

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

April 20, 2007

1:07 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Vic Kohring

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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04/16/07	(H)	RES AT 1:00 PM BARNES 124
04/16/07	(H)	Heard & Held
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04/18/07	(H)	RES AT 1:00 PM BARNES 124
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04/19/07	(H)	RES AT 1:00 PM BARNES 124
04/19/07	(H)	Heard & Held
04/19/07	(H)	MINUTE(RES)
04/20/07	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

JOHN KATZ, Deputy Associate General Counsel for Energy Projects
 Federal Energy Regulatory Commission
 Department of Energy
 Washington, DC

POSITION STATEMENT: Provided a brief overview of the Federal Energy Regulatory Commission and answered questions.

JACQUELINE HOLMES, Associate General Counsel for Energy Projects
 Federal Energy Regulatory Commission
 Department of Energy
 Washington, DC

POSITION STATEMENT: During hearing of HB 177, answered questions.

DONALD SHEPLER, Attorney at Law
Greenberg Traurig, LLP;
Washington, DC

POSITION STATEMENT: Provided a presentation on behalf of the Palin-Parnell Administration regarding issues related to the Federal Energy Regulatory Commission.

PAT GALVIN, Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: During hearing of CSHB 177(O&G), answered questions.

ACTION NARRATIVE

CO-CHAIR CARL GATTO called the House Resources Standing Committee meeting to order at [1:07:26 PM](#). Representatives Gatto, Johnson, Edgmon, Kawasaki, Seaton, and Roses were present at the call to order. Representative Guttenberg and Wilson arrived as the meeting was in progress.

HB 177-NATURAL GAS PIPELINE PROJECT

[1:07:34 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).]

[1:08:51 PM](#)

JOHN KATZ, Deputy Associate General Counsel for Energy Projects, Federal Energy Regulatory Commission, Department of Energy, explained that FERC consists of five members who are representatives of FERC appointed by the President of the United States. He further explained that the comments of commission staff are that individual's opinion and don't necessarily reflect the opinion of FERC or any of its commissioners. The FERC is a deliberative body that officially speaks through a

majority vote. However, the chair of FERC has authorized staff to speak to the committee and provide as much information as possible. Mr. Katz pointed out that FERC is authorized under the Natural Gas Act to certificate interstate natural gas pipelines. He also pointed out that a few years ago Congress passed the Alaska Natural Gas Pipeline Act, which created some special provisions with regard to an interstate pipeline and included some provisions that would make FERC's work more expeditious and efficient. The aforementioned Act also included provisions related to other federal agencies and the coordination that would occur. In fact, the Act provided for the establishment of an office of a federal coordinator, which was filled by former Alaska Senator Drue Pearce. The FERC essentially stands ready to process an application for an Alaska natural gas project as soon as such a project is put before it. He noted that FERC has worked with some of its sister agencies to prepare for that day, but FERC is essentially a reactive agency and doesn't have authority to impose requirements in the abstract.

[1:12:34 PM](#)

CO-CHAIR GATTO asked if Mr. Katz has any thoughts as to when such a project will arrive.

MR. KATZ replied no, adding that no one has told FERC that they are preparing an application. He reiterated that FERC is a reactive agency and must wait for an application before it can start the process.

[1:13:24 PM](#)

REPRESENTATIVE SEATON directed attention to the expansions in Section 7 of CSHB 177(O&G), which requires the main line entity to propose and support recovery of all expansion costs through rolled-in rates by not more than 15 percent above the initial maximum recourse rates. Some contend that such a provision supplants or defines what a subsidy is. However, he opined that FERC will review the facts at the time and determine whether a subsidy exists or not. Representative Seaton asked if Mr. Katz is concerned that the proposed language presupposes and defines for FERC what a subsidy is.

MR. KATZ replied no because FERC will have to make its own decision as to whether there's an improper subsidy. The FERC's 2005 and 2005A orders, which addressed the open season regulations for an Alaska gas project, indicate that generally

an Alaska project might be considered different because of the nature of competition in Alaska and the large expense of such a project. Therefore, FERC established a presumption for rolled-in rates specifying that it would review whether there was a subsidy by existing shippers of new shippers by expansion. However, FERC didn't define what a subsidy would be. In fact, FERC said that an increase in rates might not be a subsidy, but that such couldn't be determined until the facts of the specific case were known. Therefore, if the legislature chooses to offer an inducement to a prospective pipeline applicant, that applicant is free to accept or not accept that inducement. The FERC will then review the facts and determine whether there's a subsidy or not. Mr. Katz said that he didn't know what FERC would do with respect to an [application] that discussed a future expansion.

[1:16:53 PM](#)

REPRESENTATIVE SEATON surmised then that Mr. Katz didn't view the provision that specifies that the mainline entity has to make the proposal up to 15 percent above the initial recourse rates as defining a subsidy.

MR. KATZ noted his agreement with Representative Seaton, adding that the legislature can't bind FERC, which operates under federal law. He said that it will be up to those going through the Alaska process with regard to whether they want to accept the state's inducements or not. The aforementioned is a matter between the state and those pipeline proponents.

[1:18:01 PM](#)

REPRESENTATIVE SEATON recalled testimony that the mainline entity itself should be able to determine whether there was a subsidy or not. However, Representative Seaton related his understanding that FERC would make that determination and a pipeline entity may not view the facts and circumstances in the same manner as FERC. He asked if that's Mr. Katz's understanding also.

MR. KATZ replied yes. However, he acknowledged that a pipeline proponent could make a case before FERC as to whether it believes a subsidy will or will not occur in any given situation. Still, FERC would make it's own decision based on statements by anyone interested in the case.

[1:19:17 PM](#)

MR. KATZ, in response to Representative Guttenberg, said that it's difficult to provide examples when FERC determined there was a subsidy and when there wasn't. The difficulty lays in the 2005 and 2005A orders, which held open the possibility of reviewing an Alaska project differently than that of a Lower 48 project based on the facts of the case.

[1:20:29 PM](#)

REPRESENTATIVE GUTTENBERG surmised then that this issue is without precedence and that FERC will address matters based on the facts at the time and won't look back on other precedence.

MR. KATZ answered that the commission might use precedent. However, the aforementioned open season regulation orders of FERC recognize that an Alaska project would be different than a project in the Lower 48. For instance, most expect that there will be one pipeline and thus there won't be "pipeline on pipeline competition" and thus production in Alaska may only have one pipeline that it can travel. Furthermore, the expenses of an Alaska pipeline will dwarf those of any other project. He noted that a Lower 48 standard is one in which FERC doesn't allow a rate increase to existing shippers that don't receive benefits, which FERC orders 2005 and 2005A specify might not apply to an Alaska project.

[1:21:52 PM](#)

REPRESENTATIVE GUTTENBERG asked if there are any other examples in the FERC orders that specify whether the rates and open seasons are significantly different as well.

MR. KATZ said, "Not really, no." He reiterated his understanding that the [FERC] commissioner recognized that an Alaska project would be unique.

[1:22:15 PM](#)

REPRESENTATIVE GUTTENBERG asked if a similar situation occurred in the early 1970s with the Trans-Alaska Pipeline System (TAPS).

MR. KATZ said that he isn't familiar with the ratemaking for TAPS. However, he noted that the oil rate regime isn't the same as the gas rate regime and thus he said he couldn't answer.

[1:22:49 PM](#)

CO-CHAIR GATTO inquired as to the difference in how expansion rates are treated in the contiguous U.S. versus Canada.

MR. KATZ, noting that he's not an expert in Canadian rates, related his understanding that TransCanada has testified before the committee that rolled-in rates apply either way, whether they increase or decrease rates in an expansion. Typically, FERC is only concerned whether subsidies will occur, whether rates will increase. If, through an expansion, rates lowered, then FERC would require that to be rolled-in for a Lower 48 pipeline. He opined that there's a presumption for Lower 48 pipelines that if existing shippers have paid for cheap expansibility, they shouldn't be deprived of that and the new shippers shouldn't come on and pay for all the mainline costs. Furthermore, in the Lower 48 if the rates are lower through an expansion, those benefits would go to all shippers whereas if the rates increased, those costs would be paid by the expansion shippers. He noted that although the aforementioned is the basic presumption under which FERC operates, parties could agree to something else.

[1:24:40 PM](#)

CO-CHAIR GATTO then invited an explanation of the difference between incremental rates of the contiguous U.S. versus Alaska's rolled-in rates.

MR. KATZ explained that typically an incremental rate would be applied in the U.S. if, for example, there were significant costs associated with adding capacity and the only benefiting entities were a small class of shippers, or one shipper that would become a new shipper on the pipeline. If the costs of those additional facilities, if rolled-in, would result in an increase in rates to existing shippers, FERC would point out that the existing shippers have a contract and an agreed upon rate and shouldn't have to pay higher costs in order to bring on a new shipper. In further response to Co-Chair Gatto, Mr. Katz said that it's standard operating procedure in the Lower 48 to be incremental only if the costs would increase to existing shippers. However, if the costs for existing shippers would remain the same or be lowered as a result of expansion, then those rates are rolled-in. He noted that often there are proceedings in which new facilities are rolled-in, and therefore the standard operating procedure depends upon the features of a proposed expansion and the costs.

CO-CHAIR GATTO asked if [FERC] makes all the determinations on that matter or is there a contract prior to entering the discussion.

[1:26:22 PM](#)

MR. KATZ said that there may be contracts.

JACQUELINE HOLMES, Associate General Counsel for Energy Projects, Federal Energy Regulatory Commission, Department of Energy, interjected that FERC would make the determination on the tariff recourse rate, although companies may have negotiated rates with particular customers that would call for a different rate than the recourse rate. Ms. Holmes specified that the recourse rate would be incremental if the cost would be higher to existing customers and rolled-in if the cost would be lower to existing customers.

[1:27:19 PM](#)

REPRESENTATIVE SEATON referred to Section 6 of CSHB 177(O&G), which requires expansion in reasonable engineering increments. He asked if those are parameters that FERC usually has.

MR. KATZ said that he doesn't believe FERC specifically includes those type of parameters. However, FERC reviews whether a proposed expansion is in the public interest and performs an engineering analysis. Therefore, Mr. Katz indicated that there may not be a large difference between [Section 6 of CSHB 177(O&G)] and the aforementioned FERC review. If FERC's engineers found that an expansion was very inefficient in engineering or environmental terms, FERC may require changes in the proposal to make it reasonable from an engineering perspective. He related that FERC's policy for the price of expansion in the Lower 48 is left to the market to decide.

[1:28:55 PM](#)

CO-CHAIR JOHNSON requested an explanation of negotiated rates. He then posed a situation in which negotiated rates turn out to be a subsidy and asked if FERC has the ability to address or change those negotiated rates.

[1:29:26 PM](#)

MR. KATZ said that FERC would listen to the pros and cons of expansion rates and make a decision as to whether the negotiated rates are reasonable.

MS. HOLMES interjected that in a rate case, although a company may have negotiated a rate with shippers, FERC would treat the volumes under the negotiated rate as though they were paying the maximum recourse rate. The difference would likely go to the company rather than to the shippers, she opined.

[1:30:41 PM](#)

CO-CHAIR JOHNSON asked whether FERC gets involved with rate of returns on pipelines.

MR. KATZ replied yes. He said that when there is a full rate case before FERC it reviews [the rate of return] along with the other costs. He mentioned that sometimes the aforementioned is controversial.

[1:31:38 PM](#)

CO-CHAIR JOHNSON surmised then that FERC probably has an average rate of return for a pipeline.

MS. HOLMES related her belief that currently for new pipelines, the average return on equity that FERC will grant is 13.5 - 14 percent. In further response to Co-Chair Johnson, Ms. Holmes said that she didn't know the average return on equity in Canada.

MR. KATZ opined that with FERC recognizing the unique nature of an Alaska project, a pipeline proponent may argue for a higher return due to the risk while others may argue for a lower return because there won't be any competition.

[1:32:54 PM](#)

CO-CHAIR GATTO asked if Mr. Katz viewed the Alaska pipeline as risky.

MR. KATZ said that it depends. If there's a pipeline that is fully subscribed, then [the state] is probably in good shape. He didn't doubt that there is a market for an Alaska pipeline or that there would be customers for the gas. Furthermore, Congress directed FERC to assume that there's a need for a pipeline. However, Mr. Katz opined that it would be exceedingly

risky for an entity to move forward on the pipeline without contracts. Still, it remains difficult to pen down where the Alaska pipeline falls on the risk spectrum without more knowledge of a specific proposal.

[1:34:24 PM](#)

CO-CHAIR GATTO asked whether it's common or uncommon for there to be proven reserves when a pipeline is built, although there is no agreement to place those reserves in the pipeline.

MR. KATZ specified that it's more typical for a pipeline to have the contracts in hand prior to building, although that's not an absolute requirement. He related that [FERC staff] view the possibility of a pipeline being built as increasing along with the amount of contracts the pipeline proponent is able to secure.

[1:35:21 PM](#)

REPRESENTATIVE GUTTENBERG inquired as to how a failed first open season would be perceived by FERC and those in Washington, D.C.

MR. KATZ opined that there would be some disappointment in that [those in Washington, D.C.] have perceived an Alaska project as crucial to America's energy future. However, if the first open season doesn't succeed, it doesn't mean the project is gone. In fact, it's possible that a proponent could hold an open season and proposed shippers were unhappy with the terms offered or the size of the pipeline. Still, there's no reason that the same proponent couldn't change its proposal and be successful in a succeeding open season, he noted.

[1:36:57 PM](#)

REPRESENTATIVE SEATON posed a scenario in which the rate of return was 13.5 percent. He asked if that's calculated on the recourse rate or the mix of recourse and negotiated rates.

MR. KATZ clarified that it's based on the cost.

MS. HOLMES further clarified that it would be the cost that would go into determining the recourse rate.

[1:37:35 PM](#)

REPRESENTATIVE SEATON mentioned that there is an idea to allow vouchers that would allow buyers of gas, end users, to subscribe for firm transportation (FT) as well as shippers. He asked if FERC would have any problems with the aforementioned.

MR. KATZ said that he didn't because FERC doesn't necessarily care who owns the capacity on the pipeline, but is concerned with whether there are enough people paying on the pipeline to make it worthwhile for the pipeline to build.

MS. HOLMES noted that FERC does have a requirement that the shipper on the pipeline holds the title to the gas being shipped. She said she wasn't sure whether that requirement has any implications for the aforementioned concept.

MR. KATZ, in further response to Representative Seaton, agreed to provide the committee with guidance as to related FERC regulations.

[1:39:43 PM](#)

REPRESENTATIVE SEATON then inquired as to whether FERC has any control or policies on the dismantlement, removal, and restoration (DR&R) funds. He further inquired as to whether those DR&R funds accumulate in a company account, a trust account, or an account that grows with interest.

MR. KATZ responded that typically FERC hasn't addressed those. He explained that under the Natural Gas Act if a pipeline wants to give up its facilities or service, abandonment, it must request the authority to do so from FERC. Usually FERC will examine the environmental and other impacts of the abandonment of service and places whatever requirements necessary to address any environmental damage. He noted that FERC has, for some offshore pipelines, allowed for negative salvage such that the pipeline has been allowed to accumulate some funds through a charge to decommission or salvage the project. Typically, for a long-line onshore pipeline FERC hasn't done anything like that prospectively. In further response to Representative Seaton, Mr. Katz said that he didn't believe there is anything in FERC regulations that would prevent the state from negotiating anything it sees fit with a prospective shipper. However, FERC would review such when it received an application.

[1:41:53 PM](#)

CO-CHAIR GATTO asked if the rate of return assumes the [DR&R] is included in the cost.

MR. KATZ replied, "Typically, it's not."

CO-CHAIR GATTO surmised then that the [DR&R] expense is going to be borne by the pipeline owner. He inquired as to how the pipeline owner controls that expense without any reimbursement for it.

MR. KATZ explained typically that is something that FERC imposes on the pipeline at such time as the pipeline chooses to abandon service on portions of its facilities. The pipeline has to make that call as to whether there are expenses that it has to bear to do that.

[1:42:43 PM](#)

CO-CHAIR JOHNSON recalled testimony from a pipeline company that said its big problem with AGIA is going all the way to FERC certification after the first failed season. The pipeline company said it would be hugely expensive and it wasn't prepared to do that. He then inquired as to the costs or timelines associated with continuing to FERC certification after a failed first season.

MR. KATZ said he could address that in detail because the timing of an application and the work leading to an application is largely in the hands of the perspective applicant. However, he recalled that everyone he has heard discuss the project has assumed that it will take at least a couple of years to perform the necessary field work.

[1:44:27 PM](#)

CO-CHAIR JOHNSON inquired as to how much of the material would be pertinent when trying to reach a second open season after a failed first open season.

MR. KATZ answered that such would be up to the applicant because the open season proposal is developed by the applicant. However, there's certainly no reason why a substantial amount of the information from the first open season couldn't carry over, it depends upon how much the proposal would be changed.

[1:45:42 PM](#)

MR. KATZ, in response to Representative Wilson, clarified that FERC doesn't negotiate with shippers, producers, or pipelines. He explained that people come to FERC to file applications, FERC conducts a hearing, and decides what it thinks is in the public interest.

[1:46:59 PM](#)

REPRESENTATIVE WILSON referred to page 7, subparagraph (C) of CSHB 177(O&G) and related her understanding that this provision specifies that an applicant must agree to the rolled-in rates unless they're over 14 percent.

MR. KATZ clarified that the negotiations would be between the shippers and the pipeline proponent and they would reach an agreement. He suggested a situation in which the shippers and the pipeline proponent reach an agreement and they're the state's selected entity under AGIA, and therefore they've agreed not to protest rates unless they are over a specified amount. Those agreements would be between the state and the pipeline proponent, but that wouldn't be between those entities and FERC. Therefore, if an entity came to FERC and wanted to do something inconsistent with what they agreed to do with the state, they could do so and FERC would consider that proposal. However, that entity may be in violation of its agreement with the state and could be sued in state court or held liable at the state level. Still, the agreements at the state level wouldn't preclude FERC from considering whatever options that appear to be in the public interest. "In other words, they could reach those agreements, but they wouldn't be binding on the commission; they might well be binding on the proponent vis-à-vis the State of Alaska," he stated.

[1:49:12 PM](#)

REPRESENTATIVE WILSON posed a scenario in which a pipeline company builds the pipeline and the process is at the point of shipping the gas. She inquired as to who would be responsible if there was a hostile takeover of the pipeline company.

MR. KATZ said that it would depend. If someone purchases 100 percent of the stock of a company, that's not something that requires FERC approval. If the takeover was structured in another fashion, FERC approval would be required. He pointed out that in any case whoever took over the pipeline would be required to continue under the FERC certificate with the same

terms and conditions as the previous entity operated. Any change would require FERC authorization.

[1:51:29 PM](#)

CO-CHAIR GATTO announced that the committee would now turn its attention to a presentation by Don Shepler. He then reminded committee members that amendments would be accepted from now until about 3:00 p.m. Sunday. He confirmed that amendments should be to CSHB 177(O&G).

[1:52:55 PM](#)

REPRESENTATIVE ROSES related his understanding that there will be amendments from the administration. He asked if those would be available for review in order to avoid the introduction of duplicate amendments.

CO-CHAIR GATTO said that the administration's amendments will be made available as soon as they are in possession.

[1:53:38 PM](#)

DONALD SHEPLER, Attorney at Law, Greenberg Traurig, LLP, said that he is present on behalf of the Palin-Parnell Administration to address FERC issues. Mr. Shepler pointed out that the handouts to the committee are the full text of FERC's orders as they relate to pricing of expansion capacity while the slides of the PowerPoint are pertinent portions of those orders. He then reviewed his background, which prior to working as an attorney with the Law Firm of Greenberg Traurig, LLP, included 30 years as in-house FERC counsel for various interstate pipelines in the Lower 48. Prior to that, he said he worked at FERC and its predecessor agency, the Federal Power Commission, as both a trial and advisory attorney. In that capacity he wrote opinions for FERC.

[1:56:10 PM](#)

MR. SHEPLER said that due to the excellent testimony of Mr. Katz, he wouldn't go through those parts of his PowerPoint that have already been covered. He said that slides 1-5 provide background regarding from where FERC was coming and the congressional mandate it was addressing when it issued the 2005 series of orders. As related on slide 2, the 2004 ANGPA [Alaska Natural Gas Pipeline Act] mandate to FERC stated: "promote competition in the exploration, development and production of

Alaska natural gas." In order to achieve that, FERC concluded that incremental pricing of expansion capacity could place expansion shippers at a significant competitive disadvantage and discourage exploration, development, and production. As mentioned by Mr. Katz, FERC did find that in light of the uniqueness of the Alaska project, a rate increase isn't necessarily a subsidy. The aforementioned led FERC to posit that a subsidization definition "could be whether the expansion rate is no higher than the actual initial rate or of an initial rate without built-in subsidies."

[1:58:18 PM](#)

MR. SHEPLER explained that the reference to built-in subsidies refers to the fact that when FERC receives an application for a certificate or an expansion, it will review that application and the proposed rate structure to determine how the expansion will be priced, on an incremental or rolled-in basis. The FERC, in considering a case-specific application, has said it would be willing to consider the argument relating to whether the federal government's loan guarantees and accelerated depreciation amounted to a "subsidy" of initial shippers' rates. In other words, whether the recourse rates were pushed down as a result of the government subsidies consisting of the loan guarantee and the accelerated depreciation.

[1:59:24 PM](#)

REPRESENTATIVE GUTTENBERG, referring to slide 4, asked if the loan guarantees would have to be used or would it merely be a matter of whether they influence the process or loan rates.

MR. SHEPLER answered that the assumption is that because the loan guarantees would tend to reduce the debt cost, the expectation under AGIA is that the licensee would make substantial use of those federal loan guarantees in order to reduce the debt cost. Therefore, [FERC] does assume that the licensee does take advantage of the loan guarantees or obtains financing at a cost no higher than the licensee could've obtained had they used the federal loan guarantees.

[2:00:32 PM](#)

REPRESENTATIVE GUTTENBERG asked if the aforementioned could be used as an argument for increasing the tariffs. For example, if the licensee wanted to exclude the federal loan guarantees from the rate, could the licensee argue either way.

MR. SHEPLER clarified that if the licensee didn't use the federal loan guarantees and their borrowing cost is higher than it would have been if they had used the loan guarantees, there would be a question as to whether that was appropriate financing of the project. He reminded the committee that the goal is to obtain the lowest cost project. The aforementioned would be problematic from the standpoint of the state as well as FERC, he opined.

[2:01:40 PM](#)

MR. SHEPLER, moving on to slide 6, highlighted that the seven-year accelerated depreciation is another benefit to the project sponsor as it tends to reduce rates when it's run through the ratemaking mechanism. Additionally, the AGIA contribution to the project would also tend to reduce the rate to initial shippers. Furthermore, whoever builds the North Slope gas treatment plant (GTP) will qualify for 15 percent income tax credit. He pointed out that slide 6 includes the percentages presented by Antony Scott, Division of Oil & Gas, Department of Natural Resources. Collectively, the value of the government subsidies have the result of reducing the initial recourse rates by more than 15 percent. He characterized 15 percent as a good approximation of the minimum value of those government contributions.

[2:03:21 PM](#)

CO-CHAIR GATTO asked if the additional 15 percent federal income tax credit given to owners of GTP is utilized nationwide.

MR. SHEPLER replied no, that provision was enacted as part of the comprehensive legislation included in the Alaska Natural Gas Pipeline Act in 2004. He noted that a GTP is very expensive to construct.

[2:04:01 PM](#)

CO-CHAIR GATTO asked if the cost of a GTP is kept separate or is the pipeline worthless without it.

MR. SHEPLER said that although someone is going to have to build a treatment plant, AGIA doesn't address that issue. However, AGIA does ask that [an applicant] specify how it will deal with the GTP, regarding who is going to build it. If the GTP is part of the AGIA project, then the GTP [builder] has to pursue FERC

certification and receive FERC jurisdictional rates. Mr. Shepler emphasized that FERC isn't dictating who is going to build the gas treatment plant. However, he highlighted that given the gas quality, someone is going to have to remove the CO₂ and sulfur before it reaches the mainline because it's corrosive in the pipeline and wouldn't be acceptable, merchantable, commercial quality natural gas to be transported. In further response to Co-Chair Gatto, Mr. Shepler acknowledged that the percentages specified on slide 6 add up to less than 15 percent and noted that the value of the 15 percent of income tax credit on the GTP wasn't included. That wasn't included because the cost of the GTP is unknown. Mr. Shepler then turned attention to slide 7, which specifies that AGIA caps the roll-in filing commitment roughly at the level of governmental subsidies.

[2:06:34 PM](#)

MR. SHEPLER opined that FERC recognized in its order that the argument relating to whether the federal government's loan guarantees and accelerated depreciations amounted to a subsidy would be considered by FERC. He explained:

What we have done is we have calculated the impact of what those contributions are and said that as a condition of obtaining the AGIA license that the applicant would agree to propose to the FERC rolled-in treatment up to the point that the rate increase got to the 15 percent level, which ... is what we calculate to be the value of those government subsidies which ties back in to the FERC's point that they would consider that issue in determining whether there was a subsidy when they were presented a fact-specific case.

[2:07:33 PM](#)

CO-CHAIR GATTO pointed out that AGIA sets the rate at 15 [percent], but when the aforementioned numbers are added together it probably amounts to more than 15 [percent].

MR. SHEPLER said, "I wouldn't try to put too sharp a pencil to it; it's in rough numbers it's about 15 percent. We've calculated it being more than 15 percent."

[2:08:00 PM](#)

CO-CHAIR GATTO surmised then that conceivably, whatever the charge for rate increases, it could be that there's really no increase until more than 15 percent is reached.

MR. SHEPLER said, "I think I'm agreeing with you, Mr. Chairman." He explained that the recourse rate has already been pushed down by at least 15 percent. Therefore, until the cost of expansion exceeds the starting recourse rate plus the 15 percent that's already a subsidy from the government, that wouldn't be an inappropriate subsidy by existing shippers for new shippers, he opined.

[2:08:57 PM](#)

REPRESENTATIVE WILSON related her understanding that the GTP can be built by the shippers, the pipeline company, or an independent group. Still, FERC reviews the price and determines what the people that use the GTP are to be charged.

MR. SHEPLER responded that it depends. He reiterated that the GTP has to be built because the gas must be treated. The GTP is going to be very costly and will require payment by the people whose gas flows through it. Therefore, [the administration believes] since the owner, whoever that is, is receiving a federal income tax credit for building the GTP, that should flow through into the rates of the treating service. As a result of the aforementioned, it will cost something less than what it would've cost without the tax credit. Whether FERC takes that into consideration or not depends upon whether the plant is deemed to be under FERC's jurisdiction or not. He said that's an issue that would be decided further in the process.

[2:11:16 PM](#)

REPRESENTATIVE WILSON opined that someone has to ensure that it's a fair rate for everyone who uses it.

MR. SHEPLER said, "I really can't answer that question, I would think so." If FERC regulates the GTP and certifies it, then FERC will set a rate for it. He recalled that the 1977 Alaska Natural Gas Transmission System statute required that the treatment plant be certificated as a part of that project. However, in light of the 2004 statute it's apparent that the Alaska project can be built outside of the terms and conditions of the 1977 statute. Mr. Shepler pointed out that in the Lower 48 the gas treatment conditioning isn't typically a pipeline

function and isn't included in jurisdictional rates rather it's a service provided by another entity.

[CO-CHAIR GATTO passed the gavel to Co-Chair Johnson.]

[2:13:38 PM](#)

MR. SHEPLER, returning to the PowerPoint, directed attention to slide 8. He then related that [the administration] hasn't contemplated that AGIA would intrude on FERC's authority. In the pipeline world, the following adage exists: "The company proposes, but the FERC disposes." He said that AGIA merely requires that the pipeline owner file a proposal to use rolled-in rate treatment up to the 15 percent. [The administration], he related, is perfectly content with allowing FERC to decide whether rolled-in treatment will be required or not.

[2:14:59 PM](#)

MR. SHEPLER, in response to Co-Chair Johnson, explained that the pipeline has to propose a certificate and a rate recovery mechanism. He related that FERC has said that it has established a rebuttable presumption that will use rolled-in pricing for an Alaska project.

[2:16:02 PM](#)

REPRESENTATIVE WILSON asked then if the producers have the opportunity to argue however they want or are they locked in.

[2:16:36 PM](#)

MR. SHEPLER said that would be answered later in the presentation. He then returned to his presentation [slide 9] and recalled staff asking whether rolled-in pricing went both ways in the U.S. as opposed to Canada. The FERC goal is for the lowest possible rates for as many shippers as possible. Therefore, if an inexpensive expansion would result in a rate reduction to all of the customers using the pipeline, the FERC has universally required the use of rolled-in pricing going down. In fact, in the Lower 48 FERC doesn't allow rolled-in pricing going up. However, as stated earlier, FERC has a presumption that it would establish rolled-in pricing going up.

[2:17:55 PM](#)

MR. SHEPLER moved on to FERC Order 636, as presented on slide 11, which required that interstate gas pipelines "unbundle" and offer gas transportation service separate from the gas sales service. In the past, the pipeline purchased the gas at one end, owned the pipeline and service, moved the gas to market, and then sold it for the price of the gas plus the cost of the transportation. The price of the gas was regulated by FERC for many years, he noted. In FERC Order 636, the pipelines were told they would be contract carriers and wouldn't own their own gas in the pipeline, and couldn't sell gas at the downstream end. Therefore, the pipelines would simply be transporters. This order, he mentioned, was based upon complaints that the pipelines had a competitive advantage over producers and gas marketers who were trying to sell to gas users and distributors at the downstream end.

[2:19:34 PM](#)

MR. SHEPLER, referring to slide 14, related that FERC has established two species of rates. One rate is a recourse rate, which is a cost-based rate that is set by FERC under conventional public utility ratemaking methods. A minimum and maximum rate is established by FERC. The current policy of FERC requires that virtually all system costs be recovered through a "reservation charge." Such a charge is paid regardless of whether the gas was shipped. However, there are some exceptions, including in the following circumstances: if the pipeline isn't ready for service when the contract provides for shipping; if the pipe isn't capable of providing service, a credit is typically given for charges during that time; and force majeure typically results in a partial credit for charges back to the shipper.

[2:21:25 PM](#)

REPRESENTATIVE SEATON asked whether the minimum and maximum recourse rates set the parameters for a negotiated rate or is it totally independent.

MR. SHEPLER, referring to slide 15, said that negotiated rates are the second species. He explained that FERC will allow a willing buyer and seller of capacity to agree on an arm's length deal to a rate that's different than the regulated rate. He further explained that although it may be somewhere within that band, it may be fixed for the term of the contract. Therefore, at some point it could go outside that band and even be above the recourse rate. The FERC says that at all times a potential

shipper must have access to the service at the recourse rate in order to protect the small players. The negotiated rates are becoming more common, especially in new projects. As a matter of policy, FERC has required that pipelines and shippers try to negotiate cost-sharing arrangements in order to address the cost of new projects, including cost overruns. In fact, the Rockies Express Project that's currently being built will utilize fixed rate contracts for the services that will go forward once the pipeline is in service. Whatever the parties negotiate, FERC will tend to accept, he opined.

MR. SHEPLER recalled that there was a question to FERC as to whether it would look into the subsidy issue if the rate was below the recourse rate. He noted his agreement with the FERC representative who said that FERC would review such and would tend to allow it as a deal between parties, although the pipeline company would be required to design its recourse rates as if it collected the full amount of the recourse rate from that shipper. Therefore, the pipeline is at risk for the degree to which it negotiates a rate that's below its cost-based rate. He noted that sometimes the pipeline company will do the aforementioned in order to meet competition or other reasons. Mr. Shepler pointed out that typically a pipeline company doesn't have to make a rate filing on any particular timeline. However, FERC usually requires [a pipeline company] after about three years of service of a new project to return to FERC and rejustify whether the initial rate, based on estimates, is the appropriate rate given the actual costs.

[2:25:16 PM](#)

REPRESENTATIVE SEATON recalled that Mr. Shepler mentioned that negotiated rates could be higher than the recourse rates. He then asked if there is language in AGIA that protects the state from entering into the TAPS settlement problem.

MR. SHEPLER characterized AGIA as a totally different animal than TAPS. He highlighted that no one has to enter into a negotiated rate as the recourse rate is always available. If a rate higher than the recourse rate is negotiated, he said he sensed it would be on one of the rate components. For example, a rate dependent upon the amount of volume actually shipped may be negotiated. The FERC policy, he reminded the committee, for recourse rates is such that almost all of the costs are recovered through the reservation charge and relatively little is covered through the commodity charge. Mr. Shepler did note that at different times the ratemaking policy of FERC has been

different. There's no reason that a willing shipper and a willing pipeline couldn't negotiate a rate that had a lower reservation charge but a higher commodity charge than if the recourse rate or FERC's straight fixed variable method of establishing rates was applied.

[2:27:15 PM](#)

REPRESENTATIVE SEATON asked if Mr. Shepler is convinced that the state doesn't have to worry about a rate being charged that would then be charged against the state's royalty gas.

MR. SHEPLER said he supposed that's a risk. He reiterated that nothing in AGIA addresses a situation in which a willing buyer and a willing seller negotiate a rate above the cost-based rate. In further response to Representative Seaton, Mr. Shepler agreed to review whether a provision is necessary to protect the state from under-valuation similar to under TAPS.

[CO-CHAIR JOHNSON returned the gavel to Co-Chair Gatto.]

[2:28:38 PM](#)

MR. SHEPLER turned the committee's attention to slide 16, which addresses Representative Wilson's earlier question regarding upstream inducements and whether shippers could protest the rolled-in treatment. When introduced AGIA contemplated that as a condition of receiving the upstream inducement, the tax certainty and royalty relief, a party would commit that it wouldn't oppose FERC at the pipeline filing required in AGIA. He explained that the rationale for the aforementioned is:

We're asking the pipeline to propose something that is in the best interest of the State of Alaska in terms of facilitating the maximum development of the resources so that rates are low for everybody for as long as possible. And, so if the state wants rolled-in rates for maximizing the resources, it should do what it can to ensure that FERC actually approves those rates -- that rolled-in treatment. So, that was our rationale for linking ... the access to the tax certainty to the agreement not to protest the rolled-in, but only up to the 15 percent.

[2:30:20 PM](#)

MR. SHEPLER, in response to Representative Roses, clarified that the rolled-in language is in the legislation twice. The rolled-in language in the pipeline context specifies that the project sponsor agrees to propose and support rolled-in pricing for the expansion. In the upstream inducements portion of the legislation, it specifies that the recipients of the tax certainty and the royalty relief agree not to protest the rolled-in rate.

[2:31:06 PM](#)

MR. SHEPLER moved on to DR&R, slide 17, and pointed out that DR&R is an oil pipeline term. In the gas pipeline industry the same concept is referred to as negative salvage. He opined that FERC didn't quite understand what it was being asked. Negative salvage, he explained, is allowed for gas pipelines. However, it comes about through rate cases not in the certificate process when the pipeline is being permitted. On the gas side, FERC requires that the dollars associated with negative salvage be booked in a separate account in order to track the accumulated negative salvage dollars that the pipeline company has collected.

[2:32:17 PM](#)

CO-CHAIR GATTO noted his confusion with the term "negative" because salvage normally has a positive value.

MR. SHEPLER pointed out that the term "negative" [refers to the fact] that it's going to cost more to take up [the pipe] than can be obtained when it's melted.

[2:32:48 PM](#)

REPRESENTATIVE SEATON, referring to subparagraph (C) on page 7 of CSHB 177(O&G), related his understanding that the aforementioned provision precludes the pipeline company from negotiating any contracts or rate with a shipper that would place them in contractual obligation or allow them to contract to oppose rolled-in rates.

MR. SHEPLER replied no, and specified that the concern is regarding how to protect the recourse rates for the shipper. [The legislation] specifies that the recourse rates must reflect rolled-in pricing to a certain level. The [administration] didn't want the pipeline company to negotiate a totally flat, fixed, or capped rate for some customers under the negotiated

rate mechanism that wouldn't allow them to recover that roll-in from that shipper. In other words, if 80 percent of a pipeline is subject to negotiated rates and there is a commitment not to raise the rates beyond a specified amount, even if there's an expansion, then the roll-in can only be recovered from 20 percent of the pipeline customers that are under recourse rates. Therefore, [that 20 percent] will face a substantial rate increase for any expansion.

[2:35:38 PM](#)

CO-CHAIR GATTO surmised then that at the same time that price rises, it becomes substantially higher for the pipeline company as well.

MR. SHEPLER responded, "As a recourse rate shipper, yes." The idea [behind the legislation] is to spread the costs throughout all the shippers without limiting the ability to recover from the negotiated rate group of shippers.

REPRESENTATIVE SEATON suggested then that would basically result in incremental rates.

MR. SHEPLER noted his agreement that such is the effect.

[2:36:43 PM](#)

REPRESENTATIVE SEATON returned to the notion of FT being purchased by shippers. He recalled that there was some question regarding the aforementioned.

MR. SHEPLER related that [in Alaska] it's generally assumed that the people who contract for capacity on the pipeline are going to be the producers. Although that may be the case, in the Lower 48 it's just as likely that the holder of capacity on a pipeline is going to a gas utility, known as a local distribution company (LDC) or an electric generator. The voucher system is an attempt to create a mechanism by which the party contracting for the capacity who had no use for production tax credits or royalty relief could transfer that relief and value back to the producer with the production tax and who is subject to the royalty agreement. Therefore, even if an LDC or electric generator purchased half of the capacity in the pipeline, the upstream inducements would remain available to the parties supplying gas into that FT contract. In further response to Representative Seaton, Mr. Shepler noted that it's FERC policy that an entity holding capacity in the pipeline has

to have title to the gas that's moving in that entity's capacity. He offered to refresh his knowledge on the aforementioned and provide the committee with the policy basis behind the provision.

REPRESENTATIVE SEATON related his understanding then that a downstream entity has to purchase gas from someone in order to have title to it and be able to ship it. He surmised that it's not a "mechanistic" problem with having downstream purchasing.

MR. SHEPLER replied no.

[2:41:43 PM](#)

PAT GALVIN, Commissioner, Department of Revenue, inquired as to whether the committee had any questions for him.

[2:42:18 PM](#)

REPRESENTATIVE SEATON requested that Commissioner Galvin inform the committee of any other provisional changes or ideas that have been vetted in other committees considering the legislation.

[2:42:43 PM](#)

COMMISSIONER GALVIN related that in the Senate Judiciary Standing Committee the administration suggested language clarifications regarding the rolled-in rate treatment and some clarity with regard to the relationship between the recourse rate and negotiated rates. The administration also suggested language clarifying that the 15 percent is viewed as a set limit from the time the initial shippers set the rates. Both of those suggestions were incorporated into the Senate companion legislation.

[2:44:05 PM](#)

COMMISSIONER GALVIN then turned to the abandonment section and reminded the committee of yesterday's discussion with regard to the use of arbitrators in setting up arbitration when one party thinks a project is economic and another does not. Furthermore, there needs to be clarification with regard to what the arbitrator would be deciding and what the standard would be to rule the project uneconomic. The aforementioned resulted in the development of a test with regard to the determination, which was included in the Senate companion legislation. Basically, to

find the project uneconomic one must find that it doesn't have existing financing and it isn't going to provide a reasonable rate of return for the resource owner.

[2:47:15 PM](#)

REPRESENTATIVE GUTTENBERG asked if this is an appropriate place to review community impacts.

CO-CHAIR GATTO pointed out that the experience of the community is that the workers bring their families and thus there's a need for services on a temporary basis. The aforementioned was addressed in the TAPS issue such that once the pipeline workers left the area, there was a need for balance.

[2:48:38 PM](#)

REPRESENTATIVE GUTTENBERG recalled that in Fairbanks there was a moratorium on property tax until the production was flowing through TAPS. Still, the City of Fairbanks, which doesn't receive property tax from the pipeline, experienced huge impacts for various services. He inquired as to how such impacts will be mitigated going into this gasline project.

COMMISSIONER GALVIN said that the administration does recognize that as the project moves into the construction phase the primary issues will be related to the socioeconomic reaction to the oncoming work. With regard to AGIA, Commissioner Galvin opined that it's too early in the process and there are many unknowns. However, there will be adequate time as the process moves forward to address these issues. He noted that as part of the administration's evaluation prior to the introduction of AGIA was the review of a property tax waiver during construction. Such a waiver wasn't included in the legislation because there needs to be investment in the communities during that period of time. He opined, "We didn't want to exacerbate it by putting a stop to those payments. In the end, it didn't have as much of an impact on the finances of the project as some of the other things that we've included in the bill."

[2:50:55 PM](#)

REPRESENTATIVE GUTTENBERG recalled that out of the previous Stranded Gas Act was borne the municipality assessment group (MAG), which reviewed the impacts of a pipeline. He highlighted that a pipeline traveling down the highway impacts more than just Fairbanks. He expressed the desire to include those who

worked on the aforementioned in the process because impacts start early and linger.

[2:51:54 PM](#)

REPRESENTATIVE ROSES referred to page 8, lines 11-15 of CSHB 177(O&G), and inquired as to why it's important to have the language "regardless of whether any shippers bid" versus "if any shippers bid".

MR. SHEPLER explained that beyond specifying that there have to be five off-take points, it restates FERC policy that the applicant, the natural gas company, still has to offer the service even if no one contracts for it.

[2:54:12 PM](#)

REPRESENTATIVE GUTTENBERG recalled when Mark Hanley, Anadarko, showed the committee Anadarko's holdings, a considerable amount of which are in the foothills. He questioned whether it would be prudent to also include possible input points.

MR. SHEPLER said that he would need to think about that question.

COMMISSIONER GALVIN mentioned that when [the administration] was conventionalizing delivery points, they were also viewed as entry points. "Once you tap in, the gas can flow either way based upon the demand," he related. He then said he would ensure that no language change is necessary in order that the aforementioned isn't precluded. Ultimately, through the AGIA process the state will end up with a pipeline designed to ship gas for the demand that is present.

[2:56:33 PM](#)

CO-CHAIR GATTO asked if the gas from Cook Inlet requires any GTP at all.

COMMISSIONER GALVIN said he isn't aware of any gas treatment in the Cook Inlet.

CO-CHAIR GATTO questioned whether anyone has evaluated the gas in Nenana. He suggested that requiring a conditioning plant before the gas can be injected in the pipe may overwhelm the value, depending upon how much gas is present and the quality of it.

COMMISSIONER GALVIN commented that the aforementioned is the nature of the evaluation process. At this point, the gas hasn't been discovered.

[2:57:47 PM](#)

REPRESENTATIVE GUTTENBERG suggested that the infrastructure may already be available to get the gas off the AGIA line to Anchorage, which would be stuck with exporting it.

[2:57:56 PM](#)

CO-CHAIR GATTO pointed out that it's pipeline quality gas as it has been treated. The treatment plant, he opined, has a big job to do as this gas isn't the quality of that found in Cook Inlet. He mentioned he has heard that Cook Inlet gas is the cleanest in the world.

[2:58:36 PM](#)

REPRESENTATIVE ROSES posed a situation in which there were four bidders and each bidder met 19 of the 20 requirements in AGIA. In such a situation, he related his understanding that the language on page 9, line 14 of CSHB 177(O&G) would mean that the commissioners would have to reject all four of those bidders. He asked if that is the intention.

COMMISSIONER GALVIN replied yes, and related the administration's belief that the 20 "must-haves" is a reasonable list and an application that doesn't meet them all should be rejected. Commissioner Galvin said that [the administration] believes it's important for the state to make a clear statement of what it expects so that apples to apples can be compared with the applications. Therefore, it was a deliberative decision to use the term "shall".

[3:00:26 PM](#)

COMMISSIONER GALVIN, in response to Representative Roses, pointed out that there is a fiscal note from the Department of Labor & Workforce Development regarding the provision on page 24, lines 21-24 of CSHB 177(O&G) that specifies the currently projected costs of this program. The original structure of HB 177 was to include this training program as an inducement to get the projects. Based upon the discussions in the previous committee, the decision was made to not make the training

program exclusive to the AGIA-licensed projects. Therefore, it was pulled out and made available as a separate training program for any similar project. With regard to the funding for the training program, Commissioner Galvin said the state would come up with the money, likely through the general fund, to pay for it in order to ensure that the project has an Alaskan workforce.

[3:02:22 PM](#)

REPRESENTATIVE ROSES acknowledged that there is money set aside in another area. However, he expressed concern that anticipated costs never seem to anticipate enough. Therefore, he questioned whether not addressing this at all, precludes [the state] from requesting that there be matching funds from the bidder to help develop the workforce.

COMMISSIONER GALVIN said there wouldn't be a direct opportunity to place an additional requirement on the licensee to make such a match in order to continue to enjoy the benefits of the license. He said that he didn't think that AGIA is intended as a vehicle to provide such a matching arrangement.

REPRESENTATIVE ROSES surmised then that nowhere in that RFA or RFP would there be any language referring to expenditures for training.

COMMISSIONER GALVIN related that in the past when there were similar arrangements for projects to creative incentives for something in return, there was usually a request associated with training. The aforementioned always met resistance that seemed to exceed the actual monetary cost of the training program. Therefore, when developing AGIA it was decided to promise [to the licensee] that the state would provide training so that there would be a workforce for the project and thus it wouldn't be included in an RFA.

[3:06:02 PM](#)

CO-CHAIR JOHNSON, recalling the testimony from Antony Scott, Division of Oil & Gas, asked if the Department of Revenue is in agreement with Dr. Scott's testimony and numbers.

COMMISSIONER GALVIN said that the administration supports Dr. Scott's testimony. He did acknowledge that there are economists in the Department of Revenue and Department of Natural Resources who will hold different opinions.

[3:08:12 PM](#)

COMMISSIONER GALVIN, in further response to Co-Chair Johnson, informed the committee that DNR has a model that it developed to be able to run a variety of scenarios to generate an 85 percent expectation of a particular number and a 50 percent expectation of other numbers. He noted that DOR doesn't have an alternate way to develop that type of sophisticated result. Therefore, DOR doesn't have a way to generate an alternative view.

[3:09:52 PM](#)

CO-CHAIR JOHNSON asked if it would serve a purpose to have DOR's economist plug DOR's numbers in DNR's formula.

COMMISSIONER GALVIN said that the numbers and assumptions are basically the same. He acknowledged that there's a question with regard to Dr. Scott's numbers and how the FT commitment should be treated in the upstream economic forecast. The question is whether those should be treated as a debt equivalent or not. Dr. Scott made it clear that the administration believes that the FT commitment shouldn't be considered a debt instrument when considering upstream economics. He noted that a DOR economist may hold a different view. In my opinion and that of the gasline team, that DOR economist's opinion isn't backed by that of the experts and isn't appropriate. Commissioner Galvin, drawing from everything he and the gasline team have heard, said considering the FT commitment a debt instrument when considering upstream economics isn't an appropriate position to hold with the economic analysis of the upstream.

[3:11:55 PM](#)

CO-CHAIR JOHNSON asked if FERC weighs in on this.

COMMISSIONER GALVIN replied no, it's not relevant to FERC's analysis. In further response to Co-Chair Johnson, Commissioner Galvin said that one would have to review how the financial community would treat a similar situation. In discussions with the financial community, they wouldn't recognize FT commitments as debt in upstream economics. Therefore, he said he is confident in the type of analysis being performed. Commissioner Galvin clarified that the numbers were based upon the information from the financial communities, in terms of how the financial communities would view the project not based on [the administration's] desired outcome. Still, he acknowledged that views based upon the desired outcome can be obtained, but the

administration went with the analysis of those who don't have an interest in the outcome.

3:14:19 PM

REPRESENTATIVE ROSES related his understanding that if there is a FT commitment, then it becomes an asset at that point because they can now borrow against that. Furthermore, it remains an asset until the amount to which there is commitment exceeds what is shipped. He suggested that the FT commitment becomes a debt when the potential for not being able to ship what was committed becomes a liability. Therefore, it depends upon the point of the process.

COMMISSIONER GALVIN highlighted that it's an obligation to make a payment as well as an opportunity to get gas to market. So long as one recognizes both ends of the obligation and opportunity, then it's being given a fair review. Ultimately, there has to be a fair representation of the economic impact of a decision. Commissioner Galvin reiterated that the administration believes Dr. Scott's numbers are the fairest representation.

3:17:08 PM

REPRESENTATIVE ROSES then turned to the producer and pointed out that it has shareholders and stock that it sells on an open market. He opined that on the day there's a pipeline contract, an absolute commitment, the stock of those companies will actually rise in value. He further opined that when those companies can't meet the obligation, there would be a decrease in their stock value. The aforementioned would prove that it was a liability/debt, he opined.

3:18:15 PM

COMMISSIONER GALVIN, in response to Co-Chair Johnson, reiterated the need to recognize both sides of the decision. If a FT commitment is going to be made, there's suddenly many reserves to book because there is an opportunity to place them into market. He emphasized that the FT commitment isn't a debt. Although there can be an argument that it is debt, Commissioner Galvin stressed that it isn't appropriate to make a FT commitment a debt-like instrument for the purposes of economic evaluation. The aforementioned is supported by the information from financial communities, oil and gas companies, and others without an interest in making this argument.

[3:19:30 PM](#)

CO-CHAIR JOHNSON commented that if this is accurate, it is really damning information and really sways his opinion.

COMMISSIONER GALVIN said that there is a tendency to want to view everything as someone's view of the truth. Ultimately, the administration and the legislature is striving for the truth, not just a version of it. He suggested that the committee review what the administration has presented as well as the legislature's own economic advisors from a year ago. The numbers presented a year ago are consistent with Dr. Scott's numbers, he pointed out. Commissioner Galvin stated, "We're doing the best in our ability to identify what is the appropriate way to evaluate this project because in the end the state's interests are borne by having the best information we can provide for you rather than trying to push us in a direction that ends up failing."

[3:23:04 PM](#)

REPRESENTATIVE SEATON, from a fisherman's standpoint, said that there's a debt when there is a payment and an interest rate. When FT is taken, there's no payment or interest unless the product isn't shipped at which point the part not shipped is converted to debt.

CO-CHAIR JOHNSON, from a parent's standpoint, said if a child asks a parent to co-sign on a loan for a car, the parent doesn't face payments or interest. However, the parent's credit rating is impacted, which is a debt. This is the problem, he opined.

CO-CHAIR GATTO said that the FT commitment could be referred to as debt. However, it's not a fair appraisal because although the obligation of debt is there, it produces an asset and the asset overwhelms the debt.

[3:26:41 PM](#)

REPRESENTATIVE SEATON asked if the legislation specifies that a community dividend and the 60 percent profit sharing with the state will only be countered if contractually obligated in the license. He also recalled that there was something related to municipal revenue sharing payments and whether those will be counted as part of the net present value anticipated cash flow to the state from the proposal. He inquired as to what

categories will be considered net present value and cash flow to the state.

[3:29:15 PM](#)

COMMISSIONER GALVIN said that the administration hasn't prepared nor is it in the process of preparing an amendment to the section described by Representative Seaton. He acknowledged that the provision doesn't include cash flows to a municipality of the state. The administration hasn't made the determination that it's necessary to expand it to include such cash flows. With regard to whether or not additional revenue that would result in a cash payment to the state would be included, he opined that would likely fall under "other factors found by the commissioners to be relevant to the evaluation of net present value of cash flows to the state" and could be expanded more fully in the RFA. "As far as the payments to the municipalities, we're not currently including that in our interpretation," he specified.

[3:31:07 PM](#)

COMMISSIONER GALVIN related that he didn't believe [the administration] would object if the legislature feels that cash flows to municipalities should be included as part of the evaluation criteria. He characterized it as a policy call. From the state's perspective, it's a matter of whether it actually provides an offset to other obligations that the state would have to make.

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REPRESENTATIVE SEATON recalled that the administration brought forward an amendment to the Senate's companion legislation regarding carbon emissions. He asked if that amendment will be brought forward for HB 177.

[3:31:46 PM](#)

COMMISSIONER GALVIN replied yes. In further response to Representative Seaton, Commissioner Galvin confirmed that the FT voucher amendment will also be brought forward. He then explained that the administration is in the process of reviewing CSHB 177(O&G) and CSSB 104(JUD) to identify the differences between the two and prepare amendments for them. He clarified that there will be amendments that arise to improve the legislation as well as amendments made by the Senate committee

for discussion. There will also be amendments that are due to the drafter's refinement of the language. Commissioner Galvin informed the committee that the intent is to make amendments available to align the two versions.

[HB 177 was held over.]

[3:33:54 PM](#)

ADJOURNMENT

CO-CHAIR GATTO recessed the House Resources Standing Committee at 3:34 p.m. to the call of the chair until 1:00 p.m. April 21, 2007.