

HOUSE FINANCE COMMITTEE
April 27, 2007
1:44 P.M.

CALL TO ORDER

Co-Chair Chenault called the House Finance Committee meeting to order at [1:44:35 PM](#).

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair
Representative Kevin Meyer, Co-Chair
Representative Bill Stoltze, Vice-Chair
Representative Harry Crawford
Representative Les Gara
Representative Mike Hawker
Representative Reggie Joule
Representative Mike Kelly
Representative Mary Nelson
Representative Bill Thomas Jr.

MEMBERS ABSENT

Representative Richard Foster

ALSO PRESENT

Representative Anna Fairclough; Representative Mark Neuman;
Representative Woodie Salmon; Tom Irwin, Commissioner,
Department of Natural Resources; Pat Galvin, Commissioner,
Department of Revenue; Kurtis Gibson, Acting Deputy
Director, Division of Oil and Gas, Department of Natural
Resources

SUMMARY

#HB177
HB 177

An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date.

HB 177 was HEARD and HELD in Committee for further consideration.

HOUSE BILL NO. 177

An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date.

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Co-Chair Meyer disclosed a potential conflict of interest stating he works for Conoco-Philips during the legislative interim; he asked to be excused from participating. Representative Joule OBJECTED. Co-Chair Chenault commented that Co-Chair Meyer would be required to participate in the meetings.

TOM IRWIN, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, noted the Administration is diligently working on the Alaska Gas Inducement Act (AGIA), to move Alaska to move forward. He voiced full support, stating that the purpose of the plan takes a business approach. The fair open process gears the proposal request, trading Alaska's gas as a business to move the gasoline forward.

Commissioner Irwin addressed gas volumes belonging to Alaskans. There are significant volumes, over thirty-six trillion cubic feet of gas, which has been identified when looking for oil. Those are certifiable reserves that can be recovered.

Commissioner Irwin directed his comments to the producer's intent to take care of their business; of course, the Administration's work is to protect the State's business. The newest estimate of identified gas is 262 trillion cubic feet, which is a significant quantity. Alaska is rich with gas potential.

Commissioner Irwin mentioned gas hydrates, identified by the U.S.G.S. as over 32,000 trillion cubic feet. At present time, the recovery technology is not available & may never happen; however, there is significant time to work on the gas hydrates. The bottom line is that Alaska has a significant future in gas reserves.

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Commissioner Irwin addressed previous negotiation language, claiming that if the State only negotiates with the producers, no one wins. The previous deal gave away all judicial rights of the State. If that language passed, during the next 45-years, our upcoming generation would have no judicial right on the slope. The State entered into a highly unbalanced arbitration process. The State, in front of a single arbitrator, was responsible for showing non-diligence, through surrendering judicial rights and

restricting the ability to sue. That bill would eliminate the State's administrative rights to manage leases. It was not acceptable that large quantities of money could be lost through various definitions of the contract. AGIA was created through determining how "business" is handled in the world. Proposals are common. At this time, Alaska is not trusted by any of the companies.

Commissioner Irwin recommended providing inducements to certain areas and protecting the State's future gas development. The Administration has defined "must have's", including creating an incentive program, in the amount of \$500 million, not a gift. He noted the intent to make a fair bidding process to help move the project forward. The State defines the variables.

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Commissioner Irwin stated it is critical for Alaska to maintain pipeline expansion and fair tariffs. If companies do not have a certainty to be able to monetize their value, they do not explore. He reiterated the need for fair tariffs and an "expandable" gas line. If the line moves through Canada, two-thirds of the rates could be "rolled-in". The Administration maintains the fields so that they are affordable and expandable. There are no other options. He emphasized that there are no risks to the State through the AGIA plan. There would be clear definition through a fair and open process. When the plan is chosen, then the Department will come back to the Legislature.

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PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, distributed a handout: "The Palin-Parnell Administration presents AGIA - the Alaska Gasline Inducement Act". (Copy on File).

Slide 2 highlights AGIA designed to be a commercial vehicle to create a competitive playing field, providing a pipeline on Alaska's terms through a transparent inducement process.

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Commissioner Galvin noted Slide 3:

- AGIA uses competitive bidding, not negotiation;
- Successful bidding process requires AGIA's inducement and without inducements, there would be no 3rd party bidders. Without bidders, the State has no ability to get a pipeline on its own terms.

Representative Joule mentioned the competitive process, recalling that TransCanada had submitted an application but since has backed away. He asked which companies remain in the bid process. Commissioner Galvin explained that the bill attempts to strike a necessary balance to provide the State with a credible opportunity for the 3rd parties entering the process. The identified parties within that group are:

1. Ambridge
2. TransCanada
3. Mid American

Commission Galvin pointed out that the message from TransCanada has been "warm" and have concerns with the portion of AGIA that requires the State to mandate the applicant to commit to obtain a Federal Energy Regulatory Commission (FERC) certificate even if the season is not successful. Mid American has indicated they are comfortable with the current bill. AGIA will only succeed through maintaining competition.

Commissioner Irwin interjected that no producer had specifically indicated they would not participate. TransCanada has already invested \$200 million dollars in the process. All the companies are interested in the reserves, but want to make sure it is a fair process. There are many other companies closely watching what Alaska is doing. He reiterated the value of a fair process.

Representative Gara asked about other all-Alaskan lines. Commissioner Galvin recognizes that the Port Authority presents a unique case and do have a viable project, which could come forward as a proposal. Criteria and evaluation of all projects will compare them.

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Representative Joule noted his concern about which options were best for Alaska. He asked if a single application would be fair. Commissioner Galvin replied the State does not know; it should be determined through an evaluation of each proposal. If an application meets all the criteria, the bill proposes the commissioners make that determination. Any proposal is based on expectation. Commissioner Irwin added that to date, there have been two confirmations made. Once a competitive process is started, he anticipated other producers coming on line.

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Commissioner Galvin pointed out the inducements indicated on Slide 4:

- Midstream inducement of \$500 million dollars, reducing the licensee's project development risks, especially the independent pipeline licensee; and
- Upstream tax and royalty inducements coupled with the licensed midstream project to make the license more valuable, encouraging open season participation. It ensures that the State would stick with its licensed partner.
- The requirement to obtain a pipeline certificate reduces the overall project risks & improves the State's strategic position.

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Commissioner Galvin said Slide 5 shows a proposed Project on State terms:

- By creating a more competitive playing field, the State can specify some "must haves".
- Such factors focus on the State's future such as creating a pipeline quickly, competitive and vibrant oil and gas industry, jobs and careers not only from the pipeline, but also from a competitive oil patch, bringing gas to Alaskans.

Representative Thomas inquired about the job portion of the negotiated project labor negotiation. Commissioner Galvin explained that it is the intent of the Administration to provide only a "broad" overview at this meeting. At the meeting scheduled for 4/28/07, the Department will provide an analysis of each section, reiterating the intent for Alaskan hire.

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Commissioner Galvin noted Slide 6 indicates the State's "must haves" obtained through the pipeline tariff and access terms that ensure a competitive oil and gas industry:

- Competitive oil and gas industry flowers if pipeline ownership provides no upstream competitive advantage;
- Jobs and careers for Alaskans would be maximized by ensuring a competitive upstream industry; and
- Cheap gas for Alaskans will be enjoyed if the pipeline expands regularly.

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Commissioner Galvin explained that Slide 7 illustrates a State of Alaska terms project.

- A pipeline more quickly
- The required minimum of 70/30 debt/equity ratio, ensuring reasonable base tariffs
- Expansion requirements ensuring the gas found by any party could access the pipeline
- Rolled-in rate requirements guaranteeing that all parties have the economic incentive to explore for the gas. The competition for oil and gas and all of Alaska's gas could move into that pipeline.

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KURTIS GIBSON, ACTING DEPUTY DIRECTOR, DIVISION OF OIL AND GAS, DEPARTMENT OF NATURAL RESOURCES, explained that Slide 8 represents the costs of delays on the project and/or the benefit resulting from the acceleration of getting under way. With prices at the \$7 dollar range, the project acceleration represents nearly five times what the State's capital contribution is. Delays are costly. The AGIA process establishes a competitive process for developing a framework for the State. The slide indicates a \$500 million dollar capital contribution value.

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Mr. Gibson continued, Slide 9 represents the tariff & State revenue effects of a debt-equity structure, referenced in the FERC rate-making. The slide does not indicate anything related to the capital structure of the project nor does the bill. It would protect the State's low tariff interests ensuring that no less than a 70/30 split would be used instead of the mentioned split of 50/50, including the associated tariff benefit of 41 cents. The State revenue benefits would total approximately \$2.5 billion dollars.

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Mr. Gibson addressed the expansion provisions indicated on Slide 10. He pointed out the difference between the likelihood and interest of expanding a pipeline, hinging on whether the owner is an integrated energy company or independent pipeline company. Integrated energy companies will not commit capital to a project with roughly a 14% projected rate of return. An independent pipeline company is interested in projects with regulated and low-risk and low-rates of return in the neighborhood of 12%-14%. In the event that an explorer wanted to get the gas to the pipeline, the expansion provisions not included and delays could result, ultimately becoming a strong deterrent.

Mr. Gibson highlighted Slide 11, illustrating the expansion provisions addressing the cost of delays to the explorer, outlining net present value (NPV). He acknowledged that expansion provisions exist and that a non-independent pipeline company could act as the pipeline operator, which could result in significant delays to the explorers.

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Representative Gara asked for more information on the net present value (NPV) in relationship to time/valued money, questioning if it were the same for the State as it would be for a private investor. Mr. Gibson advised that the discount rates apply to private enterprise as opposed to those used by the government. The figures used indicate a 5% State discount rate in terms of delayed project costs.

Representative Gara questioned what had been factored into the State's rate of return. Commissioner Galvin responded that the nature of the question is determined by when it is spent. He suggested that a 5% rate or discount return factor is an appropriate cost approximation for opportunity lost. The State recognizes different opportunities when creating projected revenue streams. He maintained that the State is better off having access to the money now for investment purposes. He acknowledged that 5% is a lower rate than most businesses want to assume. Mr. Gibson added that there is a portion of the royalty revenue collected and placed into the Permanent Fund Division included in the General Fund.

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Representative Kelly observed the value of a present cost calculation, pointing out the volatility of the oil industry and the explosive price fluctuations. Mr. Gibson agreed that price could be one of the most volatile factors.

Mr. Gibson spoke to Slide 14, the rolled in expansion provision options. He mentioned that the cost-of-delays, pointing out that all shipper prices could come down under the FERC expansion. The transportation rate would be driven up due to increases in fuel rates. There would be an incrementally calculated transportation rate. Under the lower 48 FERC regulations, there is a looping expansion, which could drive the price up.

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Mr. Gibson reviewed Slide 12, which compares the AGIA expansion rate policy to the normal lower 48 FERC policy. He thought the AGIA mechanism would look different for explorers under that, rolling in all the expansion costs up

to 115% of the shipper's tariff rate. The difference could be a 15% up-lift of the original transportation costs.

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Mr. Gibson continued, Slide 13 indicates scenarios on how an explorer should view the program depending if the expansion rate treatment was rolled-in or incremental. Rolled-in rates would be spread evenly to all shippers and within the incremental, all the costs of the expansion, and fall upon the expansion shipper.

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Commissioner Galvin pointed out that Slide 14 indicates the transparency issues of the public making decision process. The process will be competitive, not negotiated; bids will be submitted, commented upon and then evaluated. A "winner" should be chosen by the commissioners; their decision would be reviewed by the Legislature.

Commissioner Galvin hoped the risks and inducements would also be transparent, providing contrast to the previously proposed contract. There would be a cap on the contribution with a clearly defined role for the State.

Commissioner Galvin summarized that the State needs competition to encourage participants to reach for the best and most competitive proposal. Without competition, the State is placed into a leveraged position of waiting for producers to move the project ahead. AGIA creates a competitive arena while establishing commercial incentives for all interested parties.

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Representative Hawker requested further information regarding the \$10 million dollars of the previous Administration. Commissioner Galvin agreed.

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In response to a question by Representative Gara, Commissioner Galvin revisited Slide 13, explaining how rolled-in rates encourage exploration. He reiterated that the Administration is "excited" by the proposed AGIA plan; a sectional analysis will be presented at the next scheduled hearing on the bill.

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Representative Kelly requested information regarding how the Administration intends to execute the plan. Commissioner Galvin agreed to provide that data.

HB 177 was HELD in Committee for further consideration.
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ADJOURNMENT

The meeting was adjourned at 3:02 P.M.