of depositions is limited to between two and five, depending on the size of the issue. The State should consider the instances that could happen where they wouldn't have as much information that the producers would have. The producers might have important information that the State would not have access to for arbitration purposes and that would put the State at a disadvantage.

SENATOR THERRIAULT asked Mr. Harper whether baseball arbitration also limits discovery documents.

MR. HARPER responded yes. Entities are limited to a maximum of three requests of documents in all instances.

SENATOR KIM ELTON asked whether the arbitrator would be limited in the discovery process or whether it was just the parties that were limited.

MR. HARPER said in theory the arbitrator can ask for documents for his own purposes but that is different than litigants seeking documents that support their position. He said he wouldn't rely on an arbitrator to carry the State's water.

SENATOR THERRIAULT asked Mr. Barnes to elaborate on what the State could do in terms of diligence on work commitments and what it would take to terminate a contract.

10:18:50 AM
MR. BARNES replied that would be handled through arbitration. There is a presumption that the contract would continue and so the State would have an obligation to overcome that presumption. The State would have to prove the parties were not acting with prudence under the circumstances. There is not a great body of language built around what is considered prudent. The burden of proof is not as high as with a criminal proceeding. The State must also prove that the lack of planning has made an adverse impact on the project. The arbitration panel would consider the difficulties and delays but they are prohibited from considering any errors in judgment and the unwillingness of a party to enter into a contract or to settle a dispute. In summary, it would be a hefty burden for the State to prove and almost impossible for the State to exercise a right to terminate.

SENATOR ELTON expressed concern that there were not enough inducements for good behavior on the part of the other parties and asked Mr. Harper to speak on that note.

MR. HARPER agreed that was a concern for consideration. He mentioned the absolute limitation on damage awards was a key item. For instance, for any breach arising in the contract there cannot be an award for consequential damages including lost profits. This is a trade item that can be added and included in the contract.

10:24:49 AM
MR. BARNES added that the prohibition on consequential and punitive damages is not unusual but it usually applies to ordinary behavior. The gross negligence standard is imposed and it works such that the operating company is not responsible for consequential damages to the parties unless the operator engages in gross negligence or willful misconduct. It is appropriate for that language to appear in the project entity documents. The wholesale exclusion of punitive and consequential damages is normally the way the industry deals with limitation on liability.

10:26:32 AM
CHAIR SEEKINS commented anything doing with PILT or the PPT issues would not be subject to discovery restrictions in regard to the contract.

MR. HARPER offered to look into that.

CHAIR SEEKINS asked Mr. Harper to define the kinds of disputes that would be subject to arbitration.

MR. HARPER advised that the contract requires arbitration for all disputes. There may be a broader standard for discovery in terms of PILT and PPT but he was not certain. He surmised there would be extraordinary potential for disputes in the realm of very large damage claims. The commercial aspects of the pipeline are extraordinary in scale and scope. It has not been his experience that arbitration is a quick process. It is generally a detailed procedure and that raises concerns as far as making sure the project gets done quickly. Arbitrations do not have standing jurists.

CHAIR SEEKINS asked how often in a normal dispute would there be a request for production of additional documents.

MR. HARPER replied it depends on the size and nature of the dispute. In a large dispute with very high stakes where parties can afford extensive representation, he has seen over 20

document requests. It is hard to imagine that there will be small dollar disputes in the context of this contract, he said.

SENATOR FRED DYSON asked Mr. Barnes whether he thought the State should make firm two-year and four-year milestones with possible sanctions for work commitments that are not performed.

MR. BARNES replied yes but said it was not his position to advise the parties. The use of milestones with specific dates would create the impetus to move the project along.

SENATOR DYSON asked Mr. Barnes whether the beginning of open season was coincidental with filing for certification.

MR. BARNES said Mr. Shepler was better informed on that subject. The open season is part of getting to the project sanctioning though.

SENATOR DYSON asked Mr. Barnes to define when would be a reasonable period to establish a milestone for the opening of open season.

MR. BARNES again deferred to Mr. Shepler but commented it is tied into the application for certificate of public convenience and necessity. There are certain prerequisites under the FERC process that would guide the State through the process. The first milestone is a filing to initiate the open season process and that is a milestone that the parties would have agreed upon. Just as in the case with international agreements, the selection of milestones and corresponding dates is an item for negotiation but they are usually set out in the contract with definition.

SENATOR DYSON asked whether it was his opinion that having an open season two years out was reasonable.

MR. BARNES asserted that depended on the planning timeframe but the expert parties should negotiate on that subject if the State were to use the milestone and corresponding date mechanism as a way to drive the work commitment forward.

10:38:36 AM
SENATOR THOMAS WAGONER noted Alaska currently has leases on the North Slope between the State and the producers with separate terms and conditions. He asked Mr. Eason whether those leases were being rolled into the fiscal contract and would then be subject to the terms and conditions of the fiscal contract.

JAMES EASON, Consultant, Legislative Budget & Audit Committee, introduced himself for the record and listed his credentials. He emphasized his extensive background and relayed his intention to speak in an advisory manner to the State. He responded to Senator Wagoner's question and replied that the leases would be covered under the terms of the agreement. Additionally hundreds more may be brought under a portion of the agreement, excluding the work commitment. This would apply to lessees in the future who nominate gas in the event they find gas. A separate piece of legislation called the Uniform Fiscal Contract would allow other lessee's to come into the process. A number of current lease provisions would be governed under the contract and language in the contract specifically states that if there is any conflict between the two, the contract will govern.

10:43:14 AM
SENATOR WAGONER asked Mr. Harper whether he had experience with sales of gas.

MR. HARPER replied yes.

SENATOR WAGONER asked the risk level the State of Alaska would face when they become involved in the taking, transporting and marketing of its share of the gas.

MR. HARPER aired currently the State rides the coat tails of the lessees. Settlement would be based up on what the producers are able to realize for themselves. The setup is such that the State has no marketing expense at all. The decision to take control of the gas on an "in-kind" basis puts the State in the business of all the aspects that go along with bringing that gas to market. Instantaneously Alaska will become a competitor with British Petroleum, Exxon Mobile, ConocoPhillips, Shell Oil and the others. Taking ownership at the terminus would have eliminated that. The risks are very broad, uncertainty is large and it has been defined as up to 12 percent decrement of the overall State's net present value in the production.

10:47:41 AM.
In terms of marketing gas commercially, the State would be a significant single-source marketer. The competitors have the benefit of a wide portfolio for marketing and the State will be dependent upon the quality and timing of information, reliability of production, implications of maintenance schedules and outages, and other such things. The State will not have the benefit of the broader portfolio to balance its production against.

CHAIR SEEKINS referred to Section C (11) of the contract (page 279) regarding the five oral depositions, and asked if good cause were shown, would an arbitrator extend the size and scope of the discovery process.

10:51:29 AM
MR. HARPER replied there is a separate standard for the restriction under Article 14 and a set of circumstances for things like that.

CHAIR SEEKINS asked how responsive arbitrators would be for things like exemptions in C(11)(b)(4)(c).

MR. HARPER replied it would depend on who the arbitrators were and the circumstances of the subject for arbitration. It appears that it is the intent of the parties that discovery and depositions be significantly limited and so that principle would guide the arbitrators. It would take a significant situation and there would probably be a split within the arbitration panel. It would be difficult to speculate on any outcome.

10:56:36 AM recess 11:12:38 AM

CHAIR SEEKINS brought the Special Committee on Natural Gas Development back to order.

SENATOR BEN STEVENS joined the meeting.

SENATOR WAGONER asked Mr. Eason how the arbitration in the fiscal contract would affect the current leases.

MR. EASON was not prepared to comment on the full implications but the intent was that some of the lease provisions would be amended by inclusion in the contract. There has been discussion of avoidance of cost and time delays by going to arbitration versus litigation and at least one representative of the Administration laments that the State has spent tremendous money over the years in litigation. The other side of the story is that that expense has returned the State hundreds of millions of dollars in unpaid royalties and also has established court precedence. Arbitration abandons those precedents and that is a policy call but it breaks with what the State has traditionally done.

11:15:42 AM

REPRESENTATIVE PAUL SEATON asked Mr. Barnes to consider the following: If one of the producers decided the project would be positively impacted if it were built in the future, say 2025, would the State's position be that they would have to prove with clear and convincing evidence that the producer's assessment was wrong if it delayed the project to the year 2025.

11:17:04 AM
MR. BARNES replied during arbitration the burden of proof is upon the State and they do have to prove with clear and convincing evidence that participants are not acting with "prudence under the circumstances" and that delaying the project to 2025 would have an adverse material impact. He said there would most likely be no judicial guidance on that point and the State's position would be attenuated by limitations on discovery.

REPRESENTATIVE SEATON noted his concern was due to the fact that the issue has already been raised. He surmised that if a producer's business model showed that the project would be prudent to commence at a later time the State would then have to disprove the producer's modeling.

MR. BARNES agreed.

MR. HARPER pointed out that errors in judgment could not be taken into consideration in that set of circumstances.

11:20:29 AM
CHAIR SEEKINS asked Mr. Barnes to define how the standard of "clear and convincing evidence" is used.

MR. BARNES replied that it is a higher standard than a preponderance of the evidence although he admitted he was not suited to answer that question.

REPRESENTATIVE SEATON expressed concern that the State would be in a situation of models versus models and the difficulty would fall to proving that one of the models was definitely wrong. He expressed concern also that even if the work commitments were completed within the timelines the State would not have the information needed to go to project sanction.

MR. BARNES referred to the producer's project summary chart and said Article 5 of the contract specifically states that the work would continue until the planning process to begin open season starts. The planning for the open season process appears to be

set to begin halfway through the year 2007. So if the beginning of that planning process is the end of the work commitment then it appears that everything that occurs before that point is the work commitment. Understand that the work commitment is not actually set out in the contract, he stated.

11:28:16 AM
SENATOR THERRIAULT asked whether there would be any preservation of deference to the state agency in the arbitration process or would it be a complete separation to deference.

MR. HARPER replied that he has not identified any deference of maintenance at all.

SENATOR THERRIAULT asked whether an entity gives up the right to receive any deference when selecting arbitration instead of litigation.

MR. HARPER replied that appears to be the case, yes.

CHAIR SEEKINS asked Senator Therriault to explain his concern regarding deference.

SENATOR THERRIAULT said the way deference works is that the courts do not substitute themselves necessarily for the role of the agency decision-maker. They just look to make sure that person applied the law in a fair and decent way. If the court finds that, they would defer or uphold the agency decision.

MR. BARNES added there are two provisions in the fiscal contract. Article 19.10 says the State's interpretation of a law is neither presumed correct or entitled to deference. Again in Article 38.3 the provision says, "No doctrine, rule, or principle of law, tax law, or equity that would create a presumption for or against or deference to the position of any party applies in the interpretation of the contract."

SENATOR THERRIAULT commented at the end of the day a court action will set a precedent, but arbitration doesn't set precedence.

CHAIR SEEKINS asked Mr. Harper whether, as an arbitrator, is he able to look at past preference in arbitration.

MR. HARPER replied there was nothing that preserved preference in arbitration. He agreed with Mr. Eason and with Senator Therriault.

11:35:14 AM
SENATOR THERRIAULT wondered whether an arbitrator considered the severity of an issue when applying the standard.

MR. HARPER replied an arbitrator is bound by the standards they are presented with. They do not alter their view for bigger cases.

SENATOR THERRIAULT asked Mr. Eason whether he knew of any other time when the producers requested the State to move to an arbitration system.

MR. EASON advised that his direct affiliation with the State of Alaska ended 10 years ago. Prior to that the Department of Natural Resources (DNR) entered into settlement agreements with the producers over how royalty evaluation would occur after the long-standing lawsuit of Amerada Hess. That was the first instance of arbitration but he didn't know how many instances there have been or whether they were successful. Many times the State wanted an alternative to where they were at the time.

11:40:05 AM
CHAIR SEEKINS posed a hypothetical situation of a dispute between the Department of Revenue (DOR) and the producers on the terms of the PPT or PILT. The situation would go to arbitration where the DOR might state that their position entitles them to deference because of precedence. He asked Mr. Barnes whether one party in a dispute could be entitled to deference or whether the case would be settled strictly on the arguments presented and the law.

MR. BARNES addressed the hypothetical situation noting that it wouldn't be strictly an Alaska situation. He said:

> The notion is that any agency, in interpreting it's own regulations, is entitled to deference and it's a presumption that it's being reasonable as it interprets those regulations. That interacting with your burden of proof, all things being equal, the agency is entitled to prevail and I think that is really just the extent of it as best I recall.

CHAIR SEEKINS asked the reason any producer or contractor would enter into court or arbitration against a state department when that department would have deference.

MR. EASON responded there was another piece to consider in a situation such as that. The State has a long history of oil development and lessees enter into the contract knowing they are bound by the contract and by the law. History shows that the State wins some disputes and it also loses some. The State has established very important precedence and so disputes don't occur anymore over certain issues. He stated:

> Even on the documents and the issue of depositions, whether there are three or five. Let's assume that you're talking about five depositions. Really you are talking about fifteen depositions on the participant's side and five on the State's side. It's a minority participant and it truly has minority, sort of skewed rights relative to the others and that's not suggesting that the producers always have a common interest in combining their depositions and combining their discovery requests, but I think there will be instances where they do, and as you've been told before, the relative access to that information is dramatically skewed to the producer/participant side relative to what the State is going to know when it tries to pursue arbitration.

CHAIR SEEKINS aired that Alaska was "putting itself [in many respects] into the position of being a corporation rather than being a sovereign."

11:47:10 AM
MR. BARNES interrupted to clarify that the deference would be with regard to the State's interpretation of its own regulations and the application of those regulations. On commercial matters, he said, it would be just as it would in any commercial dispute where the claimant party has to bear the initial burden of proof. The reason that the waiving of deference is significant is that under Article 41.2 of the contract, all of the decisions, regulations, rules, settlements, and agreements must conform to the lease. The provision coupled with the waiver of deference on interpretation of the regulations sets the State back to an earlier stage in the situation of a conflict.

11:49:54 AM
CHAIR SEEKINS opined he recently found a definition of "clear and convincing evidence" to read as such: "Clear and convincing evidence is the intermediate level of burden of persuasion sometimes employed in the US civil procedure. In order to prove something by clear and convincing evidence, the party with the burden of proof must convince the 'trier of fact' that it is

substantially more likely than not that the thing is in fact true. This is a lesser requirement than proof beyond a reasonable doubt."

11:51:24 AM
SENATOR WILKEN referenced Mr. Eason's letter to the committee and said the re-surfacing of the "over-the-top" issue intrigued him. He also made comment that Mr. Eason said the PPT could be altered and "the people's voice could be silenced." He asked whether there was a downside to the State's insistence that Alaska won't have an over-the-top method to extract North Slope Gas.

MR. EASON replied there was no downside that he was able to determine but pointed out the State would have no certainty under the contract unless they inserted an agreement because the contract provides for unilateral amendment of the qualified project plan. The project currently provides for a southern route but the producers have the right to amend the contract at any time. He strongly recommended adding a provision to protect the southern route.

SENATOR WAGONER said that the current estimate of approximately $25 billion dollars was based on five-year old data. He asked whether that was something to be concerned about.

MR. HARPER admitted he wasn't comfortable with data that old.

MR. EASON added there is language in the best fiscal finding addressing that but the data isn't quite five years old. The Commissioner of the Department of Revenue made a policy decision to stick with those numbers and proceed.

SENATOR WILKEN asked whether there was a summary that compares the old contract with the new one.

11:58:15 AM
KEN GRIFFIN, Deputy Commissioner, Department of Resources (DNR), replied yes but he does not have it with him.

SENATOR WILKEN asked Mr. Griffin the status of the study by the Lukens Energy Group.

MR. GRIFFIN advised that he would get back to the committee with an update.

SENATOR THERRIAULT said there is a definition that defines the mainland going to Alaska and then there is Article 4. He asserted the committee should look at how that interacts with the PPT in anticipation of the roundtable discussion for the following meeting.

12:00:05 PM
SENATOR OLSON asked what happens to the State's 20 percent control in the event of cost overruns. His concern was whether the State's interest would diminish in the situation of project cost overages.

MR. EASON replied that the State would bear the obligation to pay 20 percent of whatever the cost overage was but the ownership would remain at 20 percent.

SENATOR OLSON commented that could be as much as $4 billion dollars.

MR. EASON agreed.

SENATOR STEDMAN pointed out the risk of exposure is not dollar for dollar.

12:02:16 PM
CHAIR SEEKINS asked Mr. Harper whether an arbitrator would consider State of Alaska law as the basis for settlement.

MR. HARPER advised the contract states that State of Alaska law would be used to administer the agreement.

CHAIR SEEKINS asked whether the entire contract was subject to Alaska law.

MR. HARPER replied yes.

SENATOR THERRIAULT asked how it would work if there were a dispute over the operation of an LLC and that LLC were subject to Delaware law yet the contract was subject to Alaska law.

MR. HARPER did not know.

SENATOR THERRIAULT opined his interest was due to the fact there are heightened duties under Alaska LLC law that make it very clear what a majority owner owes to the minority owners. He wondered whether the State would get that protection back or whether the arbitrator would interpret Delaware law.

MR. HARPER said the LLC was a separate agreement that nobody has seen yet.

12:05:08 PM
SENATOR BEN STEVENS stated he had a copy of the federal Alaska Natural Gas Pipeline Act. Section 103(d) Prohibition of Certain Pipeline Route reads, "No license, permit, lease, right-of-way, authorization, or approval required under federal law for construction of any pipeline to transport natural gas from the land within Prudhoe Bay oil and gas lease area may be granted for any pipeline that follows a route that 1) traverse land beneath navigable water adjacent to or beneath the Beaufort Sea 2) enters Canada at a point of north of 68 degrees latitude." That answers the ambiguity of the over-the-top route, he said. "Congress did not allow FERC to issue that permit."

MR. EASON responded he referenced that in his memo. Congress can always revisit that and under it's eminent domain authorities, has the ability to change it. He reiterated his earlier suggestion to add an amendment to the contract regarding the second route.

SENATOR BEN STEVENS said what spurred him to find the federal statute was the discussion that the QPP could not be changed once the certificate was issued. He said it would be a violation of federal law since FERC has said that they will not issue a certificate upon the convenience that enters the Canadian border below 68 degrees latitude. The earlier discussion that the QPP could be changed without any consent to go over the top is just adding ambiguity and uncertainty, he asserted.

12:08:30 PM
CHAIR SEEKINS recessed the committee for lunch.

CHAIR SEEKINS called the meeting back to order at 1:46:15 PM. He asked Phillip Gildan to testify.

1:46:37 PM
PHILLIP GILDAN, Greenberg Traurig, LLP, Consultant to the Legislative Budget and Audit Committee, introduced himself for the record and listed his credentials. He stated his background is in representing governments and government proprietary businesses predominately in utility transactions, electric projects, natural gas, water and sewer.

1:47:26 PM

SENATOR BEN STEVENS referred to the federal Alaska Natural Gas Pipeline Act that he previously read aloud and highlighted a couple of areas in the Act. He said it was the template under which FERC acts. He reminded the committee that federal law preempts state law. Another important provision is Section 105, Pipeline Expansion, which begins on page 4. He encouraged members to study subsection (b) and derive their own interpretations for discussion. He pointed out Section 107(b) and said the deadline for filing a claim is 60 days after the decision of action. He claimed the most important section to discuss was Section 109 and expressed alarm that the consultants had not addressed this topic. He went paraphrased Section 109 - A Study of an Alternate Means of Construction:

> The requirement of a study, if no application for the issuance of a certificate or amended certificate of public convenience as necessary, authorizing the construction and operation of Alaska Natural Gas Transportation project has been filed with the commission by the date that is 18 months after the date of this enactment. Mr. Chairman, I might highlight that that date expired on April 11, 2006 according to the reports I have. The Secretary shall conduct a study of the alternative approaches to the construction and operation of such Alaska Natural Gas Transportation project. The scope of the study under this subsection shall take into consideration the feasibility of 1) establishing a federal government corporation to construct the Alaska Natural Gas Transportation project and 2) secure alternative means of providing federal financing and ownership including alternative combinations of government and private corporate ownership.

1:51:17 PM

SENATOR BEN STEVENS continued:

> [Sub] section (c) – Consultation: In conducting the study the Secretary shall consult with the Secretary of the Treasury obviously to finance it, and the Secretary of the Army, to the Corps of Engineers obviously to build it, and the report shall make recommendations to [US] Congress with the results of this study and any recommendation. Mr. Chairman, I believe that study is underway now.

CHAIR SEEKINS concurred.

SENATOR BEN STEVENS stated his belief that there was continued delay of the opportunity to understand the scope of the project and the alternatives of the project. He wondered why Mr. Shepler or Mr. Gildan hadn't highlighted that to the committee. He said the timeline for the issuance has expired and the State is now in a study period where the federal government is looking at taking over the project.

1:52:35 PM
SENATOR BEN STEVENS called for the Washington D.C. consultants to investigate the status of the study.

MR. EASON offered to speak for Mr. Shepler. He said he recalled that Mr. Shepler did discuss the issue in a work session and he also researched the status of the study.

SENATOR BEN STEVENS requested a memo on the status. He offered to write a letter of request for the update. He asserted the magnitude of the process and the delays associated with the project and contract is the reason why the State is at a "need to know" point on the status of the impact.

1:54:33 PM
SENATOR THERRIAULT offered a quick comment to let the members know that during the Energy Council he had a series of meetings with Mr. Shepler, one of which was in the FERC offices. They met with FERC and staff and also staff from the Department of Energy. He questioned them on the status of the study and the indication was that nobody was anxious to "sweep in and take over this project." He doubted that Congress would get into the pipeline business, but suggested if the pipeline was not going forward that Congress might simply change the routing. He advised that he would request an update on the study.

1:57:36 PM
SENATOR BEN STEVENS commented the proposed over-the-top route would transverse the area that is right off the coastal plain of the Alaska National Wildlife Refuge (ANWR). He asserted since Congress has been embroiled over ANWR for 25 years that they would be very reluctant to pass an approved project in an even more environmentally sensitive area, such as the submerged waters off the coast.

1:59:06 PM
SENATOR WAGONER commented ANWR is no different from any other national park or any other national piece of land set aside as pristine. "When it comes to water, they only go to the mean high

tide line." He suggested the mean high tide line from the North Slope to the territorial boundary was state jurisdiction.

2:00:17 PM
SENATOR OLSON said the people from the North Slope region would vehemently oppose anything that goes into the water since it would have a disastrous effect on the migration of whales.

CHAIR SEEKINS aired his belief that the federal government takes on large projects, referring to the Grand Coulee Dam and the Tennessee Valley Authority, if it believes it is good for the country.

2:02:38 PM
SENATOR BEN STEVENS asked Mr. Gildan whether he had the memos dated June 2, 2006 from himself and Mr. Shepler.

MR. GILDAN replied yes.

SENATOR BEN STEVENS said as he reads Mr. Shepler's memo regarding SGDA contract issues, it expands on a series of issues and yet Mr. Gildan's memo corrects some of those points with some proposed amendments.

MR. GILDAN said that fairly summarizes the memorandum.

SENATOR BEN STEVENS read from the memorandum: "The State is providing its tax and royalty concessions to the producers now at the time the contract is executed and those commitments will be effective potentially for decades." He asked how a tax concession could now be applied. The impact of the proposed production tax is not a concession. "If there are in fact tax and royalty on gas, they [concessions] certainly don't occur now," he said. He added that he didn't think that was the intent but that is how the memorandum reads.

CHAIR SEEKINS advised he would provide committee members with a copy of the memorandum.

2:07:54 PM at ease 2:21:41 PM

CHAIR SEEKINS announced that all committee members now have the memorandum to which Senator Ben Stevens and Mr. Gildan have been referring. For the record, it is dated June 2, 2006 from Don Shepler titled SGDA Contract Issues.

SENATOR BEN STEVENS said the dialogue in the executive summary translates specifically into Exhibit 1, which is in Mr. Gildan's summary. He announced that he would be referring back and forth between the two documents.

2:23:05 PM
SENATOR BEN STEVENS referred to page 7 of the executive summary where it states, "No provision for the State to consent for the approval of material changes to the qualified project plan." The bottom of the page states, "In as much as the State, through the contract, is making material and long term tax and royalty concessions, these concessions will become effective when the contract is signed rather than when the project is completed." He said he didn't understand the definition of the tax and royalty concession. He referred committee members to page 8 where it lists several instances where material changes to the plan may be warranted. As presently written the contract provides the State with no control over the circumstances to which material changes could be made. He asked Mr. Gildan whether that was accurate.

MR. GILDAN advised that provision was drafted and put together by Mr. Shepler but said he believed it tied to paragraph 6.

SENATOR BEN STEVENS asked whether the amendment was the result of the discussion or whether the discussion was the result of the amendment.

MR. GILDAN said he presumed the amendment followed from the discussion. The amendment was an attempt to ensure that if the State never saw the LLC agreement that there would be provision for tying the two together. Eventually there would be a provision in the LLC agreement to assure that the State will have the right and ability for proper review.

2:27:33 PM
SENATOR BEN STEVENS said, "That's an interesting addition, I think, to the deliberations we've had for the last two days."

MR. GILDAN interrupted to say he only recently had an opportunity to talk with administrative team members. He said he felt comfortable that the Administration will address the issues brought forth by the memorandum and the committee.

2:28:24 PM
SENATOR BEN STEVENS countered he now has a series of documents that raise questions and he wondered why the presenters say

they've seen the information and that the documents may not apply.

MR. GILDAN reported the Administration has not seen the information but the discussion subsequent to the memorandum denotes that they will have the opportunity to see the LLC beforehand. Many of the suggestions and issues were options for the committee and the Legislature in the event they didn't get the option to see the agreements. "Now that we're going to be able to see them, we'll be able to tell whether or not the concerns that these were drafted to provide options for the Legislature are necessary or not," he stated.

SENATOR BEN STEVENS said he never anticipated that the Legislature would not be able to see all of the LLC agreements before approving the project. Discussion for the past two days suggested that most of this had to do with PipeCo, which the committee wasn't prepared to bring up again until after it had seen the agreements.

2:30:34 PM
SENATOR BEN STEVENS added the committee has endured much discussion on the inadequacies of something they haven't even seen yet. He questioned how anybody could expect the committee to analyze summaries about something it hasn't seen.

2:31:38 PM
CHAIR SEEKINS referred to Page 4 of Exhibit 1 where it says the operating agreement shall provide that the State shall not agree to a waiver of sovereign immunity without a reasonable monetary limit on such waiver and goes on to read, "The State shall not indemnify or otherwise hold harmless any person or entity that has been adjudged in a judicial administrative or alternative dispute, resolution, proceeding to be liable for negligence or misconduct in the performance of the person's or entity's duty or has been adjudged guilty of a crime at such criminal adjudication withheld subject to probationary terms … the State may not eliminate claims for actual damages incurred by the State, may not eliminate the equitable rights to seek specific performance and injunctive relief and provided further that the rights and limitations provided in this subsection shall apply to collateral agreements to be entered into."

CHAIR SEEKINS said the State then is basically duplicating a corporate entity in terms of the partnership, rather than being a sovereign. He asked whether it was unreasonable to assume that

all parties were going to be equal in the ability to seek judgments against each other.

MR. GILDAN responded that each entity would be on an even keel.

CHAIR SEEKINS agreed. He said if one party indemnifies the other, they all indemnify each other on an equal basis. He asked Mr. Gildan whether that was true.

MR. GILDAN did not know, saying he didn't have that document but from a business perspective, those are protections that the Legislature may wan to consider for those indemnity provisions.

CHAIR SEEKINS said he struggles with how to bring the State to the same level of responsibility that the other entities share in the joint venture. He asked how the State would limit its responsibility to a certain dollar amount before asserting sovereign immunity from suit or judgment.

MR. GILDAN said it would be done in the agreement that each entity would have a limitation on the amount of indemnity. All parties would negotiate a level that was comfortable or commensurate so that it wasn't an "open checkbook."

CHAIR SEEKINS asked whether he thought that would be fair.

MR. GILDAN said yes.

CHAIR SEEKINS asked Mr. Gildan whether he knew of other government entities that waived sovereign immunity for arbitration or judicial proceedings.

MR. GILDAN replied yes. It is a relatively common and reasonable thing to do. He said it was also not uncommon to have limitations so that the parties know the limits of potential liabilities.

2:37:14 PM
MR. GILDAN advised the committee that during the recess he emailed Mr. Shepler and asked for a quick response to the issue that Senator Ben Stevens raised. Mr. Shepler indicated in his response that the issue was discussed two weeks ago at a Legislative briefing and the discussion at the time was to go through the Governor's office to get the update on the information, thinking that the Governor's office would have a better and more direct line into the federal government for that information.

2:39:38 PM
SENATOR BEN STEVENS commented that the second report to Congress from FERC regarding the application process would be presented July 1, 2006.

CHAIR SEEKINS referred to paragraph 10 and read, "The operating agreement shall provide that the State member have the right to participate in all meetings of the governing board of the entity and vote on all decisions of the entity, including but not limited to decisions affecting tax allocations." He asked Mr. Gildan whether he had any indication to believe that would not be the case.

MR. GILDAN said he heard weeks ago that there was an indication of that. "In a public/private partnership where the State is actually an owner in an entity like this, there are different tax treatments of the for-profit entities that are owners of that entity versus the State." Any decisions that are made might not necessarily impact the State but they could, depending on how the tax decisions were structured, he stated.

2:42:27 PM
CHAIR SEEKINS referred to paragraph 11, the right to review all books and records of the entity, and clarified that was talking about the entity in which the State owns a 20 percent share and not necessarily the books and records of the parent company.

MR. GILDAN said absolutely.

2:43:49 PM
MR. GILDAN added his belief that the Administration's consultant team was "top notch" and would "try their darndest to do everything that is on this list." But other members of that ownership group might disagree with what the Administration's team is trying to do. That is the reason for his list of precautions, he stated.

2:44:54 PM
CHAIR SEEKINS thanked Mr. Gildan for his participation and said they would address the issue further in tomorrow's roundtable discussion.

2:45:15 PM
SENATOR STEDMAN said he is feeling a tone of defeat before the project is even started. There should be a more optimistic view

in getting to the end, which is the gas line, rather than "going down a bunch of different rabbit trails."

CHAIR SEEKINS said it was important to get answers to the questions first. He asserted that the committee should get to see the template of the LLC. Just the same as with the "ghost contract" now there is a "ghost LLC agreement." He said there is a great deal of distrust because of the requirements of confidentiality in the SGDA. The Governor was accused of negotiating a contract in secret when in fact he was required by law to negotiate the contract in strict confidentiality. The media mis-portrayed that, he claimed.

2:48:08 PM
SENATOR FRED DYSON said the process has been long and frustrating but he sensed that the Administration was acting diligently in keeping it going forward. The complexity and magnitude of the project and all the issues that have been brought up are the sole reason for the delay.

2:49:55 PM
SENATOR BEN STEVENS said he would like to address the LLC agreements and the unavailability for review and interpretation. An LLC operates under a management agreement, which defines the terms of ownerships, and the operating agreement, which defines the terms under which the entity will operate. While he shares the other member's frustration at not being able to see those agreements, he understands the complexity of putting those things in place. He said if legislators believe they should be involved with every intricate detail of the operating agreement of each LLC, they would be overreaching their authority. The Legislature does have the authority to see the management agreement of the LLC. "That is what I'm interested in seeing," he said.

2:54:40 PM
CHAIR SEEKINS thanked the consultants Mr. Eason, Mr. Harper, and Mr. Barnes for their participation today. He asked for closing comments from each of them.

MR. EASON neglected to comment saying it was a legislative process.

MR. HARPER expressed appreciation at being part of the process.

MR. BARNES expressed appreciation for the opportunity to participate. He noted that it was not unusual to spend this much

time on a complex project and urged committee members not to get discouraged.

CHAIR SEEKINS announced Dan Dickinson and asked committee members whether they had questions for him.

2:57:14 PM
DAN DICKINSON, CPA, Consultant to Governor Frank Murkowski, commented on an earlier question regarding the comparison of the contracts. He directed committee members to the Governor's website where there is that information available.

2:58:19 PM
SENATOR WILKEN advised Mr. Dickinson that the committee has had discussions relating to the 20.4 percent throughput payment to the municipalities and because of the valuation they understand that will become 25 percent.

MR. DICKINSON nodded.

SENATOR WILKEN asked whether that was a net zero increase of whether that increase would be taken out of somewhere else.

MR. DICKINSON advised there were two aspects regarding the valuation and who pays for it. Roughly some number in the "high forties" is the portion of TAPS in the unorganized borough that will go directly to the State. The other dollars will be roughly proportioned between the North Slope, Valdez, Fairbanks, and so on in descending order of portions. However, this is a cost to TAPS that goes into the tariff and it makes the wellhead value of every shift on TAPS lower as a consequence.

SENATOR WILKEN asked whether that was just a realignment of revenue stream or whether the State would gain new revenue.

MR. DICKINSON clarified there would be a net increase because taxpayers would pay more.

3:02:25 PM
CHAIR SEEKINS advised committee members of the agenda for the following day.

3:03:23 PM at ease 3:06:38 PM

CHAIR SEEKINS adjourned the roundtable meeting at 3:07:27 PM.