

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

July 14, 2006  
9:17 a.m.

**MEMBERS PRESENT**

Senator Bert Stedman  
Senator Ralph Seekins, Chair  
Senator Lyda Green  
Senator Gary Wilken  
Senator Bert Stedman  
Senator Lyman Hoffman  
Senator Donny Olson  
Senator Ben Stevens  
Senator Kim Elton  
Senator Albert Kookesh

**MEMBERS ABSENT**

Senator Con Bunde  
Senator Fred Dyson  
Senator Thomas Wagoner

**OTHER LEGISLATORS PRESENT**

Senator Gary Stevens  
Representative Ralph Samuels.

**COMMITTEE CALENDAR**

**SENATE BILL NO. 3001**

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the production tax; amending the definition of 'gas' as that definition applies in the Alaska Stranded Gas Development Act; making conforming amendments; and providing for an effective date."

HEARD AND HELD

**SENATE BILL NO. 3002**

"An Act relating to the Alaska Stranded Gas Development Act; relating to municipal impact money received under the terms of a stranded gas fiscal contract; relating to determination of full and true value of property and required contributions for

education in municipalities affected by stranded gas fiscal contracts; and providing for an effective date."

HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SB3001

SHORT TITLE: OIL/GAS PROD. TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

07/12/06	(S)	READ THE FIRST TIME - REFERRALS
07/12/06	(S)	NGD
07/13/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/13/06	(S)	MINUTE(NGD)
07/14/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532

BILL: SB3002

SHORT TITLE: STRANDED GAS AMENDMENTS

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

07/12/06	(S)	READ THE FIRST TIME - REFERRALS
07/12/06	(S)	NGD
07/13/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/13/06	(S)	Heard & Held
07/13/06	(S)	MINUTE(NGD)
07/14/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532

**WITNESS REGISTER**

BRADFORD G. KEITHLEY, Partner  
Jones Day  
Counsel to BP  
Dallas TX

**POSITION STATEMENT:** Commented on SB 3001.

PATRICK COUGHLIN, Senior Counsel  
BP

Anchorage AK

**POSITION STATEMENT:** Commented on SB 3001.

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

**POSITION STATEMENT:** Commented on SB 3001.

BOB LOEFFLER  
Morrison & Foerster  
Consultant to the Governor  
PO Box 110001  
Juneau AK 99811-0001  
**POSITION STATEMENT:** Commented on SB 3001.

BILL MCMAHON  
ExxonMobil Corporation  
Anchorage AK  
**POSITION STATEMENT:** Commented on SB 3001.

JIM CLARK, Chief Negotiator  
Office of the Governor  
PO Box 110001  
Juneau AK 99811-0001  
**POSITION STATEMENT:** Commented on SB 3001 and SB 3002.

KEN GRIFFIN, Deputy Commissioner  
Department of Natural Resources  
400 Willoughby Ave.  
Juneau AK 99801-1724  
**POSITION STATEMENT:** Commented on SB 3001.

JIM BALDWIN, Counsel  
Office of the Attorney General  
Department of Law  
PO Box 110300  
Juneau AK 99811-0300  
**POSITION STATEMENT:** Commented on SB 3002.

**ACTION NARRATIVE**

**CHAIR RALPH SEEKINS** called the Senate Special Committee on Natural Gas Development meeting to order at [9:17:45 AM](#). Present at the call to order were Senators Albert Kookesh, Bert Stedman, Gary Wilken, Lyda Green, Kim Elton, Lyman Hoffman, Ben Stevens and Chair Ralph Seekins.

**SB 3001-OIL/GAS PROD. TAX**

CHAIR SEEKINS said he had asked some of the producers if they would address the committee on Basin Control issues today. He introduced Wendy King, Director of External Strategies, ANS Gas Development Team, ConocoPhillips Alaska; Brad Keithley, of the law firm Jones Day, representing BP; and Patrick Coughlin, Counsel for BP.

[9:22:36 AM](#)

BRADFORD G. KEITHLEY, Partner, Jones Day, Counsel to BP gave some background on Jones Day and his own experience in oil and gas issues. He had worked extensively with the Federal Energy Regulatory Commission (FERC) and was asked by BP to appear before the committee to discuss pipeline affiliate issues.

He said that he wants to make sure the record is complete on three issues that came up in yesterday's meeting. First, Mr. Shepler's concern that the FERC cannot deal with pipeline issues that arise after the open season as additional exploration occurs; second, Mr. Shepler's concern that the FERC is too far away and proceedings are too slow; third, Mr. Harper's suggestion that various specific terms such as a pipeline tariff could and should be drafted at this point. He emphasized that all three of those points are wrong.

[9:24:45 AM](#)

MR. KEITHLEY said Mr. Shepler also indicated that the contract needs provisions to prevent discrimination against non-affiliates after the open season, because FERC does not have the authority to do so. In fact, the FERC's existing rules do deal with producer/pipeline affiliate issues of exactly the type raised here.

In FERC Order No. 2004 [Standards of Conduct for Transmission Providers], the FERC noted that as of 2003, 16 pipelines in the Lower 48 were transporting gas with their production affiliates, and held an average of 37 percent of the pipeline's capacity. On 6 of these, producer affiliates held more than 60 percent of the firm transportation capacity. Consequently, FERC Order No. 2004 provided rules and remedies related specifically to expansions on affiliated pipelines after the initial open season.

He said that in FERC Order No. 670 [Prohibition of Energy Market Manipulation], the commission also issued rules making it clear that it is unlawful for a pipeline or an affiliate to engage in any action "for the purpose of impairing, obstructing, or defeating a well-functioning market." Refusal to expand a pipeline in order to coerce other producers into selling their lease position or restricting their ability to market gas, would violate Order 670, resulting in civil and criminal sanctions against the pipeline and the producer affiliate.

He stressed that it is BP's goal to be in the business of producing and exploring for gas and oil on the North Slope, not

to put others out of that business, and the FERC orders compel it to behave in a way that promotes open access.

MR. KEITHLY also pointed out that Section 105 of the Alaska Natural Gas Pipeline Act (ANGPA) gives the FERC unprecedented authority to require expansions. That authority is in direct response to state and non-affiliated producer concerns expressed at the time that the ANGPA was passed.

[9:28:26 AM](#)

He said that Mr. Shepler also expressed concern that the FERC is too far away and these issues would require extensive proceedings, but that is not the case. The FERC has developed an Enforcement Hotline that is staffed 12 hours per day, every business day, to deal with potential violations. It has also established audit teams that conduct onsite audits for compliance with the Commissioner's orders. Another enforcement tool is that the state has the power to act as a policeman in connection with these issues and can provide information to the FERC directly in order to expedite its response.

MR. KEITHLY said that, with regard to Mr. Harper's position that we should be preparing a tariff now, a pipeline tariff is usually several hundred pages long and provides the details of pipeline rates and terms and conditions of service. To prepare it requires full knowledge of the costs involved, the operating parameters, the design, the pressures, and the takeoff and delivery points. It is unreasonable to believe the participants have all of those details now.

He said that BP is already developing a plan to comply with the non-discriminatory aspects of the FERC regulations and Order 670 requirements. It is also working on how to separate the pipeline function from the producer function, how to ensure non-disclosure of information from the pipeline side to the producer side, and on selection of an internal chief compliance officer as required by the FERC regulations.

[9:33:58 AM](#)

SENATOR OLSON arrived.

[9:34:30 AM](#)

SENATOR GREEN asked about the state's obligation, as a partner in the pipeline, to provide information in a FERC investigation.

PATRICK COUGHLIN, Senior Counsel, BP, responded that exactly what information the state could disclose publicly would be

covered in the LLC agreement. In terms of operating the pipeline business that would be dealing with FERC, the state would be in a position to share that information just as any other member of the LLC would be.

SENATOR GREEN corrected that she was not asking whether the state would be free to share that information, but whether it would be obligated to do more than another partner would in the same circumstances.

MR. COUGHLIN answered that, if the state thought that the LLC was not complying with FERC regulations, it would have an obligation to report that.

[9:36:15 AM](#)

SENATOR BEN STEVENS asked Mr. Keithley if he had ever seen a tariff published prior to sanction.

MR. KEITHLEY replied that he has never seen a draft tariff prepared prior to that. It is available at the open season so all parties know the terms and conditions of service that will be applied to the pipeline they are bidding on.

[9:37:19 AM](#)

SENATOR BEN STEVENS asked if it is unusual for a non-owner group to request publication of a tariff on a project of this size with multiple owners.

MR. KEITHLEY replied that it is not unusual, but it is not possible to bring the information together this early. He went on to say that the behaviors he has seen are what he ordinarily expects in a large project, that a lot of posturing goes on and people sometimes ask for things that they don't expect to get.

SENATOR BEN STEVENS said he finds it interesting to hear that this is nothing new in terms of trying to garner an advantage.

[9:40:34 AM](#)

WENDY KING, Director of External Strategies, ANS Gas Development Team, ConocoPhillips Alaska, Inc. emphasized that she sees this as a Basin-Opening opportunity for oil and gas exploration in the state, as oil and gas often exist in the reservoirs together. She said it is safe to assume that the FERC will scrutinize this project to ensure open-access, because it is estimated to be between 6 and 10 percent of the nations domestic supply, which is a significant portion from one project.

She said that in the base design, laid out in the 2001-2002 [feasibility] study [undertaken by the Alaska Gas Pipeline Producers Team: ConocoPhillips, ExxonMobil, BP], it was estimated that it would take about 50 trillion cubic feet (tcf) of gas to fill the pipe for approximately 30-35 years. Of that 50 tcf, only 35 tcf is publicly known resource, indicating that the pipeline company anticipated the need for exploration volumes to fill the pipe over the project scope. She also noted that since the pipeline doesn't know who will show up and bid for capacity, it may need more than 50 tcf to fill the base design as a result of the open season.

MS. KING said that, in that 2001-2002 study, the pipeline producers were looking at roughly a 4.5 billion cubic feet (bcf) per day pipeline. In-fill compression (adding compressor stations) can increase the deliverability in the pipeline from roughly 4.5 to 5.6 bcf per day, but significant gas volumes will be needed to fill that additional bcf per day. So, exploration will be necessary to fill the base design and any expansion. She emphasized that there is no "one size fits all" expansion model. There is a whole host of scenarios that could evolve over time.

[9:44:36 AM](#)

MS. KING then addressed yesterday's discussions relating to a FERC petition submitted by the pipeline producers, which addresses the need to streamline the permitting process. Delays in the project will result in increased costs, so the sponsors are continuing to advance this petition on that sole issue.

Thus, FERC established numerous unprecedented procedures, conditions, and presumptions, applicable to the award of capacity on and rates for Alaska Natural Gas Transportation Projects in order to promote competition in the exploration, development, and production of Alaska Natural Gas. These extensive requirements are not challenged here. This petition challenges the commission's authority in Sections 157, 157.36, and 157.37 to mandate, long after the open season has ended, increased capacity for an Alaska Gas Pipeline project or expansion and to dictate the amount of unsubscribed capacity and unused expandability that initial project must build in.

[9:46:04 AM](#)

MS. KING said that since the FERC Order 636 [The Restructuring Rule (1992)] was issued in April 1992, there have been a number of producer-owned pipelines, and all pipelines that have a portion in the US are subject to Order 2004 and the FERC

Affiliate Rules. ConocoPhillips believes it is important to align its ownership in the pipe with the firm shipping commitments (Firm Transportation [FT] Commitment) and the expected gas volumes. The costs get passed on to the holders of the FT Commitments, which underpin the project. Because it is such a significant cost to stand behind the FT commitment, ConocoPhillips feels it should have an ownership position.

[9:48:36 AM](#)

SENATOR STEDMAN said that there have been discussions regarding the potential for 100-200 bcf within the basin area, and asked how much exposure the state is actually facing in trying to get from 35-50 bcf when the estimates are so much higher, and a vast area is yet unexplored.

MS. KING responded that Senator Stedman is correct, she has seen data from a number of public sources, including USGS Minerals Management Service, that have indicated there is exploration potential between the North Slope and the Chuckchi Sea in the order of magnitude of 50-100 tcf or more. She said that the exploration potential is a function of whether you can find the gas, whether you can find it in commercial quantities, and whether it can be developed in a timely fashion. That is why the producers have factored the need for additional volumes into the design. The state's estimate was for 70 tcf on the upstream model contract, but the condition of that was 4.5 bcf expanding to 5.6 bcf per day over the course of the pipeline, which means about 70 tcf per day would be needed to fill the expanded volume over a period of 30-35 years.

[9:51:04 AM](#)

BOB LOEFFLER, Morrison & Foerster, Counsel to the Governor, went back to questions posed earlier by Senator Green related to information and the Public Records Act. He said that the state is trying to strike a balance in the LLC between protecting confidential information and recognizing that the public has an interest in this project, so it does not have a general exemption from the Public Records Act, but there is protection of confidential information. Also, there is an exemption in PipeCo [Alaska Natural Gas Pipeline Corporation] from the public meetings part of state law.

[9:52:37 AM](#)

BILL MCMAHON, Alaska Gas Commercial Manager, ExxonMobil, said there is a concern about what the FERC will do in the future in terms of protecting the pipeline, but the administration, the legislature, and independent producers have all been very

successful in getting their issues before FERC and having them reflected in rule-making. This pipeline will have three ways to expand: the traditional voluntary expansion, FERC mandated expansion, and the state-initiated expansion that is in the fiscal contract.

He explained that a shipper coming in outside of the open season would have three additional ways to move gas on the line, existing shippers could release excess capacity. The pipeline could have a reverse auction, in which companies with excess capacity give it back to the pipeline to go to another shipper, and there are business deals that could be made to sell gas to a shipper that has capacity available.

[9:54:52 AM](#)

SENATOR BEN STEVENS asked Mr. Clark and Mr. Loeffler what the state's interest would be, as a shareholder and royalty owner, in a new discovery made by an entity that is not an existing shipper after the open season.

JIM CLARK, Chief Negotiator, Office of the Governor, responded to Senator Steven's question by referencing Mr. McMahon's explanation of what the state has done before FERC up to this point, both in legislation that has passed Congress and in the FERC open season regulations. He said that the state took an ownership interest in the gas, in part, to assure all potential producers in Alaska that it can get that gas to market and because it gives us added royalty and tax cash shares. He said that the administration's intent is to increase activity on the North Slope as much as possible.

[9:57:52 AM](#)

He explained that some of the things the administration is looking at are more reflected in the fiscal interest findings than in the contract. The state is taking gas-in-kind, has a mileage-sensitive rate, and has four takeoff points. It is hoping that Anadarko will be successful in the Foothills and that other producers will come to Alaska to buy leases and explore.

[9:59:03 AM](#)

MR. LOEFFLER added that the state has a financial interest in getting more volumes to market and in expansion. More gas equals more cash. Expansion equals more investment in the pipeline and greater returns.

SENATOR BEN STEVENS commented that, if he understands correctly, the way that the contract is crafted aligns the state with the independents for the development of future expansion, and it is interesting that, although the committee has been established for over a month and has continued to hear concerns about independent expansion, not one independent has come before the committee to express those concerns.

CHAIR SEEKINS responded that the consultants the legislature hires advise it on what is in the best interests of the people of Alaska and understand how important it is to make sure the independent non-owners can get their gas to market.

[10:02:42 AM](#)

MR. CLARK said that he fully subscribes to the Chair's comments and believes the administration has strong policies to assure independent access.

[10:04:21 AM](#)

SENATOR WILKEN prefaced his question by saying that he understands that inexpensive compression expansion would allow an increase of about 25 percent, but anything more gets very expensive. He also understands that the state cannot tell the FERC what to do, although it can express a preference. He then asked Mr. Clark whether there is [or should be] a formal expression in the contract that expansion will be limited to rolled-in rather than incremental pricing.

MR. CLARK deferred to Mr. Loeffler to answer the question.

MR. LOEFFLER answered that the state's position has always been in favor of rolled-in pricing within limits. Some parties have suggested that it should be willing to pay for an uneconomic expansion, but the state favors the FERC policy in that regard, which states that there is a presumption of rolled-in pricing, but because every expansion is so fact-specific, each will be dealt with on a case-by-case basis.

[10:06:46 AM](#)

MR. CLARK added that opponents to an application for expansion would have to prove to the FERC that it is a subsidy in order to preclude rolled-in pricing. The position the state has taken in Article 8.7 of the contract, is that it would take on state-sponsored expansion in order to ensure expansion and so that dispute resolution is contractual and not only a regulatory matter.

10:08:05 AM

SENATOR HOFFMAN apologized for getting off topic, but said that he wanted to bring up a couple of comments made by the governor in his address of the previous evening. In that presentation he talked about sharing energy with Alaskans who pay property taxes, but many of the people who have the highest energy needs do not pay property taxes. Also, he talked about how to get the use of in state gas to Kenai, Anchorage, Fairbanks, and other major metropolitan areas, but did not explain how the rest of Alaska will benefit from it.

10:10:39 AM

MR. CLARK responded that the governor's speech included a reference to using the Yukon River takeoff point to strip propane and butane from the gas and barge it to villages along the Arctic-Yukon-Kuskokwim (AYK) River system, thereby lowering rural energy costs. He also envisioned using part of the PPT funds to provide relief for property owners, but that is balanced with his intent to fully endow the Power Cost Equalization (PCE) Fund.

10:13:29 AM

SENATOR ELTON asked if anything in the contract could preclude the kind of expansion downstream that would prevent expansion upstream.

MR. LOEFFLER replied that there can be all sorts of expansions, and one does not necessarily preclude another. Also, the state would have the same rights on the Canadian side that it does on the Alaskan side to participate in planning. He then deferred to Ms. King to answer from an engineering standpoint.

10:15:41 AM

MS. KING said that she is a reservoir engineer, not a pipeline engineer, but she understands that there are multiple options for expansion, and each must be handled on a case-by-case basis. She knows you would need to look at the J-curves, but if the committee would like further information on that, ConocoPhillips has pipeline-engineering experts who can address it in more detail.

SENATOR ELTON said he'd like to see follow-up on this.

10:17:43 AM

MR. LOEFFLER agreed that one of the tricky issues on expansion is that, expanding one field could foreclose a field coming on

in a different geographic area, and so it is good to have a formula for optimal expansion.

[10:18:53 AM](#)

MS. KING added that productivity generally plateaus for a time and then the reservoir pressure starts to decline, creating new capacity. So, before doing an expansion, one would want to look at where there might be capacity available due to natural decline. Also, the cycle time from discovery of a reservoir to production is considerable, and should be included in the formula when calculating capacity.

[10:21:36 AM](#)

KEN GRIFFIN, Deputy Commissioner, Department of Natural Resources, explained that a J-curve refers to the energy efficiency of a compressor or a pipeline system. The equipment has a range at which it is most efficient, and when it goes above or below that range, efficiency declines increasingly rapidly. Terrain, temperature and other things affect efficiency, so the appropriate expansion method will change from one part of the system to another.

[10:24:23 AM](#)

CHAIR SEEKINS said that the committee had finished discussion of expansion issues, and that Mr. Harper would provide a written summary of his comments and observations. He also said that the Legislative Budget and Audit Standing Committee (LB&A) has agreed that he can request consultants as they are needed and has given authorization to proceed with an independent analysis of the port authority plan using Econ One Research, Inc.

[10:26:34 AM](#)

CHAIR RECESSED from [10:27:06 AM](#) to [10:42:33 AM](#)

#### **SB 3002-STRANDED GAS AMENDMENTS**

JIM CLARK, Chief Negotiator, Office of the Governor, said that he wanted to talk about the Stranded Gas Amendments that are before the committee.

CHAIR SEEKINS asked if he meant SB 3002.

MR. CLARK replied yes.

He explained that the administration hopes to incorporate what they learn during the public comment period with the will of the

committee and the thoughts of the administration to formulate a more comprehensive Committee Substitute.

10:46:39 AM

JIM BALDWIN, Outside Counsel, Department of Law, briefly described sections 1-5 of SB 3002.

Section 1 contains an amendment to the purpose clause of the Stranded Gas Act, to remove a provision that would restrict the state's ability to propose terms related to the taxation of oil. MR. BALDWIN explained that Section 2 creates the fiscal structure to receive municipal impact funds [\$125 million in municipal impact funds]. It relates to how the money is received into the state treasury and how it is made available for appropriation by the legislature. Sections 3,4, and 5 are amendments that were proposed during the second special session and were the product of recommendations received from the Municipal Advisory Group.

He said that the state also needs conforming amendments to the Stranded Gas Act in order to make the contract provisions consistent with the SGDA.

10:50:55 AM

Some of the subject matter included in the version that DOL introduced during the last special session related to the interaction of the contract with other agreements that are in effect by law.

10:52:08 AM

CHAIR SEEKINS said that his intent is to hold the bill and work on it after the committee returns on July 24.

MR. CLARK noted that he hopes to come back to the committee at that time with ideas on how this might be fashioned in a way that is consistent with what the committee has already done.

CHAIR SEEKINS commented that they would probably discuss project labor agreements.

MR. CLARK said that is another point the governor raised in his speech and an issue they will be discussing as they put the contract together. He pointed out that the fiscal agreement with the producers is not the right spot for a project labor agreement; the entity that will enter into that agreement will be the LLC, and the appropriate person(s) to undertake the negotiations are the contractors to the LLC.

[10:55:23 AM](#)

CHAIR SEEKINS said the Alaska hire features in the Stranded Gas Act are very important to members of the Legislature and to the governor.

[10:55:56 AM](#)

SENATOR WILKEN referred to a memo from Phillip C. Gildan of Greenberg Traurig, dated July 13, with his initial reaction to SB 3002, and suggested that might be a place to start when the committee returns on July 24. He asked Mr. Clark when the LLC might be available, as he does not see how the contract can proceed until they have seen the entity agreements.

MR. CLARK replied that the administration thinks the LLC is long overdue, and that he will be talking to the producers about that.

[10:59:16 AM](#)

CHAIR SEEKINS said he also has concerns about the integration clause in the contract. This contract requires legislative approval in order for the administration to execute it; but according to the reading of an attorney in Fairbanks, once it has been executed it can be amended without legislative approval.

[11:00:22 AM](#)

MR. CLARK replied that he would make sure that is clarified. He feels that there are things in the contract the executive body ought to be able to change, but there are also key functions, like tax rates, that the executive body should not be able to change without legislative approval.

At ease [11:01:42 AM](#) to [11:02:25 AM](#)

SENATOR WILKEN asked Mr. Griffin if the committee is supposed to get an update on the Lukens study [Market Analysis and Alaska Price Model by Lukens Energy Group, October 26, 2004] on gas prices and capacity management issues.

MR. GRIFFIN replied yes, he will check on that and report back.

There being no further business to come before the committee, Chair Seekins adjourned the Senate Special Committee on Natural Gas Development meeting at [11:03:13 AM](#).