

**ALASKA STATE LEGISLATURE**  
**SENATE SPECIAL COMMITTEE ON NATURAL GAS DEVELOPMENT**  
Fairbanks, Alaska  
August 25, 2006  
9:08 a.m.

**MEMBERS PRESENT**

Senator Ralph Seekins, Chair  
Senator Thomas Wagoner  
Senator Kim Elton

**MEMBERS ABSENT**

Senator Lyda Green  
Senator Gary Wilken  
Senator Con Bunde  
Senator Fred Dyson  
Senator Bert Stedman  
Senator Lyman Hoffman  
Senator Donny Olson  
Senator Ben Stevens  
Senator Albert Kookesh

**OTHER LEGISLATORS PRESENT**

Senator Gene Therriault  
Representative David Guttenberg  
Representative Bill Stolz  
Representative Ralph Samuels  
Representative Michael Kelly  
Representative Paul Seaton

**COMMITTEE CALENDAR**

Round table discussion of Port Authority Plan.

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

DAVID VAN TUYL, Commercial Manager  
Alaska Gas Group  
BP

**POSITION STATEMENT:** Commented on Port Authority project.

DAN DICKINSON, CPA  
Consultant to the Governor  
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Juneau, AK 99811-0001  
**POSITION STATEMENT:** Commented on Port Authority project.

Michael Menge, Commissioner  
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Juneau, AK 99801-1724  
**POSITION STATEMENT:** Commented on Port Authority project.

KEN GRIFFIN, Deputy Commissioner  
Department of Natural Resources  
400 Willoughby Avenue  
Juneau, AK 99801-1724  
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DR. ANTHONY FINIZZA, Consultant  
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Three Allen Center  
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**POSITION STATEMENT:** Commented on Port Authority project.

ROGER MARKS, Economist  
Department of Revenue  
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**POSITION STATEMENT:** Commented on Port Authority project.

STEVEN B. PORTER, Deputy Commissioner  
Department of Revenue  
PO Box 110400  
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JIM WHITAKER, Chairman  
Alaska Gasline Port Authority;  
Mayor, Fairbanks North Star Borough  
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**POSITION STATEMENT:** Commented on Port Authority project.

BILL WALKER, General Counsel and Project Manager

Alaska Gasline Port Authority  
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Fairbanks, Alaska 99701

**POSITION STATEMENT:** Commented on Port Authority project.

RADOSLAV SHIPKOFF, Director  
Greengate LLC  
2001 L Street NW, Suite 901  
Washington, DC 20036

**POSITION STATEMENT:** Commented on Port Authority project.

EDWARD J. TWOMEY  
Morrison & Foerster  
Counsel to the Governor  
Washington, DC

**POSITION STATEMENT:** Commented on FERC issues.

#### **ACTION NARRATIVE**

**CHAIR RALPH SEEKINS** called the Senate Special Committee on Natural Gas Development meeting to order at [9:08:27 AM](#). Present at the call to order were Senators Thomas Wagoner, Kim Elton, and Chair Ralph Seekins.

#### **ROUNDTABLE DISCUSSION OF PORT AUTHORITY PLAN**

[9:08:27 AM](#)

CHAIR SEEKINS recapitulated the question under discussion at the close of Thursday's meeting. The issue was whether FERC would allow construction costs to be rolled into the tariff if the state builds a gas line larger than the capacity it has commitments for. They discussed building a larger line to Delta Junction with the idea that it would eventually connect to the Lower 48, until which time it would carry only 1.2 Bcf/d to the LNG plant there.

EDWARD J. TWOMEY, Morrison & Foerster, Counsel to the Governor, said that 20 years ago he would have said that FERC would probably refuse the application, or say to come back when the line is full; but today FERC is less insistent that applicants be able to show the line will be 90-100 percent full. If an applicant wants to build a pipeline twice as big as he has FT commitments for, FERC would likely allow it, but require him to bear the cost of the excess capacity. That could be done two ways:

1. If a 12" line would have been appropriate for existing Bcf, one could get experts to calculate the cost differential of a 48" pipe vs. 12" and back that cost out of the rate base.
2. Alternatively, and probably how FERC would do it, one could look at the pipeline as if it would be full. For example, if the total cost of service is calculated to be \$100 (including operating cost, income tax, and return on rate base) and it would take 50 units to fill the pipe, FERC would calculate the tariff at \$100 cost of service divided by the 50 units that would be going through the pipe, so each unit would bear \$2 of cost.

If you apply the example in method two to the Port Authority's proposal, only  $\frac{1}{4}$  of the pipe would be full for the first three years, so AGPA would be transporting only 12.5 of the 50 units. FERC would allow it to charge only \$2 per unit for a total of \$25, but AGPA or its investors would have to eat the \$75 that is not subscribed until they get commitments for that unused capacity.

DAVID VAN TUYL, Commercial Manager, Alaska Gas Group, BP, commented that its FERC attorneys gave him a response very similar to Mr. Twomey's.

[9:15:58 AM](#)

BILL WALKER, General Counsel and Project Manager, Alaska Gasline Port Authority, clarified that AGPA looked at a larger pipe because it is best for Alaska based on the vast resources on the slope. Discussion with its FERC counsel indicated that it is a possibility; but their project does not depend on it to be economic.

[9:17:17 AM](#)

CHAIR SEEKINS said his question is whether they can build a bigger pipe and make it economic.

RADOSLAV SHIPKOFF, Director, Greengate LLC, said that he was on the call with their FERC counsel, who said that it is not only possible, but that he thinks it is the only plan FERC will approve, because the pipe is properly sized for the commercial development of the field and makes commercial sense for all parties. FERC won't overrule a commercial agreement that makes sense.

[9:18:14 AM](#)

CHAIR SEEKINS asked what commercial agreement Mr. Shipkoff was referring to.

MR. SHIPKOFF replied that he is not suggesting that they are sizing the pipe to accommodate future expansion, the fact that they are designing a pipe that accommodates future expansion means they must have had discussions with the shippers (whoever they may be) such that they anticipate an expansion. He asked why they would design it this way if they didn't know an expansion was coming.

CHAIR SEEKINS said that is his question exactly.

MR. SHIPKOFF retorted that, if there is not a reasonable expectation of expansion, it means the highway project is not proceeding.

CHAIR SEEKINS said that his sole purpose is to look at this proposal through the eyes of his constituents and determine what is in their best interests. He asked Mr. Shipkoff if they have had talks on that commercial agreement, or if he anticipates talks, because the only four shippers that he is aware of are the three producers and the state of Alaska.

MR. SHIPKOFF responded that there are four shippers today; who potential shippers might be in the future he did not know.

CHAIR SEEKINS interjected that he knows that Anadarko plans on an exploration effort in the future, but there are only four now. He asked where AGPA is at on discussions with them.

MR. SHIPKOFF answered that they would like to engage in conversation about commercial gas supply; clearly, they will not have a project without such discussions.

JIM WHITAKER, Chairman, Alaska Gasline Port Authority, agreed with Mr. Shipkoff that, if there is no conversation, there is no gas. He said that the legislature, given its legal mandate, and the administration, should understand that and, if there is incremental value in a Port Authority or other similar project, should ensure that gas supplies are made available. If the legislature and the administration are unwilling to do that, then whatever is in the best interests of the three major producers will proceed, and that might mean doing nothing for another three years, or doing something that strips significant value from the state's share in a deal. He said that AGPA does not believe that is acceptable; there is another option and the

legislature has the responsibility to ensure that the option is given fair vetting.

[9:22:28 AM](#)

STEVEN B. PORTER, Deputy Commissioner, Department of Revenue, said that he appreciates the state's responsibility and, as the Port Authority mentioned yesterday, the only way to succeed with the Port Authority plan is to cut a commercial deal with the producers first.

CHAIR SEEKINS said that, as he understands it, at some point there has to be a determination as to whether or not the project will be regulated by FERC. He asked Mr. Twomey at what point in the process that would happen.

MR. TWOMEY replied that, assuming the Port Authority continues to assert that it is not subject to FERC regulation, it is not clear when FERC would step in; but it would be sometime before the beginning of construction. He said that the more he considers it, the more convinced he is that FERC will try to take control of the Port Authority project, both the pipeline and the LNG terminal. He referenced an article by Greenberg Traurig on the Energy Policy Act of 2005, which strengthened FERC's control over LNG facilities. It reads in part, "The act amends the Natural Gas Act [NGA] by granting the commission the exclusive authority to approve or deny applications for the siting, construction, expansion, and operation of LNG terminals."

[9:26:31 AM](#)

With regard to the pipeline itself, Mr. Twomey said he understands the Port Authority's argument, but believes that it is misreading the NGA, which also states that FERC has exclusive authority over sales and the transmission of gas in interstate commerce. He believes that the NGA intends that municipalities will be outside its authority unless they choose to do those things that are specifically within FERC jurisdiction.

MR. WALKER provided some background on this issue. He said they met with FERC assistant general counsel in Washington DC about four years ago and explained that they believe AGPA's project is FERC exempt under section 2 of the Natural Gas Act. They were advised to speak with FERC's general counsel, who verbally acknowledged that they were probably right.

[9:29:40 AM](#)

He said that AGPA has since retained Hogan and Hartson, which performed a thorough analysis and concluded that AGPA is indeed exempt. They did this to accelerate the loan guarantee process. At this point, AGPA could attempt to obtain a declaratory order that they are FERC exempt; but they intend instead to sit down with FERC within the next 30 days and discuss it with them. If it looks like it will be a long drawn-out battle, they'll reconsider their plan.

[9:30:52 AM](#)

CHAIR SEEKINS said that, according to Dr. Finizza's report, the advantage of the Port Authority project is Net Present Value (NPV). This project can get gas to market three yrs earlier if all of the hurdles are overcome in the time frame required, and he is trying to determine if that is really possible. He said he wants to believe it is FERC exempt, but if it is not, he asked, does it lose its economic advantage.

MR. WALKER responded that they look at the 3-year (maybe more than 3 year) advantage as the result of work already done by Yukon Pacific. It is not related to FERC, but to work that has been done on fuel order permits, gathering soil samples, core samples, performing air quality studies etc. AGPA's advantage doesn't hinge on the FERC exemption.

CHAIR SEEKINS asked whether, if we end up with a commercial agreement to build a larger pipe to Delta Junction, some of the permitting would be tied together and on the same timeline, such as the permits from Prudhoe Bay to Delta, and whether there would be two certificates of public convenience or just one.

[9:33:56 AM](#)

MR. WALKER answered that they will have to talk to FERC and do what is most expeditious. He thinks that, if there is any certificate at all, it will be only one.

[9:35:14 AM](#)

MR. WHITAKER re-emphasized that the downstream regulatory regime is FERC controlled. Every receiving terminal will be FERC regulated, so it is understood that anything downstream of Valdez is FERC. With regard to upstream regulation, that is yet to be determined.

[9:36:09 AM](#)

MR. SHIPKOFF clarified that the Costa Azul terminal is regulated by CRE (Comision Reguladora de Energía ) rather than FERC.

ROGER MARKS, Economist, Department of Revenue, pointed out that the EIS (Environmental Impact Statement) that Yukon Pacific did 20 yrs ago was for a different project that was not FERC regulated. If this is under FERC regulation, it is very possible that a new EIS will be required, which will add about two years to the process. Additionally, he thinks that a 20-year-old EIS will be considered out of date by NEPA (National Environmental Policy Act).

MR. TWOMEY added that Mr. Marks is correct, because implicit in the 2004 Alaska Natural Gas Pipeline Act are specific provisions for the timing of EIS.

[9:38:03 AM](#)

MR. WALKER said that consultants who are familiar with the NEPA process and the permits, have said that the EIS will need to be updated, not replaced, whether it is FERC regulated or not.

[9:38:45 AM](#)

SENATOR WAGONER prefaced his question by saying that he believes AGPA has an option on a permit for siting of an LNG facility in Valdez. He asked if any studies have been done on that siting due to changes in the industrial standards and recommendations regarding lot sizes since the explosion in Algeria.

MR. WALKER answered that they have looked into it and their permits comply with requirements for an exclusionary zone.

[9:39:53 AM](#)

SENATOR WAGONER asked if, in case they cannot come to a commercial agreement in a reasonable amount of time, there has been any interest by the three majors or any other companies, in taking over the right-of-way that AGPA now controls.

MR. WALKER replied they have not been approached by anyone about their exclusive option to date.

[9:41:10 AM](#)

CHAIR SEEKINS asked if there were any further questions or comments related to FERC.

MR. TWOMEY commented that he does not dispute Mr. Walker's statement that AGPA is FERC exempt; they may be exempt because they are a municipality. It does not follow that when they engage in FERC jurisdictional activities they do not become subject to FERC jurisdiction.

[9:42:40 AM](#)

MR. WALKER said that he appreciates that clarification. He knows that, although they are a municipality, they could become FERC regulated through involvement in certain activities outside the state; but they have maintained involvement to remain within the FERC exemption. They know where the boundaries are and believe they are well within them.

CHAIR SEEKINS asked if the boundary is at Valdez before it gets on the ship.

MR. WALKER answered that the sale would take place in the state of Alaska.

CHAIR SEEKINS asked Mr. Walker to clarify that the boundary is that the sale takes place in Alaska and the molecules transfer ownership before they leave the state.

MR. WALKER agreed that is correct.

CHAIR SEEKINS asked whether the Port Authority would be involved in the transportation of gas on the ships.

MR. WALKER answered that, as far as ownership of the ships or gas in the transport process, no.

[9:44:17 AM](#)

DAN DICKINSON, CPA, Consultant to the Governor, asked Mr. Twomey where he thinks FERC will draw the boundary in this project. If the gas ends up outside the state, would FERC regulate only the activity that occurs outside Alaska, or would it consider anyone involved in the process as engaged in interstate commerce and therefore under FERC jurisdiction?

[9:44:42 AM](#)

MR. TWOMEY replied that he thinks FERC would look very closely at the situation Mr. Walker postulated. The gas is unquestionably going into interstate commerce, and selling at the border seems to be an artificial way to avoid FERC regulation. He thinks they'd blow right through that argument.

[9:46:00 AM](#)

CHAIR SEEKINS asked who decides.

MR. TWOMEY answered that FERC would assert jurisdiction and, if the party objected, it would go to court and get an injunction.

[9:46:33 AM](#)

MR. MARKS said he wanted to address an issue regarding the economic analysis done by Econ One. Shipping costs are big part of the LNG project, and Econ One must have used the Port Authority's shipping costs, which assume that the LNG tankers built domestically in the 1980's could be reflagged. When these ships were built 25 yrs ago, the Maritime Administration (MARAD) had a Construction Differential Subsidies (CDS) program in place because U.S. shipyards were not competitive with shipyards worldwide. Ships built under this program were built for foreign trade and were not allowed to compete in the domestic trade. The Jones Act is quite clear that domestically built Jones-Act ships that were flagged for foreign trade, cannot be reflagged for domestic trade. It is possible to get a temporary waiver for purposes of national defense and for passenger ships, but it can only be reflagged for commercial activity through an act of Congress, which is no simple thing.

He said that the Department of Revenue had a report prepared by Wilson, Gillette and Company, a maritime economics firm in Washington DC, that looked at the political climate for getting Jones Act ships reflagged. They concluded that it would be very difficult due to stiff resistance from the shipping industry and unions. Shipyards have a presence in every coastal state and are active in state politics in those states. So, this project would need to build new ships in the U.S., which would add significant time and about a billion dollars to the project, negating any NPV advantage.

[9:50:53 AM](#)

MR. WALKER said that they retained the best maritime counsel they could find in Washington DC, and were advised that it would require an act of Congress; but both the Maritime Engineers Beneficial Association (MEBA) and the Seafarers International Union (SIU) have provided Memorandums of Understanding (MOU's) to work with AGPA in the reflagging process. They are anxious to put their members to work, and U.S. Shipyards typically don't get involved. Totem Ocean Trailer Express (TOTE) proposed bringing a foreign LNG ship builder to a U.S. shipyard to build new ships if necessary, and thinks that it would be economic.

He said that he worries because those who stand to benefit most, quickly challenge every suggestion and solution they offer. It's just tiring. They don't make things up, they get advice from the best attorneys and experts at every step.

[9:54:04 AM](#)

CHAIR SEEKINS responded that, while it may be tiring for him, it is the first time some of the legislators have heard this, and that is why they are meeting.

MR. WALKER responded that he appreciates the fact that it is being discussed, but AGPA has spent the last four years climbing some very tall mountains; try talking someone into putting millions of dollars into a project when it doesn't have any gas.

[9:54:51 AM](#)

MR. SHIPKOFF said that the Port Authority was approached by the company that owns the ships in question, a U.S. company and 75 percent shareholder in the largest LNG shipper in the world, that has been in the LNG shipping business for 25 yrs. He said they are working with AGPA to reflag those ships and have been given a timeline of one to two years.

CHAIR SEEKINS asked if that takes an act of congress.

MR. SHIPKOFF confirmed that it does.

[9:56:26 AM](#)

MR. MARKS encouraged the committee to read the Wilson, Gillette report. He said that MEBA is discussed in the report as a fairly insignificant union with little political influence and that the two larger unions, SIU and American Maritime Officers (AMO) would offer considerable resistance. He offered to have Mr. Wilson meet with the committee to address the issue in detail.

MAYOR WHITAKER said he wanted to pick up where Mr. Walker left off regarding the hurdles AGPA has continued to cross. He said one of the biggest is a very uncooperative administration. If there were problems with FERC, Jones Act shipping, or the IRS, one would think that the state would be cooperative and helpful in dealing with them. Instead, the response is continual, incredible resistance!

He said he appreciates the opportunity to come before the committee and, if they had received this type of cooperation throughout the process, the Port Authority project and Alaska's gas would be much further along than it is today.

[9:59:06 AM](#)

MR. PORTER said he agrees with much of what Mayor Whitaker said. He has been a proponent of moving the Port Authority's plan into a project management style of process, hiring a project manager and beginning to work toward overcoming the hurdles. The state

should financially and verbally support that methodology; but part of that is making sure that the parties are all on the same page. For example, it would have been helpful to the state to know that reflagging would take an act of Congress; but this is the first time the Port Authority has acknowledged that for the record. The maritime union information is accurate, which does not mean that it is a showstopper, it means that the Port Authority should approach those other unions and try to get the support it needs. The key is to make the project commercial, to get the per-unit cost of production down to the point that somebody is going to ship gas on this line. To put it in very simple terms, if it is competitive, shippers will want to ship on this line and, if you can get it going two or three years earlier, everybody wins. If it is not competitive, you must get it online two or three years earlier in order to beat the competition so shippers will have to use it. In that case, the shippers will sign an FT contract to sell gas early, but then will be selling gas at a loss for the next 30 years. They are banking on the incremental advantage of those three years. So the first and foremost thing this project has to do is get competitive.

CHAIR SEEKINS commented that not all of his colleagues believe in net present value either.

[10:02:42 AM](#)

SENATOR WAGONER said that, when he was at an energy conference in Washington DC about two years ago, he and several other state senators asked Senator Ted Stevens if the Port Authority would be able to get a Jones Act waiver and were told that it would not happen. He said he thinks that the Port Authority will have to work with Senator Stevens on this reflagging issue.

[10:04:15 AM](#)

MR. WALKER agreed with Senator Wagoner and said that was one of the reasons they adjusted their plan. He commented that one of the things they suffer from is that they put out a great deal of information, but it isn't always used in the Port Authority's best interest. He said that the Jones Act issue is one they have addressed fully, and they have recently received a resolution of support from the Seafarers International Union. He thinks they are lining up the appropriate issues, and they plan to address this with Senator Stevens soon. He reminded the committee that Senator Stevens was a huge help to the project with regard to loan guarantees.

[10:05:49 AM](#)

MR. PORTER said he wanted to follow up on Mr. Walker's comment about information utilization, and said that there is a level of mistrust that is hindering communications. He noted that there have been times when the administration has asked for additional information to try to understand the project and been told it is confidential, perhaps partially because the Port Authority is afraid it will be used against them. That is not the administration's intent, and for this project to move forward will require a greater level of trust.

[10:06:36 AM](#)

MR. SHIPKOFF said he wanted to provide clarification on one of the points Mr. Marks brought up. The CDS for the ships in question has been repaid, a condition of them being flagged out of the trade.

CHAIR SEEKINS asked if there were any more questions on the Jones Act or shipping before the discussion moves on to other things.

[10:07:12 AM](#)

MR. MARKS went back to page 20 of Dr. Finizza's presentation, to the discussion of Internal Rate of Return (IRR). He said that 66.9 and 74.8 percent are very high and, although Dr. Finizza doesn't place much value in IRR, some people will focus on those high numbers. He thinks Dr. Finizza calculated it with the producers paying the tariff over time instead of up-front, which results in higher figures. He believes that most corporations capitalize that commitment up front and wondered if Dr. Finizza would address that issue.

[10:09:41 AM](#)

DR. ANTHONY FINIZZA, Consultant, Econ One Research, Inc. said that, on page 20, he showed some IRR's when comparing how the two models he was evaluating were performing, but that is the only place he used them, because he does not feel that IRR is going to be helpful in this case. To illustrate, he said that if the IRR is calculated as Mr. Marks suggested and the LNG project is scheduled to start three years before the highway project as proposed by AGPA, but there is a 1-yr delay in the LNG project, the IRR goes up. It does not seem helpful that, when the project is not on target, the IRR would be higher, which is why he did not use that calculation more extensively.

MR. MARKS agreed that that IRR has limited applicability, but it is an important metric for the specific question of whether a project can repay its investors. he simply cautions the

committee not to look at a 65 percent IRR and get carried away with how great it is, because if one capitalizes the commitment, it is much lower.

DR. FINIZZA reminded Mr. Marks that this is not an analysis of the Port Authority project; it is an analysis of two models.

10:12:12 AM

MR. SHIPKOFF said that, if he understands Mr. Marks' argument correctly, he is saying that the proper way of looking at returns to the producers is to include all of the midstream components into the overall return. The conceptual problem with that approach is that it is blending two very different types of projects with very different risk profiles. He pointed out that midstream components are regulated and generally obtain lower returns because of the nature of those investments. If they are blended with the upstream, it drags the upstream returns down. In response to Mr. Marks' statement about capitalization of the firm transportation commitments (FTR), there is some truth to that; but some of Econ One's slides illustrate very effectively the essential difference between including the obligation into an integrated project and treating the upstream as separate, while taking into account the commitments to supply gas and to pay the tariff.

10:14:47 AM

DR. FINIZZA said he agrees with Mr. Shipkoff, and if the analysis were simply comparing the highway line against similar projects he would engage in this argument; but he said he does not want to spend a lot of energy proving a measure that he doesn't think will be useful.

10:15:30 AM

MR. VAN TUYL said that Mr. Marks and others have suggested how the producers might look at economics, so he thought it would be appropriate to provide a producer's point of view. The critical observation is that the cost of the firm transportation obligations has to be recognized when looking at project economics or upstream economics. The midstream and upstream investments are linked, because the upstream owners of the resource only have the midstream investment due to a firm transportation commitment, which has value to those seeking a loan; therefore, it has a cost to those who make the obligation. He said that Mr. Marks is right that it is typical to capitalize the cost of that obligation. Mr. Shipkoff is also correct that the nature of the two cash streams may have different risks, so a more rigorous analysis might include a dual discount approach

to reflect the profile of each of those obligations. The bottom line is that you can't ignore it; and it seems that much of this analysis, in looking at the upstream returns, simply ignores the fundamental commitment that is made by the resource owners.

[10:17:38 AM](#)

SENATOR THERRIAULT prefaced his question by saying that type of commitment is made on all the pipelines BP ships on, and BP doesn't own them. He asked Mr. Van Tuyl why this one is different. He noted that Exxon is very strident that this isn't to be treated as a debt, and the state's independent consultants say that it is noted on the balance sheet, but is not listed as a debt.

MR. VAN TUYL replied that this is not a unique valuation; it is done for every pipeline project that BP invests in. There are examples of projects like this that are not simply noted, but end up on the balance sheet and are classified under international GAAP as debt-like payments. The appropriate treatment of them, whether they end up on the balance sheet, noted, or as footnotes, is that they are treated like a debt because they are actual obligations. There are different methods for calculating them in project economics.

MR. MARKS followed up by saying that he would supply documents from GAAP and Moody, and chapters from financial textbooks on how long-term purchase obligations like the tariff are treated financially. The reason these don't show up on the balance sheet is that, per GAAP standards, unless the commitment involves 90 percent of the life of the asset or 75 percent of the asset value, it appears in the notes. Just because it is off-balance-sheet debt, does not mean it isn't debt.

[10:20:49 AM](#)

MR. DICKINSON said that, as the only CPA at the table, he wanted to point out that the notes are an integral part of the financial statement, but cautioned the committee not to get caught up in accounting treatment issues. He said there are two important points here, one is balance sheet impairment, that is, what will those long-term financing commitments do over time; another is how financial analysts look at those commitments relative to the company's position.

[10:22:09 AM](#)

REPRESENTATIVE KELLY asked Mr. Dickinson if he supports pitching IRR over the bank and using the cash flow analysis, as Dr. Finizza recommended.

MR. DICKINSON responded that he does not believe Dr. Finizza is suggesting that they pitch IRR out, but that each of these financial metrics has a place, and one has to decide which metric and which criteria are important. He thinks Dr. Finizza was saying that, depending upon what one is comparing, IRR becomes a better or worse measure. IRR is good for valuing a project, but becomes problematic when comparing projects because of the reinvestment problem.

[10:24:01 AM](#)

DR. FINIZZA commended Mr. Dickinson for his clear and accurate explanation. He thinks it is better to avoid using that measure on this type of comparison to avoid having people choose the numbers they like.

[10:25:16 AM](#)

MR. SHIPKOFF said he agreed with Mr. Dickinson that the accounting treatment of these obligations is of secondary importance to the cash flow side and analyzing the project's competitiveness. He said he is not arguing that commitments on the firm service obligations should be ignored in the analysis; but making those is not the same as investing in the midstream infrastructure. Part of the reason upstream investment is riskier than midstream investment, is that they have to make firm service obligations. In effect, the upstream shippers are leveraging against the midstream infrastructure, which increases their risk, therefore their expected return on capital is higher.

[10:27:11 AM](#)

MR. MARKS commented that there is an old adage in finance that you can't make a bad project good by borrowing money. If, instead of paying off the \$24 billion to build a project, you borrow it, your IRR goes way up and it looks good. There are two reasons why that does not work. First, the long-term FT commitments are debt that impacts the credit-worthiness of a company. Second, if your tariff includes both principal and interest, you're paying off the interest of the weighted average cost of capital so your hurdle rate becomes the cost of equity itself.

[10:29:42 AM](#)

MR. SHIPKOFF said that, as Senator Therriault pointed out, upstream production companies engage in FTR with third parties all the time. No one has suggested that it would be unique for a third party to provide the midstream service to the upstream

producers, and the inherent increase in risk to them because they are leveraging off the midstream infrastructure is reflected in the risk profile of the upstream investment. But, if one ignores this issue and rolls the entire midstream infrastructure into this project, the returns still look good. He said that, either way, he is not sure what the issue is.

[10:30:52 AM](#)

MR. VAN TUYL said that earlier, Mr. Shipkoff presumed his agreement with the assertion that firm transportation obligations are treated differently from a cash obligation or cash stream generated by a project, and he wanted to be clear that he does not agree with that assertion, they are a debt obligation.

At ease [10:31:31 AM](#) to [10:43:33 AM](#).

MR. MARKS prefaced his comments by saying that he believes the public concern is advanced when people understand the complexity of these issues. He said it has been pointed out that the price of gas in Asia is generally tied to oil prices, and most of it is sold on contract. What ensues from that is that prices in Asia are not set by supply and demand, so just because prices are high in Asia does not mean demand will be there. So, although prices are high, it does not necessarily open up opportunity for a diversion option. In addition, when diverted oil does show up for sale in Asia, it is outside the realm of the contract, not tied to oil prices, and subject to competition. In that dynamic, it is the lowest priced bidder that commercializes the gas. Accordingly, any value that can be realized from a diversion option of Alaska gas would be very small.

[10:46:16 AM](#)

MR. SHIPKOFF said that it was widely reported that, during last winter, Japan was outbidding the U.S. for spot cargos because of shortages. AGPA is suggesting that Alaska will be one of those who have opportunity to sell there. More importantly, he stressed that Dr. Finizza's analysis ignores the value of that option and still shows the LNG project is very robust.

CHAIR SEEKINS asked Mr. Shipkoff to remind him, regarding the effect of long-term shipping commitments, how they could divert some of the gas.

[10:47:50 AM](#)

MR. SHIPKOFF replied that, the way it is done contractually is that the seller has the right to divert but must compensate the buyer for any replacement gas costs, because the seller has to obtain the gas somewhere else. He said that their analysis took into account all of the costs the seller would have to pay, including the fixed infrastructure capacity reservation.

[10:48:45 AM](#)

CHAIR SEEKINS asked if it is economic to divert gas, even with the cost of buying gas elsewhere, paying for the terminal and the diversion.

[10:48:57 AM](#)

MR. SHIPKOFF answered yes, when the price is sufficiently high to cover your fixed costs.

MR. PORTER commented that, in the winter you can produce gas better and may be able to exceed the FT commitments and move more gas. So, it doesn't always have to be a trade.

MR. SHIPKOFF agreed that a lot of spot trade occurs because of increased output.

DR. FINIZZA asked if Mr. Shipkoff took into account the discounted price in the diversion market.

MR. SHIPKOFF said no, that the analysis assumed the average Japanese price, and he projected the Japanese landed prices on the basis of an assumption of contractual oil prices. One might have to take into account a discount below market price, but he repeated that the analysis did not rely on the value of the diversion option to make the project economic.

[10:52:39 AM](#)

MR. PORTER said that one of things the administration is looking at is Costa Azul's intent to be fully subscribed by the end of year, so that window will close. He thinks they need to look at what the options will be some time from now and how to open those doors.

MR. SHIPKOFF reminded Mr. Porter that AGPA is negotiating with Costa Azul regarding their time schedule.

MR. PORTER said he appreciates that because, if you have no gas now, you can't subscribe.

MR. SHIPKOFF assured him that Costa Azul knows their situation.

[10:54:26 AM](#)

CHAIR SEEKINS asked for questions from members.

[10:54:39 AM](#)

REPRESENTATIVE SAMUELS said he would like some input from representatives of the Port Authority, the administration, and the producer group. He asked, if he has gas, and the constitution says he can maximize the revenue for the state of Alaska, and he can choose to pay \$3.55 on the slope, or pay \$2.17 across the continent, even if they are off by 50 percent and the Port Authority is right on and gets the gas, the problem remains \$3.55 to \$2.17. He said he understands the timing with regard to NPV, but is having a hard time understanding how to make it a commercial deal initially.

[10:56:38 AM](#)

MR. VAN TUYL replied that BP wants to deliver gas to market at the lowest possible cost. BP has tried to make LNG work over the years and was a member of the LNG sponsor group, but it shifted its focus to the gas pipeline when it realized it could deliver gas to the Lower 48 and the West Coast lower than it could LNG.

He continued that Representative Samuels referenced a 5.5 Bcf/d project, which would be the 1.2 LNG and the 4.3 gas projects, and that raises questions in his mind, because it takes a fundamentally different gas treatment plant to process gas to LNG specs than it does to process gas to pipeline specs. LNG doesn't tolerate CO<sup>2</sup> or aromatics, so it is a different process.

[10:58:29 AM](#)

REPRESENTATIVE SAMUELS asked if it is possible to have a gas treatment plant (GTP) on the slope that makes it pipeline quality, and a fine-tuning mechanism in Delta.

[10:58:50 AM](#)

MR. VAN TUYL responded that it is possible to treat the gas anywhere along the line; the challenge is to dispose of the additional CO<sup>2</sup>. On the slope, there are multiple options for handling that, but taking it off downstream would present problems for CO<sup>2</sup> disposal. He commented that the other concern with a 5.5 Bcf/d project is that the pipeline from the North Slope to Delta is fundamentally different from what the producers have discussed. To get all 5.5 Bcf/d to Delta would require them to put in intermediate compression, so the downstream system would no longer be expandable, which would not be good for stimulating exploration.

[10:59:56 AM](#)

MR. WALKER said he believes the LNG project is very competitive with the highway project, but AGPA approaches it from a different standpoint. He reminded the committee that there were efforts to run the TAP line through Canada, but those efforts were defeated because the state wanted the largest footprint to be in Alaska. They are afraid of losing an opportunity for Alaska if it holds out waiting for a highway project that there is no commitment to build and that depends on one market. The LNG project offers Alaska the best of both markets and the opportunity to enhance the economics of the highway route by bringing gas to Alaska through Southcentral for export sooner than later. AGPA does look at the wellhead numbers, but that isn't only yardstick for measuring the maximum benefit for Alaska. If this project is pushed out to 2025 or later, the situation will be very different. He thinks the state can have it all if it moves quickly to take advantage of the LNG option now and pave the way for a pipeline and highway project later.

[11:03:10 AM](#)

MR. SHIPKOFF said that the differential in the netback is not as wide as Representative Samuels suggests and pointed to Econ One's presentation for that figure. He also said that he believes that, with further technical work, that differential will narrow further and possibly be eliminated. Regarding the technical issues of LNG spec gas and pipeline spec gas, he offered to arrange for Bechtel's engineers to meet with the producers to address those.

[11:04:21 AM](#)

DR. FINIZZA said that any analysis will show that, contemporaneously, an LNG netback will be lower than a highway line netback, and it is only when they diverge that the value changes. As Mr. Porter pointed out yesterday, one would have to be sure that the 3-year advantage is permanent, that there is no leakage, and that the differential is very small before entering into this. Most importantly, the producers have to accept this as a viable business proposition.

[11:06:16 AM](#)

MR. DICKINSON said that, if the base case shows one project is clearly more competitive than the other, the question is whether there are intangibles. Mr. Walker said that the LNG project is competitive, so there must be other things that should be looked at. Clearly, more options are better than fewer; so there is the diversion option. If there is a pipeline that heads toward the

AECO hub, it would probably preclude the ability to go into Asian markets; but he does not think the baseline pipeline to Chicago is what is going to be built, rather there will be a pipeline to AECO and multiple options from there. He does not think it's a choice between a single market and multiple markets, but between different multiple markets available to the two projects. If the best use of the gas is the mid-continent market, and the project has to go down to Kitimat and regas after the short voyage back into AECO, it would be getting to the same hub at a much higher cost of transportation.

He added that Mr. Shipkoff is absolutely right in saying that further technical work on both of these projects may narrow or eliminate the differences between them, or it may widen them. And while Mr. Walker mentioned that Bechtel has already put about 55,000 hours into this project, the sponsors have put in over 1,000,000 man-hours, so a huge amount of work has gone into both projects and further work will refine the numbers fully. Both are best estimates at this point.

[11:09:21 AM](#)

MR. VAN TUYL commented that, regarding the GTP issue, it is ultimately resolvable, it will just cost more and it would be appropriate to reflect that in a true characterization of the LNG project. He agreed with Mr. Walker that it is unwise to bet everything on one project and noted that an advantage of the highway project is that, as the lowest cost project to open the basin, it makes everything else possible: more offtake points and cooperation with interconnecting projects including the Port Authority's. So, the highway project does not exclude other options.

[11:11:06 AM](#)

REPRESENTATIVE STOLZ said he thinks there is some value in the Port Authority process, and he is getting the impression that the sponsors may be willing to entertain options as well. He asked if the industry partners are willing to come back to the table and work on it.

[11:12:26 AM](#)

MR. VAN TUYL said he was referring to language that is actually included in the contract, that allows for spin-off projects including the Port Authority's. There is also language in the contract that commits the mainline entity to cooperate with those projects; so, the framework is already in place.

MR. DICKINSON said that, with this contract the state is going to have as high as 20 percent of the gas, and what they do with it is not part of the fiscal contract. What the state decides to do with it will drive some of these decisions.

[11:15:08 AM](#)

REPRESENTATIVE KELLY said he likes lots of options and is glad to have the opportunity to discuss this one. He also said that it is important to recognize the difference between hostile questions and hard questions designed to get at necessary information. The Port Authority should not take offense because the legislators are trying to get at what is best for Alaska, and whether AGPA can do what it says it can within the time frame stated is a real issue.

[11:18:36 AM](#)

SENATOR WAGONER said that he has a request of the administration. He recalled that Tony Palmer said every penny difference in the tariff on the pipeline project will cost the state \$150 million over the life of the project, and \$3.55 versus \$2.17 calculates out to about \$20 billion. He asked if the industry representatives would get a realistic calculation for him.

[11:19:34 AM](#)

SENATOR THERRIAULT said that his constituents are uneasy with any proposal going through Canada, and that's one reason that the Port Authority proposal is attractive to them. He asked the administration representatives how the state should deal with the uncertainty of going through Canada. There is no assurance that the pipeline can get through Canada in 3 years and the legislators have heard that the current contract with the producers doesn't get Alaska anything with regard to Exxon Canada. He asked if Alaska is going to need additional agreements with Canadian companies and the Canadian government.

[11:21:37 AM](#)

MICHAEL MENGE, Commissioner, Department of Natural Resources, said there is no guaranty (feedback). But there is netback benefit to Canada in this project, so it is in their interests. Also, Canada is the U.S. largest trading partner, so preventing us from moving gas through Canada to the Lower 48 would not be politic. And finally, this is a transit and not production line, so there are mutual interests and there is a willingness to come to an agreement.

[11:23:52 AM](#)

SENATOR THERRIAULT asked a question about dealing with Canadian subsidiaries of the major producers. (partly indiscern.)

MR. MENGE replied to the effect that it is a more efficient way to do it. (partly indiscern.) He said that the administration has spent three years working on this day and night, and they all would love to fully embrace the Port Authority plan; but they have to do what they believe is in the principal best interest of Alaska. They have looked at the Port Authority project from every angle and simply do not believe the economics are there.

[11:27:27 AM](#)

CHAIR SEEKINS commented that this is a very complex issue for the legislature. He agrees with the underlying premise of the Port Authority, which was from its inception to build, or cause to be built, a natural gas pipeline. No Alaskan disagrees with that premise, and he believes that the Port Authority is putting their project forward because they think it is the best thing for the people of Alaska. Other people are resisting it because they believe their plan is best for the people of Alaska. It is hard, but as a business person he wants to know how much it will cost to get this much gas in that big a pipe to market every day. And whichever project provides the best wellhead value is his favorite project from the start.

He said that the question today is the value of being able to get gas to market three years sooner; but the whole thing falls apart if all parties don't cooperate. The producers are saying that they will get the gas to the offtake in Delta in their pipe and the Port Authority can take it from there. So, the discussion seems to be whether it is the producers' pipe or the Port Authority's pipe to Delta Junction. From Delta Junction, it doesn't appear to be a problem.

He stressed that getting the gas, having a defined market, getting a commercial agreement, all are necessary to promote a project. He said he appreciates the opportunity to discuss this issue in a roundtable venue. There are huge hurdles, and he hopes they can be overcome to provide benefit to the state of Alaska.

[11:32:17 AM](#)

CHAIR SEEKINS asked if everyone present agrees that the benefit is to get gas to market sooner.

MR. DICKINSON replied that is one aspect of it, but it would not make sense to build something two years sooner and spend the next 30 years paying for it.

CHAIR SEEKINS said he is right, unless those two years paid off well enough to compensate for the remaining years at a lower rate of return.

[11:32:47 AM](#)

KEN GRIFFIN, Deputy Commissioner, Department of Natural Resources, added that, looking at Dr. Finizza's numbers on page 46, the 2013 start date has about a 5 percent improvement in NPV over the highway project. If that 2013 start date slips to 2016, the project loses 20 percent of the NPV, about 6 percent per year compounded. Even if it started only one year late, in 2014 it would already have lost any additional value associated with the early start. While we are looking at 3 years, we are looking at a project concept with such fragility that in only one year the economic benefits can be lost.

[11:34:03 AM](#)

MAYOR WHITAKER closed by saying that reasonably priced energy to Alaska is a significant part of the Port Authority's mission. He pointed out that the motivation of the major producers is to enrich their stockholders, while the Port Authority's motivation and mandate is to ensure that a project gets built for Alaskans. He said his greatest fear is that the market will come into equilibrium without Alaska's gas.

[11:38:20 AM](#)

MR. MARKS commented that, if these projects are in conflict, it is possible that competing forces could prevent any project from being built.

CHAIR SEEKINS thanked all of the members for their input and asked for final questions.

Adjourned at [11:40:46 AM](#).