MINUTES
SENATE FINANCE COMMITTEE
April 24, 2007
3:06 p.m.

CALL TO ORDER

Co-Chair Bert Stedman convened the meeting at approximately 3:06:17 PM.

PRESENT

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

Also Attending: PAT GALVIN, Commissioner, Department of Revenue; MARCIA DAVIS, Deputy Commissioner, Department of Revenue; ANTHONY SCOTT, Commercial Analysis, 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 continuation of the sectional analysis of the bill, specifically Sections 43.90.130(7) through 43.90.190 added by Section 1, from the Department of Revenue and the Department of Natural Resources. The bill was held in Committee.

#sb104

> CS FOR SENATE BILL NO. 104(JUD)
> "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 third hearing for this bill in the Senate Finance Committee.

Co-Chair Stedman noted that today's sectional analysis discussion would include the issue of rolled-in verses incremental rates.

3:06:51 PM

Chapter 90. Alaska Gasline Inducement Act.

Article 1. Inducement to Construction of a Natural Gas Pipeline in this State.

Section 43.90.130. Application requirements. subsection (7),(page 1, line 9)

MARCIA DAVIS, Deputy Commissioner, Department of Revenue continued the sectional analysis of Chapter 90, added to AS 43 by Section 1 of the bill. [NOTE: To view the initial sectional analysis of CSSB 104(JUD), see SFIN 042407 0905 AM Time Stamp 9:09:49 AM.]

Ms. Davis directed attention to Section 43.90.130(7), page 6, line 11. This subsection is a "continuation of the list of items" a pipeline company must include in their Alaska Gasline Inducement Act (AGIA) application. Subsection (7) specifically addresses "the manner" through which an entity should manage the costs associated with future expansions of the line.

Ms. Davis informed the Committee there were two ways through which expansion "costs could be incurred" and assessed to shippers in a pipeline. The incremental cost approach would spread expansions costs only onto new shippers; costs to existing shippers would be unaffected. The second option, referred to as the rolled-in rate approach, would combine the cost of the existing structure with the cost of the new structure. That combined cost would then be "re-divvied" between both new and existing shippers.

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Ms. Davis informed the Committee that, in an effort to provide an atmosphere that would encourage future pipeline expansion, particularly if an incremental rate mechanism was in effect, the original version of the bill specified a maximum limit on the expansion costs that would be borne by shippers.

Ms. Davis explained that the original bill permitted "the pipeline company to agree to allow a certain amount of cost-sharing with existing shippers" via a rolled-in rate approach "up to a point". Once that point was reached, any extra costs would be addressed via either an incremental or rolled-in rate mechanism as elected by the pipeline company and approved by the Federal Energy Regulatory Commission (FERC).

Ms. Davis reminded the Committee that FERC's regulations would supersede any State position, "no matter what we write in this bill … or ask a pipeline company to commit to propose to FERC". While a pipeline company's proposal or shippers' arguments would "carry some weight", FERC would be the final authority on costs "borne by the shipper in a pipeline structure".

Ms. Davis compared the expansion assessment language proposed in the Judiciary committee substitute to that of the original bill. The Judiciary bill would require "a pipeline company to come forward and agree to allow rolled-in rate treatment for expansion costs up to 15 percent of a number. The original bill made that number 15 percent of the maximum initial recourse rate" or, in pipeline company terminology "the rack rate".

Ms. Davis likened a pipeline rack rate to the rate a person walking into a hotel after driving all day would pay for a room that night. In other words, it would be the maximum rate.

Ms. Davis disclosed that pipeline companies expressed concern about utilizing the maximum recourse rate in the equation because of their preference to negotiate rates: "we like to encourage people to come in and ship gas on our pipeline by negotiating rates." Setting "the cap at 15 percent of the higher rack rate" might "dissuade people or take some of the oomph out of our negotiated rates". As a result of this concern, the original bill's language was revised.

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Ms. Davis communicated that the decision was made "to divvy that maximum recourse rate into three categories": 15 percent of the rack rate for those paying the rack rate; 15 percent of the negotiated rate for those with negotiated rates; and "a weighted blend" of the first and second categories for shippers in neither of those categories. The latter category could include a shipper who participated after the initial pipeline construction in, perhaps, the first expansion effort.

Ms. Davis stated that the language specific to these three categories is located in subsection (7)(B)(i),(ii), and (iii) beginning on page 6, line 21 through page 7, line 12.

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Co-Chair Stedman considered this an opportune time to discuss the "special treatment" this project would receive from FERC as compared to the "historic methodology" applied to other states.

Ms. Davis deferred this discussion to the Department of Natural Resources.

3:13:48 PM

ANTHONY SCOTT, Commercial Analysis, Division of Oil and Gas, Department of Natural Resources, informed the Committee that until the mid 1990s, "FERC's favored policy" in the contiguous United States (U.S.) was the rolled-in rate structure. That position changed to the incremental rate approach in recognition of "an increasingly competitive pipeline sector with producing and final demand markets being served by multiple pipelines".

Mr. Scott stated that in the case of the Alaska pipeline project, FERC adopted rebuttal presumption Orders 2005 and 2005A. Those orders supported utilizing "rolled in rates for this project in recognition of the fact that there would be no competition, almost certainly, for moving gas out of Alaska by pipeline".

Mr. Scott noted that FERC's support of the rolled-in rate structure for Alaska was influenced by U.S. "Congress' desire to ensure that the pipeline promoted exploration and development of North Slope resources."

Mr. Scott pointed out that the rolled-in rate structure has been the standard in Canada for decades. It has "led to enormous growth of the pipeline grid" as well as "gas exploration and development in Alberta".

Mr. Scott asked whether this information had sufficiently addressed Co-Chair Stedman's request to discuss how FERC treated operations in Alaska.

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Co-Chair Stedman replied "part way". While his remarks had not been to Canada's situation, he understood "that Canada has a different required rate of return on some of their investments".

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Mr. Scott communicated that because rates of return are revisited each year in Canada they "tend to be lower because of that", as a pipeline company "faces less risk of recovering their investment". As a result, the rates of return allowed by Canada's regulatory body, the National Energy Board (NEB) "are lower than those provided by the FERC".

Co-Chair Stedman asked for a "reasonable assumption" of the range of return that would be expected on the Alaska gasline project as compared to a similar one in Canada.

Mr. Scott was unable to provide such a comparison as he was unfamiliar with conditions in Canada. However, such data could be compiled.

Mr. Scott advised however, that in the U.S., "in initial certification proceedings, a 14 percent rate of return for the maximum recourse rate for the first several years of pipeline operation … would be the norm given the kind of debt equity ratios" being discussed.

Mr. Scott stated that oftentimes, "some years into a pipeline's operation one often sees those rates of return numbers come down" to around 12 percent due to "litigated rate outcomes".

Mr. Scott thought that "the rates of return on Canadian pipes tend to be" slightly lower than that. This information would be affirmed.

3:18:05 PM

Co-Chair Stedman expressed that the Committee has heard conflicting testimonies regarding the impact that expanding the pipeline, first by compression and then by looping, would have on the pipeline tariff. Some believe tariffs would increase, others believe they would decrease, and others believe they would be unaffected.

Co-Chair Stedman understood that the Department of Natural Resources was developing modeling that would "provide a more in-depth analysis on what would be a reasonable expectation on the tariff" were a 4.5 billion cubic feet capacity (BCF) pipeline expanded to a six BCF capacity line.

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Mr. Scott expected that a multitude of modeling scenarios could be developed within a week's time. The likely impact on the rate of returns due to expansion would depend on several things including the cost and timing of the expansion. The Department estimates that the further into the future expansion occurs, the more expensive it would be.

Mr. Scott stated that this position is based on several factors. For instance, compression activities over the past 15 years have experienced "significant and real price escalation" in comparison to the "economy as a whole". Thus, a one BCF expansion on day one would be less than one occurring after two years. One occurring five years out would be even more expensive.

Mr. Scott stated that the price of fuel at the time of expansion is also a cost factor, particularly in consideration of the 15 percent tariff limitation specified in subsection (7)(B)(i) through (iii).

Mr. Scott recalled testimony from TransCanada Corporation in which "they said, 'You don’t need to worry about rolled-in rates, it’s a sunny day; we can get through looping without any rate increase compared to the initial rate'."

Mr. Scott noted however, that Tony Palmer with TransCanada Corporation would also explain that that assumption, in terms of

rate impacts, presumes that all of the expansions occur when the pipeline first goes into service.

Mr. Scott pointed out that the Department's modelings are based on the assumption that expansion would occur over time, rather than immediately.

Before concluding his remarks on expansions and rate impacts, Mr. Scott reviewed the consequence of high gas prices and the subsequent affect of those prices on the pipeline tariff.

3:22:37 PM

Ms. Davis resumed the discussion pertaining to the application criteria requirements specified in AS 43.90.130. The requirement in subsection (8) page 7, line 29 was added to the original bill, which solely focused "on the construction of a pipeline", to ensure that the discussion included having a gas treatment plant (GTP) on the North Slope. While the application would not require the pipeline builder "to supply" a GTP, an evaluation process was deemed necessary in case they did construct one, "or, in order to assess the likelihood of success of the project, where would the plant come from?".

Ms. Davis specified therefore, that subsection (8) was added to require the applicant "to disclose what their plans were with respect to having a gas treatment plant".

Ms. Davis spoke to this point as follows.

> ….because there's a distinct possibility that a GTP on the North Slope would in some way engage or involve infrastructure that already exists there on the Slope, particularly at Prudhoe Bay, we wanted to also ensure that if an applicant was putting in gas treatment plant facilities that included facilities that already existed, there's a provision in here on line 6, page 8 that requires that if assets are committed, the gas treatment plants that are already owned, that they'll be committed at net book value so that they aren't put in at replacement value, in other words brand new costs that would then have to be put against the tariff rate.

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Co-Chair Stedman identified another issue associated with a GTP; that being whether the 20 percent tax credit provision included in the Petroleum Profits Tax (PPT) adopted by the Legislature in 2006 would apply to the facility.

To this point, Co-Chair Stedman requested that the Governor Sarah Palin Administration provide a definitive answer to this question.

Co-Chair Stedman declared that the Legislature spent a significant amount of time discussing how a GTP would be affected by the PPT. While the concept discussed differed from AGIA, it was the Legislature's understanding that a GTP would not qualify as a credit under the PPT.

Ms. Davis assured the Committee that the requested information would be provided. This issue had already been "flagged" as an area of concern.

Mr. Scott informed the Committee that the economic modelings provided to date on AGIA have "assumed that the GTP did not qualify for PPT credits".

3:25:31 PM

Senator Thomas asked whether language in subsection (8) would also apply to existing gathering lines that might "be used in conjunction with" the GTP.

Ms. Davis thought Senator Thomas raised "a good point". The GTP provisions in this bill were drafted from the view it would be "post-production treatment". She tended "to think of gathering lines as going from wellhead to a processing center and, in most fields, that processing is an initial processing that wouldn't be considered part of the gas treatment plant. However, one could envision gas going from another unit to this location where it would have already undergone processing for the initial processing and that a line would transit to the gas treatment plant." There could be "a question as to whether that line should be considered a FERC line or not." This issue would be reviewed in the application process.

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Ms. Davis stated that subsection (9) page 8 lines 11 through 13, required the applicant to specify the percent, dollar amount, and timeframe they would seek in regards to the State's matching contribution for the proposed project. This is commonly referred to as the State's $500 million dollar contribution.

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Ms. Davis identified subsection (10) page 8 lines 14 through 17 as one of the Administration's "must haves". It "is the obligation on the part of the applicant to commit that, for rate making purposes, they will only include a 70 percent debt structure". This level of debt would assist in insuring "reasonable tariffs".

Ms. Davis announced that language specifying "not less than 70 percent" would allow an applicant to propose "a higher debt element that would essentially lower the rates".

Co-Chair Stedman asked the reason an 80 percent debt structure, rather than the 70 percent, had not been specified. It would further the goal of having lower tariffs. Cost overruns could be separately addressed.

3:28:46 PM

Ms. Davis expanded on the 80/20 debt/equity ratio as follows.

> …80/20 is the construct or the presumption for the federal loan guarantees. However, in our reviews we felt that we wanted to cast as broad a net as we could and not keep people from coming in the door simply because we set the threshold too high for their particular structure. We recognize that obviously 80/20 is better for the State from an NPV analysis if you look at the tariff structure than a 70/30; however, we felt 70/30 would have a broader net and we would still have be in a position to evaluate which applicant would be superior. And it's certainly something that would cause someone to assume that everybody's coming in at 70/30. Someone's going to be at 75 and somebody's going to be at 80. So, we still have the competitive forces that would force them up from 70 if they're concerned.

Ms. Davis summarized that the State arrived at the 70 percent debt structure level in an effort "to be broader than narrower".

Co-Chair Stedman voiced a different perspective. Identifying the 70 percent debt structure as an Administration "must have" could also be viewed as requiring "an equity position no more than 30". He asked whether the Legislature could change the equity position to 20 or 25 percent.

Ms. Davis responded that the term "not less than 70, which is the countervailing of not more than 30" would allow a 25 or 20 percent equity position.

Co-Chair Stedman clarified his question to be whether the Legislature could alter the percentages.

Ms. Davis considered that to be the "prerogative of the Legislature". The Administration is, however, recommending a 70/30 debt/equity ratio.

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Co-Chair Stedman asked FERC's authority in regard to "the debt to equity rate setting", specifically in regards to the "actual calculation of the tariff" as opposed to internal financing or construction rates.

Ms. Davis could not address the question until after she had an opportunity to discuss this with a Department FERC specialist. She understood that FERC conducts "a multi-factored analyses" when determining debt/equity and developing a tariff structure.

Co-Chair Stedman also asked whether FERC could set a rate without consideration of a project's specific debt/equity ratio. For example, FERC might decide "to only count 25 percent of the equity even though there was 30 percent put in".

Ms. Davis understood that FERC would have such authority. She stated that this is the reason "we've limited this for rate making purposes."

> It's my understanding that an applicant could, in fact, in reality, have a debt structure that might be 50 percent debt and 50 percent equity, in reality on their books and how they're structuring their deal. But when they go to FERC, they would represent it as a 70 percent debt. In other words, they would only offer up, for recovery for

return on their equity, the 30 percent equity that they have notwithstanding the fact that they actually have 50 percent equity in the project.

3:32:14 PM

Senator Huggins pondered how requiring a 70 percent debt structure on the pipeline project meshed with AGIA's stated purposes, specifically subsection (3) of Sec. 43.90.101. Purpose. page 2 lines 1 and 2 that reads "(3) maximized benefits to the people of this state of development of oil and gas resources in this state; and ". It would appear that "the debt equity is such an important piece to the maximum value of the people" that an entity proposing an 80 percent debt and 20 percent equity position "would almost have to win assuming they are halfway functionally adequate in the rest of their contract".

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Ms. Davis agreed that this is one of the key elements of consideration: the debt/equity ratio structure might be the "core swing in terms of where the NPV [net present value} value is to the State". However, other elements of the application would also affect the NPV; some of which might not even be a consideration at the moment.

Ms. Davis reminded the Committee that "these are minimum requirements". An applicant might offer additional structures or benefits to the State beyond these that might "counter balance a difference in the debt equity rate".

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Senator Huggins asked whether the State could "set the threshold as low as 70 percent" even though a higher number might be warranted" in consideration of the importance of this element.

Ms. Davis informed the Committee that the State's gasline team based their NPV calculations on a 70 percent debt structure. Economic modeling comparisons of 70 and 80 percent debt structures could be provided.

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Senator Huggins thought such modeling would help the Committee avoid "violating the maximum benefit".

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Ms. Davis directed attention to subsection (11) page 8, line 18. This provision requires applicants to provide their strategy for managing cost overruns. In addition to the importance of seeing an applicant's "cost containment capabilities", this issue is important because "part of the negotiated approach to bringing in shippers may involve the sharing of the risk of cost overruns". How cost overruns are managed will likely be a key element in a shipper's decision to participate in an open season.

Ms. Davis advised that the requirement in subsection (12) page 8 line 21 "is the commitment by the applicant to provide a minimum of five delivery points of natural gas in the State". The applicant is not required to specify the location of those offtake points in the application as the determination was that "the sizing and the location of those will need to be flushed out subsequent to the application process in negotiation with various in-State users".

Co-Chair Stedman asked what criteria was utilized in the decision to specify five takeoff points.

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Ms. Davis communicated that the gasline team decided on that number after reviewing the minimum number of instate offtake locations identified in other gas pipeline project proposals and studies.

Co-Chair Stedman recalled that the Stranded Gas Act legislation, which had been considered the previous year, included three identified and one unidentified takeoff locations.

Ms. Davis affirmed that a minimum of five instate takeoff locations was deemed appropriate.

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Senator Thomas asked for further information about the takeoff points, specifically whether identifying their location would suffice or whether a structure of some sort would be required.

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Ms. Davis stated that an applicant must simply commit to a minimum of five takeoff points in their application. Their location would not be required. An applicant might have "aligned themselves with a spur project" and, in that case, that project would contain "specific offtake points". It would depend on the applicant and their project as to whether "specific offtake points would be identified or not".

Senator Thomas asked whether consideration had been given to any "engineering differences" between oil and a natural gas offtake points.

Ms. Davis expressed that the focus of this bill was a gasline. A minimum of five takeoff points was specified in the bill in recognition of "the engineering and technical challenges" associated with a gas offtake point.

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Ms. Davis informed the Committee that subsection (13) page 8 lines 23 through 27, addressed the obligation of the applicant to offer firm transportation service to instate delivery points as part of their tariff.

Ms. Davis addressed this provision as follows.

> [This provision would] ensure that when gas is taken off in the State, it obviously is along for the ride for a very short part of the ride compared to gas that goes all the way to Chicago for instance, or Alberta, and from Alberta down into the Lower 48. And so this is an obligation on the part of the pipeline company to help us negotiate distance sensitive rates that ensure that the shipper of gas instate bears only their fair share for proportion of costs under the federal requirements for that transport so that they don't get loaded on and in essence end up paying some of the costs for other shippers for longer distances.

Ms. Davis advised that it will be "more expensive for gas to come off in the State because you have occupied capacity to that point in the State and essentially required re-engineering or smaller pipe". There could be ways "to mitigate the extra engineering costs", but if not, there is realization that some space in the pipe was occupied due to this activity.

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Ms. Davis next discussed subsection (14) page 8 lines 28 and 29. This is "the obligation of the applicant to establish" an instate headquarters, such as a construction headquarters, for the proposed project.

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Ms. Davis stated that subsection (15), page 8 line 30 through page 9 line 7, "has been improved" as the bill advanced through the committee process. This is the Jobs for Alaskans section of the bill which requires the successful applicant to hire Alaskans and utilize Alaska businesses and hiring facilities such as job centers and Department of Labor and Workforce Development programs "within boundaries as permitted by law".

Ms. Davis noted that subsection (16), page 9 lines9 through 11, was added by the Senate Judiciary Committee. It pertains "to the waiver by the applicant of the right to appeal the issuance of a license and the appeal of the determination that no license should be issued". This language was developed to address the Judiciary Committee's concern that litigation might delay the project.

Ms. Davis reviewed subsection (17) page 9 lines 12 through 16. "This is a commitment by the applicant to negotiate a project labor agreement, and a project labor agreement here is defined as a comprehensive collective bargaining agreement between the licensee or its agent and the appropriate labor representatives to ensure expedited construction with labor stability for the project by qualified residents of the State."

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Senator Elton asked whether subsection (17) would be limited to the initial construction phase of the project and thereby not

apply to looping or other construction activities that might occur later.

Ms. Davis responded that in its current form, the language would apply to the commitment to negotiate for labor prior to project construction. The manner in which subsequent labor agreements were made would be at the discretion of the pipeline company.

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Ms. Davis explained that the purpose of subsection (18), page 9 lines 17 through 19, was to ensure that the State would receive a benefit from the matching contribution money it paid to the pipeline company. The money should "be applied and reduce equity and therefore lower the tariff costs for the State".

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Co-Chair Stedman asked that an analysis reflecting the benefit provided by this action be provided. He recalled that such an analysis had been provided to both the Senate Resources and Judiciary Committees.

Ms. Davis acknowledged the request.

Co-Chair Stedman opined that this analysis would assist in determining whether applying the $500 million "to offset the tariff" would "maximize the bang for our buck for Alaskans" since a lower tariff would best benefit "whomever has most of the gas in the line, which won't be the State". He suggested that applying the State's contribution of "to offset the cost of a line into Anchorage or down into the Peninsula" might better meet the objective.

Ms. Davis acknowledged Co-Chair Stedman's concern. While it was true that other shippers would benefit from the tariff relief, its benefit to the State could amount to $200 million over the course of the project's life.

Ms. Davis pointed out that the State would also benefit from "the add-on effect that, once the other party has the reduced tariff costs, that in turn increases the State's royalty and tax take as well because there's lower deductions against them".

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Ms. Davis concluded that the State would experience direct and indirect benefits from a tariff reduction.

Co-Chair Stedman also noted that the discussion about the $500 million State contribution has included changing the State's contribution into either "an equity position or an equity option". This would allow the State "to recoup its capital and then apply it," for example, to subsidize a spur line to benefit Alaskans.

Ms. Davis affirmed that the requested analysis would be provided.

3:46:18 PM

Ms. Davis stated that subsection (19) page 9 lines 20 through 27, would require the applicant to clearly indicate the entities that would be participating in the application. This would assist in "evaluating the economic impacts" of the proposal, including such things as entities' levels of participation and the amount of new capital "infusion" into the State.

3:47:22 PM

Senator Dyson identified one area of concern to be the "financial viability" of the entities involved in the partnership; specifically whether the parent company of a subsidiary would be "on the hook".

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Ms. Davis communicated that the bill contained provisions to address this concern. Language in Section 43.90.130. Application requirements., subsection 2(C) on page 4 lines 1 and 2, required "an analysis demonstrating the project's economic and technical viability".

Ms. Davis qualified that the evaluation criteria would include a review of the "financial solvency and integrity of the applicant". The requirement that all participants be identified, as specified in subsection (19), would allow the State to evaluate the solvency of all of the participants in this application. The evaluation would ensure that solid companies

would be participating and avoid the inclusion of "shell companies that can't stand behind the obligations they make".

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Ms. Davis then addressed the last of the 20 applicant requirements. Subsection (20) page 9 lines 28 through 30 would require a listing of other ways the applicant could "demonstrate that they are ready and able to perform their plan".

Ms. Davis stated that each of the 20 requirements was "important in its own right".

Co-Chair Stedman asked what action would be taken were an application to fail to address all 20 requirements.

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Ms. Davis communicated that if an application was remiss in addressing all 20 requirements, the commissioners would request the applicant to provide the pertinent information. If that information was not forthcoming, the application would be considered incomplete and would not be considered.

Co-Chair Stedman asked whether this approach would occur even if the Net Present Value (NPV) to the State in that proposal was substantially higher than other applications.

Ms. Davis clarified that the NPV "could not be calculated until you get a complete application". Continuing, she noted that even if the project had merit, it would not be considered if all 20 requirements were not addressed.

3:50:46 PM

Co-Chair Stedman asked whether the Legislature would be able to review any application that was disqualified.

Ms. Davis replied in the affirmative. If Legislators signed the confidentially provision included in the bill, they would be allowed "from the very beginning to look at all information that is supplied by applicants to the Commissioners … from the get go. That would include applications that were subsequently determined incomplete".

3:51:24 PM

Senator Elton asked whether the State's traditional Request for Proposals (RFPs) standards would apply to this evaluation process. For example, there could be numerous definitions of the term "detailed" as specified in subsection (19). That section requested a detailed listing of the entirety of partners who would be involved in the project.

Ms. Davis affirmed that the AGIA evaluation process would be handled in a manner similar to other State RFPs. "An above-board fair process" must be the goal. "The Administration would issue an RFA [Request for Applications] which will identify all of the information in fuller detail than is set forth in this bill of what needs to be in the application."

Ms. Davis continued. The expectation is that after the RFA is released, potential applicants would present questions to clarify the information. The anticipation is that the commissioners of the Department of Revenue and the Department of Natural Resources would establish a process to receive and respond to questions. This would likely include a website which would disseminate information on a widespread scale.

3:53:17 PM

Section 43.90.140. Initial application review; additional information requests; complete applications. (page 9 line 31 though page 10, line 14)

Ms. Davis stated that this section would establish the process through which the commissioners would receive, review, and determine whether an application was complete. In the event an application was deemed incomplete, the commissioners could request missing information and specify the timeframe in which it should be received.

Ms. Davis informed that this language had been amended to address an earlier concern that the bill "did not tie the information request to the application", and as a result, "there was concern that this could be used as a fishing expedition".

Co-Chair Stedman asked regarding language on page 10 line 4 that stated that "the commissioners shall reject any application that does not meet those terms and requirements." He suggested that

replacing the word "shall" with "may" might allow the commissioners to consider a proposal which would provide the State the highest NPV.

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Ms. Davis stated that amending the language as suggested by Co-Chair Stedman had been discussed. The reason the Department supports the word "shall" in this case, "is because when you put 'may' you've essentially put a discretion upon the commissioners to decide when they will decide to reject an application for being incomplete and when they will not". Not having a written standard to guide that decision could result in a "lawsuit" that could delay the project.

3:56:05 PM

PAT GALVIN, Commissioner, Department of Revenue, contending that Co-Chair Stedman's question "drives at the heart of AGIA", spoke as follows.

> It's a question of whether the State is actually going to have must have provisions in the bill or whether they're going to be mere recommendations or requests.
>
> We feel that its imperative that AGIA contain the State's must have provisions. That if you fail to meet these requirements you're not going to be considered. It is part of the communication that is set up by AGIA, that the State through this vehicle is saying this is our bottom line, this is what we have to have in order for a participant to be considered.
>
> We do not believe that there is a provision within our must have list that is commercially unreasonable, or is not appropriate for the State to request in response to what we're putting out there on the table. And we believe that it would strike at the heart of the purpose of AGIA if we were to soften the message when it comes to our initial request. And to say that there are certain things that the State has to have unless you feel that we should consider something else.
>
> And it's the nature of discussion and negotiation as you say, this is our bottom line and that's it. As opposed to

this is our bottom line and we can continue to talk about it.

Within the context of AGIA, the State has to have must haves. If there's something within that list of 20 items that the Legislature feels is inappropriate; is potentially a hurtle to getting the applications that we want; then lets talk about those provisions. But we do not believe that there is one within the list that should be negotiated or amended if the Legislature and the Administration decided it is a must have.

And so, we feel very strongly that AGIA would not be what it is if we were to change that provision.

Co-Chair Stedman pointed out that subsection (16) in the list of requirements would require the applicant to waive their right to appeal the issuance of a license.

3:58:53 PM

Co-Chair Stedman asked whether this requirement would address the litigation issue raised by Ms. Davis.

Ms. Davis clarified that "Constitutional arguments can't really be waived." While it might be appropriate for someone to waive their right to appeal regarding such things as an applicant's claim that the State made a decision based on an incorrect NPR evaluation or a failure to consider certain aspects of the proposal, an entity could file a claim on a Constitutional basis.

Commissioner Galvin stated that "the question about Constitutionality and the discretionary authority of the commissioners in going from 'shall' to 'may' is not the driving factor in our insistence on it being 'shall'. It's strictly, as I stated, we have to have must haves in this bill in order to be able to get what we want out of this process."

4:00:12 PM

Senator Thomas agreed it would be impossible to preclude someone from suing. They could always find a way.

Senator Thomas asked whether a procedure had been developed to notify an applicant in the case their application was either rejected or incomplete.

Ms. Davis stated that Section 43.90.140(b), page 10 line 6, specifies that during the application evaluation process, the commissioners could request "additional information from the applicant". It is envisioned that this provision would be utilized "to reach out and try to save applications that are missing critical information by requesting additional information".

Ms. Davis pointed out that an application proposing a 50 percent debt component rather than the required minimum 70 percent debt requirement would be a sign that the applicant deliberately choose not to comply with the State's must-have criteria.

4:01:33 PM

Senator Thomas stated that the intent of his question was to clarify whether language in Section 43.90.140(b) specifically referred to an application that was not rejected under (a) of this section.

Ms. Davis acknowledged that the wording could be confusing. The language could be reworked to clarify that "no application is rejected because of some inadvertency on the part of an applicant or a belief that they adequately treated a topic and we determined we needed more information."

Senator Elton revisited the "'shall' verses 'may' reject" question by asking whether the use of the word "shall" would "preclude the State, after a license is awarded," to discussing with the licensee, adding a provision included in another application to their proposal.

4:02:49 PM

Ms. Davis stated that once the State "selected an application and made the determination it is ranked first", based on the ranking criteria included in the bill, both the State or the licensee could "modify a project plan if" that modification would improve, for instance, the NPV to the State. She was unsure "what leverage the State would have on an applicant who's successful and has won, to make further changes that would

further enhance the State's position unless it could do so without resulting in harm or loss of value to itself".

Ms. Davis deemed "going to an applicant before we've made the selection" and asking them to "change the application to make it better" to be "improper".

4:03:50 PM

Section 43.90.150. Proprietary information and trade secrets. (page 10 line 15)

Ms. Davis stated that this section "would allow applicants to provide information in their application" they deemed important in the evaluation and to "their competitive standing". This might include commercially sensitive or trade secret information.

Ms. Davis remarked that this provision would allow the applicant to label information they wanted treated as proprietary or trade secrets. After reviewing the information, the commissioners would decide whether to grant that status to the information. The commissioners would notify the applicant if they did not agree with the request and the applicant would be permitted to either withdraw the information or keep it in the application "knowing that it would not be treated as confidential".

Ms. Davis noted that the entirety of the information submitted by the winning applicant would be made public, including their proprietary or trade secret information.

Ms. Davis specified that information of any entity choosing to challenge the award would also be made public. She noted that this provision might require reworking in consideration of the fact that an applicant must waive their right to appeal the issuance of a license.

4:05:27 PM

Senator Dyson asked for further clarification regarding the extent of the information that would be made public if an applicant was awarded the license. His particular concern was to whether proprietary information relating to the business affiliates would be made public.

Ms. Davis explained that the experience to date in FERC and other pipeline related activities is that the type of information an unsuccessful applicant would desire to keep private would be that associated with "the commercial arrangements that a pipeline company enters into and makes with shippers that enables them, that they feel gives them a competitive advantage in lining up and acquiring shippers."

Ms. Davis explained that these and other types of arrangements and information would be made public in the case of the successful applicant since it would be included in a number of required public filings, such as the information submitted to FERC.

4:06:49 PM

Ms. Davis emphasized that the release of this type of information is particularly worrisome to unsuccessful applicants who might desire to use a similar arrangement when bidding another project.

Ms. Davis addressed Senator Dyson's concern about the release of information pertaining to affiliates and other types of business relationships. The understanding is that this is the type of information "that they'd be worried about".

4:07:16 PM

Section 43.90.160. Notice, review, and comment. (page 11 lines 1 through 18)

Ms. Davis explained that this section specifies that "the commissioners shall publish notice and provide a 60-day period for public review and comment on all applications determined complete under AS 43.90.140."

Ms. Davis specified that completed applications are not made public until after they are ranked and evaluated by the commissioners.

Ms. Davis stated that language in subsection (c) of this section, page 11 lines 12 through 18, is important. It would allow "Legislators to become engaged in this process from the get go" by specifying that they could access the entirety of the information submitted to the commissioners.

Section 43.90.170. Application evaluation and ranking. (page 11, line 19 through page 12 line 27)

Ms. Davis deemed this section to be an extremely important provision as it specifies the ranking criteria for the submitted projects. A key element is that the commissioners would utilize "two different sets of criteria" to evaluate and rank the projects: one would be the NPV to the State and the other the likelihood of the success of the project.

Ms. Davis continued. Subsection (b) of this section, page 11 lines 26 through 28, detailed the net present value or "project economic" criteria that would be utilized in the net present value evaluation. This evaluation would include "an analysis that includes an undiscounted value and" minimum specifications on discounted rates.

4:09:30 PM

Ms. Davis pointed out that the project economic criteria is listed in subsection (b)(1) through (5) page 11 line 29 through page 12 line 7. This considers such things as the project's timeliness, net back to the State, cost overruns, pipeline design capacity, and the amount of the matching contribution the entity would request from the State.

4:10:07 PM

Ms. Davis stated that the second set of criteria, that relating to the likelihood of the success of the project, is detailed in subsection (c)(1) through (6), page 12 lines 8 through 25. This evaluation would include professional experts' view of the project, the financial resources of the applicant, and the myriad of other considerations specified.

4:11:14 PM

Senator Huggins asked for examples of what an applicant might do to "encourage shippers to participate in the first binding open season", as specified in subsection (c)(1), page 12, line 13.

4:11:36 PM

Ms. Davis clarified that the focus of subsection (c)(1) is primarily to cost overruns. It would evaluate how the applicant would insulate shippers from such costs and thereby encourage them to participate in the first open season. Shippers would consider "the degree of specificity" and "the technical quality of the design parameters of the pipeline" in determining "how solid" the cost estimate of the project and thus "how solid" the estimates on the tariff offered in the open season might be.

4:12:31 PM

Senator Huggins questioned whether shippers would be conferred with to gauge their "perspective" on this aspect of the proposal.

4:12:42 PM

Commissioner Galvin informed that extensive negotiations occur between a pipeline company and shippers in the process of conducting an open season. The discussion would include the "types of arrangements that should be made within the open season in order to increase the attractiveness of the open season to those particular shippers".

Commissioner Galvin noted that the State would evaluate "the plan that the pipeline company provides us in terms of how they are going to get the most attractive open season terms that they can provide at that time and some of it is going to be spelled out in the application directly". This would include the proprietary types of arrangements they are willing to offer to the shippers that they've used in other places that have created an attractive open season.

Commissioner Galvin informed that the pipeline company might also explore other options with shippers. Some of those things might not be shared with the State upfront because of the uncertainty as to whether they would be ultimately offered; it would depend on the response from the shippers.

Commissioner Galvin stated that the applicant would explore additional "ideas with potential shippers as we move closer to an open season". "It's going to be a combination of things that they can tell us up front. We believe these things are going to provide value".

4:14:24 PM

Senator Huggins surmised that an applicant who stated that "under these conditions" they had an agreement with a shipper to commit in the open season would win the license provided that other considerations were equal.

4:14:54 PM

Ms. Davis stated that such a commitment "certainly increases the evaluation of the likelihood of success of that project," assuming all things being equal. It would not be "the sole element", there are other considerations.

Commissioner Galvin agreed. A commitment to "getting the gas" is paramount.

Senator Huggins acknowledged the range of criteria that would be considered. He inquired as to whether there were "other elements" besides the work plan, timeline, and specified criteria that might be "encouraging" to a particular proposal.

4:16:01 PM

Ms. Davis asked for time to consider this question.

Commissioner Galvin advised he could ask this question of Department personnel, particularly those in the Department's commercial section and Department consultants.

4:16:32 PM

Senator Huggins deemed it important to understand the range of elements that might encourage a project and "seal a deal".

4:17:23 PM

Co-Chair Stedman asked for further discussion in regards to NPV as it applied to the State.

4:17:38 PM

Ms. Davis directed attention to Section 43.90.170 subsection (d) on page 12 lines 26 and 27 which defined NPV as "the discounted

value of a future stream of cash flow." For example, the income stream associated with the royalties, taxes, and other income generated by a project "would be offset by the costs experienced by the State". The resulting net would be "discounted by a given rate over time because the project happens over the course of say 30 years" to provide the net present value to the State.

4:18:31 PM

Co-Chair Stedman asked how the NPV would be calculated for an "applicant that has no gas".

Ms. Davis communicated that a range of gas flow assumptions that "remains steady for all projects" would be applied.

4:19:04 PM

Commissioner Galvin explained that the evaluation process would include "a blending" of the NPV analysis and the likelihood of success. There would be a multitude of possible outcomes in the NPV analysis depending on such things as the type of pipe and the outcome of the open season. Some probability assumptions would be required when determining the likelihood of that particular outcome into the future.

4:20:36 PM

Co-Chair Stedman spoke to the provision in the bill that specified "an 80/20 match past open season to the FERC certificate". He asked how the risk factor or discount rate would be affected by an application that had no gas.

4:21:23 PM

Commissioner Galvin stated that the likelihood of a project being on time and meeting other requirements would be lower for a project with a low likelihood of getting gas at an open season. A project having "a greater likelihood of getting gas at an open season, whether because its been pre-committed or whether because we have confidence in the attractiveness of their particular proposal, then its going to have a higher probability of getting that cash flow in the timeframe that provides the greatest value both to the State and to the project".

Commissioner Galvin discussed a variety of project scenarios.

4:23:11 PM

Co-Chair Stedman asked what would happen were the State to only have one applicant.

Commissioner Galvin advised that the commissioners would determine whether it would be in the State's best interest to move forward. The commissioners are not "obligated to issue a license".

4:23:42 PM

Co-Chair Stedman stated "it would be interesting to look at the calculations for the fellow that had no gas".

Commissioner Galvin acknowledged the challenges moving forward, both in evaluating projects and in presenting the outcome of the process to the Legislature.

4:24:19 PM

> Section 43.90.180. Notice to the legislature of intent to issue license; denial of license. (page 12 line 28 through page 13, line 19)

Ms. Davis resumed her analysis. This Section addressed "the manner in which the commissioners, after taking into consideration the public comments and after evaluating" the applications, and determining project rankings, would determine whether a project merited being issued a license.

Ms. Davis stated that if the commissioners determine that a project merited being granted a license, that determination and accompanying findings would be issued. A notice about the intent to issue a license would be published and provided to the Legislature for action as specified in the bill.

Ms. Davis stated that if the commissioners determine that no project merited a license, they would also issue a written notice and findings for that decision. No further agency action would be required.

4:25:39 PM

Section 43.90.190. Legislative approval; issuance of license. (page 13 line 19 through page 14 line 8)

Ms. Davis advised that this section has undergone numerous revisions during its progress through committees. It would require the Legislature to approve the license proposed by the commissioners within 60 days of receipt.

4:26:24 PM

Senator Elton addressed language in Section 43.90.190(b) that specifies that "the commissioners shall issue the license as soon as practicable after the effective date of the Act approving the issuance of the license." He asked how this would be addressed were the Legislature to approve the bill without an effective date; specifically whether there has been consideration of waiving the standard 90-day effective date delay applied to other legislation under similar circumstances.

4:27:25 PM

Commissioner Galvin remarked that the language in this provision was drafted by the Judiciary Committee. No in-depth discussion of its ramifications had occurred.

Commissioner Galvin elaborated. While the Administration did not object to the Legislature's role in the process, they had raised concern about the timeline as the Legislative approval requirement provided the potential for there being multiple delays as opposed to simply issuing the license. The scenario described by Senator Elton was one example of the delays that could be experienced.

4:29:00 PM

Commissioner Galvin pointed out that another concern evolving from the Legislature' approval requirement is in respect to how confident the licensee might be that the license was forthcoming. They might be willing to spend the money necessary to begin work and enter into contractual obligations or they might not. A "field season" might be lost if this was considered a hurtle. The State could not compel them to act until the license was issued. This lack of control was worrisome.

4:30:40 PM

Co-Chair Hoffman expressed that there would be no problem with the deadlines specified in the bill if the Legislature was in session; it might be a problem otherwise.

Commissioner Galvin appreciated the Senate Judiciary Committee specifying that the Legislature must address the commissioners' licensee recommendation within 60 calendar days of its receipt as opposed to 60 Legislative session days. This would include calling, convening, and acting within the time constraints of a 30-day session. The State could not take any action until the Legislative approval was obtained.

Commissioner Galvin characterized the 60 day timeframe "as a self-imposed deadline that can be missed". The commissioners would have the authority to begin the RFA process all over again were that deadline missed.

4:32:53 PM

Senator Huggins considered this legislation to be "the largest decision" he and other legislators would ever make on behalf of the citizens of the State. "If we collectively cannot come to that decision, it probably should not be had." Thus, he would not be unsettled if the project was delayed until the time a consensus was obtainable.

Senator Huggins contended that a good project would have the support of both the Administration and the Legislature. Further effort would be required otherwise.

4:34:20 PM

Commissioner Galvin did not disagree. The Administration has presented AGIA because of their desire "that the process be one that is accepted and endorsed by the Administration and the Legislature together." This would apply to both the nature of the bill and the licensee selected. If the selected licensee "can't engender a majority of the Legislature, then we do need to consider whether or not its appropriate for us to go forward and how successful it could be if we have that kind of a split."

Commissioner Galvin communicated that the decision making process could take a long time "even when everyone understands

the import and to a certain extent, the inevitability of a particular result." It is important to be thorough.

4:35:38 PM

Commissioner Galvin voiced "that we must all be on the same page". We have two goals. It is paramount that we get the right licensee and that we give that licensee the opportunity to begin work in the summer of 2008.

4:36:15 PM

Senator Huggins asked for further discussion about "what actually comes to Legislature." He assumed that "at least one license application" would be advanced by the commissioners. The question was whether the ability of the Legislature to review other applications needed to be further delineated.

4:36:39 PM

Ms. Davis clarified that the Administration would be presenting justification as to "why it ranked" one project higher than other qualifying applicants. Information on those applicants would be provided as a "frame of reference".

Commissioner Galvin informed the Committee that two different sets of rankings might be provided, "depending on what we receive.

> The first is the finding that will evaluate the qualifying applications…that met the requirements. And, as part of that, we are obligated to determine the net present value along those different discount rates and you will receive that information for all of the qualifying applications. And then you will receive a discussion of the likelihood of success elements for each of those. And, in the end, a justification for how they ended up being ranked in the particular order and the project that ranks the highest will be submitted as the proposed licensee.
>
> You will also have access to the applications that were rejected because they were not-qualifying. They did not meet the State's requirements. And those will be provided to you or available to you, but they will not be part of that evaluation process.

4:38:36 PM

Senator Huggins understood that the information would be presented in a format similar to a "side by side" comparison.

4:38:48 PM

Co-Chair Stedman stated that the sectional analysis of the bill would continue, and likely conclude, during the next Committee hearing on the bill.

The Bill was HELD in Committee.

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Co-Chair Stedman encouraged Committee Members to attend a Legislative Budget & Audit committee hearing scheduled for the following afternoon as a representative from an international law firm, Sullivan & Cromwell LLC, would be presenting information on pipeline financing.

ADJOURNMENT

Co-Chair Bert Stedman adjourned the meeting at 4:40:45 PM.