

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON OIL AND GAS**

March 20, 2007

3:06 p.m.

**MEMBERS PRESENT**

Representative Vic Kohring, Chair  
Representative Kurt Olson, Vice Chair  
Representative Nancy Dahlstrom  
Representative Jay Ramras  
Representative Ralph Samuels  
Representative Mike Doogan  
Representative Scott Kawasaki

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Representative Carl Gatto  
Representative David Guttenberg  
Representative Craig Johnson

**COMMITTEE CALENDAR**

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."

- HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 177

SHORT TITLE: NATURAL GAS PIPELINE PROJECT

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

03/05/07	(H)	READ THE FIRST TIME - REFERRALS
03/05/07	(H)	O&G, RES, FIN
03/06/07	(H)	O&G AT 3:00 PM BARNES 124
03/06/07	(H)	-- MEETING CANCELED --
03/08/07	(H)	O&G AT 3:00 PM BARNES 124

03/08/07	(H)	-- MEETING CANCELED --
03/13/07	(H)	O&G AT 3:30 PM HOUSE FINANCE 519
03/13/07	(H)	Heard & Held
03/13/07	(H)	MINUTE(O&G)
03/15/07	(H)	O&G AT 3:00 PM BARNES 124
03/15/07	(H)	Heard & Held
03/15/07	(H)	MINUTE(O&G)
03/19/07	(H)	O&G AT 8:30 AM CAPITOL 106
03/19/07	(H)	Heard & Held
03/19/07	(H)	MINUTE(O&G)
03/20/07	(H)	O&G AT 3:00 PM BARNES 124

**WITNESS REGISTER**

MARCIA DAVIS, Deputy Commissioner  
 Department of Revenue (DOR)  
 Anchorage, Alaska

POSITION STATEMENT: Presented portions of HB 177 and answered questions.

PATRICK GALVIN, Commissioner  
 Department of Revenue  
 Anchorage, Alaska

POSITION STATEMENT: Presented portions of HB 177 and answered questions.

BONNIE HARRIS, Senior Assistant Attorney General  
 Oil, Gas & Mining Section  
 Department of Law (DOL)  
 Anchorage, Alaska

POSITION STATEMENT: Answered questions on HB 177.

TOM IRWIN, Commissioner  
 Department of Natural Resources (DNR)  
 Anchorage, Alaska

POSITION STATEMENT: Responded to questions on HB 177.

DON BULLOCK, Attorney  
 Legislative Legal Counsel  
 Legislative Legal and Research Services  
 Legislative Affairs Agency  
 Juneau, Alaska

POSITION STATEMENT: Answered questions on HB 177.

**ACTION NARRATIVE**

**CHAIR VIC KOHRING** called the House Special Committee on Oil and Gas meeting to order at [3:06:19 PM](#). Present at the call to order were Representatives Kawasaki, Olson, Samuels, Doogan, and Kohring. Representatives Dahlstrom and Ramras arrived as the meeting was in progress. Representatives Gatto, Guttenberg, and Johnson were also present.

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HB 177-NATURAL GAS PIPELINE PROJECT

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CHAIR KOHRING announced that the only order of business would be 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."

MARCIA DAVIS, Deputy Commissioner, Department of Revenue (DOR), continued her sectional analysis of the Alaska Gasline Inducement Act (AGIA). She explained that Section 330 directs the governor to appoint an AGIA coordinator to oversee coordination of state agencies involved in the project, to ensure compliance by state agencies with the provisions of AGIA, and to coordinate with the federal coordinator of natural gas projects in the state. This coordinator shall serve until one year after the gas pipeline commences commercial operation. She stated that this language is modeled after federal law and that the coordinator answers directly to the governor.

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MS. DAVIS explained that Section 340 is modeled after federal law and outlines requirements imposed on state agencies. Essentially, this provision requires expeditious handling of permits and prohibits inclusion of any discretionary term or condition that is not required by state law.

MS. DAVIS explained that Section 400 provides a procedural mechanism to account for matching contributions for the pipeline inducement fund. Section 410 authorizes the commissioners of DOR and DNR to adopt regulations to implement AGIA.

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REPRESENTATIVE SAMUELS expressed concern with the possibility that statutory changes may affect the regulatory scheme, and referenced prior legislative changes regarding qualified expenditures for the production profits tax (PPT).

MS. DAVIS replied that qualified expenditures are defined in AGIA and will be incorporated into the license, therefore will have a contractual basis. That will give that provision constitutional protection, she explained.

REPRESENTATIVE DOOGAN asked whether the matching contribution fund is a non-lapsing operating budget fund.

PATRICK GALVIN, Commissioner, Department of Revenue, explained that the fund is not a capital fund, but is a non-lapsing fund to be used for purposes established under AGIA.

REPRESENTATIVE DOOGAN queried about the constitutionality of this provision.

BONNIE HARRIS, Senior Assistant Attorney General, Oil, Gas & Mining Section, Department of Law (DOL), opined that the fund proposed by AS 43.90.400 is not unusual and is similar to other funds for other agencies.

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MS. DAVIS explained that Section 420 contains a statute of limitations provision that requires lawsuits challenging the constitutionality of AGIA to be filed 90 days from the date a license is issued. Section 430 sets forth the procedure and rate to determine interest due the state on delinquent payments. Section 440, the license project assurance section, provides fiscal stability to the pipeline builders. Once the state awards a license and construction begins, the state is limited in its ability to extend offers to other competing proposals. This provision contains a section which would require the state to reimburse the original lessee for up to three times its reasonable development costs should the state extend favorable treatment to a competitor, she explained. She indicated that if the state was to consider a change in the project lessee, this provision contemplates legislative evaluation of the economic benefits and costs attributable to extending favorable treatment to a party other than the original lessee.

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REPRESENTATIVE GUTTENBERG asked whether the statute of limitations contained in Section 420 is authorized by law.

MS. HARRIS opined that it is defensible to put limitations on rights of action, but that it is uncertain whether a court would sustain a limitation on the right to bring a constitutional action.

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MS. DAVIS explained that the DOR anticipates some fluidity in the project participants over the life of the project, therefore Section 450 allows transfers of licenses in certain situations. License transfers must be approved by the commissioners, and transfer of royalty inducements is allowed in conjunction with a transfer of all the licensee's other assets. Section 460 is a fairly "boiler plate" provision on conflicting laws.

REPRESENTATIVE SAMUELS asked whether there were discussions about the possibility of allowing project proposals to grow and develop before a final exclusive lessee is determined so as to allow a better examination of which project is preferred.

COMMISSIONER GALVIN replied that initially the state considered a different method, but explained that the state received feedback that interested parties wanted assurance that the state would go with one project. He noted that there were concerns by interested parties that a party could spend time and money, only to have the state choose another licensee later in the process. He indicated DOR had considered a staged process, but had determined to proceed as set out in AGIA.

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REPRESENTATIVE DOOGAN observed that the license will become an economic asset since it is transferable under Section 450.

COMMISSIONER GALVIN explained that as the project moves forward, the commercial dynamics are going to change. He said that the state needs to provide opportunities for the dynamic to shape the project, and noted that the transfer provisions are structured to protect the state's value.

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REPRESENTATIVE DOOGAN asked whether the original licensee can sell license to another company if the provisions of Section 450 are met.

COMMISSIONER GALVIN agreed with the aforementioned scenario, and opined that a more likely scenario is that the licensee will bring in a partner.

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MS. DAVIS explained that AS 43.90.900 contains definitions while Section 990 sets forth the act's short title. Sections 2 through 4 of HB 177 are conforming sections and Section 5 provides for an immediate effective date.

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MS. DAVIS explained in response to a question that proposed AS 43.90.440 does not allow the state to take back the project from a licensee at will, and would only be activated if the state extended favorable financial treatment to a competing gas pipeline project. If the state wanted to take the project back because of concerns about economics, the state would activate the third-party arbitration clause contained in AGIA, she explained.

COMMISSIONER GALVIN explained that if the state decided it wanted to terminate the contract with the licensee, it would inform that party. It is likely that the licensee would then attempt to invoke the provisions of AS 43.90.440, and there would likely be some negotiations. He indicated there would be a way for the state to recover its maximum costs.

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COMMISSIONER GALVIN responded to a query about the process to resolve differences between the commissioners of DNR and DOR by explaining that the DOR and DNR would work together to come to a resolution of disputed issues. If the departments could not come to a resolution on an issue, the governor would have to decide, he said.

TOM IRWIN, Commissioner, Department of Natural Resources (DNR) offered his opinion that the decision making model in AGIA will provide a healthy tension between the two commissioners and reminded the committee that the legislature and governor will be involved.

REPRESENTATIVE DAHLSTROM said she is satisfied with the proposal that the commissioners of DOR and DNR be the decision-makers.

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REPRESENTATIVE RAMRAS asked how the tariff rate would adjust if the equity shares were adjusted to allow investment by state entities such as the Permanent Fund Corporation and Alaska Retirement Management Board (ARMB). He said he would appreciate further information regarding different methodologies by which state entities can participate in the gas pipeline revenues without compromising the state's position as the sovereign. However, he offered his opinion that other state agencies with some independence may be able to have some involvement and reiterated his desire for state participation over and above the 70:30 debt-equity formula. He further reiterated his desire that constituent groups in the state have the ability to participate in the project in some manner. He noted that there are many complexities regarding this issue and that it will effect different entities in different ways. He went on to say he also would like to see disclosure of alignment interests related to the project, perhaps through an amendment.

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COMMISSIONER GALVIN responded that DOR will provide different scenarios based on different tariff rate increases and adjustments to the debt-equity ratio in order to provide for possible investment by quasi-state agencies.

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REPRESENTATIVE RAMRAS asked for information on whether the state's share of equity investment is diminished if the pipeline costs rise from \$20 billion to \$30 billion. He offered that interested state entities would like to know how their investment and tariffs would be effected by rising pipeline costs and that he would like DOR to provide some further information on this issue.

REPRESENTATIVE SAMUELS also expressed interest in further information on the effect of an adjustment in the debt-equity ratio and the risks associated with participation in the project.

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COMMISSIONER IRWIN offered his opinion that competition for proposals is a good method to choose a project. However, there is a risk in letting a parallel competitive process carry on too far as parties begin to spend money and make commitments. Furthermore, there can be a duplication of efforts if more than one party is moving along with the process.

REPRESENTATIVE SAMUELS cautioned that it is difficult to determine the best proposal at the beginning of a process.

COMMISSIONER GALVIN agreed this is a difficult issue, but disagreed with any suggestion that the state will have "no idea" which proposal is best at the beginning of the project. He noted that the process has been designed to give the state a very good idea of which project to choose, but agreed there is no guarantee as to which project is the best one.

REPRESENTATIVE SAMUELS noted that the decision making process may be difficult as the producers will all have many of the same attributes, such as experience and costs, at the beginning of the project. This may make it hard to determine which entity will do the best job, he indicated.

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COMMISSIONER GALVIN opined that it would be favorable if all the producer proposals are similar. However, he said he believes that the proposals will likely be somewhat different from each other. He said the state is trying to create an opportunity for parties in addition to the producers to come forward with a proposal. He reiterated his belief that the interested parties want a commitment at the beginning of the process.

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REPRESENTATIVE DOOGAN noted that while there is an extensive review of an initial licensee's qualifications, the process by which a license can be transferred appears to involve a less rigorous examination and questioned whether some provisions of the original criteria should be added to the transfer process.

CHAIR KOHRING assigned the aforementioned issue to Representative Dahlstrom's sub-committee. He expressed some concern about the possible lengthy term of the AGIA coordinator and asked about the administrative support the coordinator would receive.

COMMISSIONER GALVIN explained that the position is designated for life of project. However the person in that position would serve at the pleasure of the governor. The fiscal note accompanying AGIA contemplates funding of four positions in the coordinator's office.

DON BULLOCK, Attorney, Legislative Legal Counsel, Legislative Legal and Research Services, Legislative Affairs Agency, told the committee he would be the drafter as HB 177 moves through committee. He offered that the bill is structured into five basic articles which address AGIA's purpose, the license process and cash incentive, the shipper inducements, miscellaneous provisions, and definitions. He directed the committee to proposed AS 43.90.110, the section that provides for the state's matching contributions of \$500 million. He explained that the matching funds are paid in two intervals. The first interval is from the time the license is issued to the end of the first open season. During that time, the state will provide a 50 percent match to licensee funds expended. If there are matching funds remaining after the first interval, the state can match licensee funds spent up to 80 percent, he explained. He suggested the committee may want to consider requiring the license application to indicate how much the licensee plans to spend through the first open season. He went on to say that this section also refers to a state training program for gas pipeline related jobs and suggested that this reference needs to be clarified as it is being offered as an incentive category.

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MR. BULLOCK suggested that the proposed Section 120 regarding abandonment of the project be moved to a later section of the bill. He opined that Section 130, which requires the commissioners to commence a public process within three months of the bill's effective date, is problematic if the process does not begin within the three months. He suggested that wording this as an intent section at the end of the bill could be preferable.

REPRESENTATIVE RAMRAS requested some further information regarding how to take some of the subjectivity out of the criteria evaluation process. He referred to proposed AS 43.90.130's provisions regarding the evaluation of application and asked for some guidance as to how to set forth evaluation criteria.

MR. BULLOCK suggested that this issue is policy driven, and one criteria may be to maximize the well-head value to provide more PPT and royalty revenues to the state. He noted that there may be proposals for two routes, each with different cost overrun concerns that will be difficult to compare due to the differing nature of the projects. Another consideration is the availability of gas for in-state consumers and whether the state could request that off-take points be specified in the application. He offered his belief that the committee consider its priorities for this project, and advised that the bill contain these provisions in statute so that the commissioners of DNR and DOR can consider the legislative priorities in evaluating license applications. He noted that the evaluation criteria need to be defensible if there is a challenge to the decision.

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MR. BULLOCK reviewed the bill sections that relate to the evaluation criteria. First, he noted that the license application requirements are in proposed AS 43.90.140. Second, section 170 contains the application evaluation criteria. Last, he stated there is some uncertainty with the timing contained in Section 180, which requires notice and review in a 60 day period. He said that the notice for public comment comes after the evaluation criteria, but queried whether the intent was for the public to see all the applications the commissioners deemed as qualified, or whether the commissioners will submit only their favored application for public review. He suggested this be clarified. He went on to discuss the issue regarding the "30th legislative day" and the problem that arises if an application is submitted with fewer than 30 days left in the regular legislative session. As the bill is written, an application will carry over into the next year's legislative session if submitted when there are fewer than 30 days of the session remaining. He explained that the timing is in the hands of the commissioners and that he is considering this issue, especially in conjunction with its relationship to special legislative sessions.

REPRESENTATIVE DOOGAN asked what would happen if the legislature had a 60 day review period.

MR. BULLOCK reminded the committee that special sessions are limited to 30 days, although the legislature has discretion to call more than one special session. He noted that the issue is

how many legislative days will be available to review an application.

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REPRESENTATIVE GATTO asked if the language could be changed to accommodate timing concerns.

MR. BULLOCK said that he understands that the intent of HB 177 is to get the gas pipeline project started in an expeditious manner, and that intent may effect the timing provisions in the statute so that applications can be submitted without the applicant having to wait until the next regular or special session.

REPRESENTATIVE DAHLSTROM asked for clarification as to whether a submitted, but incomplete, application will be considered.

MR. BULLOCK replied that some applications will be weeded out as non-responsive, while others may require additional information. The commissioners will review all responsive applications to choose the one they deem best for presentation to the legislature. If the legislature does not disapprove, the application will go forward. In response to a question, he agreed there are ways to word these provisions so as to express a preference for a particular date or time period.

REPRESENTATIVE DOOGAN asked whether the provision giving the legislature 30 days to disapprove the license is a standard approach.

MR. BULLOCK replied that an issue that arose in prior gas pipeline discussion was the issue of executive power and legislative power. He offered that some consider the type of contractual agreement contemplated by AGIA as an executive function. In that case, the decision of who to award the license to would be subject to legislative review. He opined that by enacting AGIA, the legislature would be consenting to allow the executive branch to take the lead, while reserving for itself the right to review the license award. He went on to say that proposed AS 43.90.210 covers licenses for the in-state and out-of-state portions of the line and suggested that there may be further review of this by persons experienced in tariff matters.

MR. BULLOCK discussed the possibility that the section authorizing the AGIA project coordinator be moved to section two

of the bill. He went on to say that there are issues to consider when a person is appointed to a position by the governor, such as whether the governor has the ability to remove that person from the appointed position. He also suggested that there be minimum qualifications required for this position and that the coordinator be authorized to hire additional experts. He suggested the bill be amended to reflect that the AGIA coordinator is under the governor's authority.

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MR. BULLOCK said he is unsure how the royalty inducement provisions of AS 43.90.310 operate, but said that his expectation is that the producer will not want to commit gas that cannot go into the gas pipeline. He opined that this provision was intended to give some security as to how much gas the producer will have available for the gas pipeline.

MR. BULLOCK reviewed the gas production tax exemption in Section 320. There may be a constitutional issue if the tax rate is locked into the contract, and the legislature later changes the tax rate, since Article I, Section 15 of the Alaska State Constitution prohibits impairment of contracts, he explained. This bill does not attempt to lock a tax rate into the contract, but provides a remedy through an exemption if the tax rates increase. He opined that the exemption is in reality a tax credit. He suggested that another option would be to exempt a portion of the production commodity from taxation. He offered his opinion that an exemption approach is more in accord with examples of exemptions in Article 9, Section 4, of the Alaska State Constitution. He opined that AGIA is a general law which the legislature has the ability to reconsider.

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MR. BULLOCK explained that a special fund is not a dedicated fund and that this can be made clear in the language of the bill.

REPRESENTATIVE RAMRAS asked about the remedies for state if a qualified applicant does not show commitment at the time of open season.

MR. BULLOCK replied that this would likely come under the abandonment section of the bill, and noted the purpose of open season is for the applicant to show commitment to the project.

REPRESENTATIVE RAMRAS asked about the remedies available to the state if the process does not go beyond open season and what type of inducement components apply to the open season time period.

MR. BULLOCK indicated that the current litigation surrounding the Point Thompson lease termination litigation may set precedent in this area as those leases were withdrawn by the state due to lack of development. He said that AGIA provides incentives for shippers to commit to the gas.

REPRESENTATIVE RAMRAS expressed serious concern as to how the state will induce the producers to proceed with development upon reaching open season.

REPRESENTATIVE DAHLSTROM expressed some skepticism with the likelihood that the producers will walk away from the project.

REPRESENTATIVE SAMUELS opined that there is a significant difference between taking away an undeveloped area such as Point Thompson, and taking away a lucrative and developed area such as Prudhoe Bay from a producer. He expressed concerns as to the remedies and options available to the state if there were difficulties during the second open season. He noted that economic incentives can change and make a planned project less lucrative.

MR. BULLOCK noted that leases are a matter of contract and can be renegotiated.

REPRESENTATIVE DOOGAN expressed concerns as to whether there would be enough gas committed at open season to go forward with the gas pipeline.

COMMISSIONER IRWIN relayed his opinion that it was important for the state to act to encourage gas pipeline development. He opined that the business world will be likely to desire participation in a project of this size.

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REPRESENTATIVE RAMRAS reiterated his concern as to the inducement component of AGIA at the critical period of time surrounding open season. He also expressed concern about inducement to actually connect to the gas pipeline.

COMMISSIONER GALVIN said that the state cannot anticipate today exactly what the dynamics will be at the time of open season. Therefore, there has been much consideration as to how to make the producers commit to this project in light of the many unknowns. The approach of AGIA is to move through and eliminate the uncertainties as much as possible, he explained. That is why the state is providing support through the risky period before open season. He said that at that point more will be known about the project costs. He opined that given the options, the best approach for the state is to get to the point of open season.

REPRESENTATIVE RAMRAS opined that the legislative process is designed to anticipate and correct problems. He expressed concern regarding the lack of inducement at the time of open season and suggested that the legislative process address this.

COMMISSIONER IRWIN cautioned that the aforementioned approach can cause some difficulties.

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REPRESENTATIVE GATTO opined that the free market is an incentive for development, particularly in Prudhoe Bay because non-development of gas affects the ability to remove and ship oil. He opined that if the state gives the producers enough of a reason, the gas development will happen.

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REPRESENTATIVE SAMUELS noted that one approach is to use the open season to provide a tax break, but that there are many complexities in how to use a tax as leverage.

COMMISSIONER GALVIN set forth that AGIA has been designed to allow commercial forces to be the primary drivers of development. The hope is that by creating a project, the producers can make their own decision as to whether to participate or not, he explained. If the project is not developed despite favorable economics, the state's approach may depend on the details of the situation because at present there are unknowns, he indicated.

REPRESENTATIVE GATTO reminded the committee that the federal government also wants the gas pipeline project to happen and it may provide some assistance in the area of inducements.

[HB 177 was held in committee.]

**ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 5:06 p.m.