

MINUTES
SENATE FINANCE COMMITTEE
April 25, 2007
9:04 a.m.

CALL TO ORDER

Co-Chair Bert Stedman convened the meeting at approximately [9:04:15 AM](#).

PRESENT

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

Also Attending: MARCIA DAVIS, Deputy Commissioner, Department of Revenue; PATRICK GALVIN, Commissioner, Department of Revenue;

Attending via Teleconference: There were no teleconference participants.

SUMMARY INFORMATION

SB 104-NATURAL GAS PIPELINE PROJECT

The Committee heard from the Department of Revenue and the Department of Natural Resources. The bill was held in Committee.

#SB104
[9:06:04 AM](#)

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 forth hearing for this bill in the Senate Finance Committee. The Committee continued hearing a sectional analysis of Chapter 90, added by Section 1 of the legislation.

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Chapter 90. Alaska Gasline Inducement Act

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Article 2. Alaska Gasline Inducement Act License.

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Section 43.90.200. Certification by regulatory authority and project sanction. (page 14, line 9)

MARCIA DAVIS, Deputy Commissioner, Department of Revenue, characterized this section as "the stick" that provides another deadline that the license holder must meet. She reminded the Committee of the "one firm deadline" that would require the holder of the Alaska Gasline Inducement Act (AGIA) license to hold an open season to obtain commitments to ship natural gas through the proposed pipeline within 36 months from the date the license was issued. Additionally, the licensee's AGIA application must contain a "date certain" in which the license would submit its request for certification from the Federal Energy Regulatory Commission (FERC).

[9:07:08 AM](#)

Ms. Davis explained that Section 43.90.200(a) on page 14, lines 10 through 14, would require that the applicant, once it receives a FERC certificate, must "actually accept the certificate and go forward." She initially deemed this provision "odd" as she assumed that once a party applied for a FERC certificate, it would accept the awarded certificate. However, she learned that in the consideration process, FERC would commonly impose certain conditions requiring the applicant to change specific design aspects or perform other work. Objection and requests for reconsideration of these conditions by the applicant was not infrequent.

Ms. Davis stated that once the reconsideration process was completed, FERC "is done with you and it's as good as you're gonna get it." In this instance, an applicant could maintain its objection and file a challenge with the U.S. District Court of

Appeals, and subsequently with the U.S. Supreme Court, and which could result in a lengthily process.

[9:08:35 AM](#)

Ms. Davis relayed that the provision of subsection (a) "struck balance" to stipulate that the applicant must accept the certificate once all administrative appeals were exhausted.

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Senator Elton asked the consequences if the licensee refused to comply with the provision of subsection (a).

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Ms. Davis responded that the party would have violated a term of its AGIA license and the State would activate the default and violation provisions.

[9:09:17 AM](#)

Senator Elton understood that the most stringent violation provision would allow the State to attempt to recover any portion of the \$500 million incentive payments made to date.

Ms. Davis added that the license could be revoked and reissued to a different party and the property and data collected could be seized.

[9:09:41 AM](#)

Senator Elton asked if this would require a court ruling.

Ms. Davis answered that ultimately the matter would be decided in court; however only after a 90-day informal "talk-it-through" process between the Executive Branch and the licensee failed to bring consensus and resulted in the State revoking the license.

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Co-Chair Stedman asked the commonality of provisions similar to the stipulation that the licensee "shall accept the certificate" in business relationships involving the FERC.

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Ms. Davis was unsure and indicated she would provide a response at a later time.

[9:11:26 AM](#)

Ms. Davis continued the sectional analysis summarizing that Section 43.90.200(b) and (c) related to the obligation of the applicant to proceed and sanction the pipeline project. "Sanction" was defined in AGIA as the commitment by contract of \$1 billion and "moving toward the pipeline" and pertains to the construction phase.

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Ms. Davis explained that subsection (b) related to the obligation of the applicant if it had credit support to sanction the project within one year of receipt of the FERC certificate. Ownership of the gas reserves, commitments to transport gas, and private or government financing necessary to proceed with the project would be considered "credit support".

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Ms. Davis noted subsection (c) would require that in the event the licensee did not have credit support, the State would allow the license up to five years to obtain that support. Therefore, regardless of the financial circumstances, the licensee would be required to sanction the project within five years.

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Co-Chair Stedman opined that this section could potentially be problematic to the State given the projected revenue declines. He asked if the Department had considered the impact of this and whether a plan was devised to avoid a situation in which the Alaska Permanent Fund or other funding sources would be needed to address a revenue and expenditures imbalance.

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Ms. Davis deemed revenue planning over the next 15 years as "probably the most important issue facing the State". She cautioned as follows.

In terms of assessing where the potential cash flows are going to come, obviously ... even if ... a project were sanctioned within one year of having received the certificate the State cannot envision cash flows actually coming to the State for the pipeline construction period of time, which has been estimated anywhere from seven to ten years. ... It obviously depends upon which project is selected. Obviously the revenues will depend upon what project is selected.

But clearly, once an application is selected and identified, the revenue flow that could be expected from that project is going to have to be mapped out and the Department of Revenue will be doing so. That is going to give clearer definition to where revenue gaps are and what measures or means are going to need to be taken to address that gap.

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Co-Chair Stedman asked why a period of five years was selected, as opposed to seven, three or other period of time.

[9:14:47 AM](#)

Ms. Davis gave the following response.

Five years was identified as a period of time that would enable a reasonably prudent pipeline company that has the FERC certificate in hand to address the likely problems that we could envision that would have impaired or not enabled a pipeline company to have financing in place by the time a certificate were issued.

Clearly the pipeco [pipeline company] would have been working on financing long before having the certificate in hand. Namely at the first stage addressing their initial open season because clearly that's their first and best shot at lining up financing for the project in the form of firm transportation commitments.

If they have not succeeded in gaining sufficient firm transportation commitments at that open season, they're going to be going through and working through whatever

technical issues, whatever economic issues are facing them in terms of moving toward that FERC certificate.

As they work through that process - again we try to calculate how long it takes to do reasonable field work, reasonable engineering work, in satisfying what shippers' needs would be to lining that up. That's one path. The other parallel path is the pathway for addressing obtaining the federal loan guarantees if for some reason they were unable to obtain the proper firm transportation commitments for reasons beyond their control and that were not indicative of an uneconomic project. They would be pursuing the federal loan guarantee.

So again, we sort of mapped out the procedural process of helping - that it would take a reasonably prudent pipeco to work along that pathway and we felt that five years gave them enough time to reasonably have exhausted those means of establishing loan support, credit support for the project.

We wanted to pick something that wasn't so short that a pipeline company would look at the risk of having put in all the money, because that's what all the money is getting the FERC certificate. If you've got the FERC certificate that means this company has probably expended anywhere from \$500 million to \$1 billion. That's a lot of money that they've put at risk in the hope of getting the financial support. So we wanted to stick with that partner for a prudent period of time and we felt five years was the right mark that we could at that point say everything that could be done has been done and it's time to split up.

That's not to say we can't break it up sooner because certainly the State at any point in the juncture could look at the project and say this is an uneconomic project, we need to cut it right now - cut our losses - you walk, we walk. Both parties could pursue that under the abandonment clause, which would provide for arbitration to determine if in fact the project's uneconomic.

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Co-Chair Stedman asked the cost of an abandonment to the State.

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Ms. Davis replied that the State's portion of a determination by arbitration would be the cost of one and one-half arbitrators, plus State experts to testify as to whether or not the project was uneconomic. Typical litigation costs could be expected to reach \$200,000.

Co-Chair Stedman asked if "triple damages" would be included.

Ms. Davis answered this process would not activate triple damages. "Triple damages" would pertain in the event the State was to give preferential treatment to a competing project during the period that the initial licensee was attempting to secure credit support.

[9:18:43 AM](#)

Co-Chair Stedman assumed the Department would present a timeline of "optimistic development schedule and a less optimistic development schedule including the five year extension and the potential revenue and expense are that the State going to be facing along that timeline."

[9:19:31 AM](#)

Ms. Davis assured the Department would endeavor to provide this information, as the Committee could benefit from knowing best and worst case scenarios and the subsequent revenue impacts.

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Senator Thomas expressed concern that consideration would be given to an application that proposed that the project might not be sanctioned for five years. Given the time required to secure a FERC certification, sanctioning could be up to eight years in the future.

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Senator Elton assumed that any entity that invested the significant funding into the project necessary to obtain a FERC certificate would have already secured financing with "almost 100 percent certainty." Therefore, a five year allowance between final certification and sanctioning of the project was

excessive. Instead two or three years would be a more appropriate period of time and would be more beneficial to the State.

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Ms. Davis responded that in considering the situation from the standpoint of an applicant, the reasons that credit support might not be achieved and methods to secure that support must be identified. From the standpoint of the State, the alternatives must be also considered in the event the licensee obtained FERC certification but had yet to secure credit support.

Ms. Davis admitted that most likely just a few reasons would justify the situation. One would be failure to attract shippers to commit gas to the project because the potential shippers either determined the project uneconomic for them or decided for other reasons not to participate. If the commitment was uneconomic from a shipper's perspective the argument for abandonment would have been mostly proved and could be determined within two years.

Ms. Davis stated that if the shippers failed to commit gas for other reasons, alternative remedies "would need to be resorted to" whether by the U.S. Congress, FERC, the "White House" or another entity that "would have sway over the decision making process of the shippers."

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Ms. Davis suggested that if the State determined to not engage in the political aspects of this matter, alternative options must be considered, such as revoking the license if the credit support was not secured within one year of the issuance of the final FERC certificate. In this event, the State must identify other parties that could potentially undertake the project, which could be the "holders of the gas".

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Ms. Davis cautioned of one challenge for the party that held an asset and that was required to develop that asset within a defined period of time. Such a situation diminished the holder's "bargaining position" with entities needed for the development of the asset. A message would be given to the marketplace that

the asset holder would be "desperate" at a certain period of time and subsequently, potential shippers in the AGIA case would be prudent to wait until the deadline neared. The intent of AGIA was to ensure that the holder of the license would not be in a position to be leveraged by the potential shippers. Establishment of a shorter time period in which the licensee must obtain credit support would cause the licensee to "look pretty desperate" and cause a potential shipper to delay making a commitment until the deadline was close and at that time attempt to renegotiate terms to its advantage.

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Ms. Davis could not guarantee that the five year time period was the best option because the matter was not "an exact science" and given the "commercial factors at play" and the many "parties that could influence that whole process". The process contains multiple uncertainties.

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Senator Elton argued that the State would be best served if the deadline was established at two years with an option that the State could grant an extension in certain circumstances. A situation should be avoided that could allow the licensee to determine that a prolonged process would be in its best interest. A timely process would be in the best interest of the State.

[9:27:46 AM](#)

Ms. Davis acknowledged the option as possibly viable. The issue would be whether a licensee holding a FERC certificate would experience an urgency to secure financing if the time period was shorter that was greater than the urgency already experienced given the investment it made to date in achieving the FERC certificate. She presumed that the financial "pressures" to secure credit support would be "tremendous" and that the pressure of a shorter time period would "pale in comparison".

Ms. Davis assented to consideration of a shorter time period, but cautioned that an applicant would have to determine that it would trust the State to grant an extension if certain circumstances arose.

[9:29:02 AM](#)

Co-Chair Hoffman shared the concerns of Senator Elton and Senator Thomas. In reviewing the State's "must haves", the first stipulation was completion of a natural gas pipeline sooner rather than later. However, this provision could have the opposite consequence. It would favor applicants that did not hold the gas resources.

Co-Chair Hoffman asserted he would negotiate a similar contract differently and would not provide a five year "carte blanche" "blanket timeframe". His contract would require assurances during the process and would not delay the State's ability to seek abandonment for five years. He would support extensions for the circumstances Ms. Davis exemplified. However, the contract must include performance measures and time increments for those measures to be achieved.

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Senator Huggins requested the witness describe a scenario to demonstrate the project's status by a certain date. Assuming that an AGIA license was issued in 2008, he recalled Department testimony predicting that the licensee would apply for FERC certification five years afterwards.

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Ms. Davis qualified that the assumption was based on the maximum number of years the State would provide incentive payments. This five year period was not definitive.

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Senator Huggins stated that if the full five year period in which incentive payments were made was utilized, receipt of a FERC certificate would occur in 2013.

Ms. Davis clarified that the actual date could be later because the process to secure a FERC certificate could take up to two years.

[9:33:12 AM](#)

Senator Huggins adjusted his calculation of the date of FERC certification to 2015.

Senator Huggins next referenced documentation provided by the Department outlining the "tremendous decrement" of billions of dollars in net present value resulting from project delays.

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Ms. Davis informed that the licensee's "drop dead" date to sanction the project would be 2020.

[9:34:04 AM](#)

Senator Huggins then asked the date of "first gas" when the pipeline would begin production.

Ms. Davis replied that estimates predict that the construction period would require eight to ten years, assuming that the pipeline capacity would be 4.5 billion cubic feet (bcf).

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Senator Huggins concluded therefore that operation of the pipeline could be as far away as 2030.

Ms. Davis affirmed.

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Senator Huggins commented that this was a sobering prospect which "scares the heck out of me."

[9:35:07 AM](#)

Ms. Davis corrected her estimate of the pipeline construction to be two to three years.

[9:35:24 AM](#)

PATRICK GALVIN, Commissioner, Department of Revenue, confirmed that once all permits had been secured, industry representatives have stated that the construction phase would require two to three years.

9:35:45 AM

Co-Chair Stedman pointed out the necessary "lead time" to gather materials and equipment.

Mr. Galvin emphasized that two to three years would be the longest possible timeframe. The licensee would be expected to undertake significant preparations while awaiting the FERC certificate.

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Senator Huggins changed his calculation to reflect that production through the pipeline would commence in the year 2023 at the latest. He returned to the date of a potential unsuccessful open season in approximately 2011.

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Ms. Davis affirmed.

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Senator Huggins continued, noting this would be a "critical juncture". Of the three pipeline companies that testified to the committees that previously heard this bill, two indicated a lesser concern with obtaining a FERC certificate than in committing gas. A representative from the third company stated exactly, "I can't answer that question." Senator Huggins pointed out that none agreed to pursue a FERC certificate, which concerned him. He questioned the State's concept that would require the AGIA licensee to do so despite the companies' assertions.

9:38:16 AM

Mr. Galvin asserted, "Continuing past an unsuccessful open season to a FERC certificate is something that's in the State's interest." He elaborated as follows.

We want to ensure that the project continues to move forward. From the company's perspective, because these particular companies are pipeline companies, they get regulated set rate of return, they don't see the upside of taking that risk. That's why within our "must haves" we

have to require them to move to the FERC certificate in order to get them to do so. It's not that they would have the option or that they would be given the choice at that particular time of whether or not to do so, it's that as a condition of accepting the license they have to agree to do so.

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Senator Huggins understood. He stressed that this requirement must be emphasized to the applicants. A penalty formula, equal to that which the State would be subject to in the event the State violated the exclusivity clause, must be levied for an applicant's failure to pursue FERC certification. Current language pertaining to the exclusivity clause would provide a damage award of three times the amount of investment.

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Co-Chair Hoffman asked if the construction estimate of two to three years includes completion of the pipeline to Chicago, Illinois.

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Mr. Galvin corrected this estimate would entail completion of the pipeline in Alberta, Canada.

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Co-Chair Hoffman recalled testimony given to the Committee during the previous legislative session about the limited supply of steel available. Estimates predict that the entire amount of steel produced in one year worldwide would be needed to construct the pipeline. However, competing projects would also be attempting to secure steel supplies. He doubted that this "mega" pipeline project could be completed in two years.

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Co-Chair Stedman asked the number of FERC certificates issued for projects without credit support and the terms of those certificates. The presentation on "opportunity costs" given to the Committee at the previous hearing only included delays of one to three years. He pointed out the following.

Roughly at seven dollar gas - three year delay you're looking at about a \$7 billion, and a five year delay you're looking a \$10 billion. That's one quarter of the permanent fund. There's a huge opportunity cost that we're talking about here with this delay and that's - we've not only got the roughly \$10 billion in opportunity costs over five years, but we've got the issue that this Committee faces every year in the operating budget trying to make ends meet and run our State. It is of a concern when we get stretched out in particularly if we're looking into the mid - going from 2018 into 2025 or 2027.

Co-Chair Stedman requested a forecast of the opportunity costs incurred from this delay.

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Mr. Galvin advised that opportunity costs must have "something else" to be compared against. The suggestion that if the time limit in which to secure credit support was reduced from five years to one year makes an assumption that the project would be successfully advanced in one year. However, it did not recognize that the purpose of the five year limit was to "get them in the door in the first place" and allow an entity the possibility of building a pipeline. Potential AGIA applicants would not participate given the risk involved in the expenditure of significant funding to obtain FERC certification if time was not permitted for the licensee to secure credit support. The competition necessary to further the project would not be forthcoming.

Mr. Galvin continued as follows.

By saying through some form of analysis that we can make a choice between having the pipeline come in in 2016 versus having it come in in 2020 - I can assure you that the 2016 is going to look a heck of a lot better. But it's a false choice. It's not as though we're making a decision to say let's have it come in in 2020 versus 2016; it's a question of whether we are presenting reasonable terms so that we can bring them in the door in the first place.

Mr. Galvin summarized that the Department would provide the Committee with the State revenue forecast and expenditures

predicted for the timeframe. He impressed, "we will all see how far underwater we're going to get". At that point, timeframes in which a gas pipeline could be possible would be reviewed.

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Co-Chair Stedman understood the inability to predict the exact date that the pipeline would begin production. However, the issue was the State's risk exposure and if the date was to be later than sooner, the Committee must be made aware of this. The risk exposure of a scenario with no gas pipeline was known.

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Mr. Galvin stressed that this issue was recognized. The intent of AGIA was to obtain a gas pipeline and as quickly as possible. The question embedded in this discussion was whether a pipeline could be completed sooner "by simply shrinking all the timelines that we give to our applicant." The timelines could be shortened, but the consequence would be that potential applicant would decide against accepting the risk. The State would have the ability to "pull the plug out" before a licensee would have reasonable opportunity to benefit from its investment.

[9:48:58 AM](#)

Co-Chair Stedman spoke of amendments considered to this bill to change the time periods of some provisions from 90 days to 60 days. This discussion involves five years. Time delay was an issue that would affect cash flow. The Committee must have an understanding of the risk exposure.

Co-Chair Stedman furthered on an interrelated issue pertaining to the gas tax and the possibility that the first open season was unsuccessful and other open seasons must be offered. He deferred this topic to a future discussion relating to the inducements.

[9:50:40 AM](#)

Senator Elton commented to his skepticism that a natural gas pipeline could be completed in two to three years given the changed regulatory environment from the time that the Trans Alaska Pipeline System was constructed 30 years prior. He requested an explanation of the reasoning for the projection.

Senator Elton next opined that the State could achieve some control by requiring credit support within two years with an opportunity for two one year extensions. He requested an analysis of this "midway approach".

[9:52:15 AM](#)

Mr. Galvin qualified that the choice was not just whether to provide for a two or five year time restriction. The proposed five year period was not "magical". His statements had been in response to the premise that a shorter deadline would result in a sooner construction date. Instead, such a shorter deadline could result in fewer applicants under AGIA.

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Co-Chair Hoffman concurred with Senator Elton's comments based on the State's "must haves" of achieving a pipeline sooner. The language of this provision must be "tightened up" specifically to allow the State to "take control" during that time period rather than allowing the licensee to make the decisions. The licensee must be "pushed"; perimeters must be established and assurances received to demonstrate that the project was progressing.

Mr. Galvin agreed and relayed the intent to guarantee the process would be "buttoned down". The licensee would not be allowed to operate without oversight. Whether in the form of formal deadlines or through other methods, the licensee would be required to demonstrate its actions in furthering the project.

[9:55:25 AM](#)

Co-Chair Hoffman countered that such a guarantee was not provided for in the provision of subsection (c). The language should be specific.

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Mr. Galvin assured this issue would be addressed.

[9:55:49 AM](#)

Section 43.90.210. Amendment of or modification to the project plan. (page 15, line 11)

Ms. Davis resumed her analysis of the bill and informed that amendments had been made to the original language to include three situations in which a project plan could be amended. An improvement to the net present value of the project would be justified, as well as a change necessitated by an order of the Alaska Oil and Gas Conservation Commission (AOGCC), and a situation resulting from unforeseen circumstances outside control of the licensee. Additionally, this provision stipulated that with an exception of a change required by the AOGCC, any amendment to the project could not diminish the net present value of the project to the State or the project's likelihood of success.

[9:57:04 AM](#)

Section 43.90.220. Records, reports, conditions, and audit requirements. (page 15, line 22)

Ms. Davis described this section as "the State's rights to audit, inspect books, [and] compel information to be provided to it both in hard copy and electronic format." She directed attention to subsection (d) on page 16, lines 3 through 10, which would grant the State the right to participate "as an observer, in a room with the applicant's owners, equity members, groups, at meetings" to monitor progress and ensure compliance with the license provisions as well as statutes. This right would terminate after commencement of commercial operations.

[9:58:06 AM](#)

Co-Chair Stedman returned to AS 43.90.210 in an attempt to understand the concept of "the group that makes the proposal that doesn't have any gas." He stated, "We run it through the net present value model. How we do that, I don't know because there's no gas to run through the model."

Ms. Davis interrupted to respond that assumptions would be made in this situation.

[9:58:37 AM](#)

Co-Chair Stedman continued as follows.

So we make assumptions. That entity that doesn't have commitments for gas prevails in the issuance of the license; gets the license; moves forward. But economic reality sets in and the gas expectations either due to tax changes or some other issue, the revenue would go down to the State, which would move the net present value down.

Co-Chair Stedman asked if in this instance the licensee would not be in compliance.

[9:59:12 AM](#)

Ms. Davis explained that the State's analysis of the net present value was addressed twice in this legislation. The net present value "balanced with" the likelihood of success would be first calculated during the initial selection period. Applications for the AGIA license would be ranked at that time and a "winner" would be selected. Once the license was granted, the project would progress and encounter "whatever's going to happen relative to costs of materials ... what's happening with gas commodity pricing, [and] ... the world of taxes and royalties and how they impact the mentality and the desires of its ... producers to want to ship gas on its pipeline."

Ms. Davis suggested that during that time period, if the State determined that the project would not be economic to the State, it could potentially also be determined to be uneconomic to the licensee as well and an agreement could be reached to cease the project. However, if one party disagreed with ceasing the project the issue would be decided in arbitration. The abandonment clause "focuses on" the ability of the shipper to secure credit support and whether a shipper would "reasonably want to ship on that pipeline."

[10:00:57 AM](#)

Ms. Davis posed an assumption that this process was undertaken and neither party prevailed in the arbitration or that abandonment was not considered, "the economy and the economics of the project are what they are" and no opportunity would exist to review the economics before the next phase of the process. In the event a licensee was unable to secure credit support and proceeded to obtain a FERC certificate, the issue would be

whether the license could sanction the project within the allowed timeframe.

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Ms. Davis stressed that the provision of AS 43.90.210 would only be activated in the event a party sought to amend the project plan. She gave an unsuccessful open season as an example of a reason a party could attempt to amend the project plan. Amendments to the project could include construction of a pipeline utilizing a smaller pipe size. The project could remain economic, although with a lower net present value to the State. If a determination was made that the change was necessary as a result of changed circumstances beyond the licensee's control and not reasonably foreseeable, the AOGCC could agree to that change.

[10:02:50 AM](#)

Co-Chair Stedman asked if this would provide an opportunity for the licensee that had no gas commitments to negotiate with the producers then leverage the State.

[10:03:04 AM](#)

Ms. Davis answered "no", that this provision would require the State to "consent" to whether it should proceed. This provision also stipulated that a change to the project plan could not diminish the net present value to the State.

[10:04:01 AM](#)

Ms. Davis repeated that Section 43.90.220 relates to the State's right to monitor the licensee's activities in pursuing the project.

[10:04:14 AM](#)

Section 43.90.230. License violations; damages. (page 16, line 14)

Ms. Davis stated that this provision listed violations and damage allowances and outlined the resolution process. These include conditions imposed in many other contracts for State projects, such as prohibitions against violation of State

statues or misuse of funds. If a dispute to correct a violation was not resolved in 90 days, the AOGCC could invoke certain remedies, including suspension of disbursement or recuperation of State funds contributed to the project, revocation of the license with assignment of all project data surrendered or any other remedies provided for by law. The provision was expanded to include "in equity" as a potential remedy in the event "a particular situation called for a specific performance."

[10:05:28 AM](#)

Section 43.90.240. Abandonment of project. (page 17, line 17)

Ms. Davis reminded that this provision had been mentioned in previous discussions. Abandonment of the project would occur at the point the project was found to be uneconomic, either by agreement of the State and the licensee or by arbitration. The rules provided for by the American Arbitration Association had been invoked for this section. This issue had been given significant attention by the Senate Judiciary Committee and improvements were made to the original language to ensure "Alaska's state substance and procedural laws". Additionally, this section would provide that each party would select one arbitrator who in turn would select a third arbitrator. Arbitration would be conducted by a panel of three members. All arbitrators would be selected from the American Arbitration Association roster.

[10:06:30 AM](#)

Ms. Davis pointed out that the language adopted by the Senate Judiciary Committee was also utilized in an amendment to the House of Representatives companion legislation. However, upon later review conflict was identified in the provision of Section 43.90.240(d) on page 18, line 17 and 18, which would require the party filing an appeal of a final arbitration determination to provide the burden of proof. Alaska's Uniform Arbitration Act established the procedures pertaining to which party was obligated with the burden of proof. Although the language of this bill was similar, concerns were expressed that it should not be included in the AGIA bill. As a result, this subsection was deleted from the House bill and should be removed from the Senate version as well.

[10:07:37 AM](#)

Co-Chair Stedman took note of the matter.

[10:07:45 AM](#)

Ms. Davis stated that the language of AS 43.90.240(c) on page 18 lines 5 through 16 contained the standards the arbitrators would apply to determine whether a project was uneconomic. To make the determination the arbitrators would be required to find that the licensee did not have credit support. Additionally, an "objective standard", utilizing the assumption that the pipeline would have "100 percent load factor using reasonable predicted prices for the future applied to that gas volume", would be applied to determine whether a "reasonable producer would ship on that pipeline." These objectives would be considered to determine if the project had a likelihood of success.

[10:08:38 AM](#)

Senator Elton questioned the definition of "uneconomic" in the context of this legislation. Subsection (c)(1) stipulated uneconomic as, "the project does not have credit support sufficient to finance construction of the project..." He asked why language similar to "can not get" was not instead utilized. Because the licensee did not have the credit support did not conclude that it could not obtain that support.

[10:09:13 AM](#)

Ms. Davis agreed that the language of (c)(1) was "clearly pointing to the here and now." This provision considered the status of credit support at the point in time of a request for abandonment. The provision of subsection (c)(2) however, addressed the issue in the event that a determination found a reasonable likelihood that producers would ship gas on that pipeline. This would provide proof that credit support was obtainable.

Ms. Davis explained the intent to provide criteria that reflected the subjective status of the licensee at the time of arbitration as well as an objective standard to predict future credit support.

Ms. Davis acknowledged that the point raised by Senator Elton had been considered with the following conclusion reached.

Each time we looked at it we kept peeling the onion and wanting to get to the core of what makes a project objectively uneconomic. We eventually ended up with the bottom line [of] whether there would be shippers to ship gas because that ultimately influences whether financiers are going to step up and offer financing for the project.

Ms. Davis confirmed the need for an objective standard, but stated that this would be achieved through the provision of Section 43.90.240(c)(2).

[10:10:46 AM](#)

Section 43.90.250. Alaska Gasline Inducement Act coordinator. (page 19, line 2)

Ms. Davis informed that the original language of this provision would have required legislative confirmation of the person appointed to this position by the governor. Legislative legal counsel advised that legislative confirmation would violate the Alaska Constitution article pertaining to separation of powers of the three branches of State government. The Senate Judiciary Committee chose to delete the legislative confirmation provision from this section.

Ms. Davis stated that with the aforementioned exception, the provision relating to the coordinator position was modeled after the federal pipeline coordinator position. Ms. Davis had provided Co-Chair Stedman a copy of the provisions relating to the federal position.

[10:11:42 AM](#)

Co-Chair Stedman indicated he had received this information and would distribute it to the Committee [copy on file].

[10:11:48 AM](#)

Senator Dyson understood from industry representatives that possibly more than one pipeline project could be undertaken; one utilizing the AGIA license and another as an independent project. In such an instance, concern was expressed that the

AGIA-licensed project would have the advantage over the other project through the assistance of a designated representative in the Office of the Governor. The other project would not have the benefit of "inside support." He asked if the Administration had considered this possibility.

[10:12:44 AM](#)

Ms. Davis responded that this issue had been considered and that the Administration intended to "incentivise" the AGIA process. The coordinator and the assistance provided from that position would be "as attractive as possible". The Administration preferred to not have multiple projects. Rather the best project should be undertaken, with that project operating under the AGIA process. Therefore the maximum incentives would be provided to encourage potential parties to participate in AGIA.

Ms. Davis qualified that the State, as a sovereign entity, had an obligation, under federal law, to support and provide guidance on matters including right-of-ways and permitting for any project involving an interstate pipeline through its lands. A State statute governing the Department of Natural Resources was currently utilized for the Pebble Creek Mine operation and other projects that allowed the Department to establish a "large project coordination team" to facilitate the permitting process for all State agencies. Although this effort was not conducted by the Office of the Governor and did not provide "as explicit directions to State agencies" as the proposed AGIA coordinator position would, the process existed to accommodate an alternative pipeline project.

[10:14:53 AM](#)

Senator Dyson commented that in the following two to three years, the national energy supply and national security situations could change significantly at which time an entity that had decided to not apply for the AGIA license could determine that a pipeline project had "huge economic potential". Efforts by this entity should not be hindered by the predisposition of the State in supporting the AGIA-licensed party. He was unsure how to resolve this issue.

[10:15:53 AM](#)

Senator Huggins agreed with Senator Dyson and suggested that if the coordination process administered within the Department of Natural Resources would be sufficient for a non-AGIA licensed project it should be acceptable for the AGIA project as well. Otherwise, a second pipeline coordinator position should be created within the Office of the Governor to assist with a competing project. This competing project could also be beneficial to the State and therefore assistance should be provided for its benefit as well as the assistance provided for the AGIA project.

[10:16:54 AM](#)

Ms. Davis shared that the original language of the license assurance section would have only prohibited preferential tax, royalty and monetary treatment for the AGIA licensed project. The section deliberately did not provide for preferential pipeline coordination or agency facilitation "that would activate the damages clause" because the State's sovereign duties to manage permits could not be conditioned on the securitization of the AGIA license. However, facilitation of the AGIA project in the form of the AGIA coordinator would benefit the project. If another project were undertaken, an additional pipeline coordination position could be created, provided that the provisions of the assurance clause were complied with.

[10:18:26 AM](#)

Senator Huggins clarified the intent that the pipeline coordinator position established under Sec. 43.90.250 would not be "shared" with a competing non-AGIA project.

[10:18:38 AM](#)

Ms. Davis answered that the language of the section would provide that the coordinator position would be applied to only the AGIA-licensed project.

Senator Huggins asked if the provisions of this bill would preclude future sharing of the coordinator.

Ms. Davis responded that the original version of the bill contained no such preclusion. Language had been inserted in the committee hearing process that "might arguably create a problem that we can look at that is not fundamental to that section ...

that might cause a little bit of a hiccup" and which could be reviewed.

[10:19:12 AM](#)

Senator Huggins asked if under existing statute an additional pipeline coordinator position could be created.

Ms. Davis stated that no provision in AGIA would prevent this. Existing statute governing the Department of Natural Resources established the Department's role and obligation to provide lead support and the structure to support a large project. Therefore, a new statute could be adopted or the existing statute could be amended to provide for the additional pipeline coordinator position.

[10:20:03 AM](#)

Senator Huggins identified the existing statute under Title 38.

Ms. Davis affirmed.

[10:20:10 AM](#)

Sec. 43.90.260. Expedited review and action by state agencies. (page 19, line 10)

Ms. Davis explained this section would provide direction to State agencies as administered by the pipeline coordinator to ensure that agency permitting processes would not delay the project unnecessarily. This language was modeled after federal legislation.

[10:20:40 AM](#)

Article 3. Resource Inducement.
Section 43.90.300. Qualification for resource inducement. (page 19, line 26)

Ms. Davis characterized this section as the "overarching umbrella that introduces the resource inducements" contained in Article 3. She listed the other two sections comprising Article 3 as providing for royalty inducement and inducement vouchers.

[10:21:07 AM](#)

Co-Chair Stedman directed the witness to address the provision of Section 43.90.300(a) pertaining to the "reoccurring theme" of "committed to acquire firm transportation capacity in the first binding open season..."

[10:21:46 AM](#)

Ms. Davis remarked that "conceptually" the resource inducements had been structured to "drive shippers to the first initial binding open season". To receive a benefit provided for in AGIA, potential shippers must participate in the first open season rather than a later open season, and "just sort of sit on the sidelines and see how it goes and decide to come in later if it looks good." These producers "need to be part of the solution and not part of the problem."

Ms. Davis explained the process in which a "gas owner" or "gas controller" would receive notice that a pipeline company would propose to construct a pipeline and that it would solicit the gas controller's interest in shipping gas on that pipeline. The pipeline company would provide information regarding the pipeline such as its design, proposed design, proposed route, anticipated tariff, likely cost and plan to address any cost overruns. The pipeline company would invite the gas controller to enter into a commercial negotiation to ship gas. That process, under FERC regulations specifically directed to an Alaska natural gas pipeline, would last a minimum of six months.

[10:23:28 AM](#)

Section 43.90.310. Royalty inducement. (page 20, line 6)

Ms. Davis outlined this section, which would provide that a gas controller or party that would purchase gas subject to royalty, would have a right to receive "certain changes in the terms under which [royalty was] currently governed." Those changes related to the valuation of the gas for royalty purposes, the manner in which "gas was taken by the State, known as take-in-kind versus take-in-value" and the State's ability to "switch between those two options under its lease contract."

Ms. Davis informed that the structure of subparagraph (2)(1) on lines 14 and 15 provided that the State would direct the

commissioner of the Department of Natural Resources to develop regulations that would provide the following benefits only to those parties that commit to ship gas at the first open season.

Ms. Davis stated that under this subsection, the Legislature would direct the commissioner to "minimize retroactive adjustments to the value of the State's gas". Such retroactive adjustments occurred previously in instances in which the producer sold gas at a certain price and after an audit, the State under its contractual agreement, increased the royalty to reflect a higher price received by a competitor.

[10:25:18 AM](#)

Ms. Davis continued that Section 43.90.310(a)(2), on line 16 through 30, related to the pricing for the royalty gas. Up to the present time, a "wide range of different prices" had existed. This provision would stipulate through various criteria that the pricing would be "fine tuned" and "made more certain; more definite" for the royalty payer.

Ms. Davis furthered that subsection (a)(3), on page 20, line 3 through page 21, line 3, would direct the commissioner to modify the manner in which the State "switched back and forth" from taking gas royalties-in-value and royalties-in-kind. Currently, the State generally had the right to switch between the two royalties by providing a 90-day notice. This presented a challenge to resource owners because, upon announcement by the State that it would collect the royalty-in-value, the producer would sell gas at a certain price and commit to ship that gas through a pipeline. A change in the State's decision to instead collect the royalty-in-kind would require the producer to divert the gas that had been committed. The shipper had "paid for that space" in the pipeline to the original destination and would not have sufficient time, given the 90 day notice provision, to "pass that space off" to a different shipper or otherwise mitigate the loss.

Ms. Davis stated that the provision of this subsection would limit the State's ability to change the royalty and would ensure that the State would "make whole" the impacts to the shipper.

[10:28:09 AM](#)

Senator Huggins asked how realistic was the State's likelihood to collect the gas royalty-in-kind.

[10:28:33 AM](#)

Ms. Davis replied that the State historically had not collected gas royalties-in-kind because gas had not been produced in Alaska. The State had collected oil royalties-in-kind in limited amounts.

[10:28:59 AM](#)

Mr. Galvin clarified that the State does receive oil royalty payments in-kind for in-state use. Currently, oil was taken in-kind and sold to the Flint Hills refinery as well as taken in Fairbanks and sold to Tesoro for its refinery. This form of oil royalty is generally taken to meet the in-state needs not met through the royalty-in-value commercial sales.

[10:29:30 AM](#)

Senator Huggins understood that changing the form of the royalty was more cumbersome for gas than oil. He asked the "window that would merge out of this that you could switch from to in-kind or value."

[10:29:54 AM](#)

Mr. Galvin gave the following response.

The concern about the switch isn't so much on the State's part. There would be a question of - it's an option that we have under our leases. So from our perspective it would likely only come up on instances where there was in-state needs that weren't being met and that we would be looking to take it in-kind in order to be able to deliver to those in-state needs.

Looking at the oil scenario, we haven't encountered a situation where there's some opportunity in the market that we decided only the State can take advantage of so that we switch to in-kind and make that sale on our own. So it's probably similarly unlikely that we're going to find a scenario in the open market that the State wants to take advantage of.

So it is relatively low likelihood that we would be making the switch ourselves except for those in-state needs that we may need to meet at some point. However, from the lessee's perspective, the fact that the State could switch causes them concern because, as unlikely as we see it, they may see it as something that the State may take advantage of and suddenly switch out on them. Then they're left not having as much gas to sell, ship, as they expected and took their positions on capacity or in the market sales contracts that they no longer have the gas to fill.

[10:31:34 AM](#)

Ms. Davis reminded that Anthony Scott of the Department of Natural Resources had testified previously that the time period could be two years. The exact time period was not specified in this bill to allow for input from the industry during the regulatory process to learn its opinion of "the more reasonable timeframe for switching". To some extent, the time period would be dependant upon the lease holder because it would reflect its commercial arrangements.

[10:32:23 AM](#)

Senator Huggins asked if the time period would likely be measured in months or years.

[10:32:28 AM](#)

Mr. Galvin answered, "If we were to make it something that we think is going to be attractive it's going to be years."

[10:32:41 AM](#)

Senator Huggins asked the expected date that the regulations governing the calculation of royalties would be enacted. Although some had projected this would be completed in a matter of months, regulations pertaining to the Petroleum Profits Tax (PPT) were not yet complete although the legislation establishing that that system was passed by the previous legislature.

[10:33:14 AM](#)

Ms. Davis responded that "to be valuable" regulations establishing a method to determine the monthly value of the State's royalty share must be completed before an open season could be held. The AGIA license should be issued by April 2008 and she predicted that these regulations would be established by that time.

[10:33:36 AM](#)

Mr. Galvin furthered that the Department of Natural Resources would begin the efforts upon passage of AGIA to ensure that regulations were in effect by April of 2008 or shortly thereafter.

[10:33:53 AM](#)

Senator Huggins asked if a requirement that regulations be enacted by the date of the license issuance would be "unfair".

[10:34:09 AM](#)

Mr. Galvin responded that in October 2007, once the applications had been received, an estimation could be made for the time that the open season would likely occur. Upon receipt of the applications, efforts would commence to draft and implement regulations. The parties which the State intended for participation could require additional time to provide "feedback" on the proposed projects. Therefore, a specific deadline could be detrimental.

[10:35:00 AM](#)

Ms. Davis pointed out Section 43.90.310(b)(1) contained the condition that to receive the royalty inducement, the lease holder must commit "to ship to acquire capacity" at the initial binding open season.

Ms. Davis listed the condition of subsection (b)(2) as the commitment of the lease holder to not protest the "rolled in expansion" costs of the mainline pipeline "up to the level that the pipeline company was required to accept rolled in rates."

[10:35:37 AM](#)

Co-Chair Stedman understood the rate to be 15 percent.

[10:35:41 AM](#)

Ms. Davis clarified the rate would be 15 percent "above either the rack rate, the initial maximum recourse rate, or 15 percent above their negotiated rate."

[10:36:04 AM](#)

Ms. Davis specified that the commissioner of the Department of Natural Resources would also be required to review the regulations it enacted ever two years. The shippers would not be required to rely solely on regulations. A producer-shipper of gas could elect "to have the regulations incorporated as a contractual term in their lease so that when that is embodied in their lease it's theirs, they own it, they hold it for the duration of that entire lease." If the commissioner revised the regulations subsequently because "they got out of step with the requirements of AGIA," the shipper could elect to "opt into" the revised regulations or remain under the commitment of their lease agreement.

[10:37:14 AM](#)

Senator Huggins posed a scenario of the ten year gas production tax exemption for those parties that committed during the first binding open season and asked if the parties would limit their commitments to ten years rather than for 15 or 20 years or more.

[10:37:40 AM](#)

Ms. Davis admitted difficulty in providing a response to this due to changes to the tax exemption adopted by the Senate Resource Committee. If it was assumed that the ten-year exemption was "durable and it would last", she did not predict that a producer would restrict its shipments to ten years. Instead, a producer would consider the "larger financial issue" of its "business interest relative to acquiring capacity in the pipeline given the volume of gas I need to move from the [North] Slope and the contracts." She elaborated that the producer's "driving commitment" for the pipeline would determine that the amount of capacity it would acquire and the duration of that capacity would be "driven" by its commercial model for monetizing the gas. This economic analysis would consider a tax exemption, the royalty provisions as established in the

regulations, and primarily by "the economics". Any changes to the tax that occurred after the ten year exemption period would be less important to the producer's net present value, but would remain important from "a cash flow standpoint."

[10:39:50 AM](#)

Section 43.90.320. Gas Production tax exemption. (page 22, line 12)

Ms. Davis reported that this provision was amended by the Senate Judiciary Committee as a result of a "legal view" that the Alaska Constitution, which provides for the manner the Legislature could handle taxation, stipulated that the Legislature could never surrender its power to tax. The Legislature could however suspend or "contract away" the power to tax and could grant exemptions "by general law". The "general law" language was the basis of the legal debate with regard to the tax exemption proposed in this bill. One position held that an exemption could have no "contractual connection" and although laws passed by a legislature could be changed by a future legislature and therefore be, "a constitutional grant of an exemption by general law" the exemption could not be made durable.

Ms. Davis contrasted this argument with another legal view supported by the Administration and producers "by virtue of the fact that this was the prior fiscal contract structure." This view held that general law, such as AGIA, could authorize the execution of a contractual exemption. This "extra contractual underpinning" authorized in the constitutional provision that allowed taxation to be "contracted away", would invoke another constitutional provision known as the "impairments of contracts clause". That clause "essentially disables" a future legislature from impairing the contract of an earlier legislature. For that clause to apply, a "very express statement of intent by the earlier legislature that it intended to create a right via contract" must exist.

[10:43:30 AM](#)

Ms. Davis relayed that because the Senate Judiciary Committee concurred with the former legal argument, it deleted the contractual tax exemption language from this bill. The language

no longer provided for a "certificate signed by both parties" or a reference to a "very clear contractual right".

Ms. Davis pointed out that the amendment language did include a "grant of ten years" of protection to a shipper that stated that "on the date that they commit their gas at open season, that whatever tax rate is in place on that date for production tax - this whole provision only relates to production taxes ... they can count on the fact that the tax will never be higher than that." The tax rate could be lower if a future legislature changed the tax to a lower rate.

[10:45:00 AM](#)

Co-Chair Stedman asked the possibility of multiple binding open seasons to achieve the capacity needed to warrant a "four and a half bcf line" or other configuration.

[10:45:17 AM](#)

Ms. Davis affirmed the possibility that the first binding open season would not secure the necessary commitments to fill the pipeline to its capacity. In this instance, a second binding open season could be held to "top off" the capacity commitment.

[10:45:47 AM](#)

Co-Chair Stedman surmised that if a smaller company was unable to commit gas at the first open season because of its production volume, the company could have a second opportunity to ship gas through the pipeline.

[10:46:06 AM](#)

Ms. Davis stressed that any company that participated after the first binding open season would not be eligible to receive the AGIA incentives.

[10:46:29 AM](#)

Co-Chair Stedman asked if one company committed gas in both a first and second open season whether only the gas committed at the first open season would qualify for the incentives.

[10:46:47 AM](#)

Ms. Davis again affirmed that only the volume of gas committed at the first open season would be eligible because the intent of the AGIA incentives was to encourage and accelerate the progress of the project.

[10:47:06 AM](#)

Senator Elton opined on the unlikelihood that a legislature would increase the gas production tax at a time "somebody" was "struggling with the economics of trying to make the project work." Therefore, the tax rate would be "locked in" before the first open season. Given the timeline discussed earlier in the hearing, the pipeline might not be completed before the year 2023 and it would be unlikely that a future legislature would "kind of break faith with this general law". He concluded that the State could be essentially committed to a gas production tax until possibly 2033. This was a long period of time and the "lock down" was "more of a political imperative."

[10:49:06 AM](#)

Senator Huggins reminded that the Committee had agreed that a "window" would be established to provide the timing of when the taxes would be in effect.

[10:49:37 AM](#)

Co-Chair Stedman posed the following.

The issue, I guess the question is, the way this is written, there's the opportunity at the first binding open season to lock in whatever tax rate it is, currently its 22 and a half. Is the Administration looking at some window where that's going to be reviewed or is the operational plan to leave it at that or what's the desire of the Administration?

[10:50:03 AM](#)

Mr. Galvin responded as follows.

With regard to the current PPT, we're looking closely at both the tax rate for both oil and for gas. We have discussed in the context of the revenue projections and the

fact that we're experiencing lower PPT receipts than what we had anticipated that the PPT itself is going to have to be evaluated in terms of whether it is performing and resulting in what you expected when it was passed by the Legislature last year.

Co-Chair Stedman directed Mr. Galvin to limit his response to taxation on gas because "oil's a whole other problem".

Mr. Galvin continued.

In the context of PPT in general, we're looking at the nature of the tax itself. That also leads us to a question of the gas tax rate. At this particular point and time, we don't have enough information to be able to take a position on whether or not the 22.5 percent is an appropriate rate - is too high or too low. But we do anticipate both in the near term and mid term, receiving more information so that we can have a better handle on where we feel that rate should be and information that we can provide to [the] legislature to make a determination on how you feel where that rate should be.

What we all are committed to is making a decision as soon as we can with the information that's available to us. Clearly we need to come to an understanding before we get to that open season so that the rate that's locked in for the timeframe that we all recognize could be much longer than ten years, that it's a rate that we're all comfortable with. So we all are going to need to assess that. I don't think it's something that we want to say at this point that 22.5 percent is the rate that's going to be in place at the time of the open season. I think we're going to need to look at that.

[10:52:13 AM](#)

Senator Huggins agreed that the Administration was reviewing the "elements". The issue was that the date of the "window" would be agreed upon rather than the actual rate.

[10:52:56 AM](#)

Co-Chair Stedman commented that if the rate were increased, calculations must be made to ensure that the State was not disadvantaged during the first open season. Conversely, if the

rate were too high, the tax could "block" participants from committing at open season due to the economic impact.

[10:53:15 AM](#)

Mr. Galvin agreed to the duty to establish a time frame in which the tax rate would be discussed. The Department of Revenue anticipated information would be available in the upcoming summer evaluating the current tax rate in comparison to rates imposed elsewhere. Upon receipt of that information and discussions with the Legislature, an appropriate timeframe could be determined.

The bill was HELD in Committee.

#

ADJOURNMENT

Co-Chair Bert Stedman adjourned the meeting at [10:55:13 AM](#)