

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 14, 2007

1:04 p.m.

MEMBERS PRESENT

Representative Carl Gatto, Co-Chair
Representative Craig Johnson, Co-Chair
Representative Vic Kohring
Representative Bob Roses
Representative Paul Seaton
Representative Peggy Wilson
Representative Bryce Edgmon
Representative David Guttenberg
Representative Scott Kawasaki

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

PRESENTATION: ENBRIDGE INC.

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

DOUGLAS KRENZ, Vice President, Gas Transportation & Development
President, Enbridge Offshore Pipelines, L.L.C.
Enbridge, Inc.
Houston, Texas

POSITION STATEMENT: Presented information regarding Enbridge,
Inc. and the proposed Alaska Natural Gas Pipeline.

RON BRINTNELL, Director of Pipeline Development
Enbridge, Inc.
Calgary, Alberta, Canada

POSITION STATEMENT: Answered questions during the Enbridge,
Inc. presentation.

IAN MCFEELY, Vice President, Gas Development

Enbridge, Inc.

Calgary, Alberta, Canada

POSITION STATEMENT: Answered questions during the Enbridge, Inc. presentation.

ACTION NARRATIVE

CO-CHAIR CARL GATTO called the House Resources Standing Committee meeting to order at [1:04:23 PM](#). Representatives Kawasaki, Roses, Wilson, Edgmon, Guttenberg, Johnson, and Gatto were present at the call to order. Representatives Seaton and Kohring arrived as the meeting was in progress.

PRESENTATION: ENBRIDGE, INC.

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CO-CHAIR GATTO announced that the only order of business would be a presentation by Enbridge, Inc.

DOUGLAS KRENZ, Vice President, Gas Transportation & Development, President, Enbridge Offshore Pipelines, L.L.C., Enbridge, Inc., began his presentation with an overview (slide 2) of Enbridge, Inc., an oil and gas pipeline transportation company. He said Enbridge: has an interest in 50,000 miles of oil and gas pipelines; owns and operates the world's longest and largest oil pipeline system running from western Alberta, Canada, to the Midwest and East Coast of the U.S.; delivers half of the Gulf of Mexico's deep water natural gas production; has Canada's largest gas utility which is in Toronto, Ontario; and has international interests in Columbia and Spain. Mr. Krenz reviewed his responsibilities within Enbridge and stated, "The most important thing I am focusing on is how Enbridge can help facilitate moving the Alaska Natural Gas Pipeline forward."

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MR. KRENZ, in response to Co-Chair Gatto, clarified that moving the Alaska gas pipeline forward is the most important thing that he personally is working on, as opposed to it being the most important thing for the company. The most important thing for Enbridge is a very significant capital growth program to expand its oil pipelines. Strategically, the Alaska gas pipeline is very important to Enbridge, he said, but it is even more critically important to the industry. North America currently has an extremely fragile supply and demand balance. An extreme winter could result in school closures, he warned.

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CO-CHAIR GATTO inquired whether the fragility in North America's gas supply extended to Alaska.

MR. KRENZ responded that Alaska has its own growth and demand requirements that come into play. However, Alaska is a significant frontier supply source for natural gas that can primarily serve the Lower 48's demand for natural gas well into the future. Everybody in North America would benefit, he said.

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MR. KRENZ pointed out that there is a gap in the supply-demand balance between now and the time the Alaska gas pipeline is expected to come on-line in 2017. It was thought that liquefied natural gas (LNG) would fill that gap beginning in 2010, he said. However, global liquefaction projects are sliding and LNG is not coming on-stream as fast as was anticipated. Re-gas projects in North America are operating today at less than a 50 percent load factor. What has happened is that LNG has become a global commodity. He advised that even with full contract assurance and shipper-pay utilization for new projects, there is no guarantee that the LNG will show up at that facility. This is because the primary owners of LNG tend to be major oil companies and governments, and they will ship the LNG to where ever the highest priced market for that LNG is. Enbridge's concern, he said, is that the U.S. will not be able to compete with Europe, especially in winter, which puts further dependence on finding a secure, stable, long-term natural gas supply - Alaska has it.

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MR. KRENZ cautioned that supply will meet demand. What this means is that demand will be destroyed if Alaska does not get moving soon and LNG keeps falling off. Demand will move offshore or somewhere else, alternate energies will get lots of legs and create lots of competition, and it will get harder and harder to justify moving this project forward. This is the biggest risk to all of industry, he said. Right now the economics are aligned to make the project work and while the producers are very tough negotiators, they want the project to move ahead.

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MR. KRENZ, in response to Representative Wilson, confirmed that Enbridge's inter-state pipelines are regulated by the Federal Energy Regulatory Commission (FERC).

REPRESENTATIVE WILSON asked whether there will be an open season sometime in the future because Enbridge needs more gas in its pipelines.

MR. KRENZ responded that Enbridge's Alliance Pipeline is fully contracted through 2015. After that, all the contracts are up for renewal. The Alaska gas project would go through a process of having an open season. He explained that when Enbridge is determining whether there is the demand for a pipe, the company will go out with a nonbinding open season to see if anyone shows up. If they do, then an attempt is made to negotiate terms and conditions to put the framework together such that there is the support for a FERC application.

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MR. KRENZ, in response to Representative Roses, confirmed that Enbridge is basically in the business of transporting product and does not buy or explore for product.

REPRESENTATIVE ROSES inquired about Enbridge's process for working with the producers.

MR. KRENZ replied that if Enbridge owns the pipeline, a strong shipper-pay contract is required in order to proceed. This contract guarantees that the producer will pay Enbridge regardless of whether the producer ships volume in the pipeline or not. That contract, then, is used to finance the project. The bank looks at that, he said, because Enbridge does not have nearly the credit-worthiness as a major oil company and the bank looks to see who the real player is that will be backstopping the project.

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REPRESENTATIVE ROSES asked what percentage of the gas product is expended through the liquefaction process and any other processes that are required to get the product to market.

MR. KRENZ said Enbridge's position is that the natural gas pipeline is by far the best solution for the industry and for Alaska. There are competitive proposals to build a natural gas

pipeline to Valdez and liquefy it there for transport to various markets, but Enbridge does not think that makes sense in the long-term. There is energy compression to liquefy gas, so there are losses, he said. Because of the large volume of gas in Alaska, there is not market available on the North American west coast to accept that and floating LNG to foreign countries does not do what needs to be done from North America, nor are the economics as attractive as the gas line. The gas line will also have rich gas flowing through it and at some point there will be some processing of the gas to extract the entrained liquid products - the ethane, propane, butane - that will move ultimately to refineries or petrochemical plants. A key synergy is the tar sands development in western Canada, Mr. Krenz continued. Because the oil is very thick, diluent must be mixed into it and the diluent is nothing more than the pentanes and the heavier liquids that are extracted from the gas. This would be a win-win scenario for everybody.

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REPRESENTATIVE ROSES reiterated his question as to what percentage of product would be lost by liquefaction.

MR. KRENZ answered that he would be guessing on that number.

MR. KRENZ, in response to Co-Chair Gatto, confirmed that pentanes can be shipped with the gas.

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CO-CHAIR JOHNSON asked what the Alliance Pipeline capacity is.

MR. KRENZ replied that the capacity is approximately 1.6 billion cubic feet per day (bcf/d). Enbridge has contracts for approximately 1.3 bcf/d and, for the incremental volume, Enbridge provides an authorized overrun service. Thus, utilization of that pipeline system is maximized, he said. In response to further questions from Co-Chair Johnson, Mr. Krenz confirmed that the capacity is through compression and various technologies. The Alliance Pipeline system went into service in 2000. It is a high pressure, state-of-the-art system and could easily be expanded with some incremental compressor stations. He guessed it could be incrementally expanded to a maximum capacity of about 2.5 bcf/d without putting new pipe into the ground. Regarding whether [the Alaska Natural Gas Pipeline] needs to run all the way to Chicago, he said that Enbridge has looked at the decline curves in western Canada, and its

preliminary assessment is that between the Alliance Pipeline system and TransCanada there should be adequate capacity to accept the gas from Alaska's pipeline.

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MR. KRENZ again stressed that timing is critical. He further outlined Enbridge's extensive experience in natural gas (slide 3) which includes 10,000 miles of natural gas gathering and transmission lines and involvement in joint venture partnerships that move over 5 bcf/d. There are technical challenges to building the Alaska pipeline and Enbridge has technical experience in both the north and south, he said. For instance, in the Gulf of Mexico the company's deepest pipeline lays on the ocean floor at 6800 feet. Enbridge is experienced with very sophisticated techniques, including robotics. In Arctic Canada (slide 4), the company built the first pipeline buried in permafrost - the Norman Wells Pipeline. It was built in 1985 and is still owned and operated by Enbridge. He noted that Enbridge is providing technical consulting to Alyeska Pipeline Service Company regarding the changing of some of the controls on the Trans-Alaska Pipeline System (TAPS).

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MR. KRENZ, in response to Representative Wilson, relayed an answer from his assistant in the audience that the gas pipeline to Inuvik is about 35 miles long. One of the benefits of that pipeline, he said, is being a part of the community and the culture. The northern cultures are key stakeholders in the Inuvik project and this requires developing and maintaining a good relationship to prove that Enbridge will do what it says it will do. Mr. Krenz detailed Enbridge's commitment to corporate social responsibility (slide 5). Social responsibility is going to be a key to success in this project, he said, and First Nations engagement will also be critical to success.

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MR. KRENZ moved to slide 6 and noted that Enbridge is constructing \$15 billion worth of capital projects over the next 7-10 years. These projects are primarily new and expanded pipelines associated with the growth in tar sands. This relates to the Alaska Natural Gas Pipeline because the labor force is not there to carry out the magnitude of the projects in Alaska and Canada. Enbridge will be recruiting and training workers for its upcoming projects who will then be able to work with

contractors from both Alaska and Canada. When its project is complete, he continued, Enbridge will have the most recent state-of-the-art experience in managing and completing major cross-country natural gas pipelines.

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CO-CHAIR GATTO inquired whether Mr. Krenz envisioned a single pipeline or multiple pipelines.

MR. KRENZ replied that there is not a detailed design as that is the next phase of the project. He relayed that Enbridge would expect a single, buried pipeline with a diameter of 48 inches.

CO-CHAIR GATTO commented that this agrees with testimony the committee previously received.

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REPRESENTATIVE SEATON noted that several years ago Enbridge had talked about two 36 inch pipelines. He asked whether this was still in the mix.

MR. KRENZ responded that no option has been eliminated at this point because there is not yet a project sponsor and the sponsor will be the one to determine the pipeline design. Building two parallel pipelines is much more expensive than putting one in a ditch, he said. Two smaller pipelines would give optionality down the road to use one of the pipelines for something else should the gas supply drop off. Enbridge, however, is optimistic that the larger diameter pipeline is the way to go because there is significant reserve in Alaska. Additionally, he said, once the project proceeds there will be more development.

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REPRESENTATIVE WILSON told of her tour at Fort McMurray, Alberta, one and a half years ago and of the drastic need for more workers at that time. Enbridge will likely be fighting for the same workers, she surmised, thus any workers trained right now would find employment immediately.

MR. KRENZ answered yes, very definitely. There is a significant labor shortage; over the last several years, Enbridge has seen its labor costs go up 50-60 percent and this is concerning.

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CO-CHAIR GATTO returned to the topic of two pipes versus one. While it is more expensive to put two pipes in the ground, the first pipe could be built and finished a year earlier and money could start being made, he said. Then a second pipe could follow the same route as the first. He asked whether the economics of that have been dismissed.

RON BRINTNELL, Director of Pipeline Development, Enbridge, Inc., stated that it was three years ago when Enbridge first looked at the "dual 36's". At that time it appeared unlikely that the market would be ready for, or able to handle, 4.5 bcf/d "out of the chutes." The thought was that if a 36 was built, the market could be ramped up over time, he said. However, there is no longer a need for the dual 36's because, as time has gone on, the need has increased and the supply has decreased. Thus, there should be the ability to take the full 4.5 bcf/d right away.

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REPRESENTATIVE SEATON related that one of the concerns at the time was that much gas coming on at one time would drop the price significantly. He asked whether this would still be the case or will people buy it if it is cheap enough.

MR. KRENZ replied that Enbridge's perspective is that it will reduce the amount of demand that is being destroyed for natural gas. "There is adequate market to be served with this gas supply based on our projection of when it is going to be coming on," he said. We need it all and it is not going to be a pricing issue.

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MR. KRENZ discussed several points made by the Honorable Jim Prentice, Minister of Indian Affairs and Northern Development, during a presentation to the Canadian Energy Pipeline Association in May 2006 (slide 7). He said the points made by Minister Prentice are still relevant: the market will decide what is the best and optimum solution and timing for this project; there must be an efficient regulatory process to support the project to move it ahead and expedite the regulatory approvals; project management and cost control is going to be significant and key to a successful project; social responsibility and Aboriginal issues; and, finally, it must be a

win-win solution for all of the stakeholders, whether Alaskan, Canadian, or North American end users.

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MR. KRENZ explained that in Canada there is debate about which regulatory process to use - the old Northern Pipeline Act (NPA) process from 30 years ago along with the [1976] Alaska Natural Gas Transportation Act (ANGTA), or the new policies and procedures based on today's environment (slide 8). He said Enbridge is optimistic that it will be the latter. The outlet of this pipeline will not access a single pipeline. A producer is going to have significant commitments to the Alaska Natural Gas Pipeline in the form of "taker pays". What that means, he advised, is that the producers are going to want assurance and reliability that the downstream pipelines are going to take the gas.

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CO-CHAIR GATTO inquired whether there is First Nations land on the expected highway route to Alberta.

MR. KRENZ answered yes, through the Yukon Territory. The right-of-way has been defined through that area, he said, but there are stakeholders there that will need to be dealt with.

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REPRESENTATIVE SEATON requested Mr. Krenz to address the concern expressed by some that a private company building the pipeline will have no incentive to keep the construction costs as low as possible in order to keep the tariffs low so that the producers can have a high netback.

MR. KRENZ stated that there is much risk in the construction phase of this pipeline project and Enbridge cannot take that risk. The regulated returns that are allowed by FERC are not high enough for a pipeline company to take that level of risk. Therefore, Enbridge's contracts would clearly state that any cost directly accrues to the tariff in the transportation rates. "In the future, and we have it in our oil pipeline systems, we will likely enter into some form of incentive tariff with the shippers where we both benefit if we can create operational efficiencies and lower the cost," he said.

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REPRESENTATIVE GUTTENBERG inquired about Enbridge's experience in dealing with the different regulatory processes on both sides of the border and how they do or do not mesh. He referred to slide 2 and asked whether there is a significance in regard to the break in the pipeline where it crosses the border between Regina, Saskatchewan, and the United States.

MR. KRENZ explained that the blue line [shown on slide 2] is the oil pipeline system and the red line is the Alliance natural gas pipeline system. He said the break in the oil pipeline shown on the slide is a printing glitch and that the pipeline in reality is continuous. With respect to the regulatory process, the Canadian and U.S. segments would need to be worked together in a concurrent process for approval. The Alliance Pipeline system is a good example of this, he said, because it is both a U.S. and Canadian pipeline and there are tariff structures on both sides of the border.

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REPRESENTATIVE ROSES asked what other benefits, in addition to petrochemical plants and oil extraction from tar sands, could be expected from a pipeline through Canada.

MR. KRENZ said this is the first project going through Canada that is not sourced by Canada and the end use is not in Canada. Thus, the comment that Enbridge hears is, "So what's in it for us in Canada?" There is a lot in it for Canada, he said, such as liquids extraction and the petrochemical fit. He said he tries to portray that it is a North American situation on a supply-demand balance. Other benefits to Canada could be that a large diameter pipeline going through a portion of the country could become a conduit for other development.

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REPRESENTATIVE ROSES inquired what the anticipated benefit that Canada will go after is. Is the petrochemical part going to be enough, is the liquid extraction going to be enough, he asked. "At some point in time what we have to take a look at is: are we better off to extract those and use them ourselves and develop a product here," he said. "Are we better off to use that as part of the enticement in order to 'allow' us to use their land to move our pipeline through to our other states."

MR. KRENZ responded that the traditional issues will come into play, such as how much [revenue] Canada will receive for the right-of-way and in taxes on the asset. From a bigger picture, Canada understands the strategic nature of the natural gas supply in Alaska, the need to serve the North American market, and the longer term impacts of not serving that market. If all the alternate energies are spurred on, he said, Canada has a significant resource that may not be of nearly as much longer-term value as it is right now. So, Canada is very incented to work together to make this happen.

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REPRESENTATIVE ROSES commented that Canada's knowledge of the need to move product is partly what pleases him and partly what scares him. Canada's recognition of the value of utilizing its land puts Canada in the more advantageous bargaining position.

MR. KRENZ said this is the real crux of the whole situation. There are numerous stakeholders in this project and if reasonable compromise cannot be reached, if greed cannot be replaced with compromise, then everybody loses. Look at the significant tax revenues that Alaska loses every single year that this project is delayed.

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CO-CHAIR JOHNSON asked what the compensation would be for gas taken from the pipeline [somewhere in Canada].

MR. KRENZ explained that the shippers on the pipeline would have title to the gas on the liquids; initially, these shippers will likely be the major oil companies. If Alaska transports its royalty-in-kind gas and has a shipping contract through the pipe, those liquids may be part of Alaska's. Basically, there would be a commercial arrangement with the party that extracts those British Thermal Units (BTU's) from the gas stream and the shipper would be paid for them. Typically liquids are more valuable than natural gas, he said. Total BTUs may be lost at the end of the pipe, but the economic value will not be lost. Whether Alaska decides to sell its gas or just do a netback calculation to determine the royalty value, it would just be part of an equation as to what percent of liquids is being extracted and the value of that amount.

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CO-CHAIR JOHNSON inquired whether extraction would affect tariffs. Will tariffs go down after the point of extraction, he asked, or is the tariff from Prudhoe Bay to Chicago.

MR. KRENZ said that in the case of an extraction plant located at the end of the Alaska Natural Gas Pipeline, there would be less gas going into the downstream pipelines and, yes, the tariff would be based on the actual gas going through those downstream pipelines. He said he did not know what would happen if the extraction is in the middle of the Alaska pipeline system because there must be a tariff structure that covers the cost of the Alaska system. He did not know how it would be structured if the upstream capacity is used. He said he thought that in reality it would be more likely that the liquids plants would be located at the end of the Alaska system.

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IAN MCFEELY, Vice President, Gas Development, Enbridge, Inc., stated that the Alliance Pipeline is a bullet line that goes from northeastern British Columbia to Chicago. Liquids are extracted from the rich gas in Chicago by a company owned in-part by Enbridge. After taking the liquids from the shippers on the system, dry gas - methane gas - is returned to the pipe that has the same BTU value as the liquids that were taken out. That dry gas is then shipped downstream to make money for the shippers. There are other alternatives that Alaska could consider, he said. For example, Alaska could build an extraction plant at the end of its pipeline, take the liquids and sell them into the Alberta market. Nobody will grab Alaska's liquids if the state wants to keep them.

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CO-CHAIR GATTO asked whether a BTU of propane is worth a BTU of natural gas.

MR. KRENZ responded that liquids tend to track oil price much more than gas price.

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MR. KRENZ moved to slide 9 of his presentation and noted that Enbridge's agenda with the First Nations is an on-going process of education, engagement, training, building relationships, and creating long-term employment opportunities.

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REPRESENTATIVE GUTTENBERG asked whether Mr. Krenz is pointing out that TransCanada may not have the exclusivity with the First Nations that it thinks it has.

MR. KRENZ explained that the NPA was approved 30 years ago when much of the Alberta infrastructure was not there. There is a route that is defined and, not surprisingly, TransCanada thinks it should have the right and the NPA regulatory approval should still be used. But that approval does not acknowledge that the First Nations are a stakeholder in the project and it is not in compliance with today's regulatory and environmental requirements. Why would anyone think it will be rubber stamped based on an out-of-date, 30-year-old deal, he asked.

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MR. BRINTNELL clarified that there are First Nations in the Yukon who actually own the land and have title and control of the land, although there are some that do not. Consultation requirements are a responsibility of Canada's government, not Alaska's. TransCanada has certain things that it was granted exclusive rights to under the NPA, but that was prior to modern consultation requirements that have been put into law over the last 10 years in Canada. Constitutional rights of the First Nations have changed since the NPA was enacted, he said. Thus, while TransCanada has specific rights, Enbridge questions whether TransCanada has the exclusive right to move the project forward. There is no chance that TransCanada has the ability to go unchallenged by the First Nations in Canada.

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CO-CHAIR JOHNSON pointed out that an agreement still has standing regardless of how old it is. Just because things change in between, that agreement does not change, unless laws are different in Canada than in the U.S. Of course, anything can be litigated, he said, but winning is another thing.

MR. KRENZ answered that the defined right-of-way is protected and that has not changed.

MR. BRINTNELL added that it is only a partial right-of-way. He asked whether Co-Chair Johnson was referring to the First Nation issue or the exclusivity issue.

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CO-CHAIR JOHNSON said he is referring to both. He inquired whether there is something in Canadian law that supersedes the agreement of 30 years ago with the new constitutional amendment for First Nations.

MR. KRENZ stated that the government has not yet ruled on this. There are challenges on the Canadian side of the fence and this is one that Enbridge is pushing to get resolved. The response has been that the Canadian government will do something once the Alaska project is actually moving.

MR. BRINTNELL added that only certain parts of First Nations issues have been dealt with under the NPA.

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CO-CHAIR JOHNSON remarked that this is a red flag to him. Why would Alaska want to enter into a 40-year agreement knowing that it is going to be changed in 25-30 years, he asked.

MR. BRINTNELL stated that Enbridge is not trying to take away the rights granted to TransCanada and is not trying to change the agreement. TransCanada has specific rights, but it does not have exclusivity.

MR. KRENZ said there will be an approval process that will define what has to be lived with on the pipeline system.

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MR. KRENZ turned to slide 11 of his presentation and noted that the traditional supplies in the Lower 48 are dwindling. He said Enbridge expects the majority of Alaska gas to go to the northeast and eastern markets. [Slide 11 lists the key markets for Alaska gas as being the Midwest and Northeast U.S., southern Ontario, Canada, and Alaska.] He explained that there is some expansion in existing re-gas projects and some new projects are being constructed that have firm supply contracts (slide 12). The projects that have not yet started and that are still looking for supply are probably going to be looking for supply until after 2015, Mr. Krenz predicted. Some of the LNG projects are falling by the wayside; environmentally they all have challenges, but the biggest challenge is finding supply. He moved to slide 13 depicting the global LNG supply forecast for

2004-2006 and noted that the forecast for 2006 is likely optimistic as it is continuing to slide.

MR. KRENZ reviewed the motives for producer ownership (slides 14-15) and stated that the single word is control. The producers will bear the risk on this pipeline and there are technological challenges. Contracts with the producers for the capacity of the pipeline are a must-have, he said. The Alaska situation is similar to the one in the Gulf of Mexico where "Shell" built its own pipeline.

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MR. KRENZ explained that the Canadian oil sands development is extremely complicated (slide 16), but despite the challenges the development moved ahead quickly and everybody is benefitting. He acknowledged that the infrastructure is being stretched in the developing areas, such as having enough workers.

MR. KRENZ said Enbridge thinks that the producers must play a key role in the Alaska project in order for it to move ahead (slide 17). Enbridge's concern is in respect to timing and the producers need to be at the table sooner rather than later. The issues that must get resolved are those between the state and the producers and once resolved the project will move ahead rapidly, he said. The creditworthiness of the producers is needed in order to have the higher financing on the project which reduces the cost of service. In order to have the producers sign the 25-year shipper pay contracts, the producers are going to want to have cost control over the project because they will be the ones to bear the risk of cost overruns.

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REPRESENTATIVE ROSES summarized his understanding of what is being said: Mr. Krenz is confident that Enbridge would produce a quality product should it be granted the authority to build the pipeline; Enbridge is experienced in building pipelines in Canada and the Gulf of Mexico; Enbridge is the best company to deal with because of its relationships in Canada; and Alaska will not receive a commitment from Canada until the project is defined. However, he said, Alaska is not going to define the project until the commitments on the other end are known; it is a give and take. He asked for Mr. Krenz's opinion on how difficult it is going to be to secure a reasonable contract through Canada.

MR. KRENZ said he is very confident. While there are issues in Canada, they can be resolved in a timely fashion that will not cause any delay to the project. Once traction is seen on the project it will become a much higher priority.

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REPRESENTATIVE ROSES noted that one of the requirements in the proposed Alaska Gasline Inducement Act (AGIA) is that prospective licensees must outline how they plan to secure First Nations rights if the pipeline goes into or through Canada. Is this easily definable, he inquired.

MR. KRENZ responded that he thinks Enbridge can easily define what the issues are and establish a timeframe on when those issues would have to be resolved to work with the project schedule. He recommended the state get the producers back to the table and find compromises on those issues that need to be resolved. The pipeline is going nowhere until there is an agreement on those issues, he opined. Enbridge must come together with a producer consortium before it will spend the time and take the risk of going through the AGIA process.

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REPRESENTATIVE ROSES appreciated Mr. Krenz's candidness as Alaska cannot afford to hedge its bets and move forward without knowing what to anticipate. He said his concern is that the stakes with Canada will get higher each day if the negotiations involve putting the Alaska pipeline across Canadian land.

MR. KRENZ pointed out that there are a lot of commercial arrangements between the United States and Canada. Washington [DC] will weigh in real quickly if Canada is not playing fairly in this scenario because this is so critical to the Lower 48, he predicted.

REPRESENTATIVE ROSES remarked that Mr. Krenz may have more confidence in Washington [DC] than he does.

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CO-CHAIR GATTO stated that if Enbridge had the framework of an agreement with the producers, it could still come forward to the legislature.

MR. KRENZ expected that if the producers come forward with an application in the [AGIA] process, that application will be conditioned on resolving the fiscal issues. Fix that, he urged, then all of the other noise will go away and things will start moving.

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CO-CHAIR GATTO requested Mr. Krenz to expand his comments on resolving the fiscal issues.

MR. KRENZ understood that there was some desire by the shipper group to have clarity on future costs for the project which included taxation. It was not necessarily just gas taxation; it was also oil pipeline taxation. The producers cannot be blamed for wanting more certainty on a go forward process, he opined. There has been a little hiatus after the elections, but negotiation is still ongoing. The group that Alaska is negotiating with is "extremely sophisticated [and] will try to wear you out." They are very good at what they do, but they also want to do the deal and they want to get it moving now. The producers see the same concerns and pitfalls that I have been trying to explain, he said. Enbridge could be an operator in the project, or a neutral third party in the pipeline group with the producers to add value. Whether or not Enbridge is involved, it is a win for Enbridge and for the industry to see the project moving ahead.

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CO-CHAIR GATTO asked whether a 10 year certainty on a tax structure that is in place at the time of agreement seems reasonable to Mr. Krenz.

MR. KRENZ said it may be, but whether it is reasonable or not is unknown "until after you've gone through all this pipeline stuff to get to that." What is the disadvantage of throwing out an olive branch to [the producers] to come to the table with the new administration, he asked.

CO-CHAIR GATTO responded that he thinks this is what is being done. The tough point is getting a mediator to come up with one document that everyone can buy into that includes the tax structure, the 10 years, the pipeline estimate, the diameter, the direction, and First Nations.

MR. KRENZ agreed. However, he said, going through this pipeline scenario does not really get to the issue that needs to be fixed right now.

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REPRESENTATIVE SEATON stated that a majority of Mr. Krenz's suggestions have been done, including converting the gross tax to a net profits tax. Alaska worked really hard with the producers, and while there is a difference of a percentage or two, basically the structure is there. [The legislature] has not heard what the big problems are, he said, the problems are unknown until there is an offer on the table.

MR. KRENZ said he thought it unrealistic to expect to negotiate such complicated issues in an open forum. Closed doors are not meant to hide from the legislature what the administration is doing with the producers. It will be tough to see progress, he advised, if the players that the state is dealing with have to do something in a public forum.

CO-CHAIR GATTO pointed out that a deal had been agreed to, but there was no commitment to actually do anything with the deal. The legislature did not think that was in the best interests of the state, he said. The tax structure was one thing, but the simple core value that the producers did not even have to build the pipeline was unpalatable.

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REPRESENTATIVE GUTTENBERG stated that he has been a pipeline worker in the oil fields all his adult life. "You had to come to us with a pipeline deal that was really bad in order for us to reject it," he said, "and that's what happened." The phenomenal election that turned things around should have been a lesson to the industry about the attitudes of the people of this state. Now we are turning around and negotiating back, and the negotiations must be in public and be a part of the public process. Sovereignty and Alaska hire issues must be on the table. Representative Guttenberg said he is unsure if a proposal that went around AGIA would be acceptable, but that if some entity came back to the people of Alaska through the legislature and the governor with a proposal that at least partially answered some of the questions and concerns, "we would be at the table in a minute's notice" with a special session. Had the previous administration's product lived up to the constitution and the commitment that legislators have made to

their constituents, he said, these meetings would not be happening right now - "they'd be ordering pipe."

MR. KRENZ applauded the comments. He noted that Enbridge was not part of the previous negotiations, but that it has offered to help facilitate getting the project going because of the timing concern and not wanting to see the project slide another few years. He said he did not know whether AGIA is the right approach, but that there must be resolution with the producers for the pipeline to go ahead, "otherwise we're all just wasting each other's time." The state does not need to spend \$500 million supporting a pipeline application; fix the issues and the pipeline will move ahead.

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CO-CHAIR JOHNSON asked whether an open season commitment of the reserves that are known today would be enough to finance a pipeline.

MR. KRENZ said he thought yes with the [known reserves of] 35 trillion cubic feet (tcf). The upside is that as the reserves grow and more volume is transported, the tariff gets lower.

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REPRESENTATIVE ROSES appreciated Mr. Krenz's willingness to provide a presentation as per the committee's invitation and thanked him for answering questions that were beyond the scope of what he was asked to speak about.

MR. BRINTNELL said Enbridge has had dialog with the Canadian government and Canada will be ready to handle the issues. What Canada is looking for is that costs do not outweigh the benefits. In other words, if the pipeline goes through the Yukon and roads have to be built it is not a negative to Canada. If it is economic, Yukon would like to be able to have a tee to be able to take gas off or put gas on. It is not that Canada is going to hold out, he advised, only that Canada wants things to be fair.

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REPRESENTATIVE SEATON understood the benefits that Canada would want, such as property tax on the pipeline which would be a normal thing. He inquired whether there is normally a severance

tax on the gas or a transport fee for the BTU's when a pipeline goes through another country or province.

MR. BRINTNELL responded that normally it is just property tax on the land that the pipe sits in.

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REPRESENTATIVE GUTTENBERG asked whether there is validity to the thought that if a non-producer were to build the pipeline, the producers would be forced to release their gas into the pipeline as a result of pressure from shareholders, the public, and the U.S. Congress.

MR. KRENZ replied, "Based on my experience dealing with the sophisticated players that you are dealing with, they are not intimidated ... they react very negatively to pressure, I'm not optimistic that that approach would be very worthwhile."

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REPRESENTATIVE SEATON inquired whether Mr. Krenz could provide a written discussion paper describing what would be a normal third-party pipeline agreement regarding tariffs and who bears responsibility for cost overruns when it is a third party pipeline builder instead of the producers.

MR. KRENZ said it would be a typical, standard inter-state pipeline system.

REPRESENTATIVE SEATON said this would be helpful for discussions regarding whether to have the pipeline built by a third party or by producers.

MR. KRENZ agreed to do so. The quick answer, he said, is that on a non-jurisdictional, purely commercial pipeline - which Enbridge does all the time on its gathering systems - Enbridge estimates the cost, does a reserves analysis on the deliverability, and then establishes a tariff. Enbridge might bear the risk of the cost overrun, but the estimates are put together to compensate for that. For cost overruns on a project of the magnitude of the Alaska pipeline, he said, the expectation would be that the pipeline builder would go back for another rate case to get a revised rate approved at the higher cost of service.

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CO-CHAIR GATTO talked about the different perspectives of Canada and Alaska and the reasons why each party would like to see a gas pipeline. Alaska is motivated, he said, but it is an amateur dealing with "big guys" who know how to trick other people, and this has made the state gun shy about accepting the first offer. All the legislature is after is to have a deal presented by Enbridge or anyone else that is fair and lays out all the details.

MR. KRENZ said Enbridge stands ready, willing, and able, and has been trying to facilitate resolution of the issue. The legislature's job is to maximize value long-term for Alaska and that is what the other stakeholders are trying to do for themselves as well.

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CO-CHAIR GATTO commented that a deal may not be maximized, but it could be adequate enough to agree to. Alaska does not want to be flattened by a steamroller.

MR. KRENZ said Enbridge will try to be creative and work with the producers.

CO-CHAIR GATTO asked for Enbridge's opinion of the current structure of the petroleum production profits tax (PPT).

MR. BRINTNELL responded that the short answer is PPT can be a part of the solution, but because Enbridge is not one of the producers he cannot say whether it is "the" solution. People must come to the table to talk about whether the existing sets of tools can be used - of which PPT is one - or whether to change or modify them. So, the answer is all of the above.

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REPRESENTATIVE ROSES stated that anyone worried about getting hoodwinked should not be at the negotiating table and should hire a knowledgeable representative instead. That is part of the dynamic of where [the legislature] needs to be and why the committee is listening to presentations. This project will not move forward unless everybody has something to gain by it, he noted. The question is how to maximize the potential for the state of Alaska and minimize any liabilities. "I think we are in the position to move forward," he said. He shared Mr. Krenz's concern about how open the process can be. Teacher

contracts are not done in public, nor are they expected to be done in public. Therefore, he cannot see how something like this can be totally open. Progress on the negotiation must be reported, he said, but the negotiation is not in the open.

MR. KRENZ responded that most of his career has been business development and coming up with win-win structures. The concern is that it is not short-term, it is not the first 10 years. The state must be protected and be sure it is getting its fair share down the road. Perhaps there could be some form of incentive taxation structure that allows this fair share compensation in the future, he suggested.

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REPRESENTATIVE SEATON presented a scenario in which an oil pipeline and a gas pipeline each made \$5 billion in profits. He inquired whether Mr. Krenz would expect the tax rates to be different on the oil profits versus the gas profits.

MR. KRENZ answered that it is the financial value that has been created, so why would it be any different.

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REPRESENTATIVE SEATON remarked that this has been one of his chief conundrums in trying to understand. Even though the producers get to subtract out all of their expenses under the net profits system so that profit is the only thing being talked about, they are saying they want to pay one-third of the tax rate on gas profits that they pay on net profits. It is something for which the legislature has not been given an explanation.

MR. KRENZ said he did not know. He guessed that, "It may come down to their economics on the oil side of the business are much stronger than the gas side of the business and when they independently look at the projects ... they can negotiate with you and bear more tax load on the oil side than on the gas side and still have the project be a project that meets their criteria."

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REPRESENTATIVE SEATON stated that it is the net profit in either case, so the expense part is taken out. He said it would be very beneficial to receive an answer on this.

MR. BRINTNELL responded that the issue may be the risk factor. Net profits do not take into account the amount of return on equity that one might need for a more risky project. A riskier project may require a larger return.

REPRESENTATIVE SEATON commented that this is the main thing for which the committee does not have a good understanding.

CO-CHAIR GATTO agreed. He noted that if a certificate of deposit (CD) could be bought for a 10 percent return, why would someone go build a pipeline for 10 percent - but show me a 10 percent CD.

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ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 2:45 p.m.