

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

March 26, 2007

8:34 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Kurt Olson, Vice Chair

OTHER LEGISLATORS PRESENT

Representative David Guttenberg
Representative Craig Johnson
Representative Carl Gatto

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
03/20/07	(H)	Heard & Held
03/20/07	(H)	MINUTE(O&G)
03/21/07	(H)	O&G AT 5:30 PM SENATE FINANCE 532
03/21/07	(H)	Heard & Held
03/21/07	(H)	MINUTE(O&G)
03/22/07	(H)	O&G AT 3:00 PM BARNES 124
03/22/07	(H)	Heard & Held
03/22/07	(H)	MINUTE(O&G)
03/23/07	(H)	O&G AT 8:30 AM CAPITOL 106
03/23/07	(H)	Heard & Held
03/23/07	(H)	MINUTE(O&G)
03/24/07	(H)	O&G AT 1:00 PM SENATE FINANCE 532
03/24/07	(H)	-- Public Testimony --
03/26/07	(H)	O&G AT 8:30 AM CAPITOL 106

WITNESS REGISTER

DAVE VAN TUYL, Manager
 Gas Commercialization
 BP Exploration (Alaska) Inc.
 Anchorage, Alaska
 POSITION STATEMENT: Testified during the hearing on HB 177.

ACTION NARRATIVE

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at [8:34:39 AM](#). Representatives Samuels, Ramras, Doogan, Kawasaki, and Kohring were present at the call to order. Representative Dahlstrom arrived as the meeting was in progress. Representatives Guttenberg, Johnson, and Gatto were also in attendance.

HB 177-NATURAL GAS PIPELINE PROJECT

[8:34:51 AM](#)

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."

[8:36:50 AM](#)

DAVE VAN TUYL, Manager, Gas Commercialization, BP Exploration (Alaska) Inc., informed the committee that BP wants and needs a gas pipeline, built for a low capital cost and operated cost efficiently. He said that BP believes low costs will allow the pipeline to be built and to be successful. Low costs are good for the state and BP, as they ensure lower tariffs, higher netbacks and more revenue and will provide incentives to exploration. Alaska's gas pipeline, which will also extend the economic life of oil production, is an important project to BP, the state and the nation. BP, he emphasized, is ready to work with the Palin Administration and the legislature to reach a fiscal framework that will be successful for all parties. The future of BP in Alaska is directly linked to the construction of a gas pipeline. Therefore, it is important to complete the project. BP, he said, regards the Alaska Gasline Inducement Act (AGIA) as a step to an open and transparent path to development of the pipeline. BP has developed an outline of concerns, however, about the proposed legislation.

[8:40:02 AM](#)

MR. VAN TUYL opined that AIGA creates unintended consequences. The first areas of concern are AS 43.90.440 and AS 43.90.340, which direct the state to select an exclusive winner, and award state funds, based on promises. In addition, AS 43.90.140 requires that the exclusive winner comply with 16 specific requirements. BP, he said, believes that rather than providing selection criteria, the state should establish a clear framework for investors, and allow the market to identify the most successful project. Mr. Van Tuyl continued to say that BP supports competition in the marketplace, and does not support advance exclusivity before the competition begins. In fact, the Federal Energy Regulatory Commission (FERC) will require a successful open season before issuing its certification for the project. Mr. Van Tuyl continued to say that BP is supportive of the state's objectives for the gas pipeline project, which are jobs and natural gas for Alaskans, and future expansion of the pipeline.

MR. VAN TUYL stated that BP's second concern is that AGIA can result in one party subsidizing another. The language of section 140 requires that initial shippers will bear additional risk and cost by the possibility of increases in the shipping tariff of 15 percent or more. It is good business to have an expandable pipeline; however, increased rates to subsidize expansion shippers put an additional risk and cost on initial shippers. He suggested that instead, the state can write policy to subsidize expansion shippers if it desires. He reminded the committee that Congress makes clear by the enactment of the Alaska Natural Gas Pipeline Act of 2004 (ANGPA), that rates for initial shippers should not increase after mandatory expansion of the pipeline.

[8:44:52 AM](#)

REPRESENTATIVE RAMRAS asked for clarification regarding the expansion shipper subsidy.

[8:45:35 AM](#)

MR. VAN TUYL explained that AGIA, as drafted, would require all of the initial shippers, including the state, to subsidize expansion shippers. He reiterated that the state may subsidize expansion shippers as a separate policy decision.

[8:46:12 AM](#)

REPRESENTATIVE RAMRAS asked whether Mr. Van Tuyl was referring to a subsidy paid by rolled-in rates (RIR) or by the \$500 million grant.

MR. VAN TUYL answered that the RIR subsidy is his concern.

[8:46:58 AM](#)

REPRESENTATIVE RAMRAS observed that even if BP participates in the project as an initial shipper, it subsequently will be the beneficiary of RIRs after more gas is discovered and it participates in expansion.

[8:48:07 AM](#)

MR. VAN TUYL responded that the concern is with the initial commitment required at open season. The initial investors will be presented with a base toll that is included in the tariff

agreement. The state's policy may result in an increase to the tariff even before the operation of the pipeline begins. BP does anticipate participating in pipeline expansion; however, undue risk for the initial shippers can prevent the construction of the pipeline altogether.

[8:49:15 AM](#)

REPRESENTATIVE RAMRAS recalled that BP was supportive of last year's gas pipeline legislation. BP's testimony anticipated increasing the throughput on the Trans-Alaska Pipeline System (TAPS) as well as participating in expansions of the gas pipeline. Representative Ramras asked BP to provide for the committee the estimate of the amount of gas it planned for the 4 billion cubic feet (Bcf) per day pipeline and subsequent expansions. Even with firm transportation (FT) commitments, RIRs will be beneficial to subsequent gas shipped by BP. The calculation requested, he said, is how much additional gas BP anticipated rolling in under last year's legislation. This information will measure BP's exposure to the initial RIR cost, balanced by estimates of expansions over the next 10 years.

[8:52:53 AM](#)

MR. VAN TUYL responded that the gas nominations into a pipeline at open season are by a sealed bid. BP can not reveal its strategy at this point due to the competitive aspect of the open season. Additionally, future volumes to the pipeline will only happen if companies have enough of a guarantee of rates to participate in construction and bidding at open season.

[8:54:26 AM](#)

REPRESENTATIVE RAMRAS again requested that BP generate a graph that provides different scenarios with different rates, sizes of pipe, and tariffs. Also, he asked, the graph should include the effect of the anticipated benefits from RIRs.

[8:55:55 AM](#)

MR. VAN TUYL assured the committee that BP would provide the requested information. He suggested that if the initial toll was anticipated to be \$3 per million cubic feet (Mmcf), delivering one Bcf per day, a RIR increase of 15 percent will result in a cost increase of \$200 million per year. Add to that the potential impact of a previous 20 year FT commitment, and BP's exposure will be billions of dollars.

8:57:05 AM

REPRESENTATIVE RAMRAS observed that it is known that there will be expansions, thereby those costs can be anticipated, as can be BP's benefit from participation in RIRs. BP could also build many additional plants as the result of those expansions. The initial exposure and benefits of RIRs can be estimated over the next 20 years.

8:58:51 AM

MR. VAN TUYL indicated that BP will provide the estimates, but restated his concern over the risk to initial shippers.

8:59:19 AM

REPRESENTATIVE RAMRAS also requested that BP provide its previously submitted 50 year business plan graphic.

9:00:53 AM

MR. VAN TUYL continued his testimony by stating that ANGPA specifies that rates for initial shippers should not increase in the case of a mandatory expansion. He remarked:

This is from section 105(b) of {ANGPA}, the FERC, the commission it says which means the FERC, shall insure that the rates do not require existing shippers on the Alaska natural gas transportation project to subsidize expansion shippers. Also, in order 2005, FERC put in place a rebuttable presumption of rolled-in rates for expansions, with a proviso, it says, provided it did not require subsidization by initial shippers. ... In conclusion, to provide guidance to potential shippers in advance of the initial open season that is the subject of this rule, the commission intends to harmonize both objectives. And that is rate predictability for initial shippers and reduction of barriers to future oil exploration and production in designing rates for future expansions of any Alaska natural gas transportation projects. It is consistent with our guiding principal that competition favors all of the commission's customers as well as the objectives of the act, here's the proviso, to adopt rolled-in rate treatment up to the point that would cause there to be a subsidy of expansion shippers by

initial shippers if any subsidy were to be found. ... These two excerpts, from federal law and from federal regulation, suggest that section 140 of AGIA and federal law could be in conflict. ... Resolving [this conflict] would add delay and uncertainty. ... I just wanted to ensure that the nature of the producers challenge to order 2005 (a) was clear. We're only challenging the issue of whether or not FERC should be able to dictate a design change after the conclusion of the open season....

[9:04:46 AM](#)

REPRESENTATIVE DOOGAN said:

If there's a rebuttable presumption of RIRs and RIRs by their very nature mean that the original shippers are going to pay more, ... isn't any RIR, under your definition, a subsidy?

[9:05:36 AM](#)

MR. VAN TUYL answered not necessarily. The nature of the service of the line would affect the rate. He said that he believes FERC's intent is to leave the language of its regulations open so that FERC can look at subsidy cases individually.

[9:06:34 AM](#)

REPRESENTATIVE DOOGAN requested a definition of subsidy.

MR. VAN TUYL said he did not believe the term was defined in the federal law or FERC regulation.

[9:07:19 AM](#)

REPRESENTATIVE SAMUELS remarked:

The tariff is at \$4, Anadarko has a find, compression takes place your tariff goes under \$3.50, but they use up all the compression so you loop a little bit. When Exxon has a find your tariff goes back to \$4. So now Anadarko started at \$3.50, there're now paying \$4. You started at \$4, you're paying the same thing you agreed to. And now BG has a find but you have to loop

some more and it goes to \$5. Now Exxon, BP, and Anadarko are all paying more. What's a subsidy?

[9:08:13 AM](#)

MR. VAN TUYL told the committee that in this example, given the magnitude of the increase, the difference could not be made up in fuel usage. In addition, the difference could depend on the total expected depreciable life of the line. He pointed out that FERC wants to maintain the ability to look at rate increases on a case by case basis.

[9:10:06 AM](#)

REPRESENTATIVE SAMUELS asked whether the addition of an offshore gas discovery would drive the rates down.

[9:10:35 AM](#)

MR. VAN TUYL answered yes. In this case, he said, the state would not be participating in the additional gas that is coming from federal land.

[9:10:49 AM](#)

CHAIR KOHRING referred to BP's concern that AGIA would result in an exclusive winner. He asked if BP could make recommendations to improve the evaluation criteria.

MR. VAN TUYL suggested allowing the marketplace to determine which company should be selected. In addition, he stated that the approval process used by FERC is a good model of an evaluation process.

[9:11:57 AM](#)

REPRESENTATIVE DOOGAN questioned how selection by the marketplace would begin.

[9:12:44 AM](#)

MR. VAN TUYL explained that for the project to advance there must be a successful initial open season, which is dependent on the following two developments: the shippers must have a clear framework of the resource rules; the shippers know that the project can be built for a reasonable toll.

[9:14:39 AM](#)

REPRESENTATIVE RAMRAS thanked Mr. Van Tuyl for the clarity of his testimony.

[9:15:56 AM](#)

MR. VAN TUYL continued to say that BP's motivation for its challenge to ANGPA, order 2005, section 5(a), is that a mandated re-design of the project will add cost and delay. He then returned to BP's consideration of AGIA, section 43.90.110, and noted that the \$500 million grant was not requested by BP and may attract underfinanced applicants. Rather than specifying inducements, the state should ask the project sponsors to propose inducements. The Palin Administration, he said, believes that that the development of the project carries the greatest risk. However, BP disagrees. The riskiest phase, for the ultimate shippers, is the construction period. In fact, all project risks flow to the resource owners who must make the FT agreements. Mr. Van Tuyl said that the fourth area of concern for BP is AS 43.90.310, which relates to the resource framework. The royalty inducement terms are insufficient to encourage BP to make transportation commitments. As drafted, the royalty valuations depend on future, non-specific, regulations. In addition, AGIA allows the state to switch from royalty gas in value (RIV) to royalty gas in kind (RIK), and BP believes this ability is detrimental to its interests.

[9:20:57 AM](#)

REPRESENTATIVE RAMRAS asked for an explanation of how FTs work for the buyer.

[9:22:43 AM](#)

MR. VAN TUYL explained that the traditional firm transportation commitment (FT1) is a cash commitment made by a shipper to a pipeline company that guarantees that a certain payment will be made whether the gas is ultimately shipped or not.

REPRESENTATIVE RAMRAS remarked:

[For example], so if I built a shipping center and I had eight bays and I'm paying the bank a mortgage on all eight of those storefronts, whether all eight of them are rented, or six of them, or three of them.

MR. VAN TUYL affirmed the accuracy of Representative Ramras's example. He added that the FT1 commitment could be for a term of 20 to 30 years and equals a significant amount of money. Furthermore, down the line, the marketing arm assumes risk when marketing that gas, under the various terms and commitments.

[9:25:53 AM](#)

REPRESENTATIVE RAMRAS remarked:

A firm transportation commitment could very well be years and years ... and so the exposure for the oil companies is more significant when ... the sale price is fixed but the shipping cost is subject to movement over that period of time because it could be a 20 year commitment on the sale price of that gas and yet the cost of the tariff to deliver it there could move by \$.50, by \$1, by \$1.50. ... And the transportation cost for moving that gas from the North Slope to Chicago is an enormous part of the ... end cost of that gas, it could be 40 percent. ... Forty, fifty percent, or potentially more, of the cost of moving that gas is absorbed by the tariff and if it's a third party person who is using the \$500 million and they're an underfinanced sponsor they can go \$10 billion over budget and increases the tariff....

[9:30:20 AM](#)

MR. VAN TUYL expressed his hope that transportation costs will represent 40 to 50 percent of the value of the product.

[9:31:03 AM](#)

REPRESENTATIVE SAMUELS asked whether, under normal circumstances, customers and users take the shipping risk through the FTs.

[9:31:31 AM](#)

MR. VAN TUYL replied that Representative Samuels's example is not common; however, natural gas markets are unstable and in the recent past utilities have sought relief by requesting permission to extend commitments and move commitments upstream.

[9:33:04 AM](#)

REPRESENTATIVE SAMUELS surmised that FERC would not have an opinion on who takes an FT commitment, therefore, if Chicago Light and Power wants to buy from you at the wellhead, that would be between Chicago Light and Power and BP.

[9:33:20 AM](#)

MR. VAN TUYL said yes, that was his understanding of the process.

[9:33:39 AM](#)

REPRESENTATIVE SAMUELS further asked: "Would the Illinois [public utilities commission] have a say in that, on what Chicago Light and Power may or may not do regarding risk?"

[9:33:48 AM](#)

MR. VAN TUYL answered yes, by their regulation of utilities.

[9:34:09 AM](#)

REPRESENTATIVE SAMUELS assumed that a willingness to take some of the risk would result in a commercial agreement to discount the wellhead price.

[9:34:18 AM](#)

MR. VAN TUYL responded that yes, there would be a commercial agreement. He then returned to his presentation and restated the difficulties created by RIV and RIK switching, and noted that the solution to the unintended consequences are left to future legislation. He then called the committee's attention to section 320 of AGIA and said that it relates to gas production taxes and defines that the rates are not established until after the conclusion of the open season. Mr. Van Tuyl indicated that the shipper would not know the production tax rate prior to making its FT commitment, and this uncertainty creates additional risk. He testified that AGIA is silent on the majority of other payments that will be due to the state. Resource owners will pay all the costs and bear the risks in building the pipeline whether or not they own it. Furthermore, resource owners will pay all the costs, directly or indirectly through the tariff. Therefore, they must know the fiscal rules that will govern the project before making commitments and successfully obtaining financing. Sections 310 and 320 do not

adequately address the details needed to solve the upstream issues, he stressed.

[9:38:11 AM](#)

MR. VAN TUYL pointed out that, under the terms of AGIA, the resource owners are the state and the lessees. Risks inherent to the resource are price and production. Risks to the lessee are the possibility of changes in fiscal terms and the risks associated with construction of the pipeline. Mr. Van Tuyl provided a chart that displayed names, capital costs, and sponsors of the ten largest oil and gas pipeline project financings.

[9:41:18 AM](#)

REPRESENTATIVE RAMRAS asked about the competitive risk of not building a pipeline and thereby losing the future market for the North Slope leases.

[9:43:19 AM](#)

MR. VAN TUYL responded that it is very important that the resource owners begin preparations to demonstrate to the future markets that Alaska's gas will be available.

[9:44:29 AM](#)

REPRESENTATIVE SAMUELS questioned why the Trans-Alaska Pipeline System (TAPS) is not included in the chart of pipeline project financings.

[9:44:57 AM](#)

MR. VAN TUYL answered that TAPS was owner financed.

[9:45:31 AM](#)

REPRESENTATIVE SAMUELS asked:

Assuming that we can set a tax rate now, and set aside the constitutional issue which will be decided by the supreme court ... from BP's perspective, is it better to know your tax rate now, before the game starts?

[9:46:15 AM](#)

MR. VAN TUYL advised the committee that the fiscal framework must be established before the open season.

[9:46:55 AM](#)

REPRESENTATIVE SAMUELS clarified that he was referring to establishing the tax rate at the time of the application, instead of shortly before open season.

[9:47:13 AM](#)

MR. VAN TUYL noted that AGIA requires that the tax rate on gas would not be established until after open season.

[9:48:40 AM](#)

REPRESENTATIVE SAMUELS stressed that the intent of AGIA is to establish the tax rate before open season.

[9:48:59 AM](#)

MR. VAN TUYL referred to Section 43.90.320(a), line 7 and stated that the calculation of the tax exemption is based on the production tax in effect at the conclusion of the first binding open season. BP, he repeated, prefers tax rate certainty before making its FT commitment.

[9:49:17 AM](#)

REPRESENTATIVE SAMUELS questioned whether BP would prefer knowing the tax rate before the application period begins.

[9:49:59 AM](#)

MR. VAN TUYL expressed his opinion that the fiscal framework requested by BP extends beyond the establishment of the production tax rate and exemption. Many other elements of the revenue to the state must also be addressed. In answer to a question, he added that, unlike Alaska's tax structure, Canadian property taxes are a small portion of the government take from this project. Also unlike Alaska, federal loan guarantees and incentives are known, and will not change, during the development and construction of the project.

[9:51:31 AM](#)

CHAIR KOHRING asked whether permitting and regulations regarding the Canadian portion of the pipeline route will be an obstacle.

[9:52:23 AM](#)

MR. VAN TUYL assured the committee that BP has established relationships with the Canadian government and First Nations and that it is confident that future negotiations will be successful.

[9:54:02 AM](#)

REPRESENTATIVE RAMRAS opined that gas and oil maintain a cost ratio of approximately a 9:1 ratio.

[9:54:49 AM](#)

MR. VAN TUYL described the actual energy equivalency ratio as 6:1 with the price increase attributed to the higher market value of gas.

[9:55:18 AM](#)

REPRESENTATIVE RAMRAS recalled that the TAPS tariff was increased recently. He said that he felt it was important to discuss the cost of the natural gas pipeline tariff in relation to the barrel of energy equivalent for the TAPS line tariff. He suggested that a comparison by DOR would help committee members appreciate the risk in moving a barrel of energy equivalent from the North Slope during the next ten years, as opposed to the cost of transporting oil by the TAPS which began production 30 years ago.

[9:58:45 AM](#)

MR. VAN TUYL confirmed that historic knowledge can help to understand the differences between the transportation costs of oil and gas. The proportion of transportation cost to the value of the commodity for gas is significantly higher, therefore, gas pipelines are marginal in profit, and are regulated and financed differently.

[10:00:28 AM](#)

REPRESENTATIVE RAMRAS expressed his belief that the state would not like to pay transportation costs for shipping oil through TAPS that are relatively equal to the proposed tariff on the

shipment of gas. He suggested that a comparison of these costs would be useful to the legislature.

[10:01:48 AM](#)

REPRESENTATIVE DOOGAN pointed out that resource owners are limited to the people of the state of Alaska, and do not include lease holders. He asked whether the producers need to know the fiscal details of gas, or of both oil and gas.

[10:03:08 AM](#)

MR. VAN TUYL reminded the committee that resource owners also include the owners of private and federal lands. In response to the question, he said that the scope of the fiscal framework necessary includes both oil and gas, and also must include a risk reward balance that will work for all of the parties.

[10:04:12 AM](#)

REPRESENTATIVE DOOGAN expressed his understanding that the royalties are paid to the state, as owners of the resource, and taxes are paid to the state as the sovereign political jurisdiction. He said that he was interested in knowing whether the state can, through the royalty, provide BP sufficient fiscal certainty to ensure its participation in the open season. He also asked whether BP would be willing to sell its gas to the state for a fixed price.

[10:06:51 AM](#)

MR. VAN TUYL stated that BP will sell its gas under commercially reasonable terms. He then continued his presentation by listing the project risks borne by the pipeline company under the AGIA legislation. However, the pipeline company is a regulated entity and is granted a regulated rate of return, FT commitments, and is also able to pass the risks, via the toll, back to the resource owner. BP wants to ensure a low cost and successful project; in fact, those bearing the risk are commercially motivated to manage the costs of construction.

[10:09:09 AM](#)

MR. VAN TUYL summarized by saying that BP wants and needs a gas pipeline for its future business in Alaska. BP also supports an open and transparent process that includes participation by the administration, the legislature, and the people of Alaska, and

that leads to the successful completion of the project. In addition, for the project to proceed, there must be a mutually agreeable upstream framework. Finally, midstream details must be addressed to ensure that there are no unintended consequences.

[10:12:10 AM](#)

REPRESENTATIVE SAMUELS asked whether BP can ship gas without the cooperation of its partners, ConocoPhillips Alaska, Inc. and ExxonMobil Corporation.

MR. VAN TUYL emphasized that he questioned whether a project of this scale could be successful without the cooperation of the state, BP, ConocoPhillips Alaska, Inc., and ExxonMobil Corporation.

[10:13:29 AM](#)

REPRESENTATIVE SAMUELS re-stated his question and said,

"If three of four agreed ... that you had enough gas at the open season, according to the operating agreements, can you sell gas other than just for the field usage ... could you sell a commercial quantity of gas.

[10:14:17 AM](#)

MR. VAN TUYL opined that the operating agreements would not prevent parties from selling gas independently.

[10:14:54 AM](#)

[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 10:17 a. m.

[10:17:08 AM](#)