

MINUTES
SENATE FINANCE COMMITTEE
April 23, 2007
2:12 p.m.

CALL TO ORDER

Co-Chair Bert Stedman convened the meeting at approximately [2:12:55 PM](#).

PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice Chair
Senator Kim Elton
Senator Joe Thomas
Senator Fred Dyson
Senator Donny Olson

Also Attending: SENATOR GARY STEVENS; TOM IRWIN, Commissioner, Department of Natural Resources; PAT GALVIN, Commissioner, Department of Revenue; ANTONY SCOTT, Commercial Analyst, Division of Oil and Gas, Department of Natural Resources.

Attending via Teleconference: There were no teleconference participants.

SUMMARY INFORMATION

SB 104-NATURAL GAS PIPELINE PROJECT

The Committee heard a presentation from the Palin-Parnell Administration. The bill was held in Committee.

#sb104

[2:13:08 PM](#)

SENATE BILL NO. 104

"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."

This was the first hearing for this bill in the Senate Finance Committee.

[2:13:17 PM](#)

Co-Chair Stedman announced that the Committee would begin its hearings on the Alaska Gasline Inducement Act (AGIA).

[2:13:36 PM](#)

TOM IRWIN, Commissioner, Department of Natural Resources recognized and appreciated the efforts expended by the Legislature thus far on AGIA.

Mr. Irwin stated that AGIA was "all about business", and utilized a common practice in business. The bill defined what the State would offer as inducements, and what would be required of oil and gas producers who opted to participate in the construction of a natural gas pipeline.

[2:16:33 PM](#)

Mr. Irwin informed that the Department of Natural Resources estimated the identified gas reserves at approximately 250 to 260 trillion cubic feet. He voiced that the producers were not in Alaska because they loved the State, but rather for business and profit. He likened the oil and gas companies' responsibility to their shareholders to the Administration's responsibility to protect the interests of the people of Alaska. He stressed the importance of access to gas reserves as a "must have" in the AGIA process.

Mr. Irwin stated that the contract negotiated by former Governor Murkowski resulted in the State being placed in a "highly leveraged position". Mr. Irwin referenced comments made by producers that indicated lack of support and motivation to construct the gasline in a timely fashion. The previous contract would have positioned the State in an "untenable" arrangement, and the legislature appropriately refused to ratify the contract.

[2:19:26 PM](#)

Mr. Irwin furthered that the rejected contract was incomplete. The State should not be forced to concede its judicial, legislative and administrative rights in exchange for a commitment from producers to build a gasline, as the previous contract proposed.

[2:20:20 PM](#)

Mr. Irwin discussed the methods by which the State could progress on the construction of a gasline. He rejected the notion that the State should modify the contract negotiated by the Murkowski Administration, stating that the contract was "not tweakable". Thus, the Palin Administration opted for the common business practice of investing in its own project.

[2:22:08 PM](#)

Mr. Irwin continued that the \$500 million offered as incentives in AGIA represented the State's investment in the gasline. That investment could potentially generate hundreds of billions of dollars. He cautioned that the State should not advance a closed, isolated basin. AGIA would provide Alaska with a fair, open process.

[2:23:45 PM](#)

Mr. Irwin asserted that the State was not respected or trusted by the oil and gas companies that were party to the previous negotiations, which was another factor in the necessity of State investment in the gasline project. He commented that little risk was associated with AGIA, as it was a dollar-for-dollar investment, and if a producer withdrew from the project the State would retain the monies invested. The Request for Proposal (RFP) process would allow business to compete fairly and equitably.

[2:25:23 PM](#)

Mr. Irwin shared that companies trust in the Palin Administration's commitment to a fair and open process. AGIA would allow oil and gas companies to do business in a "safe American environment", and he expected continued support of the bill.

[2:26:48 PM](#)

Co-Chair Stedman requested the aforementioned quotes attributed to oil and gas producers indicating their reluctance to build a gasline.

Mr. Irwin would provide the documentation.

[2:27:19 PM](#)

PAT GALVIN, Commissioner, Department of Revenue, indicated he would provide a "condensed summary" of SB 104 utilizing an overhead and handout titled "The Palin-Parnell Administration presents AGIA: The Alaska Gasline Inducement Act, Senate Finance, 4/23/2007" [copy on file].

[2:27:59 PM](#)

Page 2

AGIA Overview

- Is a commercial vehicle that creates a competitive playing field
- Provides a pipeline on Alaska's terms
- Is a transparent process, with transparent inducements.

Mr. Galvin summarized the page, noting that AGIA would allow gas companies to make individual determinations of what was in their organization's best interest.

[2:29:26 PM](#)

Page 3

Commercial Vehicle

- AGIA uses competitive bidding, not negotiation
- Successful bidding process requires AGIA's inducements
 - Without inducements, no third-party bidders
 - Without third-party bidders, state has no ability to get a pipeline on its desired terms

Mr. Galvin overviewed this page.

[2:30:35 PM](#)

Page 4

Commercial Vehicle

AGIA's inducements:

- Midstream inducement of \$500 million:
 - Reduces licensee's project development risks, especially an independent pipeline licensee

- Upstream tax and Royalty inducements:
 - Coupled to the licensed midstream project to make license more valuable, by
 - Encouraging open season participation
 - Ensuring that State will stick with its licensed partner

- Requirement to obtain pipeline certificate reduces overall project risks, improves state's strategic position

Mr. Galvin highlighted the page, explaining that applications from producers would include the portion of the \$500 million maximum that they were applying to receive. The upstream incentives, including a ten-year tax "commitment" by the State, were designed to encourage participation in a successful open season.

[2:34:29 PM](#)

Page 5

A project on the State's Terms

- By creating a more competitive playing field, state can specify some "must haves"
- State's "must haves" focus on its future:
 - A pipeline sooner
 - A competitive and vibrant oil and gas industry
 - Jobs and careers, not only from the pipeline itself, but also from a competitive oil patch
 - Gas for Alaskans

Mr. Galvin spoke to the State's "must haves" under AGIA.

[2:36:31 PM](#)

Page 6

A project on the State's Terms

- State's "must haves" all obtained through pipeline tariff and access terms that ensure a competitive oil and gas industry
 - Competitive oil and gas industry can flower if pipeline ownership gives no upstream competitive advantage
 - Jobs and careers for Alaskans will be maximized by ensuring a competitive upstream industry
 - Cheap gas for Alaskans will be enjoyed if pipeline regularly expands

Mr. Galvin summarized the page.

[2:37:04 PM](#)

Page 7

A project on the State's Terms

- A pipeline sooner
- Required minimum 70/30 debt/equity ratio ensures reasonable base tariffs
- Expansion requirements ensure that gas found by any party can access the pipeline
- Rolled-in rate requirements ensure that all parties have an economic incentive to explore for gas, competition for oil and gas, and all of Alaska's gas can get into the pipeline

Mr. Galvin reviewed the page, indicating that one of the primary means for the State to receive revenue from the project was through the "net-back" value on gas in the form of leases and production taxes. This revenue stream depended on the market price of gas, as well as the tariff levied on the gasline. The tariff rate was dependent on the debt to equity ratio.

[2:41:22 PM](#)

ANTONY SCOTT, Commercial Analyst, Division of Oil and Gas, Department of Natural Resources informed that he had been involved in the development of a natural gas pipeline since 2003.

[2:42:11 PM](#)

Page 8

Gets a Pipeline Sooner

Losses to State for Each Year Delay
Discounted at 5% per Year

[Line graph depicting delays of one year, two years, and three years in billions of dollars at sustained gas prices between \$3.50 and \$10.50.]

Mr. Scott explained that there existed "real values" to the State if the gasline progressed quickly, and conversely, there would be losses due to delays. He exampled a benefit to the State of \$1.8 billion if a pipeline was completed one year earlier than projected, at gas prices of \$5.50.

[2:44:03 PM](#)

Page 9

Tariff and State Revenue Effects of Debt-Equity Structure

[Chart depicting the following:

Debt %: 80%
Equity %: 20%
Tariff: \$1.47
Present Value State Revenue \$ Billions: 37.4

Debt %: 75%
Equity %: 25%
Tariff: \$1.56
Present Value State Revenue \$ Billions: 36.9

Debt %: 70%
Equity %: 30%

Tariff: \$1.65
Present Value State Revenue \$ Billions: 36.3

Debt %: 65%
Equity %: 35%
Tariff: \$1.74
Present Value State Revenue \$ Billions: 35.7

Debt %: 60%
Equity %: 40%
Tariff: \$1.84
Present Value State Revenue \$ Billions: 35.1

Debt %: 55%
Equity %: 45%
Tariff: \$1.95
Present Value State Revenue \$ Billions: 34.5

Debt %: 50%
Equity %: 50%
Tariff: \$2.06
Present Value State Revenue \$ Billions: 33.8

Debt %: 45%
Equity %: 55%
Tariff: \$2.18
Present Value State Revenue \$ Billions: 33.1]

AGIA protects the states interest in low tariffs. It ensures that no less than 70/30 will be used rather than 50/50, with associated tariff benefits of 41 cents and state revenue benefits of \$2.5 billion.

Mr. Scott spoke to the examples on the page, and communicated that the debt-to-equity structure was an important factor in the tariff calculation due to the fact that debt is less expensive than equity. The proportion of debt to equity would therefore be a significant consideration in the overall cost of the project.

[2:47:38 PM](#)

Page 10

Expansion Provisions Cost-of-Delay to Explorer

Expected Net Present Value (NPV 12)
Generic North Slope Prospect

[Bar graph depicting expected negative net present value in millions of dollars for each year of delay to first-production. For example, a two year delay would result in a net present value of negative \$8.7 million. A five year delay would result in a net present value of negative \$23.1 million.]

Mr. Scott noted that AGIA required expansion of the pipeline in an "engineering increment" as more gas was extracted. The pipeline capacity would be expanded within the basic design of the project, by increasing compression or "looping" using the same pipe size. He set forth that the 2004 enabling federal legislation for the project provided the Federal Energy Regulatory Commission (FERC) the unprecedented authority to order an expansion of the pipeline. The process to request an expansion through FERC would cost a producer "dozens of millions of dollars," and would likely result in extended litigation.

[2:52:03 PM](#)

Page 11

FERC Lower 48 Expansion rate policy

[Bar graph depicting Lower-48 FERC policy, Original (2016) Shippers' Rates, Lower-48 FERC policy, 1st Expansion (2018) Shippers' Rates, Lower-48 FERC policy, 2nd Expansion (2021) Shippers' Rates, and Lower-48 FERC policy, 3rd Expansion (2023) Shippers' Rates for the years 2016 through 2026.]

Mr. Scott overviewed the page, detailing the effects of expansion on shipping rates in the contiguous United States. He opined that the type of policy exemplified would discourage expansion of the pipeline to full compression.

[2:55:03 PM](#)

Page 12

AGIA Expansion rate policy

[Bar graph depicting Lower-48 FERC policy, Original (2016) Shippers' Rates, Lower-48 FERC policy, 1st Expansion (2018) Shippers' Rates, Lower-48 FERC policy, 2nd Expansion (2021) Shippers' Rates, Lower-48 FERC policy, 3rd Expansion (2023) Shippers' Rates, and AGIA policy for the years 2016 through 2026.]

Mr. Scott contrasted the AGIA policy to the previous FERC example, commenting that rolled-in rates as provided for in AGIA would provide more incentive for pipeline expansion.

[2:56:11 PM](#)

Page 13

Rolled-in Rates Encourage Exploration

Examples:

Scenario 1:

Add 1 Bcf/day with compression (from 4.5 to 5.5 Bcf/day)

Rolled-in: \$6.0 million

Incremental: \$6.5 million

Scenario 2:

Add 1 Bcf/day with compression (from 5.5 to 6.5 Bcf/day)

Rolled-in: \$4.3 million

Incremental: -\$5.4 million

Scenario 3:

Add 700 MMcf/day with looping (from 6.8 to 7.5 Bcf/day)

Rolled-in: \$.9 million

Incremental: -\$25.5 million

Mr. Scott addressed the comparisons of rolled-in rates and incremental rates illustrated on this page. He summarized that rolled-in rates made additional gas prospects more profitable and thus encouraged exploration.

[2:58:38 PM](#)

Page 14

Transparent Public policy

- AGIA creates a competitive process, not a negotiated process
- Bids will be submitted, commented upon by the public, and evaluated
- A winner will be chosen by the Commissioners
- The Commissioners' decision will be reviewed by the Legislature

M. Galvin reviewed the "transparency" of AGIA. The initial request for applications would be made July 1, 2007 with a due date of October 1. The public comment period would last 60 days, and upon completion the commissioners would select a winning application.

[3:01:02 PM](#)

Page 15

Transparent Public policy

- The value of AGIA's inducements are up front and transparent
- Contrast: AGIA's \$500 million versus SGDA contract \$10 billion+
 - Much of SGDA contract value was hidden and unquantifiable
 - AGIA's benefits are explicit and quantifiable

Mr. Galvin spoke to the information on this page.

[3:02:11 PM](#)

Page 16

Summary

- Without competition, and the forward movement that AGIA provides, Alaskans will have to wait, and watch, until the Producers do the pipeline on their timeline and on their terms.
- AGIA changes the playing field.
- AGIA is a commercial vehicle that creates a competitive playing field, provides a pipeline on Alaska's terms, in a transparent manner.

Mr. Galvin highlighted this page.

[3:04:09 PM](#)

Co-Chair Stedman asked about the "breakdown" of the \$10 billion figure quoted on page 15. He also requested analysis of the negotiation requirements under the Stranded Gas Act.

Mr. Galvin asked for clarification of the question.

Co-Chair Stedman reiterated his request for the Department's interpretation of whether negotiations were to be held publicly or in private under the Stranded Gas Act.

[3:05:20 PM](#)

Co-Chair Stedman referred to page 10, and asked for further explanation regarding the cost of delay. It appeared that a one year delay would cause the project to produce a negative net present value, thus discouraging construction.

[3:06:57 PM](#)

Mr. Galvin explained that the slide was intended to represent a generic North Slope prospect, and the impact of delay of expansion under AGIA. The purpose of the example was to demonstrate that the expectation of expansion by the explorer would drive the decision of whether or not to drill an exploratory well. The expansion provisions of AGIA would provide assurance to the explorer, therefore encouraging exploration.

[3:09:26 PM](#)

Co-Chair Stedman assumed that in the event of a one year delay an explorer would not continue, as the net present value would be negative.

Mr. Galvin specified that without the expansion requirements in AGIA a producer would have to consider the probability that a FERC ordered expansion would occur, and factor in the likelihood of a delay in the expansion. He suggested that the "must haves" within AGIA would reduce that uncertainty, as the bill would provide assurance that the pipeline would expand if gas was discovered.

Co-Chair Stedman requested the supporting data used by the Department to generate this example. He remarked that previous information differed from the current example, and that he was not convinced that a one year delay could turn a profitable project into one with a negative value.

Mr. Galvin would provide the requested information.

[3:11:38 PM](#)

Mr. Scott explained that the delays referenced by Co-Chair Stedman were assumed in the analysis. The representation spoke to delays due to the FERC expansion process, which included litigation and other major financial expenses in addition to the delay.

[3:13:43 PM](#)

Co-Chair Stedman again requested the background analysis.

Mr. Scott asserted that the "downward trend was unmistakable," and would provide the information requested.

[3:14:21 PM](#)

Senator Huggins asked if the 70/30 tariff rate of \$1.65 depicted on page 9 was an actual projected rate.

[3:14:57 PM](#)

Mr. Scott responded that the \$1.65 projection was based on a scenario of a \$20.5 billion project into Alberta, Canada with particular financial assumptions.

Senator Huggins asked for the assumptions used in this projection, as well as a projected tariff rate for a \$30 billion project.

Senator Huggins understood that the gas treatment plant was excluded from this scenario.

Mr. Scott assumed that to be true, but would provide a definitive answer.

Senator Huggins requested a projected scenario that included a gas treatment plant, and asked that other examples in which the treatment plant was excluded be reconsidered to determine the impact of a treatment plant.

[3:16:28 PM](#)

Co-Chair Stedman repeated Senator Huggins' request.

[3:16:53 PM](#)

Senator Huggins referred to pages 11 and 12, and related the listed dollar amounts to those on page 9. He asked if the amounts were rounded for illustration.

Mr. Scott communicated that the differences in the projections were due to the inclusion of a gas treatment plant in one example but not the other. The consideration of the gas treatment plant changed the value by approximately 40 cents. The projection also analyzed construction costs at a level higher than \$20.5 billion, as the example accounted for subsequent costs of expansion of the pipeline.

[3:18:12 PM](#)

Senator Huggins stated that comparisons could be made more appropriately if the model used the same assumptions and figures.

[3:18:25 PM](#)

Co-Chair Stedman requested "reconstituted" charts and consistent application of a gas treatment plant inclusion or exclusion.

[3:19:21 PM](#)

Mr. Scott was "happy to do that". He reminded that the examples provided were simply an attempt to illustrate for the committee possible outcomes under AGIA. He could not predict the exact final project, and was trying to explain the dynamics in general.

[3:20:23 PM](#)

Co-Chair Stedman asked for symmetry amongst the slides, and told that disclosure would assist the Committee in understanding the materials.

[3:20:33 PM](#)

Co-Chair Hoffman appreciated acknowledgement of the State's obligations to the citizens of Alaska. He shared that Governor Palin intended to "turn dirt" in the summer of 2008, and pointed to the claim on page 7 that AGIA would produce "a pipeline sooner". He asked what provisions in the bill would contribute to achieving those goals. He understood that current loan guarantees would expire in the near future, and an increase in the project cost could require a greater guarantee. He asked if the Administration had requested an extension of the guarantees.

[3:22:07 PM](#)

Mr. Galvin replied that AGIA could expedite the erection of a gas pipeline through the requirement of time commitments and the establishment of competition. He recognized that the State and the gas producers had different imperatives regarding the production of North Slope gas, and expected that the competitive environment fostered by AGIA could encourage progress on the gas pipeline.

[3:23:47 PM](#)

Mr. Galvin was not aware of an expiration provision in the federal loan guarantee. He explained that the timeline related to the federal government's ability to take over the construction of a pipeline project. He understood that AGIA had the support of the federal government and would be allowed to move forward under the auspices of the State. Retraction of the federal loan guarantees was unlikely, but the value of such guarantees may need to be amended as cost increases continued.

[3:26:24 PM](#)

Co-Chair Stedman asked for further information on the loan guarantee.

[3:26:34 PM](#)

Mr. Irwin recounted a visit he and Mr. Galvin made to Washington, D.C. to meet with FERC, the U.S. Department of Energy, and a senior advisor to Vice President Dick Cheney. During a presentation before FERC explaining the details of AGIA, a FERC official exhibited great enthusiasm for the project. Mr. Galvin attended meetings with FERC and reported its support.

Mr. Irwin continued that he met with representatives of the Department of Energy during the same visit and requested a meeting with the Assistant Secretary. He was initially told that the Assistant Secretary was unavailable on such short notice; however, after giving the presentation on AGIA, Mr. Irwin was granted a 15 minute meeting with the Assistant Secretary the following day. The meeting with the Assistant Secretary lasted approximately four hours and was characterized by eager support of AGIA on the federal level.

[3:29:26 PM](#)

Co-Chair Hoffman recognized that the oil companies had opportunities to invest outside of Alaska, but opined that the tentative agreements negotiated with the previous administration indicated the producers' willingness to invest in a State gasline. He asked if Mr. Irwin concurred with that statement.

[3:30:52 PM](#)

Mr. Irwin did not agree with that position, citing that the language governing the creation of a limited liability company (LLC) had not been complete the previous year, and upon passage of the Petroleum Profits Tax (PPT), an oil and gas producer requested an additional one billion dollars before proceeding. There currently existed an agreement in the form of a State constitution delineating Alaska's ownership of the gas, and leases held by the producers requiring them to develop the product when it was "economic, not most economic".

[3:32:33 PM](#)

Co-Chair Hoffman pointed out that changes had occurred since former Governor Murkowski began negotiations with the oil companies and the "contentious time" that resulted in the previous legislature's approval of higher tax rates under the PPT legislation. He assumed that the higher tax rate rendered

the producers unwilling to commit to the construction of a gasline, and asked if Mr. Irwin agreed that the oil and gas companies would have signed a contract at Murkowski's lower negotiated tax rates.

[3:34:41 PM](#)

Mr. Irwin responded that he could not speak for the oil companies. He observed that the previous negotiation did not produce a guarantee for an open season, did not result in define "offtake rates" under the Alaska Oil and Gas Conservation Commission (AOGCC), and failed to make progress in many other facets of the project.

Mr. Irwin contended that "real differences" existed between the oil and gas companies potentially involved in the project. One company was investing and exploring extensively in Alaska, while others were not as involved. The previous proposal contained a "clear and convincing evidence" standard that the State must meet in demonstrating that an oil company was not advancing the project, which would have placed too much of a burden on the State in arbitration proceedings. AGIA would provide the State a different mechanism for constructing a pipeline by encouraging investment in the project using common business practices. The project would not be biased for producers or against the construction of a pipeline. He expected the oil and gas producers would object to AGIA due to their experiences with the former administration.

[3:38:15 PM](#)

Senator Elton asked if the process was designed to license only one entity, or if multiple entities could be licensed.

Mr. Galvin replied that one license would be issued by the State and would allow the licensee access to the inducements under AGIA. The Administration anticipated that the licensee could build alignments or consortiums with other entities based on mutual interests. Thus, one license would be issued, but multiple companies could be involved.

[3:40:08 PM](#)

Senator Elton asked if additional business arrangements made after the issuance of the initial license would require the

licensee to return to the State for approval or accommodation of the arrangement.

Mr. Galvin affirmed, noting that the commissioners would have to approve any assignment of interests under the license.

Senator Elton assumed that the decision would be made by the Executive Branch.

Mr. Galvin affirmed.

[3:40:58 PM](#)

Senator Thomas described the oil producer-constructed Trans Alaska Pipeline System (TAPS) as "tremendously profitable", and pointed out that AGIA would create an opportunity for a party not invested in oil and gas exploration to compete to build the gas pipeline. The State was "in a pickle" to identify new revenue sources due to waning oil production, and the producers had an incentive to delay construction of a gasline to leverage the State in negotiations. He asked how AGIA could assist the State in the erection of a gasline.

[3:42:59 PM](#)

Mr. Galvin agreed that time was not "on the side" of the State, and as time progressed the State would become more exposed financially, and could be forced to accept less attractive terms. AGIA recognized the situation and attempted to change that position.

Mr. Galvin spoke to the second piece of the question, the value of an integrated project. The business structure associated with TAPS allowed the oil industry to add value to its investment. That integrated system was currently involved in litigation regarding tariffs and other aspects, and had been examined as it related to the gasline. The alternative to an integrated pipeline was one that was built by a company that specialized solely in pipeline construction and was not a producer-shipper of gas. AGIA addressed both the time constraint concerns and the integrated ownership concerns.

[3:47:16 PM](#)

Co-Chair Stedman assumed that the Department would prepare a timeline depicting optimistic and pessimistic AGIA outcomes to overlay with the fiscal position of State to illustrate to Committee members the potential impact of the proposed legislation.

Mr. Galvin affirmed.

[3:48:03 PM](#)

Mr. Irwin commented that Senator Thomas' and Senator Elton's questions related to one another. While the State was in a time-sensitive position, significant gas potential existed within the State. The State had selected one route, but should not exclude one route over another in a long-term projection.

[3:49:17 PM](#)

Co-Chair Stedman announced that the Committee would begin a sectional analysis of the bill at the following hearing.

#sb 104

ADJOURNMENT

Co-Chair Bert Stedman adjourned the meeting at [3:50:49 PM](#)