ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS
March 27, 2007
3:11 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 David Guttenberg
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
03/26/07	(H)	Heard & Held
03/26/07	(H)	MINUTE(O&G)
03/27/07	(H)	O&G AT 3:00 PM BARNES 124

WITNESS REGISTER

TONY PALMER, Vice-President of Alaska Business Development
TransCanada Corporation, Inc.
(No address provided)
POSITION STATEMENT: Testified regarding TransCanada's interest in the Alaska gas pipeline project and regarding aspects of HB 177. He also answered questions.

ACTION NARRATIVE

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at 3:11:15 PM. Representatives Doogan, Olson, Samuels, and Kohring were present at the call to order. Representatives Ramras, Kawasaki, and Dahlstrom arrived as the meeting was in progress. Representatives Gatto and Guttenberg were also in attendance.

3:11:29 PM

HB 177-NATURAL GAS PIPELINE PROJECT

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."

3:11:38 PM

TONY PALMER, Vice-President of Alaska Business Development, TransCanada Corporation, Inc., explained that TransCanada has been in business over 50 years and owns 36,500 miles of regulated natural gas transmission lines. He provided the committee with a presentation titled "Alaska Legislature Testimony," dated March 26/27, 2007. TransCanada has built gas pipelines that are longer than, and at least as complex as the contemplated Alaska gas pipeline, he explained. The company moves approximately 15 billion cubic feet (Bcf) of gas daily. He explained that as North America's largest gas transmission company, they own approximately two-thirds of the take-away capacity from the Alberta Energy Company Ltd., (AEC) hub to North American markets. He explained that a pipeline project's complexity is not just based on cost, but also on pipeline length, regulatory, and socio-economic issues. He said that TransCanada possesses gas storage capacity and has a cash flow sufficient to fund the equity component of the Canadian project for one year. He also put forth that TransCanada has sufficient ability to raise significant funds.

3:19:54 PM

CHAIR KOHRING asked about TransCanada's recent purchase of pipelines to transfer gas from the Gulf Coast to the Midwest and asked whether that would present a problem since Alaska's gas is destined for the same markets.

MR. PALMER replied that once gas reaches the AEC hub, it could be sold to numerous regions. He opined that there will be sufficient capacity on TransCanada's systems to move the entire volume of Alaska gas through the AEC hub. He opined this would increase the ability to seek market diversity and reduce costs as Alaska could take advantage of existing pipelines.

3:22:21 PM

MR. PALMER relayed that TransCanada is a proven basin developer in Alberta. He said that the Alberta development was structured under an independent pipeline model with "roll-in" tolls. In response to a question, he explained that rolled-in tolls have been standard in Canada for decades. He opined that this system has been successful in helping foster development from the western Canadian gas basins to market. He reminded the committee that Canada, like Alaska, is far from the gas markets. He went on to say that TransCanada's evaluation of the Alaska gas pipeline shows ways to structure the process and expansion to keep toll prices reasonable. He characterized the "15 percent issue" as a "red herring up through 7 Bcf."

3:27:22 PM

REPRESENTATIVE SAMUELS asked to what extent TransCanada would absorb the risk of tariff increases.

MR. PALMER noted that his company would need to consider various scenarios in determining risk. He offered that it is normal in the Canadian model to see some fluctuation in toll rates, but they would not go back to the 4.5 Bcf a day level under his company's analysis.

3:29:24 PM

REPRESENTATIVE RAMRAS referenced the possibility that rolled-in rates could fluctuate and affect the tariffs. He asked how much of a rate increase is reasonable when the pipeline expands.

MR. PALMER replied that the original toll of $3.00 for 4.5 Bcf would decline from $3.00 to a lower number as one moves down through 5.9 Bcf a day, which he characterized as the "bottom of the cost curve" as the pipeline would be fully compressed at that level. As the pipeline expands from 5.9 Bcf up through 7 Bcf a day, the toll will increase from $2.80, but will not be back to the $3.00 level of 4.5 Bcf.

3:32:22 PM

REPRESENTATIVE RAMRAS asked whether the rolled in rate could have the effect of taking costs down.

MR. PALMER replied that the design proposed by TransCanada for this project would have the tolls declining on average on a rolled in basis, from 4.5 Bcf down to 5.9 Bcf. They would

increase slightly beyond the 5.9 Bcf, but would still be below the initial 4.5 Bcf toll.
REPRESENTATIVE RAMRAS asked about the effect on tariffs if the gas pipeline was not initially subscribed to 4 Bcf, but was at a lower rate of 2 Bcf.

MR. PALMER replied that the toll will be significantly higher if the pipeline does not receive as large a volume of gas at open season as it is capable of receiving.

3:34:57 PM

REPRESENTATIVE SAMUELS asked whether the 15 percent is irrelevant.

MR. PALMER answered that he has not looked beyond 7 Bcf when considering this issue. However, he is confident that TransCanada will not reach the 15 percent rate proposed for expansion up to 50 percent more than the initial 4.5 Bcf capacity. He went on to say that ultimately one would hope that expansion would include a second pipeline to move additional gas with little or no compression. He noted that further modeling of the various scenarios is rather complex and labor-intensive, but offered that he believes his company has been relatively fair with the committee to identify what would happen with an expansion up to 50 percent of initial capacity. He expressed some discomfort about providing further details as to what may happen when the pipeline reaches 7 Bcf. He offered that he would be putting forward those numbers in his Alaska Gasline Inducement Act (AGIA) proposal. He replied to a question by agreeing that rolled in rates may have a different affect on a pipeline design different from that planned by TransCanada. He stated his company has proposed a 48 inch, high pressure, 2500 pound pipeline system, but that another company may propose something different, which would affect the estimates related to rates. He also explained that "looping" generally uses a pipeline of the same size and strength as the original, although it can sometimes vary.

3:40:00 PM

REPRESENTATIVE GATTO asked whether TransCanada planned on submitting a conforming bid.

MR. PALMER replied that TransCanada will closely examine AGIA if it passes and the state's application requirements to determine if it can submit a bid that complies with the requirements.

MR. PALMER said that TransCanada has been a lead player in this project and has invested more than $2 billion in bringing Alaskan gas to market. He told members that TransCanada's subsidiary, Foothills Pipe Lines Ltd., holds exclusive and valid certificates for construction of the Canadian section of the project. He said that there is a treaty between the United States and Canada specifically for this project wherein the Canadian provinces agree to charge the same property tax rates on this project as they do for domestic gas. He went on to say that the treaty also sets forth the rights of Canadian customers to receive gas from the line.

MR. PALMER explained that TransCanada holds an easement under the Northern Pipeline Act (NPA) through the Yukon Territory for this project and has paid fees on that easement for 25 years. This easement has been recognized in First Nations land claim settlements. TransCanada also has assets in Alaska, he explained.

3:47:42 PM

REPRESENTATIVE RAMRAS asked whether there is any foreseeable possibility that TransCanada would be a partner in duel applications for the Alaska gas pipeline project.

MR. PALMER said that it is too early to answer that question clearly and that the answer will depend on AGIA and the application process. He opined that the best approach may be a collaboration between TransCanada, the producers, and the state. He put forth that in the pipeline business, it is not uncommon to partner with different entities on various projects. The goal is to put forward the best project to obtain the bid, he said.

REPRESENTATIVE RAMRAS asked whether an applicant could be included as a partner in more than one application for the same project.

MR. PALMER replied that scenario is possible if allowed by the application process. He noted that some projects only allow a company to be part of one bid on a project.

3:52:26 PM

REPRESENTATIVE GATTO asked if the Canadian permits require TransCanada to follow a certain corridor.

MR. PALMER replied that the permits do generally follow a route by the highway, but they allow for reasonable divergence from the general route. He reviewed the Canadian history with regard to the NPA and opined that TransCanada is the only party to hold the necessary certificates for this project.

3:57:49 PM

MR. PALMER explained that TransCanada can bring northern gas to the liquid Alberta hub where it can connect to other markets through the Nova Inventory Transfers (NIT) system. He said that the TransCanada system uses the Albert hub. He opined that the Alberta Hub (NIT) is the most liquid natural gas market in North America and that it continues to grow.

3:59:55 PM

REPRESENTATIVE RAMRAS asked about available capacity by the time the Alaska gas pipeline is ready to move gas.

MR. PALMER opined that in 2017 there will be sufficient capacity at the Alberta hub (NIT) to move the entire 4.5 Bcf of Alaska's gas. He offered that it is important to have diverse markets and that abbreviating the project to Alberta will mitigate the capital costs risks.

MR. PALMER stated that in the 1990s TransCanada constructed 7000 miles of pipeline on time and within 0.5 percent of budget. Since 1999, there has been little additional gas development in Western Canada, therefore there has not been much new pipeline construction since then. He said TransCanada has recently built a small pipeline in Mexico and has constructed some power plants.

REPRESENTATIVE RAMRAS asked about TransCanada's experience with construction in varying terrain and weather conditions.

MR. PALMER offered his opinion that the terrain in Ontario is at least as challenging as that of the pipeline route from Prudhoe Bay to Alberta. He said his company is familiar with cold weather construction and challenging terrain. In response to a question, he explained that in 1991 and 1994 TransCanada built 1,000 miles of pipeline and that the Canadian section of the Alaska pipeline will be approximately 1,000 miles.

4:07:34 PM

REPRESENTATIVE RAMRAS asked about the normal circumference pipelines.

MR. PALMER answered that most of the pipelines built by his company range from 24 to 48 inches in diameter, depending on the distance and volume. He said that TransCanada's proposal is to construct a 48 inch pipeline for this project.

REPRESENTATIVE RAMRAS put forth for committee consideration whether the pipeline size should be part of the criteria set forth in AGIA.

4:11:16 PM

REPRESENTATIVE SAMUELS asked about system capacity after the gas is delivered to Alberta.

MR. PALMER clarified that pipeline companies besides his own have spare capacity in their lines leaving Alberta. He went on to say that the total spare capacity from Alberta is 4.5 Bcf, while total capacity in 10 years may be around 15 Bcf, although there may only be 10 Bcf of gas actually moving through the pipelines. In response to a question, he explained that gas pipelines are built in segments, called "spreads" in the industry. For the Alaska gas pipeline, he predicted that the bulk of construction would occur in 2015. He opined that by that time the current construction rush may be over, leaving more labor and resources to build the Alaska gas pipeline. He told the committee that TransCanada's costs for compression are "significantly below average" without compromising reliability. The company has an excellent record in maintenance and safety he explained, referring to slides 13 and 14. He said that TransCanada inspects at least 12 percent of its pipelines annually, compared to an industry average of 9 percent. He noted that some lines are being put underground, a new technology that can save maintenance costs, and that this technology may be used on a conservative basis in the Alaska gas pipeline project.

4:19:40 PM

REPRESENTATIVE RAMRAS asked about the effect of Alaska gas on the capacity of gas lines leaving Alberta and the effect of Alaska gas going to a liquefied natural gas (LNG) plant instead of to Alberta.

MR. PALMER reiterated his estimate that in 2017, there will be a spare capacity of 4.5 Bcf in gas pipelines leaving Alberta. When Alaska gas comes on line, it can move to various markets, such as Chicago. He noted that this issue is for the shippers to decide. He explained that having gas pipelines with full capacity will lower the cost of gas in Canada. As to LNG, he opined that it is needed, but that it serves no project to wait for other projects to develop. He opined that most LNG would be delivered on the West Coast. TransCanada believes that there is a market for Alaska gas now, and that 10-year projections are for lowered demand, he said. He said that supply has been relatively flat, which leaves a market for Alaska gas. In response to a question, he said that current tariffs for pipelines of 10 to 25 years old are around $0.60 to $0.80 from Alberta to Chicago. He is not aware of possible tariff prices for a possible new line.

4:28:26 PM

REPRESENTATIVE RAMRAS asked whether is it likely that tariffs on new lines would be higher.

MR. PALMER explained that generally, yes. He noted that inflation increases tariff costs, and older lines are depreciated, which lowers tariffs.

REPRESENTATIVE OLSON asked about plans for gas liquids.

MR. PALMER said that TransCanada is open to moving a liquid rich gas stream, if proposed by the shipper. The shipper will decide where the gas will go and where the liquids will be stripped. The amount of liquid in the shipped gas effects the toll calculation, he explained.

4:33:36 PM

REPRESENTATIVE DAHLSTROM asked about the Federal Energy Regulatory Commission (FERC) process and what happens if there is a failed open season. She also queried about the value of FERC certification should there be a failed open season.

MR. PALMER summarized that TransCanada has worked in a constructive fashion with the previous administration to help this project progress. He opined that the state and the producers have not reached agreement and there is currently an impasse. He said he believes AGIA was introduced to move the project forward, and that TransCanada supports efforts to end

the impasse. He offered his belief that all key stakeholders are best served by a large scale, 4.5 Bcf per day trans-continental project. He stated that TransCanada prefers a five-party compromise developed in conjunction with AGIA that includes the three Alaska North Slope producers, the state, and TransCanada. He expressed concern with AGIA's proposal to require the licensee to obtain FERC certification regardless of the outcome of the initial open season. Independent pipeline developers may not participate if this provision is not amended, he opined. He expressed support for the state's proposal to share costs 50:50 up to open season, but cautioned that private developers will be reluctant to commit money to pursue a FERC certificate if the initial open season does not attract enough gas commitments to make the project viable. He recommended that AGIA be amended to remove the requirement that a licensee proceed with FERC certification absent sufficient shipper commitment, unless an alternate source of credit is in place. He expressed his company's willingness to continue to work towards resolution of these issues.

The committee took an at ease from 4:43:01 PM to 4:58:15 PM.

4:59:58 PM

REPRESENTATIVE SAMUELS asked about the time period for forming a solid partnership with other interested parties.

MR. PALMER opined that it would take months, possibly as few as two or three, to reach an understanding with other parties sufficient to allow them to make a joint response for purposes of AGIA.

REPRESENTATIVE SAMUELS asked about the proprietary nature of information regarding pipeline issues.

MR. PALMER responded that regulated gas pipelines in Canada provide a "huge" amount of information to the public. Financial information is publicly filed in relation to rate proceedings, he explained. He indicated that there is some difference in rate proceedings in Canada and the United States, noting that the FERC process has more settlements and is generally a more "lighter-handed method" of rate proceedings. He said that in general there is more public information on pipelines available in Canada.

5:06:36 PM

MR. PALMER, in response to a question, said that in TransCanada's view, the monies spent on a FERC certificate will not directly obtain customers for the shipper. It still has some value, however, he said. He predicted that if TransCanada was the licensee, and did not have sufficient customer commitments in open season, it would focus on obtaining additional customers. TransCanada proposes to capture value on this project based on return of equity relative to the cost of the equity, he said. He noted that project development requires an evaluation of the costs, risks, and probability of capturing customers.

REPRESENTATIVE SAMUELS asked about how the project would proceed after a successful open season.

5:11:56 PM

MR. PALMER set forth that his understanding of AGIA is that if there is a successful open season, the toll would be lowered by "the amount of those dollars the state would advance." He opined that in such a situation it would be normal for the equity sponsors to continue to fund through the certification process. He said it is favorable for an equity holder to have another party funding the project during the most risky period of the project, which "is before I'm getting some debt in there."

REPRESENTATIVE SAMUELS asked for estimates on the cost of getting to the open season.

5:15:31 PM

MR. PALMER estimated that it may cost somewhere in the tens of millions of dollars to prepare for open season. If the licensee had the gas committed to it at the beginning of the project, it could reduce the risk by waiting, which increases costs.

5:17:52 PM

REPRESENTATIVE SAMUELS asked about the calculation of an attractive debt to equity split.

MR. PALMER replied that pipelines have risk, and that risk cannot be passed through to the customer. Therefore, these projects cannot be funded with 100 percent debt. Furthermore, 100 percent equity financing would cause the tolls to be too high. He said that pipeline projects in the United States tend

to have higher equity ratios than in Canada. Many new Canadian pipelines have been constructed with 25 to 35 percent initial equity, which often increases over time as the project costs depreciate. He went on to say that if a party was willing to fund cost overruns with 100 percent debt, the company is still motivated to moderate costs. He noted that companies desire low tolls, and although a low debt rate will lower the costs, it will also increase the tolls.

5:22:05 PM

REPRESENTATIVE DAHLSTROM asked about the difference of value of a FERC certificate in the United States and Canada.

MR. PALMER clarified that an open season that does not capture sufficient volumes to make the project viable changes the value attributable to a FERC certificate. In response to a question, he indicated it is not for him to say whether it is in the state's interest to pursue a FERC certificate in the event of an unsuccessful open season.

5:24:59 PM

REPRESENTATIVE DAHLSTROM asked about the process of evaluating project risk.

MR. PALMER replied that it is relatively straight-forward examination for a potential licensee to consider costs to potential rewards.

REPRESENTATIVE DAHLSTROM asked whether there was value in the state proceeding with this project.

MR. PALMER answered yes.

5:26:36 PM

REPRESENTATIVE RAMRAS asked for further clarification regarding the ratio of tariff costs relative to the barrel of energy equivalent. He noted that the current tariff on TAPS is about $6.00 per barrel of oil.

MR. PALMER replied that transporting oil through a pipeline is less expensive than transporting gas. He said that in the past, the cost of transporting gas from Alberta to other areas of Canada or the United States has been as high as 40 to 50 percent of the value of the commodity ultimately delivered. He noted

that is not the case today, as gas prices are relatively high. However, he reminded the committee that gas transportation costs through newly constructed pipelines can be 30 to 50 percent of commodity value.

5:29:42 PM

REPRESENTATIVE RAMRAS asked about the relationship of the transportation system to the volatile nature of the commodity and its effect on risk analysis.

MR. PALMER replied that in general the gas pipeline business is more risky than the oil pipeline business. Contracts reduce the business risk inherent in the gas transportation business, he explained.

REPRESENTATIVE RAMRAS asked about the evaluation of economic risk in conjunction with gas pipelines in light of the ratio between the commodity's value and the commodity's transport costs.

MR. PALMER explained that if the expected toll on a project is one-third of the ultimate value of the gas at market, then gas sold at $3.00 would be subject to a toll of $1.00. For oil, the toll may only be $0.30. If there was a huge capital cost overrun of 100 percent, the toll would increase to $2.00 for gas, but only to $0.60 for oil. He described the narrower margin of profits to costs inherent in gas pipelines as part of the increased risk inherent in these projects. In answer to a question, he noted he is unaware of whether FERC calculates the increased risks of gas transportation in determining tariffs.

5:36:52 PM

MR. PALMER responded to a question by explaining that TransCanada proposes that discussions between it, the three ANS producers and the state occur now, even before passage of AGIA. After AGIA passes, any discussions must be compliant with its terms which may limit the breadth of possible discussions, he opined. He indicated one possibility would be to come forward with a joint response, if possible, under AGIA.

5:39:58 PM

REPRESENTATIVE DOOGAN asked about TransCanada's role in possible early negotiations.

MR. PALMER explained that TransCanada would like to see issues resolved, such as how to split the upstream revenues, so that the project moves forward. He opined that TransCanada could bring significant skills and property rights to the project.

REPRESENTATIVE DOOGAN asked about how customers would be solicited if there was a failed open season and a FERC certificate was not pursued.

MR. PALMER explained that in that situation, the funds would be spent on business development initiatives and further negotiations with interested parties. He said that this approach was on a different scale from the "hundreds of millions" of dollars necessary to pursue a FERC certificate.

5:43:14 PM

REPRESENTATIVE DOOGAN asked about the effectiveness of the $500 million inducement set forth in AGIA. He asked if the provision requiring that a successful bidder pursue a FERC certificate after a failed open season makes AGIA less attractive.

MR. PALMER answered that the $500 million is clearly an inducement for the risky early stages of the project. He stated that the requirement to pursue a FERC certificate has significant costs, and makes it a significant factor in evaluation project risks. He declined to declare the requirements regarding a FERC certificate a deal breaker at this early stage.

The committee took an at ease from 5:46 to 5:47.

[HB 177 was held over.]

ADJOURNMENT

The House Special Committee on Oil and Gas was recessed at the call of the chair at 5:51:32 PM. [The meeting was reconvened March 28, 2007.]