

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

April 13, 2007

1:02 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

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
03/29/07 (H) Heard & Held
03/29/07 (H) MINUTE(O&G)
03/30/07 (H) O&G AT 8:30 AM CAPITOL 106
03/30/07 (H) Heard & Held
03/30/07 (H) MINUTE(O&G)
03/31/07 (H) O&G AT 1:00 PM BARNES 124
03/31/07 (H) -- MEETING CANCELED --
04/02/07 (H) O&G AT 8:30 AM CAPITOL 106
04/02/07 (H) Heard & Held
04/02/07 (H) MINUTE(O&G)
04/03/07 (H) O&G AT 3:00 PM BARNES 124
04/03/07 (H) Moved CSHB 177(O&G) Out of Committee
04/03/07 (H) MINUTE(O&G)
04/04/07 (H) O&G RPT CS(O&G) NT 3DP 2NR 2AM
04/04/07 (H) DP: RAMRAS, DOOGAN, OLSON
04/04/07 (H) NR: SAMUELS, KAWASAKI

04/04/07 (H) AM: DAHLSTROM, KOHRING
04/04/07 (H) O&G AT 8:30 AM CAPITOL 106
04/04/07 (H) -- MEETING CANCELED --
04/05/07 (H) O&G AT 3:00 PM BARNES 124
04/05/07 (H) -- MEETING CANCELED --
04/10/07 (H) RES AT 1:00 PM BARNES 124
04/10/07 (H) Heard & Held
04/10/07 (H) MINUTE(RES)
04/11/07 (H) RES AT 1:00 PM BARNES 124
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04/12/07 (H) Heard & Held
04/12/07 (H) MINUTE(RES)
04/13/07 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

DAVID VAN TUYL, Gas Commercialization Manager

BP Exploration (Alaska) Inc. (BP)

Anchorage, Alaska

POSITION STATEMENT: Testified regarding BP Exploration (Alaska) Inc.'s concerns about HB 177 and responded to questions.

WILLIAM M. WALKER, Project Manager

General Counsel

Alaska Gasline Port Authority (AGPA)

Anchorage, Alaska

POSITION STATEMENT: Testified in favor of HB 177 and responded to questions.

PAUL FUHS, Lobbyist

for the Alaska Gasline Port Authority

Anchorage, Alaska

POSITION STATEMENT: Provided information on gas pipeline development issues and on suggested amendments to HB 177.

ACTION NARRATIVE

CO-CHAIR CARL GATTO called the House Resources Standing Committee meeting to order at 1:02:17 PM. Representatives Gatto, Wilson, Seaton, Roses, Guttenberg, and Edgmon were present at the call to order. Representatives Johnson, Kawasaki, and Kohring arrived as the meeting was in progress.

HB 177-NATURAL GAS PIPELINE PROJECT

[1:02:31 PM](#)

CO-CHAIR GATTO 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." [Before the committee was CSHB 177(O&G).]

[1:03:48 PM](#)

DAVID VAN TUYL, Gas Commercialization Manager, BP Exploration (Alaska) Inc. (BP), referred to a PowerPoint presentation, slide 2, and paraphrased from written testimony [original punctuation modified slightly]:

BP has a long history in Alaska. BP has been actively involved in the exploration, development, and production of Alaska's North Slope energy resources for decades. [We] see the opportunity for a bright future ahead. In fact, we envision our 50-year future in Alaska. It's not just a slogan. So how might that vision look to our company?

I'd like to turn your attention to the graph at the bottom of slide 2, which shows the possibility of the future that BP sees in Alaska, depicting BP's share of production through time.

There are a few key points to draw from the graph. The days of high plateau production are behind us. We still have a significant level of production today, but that production will continue to decline with time. That's what the dotted red line depicts. That shows production declining at historic levels, which already would require significant investment.

We can make up that decline in production with new investment that would result in new production from heavy oil resources and from gas. But it's not a given. It's a view of what is POSSIBLE. That future is only made possible with an Alaska gas pipeline project.

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CO-CHAIR GATTO asked whether one should assume the gas is in "barrels of oil equivalents."

MR. VAN TUYL answered yes.

CO-CHAIR GATTO noted that slide 2 shows a future decline in oil production despite continued investment, however it also seems to indicate some future production above the projected decline.

MR. VAN TUYL explained that the chart on slide 2 shows possible future production increases in viscous oil and gas should there be further investment "beyond which we have had historically." He said the historic decline rate has been around six percent annually, but that rate could be slowed somewhat should there be more investment in the development of viscous oil resources. Alternately, if the investment rate was reduced, the projected rate of future decline would be even greater.

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MR. VAN TUYL paraphrased from written testimony [original punctuation modified slightly]:

So BP wants and needs a gas pipeline. And we need that pipeline to be built for a low capital cost and then operated cost efficiently. We believe that is what is required to make the project happen and be successful. Low costs are good for both BP and the State because it results in lower tariffs, higher netbacks and more revenues for the State and BP.

Also, a low cost project will provide incentive to explore for more gas to keep the pipeline full into the future. That is also good for the State and for BP. The best way to ensure there is gas exploration in the future is to get a gas pipeline built in the first place, and to get it built for a low cost.

This is a hugely important project to BP, to Alaska and to the nation. It represents the largest, known, undeveloped gas resource in the United States, and in BP's global portfolio. The gas project is important in its own right - but it also extends the economic life of Alaska's oil production for decades. Extending oil production is good for the State, the nation and for BP.

1:10:10 PM

We share the governor's and the legislature's desire to get a successful gas project moving, and BP stands ready to engage with the administration and legislature to reach a balanced fiscal framework that works for all the parties.

And finally, a successful framework will set the foundation for a stable, healthy, and viable oil and gas business for decades to come. BP's future in Alaska is directly linked to the gas pipeline project.

That is why we are very encouraged by the Governor's and the legislature's enthusiasm about getting Alaska's gas to market. That is also our vision, and so we share your enthusiasm. It is the key to Alaska's future, and to BP's future in Alaska. Therefore, it is important that we get it right.

BP sees AGIA as the Administration's expression of its commitment to advance the gas pipeline project in an open and transparent way. We applaud that good faith expression.

Developing the right process is difficult. Since first seeing AGIA at its roll out to the legislature and the public on March 2nd, we have identified a number of important areas of concern for you to consider. We believe AGIA CAN be successful if some key issues are addressed, and I have summarized those concerns here, and will discuss them in more detail shortly.

We believe AGIA may create some unintended consequences that could jeopardize the vision of getting Alaska's gas to market quickly, and at low cost. We believe it is important for the Legislature to consider these areas of concern as you deliberate on AGIA.

Why do we feel these changes are so important? It is because we want the project to be a success, because there is much at stake for BP and for Alaskans.

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MR. VAN TUYL referred to slide 4 of the PowerPoint and paraphrased from written testimony [original punctuation modified slightly]:

It is worth a brief reminder of the importance of a successful project. And I would like to emphasize that what we need is a SUCCESSFUL gas pipeline, not just ANY gasline. As we've said, this is a project of tremendous scope and scale and that's what the picture reminds us of. Because of this it presents tremendous risk. But if it is done right, it also presents the opportunity for great benefits as well. Because there is much at stake, we need to get it right.

The project creates the opportunity for jobs for Alaskans, and if we deliver a successful, low cost project, for revenues to the State and to BP well into the future. We can create a whole new industry of gas exploration with a successful, low cost project. Gas exploration and expansion are only possible if the pipeline gets built in the first place, and if it is built for a low capital and operating cost. That will make it attractive for bringing new volumes into the project, which benefits the State, gas explorers, and initial shippers as well.

A successful gas pipeline project will provide the opportunity to bring a long term gas supply source for use by Alaskans. And finally, gas sales will diversify Alaska's economy for decades into the future.

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MR. VAN TUYL opined that AGIA can help to deliver a successful gas pipeline if certain modifications are made. He first recommended that the bill set forth objectives instead of prescriptive requirements and paraphrased from written testimony [original punctuation modified slightly]:

We fully support the State clearly providing its objectives for a successful gas pipeline project. The concern we have is that AGIA as drafted presupposes solutions to those objectives, such as those contained in Section .130 starting on page 3 of the bill.

We think that prescribing solutions up front will not result in the best project. We've heard the administration state their intent that "we need to let industry do what they do best". We fully agree with that intent, and think it only gets met if industry is allowed to offer its own unique, creative solutions.

One specific example of prescribing a solution we find particularly troubling is the issue of toll subsidization. AGIA as drafted can result in one party subsidizing another [referring to the language in Section .130(7) of the bill on page 6-7.]. AGIA specifically requires initial shippers - who financially underpin the project and who already bear most of the risk associated with the project - to bear yet another risk and additional cost: the risk of tariff increases of 15% or more by subsidizing expansion shippers:

First I want to make clear that the issue is not just the potential for a 15% rise in the tariff. And by the way, the "15% cap" as I've heard this language characterized is not 15%, and it's not a cap. In reality it could result in a significantly higher increase than 15%. But the more fundamental issue is that we believe the issue of subsidization is contrary to FERC policy. We understand and we fully share the State's desire for a pipeline to be expandable - it's absolutely good business. However, we believe that the State should carefully consider the potential adverse consequences of requiring pipeline owners to increase rates on their initial customers to subsidize expansion shippers. A policy of subsidization places additional risk on the initial shippers, making the project less attractive, and therefore puts the project at risk.

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Now if the State wants to subsidize others, it can certainly do so itself, directly, as a policy choice. But we don't believe it's good policy to do so with other peoples' money. Congress made clear in the Alaska Natural Gas Pipeline Act of 2004 that rates for initial shippers should NOT increase if a mandatory

expansion was ordered. In fact, the language of the Federal Law states that

"The [Federal Energy Regulatory Commission] (FERC) shall...ensure that the rates do not require existing shippers on the Alaska natural gas transportation project to subsidize expansion shippers." - ANGPA, Sect. 105(b)

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MR. VAN TUYL referred to Order 2005 in which FERC put in place a rebuttable presumption of rolled in rates for expansions provided it did not require subsidization by initial shippers.

REPRESENTATIVE ROSES asked whether future pipeline expansion could ever result in rates lower than the shippers' initial rates.

MR. VAN TUYL replied that it is possible for an expansion to result in a reduction in an initial shipper's rates. However, it is "not necessarily a given that the first expansion will reduce rates ... [it is] just as possible that it could increase rates."

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REPRESENTATIVE ROSES referenced FERC policy ensuring that existing shippers are not required to subsidize expansion shippers and asked about the situation where a new shipper is given a lower rate than the original shippers. He asked whether in that situation, BP would claim the new shipper was receiving a subsidy.

MR. VAN TUYL replied that he believes the aforementioned situation is what FERC was trying to address in Order 2005 and that is why it established a rebuttal presumption to rolled in rates. He said there is "quite a bit of language" in the FERC order regarding the subsidy issue. He opined that FERC recognizes the complexity in this area and accepts that each case needs to be evaluated on a case-by-case basis. He pointed out that FERC is meant to regulate inter-state gas transmission and that there is a body of law and regulation regarding this area.

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REPRESENTATIVE ROSES noted that prior testimony emphasized the need for "predictability of expenses." He questioned whether the need to go to FERC for various issues establishes or undermines predictability.

MR. VAN TUYL replied that on this particular issue of expansion and subsidization, he believes that the existing FERC regulations provide predictability for initial shippers. However, he went on to say that AGIA as currently drafted appears to allow an expansion to take place and that the rates would be rolled in provided they did not increase the initial maximum recourse rate to the downstream terminus. He explained that BP is concerned that the magnitude of the subsidy could be "well in excess of 15 percent." He explained that the term "initial" is a concern because the initial rate can be higher than the rate after the "period of levelization." Additionally, "maximum recourse" raises some concern because this term usually means the maximum rate allowable by FERC.

MR. VAN TUYL said that most pipelines are operated under negotiated rates, a point which seems to be recognized in AGIA. Negotiated rates are typically 85 percent of maximum recourse rates, he said. This could result in a potential rate increase of 30 percent to an initial shipper, he concluded. Last, there is some concern over the effect of the language if the rate relates to the downstream terminus of the pipeline. He explained that the term "downstream terminus" could mean Chicago, Illinois if the gas was shipped to the Midwest. He expressed concern that an expansion to a different part of the line could perhaps still count Chicago as the downstream terminus, which results in a "high degree of uncertainty" to the pipeline owner. He opined that FERC policy gives more comfort as it has precedent and policy regarding rate issues.

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REPRESENTATIVE ROSES asked if this language would be more palatable if amended to exclude the terms "original" and "terminus," and referred instead to the "cost at the time of expansion," and "the cost to the point of expansion."

MR. VAN TUYL replied that although BP has concerns with the technical aspects of AGIA, its main concern is that some provisions of AGIA are in conflict with FERC regulation and federal law. He suggested that a preferable approach would be to request that the applicant describe how it would support

recovery of expansion costs consistent with FERC regulation and federal law.

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REPRESENTATIVE ROSES sought clarification as to whether the witness said that the initial shippers do not want to subsidize any expansion, but do want to share should there be lowered rates.

MR. VAN TUYL answered the aforementioned characterization is not accurate; rather the issue is subsidization as described by FERC. He explained that under FERC guidelines if the rate drops as a result of expansion, it is not considered a subsidy. However, if the rate increases it may or may not be a subsidy depending on the situation. He reiterated that FERC has a body of policy which it considers in making a determination as to whether a subsidy has taken place.

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REPRESENTATIVE SEATON stated that a primary objective for the state is to encourage expansion and further exploration. Today's testimony seems to indicate a desire to remove possible benefits to later shippers and explorers, he opined.

MR. VAN TUYL disagreed with the aforementioned statement. He said BP believes it is entirely appropriate that the state encourage design of an expandable pipeline which enhances prospects for further exploration. He emphasized that his comments relate more to jurisdictional issues because FERC regulates inter-state gas transmission. He expressed concern that AGIA as currently drafted conflicts with federal law in this area. He opined that the state should articulate its objective by asking the applicants to describe how they will plan for expansion and enhanced exploration. He cautioned that an overly specific approach regarding rates is problematic and may conflict with federal law.

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REPRESENTATIVE SEATON relayed that the state's desire for pipeline expansion and future exploration might be different than FERC's regulatory structure, therefore the state should have some control over this issue so as to accomplish its objectives. He asked whether there are other mechanisms to encourage future exploration such as assuring that future

explorers receive conditions of shipment similar to those received by the initial shippers.

MR. VAN TUYL replied that he thinks that the best assurances that can be provided to initial and expansion shippers is to first build a pipeline at a low cost. He opined that it is entirely appropriate for the state to desire further exploration and an expandable pipeline. However, he expressed concern that the state's attempts to mandate the expansion process and rates could create conflict with federal law.

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REPRESENTATIVE SEATON said that FERC recognizes that higher rates may or may not be considered a subsidy. He opined that the provision in AGIA that increases within 15 percent are not considered a subsidy is not necessarily in conflict with federal law.

MR. VAN TUYL agreed that the above statement may or may not be in conflict with federal law. He went on to explain it is the manner in which "this is laid out" that could create the conflict.

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CO-CHAIR GATTO suggested that subsequent shippers can subsidize the initial shippers to some extent. He indicated that the state is justified in setting forth some encouragement for future expansion and exploration efforts.

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MR. VAN TUYL read an excerpt from FERC Order 2005, which he characterized as putting in place a rebuttable presumption of rolled in rates for expansion provided it does not require subsidization by initial shippers [original punctuation provided]:

In conclusion, to provide guidance to potential shippers in advance of the initial open season that is the subject of this rule, the Commission intends to harmonize both objectives (rate predictability for initial shippers and reduction of barriers to future exploration and production) in designing rates for future expansions of any Alaska natural gas

transportation project. It is consistent with our guiding principle that competition favors all of the Commission's customers, as well as with the objectives of the Act, to adopt rolled-in rate treatment up to the point that would cause there to be a subsidy of expansion shippers by initial shippers, if any subsidy were to be found." [Order 2005, paragraph 125]

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MR. VAN TUYL opined that the two excerpts of Order 2005 suggest that AS 43.90.130(7) could be in conflict with federal law. He said the issue is quite complicated, and is still being studied. He warned that a conflict could result in delays and uncertainties.

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CO-CHAIR GATTO asked if this issue would be resolved if the language in section 130 (7) read "not more than zero" rather than "not more than 15."

MR. VAN TUYL opined that even with that change there would still be conflict and concern because it puts the state in the place as the rate-maker rather than FERC.

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REPRESENTATIVE SEATON asked whether this is just part of a negotiated rate process.

MR. VAN TUYL agreed that FERC certainly does allow for negotiated rates, but he went on to say that his understanding of AGIA is that it sets forth parameters for any negotiated rate. He offered that this raises the issue of whether it is really a negotiated rate or a mandated rate.

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REPRESENTATIVE SEATON noted that the state is the resource owner, and perhaps this provision could be considered a term put forth by one of the parties, in this case the state.

MR. VAN TUYL opined that negotiation requires terms that are agreed to by both parties. He indicated that in this instance there is a question as to whether it is really a negotiated rate since AGIA's terms appear to mandate a certain structure. He

continued by explaining that BP believes a provision which requires a subsidy for not-yet-ready shippers at the expense of initial shippers would be a disincentive for potential shippers to participate in an open season.

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REPRESENTATIVE ROSES asked for clarification as to whether the concern was regarding possible conflict with federal law, or more with the desire to allow the applicants greater leeway to describe how they would plan for future expansion of the pipeline.

MR. VAN TUYL emphasized that he believes it would be entirely appropriate for the state to articulate its objectives and to require an applicant to explain how its proposal would allow for pipeline expansion and future exploration. He assured the committee that expansion and future exploration are also key objectives of BP. However, BP is concerned that an overly prescriptive application requirement could create a conflict with federal law.

REPRESENTATIVE ROSES asked whether it would be possible to request a ruling from FERC as to whether the provisions in AGIA are in conflict with FERC provisions.

MR. VAN TUYL said this is an issue of federal law, noting that the FERC provisions referred to today are regulatory.

REPRESENTATIVE ROSES pressed on to ascertain whether the concern would still exist if there was a ruling from the appropriate federal entity that AGIA's language is not in conflict with federal law.

MR. VAN TUYL replied that the issue about the conflict would be satisfied. However, the issue of the magnitude of the potential subsidy would still exist and could expose the shipper to a rate increase "significantly higher" than 15 percent.

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MR. VAN TUYL suggested that a second modification that would enable AGIA to help deliver a successful gas pipeline relates to the issue of exclusivity. He paraphrased from written testimony [original punctuation modified slightly]:

Under Sections .260 and .440 of the bill on pages 18 and 23, AGIA would result in an exclusive winner before any real work is done and awards State funds based on promises, not results. We are concerned that this feature may actually PRECLUDE a successful project from moving forward. That's clearly not anyone's intent, but could be an unfortunate unintended consequence.

Our understanding of AGIA is that expedited regulatory handling is offered only to the licensed project, and that the State can be penalized for assisting another competing project. We're concerned that this approach may actually conflict with Federal law and regulation, which favor competition among various project proposals and market involvement in the choice.

We think it wise that the State consider avoiding any notion of exclusivity or the government 'picking a winner'; I'm not aware of any example where that has worked successfully.

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We recognize that the Administration has, in good faith, laid out selection criteria under Section .170 to enable the selection of the exclusive winner in as transparent a way as possible.

So that leaves a fundamental question: Should the State pick an exclusive "winner" based only on a proposal? That approach gives us concern. We believe that the State can help to advance the project by setting out a clear framework for investors - from there the market will work to identify the most effective project

And we support open competition in the marketplace, rather than in advance of actual performance or before the competition actually starts

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In fact, the FERC requires that the market demonstrate that it wants that application before awarding a certificate to an applicant. That's what happens in a successful open season. We believe the Federal law

under [Alaska Natural Gas Pipeline Act of 2004] ANGPA offers a good model, in which expedited regulatory handling is provided to ANY project.

We certainly understand that from the State's perspective, there are a number of specific things desired from ANY project (jobs and training for Alaskans, gas access for Alaskans, pipeline expansions).

We support all of these objectives. Those objectives can and will be addressed by a successful project through open competition in the marketplace.

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REPRESENTATIVE ROSES asked for more clarification as to how market factors will help determine the best solution to actual performance if the performance is building a pipeline or expanding an existing pipeline. He questioned how this would work prior to establishment of a market.

MR. VAN TUYL clarified that he was referring to, as an example, "performance through conducting a successful open season" wherein a project sponsor does the work necessary to attract customers to assure a successful open season. He opined that this was the model under federal law.

REPRESENTATIVE ROSES asked if the open season should be held before there is a bidder on the project.

MR. VAN TUYL responded that he believes the best model would be to allow multiple projects to go forward so as to insure a successful open season. He opined that if only one entity is chosen, yet becomes unable to go forward to open season, it could result in a substantial project delay.

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CO-CHAIR GATTO commented that requests for proposals (RFPs) are a common business practice whereby proposals are evaluated. He opined that AGIA sets forth a procedure to allow the state to evaluate various proposals. He queried as to whether BP seeks an open process that allows applicants to come forth with any proposal they want.

MR. VAN TUYL said his suggestion is that the state allow companies to advance a project through actual performance in the marketplace. He opined that a successful open season will provide the information necessary to know if a proposed project will actually advance.

CO-CHAIR GATTO clarified that under the witness' description, bidders could choose which projects they were interested in during an open season.

MR. VAN TUYL agreed with the aforementioned scenario. He reminded the committee that the Alaska Natural Gas Pipeline Act of 2004 (ANGPA) provides for the federal government to grant expedited regulatory review of "any project." He said this encompasses the possibility that there will be multiple possible projects, and any one of them will receive expedited approval. He predicted that the customers will sign up for the project that gives them the best service.

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REPRESENTATIVE SEATON said he was trying to ascertain whether the state was setting the stage for a successful open season.

MR. VAN TUYL said that as a resource owner BP wants to have a successful open season so that the pipeline project can advance. He set forth that there are three components to establish the confidence needed to bid for firm transportation (FT) commitments and therefore assure a successful open season: knowledge of the resource rules, confidence that the open season sponsor can deliver the project offered, and an understanding of the commercial terms of the FT commitments. He opined that BP could advance a successful open season, but that there should be marketplace competition as "we don't have the market cornered on all the good ideas."

[1:57:14 PM](#)

MR. VAN TUYL paraphrased from written testimony [original punctuation modified slightly]:

A third area we suggest be considered carefully is that, although AGIA seeks to get a project moving, and we fully support that objective, it does not sufficiently address the resource framework, which is the key enabler for a financeable project.

That said, we are encouraged that AGIA recognizes at least in part, the importance of some of these key resource issues.

In Section .310 on page 19, AGIA seeks to address the issue of royalty valuation, which has been an historic source of conflict between industry and the State. But we are concerned that these terms do not provide sufficient clarity to justify making the firm transportation commitments required to underpin the project.

The royalty valuation provisions depend on future regulations; neither the shippers nor the legislature know what those regulations might say. The valuation regulations would allow for retroactive adjustments, and the regulations associated with RIV/RIK switching imply that "reasonable" disproportionate costs and "reasonable" interference with marketing is okay. I don't know what that means or how to evaluate that.

Also, these regulations may change every two years.

In Section .310(b)(3) on page 19 of the bill, AGIA seeks to address royalty issues associated with RIV/RIK switching which is incompatible with the long-term arrangements required to make a gas pipeline project happen (RIV = "royalty in value"; RIK = "royalty in kind"). RIV/RIK switching is problematic for at least two reasons:

[1:59:39 PM](#)

One is that if the State chooses to switch let us say from in-value to in-kind, the shipper would have to come up with additional gas to satisfy its customers in the marketplace.

The second problem is associated with obtaining the capacity on the pipeline if the State switches. For instance, if the State had originally elected to take gas in value, the shipper would have obtained the associated capacity to ship the State's associated share of gas. If the State then switched from in-value to in-kind, this could result in stranding downstream capacity, raising the question of who would pay for that cost of unused capacity.

Under AGIA, the specific solution to RIV/RIK switching is left to future regulation that, as I mentioned earlier, would allow for the lessee to bear disproportionate costs, and potentially interfere with long-term marketing.

AGIA includes a provision related to gas production tax in Section .320 on page 21. However, the gas production tax rate is not established, and only becomes known after the conclusion of the open season. A shipper would not know what the production tax is before having to make the FT commitment, which would be an incredible risk.

The gas production tax rate is then only established for a period of 10 years, which for reference is a fraction of the period that shippers will likely be required to make their firm transportation commitments.

[2:01:27 PM](#)

AGIA is silent as to the many other payments made to the State, which constitute the majority of industry payments. It is widely understood that the resource owners will pay the cost and bear the risk in building a pipeline whether they own it or not. Resource owners will pay all the costs of the pipeline, either directly or indirectly by reimbursing the pipeline owner through the tariff for the costs they incur.

[2:02:05 PM](#)

It's the RESOURCE that drives the construction of a basin-opening pipeline like this project, NOT the PIPELINE that drives the resource! Therefore, solving the resource issues with clarity is key to allowing a project to move forward.

Multi-billion dollar commitments spanning decades are needed to financially underpin this project;

Just like Wall Street needs to know the rules before lending money, resource owners need to know the fiscal rules that will govern the project before making

commitments that will enable the pipeline to be financed.

[2:02:44 PM](#)

Although this is widely known, the details of an upstream framework are complex and will take time and effort by both the State and the producers to agree - but unless they are addressed, a project won't secure financing; it won't advance.

MR. VAN TUYL clarified that the state is indeed a resource owner.

[2:03:13 PM](#)

REPRESENTATIVE SEATON asked about the benefit of establishing a gas production tax rate at the time of licensing, then for a three year period to cover open season, and with a guarantee in the bill that an initial shipper would get that same rate for a 10 year period.

MR. VAN TUYL agreed that certainty is good and that something like the aforementioned approach would be a step in the right direction. He said that other issues are the magnitude of the rate, and the prospect that the rate will change. He opined that it is important for an applicant to know that the rules will not change throughout the course of the project.

[2:04:51 PM](#)

REPRESENTATIVE SEATON asked for clarification regarding BP's concern with the royalty section, particularly with regard to the state switching how it takes its royalty share.

MR. VAN TUYL explained that BP's fundamental concern is that "the rules are not yet established." He agreed that the current lease terms with regard to switching between RIK and RIV are incompatible with a gas pipeline. He said that seeing this issue recognized in AGIA is encouraging, however BP has concerns with the nature of the solution. He explained that FT commitments may require BP to commit to capacity for decades, therefore the possibility that the state will switch its royalty between in-value and in-kind creates the risk of stranded capacity. He opined that it is possible to negotiate a solution to this issue that stabilizes the risk.

REPRESENTATIVE SEATON asked for more detail regarding acceptable terms.

MR. VAN TUYL offered that there are a number of ways to address risk. For instance, the state could be required to choose to take in-kind or in-value at the beginning of the project.

[2:08:46 PM](#)

REPRESENTATIVE SEATON asked whether the state's switching within an expansion, and for a qualified amount, would take care of the risk factor.

MR. VAN TUYL opined that "it is actually pretty complicated." In theory the parties can agree that the state would take responsibility for any stranded downstream capacity, however he offered that in actuality, this type of arrangement may actually violate FERC regulations since capacity must be posted for competitive bidding. He expressed skepticism that the parties could agree in advance that one party would receive another parties stranded capacity. He set forth that he does not have a solution to this issue regarding the royalty share short of the state setting forth at the beginning of the project a framework for what it intends to do with regard to its royalty share.

[2:10:34 PM](#)

MR. VAN TUYL paraphrased from written testimony [original punctuation modified slightly]:

The provisions of Sections .310 and .320 do not adequately address these upstream issues. To do so requires robust interaction.

Thus far, there have been some high level discussions between our senior management and the Governor. But we've been disappointed in the level of interaction with the Commissioners and their staff. That's where the problem will ultimately be solved. Over the last three weeks we've had three constructive discussions with one deputy Commissioner. That's a start. We would welcome the opportunity to increase the frequency and depth of dialogue with the Administration.

[2:11:31 PM](#)

What Is So Important About FT?

We've heard a fair amount, in this committee and others, about this term called "FT" which is short for firm transportation commitments. In listening to many of these hearings it seems to me that the nature of these commitments is not fully understood

However, these commitments are absolutely critical for a gas pipeline to be successful. Therefore, I thought I'd spend a moment hopefully adding a bit of clarity to the understanding of FT.

These commitments, typically obligations to "ship or pay" made by the resource owners or "shippers", are needed by the pipeline company to get financing. Validating just how important they are, we've heard some very simple and straightforward comments from pipeline companies who have testified in the past couple of weeks. TransCanada has said "No customers, no credit, no pipeline" (and in this context customers means shippers)

Enbridge put it even more simply by saying "No producers, no pipeline". Those aren't "political" statements. They are statements about the simple financial truths of gas pipeline projects

[2:12:56 PM](#)

FT is a binding FINANCIAL obligation. I've sometimes heard FT described as "committing gas to a pipeline". I've heard that quote from industry as well as others, so I'm not pointing any fingers here. But I just wanted to make it clear that FT is an actual financial obligation. Typically, FT is known as a "ship or pay" obligation. That means that a shipper commits to pay the pipeline company for use of its service whether or not the shipper actually delivers gas to the line

And it's also important to note that a company does not need to have ANY gas resources to enter into a firm transportation commitment. Any company who meets the creditworthiness standards set by the pipeline company is free to bid for capacity. Gas pipelines are "open access". Anyone is free to obtain capacity if they make the requisite commitments.

These FT commitments are real financial obligations. We are required to disclose these commitments as additional information with our filing with the SEC. Clearly, an FT of this magnitude will be taken into consideration by financial entities like banks when evaluating our company. That's because it's a real obligation.

Once these commitments are made to the pipeline, they are used by the pipeline to obtain financing from the financial markets, provide coverage for that financing, and a return for the pipeline.

[2:14:46 PM](#)

Maybe an example to explain the nature of these commitments would help. Let's say we've had a successful open season, the pipeline gets project financed, is built and it's in operation. Then, heaven forbid, for some reason the pipeline company goes bankrupt. Not what we're hoping for, for sure. But what would the lenders do? So they would turn to the FT commitments made by the shippers to get their repayment. And these FT commitments would indeed be paid to the lenders. That's because they are a REAL FINANCIAL COMMITMENT. They have to be properly taken into consideration when evaluating project economics.

The scale of these commitments is often oversimplified. It's not "just" the capital cost of the project, if that weren't in itself a large enough commitment. The commitment is for what is known as the "demand charge" which is the cost of service the pipeline will charge through time. Capital is one major component

But for illustration, I've provided some broad assumptions to put the scale of these commitments in perspective. Assuming a 4.5 bcfd project, at a unit cost of \$3.50/mcf for 25 years results in a total FT commitment of \$144 billion

[2:16:57 PM](#)

MR. VAN TUYL noted that \$144 billion is a huge sum, even for a company the size of BP. He reminded the committee the FT costs

can be three to four times more than the cost of the pipeline. He responded to a question by explaining that FT commitment terms vary from project to project. Sometimes in an open season the term can be used "as a differentiation where that is bid." The rate may vary depending on the terms of the FT commitments, with a higher rate for shorter terms, he explained. He indicated that the Alaska project will likely require fairly long term FT commitments of 25 or more years, which he characterized as fairly long term. He indicated that a more usual FT commitment term is around 15 to 20 years.

[2:18:44 PM](#)

CO-CHAIR GATTO asked whether FT commitments are based on time, or other terms, such as volume.

MR. VAN TUYL responded that in a typical FT commitment a company reserves a specific amount of pipeline capacity for a specified period. He said it is possible there are forms of FT commitment that relate only to volume.

MR. VAN TUYL responded to a question regarding the size of the pipeline project by explaining that this project was studied several years ago. At that time BP considered the issue of the size of the pipe and came to the conclusion that the rate of around 4.5 billion cubic feet per day (Bcfd) was a good balance between commercial viability and expandability. He explained that at 4.5 Bcfd, there would be an opportunity with a 52 inch pipe to expand it at a rate not to exceed the initial rate.

[2:21:00 PM](#)

CO-CHAIR GATTO asked whether there is a minimum pipe size for this project.

MR. VAN TUYL replied that a smaller diameter simply does not have the through-put necessary to lower the unit cost to a level that makes it viable to get gas off the slope. He said a 48 to 52 inch size is "sort of what we were looking at."

CO-CHAIR GATTO offered that it may be difficult to compare very different proposals, which is why AGIA has some "sideboards" to somewhat limit the proposals so that they can be more easily compared.

[2:22:58 PM](#)

MR. VAN TUYL said he has some concerns about requiring too much specificity early on because very often the project details are determined based on the outcome of the open season. For example, if there is more demand than anticipated, the pipeline size may have to be increased, he said.

[2:24:02 PM](#)

REPRESENTATIVE ROSES set forth that his understanding of the aforementioned discussion is that the project license may be awarded based on a proposal, but then the open season may dictate a larger or smaller pipe than set forth in the original proposal. He queried as to how the state could be assured that the successful proposal was actually the best one if it later has to be re-designed based on the results of the open season. He offered that perhaps a different applicant may have done better research to more accurately predict the outcome of an open season, but that applicant would be foreclosed from proceeding once the license was awarded to a different applicant.

MR. VAN TUYL said that the aforementioned scenario is also of concern to BP. He predicted that the best pipeline project plan will become clear after open season - at that point the state will know what the best solution is, he opined.

MR. VAN TUYL responded to a question by explaining that he is unaware of the shortest and longest terms of BP's FT commitments, but he does know that the terms vary.

[2:26:43 PM](#)

REPRESENTATIVE GUTTENBERG asked for more clarity regarding the statement that the market will determine the best project through actual performance.

MR. VAN TUYL replied that an example of actual performance would be a project that conducts a successful open season. He indicated that the open season approach is the "mechanism for gas pipeline projects in the U.S." He said that projects come together when customers and the project sponsor come together to demonstrate their commitment through the open season process. He said he is not sure how many open seasons BP has participated in, however, he could get further information on this.

[2:27:58 PM](#)

MR. VAN TUYL responded to a question by opining that the state is entitled to pick a project and to provide financial support to the licensee. He suggested that a better approach would be to allow multiple parties to proceed to open season and allow the result of the open season itself to determine which company has the best project. He opined that this approach would provide a greater likelihood that the pipeline will actually be built because the project will have demonstrated market viability through actual performance.

[2:29:50 PM](#)

REPRESENTATIVE WILSON noted that sometimes open season are not successful.

MR. VAN TUYL agreed it is possible to have an unsuccessful open season. He suggested that there are a couple of key ingredients for a successful open season. First, certainty regarding resource terms gives the resource owners the confidence necessary to enter into FT commitments. Furthermore, potential customers must have confidence that the sponsor has the ability to deliver on the services offered. Another factor is the nature of the commitments themselves, he explained.

[2:31:24 PM](#)

CO-CHAIR JOHNSON asked about a situation where one or more companies participated in a competing open season, and how much it would likely cost to get to open season.

MR. VAN TUYL replied that there have been situations where multiple sponsors have advanced their projects at an open season. The cost of getting to an open season depends on the nature of the open season, he said. He estimated it would take 18 months to 2 years to get to open season for the Alaska gas pipeline project, and would cost "hundreds of millions" of dollars. He explained that the time and high cost is due to the need to obtain environmental information and to conduct a "bottoms up" cost estimate. He opined that this research is necessary to allow for a full understanding of the project prior to open season.

[2:33:24 PM](#)

CO-CHAIR JOHNSON asked whether it would help or hinder competition to have more than one company prepare for and participate in an open season. He expressed some concern as to

whether it would be reasonable to expect companies to invest time and money despite the risk of not being chosen as the project sponsor.

MR. VAN TUYL responded that it would be preferable for the parties to cooperate so as to advance the project. He opined that this is why FERC expedites regulatory handling of any project.

CO-CHAIR GATTO asked about the costs of open season should each company proceed separately.

MR. VAN TUYL opined that it was highly unlikely that each company would individually spend hundreds of millions to get to open season. It would be more likely that the parties would cooperate to find a way to advance the project.

[2:35:11 PM](#)

REPRESENTATIVE SEATON asked whether anything has prevented the producers from working together to plan a project and hold an open season. He expressed some skepticism about competing bidders for open season since to date no companies have proceeded in this direction on their own.

MR. VAN TUYL agreed with the aforementioned comment and stated that the single most enabling ingredient would be to establish "resource terms with clarity." He opined that:

"if that was done then the resource owners, such as BP, would clearly be motivated to do just what you are describing and advance ... to open season. It is the resource that will pull the pipeline project along, not the other way around. Once those resource terms are known, then the framework is set for a successful open season.

[2:36:40 PM](#)

REPRESENTATIVE SEATON observed that work on oil production taxes during last year's legislative session was to establish known resource terms. He suggested that now the terms are known, but apparently not liked. He expressed continued concern with why the producers appear to be reluctant to set forth an open season proposal on their own.

MR. VAN TUYL replied that the process that has been laid out by the administration is AGIA, which is why BP is working within that framework. He said if there was another process proposed, BP would work within that framework.

[2:37:52 PM](#)

REPRESENTATIVE WILSON summarized that BP wants the pipeline and is waiting for the state to "put something forward so that we can address that."

MR. VAN TUYL agreed that BP would very much like to have a pipeline to monetize its gas resource. He reiterated that the key enabler is an understanding of the rules governing the resource over the long term. He stated that since the current framework to establish the enabling factors is AGIA, BP is providing comments regarding whether AGIA establishes the necessary enabling factors.

[2:38:58 PM](#)

REPRESENTATIVE WILSON asked about the benefits to BP of being an owner or part owner of the pipeline, especially since pipeline returns are regulated.

MR. VAN TUYL responded that there are a number of reasons why BP would like to be an owner in the pipeline. First is that BP has world-wide experience in delivering mega-projects and is confident it could manage the risks associated with this large project. Second, as a resource owner, it is in BP's best interest to deliver the resource for the lowest cost possible. He noted that although the pipeline itself would be limited to a regulated rate of return, FT commitments will have to be made. These commitments represent a "significant sum of money" when made to a third party, he explained. He offered that information presented by the administration showing a potential high rate of return on the pipeline neglected to consider the cost of FT commitments. He responded to a further question regarding BP's desire to build the pipeline by emphasizing that BP has the experience and the commercial motivation to deliver it at the lowest cost possible. A company that is not a resource owner receives its revenue from the project's rate base, he opined. He explained that any developer will want customers, but indicated that the economic motivations vary depending on whether the developer is an independent pipeline company or the resource owner. He opined that in the latter

case there is more motivation to deliver the gas at the lowest cost possible.

[2:43:26 PM](#)

CO-CHAIR GATTO referred to an issue of The Bernstein Report which concluded that BP and other producers have project management problems regarding pipeline construction management. Based on this, he asked why the state should want the producers to oversee the pipeline project.

MR. VAN TUYL characterized the aforementioned comment as a "bit of a simplification" of what the report says. He went on to say that BP has developed some of the more challenging projects "across the globe." He noted that BP has completed a pipeline in the Caspian Sea area that had political and technical challenges. He observed that although BP does not have the market cornered on good ideas or project delivery, it "clearly has a unique motivation as a resource owner "to do the best job possible to deliver the project at a low cost."

[2:46:29 PM](#)

REPRESENTATIVE ROSES asked why it would cost \$400 to \$500 million for BP to get to an open season for the Alaska gas pipeline project in light of its significant experience with difficult projects worldwide.

MR. VAN TUYL agreed that it would take this kind of money because the Alaska project does not necessarily require "learning what we already know." He said that in 2001 BP studied and "literally walked" the possible Alaska gas pipeline route to gather information on the environment. This effort cost \$125 million and will likely need to be repeated in more detail. Additionally, BP will have to do a "bottoms up" cost study of the project, which is very costly.

[2:48:35 PM](#)

CO-CHAIR JOHNSON asked about the effect of the state contributing \$500 million towards preparation for open season, then providing information to potential pipeline sponsors.

MR. VAN TUYL said that would be a state policy call. He suggested that industry participants, whether they be producers or others, are best suited to plan and execute studies necessary prior to an open season. He responded to further inquiry by

stating that BP "would be more than happy" to put forth the money and effort necessary to prepare for an open season provided it had confidence in the resource terms. He explained that BP "would place a high premium" on needing confidence that the work and engineering done to prepare for an open season meets its needs and standards.

[2:51:29 PM](#)

MR. VAN TUYL continued to discuss FT commitments and other aspects of the pipeline by paraphrasing from written testimony [original punctuation modified slightly]:

These long term commitments are just that - commitments. Therefore, they represent real risk. And the size of these commitments magnifies the risk. And that risk is borne by those making the commitments. This next slide [slide 9] attempts to show how risk is ultimately allocated in a major resource development project like the Alaska Gas Pipeline Project. I'm going to step through it one bit at a time.

First, we start with the Resource Owners - that's of course the State of Alaska, and it includes the lessees, like BP, CP, EM, Chevron, and others.

[2:52:22 PM](#)

There are certain risks that are inherent to the resource itself. There is always price risk associated with selling a commodity like gas:

That's the risk that the price of gas will fall in the future, possibly below the tariff.

There's also production risk

Keeping the pipeline full for project life

Being able to deliver the full volume every day

These risks are important considerations when a resource owner has to make the firm transportation commitments necessary to underpin the project

[2:53:07 PM](#)

Next, there's fiscal risk for a lessee; that's the risk that the fiscal terms on the upstream business might change. On major infrastructure projects like this around the world, it's not uncommon for host governments to address fiscal risk with a mutually agreed framework.

There are also a whole host of risks associated with constructing the pipeline itself:

Regulatory process could change - schedule risk

Material, labor, and equipment costs - cost risk, which includes project management and execution

Need for finances from the capital markets - finance risk

[2:54:21 PM](#)

What is critical to appreciate is that all these project-related risks that are taken by the pipeline company are ultimately passed through to the resource owners through the toll. The pipeline company receives a regulated rate of return and gets a reasonable return on investment commensurate with the risks.

In exchange for this regulated rate of return, the regulators ensure that the pipeline does not take on certain risks. These instead are passed through to the resource owners, provided that the pipeline owner delivers the project on time and operated efficiently. That's how the risk / reward balance is struck by the pipeline regulators

So ultimately, ALL RISKS are either borne directly by the resource owners, or are passed through to the resource owners through the toll. To ensure a low cost project, it's important that those that are bearing a risk are able to manage that risk. They are commercially motivated to manage that risk downwards

To reiterate, it's critical that the fiscal system is established in such a way that the risks associated with the resource or "upstream" are adequately

addressed to ensure the risk / reward balance is right. That will maximize the likelihood of having a successful open season and a successful project. The State is uniquely positioned to address this risk.

2:55:44 PM

So in summary, I'd like to leave you with four messages. First, BP wants and needs a gas pipeline. It's critical to our vision of the 50-year future in Alaska. Second, BP fully supports an open process that leads to a mutually agreed fiscal framework with the State that allows a project to advance and attract financing.

We think there should be an open and transparent public review of the resulting framework. The Governor has already committed to keep the legislature and the public apprised - we fully support her in that. It is critical that the legislature supports and endorses that framework. The judicial branch should review that framework to ensure constitutionality. The people of Alaska and all 3 branches of government should and will be consulted. We think that the resulting framework should be available to all investors to ensure competition.

Third, we believe that a number of midstream details in AGIA should be fixed. We think the best project will come about if the State allows industry to offer solutions, rather than prescribing them up front. The provisions which result in rate subsidies of one party to another should be eliminated. Any notion of exclusivity or the government 'picking a winner' like those contained in Sections .260 and .440 should be avoided. Any process should allow competition in the marketplace to work. It is easy to make hopeful promises but it is harder, and vitally important, to deliver performance. That is what we believe the State should require -Delivery, not promises.

And finally, mutually agreeing to an upstream framework is critical. The resource issues must be resolved for the project to proceed and to ensure the resource owners have sufficient confidence to make the necessary long term financial commitments in an open

season required to advance the project. Section .310 and .320 of AGIA do not accomplish this objective.

MR. VAN TUYL concluded by stating that BP is ready to engage in developing the necessary upstream framework.

[2:58:18 PM](#)

REPRESENTATIVE ROSES asked whether it is a fair assessment to conclude BP would not bid on the gas pipeline project based on the current terms of AGIA.

MR. VAN TUYL said that BP would like to bid, but would not under the current terms of AGIA.

[2:58:58 PM](#)

MR. VAN TUYL responded to a question about the FT commitments by explaining that longer term transportation commitments have lower risks and tolls, which results in a higher netback. He suggested that it would increase the risk of financing to shorten the FT commitment terms. He said that BP's financiers have indicated that a FT commitment terms of only 10 years for this project will probably not qualify for financing.

[3:00:23 PM](#)

CO-CHAIR GATTO asked about methods to accomplish long-term financial stability.

MR. VAN TUYL responded that there are any number of ways that certainty can be structured. He noted that project finance can be complicated, but that there are a number of ways to approach it.

[3:01:35 PM](#)

REPRESENTATIVE SEATON asked about the possible effects of legislation regarding carbon dioxide emissions on the tariff.

MR. VAN TUYL replied that it would increase the tariff, although he is unaware of the magnitude of that increase. He suggested that applicants could be required to address greenhouse gas issues and possible effects of carbon credit legislation.

[3:04:31 PM](#)

REPRESENTATIVE WILSON asked exactly what BP means when it says the resource terms must be clear.

MR. VAN TUYL answered that "exactly what I mean is the rules ... that define the payments that we make to the government" be specified "for a long period." He explained that he meant taxes and BP would seek as much certainty as possible with regard to all taxes. He said he cannot offer a specific ultimatum, but indicated that there could be any number of potential solutions to the issue of certainty of resource terms.

[3:06:54 PM](#)

REPRESENTATIVE WILSON offered her understanding that the witness said BP would not be submitting an application. Based on that, she asked what the state needs to do to get BP to submit an application.

MR. VAN TUYL replied that "if he said that" he may have misspoken. He explained that BP would like to be in a place where it could submit an application and he offered that if changes were made to AGIA, BP would be able to submit an application. He indicated that BP would like to propose its resource terms in the application so that the state could examine BP's application to determine whether the terms were acceptable.

[3:07:36 PM](#)

REPRESENTATIVE GUTTENBERG asked what BP looks for in its rate of return. Second, he asked about the value of retaining basin control.

MR. VAN TUYL replied that basin is actually controlled by the regulator of the pipeline, in this case FERC due to the interstate nature of the pipeline. He said that under FERC the pipeline would have "open access" to bidders during open season. He suggested that it is unclear who will receive access to the pipe in the course of competitive bidding as required by FERC. As to the successful rate of return, he explained that companies look at a "whole host of economic indicators" to determine the pipeline's risk.

[3:09:56 PM](#)

REPRESENTATIVE SEATON asked about the factors that influence the pipeline's rate of return, such as the amount of equity in the

pipeline. He noted that negotiated rates could be 85 percent of the maximum recourse rates and queried about how this could affect the pipeline owner's rate of return.

MR. VAN TUYL answered that the shortest answer is that it depends on the specific structure of the negotiated rate. He agreed that it is possible that a negotiated rate of 85 percent could reduce the rate that the pipeline operator would receive. He responded to a question by reminding members that FERC will establish a maximum recourse rate to insure that the rates are just and reasonable. He explained that FERC allows parties to negotiate rates that could be less than the maximum recourse rates.

The committee took an at ease from [3:15:11 PM](#) to [3:31:03 PM](#).

[3:31:22 PM](#)

WILLIAM M. WALKER, Project Manager, General Counsel, Alaska Gasline Port Authority (AGPA) provided the committee with a PowerPoint presentation. He stated that in general the AGPA views the open and transparent process of AGIA favorably. He opined that AGIA "has a much better feel" than the prior Stranded Gas Development Act (SGDA).

PAUL FUHS, Lobbyist, Alaska Gasline Port Authority, opined that prior testimony indicated a desire by the producers to return to a process more like the SGDA.

[3:36:53 PM](#)

MR. WALKER reminded the committee the AGPA was formed under state statute to encourage development of Alaska's gas. He noted that a stable and secure energy source is critical to Alaska residents. He explained that AGPA would share its revenue as directed by statute- 60 percent to the state, 30 percent to municipalities, and 10 percent to energy related benefits for rural Alaska.

MR. FUHS noted AGPA is a non-profit organization created to create a public service. However, it must take in some revenue to allow it to take on debt. The aforementioned comment concerns the revenue surplus over AGPA's debt service.

MR. WALKER said that AGPA considers supply of gas to in-state markets a high priority. He said that AGPA supports use of some gas liquids for the in-state market and market optionality for

Alaska's gas. He explained it is important to maximize market options.

[3:43:25 PM](#)

CO-CHAIR GATTO asked for further explanation of whether debt is deducted prior to disbursement of the direct net-profit revenue sharing split.

MR. WALKER explained that the debt comes out prior to revenue sharing payments. In response to a question regarding gas liquids, he explained that there would be a fractionation facility in Valdez to take the propane and liquids out to be shipped separately from the liquefied natural gas (LNG). He said the volume shipped is the product not needed for in-state use. He explained that the liquids would be shipped separately from the LNG.

[3:44:39 PM](#)

MR. WALKER referred to slide 4 and emphasized that AGPA would act as a facilitator for any gas pipeline project. He offered that "world class" companies would be doing the actual pipeline work. He explained that AGPA has been working with various companies to obtain cost estimates.

MR. FUHS offered that it is not necessary for the resource owner to take the risk in building a pipeline. Instead, a customer may make a long term commitment to buy the gas.

MR. WALKER explained that AGPA plans to build a 48 inch pipeline from Prudhoe Bay to Valdez, with a pre-build to Delta Junction for later tie-in with the Alaska/Canada highway project. In response to a question, he explained that "gas conditioning" is different from a gas treatment plant (GTP). In the conditioning process, the gas is cooled to ready it for input into the pipeline.

[3:50:04 PM](#)

REPRESENTATIVE SEATON asked whether the gas conditioning aspect of AGPA's project is the same as the GTP considered in the other proposed gas pipeline projects.

MR. WALKER answered that the aforementioned statement is correct. He said AGPA is prepared to pay a toll for gas treatment costs, or to build a GTP.

MR. FUHS responded to an inquiry regarding the difference between a GTP and gas conditioning by explaining that they are very similar processes. He explained that construction requires similar construction techniques. He said the producers planned project may be larger.

[3:51:41 PM](#)

CO-CHAIR GATTO asked if the treatment was to produce pipeline grade gas.

MR. WALKER replied that pipeline grade product will be coming out of the LNG after the propane is removed. He said there would be an LNG facility and storage capability at Valdez.

[3:53:26 PM](#)

MR. WALKER estimated projects costs for the AGPA approach as around \$10 billion. He said that one cannot have a loan guarantee and tax exempt financing at the same time. He said that the federal government loan terms would guarantee 80 percent of the project amount not to exceed \$18 billion dollars. He said that the project route is well-known, and has received numerous permits, including an approved environmental impact statement.

[3:55:21 PM](#)

REPRESENTATIVE WILSON asked if AGPA suggests building an all-Alaska route.

MR. WALKER said that the AGPA project is not to the exclusion of the Canadian route and that the project would allow a later line to Canada.

REPRESENTATIVE WILSON asked whether construction of the smaller project proposed by AGPA would make a larger line out of Prudhoe Bay uneconomic. She asked what would happened if there was not a Canadian line.

MR. WALKER opined that he does not think the AGPA proposal would have the aforementioned effect. He explained that the larger projects proposed will require further exploration to find adequate gas reserves. He opined that the first 550 miles of the line would be the most expensive, and could help in a later, larger project. With respect to a Canadian line, he indicated

that he thinks the AGPA pre-build to Delta Junction would improve the economics for a Canadian line. He characterized the AGPA project as providing benefits to both the producers and the state if the pre-build aspect is built first.

[3:59:58 PM](#)

REPRESENTATIVE WILSON asked what size of project and pipe AGPA was considering.

MR. WALKER explained that "our base case is a 1.2 Bcf [billion cubic feet] project." He estimated maximum in-state use as "point five," which adds up to a project size of 1.7 to 2 Bcf. Their project contemplates a pipe size of 48 inches, he said.

REPRESENTATIVE WILSON asked about the possibility that the producers would not come to an open season due to concerns that the AGPA project would jeopardize a larger project.

MR. WALKER characterized the above point as a good question, and went on to say that AGPA would continue to attempt to acquire gas from them. He said that AGPA's reading of the leases is that there is an obligation to sell the gas. He opined that the producers are obligated to sell their gas "if there is a reasonable expectation of profit" and that they would "sell the gas into a project." He reminded the committee "that the volume of gas we are talking about" is within the volume of gas that is currently being re-injected, and that there is a cost to re-injecting gas.

[4:03:28 PM](#)

MR. FUHS agreed that one issue is what is the right size for this project. He noted that as of yet, there has not been a request of the Alaska Oil and Gas Conservation Commission (AOGCC) as to how much gas can actually be taken off the North Slope. He indicated that the current estimate is that 2.7 Bcf could be removed from the North Slope without creating catastrophic oil loss. He cautioned that a project size of 4.3 Bcf is not possible absent discovery of additional gas, a process that can cost tens of billions of dollars. He suggested there are benefits to looking at a smaller project with a quicker time line, a lower risk profile, and within the already known reserves.

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MR. WALKER responded to a question about an anti-trust lawsuit filed by AGPA by explaining that AGPA dismissed the litigation shortly after the current administration came into office. He stated that the AGPA is serious about doing a project, and felt that the prior administration's approach to the gas pipeline left it with little choice but to pursue an anti-trust claims.

MR. WALKER continued by explaining that AGPA has recently updated its cost estimates for the project and has entered an memorandum of understanding (MOU) with Mitsu OSK lines for shipping. He emphasized the importance of multiple markets and indicated that there have been inquiries from Hawaii, the West Coast of the United States, and Pacific Rim countries.

MR. WALKER explained that there are a variety of factors to consider in financing and reminded the committee that federal loan guarantees now apply to an LNG project and are very helpful. He said that Yukon-Pacific Corporation has spent about \$100 million, while AGPA has spent around \$125 to \$135 million, including spending by contractors and other entities.

[4:11:07 PM](#)

CO-CHAIR GATTO asked where the \$100 million came from and whether it was covered by the loan guarantees.

MR. WALKER explained that was from CSX corporation, when "they funded they owned Yukon-Pacific Corporation for 20 years, and that is what they put in ... acquiring the route" and other work done with respect to the project. He said this was done long before the loan guarantees were available.

MR. FUHS noted that AGPA has a significant time advantage in its approach due to the work and permits already done.

[4:12:09 PM](#)

MR. WALKER explained that this project would likely be done on a project finance basis. Under this approach, entities come together and obtain financing based on the strength of the project. He explained that non-recourse financing would "not be tied to the balance sheet" of the companies. He said that FT commitments are important to the project, but that they are not the only pieces, there are other important pieces as well. He opined that the biggest risk in project finance is a completion guarantee. He emphasized that this is an infrastructure project that should allow for maximum use and expansion.

4:16:14 PM

MR. WALKER addressed the issue of risk mitigation by opining that proximity to the Trans-Alaska Pipeline System (TAPS) line minimizes risk due to proximity and existing infrastructure. He explained that the gas pipeline would be thicker, and thus heavier, than that of TAPS. He was not sure of the exact thickness, or whether infrastructure would have to be upgraded to carry a heavier pipeline.

MR. FUHS said the Department of Transportation examined this issue based on a 52 inch pipe, and concluded some bridges would have to be upgraded.

MR. WALKER offered that Alaska's cold weather makes a LNG plant more efficient to run and that the marine transportation system offers a known shipping system. He said that the "highest unknown" is the pipeline itself.

4:19:22 PM

REPRESENTATIVE ROSES asked about the amount of product loss with liquefaction and re-gasification.

MR. WALKER answered that approximately 5.5 percent of the volume is lost due to these processes. He indicated that this is the fuel cost, not the amount of leakage.

MR. FUHS stated that some product is burned by the LNG tankers for fuel.

REPRESENTATIVE ROSES asked if the only gas lost is the gas used as an energy source when converting gas to liquid.

MR. WALKER explained there is not really a loss, but some fuel must be consumed to go through the process of converting the gas to liquid.

REPRESENTATIVE ROSES expressed some skepticism with the figure of 5.5 percent as it is the lowest percentage he has heard, noting that other companies have estimated the product loss as around 11 to 14 percent.

MR. FUHS indicated that he could provide additional information to confirm or clarify this figure.

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MR. WALKER opined that the greatest risk facing the project is that Alaska will lose the United States market for LNG to projects from elsewhere. He suggested that there are LNG projects being designed worldwide and that these projects may be complete prior to the Alaska project should the delays continue. AGPA is also concerned about the possibility that the federal government will take away the \$18 million loan guarantee if no one applies for it. He noted that construction costs are constantly increasing. This is why the AGPA is pushing for the right size project in a timely fashion, he explained.

MR. WALKER relayed his belief that an LNG project is economic and projects a rate of return in excess of 30 percent to the upstream producers. He said it provides gas to Alaskans sooner and still enhances the possibility of a later, larger project going through Canada.

[4:28:31 PM](#)

REPRESENTATIVE GUTTENBERG asked about the role of FERC and the RCA in this project.

MR. WALKER responded that the AGPA has been advised that if the gas is sold at Valdez, the project may be exempt from FERC oversight. However, if "we held on to the gas" through liquefaction and shipping, then "clearly we would be regulated by FERC." He opined that one must consider various factors to determine whether it is better or not to be exempt from FERC oversight.

[4:31:26 PM](#)

CO-CHAIR GATTO noted that whoever owns the gas for shipping is likely to come under the authority of FERC.

MR. WALKER agreed that once the gas comes back into the United States it would be regulated by FERC. He indicated that AGPA would determine the best approach regardless of whether it would involve FERC regulation. In response to a question, he said he was not sure whether the volume of LNG imported to the United States was down last year. He did indicate that some other LNG projects have been slowed down due to "other issues."

CO-CHAIR GATTO asked whether any re-gasification terminals are operating at full efficiency.

MR. WALKER replied that AGPA has not tracked the efficiency of existing facilities. He said that the initial market for their project is the West Coast and currently no LNG receiving terminal on the West Coast is in operation. He noted that recent hurricanes show the need for LNG facilities in areas besides the Gulf Coast.

MR. FUHS reminded the committee the AGPA is tax exempt, and that can be a benefit. He noted that one cannot be tax exempt and receive a federal loan guarantee.

MR. WALKER clarified that there cannot be tax-exempt financing and a loan guarantee, and indicated that there is no conflict between tax-exempt status and a federal loan guarantee.

[4:36:11 PM](#)

REPRESENTATIVE WILSON asked whether there is a limit to the federal loan guarantees and if they could be used for the Alaska portion and a later Canadian portion of the gas pipeline.

MR. WALKER explained that the federal loan guarantees apply for up to 80 percent of a project up to \$18 billion. It would apply to only one project, and he is not sure if it would apply to a subsequent Canadian line.

[4:37:56 PM](#)

CO-CHAIR GATTO referred to information dated January 2007 from the Energy Information Administration which indicated that the volume of LNG imports has decreased the last two years.

MR. WALKER reminded the committee that the AGPA project is planned to begin around 2013 or 2014. He noted that issues regarding tanker costs are part of the entire project economics.

MR. WALKER summarized that there are many benefits to an LNG project, referring to slide 11. He opined that there is enough gas for the planned AGPA LNG project and that this smaller project will allow Alaska's gas to reach the market sooner.

[4:46:26 PM](#)

CO-CHAIR GATTO asked if the AGPA project would "touch Point Thomson" and whether the amount of known Prudhoe Bay reserves is sufficient for this project.

MR. WALKER supplied that "this would not necessarily effect Point Thompson," although the volume of gas available there is enough for this project. He also said AGPA would not need Point Thomson, which he described as having "more unknowns" than Prudhoe Bay.

[4:47:22 PM](#)

MR. WALKER suggested that there be some amendments made to AGIA. First, he noted that AGIA requires an applicant to provide a great amount of detail regarding any proposed LNG project and suggested that a similar level of detail be required from Canadian line applicants. Second, he offered that any applicant should provide details regarding any additional gas off-take over what is currently authorized by AOGCC. Furthermore, any applicants should be required to provide a budget and timeline for future exploration, an analysis of anticipated oil loss should off-take from Prudhoe Bay be increased, and an analysis of how much liquid would be available in Alaska for value added processing.

[4:49:19 PM](#)

REPRESENTATIVE ROSES asked whether these suggested amendments are related to the fact that AGPA proposes an all-Alaska project.

MR. WALKER sought to assure the committee that AGPA does not seek to stop any project, however, he characterized the additional information suggested as very helpful in analyzing the viability of any project. He opined that absent additional information, it would be possible for the state to select a project that requires more gas off-take than authorized by the AOGCC.

[4:51:49 PM](#)

REPRESENTATIVE ROSES stated that there are unknowns, such as how much gas will be committed at open season, and opined that line capacity is a similar issue.

MR. WALKER replied that the project should be defined as to what it takes to be economic before the open season. He offered that prior to open season, any applicant should know if it can take the volume of gas required for its project from the North Slope.

[4:53:30 PM](#)

REPRESENTATIVE ROSES asked whether it would be advantageous for Alaska to have an open season prior to asking for a design and project bid.

MR. WALKER said that AGPA is suggesting that applicants be required to submit an application to "start the process" required to increase off-take limits should the planned project require more gas off-take than is currently authorized.

MR. WALKER continued by explaining that AGPA also suggests inclusion of a timeline for project start up and completion and current project costs estimates. He went on to say "we fully support rolled-in rates", noting that such a system has been successful in Canada. He opined that AGIA allows for independently owned infrastructure.

[4:58:56 PM](#)

CO-CHAIR GATTO asked how much revenue the state would receive under the AGPA proposal.

MR. WALKER replied that six percent is "on top" of what would go to the state under "anybody's project." In response to a further question, he said he does not have an exact revenue amount, but could provide that information.

CO-CHAIR GATTO noted that all the projects seem to require consideration of assumptions and that since the state is looking for revenue, additional information on possible revenue would be helpful.

[5:00:34 PM](#)

MR. WALKER responded to a question regarding the way revenues are determined by stating that the AGPA may be willing to enter a long-term contract with the state to "lock that in" so that option is not available. In response to a query about the likelihood of increased rates, he offered that the AGPA is not looking for a certain rate of return, rather it "wants the project to happen" to provide energy and jobs to Alaska.

CO-CHAIR GATTO asked about the number of permanent jobs under the AGPA proposal compared to the number of permanent jobs should the gas pipeline go through Canada.

MR. WALKER replied that "it would be greater because of liquefaction," which he characterized as labor intensive.

5:02:52 PM

REPRESENTATIVE SEATON characterized some of the suggested amendments as more appropriately included as part of the commissioners' evaluation criteria rather than as part of the state's initial "must haves."

MR. WALKER replied "it could be used either way." He stated that the concerns brought up by AGPA are to make it clear that there should be concern regarding the amount of gas that is currently authorized for off-take from Prudhoe Bay.

REPRESENTATIVE SEATON stated that his understanding is that proposals will be evaluated to determine which one provides the greatest benefit to the state. He questioned whether the AGPA project would provide any corporate or municipal tax benefits and if not, how the AGPA project would compare to one that pays taxes.

MR. WALKER said that "the actual model we run now is a taxable model," and that the project still sets forth "robust economics." He suggested that AGPA could provide further information on this.

5:06:36 PM

REPRESENTATIVE SEATON characterized this issue as quite important because the commissioners will be comparing and evaluating proposals side-by-side. He asked if the AGPA takes issue with any of the "must have" criteria set forth in AGIA.

MR. WALKER answered that AGPA is pleased with the "must haves" and that none of them cause it any particular concern. He clarified that AGPA proposes to pay taxes of 20 mils, which is the same as TAPS pays.

5:09:14 PM

REPRESENTATIVE ROSES referred to AS 43.90.130(16) whereby applicants waive their right to appeal, and asked whether that provision gives AGPA any cause for concern.

MR. WALKER stated that AGPA is comfortable with the process of AGIA and would likely be comfortable with the ultimate decision made.

5:10:08 PM

MR. FUHS suggested an amendment to AS 43.90.210 regarding amendments or modification to the project plans. He said that an applicant should be allowed to suggest changes that would provide additional value or benefits to the state.

CO-CHAIR GATTO suggested that the language as written would allow modifications to the plan.

MR. FUHS opined that the language would need to be modified to allow an applicant more flexibility to suggest modifications to add benefits to the project.

MR. WALKER answered a question regarding federal income taxes, by explaining that there could be a scenario whereby the AGPA would be subject to federal taxes.

MR. FUHS clarified that AGPA can make revenue, but must spend it for a public purpose.

5:14:35 PM

MR. WALKER responded to a question about the Jones Act by explaining that it requires that shipments between U.S. ports must be on vessels built and flagged in the United States. He suggested that AGPA does not need that act amended for its project because there are eight qualified LNG tankers that will become available in 2013. He indicated that some ships may need to be re-flagged. He opined that the AGPA project does not "have a Jones Act problem."

CO-CHAIR GATTO asked about why tankers would be available in 2013.

MR. WALKER replied that they are currently under contract and the contracts come due in 2013, so they could be available for other purposes. He said AGPA is currently in the process of working to secure shipping capacity.

MR. FUHS threw out that the AGIA process will help negotiations with other interested parties once the applications are out.

[5:19:07 PM](#)

MR. WALKER responded to a question by stating the AGPA has been advised that the LNG tankers referred to "will be good to go" and will not require re-fitting.

CO-CHAIR JOHNSON asked if LNG tankers are double-hulled.

MR. WALKER said that LNG is different from oil and AGPA has not found any reason to need double hulled tankers for transport.

MR. FUHS opined that in a liquid form LNG is quite stable.

[5:21:57 PM](#)

REPRESENTATIVE SEATON asked about the amount of carbon emissions from the project, the amount of energy needed to operate the pipeline and possible alternatives on how to run the pipeline.

MR. WALKER indicated that those issues are currently being reviewed.

CO-CHAIR GATTO expressed some skepticism regarding the ease of re-flagging a tanker.

MR. WALKER said AGPA has been advised that re-flagging may be an easier process if the ship was built in the United States. He said that the age of the ships has been considered and that AGPA can provide further information on this. He offered that there may be a shipyard in San Diego that could build an LNG tanker. He inferred that a United States shipyard has not built an LNG tanker since the 1970s.

[HB 177 was held in committee.]

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at [5:28:34 PM](#).