

**ALASKA STATE LEGISLATURE  
JOINT MEETING  
HOUSE RULES STANDING COMMITTEE  
SENATE SPECIAL COMMITTEE ON ENERGY**

June 9, 2008  
10:06 A.M.

**MEMBERS PRESENT**

HOUSE RULES

Representative John Coghill, Chair  
Representative Anna Fairclough  
Representative Craig Johnson  
Representative Ralph Samuels (AGIA Subcommittee)  
Representative Beth Kerttula (AGIA Subcommittee)

SENATE SPECIAL COMMITTEE ON ENERGY

Senator Charlie Huggins, Chair  
Senator Bert Stedman, Vice Chair  
Senator Kim Elton  
Senator Lyda Green  
Senator Lyman Hoffman  
Senator Lesil McGuire  
Senator Gary Stevens  
Senator Joe Thomas  
Senator Bill Wielechowski  
Senator Fred Dyson  
Senator Thomas Wagoner

**MEMBERS ABSENT**

HOUSE RULES

Representative John Harris (AGIA Subcommittee, Chair)  
Representative David Guttenberg

SENATE SPECIAL COMMITTEE ON ENERGY

Senator Donald Olson

**OTHER LEGISLATORS PRESENT**

Representative Bob Buch  
Representative Mike Chenault  
Representative Harry Crawford  
Representative Nancy Dahlstrom  
Representative Andrea Doll  
Representative Mike Doogan  
Representative Bryce Edgmon  
Representative Les Gara  
Representative Berta Gardner

Representative Carl Gatto  
Representative Max Gruenberg  
Representative Mike Hawker  
Representative Lindsey Holmes  
Representative Reggie Joule  
Representative Scott Kawasaki  
Representative Wes Keller  
Representative Mike Kelly  
Representative Bob Lynn  
Representative Mark Neuman  
Representative Kurt Olson  
Representative Jay Ramras  
Representative Bob Roses  
Representative Paul Seaton  
Representative Bill Stoltze  
Representative Bill Thomas  
Representative Peggy Wilson

Senator Con Bunde  
Senator Bettye Davis  
Senator Johnny Ellis  
Senator Hollis French  
Senator Gene Therriault

#### **COMMITTEE CALENDAR**

##### HOUSE BILL NO. 3001

An Act approving issuance of a license by the commissioner of revenue and the commissioner of natural resources to TransCanada Alaska Company, LLC and Foothills Pipe Lines Ltd., jointly as licensee, under the Alaska Gasline Inducement Act; and providing for an effective date.

HEARD AND HELD

##### SENATE BILL NO. 3001

An Act approving issuance of a license by the commissioner of revenue and the commissioner of natural resources to TransCanada Alaska Company, LLC and Foothills Pipe Lines Ltd., jointly as licensee, under the Alaska Gasline Inducement Act; and providing for an effective date.

HEARD AND HELD

#### **PREVIOUS COMMITTEE ACTION**

##### BILL: HB3001

SHORT TITLE: APPROVING AGIA LICENSE  
SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

06/03/08 (H) READ THE FIRST TIME - REFERRALS  
06/03/08 (H) RLS  
06/03/08 (H) WRITTEN FINDINGS & DETERMINATION  
06/04/08 (H) RLS AT 9:00 AM CAPITOL 120  
06/04/08 (H) Subcommittee Assigned  
06/05/08 (H) RLS AT 9:00 AM TERRY MILLER GYM  
06/05/08 (H) House Special Subcommittee on AGIA  
06/06/08 (H) RLS AT 10:00 AM TERRY MILLER GYM  
06/06/08 (H) House Special Subcommittee on AGIA  
06/07/08 (H) RLS AT 10:00 AM TERRY MILLER GYM  
06/07/08 (H) House Special Subcommittee on AGIA  
06/08/08 (H) RLS AT 1:00 PM TERRY MILLER GYM  
06/08/08 (H) House Special Subcommittee on AGIA  
06/09/08 (H) RLS AT 10:00 AM TERRY MILLER GYM  
06/09/08 (H) House Special Subcommittee on AGIA  
06/10/08 (H) RLS AT 10:00 AM TERRY MILLER GYM

BILL: SB3001

SHORT TITLE: APPROVING AGIA LICENSE  
SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

06/03/08 (S) READ THE FIRST TIME - REFERRALS  
06/03/08 (S) ENR  
06/03/08 (S) REPORT ON FINDINGS AND  
DETERMINATION  
06/04/08 (S) ENR AT 10:00 AM TERRY MILLER GYM  
06/04/08 (S) Heard & Held  
06/04/08 (S) MINUTE(ENR)  
06/05/08 (S) ENR AT 9:00 AM TERRY MILLER GYM  
06/05/08 (S) Heard & Held  
06/05/08 (S) MINUTE(ENR)  
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06/07/08 (S) ENR AT 10:00 AM TERRY MILLER GYM  
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06/09/08 (S) Heard & Held  
06/09/08 (S) MINUTE(ENR)  
06/10/08 (S) ENR AT 10:00 AM TERRY MILLER GYM

PRESENT VIA TELECONFERENCE

Spencer Hosie, Hosie, MacArthur LLP

WITNESS REGISTER

Pat Galvin, Commissioner, Department of Revenue; Greg Hopper, Black & Veatch; Don Shepler, Consultant, Greenberg Traurig, LLP; Marty Rutherford, Deputy Commissioner, Department of Natural Resources; Sheri Buretta, President, ANCSA Regional Association and Chairman, Chugach Alaska Corporation; Ken Johns, President and CEO, Ahtna Inc.; Vicki Otte, Executive Director, Alaska Native Claims Settlement Act (ANCSA) Association; Robert Fenton, Managing Consultant Gas & Strategies Consultant; Scott Smith, Black & Veatch; Deepa Poduval, Consultant, Black & Veatch

**ACTION NARRATIVE**

CHAIR SENATOR CHARLIE HUGGINS called the joint meeting of the House Rules Standing Committee and the Senate Special Committee on Energy to order at [10:06:55 AM](#).

HB 3001-APPROVING AGIA LICENSE  
SB 3001-APPROVING AGIA LICENSE

CHAIR HUGGINS brought SB 3001 and HB 3001 before the committees.

QUESTIONS AND REFERENCES TO PREVIOUS TESTIMONY  
BY SPENCER HOSIE, ATTORNEY FOR HOSIE, MACARTHUR, LLP

PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, provided an overview of the proposed schedule and the Alaska Gasline Inducement Act (AGIA) requirements through the existing authority of the Federal Energy Regulatory Commission (FERC). He added that the afternoon would be dedicated to addressing issues regarding the liquefied natural gas (LNG) economics and success.

REPRESENTATIVE ANNA FAIRCLOUGH referenced a previous statement made by Mr. Hosie regarding the Cook Inlet gas profits, which she thought had been inaccurate. He had stated that Alaska could sell the LNG at whatever profit rate they choose.

[10:09:57 AM](#)

SPENCER HOSIE, ATTORNEY FOR HOSIE, MACARTHUR, LLP, acknowledged that he had misspoken. He misunderstood that a federal judge concluded such authorization. He apologized that he had misspoken; the correct answer is that the State would have to sell at a Royalty-in-Value (RIV) market level. They will not be able to sell at above or below the market price. He did not know what rights the State has if producers refused to sell or refused to sell at a competitive market price.

REPRESENTATIVE FAIRCLOUGH noted that the general public voiced the concern and that she wanted them to know that the Legislature works within a "perimeter of the law", especially when dealing with resources in order that they are equitably available to all Alaskans.

She referenced previous comments regarding producers bringing to market their gas on reasonable commercial terms. She referenced a letter generated by Exxon. She inquired about the definition of the reasonable terms, asking who would decide what reasonable is in order to avoid litigation with the Federal Energy Regulatory Commission (FERC) or the Court system.

MR. HOSIE stated that in the event that a negotiated resolution is not possible, although the optimal outcome, the Superior Court will address that concern. Regarding what is reasonable, the commercial aspect question could be debated in great length. Case law suggests that there must be some reasonable amount of profitability. The State does not have to guarantee a rate of return of 35% (percent); he estimated the State could expect a rate of return between 8% to 12%.

[10:14:17 AM](#)

SENATOR BILL WIELECHOWSKI requested further discussion regarding the "duty to produce".

MR. HOSIE explained it would be a duty to produce and market, turning the resource into cash-money. Cycling the gas through the reservoir provides no cash for the resurfaced gas. It would neither be the production of the resource nor a royalty bearing event. The duty to produce focuses on how the hydrocarbons yield dollars.

SENATOR WIELECHOWSKI directed his comments to recommended remedies. He asked if the State should determine a failure of duty to produce, would damages then be limited to taking-back the leases and/or loss of revenue to the State.

MR. HOSIE responded that both remedies would be available, yet he hoped to avoid such an outcome. The proposed process allows the State to receive answers sooner, requiring the producers more quickly take a position.

SENATOR WIELECHOWSKI interjected that it is a dangerous position to be placed into, to be put at risk for litigation that could last for years and result in lost revenue for the State.

MR. HOSIE acknowledged that it is a high stakes risk for all parties. Of course, the producers want to own and control

the gas line on their terms. He referenced the situation at Point Thompson.

[10:17:25 AM](#)

SENATOR THOMAS WAGONER referred to the previous discussion regarding royalties. He pointed out that the current regulations were negotiated over 30-years ago, which now amount to a 12.5% royalty. He questioned how that number compares to current negotiated royalties.

MR. HOSIE explained that the 12.5% royalty was created in 1959 and that under current standards 12.5% is a very low rate. Current leasing percentages are at least double that and around 25%.

SENATOR WAGONER encouraged that negotiations with the major producers begin, given the "robust potential" of the project. Those considerations should be used in that determination.

MR. HOSIE agreed, adding that the State made a deal with the producers in the 1960's and that the State has honored living with a 12.5% royalty even when North Slope oil has been very prolific and profitable for the producers. He added, the producers have an obligation to produce & market.

[10:20:23 AM](#)

REPRESENTATIVE LES GARA referenced a letter member's had received from Exxon. He emphasized that the producers have a duty to produce gas and that they can not block an independent gas pipeline by not placing gas into that line. He acknowledged that the producers would bring forward a more formal proposal for the gas line. He questioned if that information would undercut the argument that the gas is not economic to produce.

MR. HOSIE affirmed that if the producers take the position that a gas line would be economic without substantial State concessions, then they would have the duty to go forward with the project. The issue is whether the State will be expected to "sweeten" the pot through economic concessions. He acknowledged that the Exxon response letter "moves the ball forward", which he believed recognizes the duty to produce. If the gas is profitable, it cannot be ware-housed forever.

[10:24:14 AM](#)

SENATOR HOLLIS FRENCH acknowledged that litigation is not the preferred course of action, however, he realized that the other possibility of a failed open-season in the face of high natural gas prices and no bids, could occur. He

inquired what would be different in terms of litigation, on a produced claim versus the Exxon-Valdez case.

MR. HOSIE acknowledged that there could be a resulting lawsuit, causing a "black-hole" for Alaska; however, the manner in which AGIA was written does provide the means to avoid such a lawsuit. If a third party is willing to build the pipe line and the producer's contest that, it would create a different and a more simple remedy and the subject to that production of the gas, should be reasonably economic. The lawsuit would be restricted to economics. He reiterated that AGIA allows the State to bring a short and simple case and that the issue then becomes not be "if" there will be a pipeline, but rather "when" and on what economic terms.

[10:27:42 AM](#)

SENATOR CON BUNDE predicted that the moment TransCanada hits the Alberta line, court suits will result.

MR. HOSIE responded that he had not studied pre-existing liabilities and the prospect for litigation on that front.

[10:28:36 AM](#)

SENATOR KIM ELTON recalled that Mr. Hosie had indicated in previous testimony that the Alaska North Slope (ANS) producers want to own and control the gas line. He mentioned the anti-trust issues that will result. He more quickly questioned what will happen if the ANS producers want an equity stake in the TransCanada-Alaska project.

MR. HOSIE explained the risk of down-streaming revenue, including a production tax and royalty load. If producers can move the dollar and take it down-stream as a dollar for pipeline profit, then the profit does not pay royalty or severance tax. The shifting occurs when the profit is recognized between the production business to the pipeline, then the same line of revenue becomes more valuable when the producers have taken it down-stream. Down-streaming revenue has been the subject of 20-years worth of litigation in the lower 48-states. He emphasized that a producer controlled pipeline could be a "real" risk. If the pipeline is third-party controlled, the incentives are different.

[10:32:01 AM](#)

REPRESENTATIVE CARL GATTO presented a scenario in which the pipeline is built and in 10 years time when the gas actually hits the grid, the price of gas is \$12 dollars. He questioned how that could affect the price in North America.

MR. HOSIE could not predict the effect to the cost of gas.

REPRESENTATIVE GATTO recognized that the world will know the value of the new gas when it arrives. He questioned if there exists an advantage to those that own the gas to hold it back.

MR. HOSIE explained it is a different question regarding whether Exxon needs the gas now, in light of what is happening with the worldwide production. He reiterated that Alaska is a safe place to "warehouse" gas.

[10:36:20 AM](#)

REPRESENTATIVE RALPH SAMUELS referenced the Amerada Hess case that lasted for 17 years. He observed that lawsuits take a long time and that long litigation does not help anyone. He stated that the TransCanada proposal does not offer shippers, the necessary protection from cost overruns. The reality is that the more the gas costs, the more the company makes. Cost considerations must be addressed.

MR. HOSIE acknowledged that there will be a cost overrun risk; however, he understood that with the TransCanada proposal, the risk runs with the shippers. The end question remains whether given the costs, does it continue to be economic to ship it. He reiterated the need to avoid litigation adding that royalty agreements have eliminated ongoing festering litigation with oil companies as result of previous litigation.

[10:40:26 AM](#)

REPRESENTATIVE SAMUELS reiterated that time is not on the State's side. Governor Palin believes that AGIA is the best process, but many legislators believe that time is of the greatest concern. He commented that both the State and TransCanada have put their "skin in the game". He asked how confident Mr. Hosie was that the process would take only two to three years. He indicated that the State of Alaska's economy can not "tolerate a ten year delay".

MR. HOSIE emphasized that no lawyer can guarantee how long a case will take and that the true test of that would be to ask if the lawyer would be willing to take the case on as a contingency-fee basis. The goal is to encourage producers to answer the questions regarding the economics.

[10:44:05 AM](#)

REPRESENTATIVE JAY RAMRAS asked about the loss of liquids from failure to reinject on the North Slope.

MR. HOSIE explained from a duty-to-produce and market perspective, the evidence is that the gas has to be re-

injected to maintain reservoir pressure; it would not be economic to produce that gas now. If it is not economic, no duty-to-produce exists. The issue was not addressed in the Stranded Gas Act negotiations regarding whether there is sufficient gas and how the economic value is determined. He added that if reservoir performance is a "red light issue", why then does the Denali plan exist. He reiterated that if for fact the gas can not be off-taken and must be re-injected to maintain reservoir pressure to insure oil condensate production, the gas could not be economically produced. Then there is no duty to produce it.

[10:48:21 AM](#)

REPRESENTATIVE RAMRAS understood this is the situation the State currently is in at Pt. Thompson and that is a failure in the duty of the producers.

MR. HOSIE clarified that the producers know the reservoirs and have internal documents that capture those conclusions on these issues. Under their willingness to move forward under the Stranded Gas Development Act (SGDA) and with appropriate concessions, indicates that the producers own internal analysis, suggests that gas reinjection and high pressure maintenance is not a gas line problem. He encouraged "trust, but to verify" all business considerations.

[10:50:24 AM](#)

REPRESENTATIVE PAUL SEATON referenced legal duties stipulated in the AGIA proposal.

MR. HOSIE encouraged that query be redirected.

[10:51:42 AM](#)

AGIA-LEGISLATIVE SPECIAL SESSION, INCENTIVES & MANDATES  
FOR PIPELINE EXPANSIONS, JUNE 9, 2008.  
(Copy on File)

GREG HOPPER, BLACK & VEATCH, addressed the expansion principle of the pipeline, explaining that the prospects of expansion bring the State of Alaska a great deal of value. He provided an overview of the handout: AGIA-Legislative Special Session, Incentives & Mandates for Pipeline Expansions, June 9, 2008. [Copy on File].

He pointed out the most important provisions within AGIA, address the expansion:

- The bi-annual open season offerings, which allows the shippers to plan and reduce risk premiums;

- Capital structure certainty, which helps to lower the rates for the shippers; and
- The rolled-in rates, which share the benefits of scale economics and levels the playing field.

SENATOR HUGGINS inquired if Mr. Hopper intended to address in detail, the capital structure certainty.

MR. HOPPER advised that capital structure is regarded as the combination of debt and equity within the project. As required by AGIA, the capital structure for the original bill was 70% debt and 30% equity. For the projects moving forward, TransCanada (TC) has proposed that the expansion would be compromised of a 60% debt, 40% equity component. He maintained that if there were a third party shipper, they would want to know the potential rate of the project and the capital structure.

SENATOR HUGGINS questioned which percentage structure would prevail.

MR. HOPPER responded that TransCanada had submitted the 60%/40%. He could not comment further.

MR. HOPPER noted the benefit to the shippers, which allows them to plan the drilling and exploration for future production activities. He defined the difference between a producer on the pipeline and involvement by a third party. The producer is the one that is substantially controlled by, operated or owned by a producer, as compared to a joint venture or independently owned project.

MR. HOPPER continued:

Development includes:

- Cost controls
- Operating control, including a seat at the table
- Capacity certainty
- Expansion timing
- Strategic involvement

Expansion includes:

- Outlet for increased equity production

MR. HOPPER discussed the concept of investing for a rate of return; that information had not been included in the handout. Inter-state pipeline companies as a general rule, make less money than the producers do. The producers and shareholders expect higher rates of returns. Research in inter-state owned pipelines indicates little evidence of producer owned expansions. He acknowledged that there have

been questions raised regarding the relative comparison of producer-owned pipelines to the entirety of pipelines in North America.

[11:02:06 AM](#)

MR. HOPPER pointed out seven producer owned pipelines, measuring a capacity between 3.5 - 8 billion cubic feet (bcf) per day. Each of those seven had some producer-ownership interest or was developed by producers. When comparing that number to the total deliverability, the inter-state pipeline grid becomes approximately 149 bcf per day. By and large, producers do not invest in inter-state pipelines and of the pipelines where producers hold the majority interest, no expansions were found as proposed. He continued of the 149 bcf per day delivering pipeline capacity, serves about 50-70 bcf per day of actual consumption in the United States (U.S.), which implies there is more pipeline capacity needed either up-stream or at the city delivery points.

[11:04:29 AM](#)

SENATOR HOLLIS FRENCH requested a memorandum including the aforementioned figures. He pointed out that there is no example of a producer-built pipeline, expanding to accommodate for a third-party shipper, which is a "sobering consideration" for Alaska.

[11:05:42 AM](#)

REPRESENTATIVE MIKE KELLY commented on cost controls if one of the stipulations for producers was requesting an initial equity ownership; he asked the statistics.

MR. HOPPER provided two examples:

- The Alliance Pipeline project, internationally proposed and developed largely by the producers; and
- The Destined Pipeline built for off-shore projects in Mexico, tying into the inter-state pipeline and essentially backed by producers in the eastern Gulf of Mexico.

REPRESENTATIVE KELLY inquired if such an argument could provide an equity position to the producers for a "seat at the table".

MR. HOPPER agreed that could happen.

[11:09:00 AM](#)

REPRESENTATIVE BERTA GARDNER requested clarification regarding a previous statement addressing two expansion and access proposals associated with the Denali project.

MR. HOPPER responded that AGIA provides certainty for expansion, which does not pertain to the Denali project.

SENATOR HUGGINS inquired if the Denali provisions had been carried over.

[11:11:40 AM](#)

REPRESENTATIVE SAMUELS questioned if any producer had turned-down opportunities for expansion of third party gas or if the market place had led to those decisions.

MR. HOPPER was not aware of any expansions, negotiations or projects, which lead to expansion. The Federal Energy Regulatory Commission (FERC) website only indicates expansions currently planned.

REPRESENTATIVE SAMUELS observed that the Alaska pipeline would be a "monopoly". There are federally guaranteed protections now in place. He asked if that was an accurate characterization.

[11:13:34 AM](#)

DON SHEPLER, CONSULTANT, GREENBERG TRAUIG, noted that he would later address the expansion provisions as contained in the 2004 Statute. He agreed with the assessment made by Representative Samuels. There is a network happening within the lower 48 pipelines and with the existing provisions in federal law, it provides FERC the authority to compel expansion. An expansion right does not necessarily offer comfort to a potential shipper.

MR. HOPPER interjected that he had not spoken with the Denali producers and did not know if the Administration had already had that conversation.

MARTY RUTHERFORD, DEPUTY COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, noted that she had spoken with the Denali producers. She indicated that ConocoPhillips has stated that they would not be available for third party enhanced open-access provisions of AGIA. She offered to follow up on that conversation with the Denali group.

[11:16:13 AM](#)

SENATOR WAGONER recommended a description of the advertised differences for the public's information.

MR. HOPPER focused on the inter-state pipeline arena, regulated by the FERC and inter-state commerce. There are also "intra-state" pipelines that are not regulated by FERC. Producers now do operate and flow on those systems. He noted his comments relate only to returns on equity and only on the inter-state pipelines.

[11:18:29 AM](#)

REPRESENTATIVE MIKE HAWKER observed that the issues have not changed over the past six years with regard to ownership expansion and restrictions on that expansion. He questioned if there exists stranded gas from refusal of a producer pipeline to seek expansion.

MR. HOPPER did not know.

[11:20:11 AM](#)

SENATOR HUGGINS referenced cost controls. He asked for information on those controls that apply to TransCanada with regard to other producers.

MR. HOPPER indicated that the primary point is that if there is a "seat at the table"; hopefully, it provides a greater measure of certainty that the cost of the project would be driven by design and construction and then provide some certainty of the best price.

[11:22:06 AM](#)

MR. HOPPER reviewed Slide 3: Pipeline V & the Producer Returns on Equity. He observed that gas pipeline regulated rates of "return on equity" (ROE) generally recognize lower levels of operating risks than other industries. The slated proposals on inter-state pipelines before the FERC, generally ranged around 14% or less on ROE's. After that experience, FERC lowered the ROE's based on subsequent rate cases. In a contract, exploration and production company shareholders require relatively higher (15% - 20%+) ROE's to compensate for higher perceived risks.

[11:23:59 AM](#)

MR. HOPPER discussed Slide 5: What a producer pipeline's incentive is to expand pipeline capacity for non-owners.

- ROE's typically will not meet a producer's required rates of return on capital;
- Potential for increased competition in lease acquisitioned reserves development;
- Call on capital that is needed for other purposes;

- It is not what they want to do; (core competence) and
- Regulatory complications.

[11:25:53 AM](#)

SENATOR WIELECHOWSKI questioned any producer's incentive to build a pipeline.

MR. HOPPER referenced Slide 4. He indicated that once the project is complete, the dynamic changes. The dynamic for expansion does not carry the same stipulations as the initial build makes.

[11:27:07 AM](#)

REPRESENTATIVE GARA referenced basin control, pointing out two competing projects:

- TransCanada line, and
- One proposed by the producers.

He asked if it was fair to assume that the pipeline would provide a lower rate of return than the producers are accustomed to. If they did decide to build a pipeline, it would be so that they could control the basin.

MR. HOPPER acknowledged that could be one of the strategic reasons.

[11:28:18 AM](#)

SENATOR HUGGINS questioned if producers commit to a two-year time frame, could that change the presentation.

MR. HOPPER stated if the producers committed, it would improve the certainty of other investors operating on the slope, leaving unanswered the questions regarding the terms of the expansion.

[11:30:01 AM](#)

PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, clarified that the million barrels per day (mbpd) analysis and the discussion on the presentation would be addressed during an upcoming scheduled meeting.

[11:30:44 AM](#)

REPRESENTATIVE HAWKER summarized that the argument comes down to what the alternative and regulatory process is needed to protect Alaska's interest. There are two sides to that question:

- One clarifies that the federal regulatory process is sufficient to look out for all parties, and
- The other indicates that they are not able to protect the State's interest.

[11:32:34 AM](#)

SENATOR LYDA GREEN inquired if there would be a time-certain when a mandatory open-season was inappropriate.

MR. HOPPER acknowledged there would be times when that system wouldn't work. He added that he was not aware of any mandatory open-seasons existing in the lower 48 states.

SENATOR GREEN asked if there was a way-out of a mandatory open-season every two years.

MR. SHEPLER explained that the Alaska Natural Gas Transportation Act (ANGTA) enacted in 2004, refers to mandatory open-seasons proceeding forward under that authority, accompanied with responsibilities. There are a number of conditions that FERC needs to satisfy and a number of legal risks for anyone attempting to rely on that statutory authority to obtain an expansion of the pipeline.

He added that the provision contained in AGIA that the licensee will conduct an open-season every two years is that it would be a voluntary and not mandated by the federal statutes. Except for the federal statutes, which allows for FERC to compel expansion of the Alaskan pipeline, the rules do not authorize a pipeline company to accept any contracts requiring them to expand once the contract is in affect. Once the pipeline is built and is in service, the only vehicle would be for them to wait for those contracts to expire. For an oil pipeline, expansion is not a big issue. He observed that the difference rests in the interpretation.

SENATOR GREEN stated that response did not clarify her inquiry. She recommended providing members a "glossary" to spell out the differences.

[11:38:53 AM](#)

SENATOR GREEN inquired if Ms. Rutherford had been referring to the AGIA open-season.

DEPUTY COMMISSIONER RUTHERFORD explained that she had not directed her comments specifically to an "open-season"; the AGIA open-season provisions are a requirement of the licensee soliciting new gas. If quick gas exists, the State would respond by quick expansion. Previous discussion revolved around the commercial terms regarding open-access

provisions such as 30% equity position and expansion with rolled-in rates. Expansion was not addressed as an individual element.

[11:42:53 AM](#)

REPRESENTATIVE KELLY referred to access issues with relationship to the major producer's intent on such developments.

SENATOR HUGGINS acknowledged that all legislators are supportive of exploration and oil being placed into a delivery system as soon as possible.

[11:45:06 AM](#)

AGIA - PRODUCER INCENTIVES TO EXPAND PIPELINE FOR THIRD-PARTY SHIPPERS  
(Copy on File)

DON SHEPLER, ATTORNEY, GREENBURG TRAUIG, related his background and experience representing the industry. With regard to expansion, he noted that the interests of producers are not necessarily inline with those of the State. He acknowledged the other motives. He provided a handout: "AGIA - Producer Incentives to Expand Pipeline for Third-Party Shippers"

MR. SHEPLER referenced Slide 2, a quote by the Attorney General to U.S. Congress pursuant to the Alaska Gas Transportation Act.

MR. SHEPLER identified Slide 3, the "Stranded Gas Development Act (SDGA) History."

- Draft SGDA contract included the 10 Alaska Natural Gas Pipeline Act (ANGPA) requirements for expansion and added 20 more conditions;
- Explorers objected that they were better off with no contract expansion terms; and
- Draft limited liability company (LLC) agreement provided that pipeline board representatives owed fiduciary duties not to the pipeline but to producers that appointed them.

[11:49:40 AM](#)

SENATOR HUGGINS requested that Mr. Shepler provide a list of the explorers referred to in Slide 2.

[11:49:54 AM](#)

MR. SHEPLER referred to Slide 4, the "AGIA History". He noted that ConocoPhillips alternative proposal provided for expansion at higher costs to the new shippers than AGIA basically requires. The Denali proposal provides no expansion commitments. He maintained that there are incentives and motivations and that in a producer owned pipeline, they would not be as motivated to expand their capacity to make room for up-stream competitive explorers of other pipelines.

[11:52:08 AM](#)

SENATOR BERT STEDMAN asked if there was enough information available on the Denali project to be able to make a reasonable comparison.

MR. SHEPLER explained that at this point, the Denali proposal consists only of a twelve point power presentation outline. That is all that is presently available.

DEPUTY COMMISSIONER RUTHERFORD commented that in her conversation with Denali, she was not aware that they had accepted the AGIA enhanced access provisions. However, she did have a conversation regarding additional information to the State for the proposal and the commercial structure; the information was not available.

SENATOR STEDMAN asked if it was fair to assume that they would be able to come forward with a reasonable amount of information to make the comparison. He referenced Page 5, Paragraph 4, addressing that.

MR. HOPPER questioned the type of comparisons the State would like to make. One of the comparisons is in regard to whether or not the applications made and submitted by TransCanada were complete. He asked for more specificity regarding those comparisons.

SENATOR STEDMAN commented that "reasonable" comparisons are the operative word and that the report is over 300 pages long.

[11:56:14 AM](#)

SENATOR KIM ELTON questioned how binding the two year requirement for an open-season could become.

MR. SHEPLER responded the requirements of AGIA require that they conduct the solicitations of interest and additionally require that the pipeline expand in reasonable increments and commercially safe terms.

SENATOR ELTON stated that given that information, there are various scenarios in which the State can be reasonably

confident that there could be an open-season occurring at least every two years. He asked if the definition of "reasonable" resides only with the pipeline companies.

MR. SHEPLER replied yes, pointing out that an independent pipeline company could have every economic incentive to expand.

SENATOR ELTON anticipated a scenario of a partnership equity owner in the pipeline.

MR. SHEPLER confirmed that possible scenario; however, the AGIA license requirements would continue regardless of the ultimate ownership of the TransCanada-Alaska line.

SENATOR ELTON believed it comes back to the term "reasonable".

[12:00:53 PM](#)

SENATOR WIELECHOWSKI referred to the concerns previously voiced by the Attorney General regarding a producer owned pipeline.

MR. SHEPLER agreed it could be an issue, which impacts their ability to get the necessary licensing.

[12:02:03 PM](#)

SENATOR WIELECHOWSKI wondered if the licensing would be denied as the producers attempt to move forward to qualify for the FERC certification.

MR. SHEPLER did not think so; however, a producer-pipeline that goes to the FERC for a certificate, will be subject to a different set of competitive issues. That could prompt the FERC to attach separate conditions on any certificate for that project.

[12:03:20 PM](#)

SENATOR WIELECHOWSKI asked what would be FERC's role in the process if TransCanada received the license, moved forward towards certification and then attempted to get majority ownership by the producer.

MR. SHEPLER did not expect that FERC would do that. The AGIA license could survive a change in ownership. If the company becomes a producer-owned project, the ownership at that time could prompt other conditions.

[12:04:50 PM](#)

SENATOR HUGGINS asked Mr. Shepler to provide a copy of the above referenced letter. He mentioned the qualifications on the FERC certificate.

MR. SHEPLER stated that he would not be surprised if FERC placed conditions on a certificate.

RECESSED: [12:05:37 PM](#)

RECONVENED: [1:41:06 PM](#)

#### ADMINISTRATION AND TRANSCANADA

[TECHNICAL DIFFICULTIES]

COMMISSIONER GALVIN explained that the afternoon session would consist of presentations submitted by Ms. Buretta, Mr. Johns and Ms. Otte. He introduced the speakers.

SHERI BURETTA, PRESIDENT, ALASKA NATIVE CLAIMS SETTLEMENT ACT (ANCSA) REGIONAL ASSOCIATION AND CHAIRMAN, CHUGACH ALASKA CORPORATION, PRINCE WILLIAM SOUND, expressed her gratitude to be representing the ANCSA. Last year, ANCSA passed legislation supporting the expedited development of natural gas.

She pointed out the national need for oil, which create pressure for her people. She noted that Prince William Sound has stepped up, aware of their possible contribution to that need. She emphasized that Native corporations are "coming into their own" and have the ability to take control of the resources and develop them for all Alaskans. She indicated that the Native Corporations are supportive of the Legislature and want to be a part of the process. She interjected that high prices are an issue for rural areas.

[1:48:43 PM](#)

KEN JOHNS, PRESIDENT AND CEO, AHTNA INC., stated that the pipeline moves through four villages in his area. Ahtna Inc. is an experienced company and has a history with pipelines. He thanked the Legislature and was encouraged by the work done during recent years. He realized there is statewide opportunity, however, noted the unanswered questions remaining on the table. He understood that some of the questions could not be answered until the project was under way. He encouraged members to look closely at TransCanada.

[1:52:18 PM](#)

REPRESENTATIVE NANCY DAHLSTROM addressed First Nation issues, asking if Mr. Johns was confident to work with TransCanada.

MR. JOHNS replied that his area has worked well with pipeline producers over all these years, acknowledging that they could have done better, now, there has been more time and experience addressing the issues.

[1:54:04 PM](#)

MS. BURETTA commented that part of the land settlement act provides private land to the Alaska Natives. She believed that the process provides more opportunity in land development. The First Nation groups in Canada are different from those living in Alaska. She emphasized that Alaska Natives have taken advantage of opportunities provided by the federal government.

[1:55:47 PM](#)

SENATOR JOE THOMAS asked if their associations had discussed issues such as the propane off-take in areas like the Yukon River.

MS. BURETTA affirmed that they had and that the accesses to the spurs were of greatest interest. Those regions are "excited" about the opportunities.

[1:57:13 PM](#)

SENATOR THOMAS questioned if the Village areas intended to bid on the work associated with the contracts.

MS. BURETTA explained that each of the Native corporations are competitors, yet they work collectively. The opportunities and training for rural Alaskans are enormous in terms of contracts and jobs and that each organization is discussing participation.

[1:58:50 PM](#)

REPRESENTATIVE BETH KERTTULA questioned if equity had been discussed.

MR. JOHNS responded that those are internal Administration talks; those considerations had been addressed during talks with past members of the Murkowski Administration.

[2:03:09 PM](#)

SENATOR WAGONER inquired the type of certification granted through FERC.

MR. SHEPLER indicated that it is not uncommon for FERC to issue a conditional certificate, providing authorization to do the project, fulfilling the other conditions set forth in

the certificate. He anticipated that a project with Alberta would need to have arrangements in place, to get the gas to the border and would be included as a condition.

SENATOR WAGONER understood that when a company receives a certificate from FERC for the pipeline, they could then book the reserves. He inquired if a company would be allowed to do that if having only a "conditional" certificate.

MR. SHEPLER did not know.

[2:06:22 PM](#)

REPRESENTATIVE SAMUELS indicated his frustration with testimony provided by Mr. Shepler. He referred to a technical session held in Anchorage regarding FERC's 2005 public rulings. He maintained that FERC has more influence over the expansion and building of the pipeline and Alaska's future. During that technical session, the items that the Legislature requested were included - each point was included.

He maintained that the fundamental issue is that the FERC has tremendous influence and that the State did receive everything asked for. The protections were put in place in 2005; to hear that now, nothing has changed on those issues but that those points are not now good enough.

MR. SHEPLER pointed out that in the Lower 48, the more sophisticated pipeline customers are moving more toward negotiated rates. He stated that the State has a unique opportunity to ensure that the FERC regulatory process is made available for the project. In some aspects, however, FERC cannot be relied upon. He cited capital structure issues as an example.

REPRESENTATIVE SAMUELS reiterated that Alaska had received every point that had been requested in 2005 with FERC.

[2:12:50 PM](#)

SENATOR HUGGINS inquired if Mr. Shepler had been a part of the process referenced by Representative Samuels.

MR. SHEPLER replied he had not; he had been an advisor for the Legislative Budget and Audit (LBA) Committee at that time.

[2:14:18 PM](#)

SENATOR HUGGINS asked if he had had any influence in the decisions at that time.

MR. SHEPLER explained that he had been the attorney for LBA and that they filed a few comments with a focus on rule-making for the open-season. He recalled they had focused on the rule-making issues at the time and that the regulations had not been helpful. He had argued to get the final regulations changed.

[2:15:36 PM](#)

REPRESENTATIVE KERTTULA recalled that the work done with FERC, three years prior, has provided the current capital structure.

MR. SHEPLER agreed.

[2:16:29 PM](#)

REPRESENTATIVE MARK NEUMAN expressed concern regarding what TransCanada-Alaska is requesting from the State. He pointed out that they have requested Alaska to work with the U.S. government to be a "bridge-shipper" and to reach an agreement with the ANS producers. He worried about lawsuits associated with that last request and how long they could take to litigate. He hoped to see gas on-line by 2018.

MR. SHEPLER referenced previous comments made by Commissioners Galvin & Irwin and representatives of TransCanada. He pointed out that TransCanada has not met the conditions of their application on any of the areas mentioned; instead, they have clarified that the benefit of the State's actions. That is not a condition. He maintained that the previous presentation touched upon litigation concerns.

[2:19:43 PM](#)

REPRESENTATIVE NEUMAN understood that TransCanada expected the State to evaluate the financial and commercial feasibility of dedicating significant State resources.

MR. SHEPLER responded that was an "expectation" question rather than a "condition" on the application question.

REPRESENTATIVE NEUMAN emphasized that these are conditions that TransCanada has requested from the State of Alaska. He believed that under contract, TransCanada retains the right to back out of the license.

MR. SHEPLER stated that Representative Neuman had mischaracterized the material; he advised that the language in the application does not establish conditions in the legal sense that the State must fulfill.

REPRESENTATIVE NEUMAN commented that TransCanada retains the right to back out of the contract.

MR. SHEPLER emphasized "no", they do not.

COMMISSIONER GALVIN interjected that the Administration has clarified this concern many times and that legal advisors, the Administration and TransCanada have all indicated the exact same thing that there are no conditions placed on TransCanada's commitment in the application. The statements read by the representative were in regard to expectations of the State to consider looking at using the State's influence over the producers - those are only expectations and are not conditions that would have the Board of TransCanada to back-out of the deal without breaching the violation requirements of AGIA. He stressed that the record is clear.

[2:23:37 PM](#)

REPRESENTATIVE NEUMAN noted his confusion.

COMMISSIONER GALVIN interjected that the confusion expressed by Representative Neuman is a separate issue. Under AGIA, there is no obligation for TransCanada-Alaska Company, LLC, to build the pipeline. They are required to get the FERC certification & if they have the financial backing, they would then sanction those commitments. The statement previously read is only a restatement of the AGIA requirements.

[2:25:35 PM](#)

SENATOR LYDA GREEN referred to an earlier discussion in relation to the power of FERC as the regulatory body overseeing the project. She questioned if Alaska was an exception to how projects are handled in the lower 48 states, because of the federal law passed, clarifying what happens when gas is processed across states into another state.

MR. SHEPLER agreed that the federal statute of 2004 allows the FERC to compel the owners of a project to extend new capital and expand the pipeline under restrictive conditions. Alaska's pipeline is unique. The authority is unprecedented and has not been tested in any court. There exist five to six conditions to discourage exploration. The problem is that through AGIA, the pipeline has made commitments that it will do the type of expansion-solicitation that will encourage producers to make their drilling decisions.

[2:30:39 PM](#)

SENATOR GENE THERRIAULT referred to the FERC 2005 order, addressing rolled-in rates. When FERC made the ruling, the State had requested an absolute ruling for rolled-in rates, instead, the State received rebuttal presumption.

MR. SHEPLER agreed.

SENATOR THERRIAULT added that the State had asked for a lot that they had not received. The rebuttal presumption basically means that it can be argued again at yet another date.

MR. SHEPLER agreed.

SENATOR THERRIAULT continued, through AGIA and the State partnering with a pipeline company, the State is requesting that partner to side with Alaska in any future arguments.

MR. SHEPLER agreed.

SENATOR THERRIAULT referred to the "back-filling" occurring with the AGIA proposal.

MR. SHEPLER acknowledged that was correct. The State can anticipate the position of the incumbent shippers will take on the rolled-in pricing. He agreed with how Mr. Palmer characterized it that given the position of the pipeline, making it a filing at the FERC, could become the tipping point. It is a presumption, not a rule. There is no guarantee of any outcome.

[2:32:50 PM](#)

SENATOR THERRIAULT pointed out that the FERC regulation package was challenged by the producers. Most of the issues were dropped, however, the challenge remained to mandate capacity & design changes to the initial line. He stressed that information is important. He mentioned the diameter of the pipe proposed for use.

MR. SHEPLER agreed.

SENATOR THERRIAULT questioned where any litigation regarding pipe could end up.

MR. SHEPLER responded that is a "murky" [area] resolution, as it has not been challenged on that basis and then applied in a particular factual situation. The regulation remains in place.

SENATOR THERRIAULT revisited the 4.5 bcf line that expands up to 7.2 and the exploration that could start with such an expansion; however, pointed out that the State is not assured of that. With an AGIA partner, the State would be

assured because the proposed pipe size is in a 48" line. He assumed that FERC was attempting to accommodate low-cost expansions.

MR. SHEPLER agreed that it is not available through FERC but would be through AGIA.

[2:36:01 PM](#)

REPRESENTATIVE SAMUELS asserted that there are no assurances for an explorer. The bottom line is that the project is up to the FERC to decide. The assumption is that the State "won" by getting the rolled-in tariff.

COMMISSIONER GALVIN commented that it is easy to speculate what an explorer would be more comfortable with, however, relying on only FERC rather than the AGIA requirements, does provide greater confidence in getting the desired access. Secondly, regarding the "major victory" from FERC should actually be sobering in terms of the historic expectation of the actual type of positions taken. The bar was set modestly. He pointed out that 90% of the discussion at the meeting had been with regard to what was passed last year; it does not add anything new with the TransCanada (TC) application.

REPRESENTATIVE SAMUELS concluded that the explorers will appreciate the terms of AGIA until it drives their tariff up by one cent and then they will come forward fighting the FERC.

[2:39:00 PM](#)

REPRESENTATIVE GARA directed comments to AGIA. He stated that Alaska is sovereign and is not willing to accept just what the federal government delivers. The State passed AGIA with that in mind, which he questioned was legal. As a sovereign, Alaska has an interest in rolled-in rates and by statute, FERC can only go so far. He pointed out that Alaska has pushed further. Alaska wants in-state delivery of gas; FERC does not recognize that, hence, the standard was established in AGIA. Alaska wants to keep the tariff rate and toll rate down to encourage production with a 70/30 debt equity ratio. AGIA includes Alaska hire and is not governed by the FERC. He predicted that there were complications from adopting greater protections under AGIA than the FERC will allow.

MR. SHEPLER explained that he was advocating that point. The State is "best served" by taking care of its own interests.

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RECONVENED: [2:43:23 PM](#)

THE CHALLENGES IN BUILDING AN ALASKAN LNG CHAIN  
(Copy on File).

COMMISSIONER GALVIN explained the structure of the next presentation: "The Challenges in Building an Alaskan LNG Chain" with Robert Fenton.

[2:45:55 PM](#)

ROBERT FENTON, MANAGING GAS & STRATEGIES CONSULTANT, outlined his experience over the past four years, in management, business development and strategy formulation in the gas models, particularly with LNG. He distributed the handout to members. [Copy on File].

MR. FENTON referenced Slide 3, LNG as an alternative to a pipeline:

- Not just a choice between LNG and a pipeline but between:
- LNG to the illiquid, long-term contracted and in China's case developing, gas markets of Asia, and
- Pipeline to the deep, liquid, short term-contracted market of USA.

MR. FENTON referenced Slide 4, which defines placing an LNG chain together as complex; it varies by market and is challenging in Asia. He noted that gas is not oil; the U.S. gas market is different from others and that the LNG market is challenging-especially into the Asian Pacific markets.

MR. FENTON pointed out Slide 5 highlighting the commercial contracts critical for viability of the LNG chain to ensure financing and construction.

- All elements of the chain need to be connected with legal agreements to ensure that the LNG produced will be sold over the life of the project, supporting investment risk.
- It makes LNG development complex and liable to delays and occasional failures.

Slide 6 demonstrates the producer's view of risk & rewards. He pointed out that the pipeline (to USA) is simpler by comparison:

- Single commitment to pipeline capacity of LNG requires pipeline, liquefaction, ships, and degasification;

- LNG requires higher level of reserves assurance;
- Assured market off-take;
- Transparent pricing;
- Single gas quality and blending; and
- Producers can act independently and integrate with the rest of their North American gas sales.

MR. FENTON addressed Slide 7, discussing today's prices as a basis for commitment to LNG for the long-term:

- Oil today is around \$135/bbl;
- New long-term LNG contracts into Asia priced close to oil parity;
- Implies a significant premium of \$9/MMBtu over USA prices;
- The premium will more than compensate for the higher cost of an LNG scheme; and
- The divergence of Pac-Rim LNG and USA gas prices is unlikely to sustain in the long-term fundamental price projections and Pac-Rim LNG price drivers.

2:51:37 PM

MR. FENTON highlighted the chart on Slide 8 indicating that the Asian contract prices normally sit above Henry Hub (HH); however, in some periods they don't. The slide provides the history of the Japanese LNG costs. The projects tend to be large & costly with many companies involved. All elements of the chain need to be connected with legal agreements to insure that the LNG produced & sold over the life of the project are a justified investment.

The Asian market has gas quality higher heat content than that found in the U.S. market. The difference of that places a constraint on the ability to supply different markets of the LNG and is associated with additional costs. He addressed the alignment of the producers and the complexity of selling the Alaskan gas in the Asian market.

MR. FENTON addressed Slide 9, indicating the rapid market changes leading to a scattering of prices and renegotiation.

2001-2004:

- Over ten suppliers and potential producers were offering supply;
- Buyers achieved lower prices & a reduction in the oil price linkage;
- Price ceilings at around \$25/Bbl oil prices in some contracts; and

- The result was a much lower LNG price and high oil prices in the new contracts.

2005:

- Return to "sellers market" has strengthened position of producers;
- Qatar has pushed the LNG price to crude oil parity at \$100/Bbl oil in its most recent deals;
- Wide-scatter of prices opened up by the sudden rise in oil price; and that
- Virtually all legacy contracts are being renegotiated.

MR. FENTON pointed out that Slide 10 indicates the Asian premium is limited by a growing flexible supply:

- In 2007, the U.S. supplied 16 mtpa;
- 50 mtpa of new supply for US, United Kingdom (UK) is under construction;
- Which could potentially be diverted to Asia; and
- Some Asian premiums will remain driven by security concerns.

MR. FENTON summarized the key messages of Slide 11:

- LNG project carries significantly greater costs and risks of delay or failure than the pipeline project including sale negotiations complex, quantity and quality constraints; additionally, producer alignment is difficult to retain;
- The current level of Asian price premium is unlikely to sustain;
- Producer's have substantial competing LNG interest in the Pacific Region; and
- Producer's perception of the risk is likely to drive the preference for the pipeline.

3:09:00 PM

SENATOR BERT STEDMAN directed his comments to the statement regarding risk exposure and how that would affect the State's credit. AGIA requires an applicant to go through the process. He questioned if that process would also work under an LNG contract.

MR. FENTON responded that all major producers have lead LNG contracts and are experienced in taking gas and placing it in inter-state pipelines; however, those producers are aware that putting an LNG project together is more complex. They would want to participate in the plans. No liquefaction

plant has been built by a third party. He reiterated that the companies would want to participate and be assured that the plant would be theirs to use over the life of the contract. He directed discussion regarding how to operate an open-access in a liquefaction plant and who would have jurisdiction over that. The producers would need to participate in and controlling the liquefaction plant in order to have the assurance that an experienced operator was building it & running it.

COMMISSIONER GALVIN emphasized the point that no one will build without having financial backing, parallel to the AGIA track. It would provide getting the gas commitments, to lead the completion of the project.

SENATOR STEDMAN inquired if the State had "created something" that would place LNG at a disadvantage.

COMMISSIONER GALVIN replied no, but instead, has created an equal opportunity.

[3:13:45 PM](#)

REPRESENTATIVE SAMUELS referenced Slide 7, asking if there was a difference in the Asian market between the individual countries of Korea, Japan and then the others.

MR. FENTON responded that they analyzed the demand and pricing in the largest markets: Japan, Korea, Taiwan, China and India.

REPRESENTATIVE SAMUELS asked if each had acted independently.

MR. FENTON explained that they do act independently, however, they take their lead and pricing mostly from Japan.

REPRESENTATIVE SAMUELS referenced a \$9 dollar premium, questioning if it is assumed that if the price declines, it would be because of the price of oil dropped. He wanted to know at what point it is projected that the premium disappears.

MR. FENTON responded that he could not predict what depresses the price of Asian LNG by altering the relationship of the LNG price to oil. It would need to be a change to the construction of the formula that would likely drive down the price of LNG. [Slide 9].

[3:17:18 PM](#)

SENATOR THERRIAULT understood that the LNG market in Asia requires certain British Thermal Unit (BTU) contents.

MR. FENTON noted that all that gas is a high BTU content LNG.

SENATOR THERRIAULT recalled that there are markets in Asia that use a lower BTU content for industrial use and power generation. He inquired the capacity in the Asian market for the use of a lower BTU.

MR. FENTON elaborated that at present time, all Asian markets are using the high BTU gas. If they buy low BTU gas, they add propane to increase the heat, making a higher BTU. One of the biggest questions now, is in relationship to what will happen in China, which is potentially a very large market. It is not clear how China will standardize. He added that if the State begins to produce LNG, they would be locked into one subset of the market.

[3:20:10 PM](#)

REPRESENTATIVE PAUL SEATON referenced Slide 7 and asked the comparison between the \$9 million British thermal unit (mmBtu) to the gas pipeline natural gas liquids.

MR. FENTON responded that those numbers address only the volume of gas sold. For LNG purposes, the value retains most of the natural gas liquids in. For the pipeline gas sold into the U.S., those would be stripped out and sold separately. In an economic comparison between the LNG and the pipeline, two separate revenue streams are created.

REPRESENTATIVE SEATON wanted to determine if the premium price value could capture the total value in either Canada or the U.S. He asked what the \$9/mmBtu would actually include.

MR. FENTON stated that the natural gas liquid (NGL) value would have to be added back into the pipeline gas option. He was certain that at the \$9 dollar value, there would be economics favoring the LNG project.

[3:23:10 PM](#)

REPRESENTATIVE RAMRAS asked if the U.S. was currently importing 6 billion cubic feet (BCF) per day of natural gas and if it was anticipated that by the year 2010, the number would increase to 20 BCF per day.

MR. FENTON thought that sounded correct and that gas imports would be increased.

REPRESENTATIVE RAMRAS questioned if all Arctic gas investments globally are "in trouble", while the equatorial projects are thriving and robust.

MR. FENTON agreed, noting the challenges in both places.

[3:25:38 PM](#)

REPRESENTATIVE RAMRAS requested further elaboration on the global Arctic gas projects.

MR. FENTON asked if the representative was speaking about oil and gas Arctic projects or LNG projects. He suggested it would be difficult to narrow that scope. He referenced specific projects.

REPRESENTATIVE RAMRAS asked if the Salkin project had come in on budget and on time.

MR. FENTON replied they had been out of budget by a factor of nearly 100%, from a \$10 billion dollar project to now over a \$22 billion dollar project. That project was two to three years late.

[3:27:55 PM](#)

SENATOR WAGONER referenced the comments made by Representative Ramras regarding the increase from 6 to 20 BCF by the U.S. over the next few years. He asked how the U.S. Department of Commerce would react to Alaska selling gas reserves into a foreign market.

MR. FENTON said he had not discussed that with the U.S. Congressional delegation but agreed it is an important discussion to have. He deferred to his colleagues for additional comments regarding the concern.

COMMISSIONER GALVIN reminded members that there had been reactions to the reports during the application process. He noted that Senator Murkowski had indicated concern with the LNG countries organizing into a gas group - Organization for Petroleum Exporting Countries (OPEC). He acknowledged that these are statewide concerns. That is one of the reasons that the State has determined that an LNG Y-line off the over-line pipeline would be one of the best opportunities for LNG in Alaska.

[3:30:31 PM](#)

SENATOR WIELECHOWSKI referenced Slide 3, the choice between the LNG and a pipeline. He asked about the issue regarding producers making a long-term (20-30 year) commitment. Comparing the worldwide large investments in LNG, raises fundamental questions, including the fundamentals existing in Asia with coal usage and carbon output. He challenged the manner in which Mr. Fenton presented the scenario.

MR. FENTON explained that there are many buyers and sellers in the U.S. market. Most gas is contracted for short-term. He pointed out from the producer's point of view, the risk concerns that the gas would not be taken. He believed that the producers need to make a long-term commitment to selling gas. The producers want to assure themselves of an outlet for the gas reserves.

Regarding the liquidity of the Asian LNG market, it is not a competitive market. They are either monopoly markets or a defacto regional monopoly with a number of suppliers competing. Contracting with that buyer, the country would become dependent upon them to absorb that gas in that market. He acknowledged that there are many investments in LNG marketplace. He asserted that the Chinese market is "energy hungry" and warned the world should be cautious in that market.

[3:35:52 PM](#)

SENATOR FRENCH suggested that Mr. Fenton's presentation "dashes the hopes" of Alaskans who want to see an all Alaskan pipeline with an LNG export facility in Valdez. He asked how the proposed Y-Line could overcome the same political obstacles faced as a stand alone project. He questioned how the balance could shift with an overland route to Alberta.

MR. FENTON explained that initially they were looking at the baseline project; if the State wants to go for the LNG, the Y-Line would be the correct way to address that. Additionally, the question regarding federal export is one of degree.

COMMISSIONER GALVIN recognized the dynamic as the findings being portrayed as a "death" to moving LNG out of Alaska. He said it was the important to understand what the findings were about. He applauded the presentation of Mr. Fenton regarding the comparison to an overland route, carrying a better likelihood for success. He stressed that it is only a comparison. It was never intended by the Administration for it to be considered an end to LNG. It could be true that there is someone that would want to use the findings and portray those as an indication that LNG will not work; however, that is not the conclusion of the findings. Analyzing the LNG project, has determined that it is economic. The question remains in comparison to an overland route and then which route could bring more value to the State of Alaska as a first entrance. The overland route clearly provides more value. A separate issue is whether LNG is viably economic. He believed that it will be economic.

[3:41:54 PM](#)

REPRESENTATIVE GARA recalled that in January, the TransCanada proposal had been accepted but the LNG concept was not endorsed. He worried about the risks associated with a Canadian project getting the necessary permitting. He questioned if the Legislative Body was receiving an objective discussion of the dangers and shortcomings of LNG. Representative Gara asked what was necessary for that to happen.

MR. FENTON stated that if Alaska was faced with only an LNG project, the work already accomplished was not aimed at reaching a particular conclusion. He did not want to give the impression that an LNG project would be impossible to do. In the development of the North Slope project, there is an enormous amount of gas, with over 30 million tons a year. The State of Alaska will be able to develop LNG, however, there will need to be a balance between the pipeline and the LNG.

COMMISSIONER GALVIN hoped that the subject of LNG had been properly addressed. He recognized the findings portrayed as detrimental for getting LNG out of Alaska. He stated that it is important to understand what the findings are about. He applauded the presentation given by Mr. Fenton regarding LNG as a stand-alone project. The presentation indicates that it is in comparison to an overland route, which has a better value and likelihood of success. It was not the Administration's intent for the finding to be in contrast to LNG. He clarified that the TransCanada proposes a route to an LNG project, which might not otherwise exist after identifying all the other factors. It is a comparison issue and is not the conclusion of those findings. The State will make a profit. The question remains the comparison to an overland route, which would provide more value to the State. He emphasized that the overland route would clearly provide more value and would be economic for the State of Alaska. He addressed an export license as a stand-alone project and that having an overland project could first provides a head start. The State's conclusion is that LNG is important to pursue and that the overland route would be the best place to begin.

[3:49:57 PM](#)

REPRESENTATIVE GARA asked how complete an application would need to be under AGIA. He inquired if they would need the export license, the ships and the receiving facility.

COMMISSIONER GALVIN addressed the time frame. That was not an included hurdle in the AGIA application process; the application process included providing a full project that had all the commitments required under the law and that information available by the deadline. There have been a

number of changes for an LNG project, which do not exist for any overland project. It is important to give weight to that concept. The differences between the two projects are still inter-dependent of one another and the hurdle to show the reserves and being able to sell it as separate from one another. Whereas, with an overland project, reserves would have to be demonstrated to reach the market. The market itself has a different dynamic than the Asian market because of the long-term contracts and the liquidity, which affects moving the project forward. It remains a comparison issue.

[3:53:46 PM](#)

SENATOR HUGGINS referenced Slide 11 and asked about the significant greater costs. He inquired if the analysis includes the incremental costs between the Valdez tide-water minus the maritime shipping.

MR. FENTON could not determine that amount.

COMMISSIONER GALVIN pointed out that there will be a forthcoming presentation addressing all the cost issues.

SENATOR HUGGINS noted that Alaska has the longest existing LNG plant in the world. He requested an overview of the history and success of those projects.

MR. FENTON stated that they had not studied that project specifically. The determination was made in regard to the industry rather than the Kenai project; the project was developed at the inception of the industry and was one of the first LNG projects in the world; it operated many years serving the Japanese market.

SENATOR HUGGINS mentioned the complications in the Asian market. He requested an overview of that market and how long the State had been involved.

MR. FENTON was not clear on the request.

SENATOR HUGGINS addressed the State's involvement with the Port Authority. He directed comments to BG-Group (BG) involvement internationally in LNG gas. Other than regulatory concerns, they had hoped to bid under AGIA. He asked if there had been discussions with that group.

MR. FENTON responded that they had not addressed the specific project with that group but rather dealt with all companies. At the moment, BG does not have any sales in that market. BG has recently taken on the responsibility of selling LNG to Singapore & a new pre-gas terminal in Chili. Other than that, BG has no other participation in the Asian LNG market.

COMMISSIONER GALVIN was not aware of BG providing any conflicting information on gas strategies.

SENATOR HUGGINS understood that they had contemplated submitting a bid. He recalled that on January 30<sup>th</sup>, the Administration had committed to examine the LNG course of action.

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REPRESENTATIVE FAIRCLOUGH communicated that the Administration has put forth a pipeline as an alternative, which does not preclude a Y-line or LNG. She asked the consequence to the State of Alaska's liability if they were successful in the pipeline process application and then moved to a Y-line or LNG plant concept proposal.

COMMISSIONER GALVIN clarified that a spur line (Y-line) off the main line would not be in conflict with the TransCanada proposal.

REPRESENTATIVE FAIRCLOUGH responded that the Y-line is not the question, but rather if the State is considering exporting and then creating a Y-line for State gas, how does the Y-Line extract more and does that benefit the State.

COMMISSIONER GALVIN did not understand the question. He asked if she was referencing the 500 million cubic feet (mmcf) per day as a separate project.

REPRESENTATIVE FAIRCLOUGH reiterated that if the State draws more than .5 bcf and if that was not moving through the Canadian portion of the line, there could be consequences with increased tariffs and/or additional liabilities by drawing more.

COMMISSIONER GALVIN responded that the 500 mmcf issues go away upon the initial run of the gas line; it is only in place until the initial commencement of operations. The issue is in regards to taking more gas out of the stream, which ends up going into Canada, does the State then lose value in royalty gas where market value is lower. One of the concerns is that the State, as the owner of the resource, is provided opportunities to select which market is served. Moving forward, the issue of higher-up value will play a role on the royalty-side associated with that choice.

The State does not have the ability to dictate where the gas goes; yet royalty gas is different. It becomes an issue of evaluation and the complications can be eliminated for those who make the initial offer on the AGIA line. He noted that Representative Fairclough had identified a question down-the-road regarding the Y-line project and what interest the

State has guaranteeing that project makes the maximum return to the State. Those concerns will be addressed later in the process.

The findings address the interest that the State has in providing an access to both markets. The relationship between the two markets will ebb and flow over the years and having access to both markets will provide the State's leaseholders to be able to maximize the opportunities in moving between those markets. He did not see that as an issue as to what the State needs to control in the initial selection but rather the economics in an overland project.

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REPRESENTATIVE FAIRCLOUGH explained that the reason that she had asked the question was because the State is telling Alaskans that we are not precluding options at this point, yet if the State does not understand the economics of draw-down or liability over the bcf per day, it becomes complicated.

[4:07:59 PM](#)

REPRESENTATIVE PEGGY WILSON argued that the State should not address the possibility of gas moving into China since it does not meet with U.S. Government support.

MR. FENTON replied that he was not an expert on U.S. politics. He deferred the question to the Commissioner.

COMMISSIONER GALVIN answered that the query was relevant to the issues at hand. He recognized that there would be a negative reaction to China or any place in the Asian market. The concern about getting an export license is real and continues to be subject to interpretation.

REPRESENTATIVE WILSON recalled that a gas pipeline through Canada involves FERC. She asked if they would also be involved with an LNG line.

COMMISSIONER GALVIN agreed that with a pipeline that feeds an export line, the direct jurisdictional authority of FERC would not cover the pipeline at that time; the U.S. Department of Energy would be responsible for regulating the export license. FERC is an area of uncertainty because LNG ends up being a commodity that could serve either the U.S. or foreign markets. FERC has been somewhat non-committal on their view of that issue. It was fair to say that if FERC was not set up in that manner, the Regulatory Commission of Alaska (RCA) would likely step-in to regulate it in a manner similar to FERC. At the federal level, there would need to be an export license from the U.S. Department of Energy, including much federal permitting along the way.

REPRESENTATIVE WILSON commented that has not yet been addressed. She thought the process could be difficult if Alaska was not certain that the gas would move to the lower 48 states. She recommended the subject be discussed.

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SENATOR HUGGINS reminded members that for many years, the State has been exporting gas to Japan and that the State has endorsed renewing that certificate. He urged flexibility in the discussion.

[4:14:05 PM](#)

REPRESENTATIVE KERTTULA asked if the State had analyzed any of the reasons why the producers have not yet been providing LNG from Alaska.

COMMISSIONER GALVIN pointed out that query would be addressed during the economic analysis.

REPRESENTATIVE MIKE KELLY believed that the State's choice was either yes or no. He said there is no third option and that the producers probably are not in favor of the LNG choice. He noted that there is nothing indicated under the TransCanada proposal including an LNG Y-line.

COMMISSIONER GALVIN affirmed that was true.

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COMMISSIONER GALVIN indicated that the topic of discussion for the 6/10/08 meeting would be Chapter 3 of the findings and the back-up material received from Black & Veatch. The presenters will summarize the high points in the presentation materials.

BLACK & VEATCH PRESENTATION

[4:19:21 PM](#)

SCOTT SMITH, BLACK & VEATCH, provided a historical overview of Black & Veatch, a company which handles engineering, construction and consulting worldwide. The primary focus of the presentation remains the energy & water sectors. He pointed out he leads the market analysis sector of the company and focuses on providing commercial and economic analysis to the energy industry.

Presentation to the State of Alaska Legislature -  
Liquid Natural Gas (LNG) Analysis and Results  
(Copy on File).

[4:21:06 PM](#)

MR. SMITH outlined Slide 2, the key conclusions:

- LNG projects have higher capital costs and therefore greater risk than a pipeline project;
- Similar to an overland project, price remains the primary risk to a LNG project;
- LNG projects have positive Net Present Values (NPV) with base and high LNG price assumptions;
- The 4.5 billion cubic feet per day (Bcf/d) proposal base case project produces a higher NPV than a 4.5 Bcf/d LNG project; and
- A sustained high oil to gas price relationship is required for an LNG project to be favorable when compared to an overland route.

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MR. SMITH referenced Slide 3, which outlines the expected LNG tariffs for the LNG project configurations being considered. The cash flow is determined by the price less the volume. Highlighted are four different cases, assuming the same terms as the TransCanada proposal. Comparing the tariff to the LNG tariff results in differences related to:

- higher capital costs
- higher fuel loss
- higher operations and maintenance
- higher property taxes
- delayed start date
- higher debt
- LNG shipping

[4:28:01 PM](#)

MR. SMITH referenced Slide 4, applying the gas strategies to the Asian price formula expectations. He stated that price differentials are the key element to understand whether an LNG project economics are favorable (relative to an overland project). The chart illustrates a high LNG case, a base LNG case, a low LNG case and the wood Mackenzie Henry hub projection for the years 2008 through 2044.

[4:30:31 PM](#)

DEEPA PODUVAL, CONSULTANT, BLACK & VEATCH, provided an overview of Slide 5, the estimated cash flow for the 2.7 Bcf/d LNG case with positive net cash flow of \$103 billion dollars to the State.

MS. PODUVAL explained the cash flow percentages. She noted that the State's share of gross grows through time and is driven by price assumptions. The State's share grows due to the progressivity and production tax structure. She pointed out that the percentages of the total share of the cash flow accrue for the State as well as the producers. Over the evaluation period, the State only receives 33% of the total cash flow from the project and the producers receive 21%. The net cash flow from the project is \$1.3 billion dollars.

[4:32:49 PM](#)

MS. PODUVAL referenced Slide 6, the estimated cash flow for the 4.5 Bcf/d LNG case and the positive net cash flow of \$170 billion dollars to the State of Alaska. She stated that the State has an increasing share and the slide indicates that amount is 34%, with the producers receiving 20%. The Point Thompson production field will affect those amounts. The analysis was designed to capture the cash flow. There are several factors that cause oil and gas production to be interdependent including the shared facilities & tax benefits. All the analysis provided at the meeting represents the impact of the gas line.

[4:34:50 PM](#)

REPRESENTATIVE LINDSEY HOLMES asked for further explanation on the LNG-take that will be available to the State.

MS. PODUVAL explained that the LNG represents the project developer and is essentially, whomever is building the pipeline.

[4:35:28 PM](#)

SENATOR FRENCH noted that the State is accustomed to seeing a developer receive a 12-14% rate of return. He asked why a much higher scenario had been indicated for the LNG.

MS. PODUVAL responded that the return on equity would continue to be 14%; the 26% is the percentage of the total cash flow. Because the capital costs are higher, the equity is earned over a higher rate and so receives more cash flow from the project.

[4:36:10 PM](#)

SENATOR WIELECHOWSKI asked why the 2021 start date had been chosen. He understood that typically, an LNG line-run is about seven years or less. He thought that amount of time will have a tremendous impact on the net present cash flow.

MS. PODUVAL clarified that the projected start date was actually 2022, which was driven by input from the technical

team. One year delay comes from the fact that it would be outside the AGIA process and without having the process in place to approve and get an LNG project started, there is already a one year delay. An additional year delay is attributed to the construction time frame. She deferred to the technical team for further clarification.

MR. SMITH stipulated that the start date would be delayed until the award of the AGIA project.

SENATOR WIELECHOWSKI reiterated that backing everything up seven years provides a "huge impact" to the net present value (NPV).

MR. SMITH agreed, pointing out that one of the reasons for the higher tariff was the fact that one of the project delays means that the project will experience higher capital costs due to escalation. Delays could mean anywhere between 20 and 30 cents in tariff costs on a per year bases, depending on the capital assumptions behind it.

COMMISSIONER GALVIN added that the technical team, scheduled to testify at the 7/10/08 meeting, could further clarify those questions. He noted that if the State can assume a seven year start date and assume lower costs, then clearly, the project would appear more economic than indicated on the charts. The technical team was asked to use the same schedule and costs used to analyze the TransCanada project and use that to make assumptions for an LNG project. The primary drivers are the cost assumptions associated with the liquid fraction terminal. The second part will be the gas treatment plant.

[4:41:27 PM](#)

REPRESENTATIVE GATTO referenced the LNG project; he stated that 26% seems out of reach. He questioned if it was high because the liquidification plant costs quite a bit and offers a different rate of return.

MS. PODUVAL responded that they have the same 14% return on equity with higher base costs.

REPRESENTATIVE GATTO asked how that would change the percent.

MR. SMITH clarified that the percentage noted on the pie charts are not returns but rather percentages of the total cash collected. The returns would be much lower at a 14% - 15% range because it is assumed that it is already regulated. The pie chart focuses on the total pot of dollars rather than how much each party is getting.

[4:42:45 PM](#)

MS. PODUVAL referenced Slide 7, the Y-Line - aggregate project cash flow and a positive net cash flow of \$353 billion dollars to the State of Alaska. The dip areas are times when capital is being spent. The chart also indicates the share available to the stakeholders; the State carries 43% of the shares with the producers owning 23%.

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MS. PODUVAL discussed Slide 8, estimated State net present value which is substantially positive for all LNG project configurations being considered. That amount ranges from \$29 billion dollars to \$85 billion dollars. The base line and NPV to the State just for the overland project is about \$66 billion dollars.

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REPRESENTATIVE SAMUELS referred to Slide 7, questioning the numbers indicated for TransCanada. He asked if those amounts only include where the borders start.

MS. PODUVAL affirmed.

[4:45:20 PM](#)

REPRESENTATIVE GARA asked about the range of NPV's.

MS. PODUVAL explained that they represent nominal cash flows and that they are being added back to the State without discounting them back to present day.

[4:47:14 PM](#)

SENATOR HUGGINS recalled that TransCanada had indicated that the Canadian government anticipates making \$8 billion dollars from the pipeline over time.

MR. SMITH explained that Black & Veatch did not assume TransCanada's assumption's or prices. Instead, they relied upon the technical team expert's opinion regarding capital costs. Black & Veatch carries a higher capital base assumed in that analysis.

HB 3001 and SB 3001 were held in Committee for further consideration.

#### ADJOURNMENT

The meeting was adjourned at [4:47:23 PM](#).