

**ALASKA STATE LEGISLATURE
SENATE JUDICIARY STANDING COMMITTEE
ANCHORAGE LIO**

June 25, 2008
9:06 a.m.

MEMBERS PRESENT

Senator Hollis French, Chair
Senator Charlie Huggins, Vice Chair
Senator Bill Wielechowski
Senator Gene Therriault

MEMBERS ABSENT

Senator Lesil McGuire

OTHER LEGISLATORS PRESENT

Senator Kim Elton
Senator Tom Wagoner
Representative Jay Ramras
Representative Bob Lynn
Representative Lindsey Holmes
Representative Mike Kelly - via teleconference

COMMITTEE CALENDAR

AGIA Issues

PREVIOUS COMMITTEE ACTION

No previous action to record.

WITNESS REGISTER

DONALD M. BULLOCK JR., Attorney
Legislative Legal and Research Services
Legislative Affairs Agency
Juneau, AK

POSITION STATEMENT: Provided information related to treble damages provision in AGIA license.

PATRICK GALVIN, Commissioner
Department of Revenue
Juneau, AK

POSITION STATEMENT: Delivered a PowerPoint presentation.

ANTONY SCOTT, PhD, Commercial Analyst
Division of Oil and Gas
Department of Natural Resources
Juneau, AK

POSITION STATEMENT: Delivered a PowerPoint presentation.

ACTION NARRATIVE

CHAIR HOLLIS FRENCH called the Senate Judiciary Standing Committee meeting to order at [9:06:17 AM](#). Present at the call to order were Senator Huggins, Senator Wielechowski, and Chair French. Senator Therriault arrived soon thereafter and Senator McGuire arrived during the course of the meeting. Other legislators present when the hearing began included Senator Elton, Representative Holmes, and Representative Coghill. All legislators had been invited to attend.

^AGIA ISSUES

CHAIR FRENCH said the hearing today is about in-state gas and treble damages. The reason for the hearing is that as legislators began to explore the AGIA license, questions arose about what they could and could not do with respect to state assistance for in-state gas use. Given that there won't be any gas flowing in the big pipe for 10 years or more, it seems very important to address the issue because between now and then there will be a great deal of pressure exerted on legislators to do something. "And I believe we should do something as far as encouraging and implementing the use of in-state gas - probably from the North Slope." He studied the statute for some time this morning and he wants to hear from legislative legal and the administration and then ask Trans Canada to comment when the time comes. That way we'll find out if we're all on the same page, he said.

CHAIR FRENCH noted that Representative Ramras had joined the hearing.

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CHAIR FRENCH highlighted the documents before the committee:

- Legal Services opinion dated June 24, 2008 by Mr. Bullock.
- Memorandum by Bonnie Harris and Lesa Weissler.
- Three opinions about treble damages and competing projects.
- Legal opinion about the constitutionality of a lower tax rate for in-state gas.

CHAIR FRENCH said he'd like Mr. Bullock to walk through the memo he prepared on 6/24/08. He's done excellent work laying out a logical and clear analysis of AS 43.94.40 and other related statutes, he added.

SENATOR Therriault joined the hearing.

DON BULLOCK, Attorney, Legislative Legal and Research Services, Legislative Affairs Agency, explained that his approach was to break the statute down into the elements and comment on each. The statute begs several questions. The first asks how big the project is and the second asks what the state is doing to provide inducements for the project.

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MR. BULLOCK, referring to his memo, clarified that part of the text that's not in the boxes is the statute itself and his comments and other references are inside the boxes.

MR. BULLOCK said that the first phrase, "Except as otherwise provided in this chapter," refers to whether there are other exceptions to the assurances in the chapter. He said he didn't find any. It seems that the only exceptions are within the particular statutory section itself.

The next phrase says, "The state grants the licensee assurances that the licensee has exclusive enjoyment of the inducements provided under this chapter before the commencement of commercial operations." The assurances are that this is part of the consideration the state will give in return for a licensee to come forward. "It's saying that I'm marrying you and I'm not going to give some of the benefits to the mistress that comes along." In AGIA those assurances generally are the \$500 million and the benefits of the gasline coordinator. The commencement of commercial operations is the key date and it's defined in statute. It means the first flow of gas in the project that generates revenue to the owners. That's key because the prohibition is against providing benefits before the other pipeline goes into commercial operation. The approach is that through AGIA the state is making a commitment to the licensee. As will be seen later, the state can continue to consider permits and other authorizations for a competing pipeline, but the inducements can't be the same so as to encourage the second project.

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MR. BULLOCK said the next phrase says, "If before the commencement of commercial operations, the state extends to another person preferential royalty or tax treatment." He opined that this could be broader than just gives the treatment. In other words, if the state were to advertize for another AGIA kind of license for an in-state pipeline, could that be interpreted as extending the benefits to another pipeline? It's not clear and I don't know, he said. Also, the preferential royalty or tax treatment is interesting because it goes to the producers that commit during the first binding open season to the licensee. The straightforward reading is that there's preferential royalty or tax treatment that would be offered to producers in exchange for committing to a new competing project. But it could also be read broadly enough that the tax treatment could go to the pipeline owner because pipelines are subject to the oil and gas property tax. If there were a tax break under the property tax to a competing gasline, that also could be subject to interpretation to trigger the treble damages provision.

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MR. BULLOCK said the next phrase says, "Or grant of state money." Under AGIA the state is offering \$500,000 as inducement to the licensee. That phrase isn't defined so there's a question as to how much money the state would have to dedicate to the project. Also there's an issue of how much money would be used to study the possible development of the project. Overall, he suggested thinking of the damage provision in terms of this being a contract the state has entered into with the licensee. The state is offering \$500,000 million for the consideration and promises that it will be faithful to the licensee.

The next phrase is "For the purpose of facilitating the construction." Whatever incentive or inducement is offered has to be consistent with the purpose of facilitating the construction. He suggested looking at what is given and the purpose behind it. Determining the purpose of an inducement presents an interesting burden of proof issue that he hasn't resolved in his own mind. To avoid the penalty the state could have the burden of proving that what was given wasn't for the purpose of facilitating construction. It was for some other purpose. Alternatively, to be entitled to the penalty the licensee would have the burden of showing that the purpose of whatever the state did was for the purpose of facilitating construction. He said he isn't sure what the outcome of that would be.

9:17:02 AM

CHAIR FRENCH noted that Representative Bob Lynn had joined the hearing.

REPRESENTATIVE RAMRAS outlined the various potential needs for in-state gas and asked if it would trigger treble damages if the Governor or her representatives were to go to FERC or the U.S. Department of Energy to get an expansion of the state's export license.

CHAIR FRENCH noted that Senator McGuire had joined the hearing.

9:19:50 AM

MR. BULLOCK replied it relates to a competing natural gas pipeline project, which is defined as having a throughput of more than 500 MMcf/d of North Slope gas and the end of the pipeline is in some market. The first issue is whether the increased gas use amounts to 500 MMcf/d. If it doesn't the state could do as it pleased. If the gas does add up to more than 500 MMcf/d, he said he doesn't think anything in the treble damages provisions would thwart the state from setting alternatives. That's what's happening in the AGIA review process, he said. The Legislature is considering testimony from the Port Authority and the Alaska Natural Gasline Development Authority about in-state use. There isn't a license yet and he thinks it would be possible for the state to continue to study alternatives. The damage provision doesn't say do not have a pipeline and do not give an inducement and money. It says don't do it unless you're prepared to pay the price, which is treble damages. That's ultimately a cost the state has to consider as it explores the different alternatives.

REPRESENTATIVE RAMRAS asked if he's saying that the state would be sacrificing some of its sovereign rights. If the consortium of Anadarko, CIRI, ASRC and ENSTAR said it only makes economic sense to have a pipeline that generates 600 MMcf/d, he asked if the state would be disallowed from pursuing an expansion of the export license to meet that demand without subjecting itself to treble damages.

MR. BULLOCK replied it ultimately comes down to the cost of different alternatives. Assuming that the throughput of the competing project is more than 500 MMcf/d, the treble damages provision would be triggered because it's a competing project. The statute is limited with respect to what the state is giving, but it's money and the benefit of a pipeline coordinator. The pipeline coordinator job is to grease the skids for the favored

project so if a proposed licensee's application is to be considered as well as a competing project, the coordinator could say to work on the licensee's application first as a matter of policy.

As far as soliciting support for an in-state project, that raises the issue of whether there is going to be a violation of the assurances in the future, he said. But until the competing project is extended the actual inducement, the issue of treble damages wouldn't arise.

CHAIR FRENCH highlighted that he did make an issue of the point of whether the extension means the offer of help or the grant of help.

MR. BULLOCK said the offer of help wouldn't arise until there was a request for a proposal application where the state outlined what it was extending if the applicant responded with an acceptable project.

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SENATOR ELTON disagreed that this relinquishes sovereignty. The contract provides that the state can exercise sovereignty, but there's a cost. Referring to the bottom of page 1, he asked what "extension" really means. For example, can the state offer help to a statutorily competing line as soon as commercial operations start on TransCanada?

MR. BULLOCK replied it's not clear but arguably there is a risk. The form and substance issue, which arises particularly with royalty and tax inducements, has to do with who is going to put gas in competing pipelines. If the state does something that causes a potential shipper to pause because there might be a better project down the road, that is hindering what it intended to do with the licensee, which is to encourage the licensee to build the pipeline and shippers to put gas in that pipeline.

SENATOR ELTON asked if it would be an example of extending assistance if a future governor were to say to a competing pipeline that the state would do whatever it could to help. Or would that be a comment with no meaning until a proposal is presented to the Legislature, he asked.

MR. BULLOCK replied you'd first need to consider what assurances are extended. It would become an issue of what has happened and whether there has been an extension of assurances that complies with the statutes. It's not black and white, not even the money.

The state gives up to \$500 million to the licensee, but the statute isn't clear whether or not giving \$1 million to a competing project to study would trigger the treble damages. Also, if this is litigated the statute may be a guideline but there may be some flexibility should the licensee want to give up some of the damage receipts in exchange for some other incentive. The TransCanada application did suggest they could exercise the opportunity of providing larger capacity to Delta Junction for feeding in-state use. That might imply that they would be open to work with the state on giving more than 500 MMcf/day to in-state markets, he said.

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SENATOR McGUIRE how many places in the law he's seen treble damages.

MR. BULLOCK acknowledged that it isn't common. The legislative history of the provision indicates that the Legislature approached this cautiously. The first bill that the Governor introduced allowed reasonable costs to be the basis for treble damages. As the legislation moved it became related to qualified expenditures. It was offered as an assurance for a licensee to come forward without having to worry that the state would change its mind.

SENATOR McGUIRE asked if he sees anyplace where treble damages would extend into personal liability. For example, if a particular person within the government made extensions or offers to help.

MR. BULLOCK said probably not, but it would depend on what the person that makes the offer does and the power of that person to obligate the state. Under AGIA the commissioners of revenue and natural resources do have the power to act on behalf of the state with regard to the licensee in the process. If they were to act together and offer assurances that could trigger liability for treble damages.

SENATOR McGUIRE asked what would happen in an instance where the Legislature disagreed with the Governor and decided to put forward a package itself. She asked if the Legislature would be authorized to put forward something similar to the old China Gas Development Act, for example.

MR. BULLOCK said the separation of powers issue would arise. Under the Stranded Gas Act the Legislature authorized the contracts that provided for payment of the tax, but the

administration actually has to carry it out. The focus would be on executive action rather than legislative action because to trigger the damages, the inducements and incentives have to be offered for the purpose of facilitating the competing project. Legislation itself wouldn't trigger the damages, he said.

9:32:33 AM

SENATOR McGUIRE said then she doesn't have to worry that if this exclusive license is granted to TransCanada, that she would be subjecting herself or the state to treble damages if she files a bill next December that offers a package of inducements or benefits under something similar to the old Stranded Gas Development Act that might, for example, spur development on an in-state gas pipeline

MR. BULLOCK replied he doesn't believe so. This is an assurance with a penalty if the assurance is violated so there's a cost attached to whatever you do. If the state actually offers the inducements, the assurance has been violated. The damages would be paid and the competing project could conceivably go forward. Assuming TransCanada is awarded the license, they would get the treble damages and then decide whether they wanted to pursue the project or not.

MR. BULLOCK added that the first key date is during the first binding open season when there's a commitment by the shippers. At that point it's conceivably possible to avoid the issue of shippers holding back from the licensee and waiting to see what happens with a competing project. The second date would be between the end of the first binding open season and the start of commercial operations. That is the date when the state can do whatever it wants to encourage a competing pipeline.

CHAIR FRENCH referred to his statement that upon payment of treble damages TransCanada could decide if it wanted to continue. He noted that page 4 of Mr. Bullock's analysis says that upon payment of the treble damages, the licensee shall turn back to the state basically everything it's done. He asked if the payment of treble damages ends the project or if it simply says that the data is transferred to the state making it a full-information partner with TransCanada.

MR. BULLOCK clarified that his outline later on describes how similar the provision for transfer of information under abandonment of the project is to the treble damages provision. The statute isn't clear as to whether they would continue, but the implication is that they would no longer be bound by any

"must haves" in the AGIA license. Probably the best interpretation is that this would end the AGIA license, but it wouldn't preclude any entity from pursuing a pipeline project, he said.

SENATOR WIELECHOWSKI asked when the treble damages would kick in if there was inducement extended to build a 500 MMcf/d gas pipeline project that had expansion capabilities.

MR. BULLOCK replied part of it depends on how you define a gas pipeline project - whether it's defined by its initial capacity or its expanded capacity. The answer isn't clear in this section, he said. The state could offer inducements to a 490 MMcf/d pipeline that's expanded three years later. Looking back the question is whether the state actually encouraged a larger pipeline. The better resolution would be to look at the project as initially proposed. Under the AGIA license we looked at the initial capacity although there are terms providing for later expansion. Now the proposal is treated as the size that TransCanada is offering, he said.

[9:38:11 AM](#)

SENATOR WIELECHOWSKI asked, assuming that there were treble damages, if the Legislature would have to appropriate them or if TransCanada would automatically be entitled to them.

MR. BULLOCK explained that, as specifically addressed in AS 43.90.440, the Legislature has to appropriate them.

SENATOR WIELECHOWSKI questioned what would happen if the Legislature refused to appropriate the treble damages.

MR. BULLOCK responded that's happened in the past in other court cases. A lot of litigation is involved and at some time there's a court order. Then the separation of powers issue arises related to whether the Court can order the Legislature to perform the legislative function of appropriating money.

SENATOR WIELECHOWSKI noted that Supreme Court case law in employment arbitration cases has said that if the Legislature doesn't appropriate the money, you don't get it. He assumes that would be the same in this case.

MR. BULLOCK replied that's correct according to the language in the statute.

REPRESENTATIVE HOLMES referred to the bottom of page 1 that talks about extending to another person preferential royalty or tax treatment. She asked if it would trigger the treble damages clause if the Legislature were to amend some of the state's tax structure related to gas and the changes applied equally to a TransCanada line and a Denali line, for example.

MR. BULLOCK asked if she's asking about production taxes.

REPRESENTATIVE HOLMES replied that would be one area.

MR. BULLOCK explained that production taxes apply universally to production regardless of where it ends up. If the tax rate was adjusted for natural gas produced on the North Slope that would apply to all the producers. There is a provision under ACES that says that if there's some in-state use, then there's a tax break. The problem with AGIA is that as written the inducement is to provide royalty inducements and the tax benefits to encourage commitment to a particular gasline. So if a distinction was made in the production taxes to offer a similar break from the nominal tax rate to commit gas to an in-state project, then that becomes an inducement that violates the assurances. A general affect of the tax change wouldn't affect the licensee and it wouldn't affect an alternative project, but if it specifically benefited the alternative competitive project, that could be viewed as an inducement and would trigger the damages.

REPRESENTATIVE HOLMES said then the changes would not be precluded so long as it's even-handed.

MR. BULLOCK agreed. The burden of the production tax is on the producers and it may be a factor when they're looking at potential tariffs. Setting the tax rate is a policy decision, but it could be the straw that kills the field if there's no residual wellhead value.

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REPRESENTATIVE HOLMES noted that the Legislature did make changes in ACES, including benefiting in-state gas, after AGIA passed but before acceptance of the contract for the proposal. She asked if he sees any problems for the state because those changes were made after AGIA passed.

MR. BULLOCK said no, except to the extent that it affects the general economics of gas production on the North Slope. It doesn't relate directly to the license versus a competing

project, he said. The tax affect relates to the economics of the production - what the tariff will be and whether there's something at the wellhead after paying to get the gas to market. If the producers don't own the pipeline, they're in a similar position to the state - there has to be wellhead value to have benefit. There's the possibility that the producers have additional profit from a marketing outlet at the other end of the pipeline, but the state can only get it at the wellhead, he said. That's why there's interest in a low tariff, he added.

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CHAIR FRENCH referred to Mr. Bullock's legal opinion dated June 17, 2008 that suggests that a reduced tax on the production of gas used in the state probably would be found to violate the interstate commerce clause and likely would be struck down in the future. Noting that most of the gas in this pipeline will flow out of state, he said that will bring before the Legislature the question of how to adjust taxation of in-state gas. If the tax is adjusted subsequent to the award of a licensee, he asked what implication that would have with respect to having extended to another person preferential royalty or tax treatment.

MR. BULLOCK clarified that the preferential benefit of selling gas in-state goes to the producers and not to the pipeline. It may affect the capacity of the pipelines because the producer may want to deliver its gas into a market where it has a lower production tax. It doesn't really affect the pipelines, but it comes back to that hesitation of a shipper to commit to a project. On the interstate commerce issue, he said that the flip side of looking at a discount for in-state gas is that there's a relatively higher tax imposed on gas production sent out of state. That's where the interstate commerce issue is triggered, he said.

CHAIR FRENCH agreed and added that the opinion suggests that the tax rates for out-of-state gas and in-state gas will be set at the same rate to satisfy requirements under the U.S. Constitution.

MR. BULLOCK said that's likely to happen. In a number of cases states have unacceptably attempted to impose lower tax rates on commodities within the state compared to those in interstate commerce. The Supreme Court made one exception, but the case was tied to the state's internal financing and the options it could exercise in that regard; it wasn't in a commercial situation.

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REPRESENTATIVE RAMRAS asked what the State of Alaska would be precluded from doing with regard to assisting other entities such as Denali or a small diameter pipeline, and what remedy those entities would have if they thought they were being "slow rolled" in the permitting process because they weren't getting equal treatment and a fair equal allocation of resources compared to the "favored project."

MR. BULLOCK cited AS 43.90.440(b) as follows:

(b) The review, processing, or facilitation of a permit, right-of-way, or authorization by a state agency in connection with a competing natural gas pipeline project does not create an obligation on the part of the state under this section.

Under this provision the normal application process would continue to be available without triggering the treble damages, he said. The problem is that one of the benefits to the licensee is that the gasline coordinator is specifically tasked with following the administrative process and expediting it. That could be interpreted to mean that the licensee would have priority if two competing applications were on the table for natural resources for a particular permit, he said. Another project has options to pursue under the Administrative Procedures Act to encourage state action, but there is the issue of whether there are enough resources within the permitting agencies to handle both projects simultaneously. It might be a fiscal note issue and the Legislature might respond by increasing staffing at the agency. Thus the licensee would enjoy an expedited process under AGIA and other applicants would have access to the resources of the agency to facilitate processing their applications. He identified that as an administrative law question.

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REPRESENTATIVE RAMRAS noted that Commissioner Irwin admitted that DNR is far behind in processing applications for land disbursements to Alaskans. That raises the issue of what human resources will be available within DNR to address permitting issues and to offer assistance in the AGIA process. He asked what kind of "choke hold" there will be on human resources available for permitting for small diameter pipelines, the Denali project, and the AGIA project and if competing lines would go through the AGIA coordinator or directly to DNR.

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CHAIR FRENCH noted that Senator Olson and Representative Johnson had joined the hearing.

PATRICK GALVIN, Commissioner, Department of Revenue, said the question of allocation of resources to make sure there's adequate staff is associated with any project that's going forward.

REPRESENTATIVE RAMRAS asked if he's talking about the allocation of resources within DNR.

COMMISSIONER GALVIN clarified that he's talking about the allocation of resources for the entire state permitting process. It's a question that goes across lines because the slowest permit will always be the one that slows the project. He explained that on a large project the normal course of business is to execute a reimbursable services agreement (RSA) with the state. That is the most direct vehicle for a project to ensure that resources are available within the agencies to assure expedited consideration of their permits. This is something that's done all the time and discussions are already underway to execute an RSA for the Denali project. Depending on the nature of the agreement, there could be a coordinator position that would be funded by the applicant to act as a coordinator of the state permitting processes and also as a liaison with the federal permitting process. Through that process the applicant would be able to fund positions within any of the departments that required permits and to secure sufficient capacity to expedite the process as quickly as the agency could allocate. To the extent that the RSA doesn't cover it, the agencies are able to ask the Legislature for additional resources and target the particular projects or permits that need additional funding.

[9:56:51 AM](#)

REPRESENTATIVE COGHILL asked for clarification that a competing project could go to the department and get the resources available, and the state is providing that coordinator for the selected licensee.

CHAIR FRENCH noted for the record that Commissioner Galvin nodded his head in an affirmative fashion.

SENATOR MCGUIRE remarked that it's being represented that the treble damages clause isn't a big deal. She referred to a chart showing that damages could rise to \$877 million and noted that AGIA says that the damages payment would be in full satisfaction

of all claims the licensee may bring related to the events that gave rise to the payment. She asked Mr. Bullock if he thinks it's that simple or if a court would deem TransCanada to have some other rights should they choose to pursue them. We're assuming they'd be happy to walk away with treble damages after they've given the state all their data and hard work and I don't see it that way, she said. She asked Mr. Bullock his view and why she might be wrong.

10:00:10 AM

MR. BULLOCK said that both AS 43.90.240 and AS 43.90.440 are means for the licensee and the state to terminate a project and walk away because it could be that after going through the entire process it's just not economic. He suggested thinking of it in terms of a contract because the AGIA provisions and the statute are incorporated in the contract of the license. They were there when the request for proposals went out and they'll be there if the license is awarded. It's not unlike the provision in which the potential license holders and applicants agreed not to contest the award of the license to somebody else or that no license is awarded, he said. TransCanada came forward with those terms in place so contractually they would have to abide by the provision that says that the litigation ends at that point. But that doesn't preclude litigation related to due process or some other constitutional right that the licensee enjoys that's outside the contract and this provision, he said.

SENATOR McGUIRE asked if equitable principles, such as an injunction, are allowed. I doubt we'll have trouble with economics, but it may be possible that all the parties can't get together. "That has been my concern all along," she said. There's gas, there are people that want to sell their gas, there are people that build pipelines, and there are millions of Canadians and Americans looking for jobs; but whether we can bring them together under this proposal is unclear. She asked about an injunction and the idea that TransCanada would ask the court to enjoin the state and keep it from assisting another project.

10:03:23 AM

MR. BULLOCK said that would be a contractual issue. Under good faith and fair dealing the argument could be made that the state hasn't operated in good faith in dealing with the licensee. Just like any other contract, this could be litigated.

SENATOR MCGUIRE said it's a risky path to hope that everyone will be okay and that litigation won't ensue. "I hope we're right."

CHAIR FRENCH asked Mr. Bullock to proceed.

MR. BULLOCK said page 2 is talking about a competing natural gas pipeline - the size and the route, which is key. For example, a 600 MMcf/d pipeline that has gas that's produced south of 68 degrees wouldn't be a competing project because the route isn't from the North Slope to a market.

MR. BULLOCK said when he looked back at committee minutes he found where Marcia Davis explained how they came up with the 500 MMcf/d threshold. She explained that the definition for a competing natural gas pipeline was developed with the understanding that in-state gas usage would perhaps be 400 MMcf/d over the next 20 years. It was designed to capture pipeline pieces that wouldn't be competitive with a 3.5 to 4.5 bcf project so bullet and spur lines coming off a main pipeline were reviewed. He doesn't know if those estimates have been updated, but that was the basis for determining the volume of the pipeline.

MR. BULLOCK said a lot comes back to the tariff and how much gas will be left to go through a long pipeline. The tariff is figured by dividing the cost by the volume to get a cost per unit or tariff. If the long pipeline is deprived of gas because it's going into a competing pipeline, the tariff would have to rise. One of the bases for determining the size of the pipeline is that it would have enough gas left to pay for the long pipeline.

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SENATOR THERRIAULT referred to an earlier discussion and pointed out that another way to affect the tariff is to pay down the debt on the pipeline. With that in mind he asked if the state would run afoul of the competing pipeline provision if, in order to keep the pipeline capacity under 500 million, the state paid down the construction costs so that the tariff was low enough to make the gas affordable for usage in the state. "Or because we have taken steps to keep the capacity under 500 million, it doesn't matter?"

MR. BULLOCK replied the threshold question asks the size of the pipeline. However it happens, if the competing project doesn't

have a designed capacity of 500 million, the state could do whatever it wanted.

10:08:27 AM

CHAIR FRENCH noted that Representative Gara had joined the hearing.

MR. BULLOCK referred to the discussion about the possibility of an expansion of the pipeline and said it would be a factual issue, but the likelihood of an expansion would be addressed as well. If it was very likely that a 490 MMcf/d pipeline was going to be expanded, that would be in favor of imposing the damages since it would be fact specific, he said.

The next phrase says, "If the licensee is in compliance with the requirements of the license, and the requirements of state and federal statutes and regulations relative to the project." What he discussed here is that the licensee has to satisfy the requirements of the license. That includes keeping current with requirements in state and federal law. If they don't, that not only voids eligibility for receiving the treble damages it also raises the issue of whether the license should be revoked because they would be in violation of the license. Then there's the issue of relevant to the project versus a material violation of state and federal law. "That's sort of litigation bait if we get to that point," he said.

The next phrase says, "The licensee is entitled to payment from the state of an amount equal to three times the total amount of the expenditures incurred and paid by the licensee that are qualified expenditures for the purposes of AS 43.90.110 and that the licensee incurred in developing the licensee's project." The phrase "incurred in developing the licensee's project" is redundant because the expenses on which the damages are based have to be qualified expenditures and they're defined specifically.

The other issue that's addressed is "incurred and paid." If a licensee incurred a \$1 million expenditure and the state paid \$500,000, the question is whether the licensee incurred and paid \$1 million or \$500,000 after the reimbursement. Although the legislative history is a bit weak on the specific aspect, the "incurred and paid" language was put in the bill early on to make sure it was an actual expense of the licensee. Also, the legislative intent demonstrated that reasonable costs would be the basis. Narrowing that to only the qualified expenditures demonstrates the legislative intent that the expenditures should

be strictly construed in favor of the state and against the licensee when determining the amount of damages. Thus "incurred and paid" would be looking at the end of time after the expenses were incurred and the reimbursement was paid and figuring out the net amount that was paid by the licensee.

10:12:05 AM

CHAIR FRENCH noted that Representative Roses had joined the hearing.

CHAIR FRENCH observed that should there be a dispute about whether they paid \$1 million or \$500,000, the backstop is subject to appropriation and the Legislature may come to an independent judgment about what the number is.

He thanked Mr. Bullock for quoting Ms. Davis on the subject of treble damages at the bottom of page 3. She said that "In the totality of it, we thought that the 300 percent had the zing and had the oomph that we needed to make sure that the independents came forward." He doesn't know if they're legal terms, but they said a lot to him.

MR. BULLOCK added that he very much enjoyed working with Marcia Davis during the AGIA process.

The next phrase raises the issue Senator Wielechowski brought up about the amount of the damages being subject to appropriation. The next section says that the licensee shall, at no additional cost, give all the engineering design contracts, permits, and other data. The litany list is repeated in the abandonment provision, he said.

The next section says that treble damage is to be the only remedy available to the licensee if the state breaches the assurances. Page 5 says that the application processes continue for any pipeline, not just the licensee. The issue is whether the pipeline coordinator is greasing the skids of another project. AS 43.90.260 talks about expedited review and action by state agencies. That section talks about the coordinator's responsibility to move things along and prevent unnecessary delays or additional conditions on the permit or license that would hinder development of the project. Finally, subsection (c) on page 5 contains definitions that are used within the section.

10:15:20 AM

CHAIR FRENCH thanked Mr. Bullock and said the committee would next hear from the administration.

^In-State Demand and AGIA's 500 MMcf/d 'Competing Project' Limit

ANTONY SCOTT, PhD, Commercial Analyst, Division of Oil and Gas, Department of Natural Resources, said he would talk about reasonable expectations of in-state demand over time to make sure that the notion of limiting a competing project doesn't hinder the state's ability to take care of Alaskans. He would review historical actual in-state demand, look at projections for future gas consumption for electricity and heating within the state, and point out that the North Slope isn't the only place in the state with gas. In fact, he said, most of the gas that's produced comes from Cook Inlet and that will continue during the relevant timeframe.

The information on slides 3 and 4 is derived from the DNR 2007 annual report. The graph indicates that thru 2006 the total production of gas from Cook Inlet has been less than 500 MMcf/d. Most of that has been used for industrial use and export. Slide 4 shows actual use of Cook Inlet gas for electrical generation and space heating. Although use has been increasing for some time, when tracked with the population increase it's apparent that the rate of growth is slow. Current use, as an annualized average, is a little more than 220 MMcf/d.

CHAIR FRENCH clarified that he's actually talking about Cook Inlet gas when he talks about historical in-state gas use.

MR. SCOTT said yes; currently there's a small amount of gas use in Fairbanks and the source is Cook Inlet. The figures reflect that use.

CHAIR FRENCH clarified that from Ketchikan to Kotzebue, the rest of the state isn't using any amount of natural gas.

MR. SCOTT said to his knowledge that's correct.

CHAIR FRENCH asked if any amount is used in Barrow.

MR. SCOTT said not to his knowledge, but he understands that there is or will be gas use in Nuiqsut from the Alpine field.

CHAIR FRENCH noted that committee members think that Barrow has gas coming from wells drilled in the vicinity, but that usage is small.

MR. SCOTT said he isn't familiar with that, but he's sure that usage wouldn't show on the indicated chart.

10:19:22 AM

The chart on slide 5 - Projected In-State Gas Use - is an assessment from SAIC [Science Applications International Corporation]. That 2006 assessment indicated that by 2025 the statewide demand for gas for residential and commercial as well as power usage would be on the order of 265 MMcf/d. He noted that Harold Heinze from ANGDA recently testified that future in-state demand might be as high as 300 MMcf/d.

SENATOR WIELECHOWSKI asked if he agrees with Mr. Heinze's testimony that Alaska has the capacity for up to 1.2 bcf/d for in-state use and shipping outside the state.

MR. SCOTT, acknowledging that he hadn't seen that presentation, said the state's capacity to export gas is potentially unbounded. "So I would respectfully suggest that it's considerably, potentially, much larger than 1.2 [bcf] a day if you're including LNG exports."

SENATOR WIELECHOWSKI recalled that when Mr. Heinze analyzed peak in-state use, he said that to do the pipeline economically he was projecting up to 1.2 bcf/d.

MR. SCOTT added that in other presentations Mr. Heinze has shown considerable volumes of in-state petrochemical use, some augmented LNG export, as well as in-state LPG usage to build up to the 1.2 bcf/d capacity. That number presumes a very large diameter pipeline for offtake and use of the liquids in-state. He said he doesn't believe those volumes are attendant upon 1.2 bcf/d as a bullet line, for example. He clarified that that's not what he's talking about. "When I talk about in-state use I'm talking about consumption needs within the state for heat and power - not describing all potential industrial uses that one could imagine to make use of gas within the state for subsequent export."

10:23:38 AM

SENATOR WIELECHOWSKI recalled that ANGDA said that you get economies of scale if you do up to 1.2 bcf/d. The tariff is dramatically lower than the tariff on a 500 MMcf/d pipeline, which is so high it's not economical to build the line. He asked if Mr. Scott would agree with that.

MR. SCOTT replied that the issue of what is economic is fairly unclear. What the sellers of gas demand in terms of value at the wellhead could, for example, be a certain price plus the transportation costs, but that's not necessarily the case. "So the issue of what the tariff ultimately is may or may not have any bearing on what the price the consumers ultimately pay."

SENATOR WIELECHOWSKI asked if it's economic for a bullet line to supply up to 500 MMcf/d for in-state gas use under AGIA

MR. SCOTT said the issue is the state providing incentive for another project. "I do not agree that you can say ... absent incentives from the state, the tariffs will be 'X' and therefore since it's not economic it's a problem for us." What we're describing is the state's ability to provide incentives, he said. For example, suppose that a bullet line of 500 MMcf/d or less cost \$8 billion and the state decided to spend \$X billion underwriting the cost of the project. The tariff is a function of the level of state investment. The more the state invests in the project, the lower the tariff. If the state were to underwrite the entire project, the tariff would be zero.

SENATOR WIELECHOWSKI pointed out the exposure to treble damages.

MR. SCOTT said that's right. The hypothetical was that the project needed to be a certain size to get a low tariff. "My response to that is no. You can have as low a tariff as you want with a 500 million a day line. It's just a function of how much the state wants to kick in."

SENATOR WIELECHOWSKI, assuming the license is granted to TransCanada, asked if he sees an in-state gasline ahead of the TransCanada line, which is 10-15 years down the road.

[10:28:31 AM](#)

MR. SCOTT replied it may well happen. ENSTAR is looking at a 480 MMcf/d line without any state assistance. It's a function of markets. You need a market for the gas if you want a certain level of throughput. Also keep in mind that there will still be production from Cook Inlet to meet certain in-state needs, he said.

CHAIR FRENCH commented that the administration has repeatedly said that the bigger the pipe the better the economics, but it's becoming clear that we're going to have to spend a lot for 500 MMcf/d. The conundrum is that while a 1.2 bcf/d line may be more

economic, we'd be bumping against that 500 MMcf/d ceiling should we try to make it happen.

SENATOR ELTON noted that Marcia Davis seems to define competing pipelines as those that start and end in the same location. Her previous testimony said, "Because we have a comfort level, the major projects are looking to go out of state. We don't see spurs or bullet lines being competitive and affecting the economic considerations of the big projects." Noting that the current presentation backs out the export products such as ammonia, urea, and LNG, he asked if he can infer that the state could have a 700 MMcf/d pipeline as long as the additional capacity in the line was going to noncompeting markets - for example, shipping ammonia, urea, and LNG to Asia.

[10:31:24 AM](#)

MR. SCOTT suggested that he's asking for a legal interpretation of competing project. His interpretation is that a 700 MMcf/d project that goes into service before the commencement of an AGIA licensed project would be a competing project if it runs from the North Slope to a market.

COMMISSIONER GALVIN offered to stay at the table to respond to legal questions as they arise. Chair French agreed.

SENATOR THERRIAULT summarized the discussion on the state underwriting part of the cost of a project to make the tariffs affordable and pointed out that that is nothing new for the state to consider. It underwrote a portion of the cost of the electrical intertie to the Interior and 50 percent of the spinning capacity on the Kenai. But the capacity for consumption within the state isn't large enough to get the unit costs down. When he asked ENSTAR whether they needed anything from the state, they said not now. They have lots of things to look at before they can determine what the tariff might be and whether they might need assistance, he said.

[10:34:16 AM](#)

REPRESENTATIVE RAMRAS questioned what would happen if ENSTAR said it needed 600 MMcf/d to execute a minimally economic pipeline. "What does that do to the state if that happens in 4 or 5 years time?"

MR. SCOTT replied a project that is minimally economic at 600 MMcf/d wouldn't appear to require state assistance so it wouldn't be a competing project.

SENATOR McGUIRE said she agrees with that point, but what she worries about are the current tax incentives for the Cook Inlet and Nenana basins. Suppose you had an 800 MMcf/d line that didn't need state assistance per se, but they did want preserve the current tax incentives and the state agreed. "Would TransCanada have a claim in that scenario to say that the state is, in fact, assisting with a competing line?"

COMMISSIONER GALVIN said the first question is whether it's a benefit. The second asks if it's extended for the purpose of encouraging the line that's greater than 500 MMcf/d. If the answer is yes it's a benefit and yes it's for the purpose of advancing that project, that's a technical breach of the provision. When that kind of option is presented, there are a number of things to consider. There's the question of whether there's a different way to address the issue. If larger capacity is what's needed to bring the tariff down, then the state is probably economically better off providing direct subsidy to the project to make it economic at a threshold below 500 MMcf/d. That's a better deal for the state than risking the loss of the big project. Part of the discussion to keep in context is the fact that the state is putting itself in this position because of the benefits that will be provided under the AGIA pipeline. The value that's being provided in the context of AGIA is in the billions of dollars. If the state has to preserve that right by underwriting a project for a couple of billion dollars, that's a fair economic exchange the state is making. Given the size of the markets, it's not unprecedented for the state to undertake that type of role, he said.

10:40:27 AM

SENATOR McGUIRE remarked that that supports her thought that an independent pipe builder has something to bring to the table. She said her concern today, and she's brought it up before, is that some pitfalls are unforeseen. The previous example shows the convoluted analysis that state workers have to work through to figure out how to stay below the subsidy level, bring the best benefit to the state, and stay out of legal sticky wickets. Previously when she suggested inviting some folks to the table whose worldwide business is to do this sort of negotiating, the commissioner said the administration didn't want closed-door negotiations. "I'm not proposing anything that is closed to the public that isn't unprecedented." That said, sometimes business negotiations have to be done behind closed doors because of proprietary information. Inviting these folks to the table can at the very least lead to a better understanding of the challenges for all the parties so legislators will have a better

chance in deciding before voting. Alaskans support the Governor and this gasline, but this is making a lot of people nervous. "This is as high stakes as I've ever seen." If we end up in a protracted fight and lose the opportunity, it's our kids' opportunity for decades. "And you can't get it back."

10:43:54 AM

COMMISSIONER GALVIN said when we talked about mediation before the issue of closed doors was a side issue. "My direct answer to the question was in order for there to be a relative opportunity for a discussion and mediation we have to establish the positions of the parties." He reminded her that the discussion went back to a philosophical discussion about the structure of the government. To a certain extent the administration can speak on behalf the state, but the Legislature also has a tremendous role in that regard. The purpose of AGIA was to establish the state's position and speak with one voice in terms of expectations and parameters for what's on the table. Until you have executed this license and made that decision, the Legislature hasn't spoken in that voice. Mediators will ask what the parameters are; what is in the acceptable range. "We'd be speaking blindly ... because the Legislature hasn't spoken yet on that particular issue."

SENATOR MCGUIRE countered that this Legislature and this Governor have spoken very well on a variety of things. There's a very clear statement that we want in-state access and we want a pipeline that's different than has been done in the past. "I don't think that granting an exclusive license per se has to be the sum of all of that."

10:46:04 AM

COMMISSIONER GALVIN said we began a process by passing the law. We've engaged industry - pipeline and producers - in a discussion and we've established the expectation that we're going to take things in steps. "When you identify this sense of risk of legal morass, ... I haven't seen that kind of advice coming back from our legal experts" For example, legislative legal advisors have written an opinion saying that the treble damages issue is clear and unambiguous and designed to avoid legal maelstroms. The risks associated with moving forward with this license are very calculated to get all the players together and a pipeline moving forward. We have to take things in steps and make decisions in sequence to state our position, provide opportunity for the parties to identify the ground for striking a deal, and then create the opportunity to strike that deal. "We believe that there's tremendous opportunity, once the license is

issued, to bring the parties together and to identify that deal in the context of moving the gasline forward." Until we reach that point, the foundation for the discussion isn't solid enough to engage in meaningful negotiation. "We don't see the value of doing that at this particular point in time."

10:49:00 AM

COMMISSIONER GALVIN said when this started a year ago there was talk about moving quickly and we don't want to lose that sense of forward movement. TransCanada made an offer under AGIA that's basically good. If that's set aside we lose that momentum and the sense that the project is advancing. "We have done what we need to do in order to create the atmosphere for resolution and we need to hit that home by having the Legislature make a decision on this."

SENATOR MCGUIRE said we all want to keep TransCanada at the table, but the treble damages and the exclusivity are troublesome. "Philosophically and legally you are asking 60 people ... to take a step that in my opinion could be against our constitutional obligations." She asked him to consider how mediation could or couldn't help. "It wouldn't be the idea that TransCanada just goes away; but it might be the idea of keeping them at the table with a way that's not so high stakes."

10:51:59 AM

CHAIR FRENCH noted that Representative Mike Kelly had joined the hearing via teleconference.

REPRESENTATIVE HOLMES mentioned in-state supply and demand and noted that slide 3 shows that at times disposition of Cook Inlet gas has been more than 500 MMcf/d. She assumes that the recent precipitous drop is tied to the scale-down and subsequent closure of Agrium.

MR. SCOTT said that's correct.

REPRESENTATIVE HOLMES highlighted the ANGDA projections for in-state gas in slide 6 showing that in 2006 the average use was about 465 MMcf/d, not including Fairbanks use. The projected future in-state demand is 300 MMcf/d not including industrial use.

MR. SCOTT said that's correct; "that industrial use at 250 is the LNG export and at that point still some Agrium production or use."

REPRESENTATIVE HOLMES calculated the ANGDA projections going forward and the existing industrial use and noted that that's bumping against if not already over the 500 MMcf/d.

MR. SCOTT agreed.

[10:54:15 AM](#)

REPRESENTATIVE HOLMES reviewed in-state demand going forward including the projected decline for Cook Inlet and asked what the real supply and demand needs are for the state.

MR. SCOTT clarified that when he uses the phrase "in-state demand" he is referring to Alaska's end-use needs for gas namely for electricity generation and space heating. The point is that with the 500 MMcf/d limit and the continued existence of Cook Inlet production, there will still be sufficient room for industrial uses without worrying about bumping up against that limit. As Senator Wielechowski point out, economies of scale are better with a larger pipeline. The tariff drops so you can imagine circumstances where a project is minimally economic at 600 MMcf/d. Presumably that project wouldn't need state assistance but you can imagine cases that are "on the bubble." They're asking a little help for a 550 MMcf/d line. In those fine cases, presumably the state would say it wouldn't subsidize the export of Alaskan resources as LNG. Instead it would play it safe and provide assistance to that pipeline and keep it under 500 MMcf/d.

[10:57:50 AM](#)

REPRESENTATIVE HOLMES asked if the projections for in-state use include further expansion in Fairbanks.

MR. SCOTT said yes.

REPRESENTATIVE HOLMES asked about gas to liquids for export to communities off the rail belt.

MR. SCOTT replied he doesn't believe the ANGDA projections include gas to liquids uses.

REPRESENTATIVE HOLMES asked if he has any idea how including that would affect the 300 MMcf/d projected in-state demand.

MR. SCOTT replied, "I have no idea what the demand for clean diesel produced by gas to liquids technology might be within the state."

10:58:55 AM

CHAIR FRENCH asked about the demand for liquid propane delivery down the Yukon River. He added that he thought that was the thrust of Representative Holmes' question.

MR. SCOTT replied the top-end estimates he's seen are on the order of 10,000 gallons per day, but that quantity of propane would require a large diameter pipeline. A spur line of the type that's been discussed wouldn't generate the massive volumes of propane to supply those energy needs up and down the Yukon River.

CHAIR FRENCH commented that if the state paid for a 450 MMcf/d bullet line from the North Slope to Southcentral, it looks as though that would supply Fairbanks and Anchorage, and there would be enough to ship propane down the Yukon River.

MR. SCOTT replied, "If there was sufficient propane within the gas, absolutely."

SENATOR WIELECHOWSKI observed that there's a lot of heartburn over two major issues - the \$500 million and the treble damages. "Those have caught my attention and the public's attention." With respect to treble damages he said we can't support a line with a capacity of more than 500 MMcf/d. Although there was a reason for selecting that volume, it now seems to be somewhat arbitrary. That 500 MMcf/d was probably trying to get at two issues. The first is competition for the licensee and the second issue is offtake. He said competition doesn't seem to be a big issue. This line is going to Canada so any excess gas will go to either the West Coast or Asia, neither of which are in competition with this line. Also it'll be used at Agrium, but that's probably not in competition with this line. Offtake seems to be more of a concern and the question is whether we have the ability to offtake more than 500 MMcf/d. With that in mind, he asked what the problem would be with amending AGIA or getting TransCanada to agree that the state can offtake more than 500 MMcf/d without damaging its ability to get gas. "That's really what the crux of this issue is about for TransCanada - their ability to get gas." If the state can do 1 bcf/d without hurting TransCanada's offtake, what would be the problem? That would solve a lot of heartburn and potentially get an in-state gasline more quickly.

11:02:36 AM

COMMISSIONER GALVIN replied the question goes to something that isn't known at this point. At the point in time that they're

looking for customers and looking for gas, how much gas will be committed and is the big project going to be "on the bubble." At this time certainly there are scenarios in which changing from 500 MMcf/d to 750 MMcf/d could make the difference in the big project going forward or not. Inherent in this decision is the goal we're trying to accomplish, which is to make sure that we can get gas to Alaskans at a reasonable price in a shorter period of time. Considering the demand and the available gas right now it's clear that we can have a pipeline that delivers sufficient gas to meet Alaska's needs within the bounds of the AGIA requirements.

The next question asks about the economics and if the state will be in a position where it would prefer to increase the throughput in order to make it economic or increase its participation in order to make it economic. When we talk about increasing the throughput, we create the risk of losing the big project so the 500 MMcf/d isn't completely arbitrary. That is the threshold that was identified that satisfies both needs - to make sure that sufficient gas is available for the big project while also ensuring that the state can do what it wants to do in order to make sure that gas gets to Alaskans.

Referring to a comment Senator McGuire made about the risk of getting into a convoluted situation of balancing a 1.2 bcf/d economic project versus providing state subsidy to a smaller line, he said it's only as convoluted as we want to make it. In the end it's a fairly straightforward analysis of whether there's somebody willing to build a pipeline that doesn't need state participation because the project itself is sufficient to drive the economics. There's no worry there, but if the state does have to participate in order to make the project economic, then the state has the opportunity to do so and meet the needs of Alaskans. We have that opportunity very clearly through AGIA, he said. Over the next several months to a year the state will make a fairly substantial decision on whether or not it's going to take that plunge and undertake that.

COMMISSIONER GALVIN noted that ENSTAR is currently doing work itself in order to do the analysis and identify whether it's going to be a private sector project. Right now their economics indicate that their project would be below the threshold and they need to ask for state money. That provides two opportunities, he said. If they need state participation, we can do it at that level and if they don't then it can go through as a private sector project. Boiled down to the essence it's clear that we have the opportunity to meet Alaska's needs to get gas

in the near term if we choose to do so. It doesn't have to be more complicated than that.

[11:07:02 AM](#)

SENATOR McGUIRE said what led to that discussion was not the outright subsidy scenario, but the idea that the state has incentivized certain basins. On the record that's been done with the specific intent of incentivizing development of Alaska gas in the Nenana and Cook Inlet basins. In Alberta it's been shown that the tax breaks to the oil and gas industry aren't necessarily needed but it has resulted in growth. She's talking about whether the state wants to give those incentives.

COMMISSIONER GALVIN said there are already tremendous incentives in the tax system, not only in-state but also the 40 percent capital credit for all exploration and development. Resolving the issue of in-state gas has many different opportunities including taking gas from Cook Inlet to Fairbanks without limitation and supporting a Nenana project to deliver gas to Fairbanks without limitation. Those aren't competing projects because it's not North Slope gas. "We have a number of opportunities to meet the basic goal of getting gas to Alaskans within the context of AGIA." We imagine different scenarios but we really have to keep our eye on the ultimate goal, which is getting gas to Alaskans, getting it sooner, and making sure that it's as economic as possible. The state has the opportunity to do that, he said.

CHAIR FRENCH announced a break from [11:09:30 AM](#) to [11:26:37 AM](#).

REPRESENTATIVE RAMRAS commented that in his view the FERC press release about approving the Denali pre-filing is a ray of sunlight from the private sector.

SENATOR WIELECHOWSKI asked if the state would be exposed to treble damages if ANGDA builds a gas pipeline that exceeds 500 MMcf/d.

COMMISSIONER GALVIN said probably yes, given that ANGDA is basically an entity of the state.

SENATOR WIELECHOWSKI asked if he sees a conflict between the two laws, given that the citizens of Alaska voted to create ANGDA to build an in-state gas pipeline.

CHAIR FRENCH asked the commissioner if he'd like to qualify his answer to the first question with the information about ANGDA building the pipeline with state money.

COMMISSIONER GALVIN said given that ANGDA only gets funding from the state, the assumption is that it would be using state money to build a pipeline. If ANGDA were to build the line, more than likely it would be built for in-state purposes and at a capacity to meet in-state demand. "That would be clearly within the parameters of AGIA and would not be in conflict."

Responding to the second question about an inherent conflict between the ANGDA law and the AGIA law, he said there wouldn't be a conflict. The language in the ANGDA law says to build or cause to be built a gasline. As an entity ANGDA has devoted its efforts to providing for in-state gas opportunities rather than actually building the line from the North Slope to market. In fact, their AGIA application was for a spur off the main pipeline. A spur line off the main pipeline isn't competing for any capacity because it's a customer of the main pipeline and not a competing project. ANGDA has identified a purpose within its statutory obligations that it is pursuing now and that is very much in concert with AGIA. It's very consistent with the ultimate goal of getting gas to Alaskans.

CHAIR FRENCH asked Mr. Scott to continue with the presentation.

MR. SCOTT displayed slide 7 showing historic and projected natural gas production in Cook Inlet. Going forward it shows an exponential decline in Cook Inlet production. He noted that previous DNR annual reports regularly show the cliff.

REPRESENTATIVE RAMRAS asked when the state would have to contemplate reversing the LNG facility to import gas. If this slide is accurate, notwithstanding the Conoco export it looks like we won't be able to meet in-state needs, he said.

MR. SCOTT said the state will solve how to meet its energy needs as it gets there. He said he'd get to the issue of whether the slide is accurate. "We see decline curve in the future and I would submit that this is extremely unlikely to be realized and I'd like to explain why in just a moment."

REPRESENTATIVE RAMRAS said, "Id like to know when we should anticipate that we don't have enough gas in the Cook Inlet and what is the solution if this slide is accurate and for how many

years will we have to consider an alternate supply of gas for Southcentral and for the Interior."

MR. SCOTT replied it'll be around 2015 or 2016.

REPRESENTATIVE RAMRAS asked, "What would be the solution, if this slide is accurate."

MR. SCOTT explained that there are several things the state could do. It can enhance prospects for further exploration and development in Cook Inlet; it can bring on alternative sources of supply including coal bed methane, it can bring gas from Nenana; it can bring on a natural gas spur line from the North Slope; or it can import LNG. "Finally, the state can both reduce its energy consumption through increased efficiency means and diversify its energy sources."

[11:36:37 AM](#)

MR. SCOTT displayed slide 8 and highlighted that the dismal decline curve represents a very conservative view of the future versus an accurate picture of the future. The assumptions about how those fields will produce in the future are very conservative and assumptions about new prospects being developed are similarly conservative. "In general we look at things that are being actively pursued." If you were to look at the decline curve in the 2002 annual report compared to 2007, you'd see that the pattern is clear. "In each and every single year that curve steps out to the right." The 2007 forecast shows a cumulative production of about 320 bcf of "new gas" between now and 2020. New gas is from fields that are not currently producing within Cook Inlet, he said. "Even so, there will still be, by 2020, about a hundred million a day being produced out of Cook Inlet."

Slide 9 provides a different view of Cook Inlet gas in the future. The USDOE sponsored a study of the resource potential in Cook Inlet suggested there was an additional 15 tcf of undiscovered gas in Cook Inlet. Given the modest size of the Cook Inlet market, it's reasonable to expect perhaps 1.4 tcf of reserves growth between 2006 and 2025. "It's a considerable multiple of the figure I gave you on the previous slide that's embedded in the DNR annual report." Thus under reasonably favorable market conditions Cook Inlet could easily supply energy needs in Southcentral and Fairbanks well past 2020. The blue line on the graph represents the DOE study assessment of reserves growth and potential production from the reserves growth. It's well above the assessment of consumption or demand indicated in green and red.

11:40:13 AM

REPRESENTATIVE RAMRAS noted the slide is dated 9/20/06 so it probably predates ACES and credits passed for Cook Inlet. Given all the inducements and undiscovered conventional reserves, he asked how much has been discovered and been added to the reserves since that date. "My impression is that we haven't found any gas in the Cook Inlet since 9/20/06."

MR. SCOTT said he didn't have a figure in his head.

MR. SCOTT said it appears that 300 MMcf/d is a fairly high figure for in-state energy needs through 2025. Cook Inlet production will continue and even under pessimistic projections, he would expect it to average about 100 MMcf/d. Given appropriate market conditions and regulatory signals, Cook Inlet production should be more than sufficient to meet heating and power needs as well as significant industrial use. The 500 MMcf/d limit under AGIA along with continued Cook Inlet production should meet in-state needs as well as significant industrial use.

11:42:20 AM

^AGIA Project Assurances - Treble Damages

COMMISSIONER GALVIN said that the primary question is whether the treble damages provision within AGIA would be triggered if the state were to provide financial assistance to a bullet or spur line to meet in-state gas demand. The quick answer is no if it's an in-state bullet line that has a design capacity at any time prior to the start of commercial operations of the AGIA line that is no more than 500 MMcf/d. Also, any spur off the main line will be considered a customer and not a competitor. "There is be no restriction ... associated with a spur line that's going to come off of the main line that would limit the state's ability to support or provide financial assistance to such a line."

REPRESENTATIVE HOLMES asked about the event of a spur line off a line other than the AGIA main line.

COMMISSIONER GALVIN said it would likely be considered a competing project.

REPRESENTATIVE HOLMES asked if that would be regardless of whether it was under the 500 MMcf/d.

COMMISSIONER GALVIN explained that a line that is less than 500 MMcf/d, regardless of destination, is by definition not competing. There hasn't been a legal answer about a spur line that is larger than 500 MMcf/d coming off a separate project, but he believes it will come down to: 1) whether it's a line that connects the North Slope to a market or 2) if it's designed to advance a competing project. If the answer is yes to either of those questions it would violate the treble damages provision. It goes back to the purpose. Is the purpose to make the main line economic and to advance it or is it to be there for anybody's use. If ANGDA wants to advance a line that goes from Beluga to Glennallen to Delta, having the state assist that line isn't going to cause a problem in and of itself because it's not actually advancing a competing project. It's there for whatever project happens to come past that point. If the line is specifically tied to and giving advantage to a competing project and is not available to the TransCanada Alaska project, then that would be problematic.

REPRESENTATIVE HOLMES asked, if the state's goal is to get gas from the Interior to Southcentral and the ANGDA goal is to build the spur line, would the treble damages provision become an issue the moment the spur line actually ties into the long line, whichever it is.

COMMISSIONER GALVIN suggested she think about the timeline. By the time a competing project is actually built, the term of the AGIA license will be long past, so the question wouldn't be relevant.

CHAIR FRENCH remarked that he thought he was going to say "long after the commencement of commercial operations."

COMMISSIONER GALVEN responded that her question was whether it would be a violation of the terms if a state-supported spur line is in place and waiting and it ultimately ties into the Denali line, for example. His point is that the actual timeframe for this license would be past by that time. This license will end upon abandonment of the project or when the FERC certificate has been issued. The timing of that is such that it will be long before the Denali project could come to fruition.

REPRESENTATIVE HOLMES observed that it's an important point that the license ends upon receipt of a FERC certificate.

COMMISSIONER GALVIN clarified that when the FERC certificate is issued the licensee has two years in which to sanction the

project. At that time the license would end. "The timeframes are such that it's fairly infeasible that you're going to get to that point where you're going to have a crossover of those two events."

COMMISSIONER GALVIN noted that the statute [AS 43.90.440(c)(1)] says that a competing project is one that accommodates throughput of more than 500 MMcf/d of North Slope gas to market. To be competing, the project has to take gas from somewhere north of 68 degrees. Something that's hooked up to Nenana and something that's hooked into the Cook Inlet is not going to be a competing project for the purpose of the treble damage provision of AGIA. With respect to when capacity is calculated, he acknowledged that some have asked whether the provisions of AGIA are inherently violated if a pipeline that is initially designed for 400 MMcf/d can be expanded at any time to be greater than 500 MMcf/d. We've looked at that closely and talked with the Department of Law, he said. Any pipeline could be expanded to be a line with greater capacity than 500 MMcf/d. To give meaning to the AGIA provision you have to consider that it's not intended to be the potential opportunity to expand. It's something that connects the state's actual assistance at the time of the framing of the competition that is to be avoided. It can't be greater than 500 MMcf/d so you're talking about both the initial design and the timeframe up until commencement of commercial operations of the AGIA project. After commencement of commercial operations of the AGIA line, the limitations are off and a project can expand and there is no limitation on the state assisting in those expansions or the original assistance by the state.

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SENATOR ELTON posed a hypothetical scenario of the state assisting in a 450 MMcf/d line. Before commencement of commercial operation of the project, that line is compressed and expanded to 550 MMcf/d. He questioned how that would be handled because the provisions of AGIA haven't been violated by assisting with the 450 MMcf/d line even though it was expanded prior to commercial operation of the big line.

COMMISSIONER GALVIN replied that does raise a legal question. At the point that the line expands, it raises the risk that somebody can claim that the state supported the line and prior to commencement of commercial operations of the licensed project that line was greater than 500 MMcf/d. "For that reason, we believe that the state would want to ensure that any financial assistance that it provides to any line that it's conditioned

upon the understanding that the line is not going to expand to greater than 500 MMcf/d prior to commencement of commercial operations of the other line."

CHAIR FRENCH asked what portion of that 500 MMcf/d line the state can provide assistance to. It wouldn't be a violation for the state to pay for 100 MMcf/d, but it would be a violation for the state to provide assistance to expand a 450 MMcf/d line to 550 MMcf/d. That would assist a project designed to accommodate throughput of more than 500 MMcf/d. "It isn't as if the state has to provide that entire assistance. It's if we push it past 500 million in any form, I think we'd put ourselves at risk for treble damages."

COMMISSIONER GALVIN said when the language was put into the statute there was no intention to be tricky or to put the state in a position where it could slice and dice. "Our position is you look at the pipeline project itself. If the pipeline project is designed to have a throughput of over 500 MMcf/d, the state cannot provide assistance to that project period."

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CHAIR FRENCH said he agrees. The state can't provide assistance to any project or segment of a project that ultimately delivers more than 500 MMcf/d.

COMMISSIONER GALVIN added that, along the lines of slide 8, that's the reason that if the state provided aid, it would want to prohibit any throughput greater than 500 MMcf/d.

CHAIR FRENCH restated that if the state decided to pay for a bullet line, part of the conditions would be that the bullet line operator couldn't push the throughput above 500 MMcf/d.

COMMISSIONER GALVIN said yes.

REPRESENTATIVE RAMRAS commented that when he hears the commissioner say there is no intention to be tricky he would remind the committee that the semantics of these hearings are hard on some members' nerves. For example, we see a slide that says "the former Pt. Thomson unit" and when we hear "unlicensed line" it means the Denali line.

COMMISSIONER GALVIN assured him there is no intention to play semantic games; he's trying to be accurate and precise in his depiction of things. If he were to call a non-licensed line the Denali project and that project ended up being scrubbed a year

from now and an all three producers come forward with a new project, somebody could come back and say there was no talk about this new other project. "I apologize if it comes across as trying to be precise in my language. I'm not trying to do anything other than that."

REPRESENTATIVE RAMRAS said the point is made, and he would point out that the license the commissioner is referring to is the FERC license and not the AGIA license. "So if we're going to say an unlicensed line, let's make sure that we qualify that whether we're talking about an AGIA license or a FERC license."

COMMISSIONER GALVIN clarified that he was, in fact, talking about an AGIA licensed project and not a FERC license. "To be clear, when we're talking about a licensed project in the context of treble damages, we're talking about an AGIA licensed project. That being the one that would queue this particular result."

SENATOR WIELECHOWSKI summarized that if ANGDA did a 500 MMcf/d line, there would be no problem with state assistance. But under that scenario, private industry couldn't expand that line 250 MMcf/d 5 years later so someone could build a new Agrium.

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COMMISSIONER GALVIN said that's correct if the state provides assistance on the initial line. Cautioning that scenarios should be realistic, he said that a line coming from the North Slope would already be burdened by the cost of the gas at the North Slope plus the transportation costs. And so, getting gas out of the Cook Inlet separately would be an opportunity for them to consider under the previous scenario.

SENATOR WIELECHOWSKI asked if it would be a violation of the treble damages provision if AGPA, built a line with throughput of more than 500 MMcf/d.

COMMISSIONER GALVIN said he didn't think it would be a violation for the port authority to do that as long as the state wasn't providing any additional financial assistance to the project.

COMMISSIONER GALVIN displayed slide 9 and said, "A spur line off of the licensed project is not going to be limited either in terms of what state assistance we've provided or the size of that line." If we're talking about ANGDA in particular, their participation in building a spur line is unlimited in terms of the state's participation in ANGDA's operation or intent.

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CHAIR FRENCH said that's become a concern today. He recalled an explicit reference in their license application to perhaps build a line to Valdez if that's where the market drives it.

COMMISSIONER GALVIN agreed; Mr. Palmer has publicly stated that at the initial open season for the AGIA licensed project, the opportunity will be there for people to commit gas that would go within the state, to an LNG terminal, or all the way to Alberta. Basically it's open for any of those projects to come forward and TransCanada will build to whatever destination is offered in the open season where qualified commitments have been made.

CHAIR FRENCH said his concern relates to the transferability of the license. Assuming that this Legislature votes to grant the license to TransCanada and the commissioners sign it, the state is suddenly bound by the AGIA statutes, the RFA, and their application. That will in essence become the contract. His concern is that once that transferable license is granted to TransCanada, what if somebody steps in and buys TransCanada and that successor doesn't view a spur line as benignly as TransCanada does. "I guess the answer...is that we're protected by their explicit reference in their application to a spur line." What if Exxon bought TransCanada? "The idea that Exxon now owns this license and decides that their project goes to Alberta is precluded, you would say, because of the words in the application."

[12:06:11 PM](#)

COMMISSIONER GALVIN replied it's precluded by the combination of the words in the application and the statements in Mr. Palmer's clarification.

SENATOR WIELECHOWSKI said considering how important the ability to expand is, isn't giving the license to TransCanada essentially the death knell to an ANGDA bullet line.

COMMISSIONER GALVIN replied he would say no. The limitation on expansion is only until the commencement of commercial operations of the larger line so it's not a lifelong limitation on the pipeline. There will be two different drivers. The primary drive to expand the line is economics to bring the cost down and the state can address that through additional participation. The issue of expanding for other reasons draws into question whether between now and the expected commencement of commercial operations, it's reasonable to expect demand to be

that great other than having an LNG export. "Basically we're saying we want the first slug of gas that's going to be exported to be through a large line either as a line into Canada or a spur line off of that to be the LNG vehicle for getting North Slope gas into an LNG tanker. Not through a bullet line that expands modestly to address some LNG component." Economically, the tradeoff is significant to the state. If we end up with a 1.5 bcf/d LNG project, we could end up causing a chokehold on the ability to get a larger capacity line ultimately to anywhere - whether it's LNG or to North America. Economically, the tradeoff is so significant that it is in the state's interest to preserve the opportunity for that large line and meet the state's in-state demand by providing direct state participation instead of having the economies of scale drive it to a 1.5 bcf/d line and forego the opportunity for a large line. "We get so much additional value by having the large line that we're better off providing...that small capacity line that will feed Alaska's needs in the near term."

[12:10:11 PM](#)

CHAIR FRENCH noted that Senator Tom Wagoner had joined the hearing.

COMMISSIONER GALVIN said the final point is to identify how the treble damage issue is calculated and how it isn't imposed immediately on day one. It builds up over time and isn't intended to be a limitation on the state's sovereign ability. It's simply the price of getting out of the contract. That price is tied to what we put on the table to draw in our AGIA applicant. The price builds over time as expenditures are made moving toward first open season and FERC certification. It's bounded by the amount that's ultimately spent.

COMMISSIONER GALVIN concluded the presentation and again made the point that AGIA provides the state with the ability to meet in-state demand. "We have every opportunity to pursue lines that will provide gas for Alaskans and the state can provide the economic support to make that affordable."

CHAIR FRENCH thanked the legislators for attending.

[12:12:22 PM](#)

REPRESENTATIVE KELLY said he appreciates the invitation to the hearing and the discussion was helpful. He made the point that semantics and meaning and fine-tuning can be expected to take place when there are thousands of pages of documentation and with the team of experts that is working on this. "Probably when

you have a 12-page PowerPoint that says, 'Trust us' you probably don't have many of those fine-tuning discussions." He appreciates the commissioner hanging in there and making sense out of some very good questions. It advances the ball.

There being no further business to come before the committee, Chair French adjourned the meeting at [12:13:37 PM](#).