

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

June 8, 2006

8:17 a.m.

**MEMBERS PRESENT**

Senator Ralph Seekins, Chair  
Senator Kim Elton  
Senator Lyda Green  
Senator Gary Wilken  
Senator Fred Dyson  
Senator Lyman Hoffman  
Senator Thomas Wagoner  
Senator Ben Stevens

**MEMBERS ABSENT**

Senator Con Bunde  
Senator Bert Stedman  
Senator Donny Olson  
Senator Albert Kookesh

**OTHER LEGISLATORS PRESENT**

Senator Gene Therriault  
Senator Gary Stevens  
Senator Johnny Ellis  
Senator Hollis French  
Representative John Coghill  
Representative Ralph Samuels  
Representative David Guttenberg  
Representative Les Gara  
Representative Berta Gardner  
Representative Kurt Olson

**COMMITTEE CALENDAR**

Roundtable Question and Answer Session - Legislators,  
Consultants, Producers, Administration

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

JIM CLARK, Chief Negotiator  
Office of the Governor  
PO Box 110001  
Juneau, AK 99811-0001

**POSITION STATEMENT:** Participated in the round table discussion

MARTIN MASSEY, Joint Interest Manager for U.S. Operations  
ExxonMobil Production  
Houston, TX

**POSITION STATEMENT:** Participated in the round table discussion

KEN KONRAD, Senior Vice President - Gas  
BP Alaska  
Anchorage, AK

**POSITION STATEMENT:** Participated in the round table discussion

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

**POSITION STATEMENT:** Participated in the round table discussion

DAVID VAN TUYL, Commercial Manager  
Alaska Gas Group  
BP Alaska  
Anchorage, AK

**POSITION STATEMENT:** Participated in the round table discussion

MARK HANLEY, Public Affairs Manager  
Anadarko Petroleum  
Anchorage, AK

**POSITION STATEMENT:** Participated in the round table discussion

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

**POSITION STATEMENT:** Participated in the round table discussion

KEN GRIFFIN, Deputy Commissioner  
Department of Natural Resources  
400 Willoughby Avenue  
Juneau, AK 99801-1724

**POSITION STATEMENT:** Participated in the round table discussion

RICK HARPER

Econ One Research, Inc.  
Consultant to the Legislature  
Three Allen Center, Suite 2825  
333 Clay Street  
Houston, TX 77002

**POSITION STATEMENT:** Participated in the round table discussion

DONALD SHEPPLER

Greenburg Traurig, LLP  
Consultant to the Legislative Budget and Audit Committee  
Alaska State Capitol  
Juneau, AK 99801-1182

**POSITION STATEMENT:** Participated in the round table discussion

KAROL LYN NEWMAN, Attorney

Morgan, Lewis & Bockius, LLP

**POSITION STATEMENT:** Participated in the round table discussion

JAMES EASON, Consultant

Legislative Budget and Audit Committee  
Alaska State Capitol  
Juneau, AK 99801

**POSITION STATEMENT:** Participated in the round table discussion

JAMES BARNES

Barnes & Cascio LLP  
Consultant to the Legislature

**POSITION STATEMENT:** Participated in the round table discussion

ROGER MARKS, Economist

Department of Revenue  
PO Box 110400  
Juneau, AK 99811-0400

**POSITION STATEMENT:** Participated in the round table discussion

DAN DICKINSON, CPA

Consultant to the Governor  
Office of the Governor  
PO Box 110001  
Juneau, AK 99811-0001

**POSITION STATEMENT:** Participated in the round table discussion

#### **ACTION NARRATIVE**

**CHAIR RALPH SEEKINS** called the Senate Special Committee on Natural Gas Development meeting to order at [8:17:41 AM](#). Present at the call to order were Senators Lyda Green, Gary Wilken, Ben Stevens, Fred Dyson, Lyman Hoffman and Chair Ralph Seekins; Senators Thomas Wagoner and Kim Elton joined the meeting in progress. Also in attendance were Senators Gene Therriault, Gary Stevens, Johnny Ellis and Hollis French, and Representatives John Coghill, Ralph Samuels, David Guttenberg, Les Gara, Berta Gardner and Kurt Olson.

**Roundtable Question and Answer Session - Legislators,  
Consultants, Producers, Administration**

CHAIR SEEKINS announced the committee would continue its roundtable discussion among legislators, consultants, producers and the administration.

[8:19:12 AM](#)

SENATOR LYMAN HOFFMAN advised the committee his constituents from rural Alaska are concerned that since the gas would not get out to the rural areas of the state, they question the benefit of building the pipeline for those that will not even see the product. He questioned whether Alaskans would benefit from extraction of the gas.

JIM CLARK, Chief of Staff for Governor Frank Murkowski and Chief Negotiator, responded the Administration assembled a Rural Alaska Energy Task Force headed up by Nels Anderson of Dillingham. The committee is considering that question but at this point does not have an answer yet they are in the process of developing a strategy. However, the Administration is committed to drive down rural energy costs. One thing the committee is considering is whether there is an opportunity to use the access point north of the Yukon to serve as a distribution point for butane or propane for villages.

[8:22:16 AM](#)

SENATOR HOFFMAN asked for a comment from the producers regarding the commitment in the contract to hire Alaskan workers for the project.

MARTIN MASSEY, Joint Interest Manager for U.S. Operations, ExxonMobil, explained Alaska hire was a negotiating topic from the beginning and was the first article to which the producers agreed on. He assured the committee that once the project begins there will be ample jobs for trained Alaskans. The producers are committed to provide funds to train workers out of high school and the State has committed \$20 million dollars to build

facilities and develop training programs. He said the issue would more likely be a shortage of Alaskans who are properly trained and ready to work. He assured the committee that every contractor on the job would be committed to the Alaska hire provisions in the contract.

MR. CLARK added not only are there Alaska hire provisions in the contract, there are also "Alaska buy" provisions so that secondary employment and goods are stipulated.

8:25:40 AM

SENATOR FRED DYSON said some of the bargaining units would likely be a part of the project. According to their bylaws, they have to "clear the halls" of their Northwest affiliates before they can hire qualified Alaskans. He asked whether the bargaining units with internal constraints would be allowed to be signatory to the labor agreement.

MR. CLARK agreed that was an issue to be considered. It is not part of the current contract but would be part of the next stage of negotiations. The Administration is committed to training for the jobs in state and will make sure there are hiring halls even in rural Alaska. Premier Klein of Alberta has allowed that Alaskans would be able to work in Alberta, as there is a lack of labor resources in that area.

8:28:45 AM

SENATOR DYSON asked for a summary of the preliminary work that has been done from the main line through south central and beyond.

MR. CLARK informed the committee they have taken a preliminary look at how the lines might work. The Administrations has been working with the Alaska Natural Gas Development Authority (ANGDA) board, which has taken on the business of the spur line to Cook Inlet. That has progressed further than the notion of a line from Pump One down to Cook Inlet because the spur line off of the main line would be more efficient and timely.

8:30:02 AM

Senator Kim Elton joined the meeting.

SENATOR DYSON asked whether the committee could have access to the preliminary work that has been done on that topic.

MR. CLARK advised the committee he would provide them with the work that ANGDA has done.

CHAIR SEEKINS referred to the oil pipeline construction period of the 1970s and expressed concern about predatory hiring from existing small businesses. He said the issue is likened to a "two-headed snake" and will force existing employers to have to fill the jobs left by the current employees.

MR. CLARK agreed that was an issue. The project is projected to provide 9,300 jobs and there are not that many unemployed Alaskans. The Administration is pursuing a strategy to deal with the issue because they are committed to training and hiring Alaskans for the pipeline project.

Senator Gene Therriault, Representative Ralph Samuels and Representative John Coghill joined the meeting.

CHAIR SEEKINS asked for the producers' perspective on the matter.

[8:35:34 AM](#)

KEN KONRAD, Senior Vice President, BP Alaska, commented they are keenly aware that the Alaska hire issue is important to the State and the project and BP supports it. There is adequate funding for training, mentoring programs from federal sources, and committed financial support from the producers.

[8:37:38 AM](#)

WENDY KING, Director of External Strategies, ConocoPhillips Alaska, advised they are committed to Alaska hire, buy and build and have been for a number of years. The company supports the "front end loading" of training programs for middle and high school students. After the project-planning phase, they plan to meet with the Department of Labor and Workforce Development (DOLWD) and provide them with a report highlighting all of the jobs and skills that the project would need. She emphasized there are more commitments than just that, such as annual reports that list how the funds for training are being spent and reports listing the people that are working on the pipeline project.

[8:40:37 AM](#)

MR. CLARK added the Administration is working on strategies to deal with the Alaska hire provision and the impact that will have on existing businesses and state government. Regardless of the provision, there will be an influx of people coming in from the outside looking for employment and that will have some impact on the state. There is also impact aid money written in

the contract that they want to disburse sensibly and that will need to be dealt with through the Legislature.

8:45:10 AM

DAVID VAN TUYL, Commercial Manager, BP Alaska, referred to Senator Hoffman's concern regarding rural Alaskans and how they would benefit from Alaska gas. He said a successful project would benefit all Alaskans through revenues that are brought in to the general fund. He advised that for years BP has supported programs such as the Alaska Process Industry Careers Consortium (APICC), the Alaska Native Science and Education Program (ANSEP), Alliance of Learning and Vision for Underrepresented Americans (ALVA), and the youth employment service program through the Tanana Chiefs organization. Everyone must recognize that a trained workforce is the key to success of the project, he stated.

Senator Hollis French joined the meeting.

8:49:52 AM

SENATOR GENE THERRIAULT commented the Legislative Budget and Audit Committee coordinated with federal agencies, the state administration and smaller producers when they went to FERC and encouraged them to develop the regulations and the transportation package so as to encourage exploration and competition. He asked that Mark Hanley be invited to the witness table to speak on behalf of the smaller producers.

8:52:02 AM

MARK HANLEY, Public Affairs Manager in Alaska, Anadarko Petroleum, introduced himself. He advised the committee that as an independent, Anadarko explores for and produces oil for the larger producers and does not own pipelines, refineries and gas stations. The majors are more fully integrated and that marks the distinction between the independents and the major producers.

CHAIR SEEKINS asked Mr. Hanley his view of how the independent producers would gain opportunities for access into the project.

SENATOR THERRIAULT reiterated the package that came out of FERC was advantageous to Alaskans and he expressed concern that could be undermined by the language of the contract. He indicated Anadarko Petroleum has had to retain outside legal counsel to evaluate the contract so as to understand the impact the contract would have to the smaller independent operators.

CHAIR SEEKINS said he has heard expansion could be up to 5.7 Bcf and that any expansion would be subject to an open season. There would be no guarantee that an independent would be able to take advantage of an expansion if that were the case.

MR. CLARK responded that was true.

8:55:14 AM

SENATOR DYSON asked for an explanation as to why expansions of the gas capacity are limited to 100-mile segments. He said that seemed "startlingly bizarre."

MR. CLARK deferred the explanation to Bob Loeffler who, he said could also address Senator Therriault's concern.

8:55:50 AM

BOB LOEFFLER, Morrison and Foerster, Counsel to the Governor, introduced himself for the record. He said one reason the great result at FERC was achieved is because everyone had a common position. He pointed out it was not the intent to undermine the result of FERC. "Expansion comes in at least three flavors," he stated. There is the statutory mandatory expansion, which is considered a backstop to any negotiation. It is not instant expansion but a tool in the toolkit towards expansion. FERC open season regulations exempt from the rolled in pricing requirement a mandatory expansion so that is unknown territory. The statutory language that the U.S. Congress passed allows the FERC to treat that with either incremental or rolled in pricing. So expansion solution number one is the mandatory expansion right.

Solution number two is voluntary expansion. The LLC agreement will contain a set of provisions on how the LLC deals with expansion. Under the FERC process voluntary expansion requires that the rate treatment would be rolled in.

The Administration negotiated for a third form of expansion identified in the contract as a state-initiated expansion and that has limitations on looping. It met with a lot of resistance because producers felt the Congress-backed mandatory expansion was sufficient. The argument by the Governor's Administration was they were particularly concerned with serving instate needs. As far as expansion is concerned, the FERC will look at the application to be sure it is designed to serve present needs as well as the potential for expansion. FERC will look at the expansion to ensure that it would serve existing shippers and future shippers alike. In the negotiation, the Administration sought expansion rights as part of the trade on the RCA clause.

The idea was to look at where any unsatisfied need was, such as on an upstream pipeline. He said:

The idea of the clause is that the State on its own behalf or at the request of any shipper could come to the LLC to initiate expansion and the LLC would have to respond to that. Obviously as a member of the LLC the State always had the right to trigger the voluntary expansion but this is sort of an external right and there are requirements imposed. The idea, and it's a negotiated point, was that this should deal with the smaller sized expansions - that's where you get the looping issue coming in. You can't loop the entire pipeline under state-initiated expansion.

I recollect, and others might disagree, that we were particularly sensitive to the need to serve instate needs. So that was part of the thinking behind the clause. But the idea is the party who is pushing the expansion, and it could be the State or Anadarko hypothetically, would have to advance the money for the engineering and that money could later be recovered in the rates of the LLC if the LLC paid Anadarko or whoever back. The idea was to mimic the requirements that Congress imposed on a mandatory expansion in terms of the terms and conditions. There is a clause in there that protects current shipper's rates and whether those rates would go up or down is a function of what type of expansion it is.

MR. LOEFFLER asked Mr. Clark whether he had anything to add to his summation.

9:06:09 AM

MR. CLARK added part of what they were trying to do with the state sponsored program was to ensure that the negotiations would not drag out. There was concern that going through the FERC regulatory process could slow things down for a long period of time and the State might not get the desired access within a reasonable period of time. By making it a contractual requirement it would hopefully speed up the process and better serve the needs of the independents.

MR. LOEFFLER commented one of the requirements is that the initiated expansion request not be from one of the "big three." This was designed as a remedy for an independent working outside of the LLC. The starting point is with the independent but the LLC might want to include any others who are looking for

capacity and so they would want to design an expansion that is optimal for everyone. The other point is the expansion becomes a project of the pipeline so that the pipeline is behind it. There is a special provision on dispute resolution to ensure the LLC is with the application. The clause would be triggered by an unsatisfied request of an independent, he stated.

MR. CLARK asked Ken Griffin to address the engineering principals involved with how the expansion application is looked at.

[9:10:02 AM](#)

KEN GRIFFIN, Deputy Commissioner, Department of Natural Resources (DNR), advised he has not looked at expansion for some time but recalled when they looked at ensuring that expansion provisions were available to the types of projects independents might consider, the State looked at the minimum development size on the North Slope. "There is a size of discovery on the Slope that is just not economic to move forward on it - it's just too small," he said.

The State came up with estimates of a minimum North Slope gas development size that an independent would want to move forward with. As Mr. Loeffler indicated, Article 8.7 of the contract was drafted so that the numbers are from the perspective of a single independent seeking capacity or expansion of the pipeline and that independent would most likely be a partner with others. The minimum expansion numbers were intended to approximate the minimum gross development size that an independent might be seeking to invest in.

SENATOR THERRIAULT asked for clarification on the minimum expansion size.

MR. GRIFFIN responded it would be 50 million cubic feet for a feeder line.

MR. LOEFFLER added, "It's 50,000 Mcf per day and 125,000 BTU per day."

MR. GRIFFIN stated that would be the independent share of production from the field. They took approximations and converted that to a reserve size but he could not recall the math used to convert the net rate from a total reserve size that an independent would attempt to move forward with.

SENATOR THERRIAULT asked whether Anadarko agreed with the minimum gross development size numbers. If the tariff is higher, which is a concern of expansion, that means the size field that an independent needs to find would have to be larger, which increases the risk, he opined.

[9:14:11 AM](#)

CHAIR SEEKINS asked Mr. Hanley to delay his response until the committee could hear from Rick Harper.

RICK HARPER, Consultant to the Legislature, referred to Article 8.7(a) and noted neither the State nor another party can request or require an expansion prior to commencement of commercial operations. The issue is basin control and concern that there might be a major discovery in the foothills or elsewhere and so there would not be a basis to go forward with any expansion planning given the nature and intent of the language in the contract, he suggested. He asked Mr. Hanley to comment on that subject.

MR. CLARK interrupted to ask Mr. Harper what he meant by basin control.

MR. HARPER stated the issue is that there is vertical integration for the first time in the natural gas industry and at least one of the companies is not actively engaged in exploration in Alaska at this time. He said it was critical that the State make expansions both timely and easy for the independent operators but Article 8.7(a) appears to have language that precludes both the State and other parties from seeking an expansion prior to commercial operations. He asked Mr. Hanley to comment with his perspective.

MR. CLARK inferred that was a very serious allegation and asked that the Administration and the producers be allowed to respond as well.

CHAIR SEEKINS advised that was a legitimate question and indicated that everyone would be able to provide their response.

[9:18:10 AM](#)

DONALD SHEPLER, Greenberg and Traurig, Consultant to the Legislative Budget and Audit Committee, said he would like to hear Mr. Hanley's views of expansion but asked the committee at some point to return to the discussion between Mr. Clark and Mr. Loeffler regarding the state-initiated expansion and the benefits of that provision.

MR. HANLEY said the short answer was that they question the reason for limiting the expansion application to the start of the construction period because in the meantime, Anadarko might find something that even the producers want to explore. It seems like a limit that does not need to be there, he said.

CHAIR SEEKINS asked for clarification whether Anadarko was concerned about the statement, "following commencement of commercial operations" and whether Anadarko was concerned there could be need of expansion prior to that period.

MR. HANLEY agreed and stated, "It should just say if a person, including the State, seeking expansion," rather than put a limit on a certain timeline. He said it was important to note that, "from our perspective every time we tried to do this, we have been opposed by the producers so it creates a concern for us. This has been a normal process but it has not been without opposition at every step of the way." It is a competitive process and Anadarko would prefer to rely on the FERC. Anadarko is concerned about the lack of regulation on some of the issues because access at a fair price and reasonable terms on the pipeline are an area of concern to the independents.

MR. HANLEY continued it is not Anadarko's position to make a judgment call on how the Administration negotiated the contract, realizing that perhaps there were things that had to be given up in order to secure the contract. Regarding the issues of whether the pipeline could be expanded to 5.7 Bcf, he said there is an assumption that the pipe will be 4 Bcf and easily expandable with compression but that might not be the case. "There are red flags out there and one of them is we don't see anything that says how this will be built." Generally the companies will do what they say they are going to do but he speculated, they could also not allow FERC to tell them they do not have enough capacity and prevent them from forcing expansion.

[9:24:35 AM](#)

MR. HANLEY continued if FERC had that authority Anadarko would be less concerned. Another thing is that a number of their concerns might not be addressed when the LLC agreement is finished. Frankly, it is the LLC that will apply to FERC and they will set the rates and tariffs and will determine who does expansions. Mr. Shepler's memo raises concerns that the issue is not well described, he stated. It is Anadarko's perspective that the pipeline is easily expandable but he questioned whether it was in the shareholders best interest to have a low tariff.

In a normal situation with an independent pipe, a pipeline will apply for a high rate of return because of the risk factor and the shippers would balk saying that they are the ones shouldering the risk. He said:

That's the normal tension of a pipeline [that] wants a high rate of return because that's how they get the return. A shipper, on the other hand, wants to pay as little as they can for that, so this range of acceptable tariffs on the pipeline... our concern in this particular instance is that as a producer/shipper, particularly one that is totally aligned on their capacity and ownership interest; that may shift. And the reason that may shift is because if it's the same company, if you pay a higher tariff, it's coming to yourself but there are two things that happen. It creates a competitive advantage in our view if it's more than a reasonable tariff for third party players, and this is where we see we're aligned with the State as well, and it also affects the wellhead value. As the tariff is higher, the wellhead value is lower and the tax rates on that production is lower so the State would see potentially a lower return and a company would see a higher rate.

MR. HANLEY expressed concern that the pipeline entity could demand a 15 percent rate of return on the pipe and the companies could reject that demand. The normal market forces that work in other arenas do not necessarily apply here, he said. He pointed out the reason FERC stepped out and decided to be able to force expansions is because the normal competitive forces do not work and do not exist. Anadarko is concerned that by controlling access to a pipe allows the companies too much control of exploration around that pipe.

MR. HANLEY referred to Chair Seekins' question regarding the concern that independents might not have access during an open season expansion and said Anadarko does not mind the competition so long as it happens on a fair basis. Generally the open season regulations help provide a fair basis. To the extent that there is terms and conditions within the contract that limit the ability, they are concerned, he stated. "It seems like there is a morphing of the commercial role and the regulatory a little bit in here," he added. In summary, Anadarko is concerned with the contract, particularly as it relates to access and they are concerned with the expansion language.

[9:30:55 AM](#)

CHAIR SEEKINS said there is no doubt that the shippers would pay for the pipe. The issue of basin control is an issue and the public wants to know whether the intent is to limit access to the producer's own interests. He said that was a fair question and a public forum is the right way to address it.

MR. HARPER advised the committee he has had a lot of discussion with the Administration in this area. He said the State aggressively sought expansion language but received a lot of resistance and ultimately ended up making concessions. He said perhaps Mr. Konrad could explain the reason the companies resisted the expansion language on the issue.

[9:33:37 AM](#)

SENATOR BEN STEVENS said he appreciated the discussion on access but he preferred to have the discussion arise from questions that originate from the legislators. This discussion will be resolved somewhere other than in the legislative body, he said. "Access issues on an interstate commerce project fall to FERC," he stated. He expressed concern that the committee was allowing themselves to get diverted from actually finding out information about the project.

[9:35:25 AM](#)

CHAIR SEEKINS asked Senator Ben Stevens whether there was anything in the Stranded Gas Development Act (SGDA) that addressed the issue of expansion.

SENATOR BEN STEVENS replied FERC has eight criteria on mandatory expansion and the answers to those questions lie in that body. "FERC is the determining body of all the concerns I've heard raised here," he asserted.

[9:38:05 AM](#)

SENATOR ELTON said he did not disagree with Senator Ben Stevens but pointed out that Article 8.7 provides how and when the State can ask for expansion and so that is an important component of the contract.

SENATOR BEN STEVENS responded the FERC has allowed under unique circumstance of this pipeline to allow somebody who is not in the project to request for FERC to implement a mandatory expansion. So if an independent finds a large reserve after the project commences, the independent can petition FERC for expansion. The concept of saying that the contract prohibits expansion is untrue, he stated.

CHAIR SEEKINS referred to Article 8.7 and asked whether state expansion was the only kind of expansion available.

MR. LOEFFLER replied it is only one in the tool kit. The special rights that Congress gave to FERC are totally separate from the state-initiated expansion. There are two ways to petition for expansion. One can approach the pipeline with a proposition or one can approach FERC and invoke Section 105 of the SGDA.

CHAIR SEEKINS asked whether that could be attempted at any point in the process of the project.

MR. LOEFFLER said yes.

MR. SHEPLER said he agreed with Mr. Loeffler but added there is also the voluntary expansion, to which the contract is silent. He discussed that in his memo and thought it was surprising given that the parties with whom the State is partnering have opposed FERC's mandatory expansion rights. They have appealed the portion of the FERC order that allows the FERC to require design modifications to make sure the pipe is capable of economic expansion. So voluntary expansion is not in the contract but is an available option, he said.

The other option is the FERC mandatory option, which comes out of the 2004 expansion and we just received the producers brief in the appeal of the FERC order and in that brief they describe Section 105 as providing elaborate protections of Alaska pipeline sponsors from being made to expand the pipeline. As Senator Stevens and his handout indicated, there are eight criteria that the FERC has to find before it can order an expansion. The third option is the state-initiated expansion and my concern there is that the ... mandatory expansion with its elaborate protections ... has been expanded by an additional ten criteria that have to be satisfied before the state-initiated expansion has to go forward. It's more restrictive on rates and limited in time and volumes.

MR. SHEPLER summarized there are three expansion options, two of which are not in the contract and the one in the contract is questionable.

[9:46:07 AM](#)

MR. VAN TUYL referred to the question regarding the difficulty around Article 8.7 and said Senator Ben Stevens explained the

reason precisely. That clause was unnecessary in the contract, he said. It is FERC that controls access to the pipe, not the producers. Because of that, the producers felt it appropriate that the rules of access be adjudicated by FERC. To the question of why the producers want to limit the right to request expansion before commencement of commercial operations, he said that clause is associated with the contract and not with FERC. FERC overrides everything and controls access to the system, he stated. The rationale for the contract language is that the anchor shippers are taking all the risk on building the project and the focus of the contract is to ensure that the project is successful to begin with.

The traditional open season process was supplemented by the FERC open season regulations, which included a unique provision that allows for consideration of bids for capacity received after the open season. It is FERC's job to adjudicate rates for interstate pipeline systems and they assure the rates are just and reasonable. The rates would not be set by the LLC as earlier testimony indicated, he stated.

[9:53:08 AM](#)

MR. LOEFFLER said he had a few points he would like to address. He referred to his previous testimony to the Legislative Budget and Audit Committee (LB&A) in summer of 2004 in which he studied 40 rate cases out of FERC. He said there is no difference in the rate that FERC awards to independents versus producers. "FERC just looks at the project," he said.

The LLC does address voluntary expansion and there is no additional need to put it in the contract. The LLC also captures a financing plan where the intent is to use the federal guarantee and the intent is to achieve a highly leveraged fiscal structure. It is too early to be able to know the fees and conditions that the federal government will impose and so it's impossible to lock that in at this point. "The federal government has it's own interest," he stated.

[9:56:08 AM](#)

MR. LOEFFLER continued it is true in the oil pipeline case that tax rates are not affected by tariffs but it is not true in the case of the gas pipeline. Alaska is taking the payments for taxes in gas not in cash, and so the netback affects the wellhead for everyone else but it doesn't in the tax situation in this contract.

On the issue of FERC looking at late bids he said that was a nod in the direction of the independents to help the project get built and operating. The State is aligned with Anadarko and the LB&A in opposing the one element of the open season order that the companies have appealed. That point is, "Can the FERC order design changes to what is proposed to it." He said his understanding is that is long-standing FERC law, although the companies must have an argument.

[10:00:21 AM](#)

SENATOR GARY WILKEN posed a hypothetical situation of an oil company that approaches FERC where FERC follows Section 105(b) and then grants an order according to Section 105(c). The oil company is now subject to a timeline under which they must execute a transportation agreement. He asked Mr. Loeffler where the rules are under which that agreement would come together.

MR. LOEFFLER replied the order that comes out of FERC would set a number of requirements. The firm transportation (FT) agreement that results from that has to comply with those requirements but there could be negotiation with anything that is left open between the pipeline and the oil company, he advised.

SENATOR BEN STEVENS added the fact that the oil company did that work doesn't necessarily open up the pipeline. That company still would have to negotiate a contract with the LLC.

MR. LOEFFLER agreed and said that contract would have to comply with existing tariff and everything else. He said that is the "put up or shut up" clause because it requires the person that started the process to get the capacity and so it is a special right but the person has to commit financially.

SENATOR BEN STEVENS said that phrase only applies to Alaska because Section 105(d) says, "nothing in this section expands or otherwise affects the authority of the commission with respect to any other pipeline located outside of the state."

MR. CLARK announced he had a handout for committee members that would address Representative Coghill's earlier distribution question.

CHAIR SEEKINS announced a brief recess at [10:03:13 AM](#).

[10:22:32 AM](#)

CHAIR SEEKINS brought the committee back to order and advised members they would pick up where they left off on the same topic of conversation. He asked Mr. Hanley to comment.

MR. HANLEY pointed out the contract contemplates having an effect on the State and clearly FERC is the decider, except in a case where FERC issues a certificate that the producers have to reject because of the rate. In a state-initiated expansion, a rolled in rate would not be appropriate, he said. "While FERC might have said it's a good way to go, the producers get the ultimate decision and we're forced back into a FERC mandatory process. So it does have limitations." Mr. Hanley referred to Section 8.1 and advised that has raised issues with Anadarko. He read the section:

The parties shall not seek additional, different, or supplementary requirements, or regulation of, or access to the gas transmission pipelines, GTP, mainline, any LNG plant, or the non-Alaska project.

MR. HANLEY asserted Section 8 seeks to limit the parties from seeking changes. The definition of "parties" appears to be the State of Alaska and the Alaska affiliates but not the parent companies and so it is not clear whom that section binds. He expressed concern that the State might have "tied it's own hands and nobody else's." He asked Chair Seekins whether the FERC attorney could speak to that matter.

KAROL LYN NEWMAN, Attorney with Morgan, Lewis & Bockius, advised the committee she represented Anadarko Petroleum Corporation for years on this matter. She has practiced law on FERC-related matters for thirty years. She addressed a comment made by Mr. Loeffler regarding the requirements of Section 8.7 and that they are reflective of the mandatory expansion section of the statute. "The requirements of 8.7 are far more onerous for a potential expansion of the pipeline than are the requirements set out in the statute [since] FERC has yet to issue any regulations," she stated.

MS. NEWMAN continued the next concern was whether or not the State, through the contract, agrees that it will not support an expansion by any explorer on ground other than those set out in Section 8.7. That encapsulates the greatest concerns they have with that section, she added.

CHAIR SEEKINS asked Ms. Newman whether she would prefer that Section 8.7 not appear in the lease agreement of the fiscal terms contract.

MS. NEWMAN said yes. It would make it far more difficult for explorers to advocate expansion from FERC in the situation where the pipeline is not agreeable to doing it voluntarily.

CHAIR SEEKINS asked Mr. Shepler whether Section 8.7 acts as an impediment to gain access to other methods or whether it was a third tool.

MR. SHEPLER replied that it is a third tool in the situation where an expansion is initiated by the State that is compression-based and would have the impact of a true rate-reducing expansion. He shared the concerns of Ms. Newman and Mr. Hanley that:

At the extreme, at the looping expansion end of the spectrum, I find that 8.7 takes the eight criteria that have to be satisfied under the federal statute and adds ten more, which are really much more restrictive. But in the one scenario where you have an expansion, which would clearly otherwise be economic for the pipeline, which for some reason the producer or owners or the LLC refuse to do, and which would in that instance actually reduce rates, then it would be a useful tool in the toolbox.

CHAIR SEEKINS quipped, "It's a third tool but it has a few more buttons you have to push to make it effective."

MR. SHEPLER added it wouldn't be used very much and it is not a tool for any sort of expansion that would have any effect of raising the rate for an existing shipper. "That's in contradistinction to the federal statute that Senator Stevens quoted this morning," he said. There the criteria that the FERC has to meet must satisfy that there be no subsidy of the new shippers by the old shippers. It doesn't talk about a rate increase. The federal statute is more permissive of an expansion and Section 8.7 is more restrictive because it prohibits the state-initiated expansion if there is any rate increase. Section 8.7 appears to have a benefit to shippers, he opined.

[10:34:36 AM](#)

CHAIR SEEKINS asked Mr. Shepler whether he would advise an explorer to use the FERC expansion method.

MR. SHEPLER replied if it were anything other than a rate-reducing expansion that is refused by the LLC, then Section 8.7 has little or no value.

MS. NEWMAN added she would advise an explorer not use Section 8.7 because the conditions to which they would have to agree are far greater, far more onerous, and far more costly than FERC would impose.

[10:36:25 AM](#)

SENATOR THERRIAULT asked Mr. Loeffler whether Section 8 was hard fought in negotiations with the producers.

MR. LOEFFLER referred to a point made by Ms. Newman and clarified that by having Section 8.7 it does not indicate that the State would take a position opposing any other kind of expansion. He responded to Senator Therriault's question and informed that they looked at half a dozen forms of expansion and there does exist FERC regulations. There was considerable negotiation on Section 8 of the contract, he admitted.

SENATOR THERRIAULT asked Mr. Loeffler to advise whether the terminology of no rate increase versus no subsidization was highly negotiated.

MR. LOEFFLER replied no one really knows what a subsidy is but a subsidy would be implemented in the way of fuel retention. "In effect, we were giving a little more detail as to how FERC would treat it," he said.

[10:40:09 AM](#)

CHAIR SEEKINS asked Mr. Hanley to air his concerns regarding basin control.

MR. HANLEY advised the committee that he brought some discussion papers that Anadarko compiled in 2001 that describe their issues and concerns. The papers provide examples of identified concerns that competitors often have. "Controlling access to infrastructure can control the basin," he stated. Mr. Hanley went on to quote an article from the Calgary Herald printed in 2001 - headline: Conoco Dismisses Native Demands; CEO insists on pipeline ownership:

Archie Dunham, the Chief Executive of Conoco had a message for aboriginal groups demanding one hundred percent ownership of a proposed Mackenzie Valley natural gas pipeline: "No." Dunham who gained control of 1.2 trillion cubic feet of gas in the Canadian arctic with Conoco's blockbuster takeover of gulf Canadian resources said his company must have a stake in the pipeline. "We're going to have an ownership of the pipeline. We have to have it." Dunham defended his hard-line position citing Conoco's

woes in Alaska in the early 90s when it felt it couldn't get full value for its resources because it did not own a stake in the Trans-Alaska Pipeline. "The owners of the pipeline, by adjusting the tariffs on the pipeline, could really diminish the value of the producing properties and that's not going to happen again," pledged the CEO of the Houston-based company.

MR. HANLEY added Anadarko as well as other producers have concerns about companies that demand ownership as a means to protect their ability to produce. He offered the papers to committee members to help them understand the issues that Anadarko has.

CHAIR SEEKINS asked Mr. Harper for his perspective on the topic.

10:44:20 AM

MR. HARPER said it was important to keep in perspective that an interstate pipeline company is not a publicly owned utility. It is a for-profit company aggressively promoting its interest. They have a myriad of ways to influence the outcome of how the system is managed, how rates are set and how access is granted to their system. "They are profoundly skillful at that," he stated. The FERC will not serve as an ultimate backstop protecting all interest holders and stakeholders equally. "It will not happen," he said. It's very important that the contractual terms and the intent be clearly understood both in the contract agreement and in the LLC agreement. He agreed with Mr. Hanley that the interstate pipeline company would have an impact on the interest of other stakeholders.

MR. HARPER continued interstate natural gas pipelines are not common carriers; they are contract carriers. When the contracts are negotiated, common carriage implies, "when the pipeline is full, normally you want in, you get a cut of the action." "That is not the way that natural gas pipelines function or operate," he stated. The terms of access will influence outcomes including access to the basin. "There is absolutely no question in my mind about that," he stated. He expressed concern over the structure of the contract as it stands.

10:48:40 AM

MR. VAN TUYL agreed that basin control is a serious issue that must be addressed. He emphasized that it would be FERC that would control access in and out of the basin. Regardless of who owns the physical pipe, access to capacity on the pipe has to be made available on an open access basis. The process FERC uses to

determine access is the open season process, and the stigma of the basis being locked up by the producers is false he asserted.

MR. VAN TUYL offered to speak on the issue of the rationale for waiting for the commencement of commercial operations to allow access to the state-initiated expansion. Their focus is on successful delivery of the project, he said. One concern is that entertaining such things as expansion alternatives and design changes could require submission of a revised application to FERC. If that happens it could result in having to submit a new application, which would start the clock again. "We don't think that is in anyone's interest," he stated.

[10:52:46 AM](#)

SENATOR ELTON said no one would dispute what Mr. Van Tuyl said about open access. The fundamental question is not what happens during the open season but what happens after the open season and how expansion would work so that others have access to the pipeline.

MR. VAN TUYL responded many things could happen after the open season. One of the FERC regulations require that even a shipper that didn't participate during the open season and comes in with a bid after the open season; that bid must be considered by the pipeline. In addition, there are three mechanisms that enable access after the initial open season and any one of them would be adjudicated by FERC.

SENATOR THERRIAULT said experience with the TAPS settlement methodology has shown that entering into a contract can limit the full implementation of FERC's powers. He asked whether the current contract would not do the same thing since the State would be bound by the contract and would aggressively look for full utilization of FERC's powers to protect access for others.

MR. VAN TUYL responded under a Delaware LLC structure, any member would be able to have its voice heard before FERC.

SENATOR THERRIAULT countered there are issues with the language in the contract that specifies if FERC were to come back with something other than what was requested, all members are bound by the contract to reject it whereas without that language, the State would be able to side with FERC.

[10:57:59 AM](#)

MR. VAN TUYL said Senator Therriault was referring to language specific to Article 8.7 and state-initiated expansion. Article

8.4 expressly preserves the right for any party to petition FERC. He said that goes back to Senator Ben Stevens' comment that FERC would set the rates and provide regulated access to the pipe.

SENATOR THERRIAULT asked Mr. Loeffler to clarify whether there was a presumption of rolled in rates with the National Energy Board (NEB) implementing its policy or whether it was given that they use rolled in rates.

MR. LOEFFLER informed they have a rolled in rate policy but was not sure whether that was a presumption. He offered to check into it. He continued Article 8.4 was put in the contract precisely so the State could pursue different tariffs with FERC.

[11:00:51 AM](#)

SENATOR THERRIAULT addressed Mr. Van Tuyl and said the reason he mentioned the NEB was because currently with development of the Mackenzie line by Imperial, Shell, and ConocoPhillips; British Petroleum was advocating for NEB policy because of the rolled-in rate presumption. It is a situation where BP is on the outside advocating for the system that offers BP the most protection and so there must be realism to the concern that others wouldn't be allowed to utilize the system, he stated.

MR. VAN TUYL clarified BP supports a market-based approach to the Canadian regulatory system and feels that the system should allow the market to work.

SENATOR THERRIAULT asked Mr. Van Tuyl whether there was any instance where BP has filed to support the NEB process and other companies have asked for something that offers less protection.

MR. VAN TUYL responded BP believes the NEB process allows parties to be heard and allows them the most efficient result to occur.

[11:03:01 AM](#)

MR. KONRAD added BP is seeking the same thing in Canada that the NGD contract lays out, which is that the transition lines are regulated by FERC. "In the case of Canada we are petitioning to do the exact same thing," he stated.

SENATOR THERRIAULT asked whether the NEB process was presumed or whether it was built around a rolled-in rate methodology.

MR. KONRAD did not know.

11:04:15 AM

MR. HANLEY said Anadarko would encourage FERC regulation of the main line, GTP, and transition lines so that there is an opportunity at some venue to appeal things. After the open season if an explorer were to approach the LLC and be turned down, there is no other mechanism in which to gain access. The contract is written such that if the request were outside of FERC jurisdiction, commercial arrangements would apply. Anadarko would prefer that there be no regulatory gap. If there is a recognition that the elements be regulated because of the critical nature, Anadarko would prefer there be a regulated body to turn to.

CHAIR SEEKINS said Alaska statute states that no certificate can be granted for a gas transmission line without it being regulated either by FERC or by the Regulatory Commission of Alaska (RCA). He asked Mr. Hanley to comment on that statement.

MR. HANLEY said he was unsure of the interpretation of the law but that doesn't appear to be the intent of the contract. The contract specifically says the pipeline will be regulated by federal law, or if federal law does not apply, will be regulated by the commercial agreements.

CHAIR SEEKINS asked Mr. Clark whether that was the intent.

MR. CLARK replied the intent was absolute FERC regulation of the entire system. The Administration does not contemplate a gap in that system.

CHAIR SEEKINS asked Mr. Loeffler whether he thought there would be gaps in the regulation process.

MR. LOEFFLER said he did not anticipate gaps in the regulation by FERC.

CHAIR SEEKINS asked Mr. Shepler whether he thought there would be gaps in the regulation process.

11:09:06 AM

MR. SHEPLER said his thoughts are aligned with Mr. Loeffler's. He noted that further upstream gets further away from FERC's authority under the gathering presumption. Typically in the lower 48 FERC takes the position that processing to make the gas pipeline quality is not a jurisdiction of activity. That is an upstream activity and their regulatory process starts at the

downstream end. So from the mainline going upstream, each step gets slightly more tenuous in terms of certainty of FERC jurisdiction.

MR. LOEFFLER added FERC has imposed the open season requirements on the GTP so they must have jurisdiction over it. He informed the committee that he spoke with FERC and as far as they are concerned, the GTP is "just another part of the big pipe." He said Alaska is different than the lower 48 and FERC understands that.

[11:12:10 AM](#)

CHAIR SEEKINS referred to SB 305 (24<sup>th</sup> Legislative Session) and said there was a provision that said anyone that wants to take the credits has to agree not to oppose FERC regulation on upstream elements. He asked whether that was a provision in the contract.

SENATOR THERRIAULT advised that any party that takes the credit has to go with the state government to the regulator and ask that the benefit of that credit flow through to the benefit of all shippers. That concept is in the contract.

[11:13:22 AM](#)

MR. HANLEY read Article 8.3 and said the parties expect the Alaska project to be regulated by FERC or by commercial agreements. It does not mention the RCA. He continued, "If FERC does not assert jurisdiction, no party may seek or support the jurisdiction of the regulatory commission of Alaska over any aspect of the project." The contract clearly contemplates FERC or commercial arrangements but not RCA arrangements, he asserted. The contract contemplates a regulatory gap, which means the commercial arrangements apply. "It doesn't appear to take the RCA out, it just says the State has to oppose the RCA's jurisdiction."

CHAIR SEEKINS asked whether the RCA could assert jurisdiction under state law.

MR. HANLEY was not sure but said the actions they would have to take would include changing state law. Anadarko would prefer the ability to go to a regulatory agency instead of having to approach a commercial arrangement.

[11:15:45 AM](#)

JAMES EASON, Consultant to the Legislature, agreed if there is a regulatory gap, commercial arrangements would dictate but said

even if the State opposes the RCA assertion of jurisdiction, in the event that there is a loss, the State is indemnifying the producer participants.

MR. SHEPLER referred to the issue of basin control and said certainly the FERC rules establish how pipeline capacity is initially awarded but once a contract is entered into that shipper holds that capacity for the length of the contract. If the contract is for 20 years and the pipe is fully subscribed for 20 years, open access has been accommodated. FERC establishes contract carriage not common carriage so only the parties that have contracts have assured rights of access. New players have to depend on expansion capacity being built.

Page five of the project summary is a Gantt chart that shows the open season process starting at mid 2007 to the end of 2008. It is contemplated that at the end of the open season the LLC will sign up firm transportation contracts, which will commit the shipper to hundreds of millions of dollars of demand charges over the life of the term that they bid. In order to be able to take advantage of the initial open season, that entity must have an exploration and development program in place or they have to depend on expansions. The issue of expansion is critical to the issue of basin control, he stated.

MR. SHEPLER continued typically expansions are not an issue with an independent pipeline because that pipeline has incentives to expand the pipeline. Since this is not an independent pipeline the commitments to voluntary expansions or state-initiated expansions are fundamental to the issue of basin control.

[11:21:07 AM](#)

CHAIR SEEKINS asked whether FERC regulations of expansion were different for an independently owned pipeline.

MR. SHEPLER replied no. Producer-owned interstate pipelines are uncommon, he added. FERC rules were developed in the context of the independent pipeline model and the rules address how capacity is obtained and the economic incentives drive the expansion.

MR. HARPER said in light of the producer comments he is more concerned than ever. He agreed with Mr. Shepler's assertion that an independently owned pipeline is "generally expansion-happy." The current contract is expansion-restrictive as he reads it. He took issue with comments from the producers that say expansion

requests would be regulated by FERC, but the FERC responds to complaints. He said:

One of the strategies that is employed by pipelines is the utilization of time and litigation. And if somebody has to file a complaint and somebody has to litigate a complaint before FERC on an expansion in a non expansion-friendly pipeline, those time delays and those expenses are daunting. And so whether or not a pipeline has an orientation to expand on a friendly basis as expressed contractually in addition to regulatory is absolutely vital and key to the issue of basin control.

MS. KING explained the contract is a fiscal contract and does not attempt to assert how FERC should act with respect to expansions. On the issue of basin control she said, "Actions speak louder than words. ConocoPhillips has been partnering with independents in exploration activities up here for years." She went on to say that ConocoPhillips has partnered with other companies to bring new independents to the State of Alaska and that proves that ConocoPhillips sees value in bringing new parties into the fold. There are adequate protections for expansions and FERC has spoken twice. They have passed unprecedented provisions with respect to open season regulations.

[11:26:28 AM](#)

MS. KING continued there are a number of provisions that will protect and ensure access into the pipeline. ConocoPhillips believes the pipeline needs to be flexible and needs to operate as a commercial entity to ensure that all different expansion scenarios can be assessed and evaluated. FERC has come out with the 2005 open season regulations and there is a rebuttable presumption for rolled-in rates. ConocoPhillips is not challenging that, she said. They are specifically challenging the one issue that FERC should decide how they would be treated with respect to the expansions.

MS. KING asserted there have been a number of misstatements during the last few hours of the meeting. She took issue with allegations that the producers could change the design of the project during construction and said that is not true. They would have to get permission from FERC. She took issue with allegations that the producers are not motivated to expand the pipe. "If somebody is willing to pay for an expansion, there will be a business opportunity for somebody to pursue," she stated. It is also not true that the pipeline would set the

rates. Rates would be set by FERC. She took issue with allegations that they are not motivated to have a low tariff and said unless prices tank, ConocoPhillips will generate the majority of their revenue from state gas sales. If the tariffs are high, ConocoPhillips will also have to pay.

MS. KING emphasized that FERC would balance the interest of all the parties. FERC will decide the appropriate methodology for expansion. "ConocoPhillips will not ask existing firm holders that have rate uncertainty to subsidize our business," she asserted. She posed a hypothetical situation with respect to mandated rolled-in rate treatment: An LDC might be holding firm capacity at mileage sensitive rates to try to ensure that the State has the best opportunity for instate gas consumption. ConocoPhillips finds a discovery and decides to press for expansion and it might not be advantageous to all shippers that the expansion wouldn't be a subsidy. "If you were the holder of instate LDC capacity, you'd be exposed that your rates could go up," she said. Everyone should want rate certainty to secure the ability to deliver volumes instate as well as the ability to deliver rates for maximum value into wherever they decide to ship that gas.

MS. KING referred to the issue of why ownership in the pipeline is important and said the producers would make long-term financial commitments and so ownership and alignment is extremely important. She offered to answer questions.

[11:32:31 AM](#)

REPRESENTATIVE LES GARA said his concern centered on the policy of expanding the pipeline and using rolled-in pricing. He asked for confirmation as to why he should not fear that the two major mechanisms to require an expansion would be adequate. He expressed concern that the State would not have the right to exercise required expansion. He expressed the additional concern that the producers would block an expansion that FERC might determine would cause an increase to suppliers and a subsidy to the new shipper. He said if he does have cause for concern he would like to hear from Mr. Hanley suggested language for the contract that would ensure expansion with rolled-in pricing that would be fair to everybody.

MS. KING responded there is nothing in the contract that would preclude the State from going to FERC and requesting an expansion.

MR. LOEFFLER agreed.

REPRESENTATIVE GARA countered, "I know we have the right to request it, my concern is whether we'll get it."

MR. LOEFFLER asserted FERC could not be controlled. He said, "I don't know where we're going with this discussion. You can propose things to the FERC but if you want an absolute right that the pipeline can expand, regardless of economics, it's not going to get by the FERC."

[11:37:26 AM](#)

MR. HARPER reiterated his concern that the contract is not expansion friendly and that the producers point to complaint procedures and litigation procedures with the FERC as the redress mechanism. That avenue is very time consuming and not what one would face with an independent pipeline, he said.

MS. KING advised the committee that the producers have been preparing for an open season since 2002 and explorers have had plenty of time to pursue exploration.

REPRESENTATIVE GARA said he would still like to hear suggestions for better language in the contract. He posed a hypothetical situation where it ended up that the rules were not favorable for an expansion even if the expansion would raise the tariff for existing producers and asked whether that would inadvertently deter production and deter future expansion. "We have to pay for capacity whether or not the pipeline is at capacity. So will we be risking an amount of gas that might not only fill the expansion but an amount of gas that might help contribute to filling existing capacity to protect the State from the charge of having to pay for capacity even if it's not in there," he queried. The State has an interest not only in the expansion but also in the gas that will fill capacity in the existing part of the pipeline, he stated.

MR. HARPER deferred the question to Mr. Shepler.

MR. SHEPLER agreed that was a good point. The expansion gas that would come to an expansion would fill both the expansion and solve the problem of the out-year gap. Bringing expansion gas in would presumably help fill the out-year gap and at the same time expand the resource base and the State's royalty share.

MR. LOEFFLER added when an explorer bids for capacity in the open season, they examine the amount of gas they are likely to have and for how long. The State might bid for more capacity

than it knows it has and in that event it would want to fill up the unused capacity. However, it does not have to get into a rolled-in situation. There are rules about the release of extra capacity that could "bore you to death," he said. He asked the committee to look at the issue from the perspective of the pipeline.

The pipeline or owner of the LLC wants to secure firm transportation (FT) commitments that will enable financing. It does not want to cover a financial obligation that is not backed up by the FT commitments because the pipeline has to pay for that. If a pipeline builds too much capacity to begin with, generally FERC would require the pipeline to bear the cost of the unused capacity. The open season process is very complex and there may be scenarios where there is unused capacity that individual shippers are holding.

[11:45:36 AM](#)

MR. CLARK assured the committee that the State would not bet on excess capacity and get into the excess capacity business.

MR. SHEPLER referred to Representative Gara's question and said he did not understand his question to be asking about expansion capacity in terms of the State's interest as an owner; he understood his question was toward the State as a sovereign with the objective to encourage exploration and maximize resources.

[11:47:39 AM](#)

CHAIR SEEKINS said it is the intent of the Legislature to provide availability of expansion on a fair basis and not necessarily subsidized by the owners and shippers.

MR. CLARK assured the committee that the Administration aggressively pushed for obtaining the open season with respect to federal law. Article 8.7 is intended to provide additional tools for seeking expansion.

[11:48:54 AM](#)

MR. MASSEY said he believes that the producers will find a way to expand the pipe and to move the gas down. They would not prevent anyone from tapping in. FERC policies would not allow them to stop expansion and they wouldn't want to do that anyhow. He said the key reason for the reluctance toward Article 8.7 was that it is not necessary. However it is in the contract because the producers wanted to dissuade the perception that they could lock up the basin.

[11:51:49 AM](#)

SENATOR THERRIAULT asked whether during the agreement to Article 8.7 it was also agreed that the RCA language would also go in.

MR. MASSEY advised that there were many compromises during the negotiations. The parties have agreed in the contract to seek FERC regulation but the RCA can also regulate. The only thing that they have asked is that if the RCA does something inconsistent with FERC policy that causes ExxonMobil a loss, they want the opportunity of arbitration to prove their case.

SENATOR THERRIAULT reminded the committee that the producers are not "a monolith" and not all of one mind. He said it has not always been a position of the producers to be involved in ownership of a pipeline. He referred to an early 1980s Senate Energy subcommittee hearing and said Exxon's testimony was that they were not in the pipeline business and had no interest in getting into the pipeline business. He asked what the difference is today.

MR. MASSEY replied ExxonMobil is not in the pipeline business, except for in large, complex projects where they own funding.

SENATOR THERRIAULT speculated that was the dynamic with any pipeline.

MR. MASSEY responded there is no pipeline in the lower 48 that he is aware of that matches the magnitude of the project at hand in terms of investment, exposure and risk.

MR. LOEFFLER said in the 1980s the structure of the lower 48 pipelines were different. Since the time of that testimony, FERC has forced the separation of the marketing and ownership of gas so the industry has changed considerably.

SENATOR THERRIAULT said he is not sure that explanation sufficiently answers his question. During testimony in the 1980s, producers adamantly expressed to the U.S. Congress that they were not interested in ownership of pipelines.

MR. MASSEY agreed with Mr. Loeffler that the industry has changed and producers are exposed to more risk.

[11:59:12 AM](#)

MR. HARPER asked Mr. Massey to explain the reason ExxonMobil was interested in owning the pipeline in perpetuity.

MR. MASSEY replied he did not understand the question.

CHAIR SEEKINS surmised they would want to own it forever because it was a big investment. He announced that the committee would break for lunch at [12:00:54 PM](#).

CHAIR SEEKINS called the meeting back to order at [1:31:03 PM](#). He asked Mr. Hanley to summarize the concerns that he presented earlier.

[1:31:38 PM](#)

MR. HANLEY said he wanted to put on the record that the uniform upstream fiscal contract is how third parties would get access to the agreement. That topic has not seen much discussion but he added they would work with the Administration on the issue of how that would work. The contract is drafted for the three producers and the State but other companies will have to utilize the terms and conditions of that contract.

[1:32:28 PM](#)

MR. CLARK asked to address that topic and said Mr. Hanley is right. The pipeline will be financed and constructed based upon FT commitments and they are looking for FT commitments from all parties because they want to include as many parties as possible. That is both the State's position and policy. This is not the time to get into the topic but the general policy is to create a situation that anyone who accepts FT and takes that responsibility will get upstream fiscal certainty, he stated.

[1:33:40 PM](#)

MR. CLARK continued the idea is to level the playing field. The purpose of the public comment period is to identify places where the State can enhance policy with better language. The points taken today would be addressed with receptivity.

MR. HANLEY referred to earlier comments that there has been ample opportunity to prepare for the open season and said they were not convinced in 2001 that they would have access to the pipe. Now that the FERC rules have evolved there will be exploration activity. Despite the fact that Anadarko is raising concerns over the contract, they are supportive of the pipe.

[1:37:18 PM](#)

CHAIR SEEKINS asked Mr. Clark to summarize the State's position.

MR. CLARK deferred to Mr. Loeffler.

[1:37:57 PM](#)

MR. LOEFFLER said from the point of view of the supply of gas to the United States and to Alaska, this project opens potentially a very large basin. The project is pro-competitive and brings more supply to market. The pipeline will open the basin for everyone. Anadarko can't get its gas to market today; nor can ExxonMobil, ConocoPhillips or anyone.

He advised committee members not to assume the project could be built based on personal experience and what the Commissioner of the DNR found. The Commissioner has found this is the best opportunity to get a project. Alaska had a shot at an independent pipeline in the late 1970s and that failed so it appears that the producers are an inevitable part of the pipeline project. "You need the producers to sign up and put their financial resources behind the FT commitments," he stated.

Discussing the issue of expansion is likely putting the cart before the horse, he asserted. The pipeline needs 15 Tcf of gas according to the Commissioner's fiscal interest finding. The project needs Anadarko's gas and exploration efforts, ConocoPhillips' gas and efforts and everyone else who can contribute. The pipeline must be full before anyone starts talking about expansion.

The critical part of the Administration's program to develop this pipeline was to draft a model upstream contract and there is one at page 449. He advised committee members to review the draft fiscal contract and the attachment to see how it interrelates and gets the gas committed to the project. The Administration wants the independents and the project needs more gas, he said. The Administration has made an effort to ensure that the fiscal benefits that apply upstream are available to anyone who wants to commit gas to the project.

[1:42:30 PM](#)

MR. LOEFFLER continued in terms of access to lands and leases on the North Slope; the leasing policies of the DNR and of the federal government are pro-competition. He agreed with Mr. Hanley that some recent legislation has addressed some of the concerns, such as Order 2005 and 2005A. The Administration was pro-expansion and pro-competition on its comments on those orders and will continue to be.

[1:43:50 PM](#)

Lastly it is important to remember, the State will be a member of the LLC and will be on the inside where all of the

information on the project will be. They will be voting on issues and will be there when expansion requests are presented to the LLC. The State of Alaska representative will certainly be sensitive to competitive concerns as they fill their functions within the LLC, he stated.

MR. LOEFFLER added one last comment: Overall the current discussion regards the fiscal contract and the focus of the hearings should stick to the important issues, such as the reason the State is taking an ownership position and going into the business of marketing gas. "That is an enormous public policy decision for the State and I hope that we can soon move on to address that subject as we're prepared to do," he stated.

[1:45:31 PM](#)

SENATOR ELTON asked whether any of the other applicants, such as TransCanada, addressed expansion issues in their application.

MR. CLARK advised he would check and get back to the committee. He added the committee should receive TransCanada's statement on the contract today.

SENATOR DYSON said he was intrigued about the discussion of the RCA. He asked the consultants to comment on other contracts where FERC chooses not to have administration and whether it is common to exclude the sovereign's regulatory body.

MR. SHEPLER advised he does not have the background to comment on that point. He surmised that other U.S. contracts involving state involvement to this magnitude simply don't exist.

[1:48:20 PM](#)

JAMES BARNES, Barnes and Cascio LLP, Consultant to the Legislature, said his response is outside of the U.S. However, his experience in large projects elsewhere is there is nowhere near the complexity of regulations that the U.S. has.

MR. HARPER said:

This agreement is unique in my experience in this regard in two ways. One, I perceive that the intent is to exclude state regulation specifically. I've never seen that. And then the reciprocal, under indemnification if you will, of any reduction in what the participants might receive if that were to come to pass is also unique in my experience.

SENATOR DYSON aired his understanding that FERC was taking a unique role in the pipeline because it is a monopoly. He said it seems strange not to have some provision for an objective party to regulate where FERC doesn't.

[1:51:22 PM](#)

MR. CLARK responded the reality is they expect FERC to regulate the entire system. As one of the producers earlier testified, their economics are driven by the FERC policies that are applicable. The Administration does not see a situation where the RCA would ever be involved.

[1:53:21 PM](#)

SENATOR BEN STEVENS posed a hypothetical scenario of a proposal by the State to make a spur line for delivery somewhere within Alaska. That spur line would be subject to shippers that could ship their product to an in-state point. He asked who the regulator would be.

MR. LOEFFLER advised by the federal statute, the RCA would regulate the spur line. The RCA would set the rate and terms of access. The rate to connect to the spur line would be set by FERC.

MR. CLARK added RCA jurisdiction in that situation is in no way precluded by the contract.

[1:54:53 PM](#)

SENATOR BEN STEVENS asked whether there was anything in federal law that allows a state regulatory commission to be involved in the ratemaking for the delivery of a product destined to market in another state.

MR. LOEFFLER said no. Federal law is exclusive and preemptive on a shipment of natural gas from one state to another.

MR. SHEPLER said he did not fully understand the example. In the federal law exclusive of Alaska, delivery of gas within a state that was received through interstate commerce was originally held to FERC jurisdiction but was ultimately exempted by the Henshaw Amendment. When gas originates in one state and goes to market in another it would be interstate transportation of natural gas and would be FERC jurisdiction.

[1:56:29 PM](#)

SENATOR BEN STEVENS announced if the product is produced in one state and delivered in another it is FERC jurisdiction. If the

product is produced and delivered in the same state it is RCA jurisdiction.

MR. LOEFFLER added the project described in the contract does not include a lateral. The Administration made sure to preserve the jurisdiction of the RCA over the rate from the takeoff point.

[1:58:40 PM](#)

CHAIR SEEKINS asked Mr. Clark to comment on the Administration's intent regarding the proportional tariff on natural gas from the North Slope marketed instate.

MR. CLARK deferred to Mr. Loeffler.

MR. LOEFFLER advised in the open season rulemaking, the State secured that the rate would be based only on the cost of delivering that service and not on the cost outside Alaska. The long haul rate will be based on long haul cost and the short haul intrastate rate is to be based solely on rates inside Alaska. Secondly, the FERC order suggested that the rates be mileage sensitive and so that was written into the contract.

[2:00:16 PM](#)

SENATOR BEN STEVENS said he is sure this isn't the only project set to function within the bounds of North America where a product is produced in one state and shipped to another. He raised the example of pipelines coming out of the Gulf of Mexico and traveling northeast. He asked whether the State of Texas was involved in rate setting.

MR. LOEFFLER said no. There are no cases where states own pipelines. However, in an interstate pipeline, FERC sets the rate.

[2:01:33 PM](#)

MR. HARPER noted the Texas Railroad Commission regulates the transportation, gathering and processing of natural gas in Texas on a complaint regulatory standard basis. He observed that through interstate pipelines in North America, gathering, treating and processing facilities that were regulated were "spun down" systematically so that it is no longer typical for interstate pipelines to have those facilities as a part of their regulated assets and tariffs, even though gas moves through those facilities. This situation envisions inclusion of those types of assets in the regulated pipeline activity, he stated.

[2:02:55 PM](#)

MR. LOEFFLER advised since 1938 the federal government has not had jurisdiction over gathering lines. He said he does not regard the upstream gas pipelines as gathering lines.

[2:04:20 PM](#)

MS. NEWMAN said both points have merit but over the years there has been a considerable amount of regulation over gathering lines in conjunction with interstate pipelines because they were all owned by the same entity. There has been litigation that went to the Court of Appeals regarding FERC's ability to regulate gathering lines and there was much dispute over what is and what is not a gathering line. There are many cases involving gathering lines and it is a recurring problem for FERC. She cautioned:

The lines that are upstream here from the mainline and any plant put in separate ownership, I cannot assure you at all that they would be found by FERC to be interstate pipeline, federal regulatory commission controlled facility. In that situation, which could occur once we know exactly how they're going to be structured... you can make a better call on it. It is possible that if the State of Alaska elects not to regulate those facilities or some system is put in place by the Legislature that takes that control away, that they can be left to a matter of private contract.

[2:06:37 PM](#)

CHAIR SEEKINS said that is consistent with what he has been hearing.

MR. LOEFFLER said he would have to check to see whether the RCA has jurisdiction over gathering lines. Gathering lines are not intended to be part of the project, he added.

[2:07:25 PM](#)

MR. EASON expressed concern about the symmetry of language and said the producer's rights and interests are protected. "The State's interest is taken off the table whether or not it ultimately might be asserted," he said.

MR. LOEFFLER asserted the RCA itself is not bound by the contract and would have the right to assert and pursue jurisdiction.

[2:09:17 PM](#)

CHAIR SEEKINS posed a current example of what he perceives to be an unfair business practice having to do with RCA regulation. It has to do with the tariff question that Flint Hills Resources is facing. If the tariff is changed, it will change retroactive and they will be subject to a huge economic penalty. He said it is the retroactivity that bothers him most.

MR. CLARK said as a final point the answer is that as the Administration examined the issue, they believed it was one of those "what ifs" that wasn't going to happen and they did not want the State to have to pay.

[2:12:28 PM](#)

SENATOR DYSON said the discussion highlights the need for clarification whether the RCA can have jurisdiction. That feeds into another of his concerns that there are protections the State now has under the lease agreements and the unit agreements that are apparently forfeited under the contract, he said. Regarding his question earlier, he said he was "kicking himself" for using the term 'bizarre' to describe the 100-mile increments on the expansion of the gas line capacity. He has been told that no one knows of any other contract with similar language. He said he would appreciate discussion of that in the future.

[2:13:51 PM](#)

SENATOR ELTON said on the issue of indemnification, it seems that if the expectation is that FERC will regulate, then adding the RCA language is far in excess of what the State needs in order to protect its interest.

CHAIR SEEKINS noted all parties should realize that the Legislature is after fair and equitable access, but not to the extent of subsidy.

[2:16:05 PM](#)

REPRESENTATIVE JOHN COGHILL thanked the consultants, representatives from the Administration, and the producers for their participation in the round table discussion. He said for the State of Alaska to become an owner, operator and marketer of its gas in partnership with industry people could be the biggest policy call in the history of Alaska. He said before he could cast his vote he must know how all of the parties came to this unprecedented decision. He said he is not a fan of state ownership of anything, let alone a big pipeline.

[2:18:58 PM](#)

MR. CLARK responded the SGDA gave the Administration the direction to negotiate the business deal. As they read through the SGDA they saw the partnership between producers and the State as what the Legislature intended. Litigating to assert state's rights as owner was always there but they had to answer the question of whether it was possible, in accordance with direction from the SGDA, to reach a business agreement. That is how the Administration set its policies beginning with the application phase.

The concern was how Alaska would fit in terms of a couple of important components in terms of the economics. That drove the decision for taking gas in kind. By taking Alaska's gas in kind it means the State has to handle capacity management. The Administration believes the article on capacity management is a strong success story in the negotiations. He asked Roger Marks to address the economic response and asked that Ken Griffin address capacity and marketing risks.

[2:22:56 PM](#)

ROGER MARKS, Economist for the Department of Revenue (DOR), explained that he would provide a 20-minute presentation on the philosophy and rationale of why the judgment of taking ownership and gas in-kind was important to moving the project forward.

CHAIR SEEKINS announced a brief at ease in order for Mr. Marks to set up.

[2:25:19 PM](#)

MR. MARKS advised his main points would be addressing State ownership and taking Alaska's gas in kind and how that improves the rate of return for the producers, which is important in order to move the project forward. If the project were set up so that Alaska were to take its gas in value it would have to return 16 percent in order to pay shareholders and creditors. Equity always has a higher cost than debt since debt is always the first in line to be paid off. The cost of equity represents the business risk of the enterprise. The rate of return is based on net cash flows every year. A pipeline project that is expected to last 30 years would incur three years of construction before the production start, after which revenues, costs and taxes come into the picture. Subtract the cost from the revenues to get the net cash flow.

[2:29:17 PM](#)

MR. MARKS continued in the early years Alaska would see high cost and no revenues so the net cash flow in the first years

would be negative. When computing the rate of return, corporations normally assume the project will use all of the equity without borrowing. The reason they do this is they separate the investment decision from the financing decision. The first decision is whether the project is profitable. If so, the second question is how to finance it.

Corporations measure the profitability by looking at it without regard to how the project is financed. In order to compute that, they run the cash flows as if it is financed totally with equity. The rate of return is the interest rate, which makes that net present value exactly zero. Net present value is based on the time value of money so costs that occur early on suppress the rate of return.

In the case of state ownership where the state picks up 20 percent of the costs upfront and the state takes its gas in value and not in kind it can not improve the rate of return because in that situation the state would not be able to get a firm transportation commitment from the producers.

[2:33:10 PM](#)

MR. MARKS continued the definition of debt is "future monetary obligations as a result of past transactions" so an FT commitment would be most certainly a liability or debt. Because an FT commitment over a long period of time bestows much of the rights and obligations of ownership, what generally acceptable accounting principles (or GAP) says on the financial statements is that on the financial statements you capitalize the commitment.

Many people have said FT commitments don't show up on balance sheets of the producers so they must not be important. In the post-ENRON world, off-balance sheet debt is as important as on-balance-sheet debt, he said. Under pure GAP standards debt shows up when the amount of the liability is for more than 75 percent of the life of the asset or the amount of the liability accounts for more than 90 percent of the value of the asset. In the case of a pipeline there are multiple subscribers and it's impossible to satisfy those requirements, which is why FT commitments will not show up on the balance sheet even though it is salient for credit ratings and the ability of producers to borrow.

[2:35:32 PM](#)

The question is how to treat FT commitments in computing the rate of return. In order to explain how to do that it's important to explain how not to do it, he stated. He gave an

example of a corporation with a 16.5 percent hurdle rate that came up short when the numbers were run. In order to increase that rate of return the corporation could bring the State in and have them pay 20 percent of the costs in exchange for 20 percent ownership and then the corporation would pay a tariff over time to the State. The old adage of "you can't make a bad project good by borrowing money" is what that example just did. By having the producers borrow money and pay it off over time, it increased the rate of return. That is inappropriate since it mixes up the financing decision and the investment decision, he said.

[2:42:40 PM](#)

MR. MARKS referred to the current contract where the State takes 20 percent ownership but also takes its gas in kind. The State owns the gas the entire way and does not require an FT commitment from the producers. This method incurs less money up front and increases the rate of return. Ownership raises risks, gives Alaska benefits and income, and creates marketing risks. "In our judgment, these risks are not monumental," he stated.

[2:44:16 PM](#)

REPRESENTATIVE COGHILL said that is consistent with what legislators heard at the Centennial Hall meetings. The risk is that the FT commitment will be on the State and then it would be up to the State to sell the gas. He said the fundamental issue for him is whether he could support that concept. He asked to hear from industry people as to how they also arrived at the concept of the business agreement.

[2:45:23 PM](#)

CHAIR SEEKINS clarified that Representative Coghill was speaking about two different things; one is ownership of the pipe and equity interest in the steel and equipment, and the other has to do with owning pipe within the pipe to be able to transport gas, which would be dependent for income on the transportation commitments. He asked Representative Coghill to clarify his question.

REPRESENTATIVE COGHILL replied the ownership of the steel was the lesser concern. He said he has a hard time with Alaska carrying the weight of the gas, deferring the investment in 20 percent capacity, and then having to sell the gas in order to recoup the money. "Certainly that requires a huge partnership with a group of people who have quite different interests in Alaska," he stated.

CHAIR SEEKINS speculated that owning the pipe might bring about a better return than the current investments of the Permanent Fund.

[2:47:31 PM](#)

MR. MARKS said currently Alaska is paying for the pipeline through the tariff deduction. Alaska would be paying approximately 14 percent on their equity piece. Alaska would get that money if the State owned the pipe. The fiscal interest finding showed that the State could earn close to one billion dollars. Currently the PF is earning eight percent.

MR. CLARK said there has been some confusion as to whether the State has choices to what parts of the project they can own.

MR. MARKS advised the State could take the gas in kind but not own the pipeline but it would have to make an FT commitment to the producers to ship the gas. If Alaska upstream is shipping on Alaska downstream pipe it's a wash but FT commitments would still have to be made. "I don't see any difference. What we don't get out of that is the billion dollars from pipeline ownership and that seat at the table," he said.

MR. CLARK added as the contract was negotiated it became apparent that the two would go together. As far as the producers were concerned, the State would not be able to own part of the pipeline unless the gas was taken in kind.

[2:50:59 PM](#)

CHAIR SEEKINS invited Martin Massey, Ken Konrad, and Wendy King to the table.

MR. MASSEY said Alaska successfully negotiated to have an ownership interest in key portions of the project and therefore will provide an important enhancement to the sponsor group. The State will receive gas volumes in kind for its gas royalty and taxes and the State will transport and market its gas volumes. The State's ownership position creates numerous advantages both for the State and the project participants. Sponsor group economics are improved when the producer no longer has to make transportation arrangements for state gas. "We are no longer making firm transportation commitments on gas for which we have no economic interest," he stated. Consequently the pipeline affiliates can hold a lower ownership in each of the lower midstream elements. Moving the investment to the State will have a positive impact on the producer's economics and will provide

the State with numerous benefits, including a stable, steady revenue stream.

[2:55:07 PM](#)

MS. KING recalled in October 2004 Alaska announced it would like to pursue equity participation in the project. Equity participation in the project is comprised of three components; state ownership, state taking its gas in kind, and the State holding an FT commitment. There is a fundamental shift in the economics when the State chooses to pursue the three in concert, she said. The producers would have to employ roughly 20 percent in actual capital for gas volumes they would not receive revenue from.

Over the course of negotiations it was discussed how to value gas for royalty and tax purposes. It is an historical area of dispute. The producers saw that through state ownership, one of the biggest areas of dispute would be eliminated. The State would be taking custody of its gas at the exact same place that ConocoPhillips takes custody of its gas.

[2:58:02 PM](#)

MS. KING continued her final point is there is a track record of success for in-kind gas programs. The key factors are that the partnership would lessen disputes, improve economics and build on proven success.

MR. KONRAD said BP was initially surprised when Alaska approached them with this atypical business model but they quickly saw the potential benefits for all the reasons that the two previous speakers alluded to.

One area the producers struggled with was the State's insistence that the producers handle capacity management. Ultimately they came up with a model that is in the contract where the State has the option for producers to manage capacity for the State.

[3:02:29 PM](#)

If the State decides to manage its own capacity it removes the middleman and minimizes the potential for disputes. The federal government has had a lot of successes on marketing gas. This also results in fewer disputes and lowers administrative costs. The federal government has found they get more money by taking gas in kind than in value. Wyoming is doing similar things and they are confident it will work in Alaska as well.

[3:04:21 PM](#)

MR. KONRAD summarized by putting all the pieces together it creates a win/win situation. The State gets to take direct equity ownership in the project, the producers get the benefit of lower costs, and it provides Alaska with a stable income alignment and revenue stream.

[3:05:12 PM](#)

REPRESENTATIVE COGHILL said it was important for Alaskans that he ask the essential questions so that they understand completely and so that citizens don't reject what could be a good deal. He clarified Alaska would make an FT commitment for 20 percent of the gas. Alaska would be responsible for selling it and that would be how the State gets back some of the value for its resource. He asked how the producers would ensure that Alaska does indeed receive its share and whether this would ultimately be a firm 20 percent commitment.

MR. KONRAD responded the producers would use the same arrangements that they use amongst themselves. There will be ownership established in any given unit and it will pass through a meter. The capacity management article would force the producers to stay in proportion. If BP has excess capacity, the State will have the same amount.

[3:08:17 PM](#)

MR. CLARK suggested that Ken Griffin take a place at the table and walk through that article so that the committee understands the reason that the Administration feels the State has adequate protection.

CHAIR SEEKINS announced a brief recess at [3:09:13 PM](#).

CHAIR SEEKINS called the meeting back to order at [3:20:29 PM](#).

MR. CLARK asked to speak about the capacity management article in the contract and said it was the most contested article in the contract. From a policy standpoint, the Administration was worried about the risk. They knew the pipeline needed 50 million Tcf and that there was 35 million Tcf available. The way to protect against capacity risk is to keep the pipeline full, he emphasized.

The Administration insisted that they never have more "ullage" than ownership in the pipe. The Administration also fought long and hard to have the balancing happen on 30-day periods even though the producers have always operated in 6-month periods. He

asked Mr. Griffin to explain how the Administration negotiated capacity management.

[3:23:41 PM](#)

MR. GRIFFIN advised that the capacity management negotiation was a hard-fought discussion. It was predicated on the realization within Alaska that at the upstream end, the State is not aligned with the producers. They have control of the producing areas and development schedules. They have control over where the exploration moves and that could be federal lands or private acreage or even offshore where the state royalty could end up being much less than 20 percent or none. One major question is how to manage the 20 percent commitment to capacity when the future holds no certainty as to where development will be. The producers believe that the State will want to take over capacity management in the future but currently the State has secured a commitment from the producers to ensure that the State's risks are in parity with its share of the production.

[3:26:30 PM](#)

The contract specifies how the State will obtain capacity in the first place. The State has the right to ask the producers to obtain that capacity on its behalf in proportion to the share of state gas that will be coming off of each of their properties. Separately the State has the right to seek instate capacity and to carve off some of the gas, exclude it from the balancing process, and dedicate it to instate deliveries. Over time, things will change and the State's share of gas will fluctuate. There is a process in place to readjust and restore the balance between the share of gas that the State should be receiving and the capacity that the State will hold.

[3:28:19 PM](#)

The third stage provides for the scenario where there is excess capacity. If development and production is all on state land, the State will hold 20 percent of the excess capacity. If over the years development and production moves off of state lands and the pipe is not full, the State's share of the empty capacity will be commensurate with the share of production. It will be figured by producer and by property and summed up such that what Alaska will be responsible for is proportionate to the share of gas that is being received at that point in time.

There is a fourth policy issue and that is the state marketer/shipper receives the same information in the same timeframe that the producer marketer/shippers receive. Alaska

will have the same ability to manage its marketing operation downstream. He offered to answer questions.

[3:30:13 PM](#)

SENATOR THERRIAULT advised the committee that Representative Coghill had to step out of the meeting but had asked him to address a concern for him as they represent the same constituents. He expressed concern that since the State has no experience in the business; perhaps they are not up to the task of managing capacity. As far as the decision to take value as gas molecules, a number of complications spring from that. Mr. Harper has indicated that the capacity management agreement does a fair job trying to deal with a potentially difficult situation but the people in his jurisdiction continue to ask the reason that the State should take that on. The Lukens Study indicates that there is a risk of losing value with capacity balancing.

MR. CLARK replied the logic is that changing the economics by taking the gas in kind was "like magic" because the State kept the same revenue streams that they had without taking the gas in kind. The contract sets up a system by which the State is able to "ride the producer coattails." The other option is to employ capacity management firms, which is not unheard of. Other companies have hired people to manage capacity.

[3:34:43 PM](#)

MR. VAN TUYL added there was another option. He agreed that the State doesn't currently have the expertise but the first gas is not expected for perhaps 10 years so there is ample time for the State to develop expertise in-house. Meantime the State can opt to participate in the open season process or ask the producers to participate in the open season to get the initial capacity. Anytime in the process the State can take over capacity management.

[3:36:10 PM](#)

MR. GRIFFIN said capacity commitments are a responsibility of the shipper to the LLC and then marketing is how revenues are obtained. The Lukens Study represents a scenario-based model and what their numbers said was "if these scenarios occur, the potential costs are in these sideboards." The Lukens Study did not say anything about the likelihood of those scenarios occurring. He advised the committee to read his report in the fiscal interest finding that captures that summation.

[3:38:51 PM](#)

MR. GRIFFIN continued the PPT has credits to encourage exploration and investment. The upstream fiscal contract levels the playing field and encourages exploration and investment. The contract itself encourages exploration. The DNR and the federal leasing programs work together to minimize the risk of excess capacity.

[3:39:58 PM](#)

MR. VAN TUYL expressed agreement with Mr. Griffin's assessment of Article 10 as it relates to initial capacity in the pipeline and capacity management. The contract is silent on the possibility that the producers would be interested in that business but BP Alaska would be interested in competing for the business of supplying instate gas, he stated. Article 10.2 addresses both scenarios of not enough gas to fill the pipe and also excess gas. There is a range of alternatives to address both challenges. In any event it is the responsibility of the producers to ensure that the State's gas moves along with the producer's gas, he stated. He assured the committee that Article 10.2 ensures that the State would be kept whole.

Article 10.3 addresses the scenario of an empty pipe and included in that article is the requirement to allow the State to share in any third party purchase the producers enter into. That is an anomaly in the business of competition because of the business risk of sharing market information.

[3:44:23 PM](#)

MR. VAN TUYL referred to Article 10.4 and said it was a safety-net provision. If at the end of the month the State had a different percentage of excess capacity, Article 10.4 mathematically requires an adjustment to equalize capacity. In the event of intra-month imbalances, Article 10.5 provides that each of the producers would be involved in a gas balancing arrangement.

All those things are very specific, very mechanical provisions to ensure that the State is always proportional to the producers in the way they deal with capacity. Thus Alaska does not need to be in the capacity management business if it so chooses, he said.

[3:46:53 PM](#)

MS. KING said capacity management was a difficult article to negotiate because of the challenge to develop a relationship to work with the State as a capacity holder and still keep the relationship in such a way that it would not impact the

relationship between the three producers. The capacity management provisions have found that balance. The State will receive frequent capacity notices from the producers advising of the exact capacity volumes on the pipeline. It will be a transparent process, she advised. In the event that there is not enough capacity and too much gas, the State will have a commodity. She asserted that the State would have less risk than the producers because they are exempt from federal income tax.

[3:49:19 PM](#)

The State has additional take terms in the contract. There are PILTs that are independent of the price of the commodity. The State has additional cash flow streams for its share of capital investment that the producers don't have, she emphasized.

The FT commitment period for the pipeline is unknown at this point. If the majority of the gas potential comes from federal acreage such as ANWR, at the end of the initial FT period the State can elect to reduce the amount of capacity. The FT commitment will be a point where the State can decide how much capacity it wants to hold for the remainder of the fiscal contract.

MS. KING added one benefit of state ownership is that regardless of where the gas is coming from the State will receive tariff revenues for decades to come. Essentially, the State will have state ownership of the pipeline beyond the term of the contract.

[3:51:59 PM](#)

SENATOR THERRIAULT asked whether the total revenue package presented to the State included the additional revenue streams.

MS. KING nodded.

SENATOR THERRIAULT speculated that the State would be in a much higher risk position because of capacity balancing and that the reward would be status quo.

MR. CLARK said Dr. Pedro van Meurs' paper addresses that issue. By taking the gas in kind Alaska would get the same amount of money as it would in the RIV world. If Alaska wanted to be in the RIV world, "The only way we could change the economics in the same way was to give up every dollar of royalty, every dollar of tax gets. We could have moved the needle in the same way of taking the gas in kind by giving up every dollar we would have otherwise made," he stated. What that means is if Alaska wanted to get the gas line built it could either take the gas in

kind or stay in status quo and "give up every nickel of royalty it would have gotten." He encouraged the committee to review Dr. van Meurs' paper for clarification on the issue.

3:56:00 PM

MR. VAN TUYL advised the State's ownership model is robust and is used worldwide in mega-projects. The direct government equity ownership model reduces the risk to the investors and therefore enables a project to go forward. He said it was worth repeating that the State will recover, through the tariff, the costs of overruns.

Having the State as a direct equity owner and having it take its gas in kind aligns the State with the producers all along the system, he said. Commercial alignment is very important to the producers because it forces them to focus collectively on making the project better and more efficient.

4:01:31 PM

SENATOR BEN STEVENS advised the committee that he and Mr. Clark had another meeting to attend but that he would like the committee to further address his concern over capacity risk today.

4:04:59 PM

CHAIR SEEKINS advised the committee that they would address Senator Ben Steven's question upon his arrival back to the meeting.

4:05:27 PM

SENATOR WILKEN asked whether the producers would support the State having a 51 percent vote with regard to any major changes in the qualified project plan (QPP) on the route of the pipeline. There are three things that have brought the committee where it is today, he said. In 1999 the people of the State of Alaska demanded there be no changes to the route. Secondly, the contract states that it will be a steel pipe laid across Alaska. Thirdly federal law states there cannot be a line that enters Canada above latitude 68.

SENATOR WILKEN advised he would speak about what he believes he knows and then would ask for a response from the producers. The QPP has to be updated annually by the participants and the State. When that subject comes, the people's voice in 1999 will be squelched, he said, and that concerns the people of Alaska. "In regard to the federal legislation, I take no comfort at all. Federal law can be made and federal law can be changed," he

stated. He reiterated his earlier question whether the producers would support a 51 percent voting right for the State.

[4:08:57 PM](#)

MR. GRIFFIN said the presumption that the route can be changed within the contract is not a sound presumption. He acknowledged that when negotiations began, the producers and the State were not aligned on a route. The State insisted on the pipeline route and the companies had different positions but in the end the State prevailed in the negotiations.

Recital 2 refers to the application being approved by both commissioners. That approval is contingent on the highway route. "From the very beginning this thing began with highway route as a foundation," he said. The mainline is defined as the pipeline through Alaska that is routed generally along the TAPS pipeline and the Alaska-Canadian Highway.

[4:11:41 PM](#)

MR. GRIFFIN continued Article 4.1 contains six components of the QPP, two of which are potential and may or may not occur but the mainline is a component of the QPP. The last two sentences in Article 5.3 state that specific details of the QPP are likely to change as the participants complete additional studies and the mainline entity may amend the plan. That context provides fairly narrow side rails to the scope of an amendment, particularly given the content of Article 4, the definition of "mainline", and the content of the recitals, he asserted.

[4:15:03 PM](#)

SENATOR WILKEN said he was concerned about the "soft words" that Mr. Griffin used. He understood him to say there are three places in the contract that route change is addressed and that the issue could come up at future time. He said that is the problem he is having - that "one day we'll wake up and this thing will have gotten a 90 degree elbowing."

[4:15:47 PM](#)

MR. MASSEY offered what he described as the opportunity to set the record straight. ExxonMobil's position prior to release of the contract was that they had not selected a route. That didn't mean they supported a northern route. They just did not have a commercially viable project and wanted to make sure that all the options were left open. Now that there is a "potentially commercial project," it is defined in the contract as the southern route. The definition cannot be changed unless all parties agree, he stated.

[4:16:59 PM](#)

SENATOR WILKIN referred to page 31 and asked whether the definition of the mainline was not subject to the QPP procedures.

MR. MASSEY said that was his understanding since the definition is part of the contract and the contract cannot be changed without the consent of all parties.

MR. LOEFFLER said, "As counsel for the State, I agree with that."

CHAIR SEEKINS opined "mainline" was defined in the definitions as well as in the Article.

MR. LOEFFLER clarified, "It's defined in the definitions and utilized in the Article."

[4:17:58 PM](#)

MR. VAN TUYL referred to page 225 and said Article 39.1 defines the mainline and describes the southern route and states that the contract could only be amended by written agreement and signed by all the parties.

[4:18:56 PM](#)

MR. GRIFFIN said he would like to describe the intent of Article 5.3. "The ability of the mainline entity to amend the QQP is simply to ensure that there is the leeway available to the LLC to modify the project, to employ proper project management processes as the project develops and grows." There are sure to be necessary incremental changes in order to produce a quality pipeline project. "That's the only intent," he stated.

[4:20:10 PM](#)

SENATOR THERRIAULT noted that idea is what leads to some concern from the smaller producers. As the project is scoped, it might be determined to use smaller pipe because of cost, leaving little room for growth.

MR. LOEFFLER replied that was exactly the question FERC said it would review when it looked at pipe size.

[4:21:11 PM](#)

SENATOR THERRIAULT referred to an earlier raised concern about arbitration and said some long-term Alaska businessmen have also expressed concern about that. He asked Mr. Loeffler to state his

personal opinion on the matter. He asked whether that process would save the State time and money.

MR. LOEFFLER retorted nothing could be worse than the current experience. There is TAPS litigation that has gone on from 1977 to 1985 then stopped and has resumed again. Royalty litigation took 15-20 years to resolve. "It would not be hard to improve on that record," he said. The State's experience in arbitration has been good, he added. Arbitration is used throughout the U.S. and the world and is widely adopted in commercial contracts for all sorts of industries. It is thought to simplify the process and get to a faster result.

[4:25:27 PM](#)

SENATOR THERRIAULT said the State has litigated royalty and should not have to go through that again.

MR. LOEFFLER interjected, "Royalty should be going under the new structure."

SENATOR THERRIAULT asserted the State has "fought those battles and set the precedent and the proposal now is to change the system." The State has just come through a fairly lengthy arbitration with ExxonMobil. The three arbitrators sided with the State and yet it is still being litigated. He said a person in the Department of Revenue has advised him that ExxonMobil's position that another arbitration with them "won't be any quicker and it won't be any easier."

MR. LOEFFLER said he was not a party to that conversation. He pointed out the arbitrated cases that Senator Therriault referred to were oil markets and gas markets operate differently. He indicated the royalty and tax would have to be reestablished in terms of gas markets.

SENATOR THERRIAULT asked where the arbitration proposal originated.

MR. LOEFFLER advised there was early discussion about the desirability of employing a dispute resolution process different from what was used in the past. He said his firm drafted the dispute resolution article.

SENATOR THERRIAULT asked Mr. Loeffler whether the arbitration system would save the State of Alaska either time or money.

MR. LOEFFLER said it "has the promise of saving time and money."

[4:28:11 PM](#)

SENATOR THERRIAULT quipped that was a tepid endorsement.

MR. LOEFFLER argued that was a lawyer's endorsement.

SENATOR THERRIAULT said his constituent in Fairbanks whose concern that the arbitration method would be fair and balanced would have no cause to feel differently.

MR. LOEFFLER said arbitration has to be looked at in the world context of what kinds of disputes were likely to arise in the contract. The Administration believes that royalty disputes would be non-existent since Alaska would take its gas in kind. Tariff disputes are outside the arbitration process. If the State is unhappy with the tariff that's filed by the LLC they pursue that process with FERC.

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DAN DICKINSON asked to contribute to the arbitration discussion. There are tax laws that have been transformed into contract law and the State, thinking commercially, can look at those as commercial opportunities.

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CHAIR SEEKINS expressed support for arbitration as a viable means to settle disputes.

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MR. BARNES informed the committee his background in international affairs. Arbitration in neutral form is frequently used as a means to level the playing field between a host government and the investor. Usually the arbitration provisions apply to the commercial function of the government and not necessarily to the regulatory function. People have indicated that the contract is a commercial contract but there is provisions in the contract that have far-reaching implications for the regulatory regime. Article 41.2 demands that leases, rules, regulations and agreements conform to the fiscal contract, he said.

MR. BARNES said he would like to ask the people involved in the negotiation how they see the "far-reaching confirmation provision" and the contract itself applying to the regulatory regime.

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MR. LOEFFLER said he would like to start with the issue of regulation. The contract does not touch nor does it intend to touch criminal law, environmental regulation, health-and-safety regulation and any customary regulations. He said he does not think of royalty issues as regulation in the normal police-power sense. "Royalty arises from the interest or ownership rights of the State," he aired.

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MR. VAN TUYL pointed out arbitration is used regularly in the oil and gas industries as an efficient means to resolve disputes. Baseball arbitration is the method used currently to adjudicate disputes over the vast majority of the State's revenues. One advantage is that it encourages parties to take reasonable positions. He advised that BP prefers the baseball arbitration method.

[4:47:06 PM](#)

CHAIR SEEKINS asked Mr. Harper whether arbitrators generally serve in areas where they have expertise.

MR. HARPER responded he has arbitrated solely in areas where he has expertise.

CHAIR SEEKINS opined that was an advantage to that type of dispute resolution.

MR. HARPER agreed but said there were instances where arbitration is not advisable.

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MR. LOEFFLER said he had a number of points that he has been aggregating and asked for a chance to address them. He reminded the committee that this was a "two-way street" and that the State could be sued under the contract, whereas in the past it was the State that was always suing someone in order to get a better value or increased tax revenue. One thing that people look at to determine a hospitable state for investment is access to fair and balanced dispute resolution but that resolution won't always come out in favor of the State.

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MR. LOEFFLER advised the committee that he feels he has done an inadequate job of explaining the dispute resolution clause and it's incumbent on the Administration to do a better job. "When people question limiting discovery they must take into consideration the balance of the clause and the fact that there

are limitations of discovery under the Alaska Civil Rules as they stand today," he stated. There have been three different systems in the past ten years in an attempt to address revenue disputes so regardless of the contract the State has been struggling to find an impartial adjudication system.

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MR. DICKINSON offered to expand on Mr. Loeffler's comments. If the contract goes through it will be the fourth system in less than a decade. Very few disputes go to the superior court, they usually get resolved at earlier levels. It is important to remember that the statutory rules have remained the same and the Department has retained those. The main thing is that if there is a problem the State would go to an arbitrator.

CHAIR SEEKINS turned the gavel over to Senator Wilken.

[4:58:01 PM](#)

SENATOR THERRIAULT asked Mr. Loeffler to comment on the concept of including the RCA language in the contract so as to close any gaps between FERC adjudication and the committee process.

MR. LOEFFLER said his expectation and advice is that FERC will and should regulate the whole system.

CHAIR SEEKINS returned to the meeting.

MR. LOEFFLER in regards to a regulatory gap, in the past the Supreme Court has said the states can't step in just because there's a gap if it is a subject area committed to interstate commerce. The Administration believes FERC regulation is highly likely throughout the whole system.

[5:00:14 PM](#)

MR. HARPER said it was his professional opinion that baseball arbitration is a very significant concession.

MR. LOEFFLER added the only burden of proof that's in the contract is the burden of proof that applies to the work commitment clause. There is not a general burden of proof in the dispute resolution clause.

[5:01:41 PM](#)

SENATOR BEN STEVENS advised his question was related to risk and capacity management and the comparison of how the Administration evaluated the applications and what the comparable capacity risks were associated with the proposals.

MR. DICKINSON noted Roger Marks had done a number of analyses on the Port Authority so he would speak about that.

[5:02:31 PM](#)

MR. MARKS said Alaska Gas Port Authority (AGPA) submitted a SGDA application to the State and the SGDA has a set of standards to determine what constitutes a qualified applicant and the Port Authority failed to qualify. The specific qualification they did not meet was a minimum net worth requirement. Negotiations never commenced and so the issue of capacity requirements never came up.

CHAIR SEEKINS said he thought the minimum net worth was \$10 billion or an unused credit of \$15 billion.

SENATOR BEN STEVENS said he is focusing on the sensitive risk component of capacity management and finds it hard to believe there was no proposal for capacity management in AGPA's proposal.

MR. MARKS said the negotiations never commenced. The Department, by law, could not accept the application.

SENATOR BEN STEVENS asked whether FERC could issue a certificate of public convenience without a capacity management plan.

[5:04:44 PM](#)

MR. LOEFFLER said there would have to be gas supplies and shipper commitments.

SENATOR BEN STEVENS wondered if AGPA would have qualified had Alaska made 100 percent capacity commitment and had taken 100 percent of the risk.

MR. LOEFFLER said that is true.

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MR. DICKINSON advised the discussions with TransCanada focused on the ability to get to an open season. If in that open season, the producers had all stepped forward and taken commitment on the pipeline, things might have proceeded and there would be much less risk for the State. The main focus of the discussion was what to do in the case where there wasn't a full commitment made in the open season. Much of the discussion revolved around the second open season and what the State and the other parties

were willing to do, and how much of an FT commitment was the State willing to make. The discussions were never concluded.

MR. LOEFFLER said in the TransCanada negotiations, the State was being asked to take a much higher share of the capacity than the potentially 20 percent that is involved in the current contract.

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SENATOR BEN STEVENS said the application from TransCanada expected Alaska to take a significant increase in shipping capacity. He asked whether it also expected the State to buy the gas and ship it.

MR. DICKINSON said clearly if the State took a commitment for more than 12.5 percent of the gas, it would have to obtain it somehow. He said the State would have to either have to be out in the secondary market making an FT commitment and sell it or obtain the gas. He said, "If you sign up for 20 percent or more of the FT charges and you take your royalty in kind, you've got a very large bill on your hands."

MR. LOEFFLER added there is no way to get equivalent terms from TransCanada because TransCanada doesn't own gas.

[5:11:04 PM](#)

SENATOR BEN STEVENS said he was trying to comprehend the levels of risk that the State should contemplate in moving a project forward. The committee is continually hearing about other options, but those might even have greater risks, he aired.

MR. GRIFFIN agreed that the magnitude of risk was an important factor to consider but that the amount of return on that risk would be "the best risk/return balance that is available."

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SENATOR THERRIault referred to Article 8.7(ii)(b) where it contains language about the expansion shipper having to pay the upfront costs. The following paragraph refers to reimbursement of those costs through the tariff. He asked how a pipe company recoups those costs through the tariff.

MR. LOEFFLER said the requirement on page 92 was intended to ensure that the expansion shipper is serious and so he would front the money. The costs could be placed into the rate. If the LLC wants to recover those rates, they must be a cost actually incurred by the LLC, so the LLC would reimburse those costs to the expansion shipper. "They cannot in essence put those costs

into rate base and get a return on them unless it's money they spent, so that's the incentive," he stated. He said he does not see the intent of the provision that the applicant would get a lower tariff as a consequence of whatever amount of upfront engineering it had done.

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SENATOR THERRIAULT advised the committee that he recently spent an afternoon at AOGCC in Anchorage verifying some information he received from the DNR regarding the current recycling going on at the North Slope. He said he had asked DNR personnel how long it was economically viable to continue that and at what point will the continuation of that recycling process run the risk of destroying value to the State. At a certain point, the cost of running the circular system is high enough to escalate costs, he said.

The responses from the DNR advise that with the current configuration, number of compressors, producer investment, it would begin to destroy value by the year 2014 or 2015 if that gas was not brought to market. He said it seemed like there was economic necessity for the producers to build the line and get it up and running. He asked for comment from the producer team. There is an issue of channeling where the gas is re-injected and as wells have to be re-drilled. He asked at what point the gas has to be drawn off to prevent risk of trapping it in the reservoir.

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MR. KONRAD said the producers want to get the project going before 2015. He agreed there are complex reservoir interactions and the AOGCC will be involved in developing field and pool rules. "No one has the answers today," he said.

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SENATOR THERRIAULT said because of the long lead-time for building a gas transportation system and getting the gas to market, producers must have some idea.

MR. KONRAD responded they are ready to advance within 90 days of legislative approval because they believe the time is now. There will be unknown impacts on oil production but the value created from the gas and the value created by increasing the life of the North Slope will yield both the State and the industry much more reserves.

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MR. GRIFFIN said Prudhoe Bay is the backbone of the gas-line project and the backbone of North Slope production. As Prudhoe Bay production lessens, revenues lessen. Producers have cycled as much gas back into the reservoirs that they can. Producers have long since passed the point where they felt it was economic to continue to expand gas-handling capacity on the Slope. "Oil production is essentially hostage to our gas cycling capacity and it will continue to slide despite the best management efforts," he stated.

The big hurdle is the \$26 billion dollar investment to gain access to market but once the producers see clear to make that investment the LLC will. "Not only can we reduce the overhead burden our oil production carries, we gain revenues from the gas that suddenly has access to market - we're not going to want to sell all that excess gas," he said. The producers will put excess gas back into the ground and balance the effects on oil production and maximize the gas sent to market.

[5:28:22 PM](#)

MR. GRIFFIN added the North Slope has huge fixed infrastructure costs and the producers do not intend to take major fields offline. The companies will keep the North Slope fields active until the burden of that infrastructure is too much, he said and then they will all come down together. The gas line would move that specter 20 years into the future and would provide the State with an enormous benefit during that time period. He assured the committee that the producers see the benefits of the gas market as in the collective best interests of the State, the producers and the nation.

SENATOR THERRIAULT interjected with regard to the suggestion that nobody else can build a line there is an economic necessity to move gas off the North Slope in next ten years. That is a motivator for all parties.

[5:31:10 PM](#)

CHAIR SEEKINS thanked the participants for their input and participation in the roundtable meeting. He adjourned the meeting at [5:35:27 PM](#).