

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 16, 2007

3:41 p.m.

MEMBERS PRESENT

Senator Charlie Huggins, Chair
Senator Lyda Green
Senator Gary Stevens
Senator Bill Wielechowski
Senator Thomas Wagoner

MEMBERS ABSENT

Senator Bert Stedman, Vice Chair
Senator Lesil McGuire

COMMITTEE CALENDAR

SENATE BILL NO. 104

"An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date."

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 104

SHORT TITLE: NATURAL GAS PIPELINE PROJECT

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

03/05/07	(S)	READ THE FIRST TIME - REFERRALS
03/05/07	(S)	RES, JUD, FIN
03/14/07	(S)	RES AT 3:30 PM BUTROVICH 205
03/14/07	(S)	Heard & Held
03/14/07	(S)	MINUTE(RES)
03/16/07	(S)	RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

Patrick Galvin, Commissioner
Department of Revenue
Juneau, AK

POSITION STATEMENT: Presented SB 104

Kevin Banks, Acting Director
Division of Oil and Gas
Department of Natural Resources
Juneau AK

POSITION STATEMENT: Commented on SB 104

Marcia Davis, Deputy Commissioner
Department of Revenue
Juneau, AK

POSITION STATEMENT: Commented on SB 104

Donald Shepler
Greenberg Traurig, LLP
Consultant to the Legislative Budget and Audit Committee
Juneau AK

POSITION STATEMENT: Commented on SB 104

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Resources Standing Committee meeting to order at [3:41:19 PM](#). Present at the call to order were Senators Wielechowski, Green, Wagoner, Stevens and Huggins.

SB 104-NATURAL GAS PIPELINE PROJECT

CHAIR HUGGINS announced SB 104 to be up for consideration.

PATRICK GALVIN, Commissioner, Department of Revenue (DOR), said that he would be giving the second half of his presentation covering the topics of what the state receives in return for its inducements, evaluation criteria, provisions for predictability, and the status of the fields on the North Slope.

He said that there are three points for addressing in-state use: a mandated agreement to include at least five off-take points within Alaska, distance-sensitive tariffs, and recognition of the importance of the expansion provisions.

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SENATOR WIELECHOWSKI asked how the provisions will make low-cost gas available for Alaskans.

KEVIN BANKS, Director, Division of Oil and Gas, Department of Natural Resources (DNR), said that in-state off-take points allow a gas consumer to pay for just the trip to the off ramp

instead of through the whole pipeline. He explained how the mileage-based rate will be lower for those off-taking in Fairbanks, for example.

SENATOR WIELECHOWSKI asked if that provision differs from the Stranded Gas Act.

MR. BANKS replied yes; the Stranded Gas Act relied on FERC mandatory expansion regulations.

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COMMISSIONER GALVIN said he would talk about the criteria that are going to be used to evaluate proposals. The first is to determine if an applicant has met the "must-have" requirements. If one is missing, the proposal will not be considered. There are two primary drivers for the project: value to the state and how much money the project provides, which is based on how quickly the cash will flow in. The feasibility and work plan of the project will also be considered, as well as financial strength. Cost overrun and cost sharing are also considered. There's a number of criteria that deal with the likelihood of success as well; roadblocks need to be identified and anticipated.

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He explained that for the application process, applications are received, and there's a public comment period, although some information may ultimately be kept confidential. After the commissioners select a licensee the process will return to the legislature which can approve or reject the decision.

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CHAIR HUGGINS asked if there is a minimum volume of initial capacity.

COMMISSIONER GALVIN replied no; however, there is a recognition that capacity is going to be a driving factor in the state's received value. In the comparison between proposals, if there's a low capacity there won't be any competition.

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SENATOR STEVENS asked for an explanation of legislative review and the approval or denial process.

COMMISSIONER GALVIN replied that legislative review is more of a stop-gap measure if a contract is off the mark; it's not a reevaluation of the applications.

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SENATOR STEVENS asked if the legislature would have to vote.

COMMISSIONER GALVIN replied that if the commissioners make a choice that the legislature feels is wrong, the legislature can vote against the contract. The provision will not put the legislature in the position of having to convene.

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SENATOR WIELECHOWSKI said that whatever decision is made is likely to result in a lawsuit, and asked if legislative approval lessens the possibility of a lawsuit or if the approval process could have limitations.

COMMISSIONER GALVIN replied that having the legislative capability means an additional sense of state unity that will lessen the possibility of intervention. There was a consideration of how specific the evaluation criteria should be; the model the administration decided upon is similar to the process the Department of Natural Resources (DNR) uses for oil and gas lease sales. The commissioners will weight the criteria and use their discretion to make the best decision for the state. The applicants will want as much specificity as possible, but there shouldn't be applications that are simply a reflection of the scoring system.

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CHAIR HUGGINS asked which system would be more legally challengeable in terms of recommendations and legislative approval.

COMMISSIONER GALVIN replied that someone from the Department of Law could best answer the question.

CHAIR HUGGINS asked how the legislature would treat the commissioners' findings.

COMMISSIONER GALVIN explained that the findings would be a comprehensive analysis of criteria against all three projects,

and applying the commissioners' judgment on the likelihood of success. The structure of the bill is intended to provide the legislature with the right to look at and approve or negate the commissioners' decision; it's not an obligation.

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CHAIR HUGGINS asked about a scenario wherein one of the three commissioners challenged the selection.

COMMISSIONER GALVIN replied if there was a challenge to the decision there wouldn't be testimony on it. The court would make the decision based on the findings.

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SENATOR WIELECHOWSKI said he would appreciate an eventual analysis on how to make the process as bullet-proof as possible.

COMMISSIONER GALVIN replied that that would apply to Chair Huggins' question as well, and explained that any challenge must be made within 90 days of the license being issued.

SENATOR WIELECHOWSKI said that he doesn't want to see the process wrapped up in years of litigation; there should be as little opportunity to appeal as possible.

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CHAIR HUGGINS noted a 30-day period for the legislature's approval, and asked if there has been discussion about extending that period.

COMMISSIONER GALVIN replied yes. The 30-day period was due to the likelihood that, with shorter sessions, only a quarter of the year will be in session; 30 days will be the likely timing of a special session.

CHAIR HUGGINS asked when the 30-day period would end, assuming the passing of AGIA.

COMMISSIONER GALVIN replied that if the bill passes in May 2007, applications would start to be submitted in July of that year and would become public in the middle of October, the comment period would end in December, and the commissioners' decision would come at the end of January 2008. The whole process would come to the legislative body in about a year.

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CHAIR HUGGINS commented that the session may begin in mid-February, and asked what roadblocks for project applicants could be.

COMMISSIONER GALVIN replied that the applicant will be required to give a full airing of the entire process and where possible risk points lie, and how they will be managed.

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SENATOR WIELECHOWSKI asked if a company that wasn't awarded a contract could still apply for a license from the FERC.

COMMISSIONER GALVIN replied yes; the state is not granting an exclusive right to build a pipeline, but rather the inducements.

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CHAIR HUGGINS commented on the amount of steel and other resources that the pipeline will require, and asked how feasibly an applicant could meet performance measures.

COMMISSIONER GALVIN replied that the level of specificity to be expected from an applicant is an issue; the expectation is that the applicant will provide the state with as much information as possible about their plan and its possible problems.

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CHAIR HUGGINS asked what would happen if an applicant meets four of five criteria but varies from what the state wants on the fifth, and if the state has the flexibility to favor a company that has a better way of 'skinning the cat'.

COMMISSIONER GALVIN replied that in putting together the "must-have" requirements, it was recognized that the objectives were achievable and appropriate. The evaluation criteria strike a balance between the primary drivers of the decision and discretion by the commissioners to use the application information. There is enough flexibility to allow the commercial market to be creative in their applications.

CHAIR HUGGINS said that two applications could be fairly similar but the one with the deepest pockets would win every time.

He pointed out a provision in the contract where a company with the financial wherewithal must start the project in one year. Otherwise, the requirement is five years. Being able to hit the ground running, financially, means a more feasible project.

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COMMISSIONER GALVIN replied in explaining the difference between the one- and five-year start dates requirements and said that it's a matter of transport commitments and other forms of credit. The ability to have a non-risky open season is important; a well-prepared company could eliminate the uncertainty the state feels and increase its likelihood of success. This doesn't necessarily mean that this company will be the one with the deepest pockets.

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He explained that AGIA provides additional royalty and tax incentives to get companies to commit gas to the pipeline. The state doesn't want to have to ask for more money than the initial company's projected royalty payment. In terms of the royalty rates, it will put the leases at a commercial disadvantage because of the state's ability to switch at 90 days' notice. That provision will take the uncertainty away so that companies don't worry about the state unilaterally acting on its rights under the contract.

CHAIR HUGGINS asked if that provision is important.

COMMISSIONER GALVIN replied that the royalty rate switching is a big deal, and explained why it's good for companies. It also prevents having to work out uneven rates later in the process.

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He said that he would be having Deputy Commissioner Marcia Davis help him explain property tax exemption, and explained that it's a driving force for the producers, and a matter of the state's ability to provide certainty in fiscal terms once the project becomes profitable. There are constitutional issues with providing this level of tax certainty; it may not be constitutional, but the administration is working to make it so once the time comes.

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CHAIR HUGGINS asked what the pipeline timeline will be from a legal standpoint.

COMMISSIONER GALVIN replied that starting with open season, the period is ten years. The tax rate in place then will be the rate paid in the tenth year that gas is flowing. He added that the provision doesn't mean tax avoidance; it's simply a guarantee that the open rate tax rate will remain stable.

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MARCIA DAVIS, Deputy Commissioner, Department of Revenue (DOR), explained her background in private enterprise managing bottom-line issues and as senior counsel to BP. She used her private business and legal background to create the best possible exemptions within AGIA.

She explained that the tax exemption is equal to the production tax obligation minus the gas production tax obligation that would have been applicable if open season taxes were applied. The Department of Revenue will be required to maintain a side analysis of different taxation rules if the tax rates change. Whatever the tax the legislature decides on in future years, the producers will receive an appropriate exemption. The strength of the provision comes from the fact that it's structured as a contract; the shipper must commit to buy capacity on the pipeline at the first initial open season, and must agree not to fight the rolled-in rates that the pipeline company will be required to submit to the FERC.

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SENATOR WAGONER asked if a company would lose its advantage on the production tax if it violates that agreement and goes to the FERC and protests.

MS. DAVIS replied yes. She explained that the value is set for ten years, which is an average period for Alaskan industrial standards.

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SENATOR WIELECHOWSKI remarked that courts can't make constitutional rulings, and asked if a company would have to wait until the legislature tried to pass the tax to file a suit.

MS. DAVIS replied that the statute of limitations for challenges to the act is three months; additional legal opinion may be needed.

SENATOR WIELECHOWSKI said that the matter was one to be taken up in the judiciary committee, and it may never even become an issue.

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CHAIR HUGGINS noted that that the issue would be taken up in the judiciary committee.

COMMISSIONER GALVIN said that he would next look at how much gas is currently available to fill a pipeline. The amount of gas needed isn't known; it depends on the project. The amount of gas from the fields can be predicted, though, and thus the ideal pipeline size needed.

He talked about major gas reserve fields on the North Slope, and how much gas could conceivably be produced from Prudhoe Bay.

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He cited language from a staff report on Prudhoe Bay gas off-take rates and how the Alaska Oil and Gas Conservation Commission (AOGCC) has not been asked to look at the issue closely.

CHAIR HUGGINS interjected that he wants to see that inquiry.

COMMISSIONER GALVIN said the administration is currently talking to the AOGCC. A major concern is that if gas isn't being taken off and sold elsewhere, there will be a negative impact on long-term oil recovery. Point Thompson is another area currently in flux; once it is re-released there will be explicit provisions and penalties for non-performance there. There may need to be a few years of liquid production before the saleable gas can begin to be produced. He then talked about prospects for new exploration in the future.

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SENATOR WIELECHOWSKI said he has heard comments from Exxon about their intentions to not participate in the gas-line deal.

COMMISSIONER GALVIN said the administration has not heard explicit messages; it is not sure what Exxon's position is.

MS. DAVIS said that in her experience such companies are driven by the need to serve their shareholders; it's the state's job to establish a framework to allow private enterprise to develop the project do it meets the needs of the state as well as the corporations. The state has been careful not to pre-ordain commercial outcomes in a way that hampers the process; it will analyze the applications rationally and will ensure that the process is superlative.

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CHAIR HUGGINS asked if the Shell Group is a potential participant in open season.

COMMISSIONER GALVIN replied yes, but that company's primary target is oil. If they do discover gas while drilling for oil, though, they will likely participate in open season.

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CHAIR HUGGINS asked him to answer some questions brought up in the last meeting.

COMMISSIONER GALVIN said that he would have Don Shepler, advisor to the administration, help him discuss the difference between the one- and five-year time frames after FERC certification. He clarified that after a company gets the certificate they have one year to begin the project if they have adequate financial backing; ideally they would be prepared to act. If they don't, the state gets all of the project assets. If a company doesn't have credit support, the bill allows up to five years to assemble the appropriate financing.

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CHAIR HUGGINS asked where on the project timeline a company would receive certification.

COMMISSIONER GALVIN replied that that depends on the proposal submitted. Application could be done at any point in the five-year time frame.

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DON SHEPLER, Greenberg Taurig Consultants, Advisory to the Administration, said that there is a statutory timeline as to how long the FERC has to act once it receives a completed application. In reference to the five-year period mentioned by Commissioner Galvin, he explained that the licensee would have obtained the certificate but wouldn't have firm contracts. The period would give time to put together the commercial elements of a deal that have not yet come together. Even in the Lower 48, pipeline projects do not coalesce immediately; he gave examples of pipelines in the Lower 48 that had issues with their timelines. Some time after certification is essential depending on how commercial arrangements are made.

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COMMISSIONER GALVIN added that that scenario assumes that no commitments are made at open season. The state, the licensee, and the FERC will be invested in the project; if a mutual decision is made that it is not economic, the bill will allow everyone to walk away. If the other party doesn't see the scenario that way and wants to pursue damages, a third party can be asked to make the determination.

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MR. SHEPLER said that there is a timeline in statute as to how long the FERC has to act in the five-year timeline in terms of whether the application is complete.

COMMISSIONER GALVIN added that the timeline delineates the greatest amount of time the applicant may have for the process.

CHAIR HUGGINS asked for clarification on the language of the bill, and what the timeline would be like in a worst-case scenario.

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COMMISSIONER GALVIN answered that it could go up to 12 years.

MR. SHEPLER clarified that that would be a worst-case scenario.

COMMISSIONER GALVIN added that the state will be active throughout the whole process; even from a worst-case scenario, there can be success.

CHAIR HUGGINS said that according to a chart before committee the time period would be 24 months for certificate issuance.

MR. SHEPLER agreed.

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CHAIR HUGGINS asked about the likelihood of the state entering a five-year provision scenario.

COMMISSIONER GALVIN replied that the administration hadn't yet formally heard from the producers on their viewpoint. The purpose of AGIA is to allow commercial participants to identify how to minimize the risk of a longer scenario.

CHAIR HUGGINS asked if the most likely event to lead to a five-year plan would be an unsuccessful open season.

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MR. SHEPLER said that an open season that doesn't fill the pipeline would be such a scenario. If the open season fully subscribes the pipeline and the licensee doesn't move forward within a year of receiving the certificate, it would be fair to take back the certificate and work product for reassignment. It would not be fair to do so if the licensee doesn't have firm contracts and financial commitments.

CHAIR HUGGINS asked what else besides an unsuccessful open season would be a factor in allowing a five-year period.

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COMMISSIONER GALVIN replied that the open season is a big deal and the best opportunity to get the project on firm footing, but it may be necessary to have successive open seasons in order to ultimately fulfill the need for credit support. There needs to be the opportunity to build forward from the initial open season. Within AGIA, the biggest risk is that there will be unsuccessful open seasons before and after FERC certification. Hopefully the inducements will help with a framework for a successful initial open season; if not, the open season after certification will need to be successful.

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CHAIR HUGGINS said that he's heard different comments about how FERC certification without a successful open season would work; he asked what the legal opinion on the matter was.

MR. SHEPLER replied that federal statute allows for a FERC presumption for a pipeline need and downstream takeaway capacity, and FERC regulations don't require contracts. Even if a project is certified, the pipeline sponsor will likely not go forward without project financing and contracts. The FERC would require that the pipeline be considered at-risk if a company built a line for which it didn't have full transport contracts. The FERC wouldn't think certification without such assets would be optimal, but legally it is obligated to process the application.

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CHAIR HUGGINS speculated on the level of risk such a situation would create, and asked for Mr. Shepler's thoughts.

MR. SHEPLER replied that the administration wants a pipeline for its investment; part of the price of getting the state's investment is the commitment to file for certification by a designated date. Legislation also provides that if a certificate is received the company is obligated to accept it. If at the end of a five-year or shorter period the process is decidedly failing, that's one thing; otherwise it should be given time to develop. Once a certificate is filed for, the specificities of the project narrow.

CHAIR HUGGINS asked how high the risk factor would be in a theoretical situation.

MR. SHEPLER replied that a company should discuss risk factors with its board before application. The legislation requires that a company specify how the state's money will be used after an open season. The issue should be resolved internally and be reflected in the application.

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COMMISSIONER GALVIN added that the incentives total \$500 million because that's half of the estimated cost of getting a FERC certificate. The issue of cost-sharing after open-season is important; there is a different risk profile after an unsuccessful season. The state wants to provide enough money to get from open season to FERC certification, because at that

point there is the greatest likelihood of success for the project.

COMMISSIONER GALVIN explained who would be presenting at the next meeting, and asked if the committee would like to give notice of questions that would be asked.

CHAIR HUGGINS commented that he and the commissioner agree that AGIA is malleable, and as many parties as possible should be heard from. The hearing process is about how to make the bill and open season as successful as possible; AGIA needs to be tightened up in some places.

There being no further business to come before the committee, he adjourned the meeting at [5:36:26 PM](#).