

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

March 29, 2007

3:06 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Jay Ramras

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
 03/28/07 (H) O&G AT 7:30 AM CAPITOL 106
 03/28/07 (H) Heard & Held
 03/28/07 (H) MINUTE(O&G)
 03/28/07 (H) O&G AT 8:30 AM CAPITOL 106
 03/28/07 (H) Heard & Held
 03/28/07 (H) MINUTE(O&G)
 03/29/07 (H) O&G AT 3:00 PM BARNES 124

WITNESS REGISTER

KIRK MORGAN, President
 Kern River Gas Transmission Company
 MidAmerican Energy Holdings Company
 (No address provided)

POSITION STATEMENT: Testified regarding the gas pipeline project, offered support for HB 177 and suggestions for modification.

BILL WALKER, Project Manager
 General Counsel
 Alaska Gasline Port Authority (AGPA)
 (No address provided)

POSITION STATEMENT: Explained the AGPA's proposed project. He offered support for, and suggested modifications to, HB 177 and answered questions.

PAUL FUHS, Lobbyist
for the Alaska Gasline Port Authority (AGPA)
Anchorage, Alaska
POSITION STATEMENT: Provided information on gas pipeline
development issues.

JOHN ZAGAR, General Manager, Alaska
Chevron Corporation, Inc.
(No address provided)
POSITION STATEMENT: Testified as to Chevron Corporation's
position on HB 177, and indicated support for some provisions of
the bill and suggested changes for other provisions.

TIM HOUSTON, Alaska Commercial Manager
Chevron Corporation, Inc.
(No address provided)
POSITION STATEMENT: Answered questions on gas pipeline issues.

ACTION NARRATIVE

CHAIR VIC KOHRING called the House Special Committee on Oil and
Gas meeting to order at [3:06:37 PM](#). Representatives Kawasaki,
Olson, Samuels, Doogan, and Kohring were present at the call to
order. Representative Dahlstrom arrived as the meeting was in
progress.

[3:07:23 PM](#)

HB 177-NATURAL GAS PIPELINE PROJECT

[3:09:22 PM](#)

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."

[3:10:02 PM](#)

KIRK MORGAN, President, Kern River Gas Transmission Company, of
MidAmerican Energy Holdings Company paraphrased from written
testimony {original punctuation provided}:

MidAmerican has assets totaling \$37 billion and an
employee base of 18,000. MidAmerican, through Kern

River and its sister company, Northern Natural Gas, owns and operates more than 17,500 miles of interstate natural gas transmission pipelines with a combined capacity exceeding 6.4 Bcf'd. MidAmerican's pipelines deliver approximately 8.3% of the natural gas delivered in the United States. The Kern River pipeline, which our company built in 1991, brings natural gas from the Rocky Mountain supply basins across 926 miles of rugged mountainous and remote desert terrain to customers in Utah, Nevada, and California. Kern River was the largest gas pipeline project to have been built in the United States in more than a decade. In 2003, Kern River expanded the pipeline, more than doubling its capacity, adding 717 miles of 36-inch and 42-inch diameter pipeline. The \$1.2 billion project was completed on time, \$87 million under budget, and helped restore stability to energy markets in the Western United States.

MidAmerican is a subsidiary of Berkshire Hathaway, Inc. Berkshire is one of only a few companies in the world with a AAA credit rating. Berkshire has a market capitalization in excess of \$160 billion. It is recognized world-wide for financial strength, investment acumen, and integrity.

The development of Alaska's huge natural gas reserves is essential to both Alaska and the United States. Projected market growth, combined with a decline in North American production, has created a growing supply/demand imbalance that cannot be adequately addressed by traditional gas supply basins alone. Alaska's natural gas is needed to help ensure energy security, reliability, and price stability in the United States.

The Alaska natural gas pipeline project is unprecedented in its scale and complexity. The successful development of the project will require an alignment of stakeholder interests, including the state of Alaska, the North Slope producers, future North Slope explorers and producers, a pipeline developer, shippers and the federal government.

Projects of this scale can be easily delayed. (That has been the history of this project.) Only through proper planning, organization and execution can the

project achieve its goals to accelerate development of Alaska's natural gas resources and transport gas to lower 48 markets at the lowest reasonable cost. To do otherwise will relegate this project and development of this resource to reacting to the next energy crisis where goals are frequently compromised in the interest of expediency.

MidAmerican has a serious interest in developing this project in a manner that is consistent with the state of Alaska's interests. From our perspective, the negotiations conducted by the previous administration under the Stranded Gas Act were not fruitful for many reasons. Foremost among these were that they produced proposals not supported by the people of the state; they failed to give serious consideration to alternative proposals for development; and they consumed years without advancing the project.

We believe AGIA is a positive step toward revitalizing the gas pipeline development process in a way that will move the project forward. The bill will allow consideration of competing proposals and ideas for developing the pipeline. The state benefits from such competition. The bill offers positive inducements to those who already have discovered gas to commit to the pipeline, while defining tariff provisions that will encourage new exploration. And the bill offers inducements to a pipeline developer to advance the project in a manner that the state defines as in its best interest. Perhaps most importantly, the bill establishes a process where each party that proposes to develop the line must make meaningful commitments to development milestones for the legislature and the public to see what it will and will not do and by what dates.

AGIA is a good first step. AGIA is an open, transparent and competitive process designed to advance the project on a deliberate schedule and in a manner that achieves the overarching goals of the State which are to 1) encourage new exploration on the North Slope, 2) provide for expansion of the pipeline as new reserves are brought into production, 3) achieve the lowest cost commercially reasonable tariff, 4) create jobs for Alaskans, and 5) provide natural gas to Alaskans for in-state use.

AGIA recognizes the magnitude of front-end development risks and offers to share that risk, in a significant way, by offering dollar-for-dollar matching of initial development expenditures, by offering worker training for Alaskans, and by committing to expedite state permitting requirements. These, plus separate inducements offered to resource owners, are significant commitments which signal to the marketplace that the project is moving on a serious and credible path to completion. In the absence of such progress, markets will have no alternative than to seek other means to meet market demand. The most significant alternative would be to allow imported LNG even greater market access, uncontested by development of Alaska's natural gas resources.

While LNG is certainly a necessary part of the natural gas resource mix, it makes little policy sense to unnecessarily increase our reliance on foreign energy from many unstable and unpredictable regions around the world. This project, in MidAmerican's view, is undeniably necessary and the time is now to push it forward. The key to moving the project forward is to determine the appropriate balance of risks and rewards for all stakeholders.

There is an alternate approach. The North Slope producers have for years articulated their "must haves" before advancing the project. You have heard these prerequisites before including: 1) tax and royalty certainty on gas and on oil, 2) regulatory certainty in both the U.S. and Canada, 3) cost reductions through technological advancements, and 4) federal enabling legislation.

This approach is effectively saying that the project will get started if and when all of the preconditions have been met and all concessions have been extracted. This approach has proven to be ineffective in advancing the project. MidAmerican's approach is different. We believe the project can be advanced concurrent with resolution of issues that today remain outstanding. I want to emphasize MidAmerican's view that alignment of stakeholder interests is essential. Parties will understandably act in their self-interest and in their own business interest. That is why

stakeholder interest alignment is critical to a successful project. That alignment must clearly set forth the roles and responsibilities of each party, as well as the commercial structure which will balance the risks and rewards, such that investment expectations will be known up front. Our approach does not exclude interested parties or discount new ideas which may be offered to help manage project risks. We know that even if the pipeline is developed by an independent developer, the North Slope producers will play the crucial role as shippers on the line and sellers of gas to other shippers. MidAmerican, as an independent pipeline, is impartial and in a unique position to help facilitate solutions when stakeholders' interests diverge. We are confident that an appropriate capital structure and rate design, coupled with our low cost of capital and project experience, can result in a project structure with appropriate allocations of risk and reward for all stakeholders, including the state of Alaska and the producers.

Indeed, MidAmerican believes that an independent pipeline provides the best alignment of interests. National energy policy promotes, in fact requires, competition and the unbundling of market segments. For example, the market structure in the United States typically requires that exploration and production, interstate transportation, marketing and distribution be performed by separate companies. Competition, not market concentration, will lead to efficient markets. MidAmerican has no upstream, downstream, or global commercial interest that would create any conflicts of interest or raise any type of market power concern with respect to this project. Accordingly, MidAmerican's interests align extremely well with the state of Alaska and include:

- 1) Accelerating development of this critically important project;
- 2) Achieving the lowest cost commercially reasonable tariff;
- 3) Offering a commercial structure that encourages new exploration and production to both expand and extend the life of the pipeline. Thirty-five Tcf implies only a 22- year project life, and new discoveries are critical to fill the pipeline over its useful life;

- 4) Providing open-access, non-discriminatory transportation services to ensure both receipts and deliveries are provided for in-state use; and
- 5) Ensuring Alaskan jobs and workforce development. The state's commitment to workforce training and development is extremely important. Skilled labor shortage is one of the contributing factors in construction cost increases throughout the industry. A skilled Alaskan workforce will not only ensure jobs for Alaskans, but will help address an industry-wide demand for these workers.

The process set forth in AGIA will allow these ideas, and all parties' ideas and proposals, to be advanced and tested in an open and transparent manner. We support that process and while we can understand debate over what constitutes the best pipeline development proposal, it is harder to understand why parties would object to a process that calls for an open and transparent comparison of proposals. We urge the legislature to approve this legislation this session, so that a pipeline developer can be selected in a time frame that will allow a productive 2008 field season for engineering and environmental programs to be conducted.

That concludes my prepared testimony. Thank you for the opportunity to appear before you today. I would be happy to address any questions.

[3:22:10 PM](#)

CHAIR KOHRING asked if Mr. Morgan had any suggestions for amendments or modifications to AGIA.

[3:22:49 PM](#)

Mr. MORGAN replied that AGIA is a good piece of legislation, although not perfect. He expressed concern about how quickly the bill could be passed and the timing of the subsequent application and selection periods. He stated his company desires to preserve 2008 field season and opined that to do so would require a lot of work within a short period of time. He went on to mention that some of the rate provisions in AGIA could be modified to allow more negotiation in the area of rates. He offered that the 15 percent initial cap should apply to any rate, not just the recourse rate.

3:24:41 PM

REPRESENTATIVE DAHLSTROM asked about the 10 year tax rate provision.

MR. MORGAN said that a project of this magnitude requires investment certainty up front. He noted that a 10-year period is shorter than the life of the project, and suggested it be negotiated to cover the life of the project. He offered that the tax protection offered could be based on the amount of gas committed rather than a specified time period.

REPRESENTATIVE DAHLSTROM asked how a failed open season would affect his company.

MR. MORGAN replied that he has heard talk of the possibility of a failed open season, and offered that at this point there is no assurance the project is economic as the last project cost estimates were done in 2001. By the time of an open season, there will be information to show whether the project is economic, he opined. He expressed his belief that the producers do not have an interest in withholding their gas from an open season. He opined that holders will want to commit gas to a project that appears economic. He told the committee his company is prepared for various market scenarios as market timing is important in the gas market. He expressed support for project advancement through certification by the Federal Energy Regulatory Commission (FERC). In response to a question, he said it was too early to comment with regard to project labor agreements and whether they should be written into the bill.

3:30:55 PM

REPRESENTATIVE SAMUELS asked about the time period to develop a partnership agreement and complete an application.

MR. MORGAN replied that there is no definitive answer. He noted that early in 2003, his company developed agreements with interested parties. He noted that agreements can be done quickly if there are motivated parties with aligned interests.

MR. MORGAN responded to a question regarding a failed open season by explaining that first one would examine why the open season failed. He offered that by the open season, one would expect to have done a full cost estimate to be able to offer a definitive tariff so that shippers have the knowledge necessary

to commit their gas. He said that if the project is economic, but the open season fails, his company would continue to FERC certification. If the project fails because it is not economic, one would look to the provisions in AGIA concerning project economics.

[3:34:29 PM](#)

REPRESENTATIVE SAMUELS noted that the producers who hold the gas have significant leverage for the open season, and asked about whether that leverage ever goes away.

MR. MORGAN answered that he considers the issue whether the taxes will remain stable. He stated that investment decisions require stability, but offered that as of today there is not sufficient information to make a decision on tax rates. He emphasized that there needs to be stability once an investment decision is made. He explained that tariff rates should encourage new exploration and a long-term commitment of the resources.

REPRESENTATIVE SAMUELS noted that debate on the appropriate tax will likely return in the future.

MR. MORGAN stated that an independent "top to bottom" cost estimate will be part of the FERC filing and will provide the benchmark for the project costs. He opined that would be the point where there is adequate information to make decisions regarding the appropriate tax rate. He cautioned that a 10-year tax stabilization may not be long enough for this project.

[3:40:56 PM](#)

REPRESENTATIVE SAMUELS asked for clarification as to the effect of the 15 percent limit above any rate.

MR. MORGAN responded that it is not uncommon to assign a percentage of the firm transportation (FT) commitment capacity, to a shipper for recovery. He explained that those costs can be allocated over time. It will have a significant impact on the tariff if those costs must be recovered over a shorter time period.

[3:43:40 PM](#)

REPRESENTATIVE SAMUELS asked about the normal range of debt to equity ratios for pipelines.

MR. MORGAN said that the typical range in the industry is for no more than 70 percent debt. He said there are FERC regulated pipelines which have 60 percent equity. In response to a question, he noted that his company does not have pipelines in Canada, but that he has some familiarity with the Canadian system. He said that generally the returns in Canada are lower, the risk profile is different, and the pipelines are more highly leveraged. There are protections in the Canadian regulations to protect pipelines from some risk factors such as "through put," he indicated.

[3:46:30 PM](#)

REPRESENTATIVE DOOGAN asked about the risks that are posed by potential changes in tax rates and whether the witness knows of a case in which tax changes caused failure of a company.

MR. MORGAN replied that he knows of no such case. In interstate pipeline systems, the federal commerce clause protects pipelines from being subject to unreasonable and multiple taxes by each jurisdiction the pipeline passes through. He noted that when costs rise, a pipeline company can file for a rate increase, which is a complicated procedure. There is no guarantee that a company may be able to pass rates through to its customers, he explained.

The committee took an at ease from 3:51 to 4:04.

[4:04:32 PM](#)

BILL WALKER, Project Manager, General Counsel, Alaska Gasline Port Authority (AGPA) provided the committee with a presentation titled "Alaska Legislature Testimony" dated March, 2007 and explained that the AGPA was formed under state statute as a municipal port authority to build, or cause to be built, a project to commercialize Alaska's North Slope gas. The goals of AGPA are to ensure that a gas pipeline is built with the lowest tariffs possible for Alaska and the marketplace. A gas pipeline would provide a stable source of energy, employment in pipeline and liquefaction industries, direct net-project revenue sharing of 60 percent to the state and 40 percent to municipalities, and an opportunity to supply gas liquids to in-state petrochemical industries, he explained. He went on to indicate that the AGPA is not necessarily opposed to a Y-line through Canada at some time. He explained that the AGPA plans a "pre-build" from North Slope to Delta Junction for later tie-in with the Alaska/Canada

Highway Project. He emphasized the need for early use of in-state gas.

[4:14:03 PM](#)

MR. WALKER explained that the project proposed by AGPA includes a 40 inch high density line, a liquefied natural gas (LNG) facility in Valdez, integrated gas liquefaction and extraction facilities, storage and vessel loading facilities. He relayed that AGPA has purchased the Yukon Pacific Corporation ("YPC") to facilitate obtainment of permits for the pipeline project. He offered that there is an approved environmental impact statement, terminal permit, and export license related to this project. He referred to the need for LNG facilities on the West Coast and noted that there is currently a project under construction in Costa Azul. He predicted that Alaska gas would go to markets in California, New Mexico, and Arizona. He said that AGPA has made significant progress towards a pipeline to date in areas of federal law, market research, and cost estimates, referring to slide 7 of the presentation.

[4:20:49 PM](#)

MR. WALKER opined that the initial phase for the Alaska gas pipeline should focus on in-state gas distribution. He said AGPA defines "full-phase" gas distribution as a line through Canada or an expansion of LNG capabilities. He offered that AGPA's project is the right size project, referring to slide 9. He offered his belief that the LNG project will allow Alaska's gas to reach the market sooner, as exploration efforts are underway for the larger pipeline projects. He offered that Alaska could provide a stable supply of LNG to West Coast markets.

[4:25:12 PM](#)

MR. WALKER opined that LNG will create "market optionality" in ways that a single gas pipeline will not. He said that prices can vary in markets, noting that markets in Asia have had higher prices than markets in Alberta. He offered that the phased development proposed by AGPA is less of a strain on the steel and pipe markets. He said that AGPA suggests a large line out of the basin going approximately 800 miles to Delta Junction. Cold weather in Valdez could actually help the liquefaction facilities operate more efficiently, he explained. He opined that the Valdez port could accept more tanker traffic and

benefits from substantial existing North Slope infrastructure and developed fields such as Prudhoe Bay.

[4:31:39 PM](#)

MR. WALKER suggested that HB 177 be amended to require more details from Canadian line applicants, referring to slide 13. He suggested that applicants be required to provide information regarding the determination of off-take amounts at Prudhoe Bay, the budget and timeline for exploration programs, anticipated oil loss, analysis of liquid availability in Alaska, and the timeline for project start up and completion.

MR. WALKER expressed support for rolled-in rates and AGIA's support for independently owned infrastructure. He opined that the \$500 million incentive sends a positive message about Alaska's desire to commercialize Alaska's gas. He went on to say it is good for Alaska to have an open and competitive process in the planning and development of this project. He expressed support for inducements in exchange for specific risks and for the empowering of successful applicants to build a successful consortium prior to open season. He opined that a return to anything like the Stranded Gas Development Act (SGDA) would be a "step backwards." He opined that the main project risk is that Alaska will lose out on the "great race" to move gas into the United States markets.

[4:41:41 PM](#)

REPRESENTATIVE SAMUELS asked whether the AGPA's revenue sharing proposal of 60 percent to the state and 40 percent to Alaska municipalities is subject to change by the board of directors.

MR. WALKER replied that the board of directors could change this ratio, but that there is some possibility that the AGPA would enter a long-term arrangement restricting the ability of the board to change this provision.

PAUL FUHS, Lobbyist for the Alaska Gasline Port Authority (AGPA) noted that the state will receive production and severance taxes, but if there are any net proceeds which remain with the AGPA they would be distributed back to the state and municipalities.

[4:43:26 PM](#)

REPRESENTATIVE SAMUELS asked if the AGPA would state at present that it would not file a lawsuit if not chosen for the project.

MR. WALKER replied that he cannot speak for board, but he may recommend that the board agree not to litigate in an effort to move the project forward. He suggested that the parties could agree to move original jurisdiction to the Alaska Supreme Court to expedite any litigation.

MR. FUHS noted one could limit the time in which to file an action.

REPRESENTATIVE DAHLSTROM stated it is within the committee's scope to address dispute resolution issues and approaches.

[4:46:14 PM](#)

REPRESENTATIVE DOOGAN asked whether the AGPA will ship gas to Valdez and beyond.

MR. WALKER replied that the gas may be sold at Valdez.

REPRESENTATIVE DOOGAN asked if the AGPA, as a tax exempt organization, would pay property taxes.

MR. WALKER agreed with the aforementioned statement but indicated that AGPA would pay "fixed property taxes to the state as well" on the current status quo of 2 percent.

[4:48:27 PM](#)

CHAIR KOHRING asked about the possibility of a gas pipeline along the Parks Highway to Port McKenzie.

MR. WALKER replied that the AGPA has looked at that possibility but that route has significant challenges. The disadvantage of that route is timing because a great deal of regulatory work has been done on other routes, but not on the aforementioned suggestion. He went on to say that the AGPA includes tie-in points along the route.

MR. FUHS explained that AGPA's proposal includes a proposals to include lines of various dimensions to loop into existing systems and basically "tie in" at Palmer.

CHAIR KOHRING asked whether the AGPA would work with a Canadian company to follow through on a spur to the South-central area as an offshoot of the main line.

MR. WALKER said that AGPA would work with such an option, but expressed concerns with the timing and the possibility that delay would cause demand for Alaska gas to diminish.

[4:52:07 PM](#)

CHAIR KOHRING asked about production and shipment of gas from Sakhalin Island and its possible effect on the market for Alaska gas.

MR. WALKER indicated that the Sakhalin Island may be a politically unstable region and may not be able to guarantee a secure source of gas. In contrast, Alaska provides a politically stable geographic area.

MR. FUHS added that the Sakhalin Island project has some similarities to the Alaska project. The Sakhalin project has a 500 mile pipeline to an ice-free port, and requires twice as many tankers as the Alaska project. He offered that this provides an example of the viability of the proposal to transfer Alaska gas to Valdez.

[4:54:25 PM](#)

REPRESENTATIVE DOOGAN queried why the AGPA project has not gone forward.

MR. WALKER answered that the project is actually going forward, but is in need of gas. He noted that the AGPA submitted an offer to purchase gas in April, 2005 and that access to gas is the "single piece" missing from its project. He went on to say that there has been a "significant shift" in the Alaska gas market since the termination of the Point Thomson lease.

REPRESENTATIVE DOOGAN about the amount of gas potentially available from Point Thomson.

MR. WALKER replied that the gas at Point Thompson, in addition to the state's royalty gas at Prudhoe Bay, is sufficient for the AGPA project.

The committee took an at ease from [4:56:44 PM](#) to [5:06:00 PM](#).

[5:06:48 PM](#)

JOHN ZAGER, General Manager, Alaska, Chevron Corporation Inc., provided the committee with a presentation titled "AGIA Testimony HB 177" dated March 29, 2007. He said that Chevron has a 1 percent interest in Prudhoe Bay which means it will have gas available for the first open season. He noted that Chevron is a 25 percent owner in Point Thompson, and that the lease issues there are currently in litigation.

MR. ZAGER opined that the various stakeholders should work together to find common ground so that this project can proceed. He said that the Alaska gas pipeline project's large size increases the risk inherent in the project due to the large amount of money at stake. He explained that Chevron's investors are disciplined and conservative, therefore may be somewhat wary of a possibly uneconomic project. He set forth the proposal that the objectives of the state, pipeline owners, producers, and explorers vary for the pipeline project, referring to slide 3. He noted that all parties benefit from low tariffs as they increase the netback, attract more gas, and encourage expansion. He summarized his observations about HB 177 by noting that it provides inducements for key risks in two segments: midstream and upstream, referring to slide 4.

[5:17:48 PM](#)

REPRESENTATIVE SAMUELS asked about locking in tax rates for a certain amount of gas instead of for a certain time period.

MR. ZAGER offered his belief that there are a number of mechanisms that can be used to provide fiscal certainty. He noted the aforementioned issue would have to be considered in conjunction with the volume of gas committed.

MR. ZAGER went on to say that whether AGIA's inducement provisions are sufficient for a successful open season is difficult to answer because it will depend on the circumstances at the time. He explained that although Chevron wants to sell its gas, it will make a decision based on the economic situation at the time.

[5:20:27 PM](#)

REPRESENTATIVE SAMUELS asked about rolled-in tariffs.

MR. ZAGER replied that the issue with the tariffs is whether a company has gas and is putting up one of the initial firm transportation (FT) commitments. In that case, the rate is being locked in and will be preserved with only a possible 15 percent future increase.

5:21:19 PM

TIM HOUSTON, Alaska Commercial Manager, Chevron Corporation Inc., opined that although the concept of rolled-in rates has been presented, there are many variables as to how the rates will be designed and set. In response to a question, he explained that in Canada, pipelines receive a rate of return of around 8 to 8.5 percent, compared to 12 to 13 percent in the United States. He noted that although there is some confusion about how AGIA's proposed 15 percent cap would work, it could be beneficial.

MR. ZAGER explained that the cost and allocation of risk will affect the commercial viability of the project. He noted that the cost estimate is unknown at present, but that construction costs are increasing. He said that there is uncertainty regarding gas volumes, future gas prices, and fiscal terms. These terms can change to help or harm the commercial success of the project, he said. He went on to say that at present it is difficult to argue for a particular tax rate since the project has not yet started. He offered that the inducements offered by AGIA offer a positive factor in favor of commercial success. He noted that there is still a great deal of uncertainty in the project.

5:30:03 PM

REPRESENTATIVE DOOGAN asked if these issues favor development of a smaller, faster project rather than a larger, slower project.

MR. ZAGER replied that he would be "hard-pressed" to jump to that conclusion, noting that there are advantages to moving ahead at a quicker rate, yet also advantages to proceeding with a larger project for reasons of scale and efficiency.

REPRESENTATIVE DOOGAN asked if a smaller project, with lower construction costs and possibly fewer delays, is less risky.

MR. ZAGER noted that one rule of pipelines is to "go big" so as to capture economies of scale.

MR. HOUSTON noted that schedule delays related to permits or other aspects of construction will exist regardless of project size.

REPRESENTATIVE DOOGAN referenced the possibility that a smaller, faster project may decrease many of the uncertainties facing the project, referring to slide 5.

[5:33:49 PM](#)

MR. ZAGER opined that a longer and more comprehensive approach to fiscal stability will help to move the project forward by making it more commercially attractive. He set forth that his understanding is that AGIA proposes a cap of 15 percent on the cumulative rolled-in rate, but offered that the provision as currently set forth in AGIA is unclear. He queried whether the intent is to cap the initial shippers' rates by 15 percent, or whether it is to cap the shippers' rates with the 15 percent increase. He suggested that this language be "tightened up" to clearly reflect the intent. He expressed some uncertainty as to the AGIA provisions designed to remove future uncertainties where possible, as that provision as written seems to open the door for regulatory changes. He opined that this provision may provide some benefits if it is intended to allow the state to adjust any provisions that are not working as intended.

[5:37:32 PM](#)

REPRESENTATIVE SAMUELS asked about Chevron's interest in partnering with other parties.

MR. ZAGER replied that some type of partnership is a possibility to seriously consider, but noted that Chevron's desire would be to own pipeline capacity commensurate with its shipping obligations.

[5:39:26 PM](#)

REPRESENTATIVE DOOGAN asked whether the witness is aware of changes in a tax regime that caused pipeline project or shipper to cease operations.

MR. ZAGER answered that he is unaware of taxes which "cratered" an upstream project, although they can lower a project's value.

MR. HOUSTON replied that he is not aware of a project that ceased due to changes in tax regimes.

REPRESENTATIVE SAMUELS asked if tariffs rise at the end of a project's life.

[5:41:18 PM](#)

MR. HOUSTON responded that tariffs can rise, but it depends on how the stakeholders allocate the volume risk up front. If depreciation rates are set on the known volume at start-up, and lowered as more volumes are found, the tariff rate can be higher at the project's beginning, but not "fly up" at the project's end. If rates are set with FERC by capacity, there can be a "catch up" problem at the end which can increase the tariffs, he explained.

REPRESENTATIVE SAMUELS noted Chevron's unique position as both a producer and explorer, and asked how that may effect the company's position on rolled-in tariffs.

MR. HOUSTON noted that Chevron's view as to the favorability of rolled-in rates depends on the other pieces of the rate design. He noted that sometimes during pipeline expansion, blame is placed on rolled-in rates, when the real issue may be the rate design as a whole. He set forth that the rolled-in rate provisions of AGIA are not definite enough to allow an opinion on the impact of the rolled-in rate provisions of the bill.

[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 [5:44:37 PM](#).