

**ALASKA STATE LEGISLATURE  
SENATE RESOURCES STANDING COMMITTEE**

March 22, 2007

4:19 p.m.

**MEMBERS PRESENT**

Senator Charlie Huggins, Chair  
Senator Bert Stedman, Vice Chair  
Senator Lyda Green  
Senator Gary Stevens  
Senator Lesil McGuire  
Senator Bill Wielechowski  
Senator Thomas Wagoner

**MEMBERS ABSENT**

All members present

**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      |
| 03/16/07 | (S) | Heard & Held                      |
| 03/16/07 | (S) | MINUTE(RES)                       |
| 03/19/07 | (S) | RES AT 3:30 PM BUTROVICH 205      |
| 03/19/07 | (S) | Heard & Held                      |
| 03/19/07 | (S) | MINUTE(RES)                       |
| 03/21/07 | (S) | RES AT 3:30 PM SENATE FINANCE 532 |

03/21/07 (S) Heard & Held  
 03/21/07 (S) MINUTE(RES)  
 03/21/07 (S) RES AT 5:30 PM SENATE FINANCE 532  
 03/21/07 (S) Heard & Held  
 03/21/07 (S) MINUTE(RES)  
 03/22/07 (S) RES AT 4:15 PM FAHRENKAMP 203

**WITNESS REGISTER**

VINCE LEMIEUX, Manager  
 New Ventures Alaska  
 Chevron  
 Houston, Texas  
**POSITION STATEMENT:** Spoke to SB 104.

TIM HOUSTON  
 Commercial Management, Alaska  
 Chevron  
 Houston, Texas  
**POSITION STATEMENT:** Spoke to SB 104.

**ACTION NARRATIVE**

**CHAIR CHARLIE HUGGINS** reconvened the Senate Resources Standing Committee meeting from March 21, 2007 at [4:19:56 PM](#). Senators McGuire, Green, Huggins, Wielechowski and Stedman were present at the call to order. Senators Stevens and Wagoner arrived soon after.

**SB 104-NATURAL GAS PIPELINE PROJECT**

[4:21:02 PM](#)

CHAIR HUGGINS said they would continue to take testimony on SB 104 from Chevron today via teleconference. He said one of the terms they used yesterday had to do with risk mitigation and he asked that issue to be revisited.

TIM HOUSTON, Commercial Management, Alaska Chevron, responded that as a customer, Chevron's big risk during an open season is "signing up for something where you don't exactly know what you're going to get and what it's going to cost, but you're making these large financial commitments a whole lot earlier than you otherwise would on a normal development timeline."

Chevron might end up getting something other than what was expected, he explained. Uncertainties include ultimate cost and time of completion. The terms and conditions of the rates and

other parameters of service may be different than expected and the economic returns might suffer.

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VINCE LEMIEUX, Manager, New Ventures Alaska, Chevron, said risk mitigation would bring more certainty to the items mentioned or the negative impacts could be a shared "and that is where the concept of alignment becomes important."

[4:24:33 PM](#)

SENATOR WAGONER asked how the risk in this project is any different from any other pipeline project.

MR. LEMIEUX replied that the risks aren't different, but the scope is very different. This project is unique and depends on specific technology, he said, so the risks are the same, but "uncertainties are such that it takes on new meaning."

MR. HOUSTON agreed that the risks are the same and also that this would be a basin-opening pipeline and there are some additional risks for the first pipeline in an area. He mused, "What is everyone else suppose to do when you're not sure if that pipeline is actually going to move forward or what its timeline will be?" He put it another way saying the risk is smaller if there is already a gas network and a natural gas business in the area.

MR. LEMIEUX said this pipeline is also different because "it actually is a multinational pipeline and that's not necessarily a typical thing" except in Europe.

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CHAIR HUGGINS asked if a newspaper was correct in saying Chevron stated the cost of the pipeline would be between \$20 billion and \$30 billion.

MR. HOUSTON responded that Chevron did not make the statement.

[4:28:17 PM](#)

MR. LEMIEUX said that is one of the issues the he struggles with, especially in looking at the Mackenzie Valley pipeline. There are bases for thinking \$30 billion would be the low end.

SENATOR WAGONER said he has heard a lot about risk for the last two years, but this is a risky business. He asked if there would be any difference in committing Chevron's gas to a gasline built

by an independent company or one built by the producers or one of the producers.

MR. LEMIEUX responded that an ownership position would affect how Chevron would run its internal economics, but he was not prepared or maybe not the right person to discuss this issue. However, he said the risk undertaken by those that make the firm transportation commitment is that they are signing up to pay the price of the pipeline. It is very important in terms of who is making the open season and how confident the companies that participate in that open season are in the company that is going to deliver the project. "It's a very important factor and in the perspective of a company's ability - one company's perspective on another company's ability to deliver on that type of commitment is going to vary."

MR. HOUSTON said he was not prepared to go into the nuances of the evaluation, but being an owner of the pipeline project would make a difference particularly in managing risk and making decisions that coordinate with timelines that the pipeline is on. If you're an outsider, you would get whatever information trickles out. "It's a lot easier to manage your spend and control your economic results when you've got the maximum amount of information and participation in all the decisions."

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MR. LEMIEUX used the analogy of building a house and you had built houses in the past and were familiar with the house building process, but then someone came and told you that you had to purchase the house and said "by the way we're going to bring somebody else in to build that house for you." Your comfort would depend on the builder that was chosen for the house and how familiar you are with their abilities and performance in the past.

MR. HOUSTON followed up on that analogy adding that the house you're going to be delivered at closing is not necessarily the pictures you saw in the brochure and the price isn't necessarily the price that was printed. "It's all risk."

SENATOR WAGONER asked if Chevron would prefer to have a producer-built and owned pipeline than a private pipeline company-built product.

[4:33:17 PM](#)

MR. HOUSTON answered when Chevron does its economic evaluation it's easier to have more control and make better decisions and

to help the pipeline make decisions that are aligned with their needs if they are at the table with a vote. It could improve the results of all participants by having the most informed people at the table.

SENATOR WAGONER asked how many privately owned and operated lines Chevron ships gas on and how many producer-owned gas lines it ships gas on now.

MR. HOUSTON replied that Chevron's North American gas marketing organization probably moves gas on every regulated pipeline in the U.S. and Canada. So, it does business on a lot of pipelines owned by pipelines. Chevron also owns some pipelines and does business on those. He didn't know about pipelines owned by other private people that they do business on.

[4:34:37 PM](#)

SENATOR STEDMAN asked what the largest pipeline Chevron has built is and if it is common within the industry for the major producers to build a pipeline, gas pipelines in particular, and then divest themselves of it after construction to free up the capital on to higher returning assets.

[4:35:28 PM](#)

MR. LEMIEUX replied that Chevron has partial ownership in several large pipelines in Azerbaijan, but they were not the right people to answer that question and they would have to follow up with that information.

MR. HOUSTON answered on the second part of the question, there have been pipelines that were conceived and driven by producers through the open season process through the regulatory approvals and the construction contracting and that once they had reached the point where they had supplied the maximum amount of cost control they could in order to help deliver the best project, some of the producers decided to sell off pieces of their interests. So the ownership of the pipeline, once it starts up, can wind up being different than its ownership at the time of the open season. "That's just a method of helping the best people be at the table to make decisions that are the ones that hit their bottom line the hardest." It's hard to predict, because all those decision get made at the time based on the circumstances at the time.

[4:37:32 PM](#)

SENATOR STEDMAN asked if AGIA should consider inserting a clause that would require divestiture of the line a number of years after first gas, regardless of who constructs it.

MR. HOUSTON replied that he is not sure what that would do for the state in terms of getting a better project compared to one person owning it and selling interest in it as it makes sense to him.

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SENATOR WAGONER pointed out that there would no reason for a private pipeline company to have to divest itself of ownership.

CHAIR HUGGINS asked him to address that question if Senator Stedman's question were rephrased to whether it was a producer-built pipeline and then there was a divestiture requirement.

MR. HOUSTON responded that there are quite a few pipelines that have marketing affiliates - that is companies that actively buy and sell gas and ship gas on their affiliated pipelines. So, he wasn't sure if they were saying it would be producers that would have to sell or any affiliated entity of that company that ends up being a customer. When you look at it a little more broadly it gets complex.

If it's a regulated pipeline, if the decisions that are being made by that pipeline are consistent with the public interest, he saw no benefit to having a forced sale. "It all comes down to are the parties aligned, are the decisions being made that move things down the path, that all parties collectively agree is the right path, and if that's the direction things are moving, then that's the way you want them to go."

[4:39:59 PM](#)

CHAIR HUGGINS went to page 11, line 14, and asked a question about what the pipeline builder's capability is. The first part says:

If the licensee has credit support sufficient to finance construction of the project through ownership of rights to produce and market gas resources, firm transportation commitments or government financing, the licensee shall sanction the project within one year after the effective date of certificate of public convenience and necessity issued by the FERC.

So, he asked if you have the financial wherewithal and the commitments, you have one year. If you don't, with the same scenario, you have five years. He asked for his thoughts on those two provisions.

MR. LEMIEUX observed that the financial strength of a company is only one of the measures of the timeframe that should be required. The capability of the company and the availability of the right resources and their ability to bring the right resources to bear would be an equally or even more important element of that time sensitivity of decision-making.

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CHAIR HUGGINS said he reads that to mean if one had a successful open season and the other one didn't.

MR. HOUSTON responded within the idea of a successful open season, that paragraph touches on a few other risks, but those aren't explicitly stated. If you're presuming the pipeline is going to borrow the money, it is possible it could have a successful open season as far as getting sufficiently credit-worthy customers expressing interest for service on it; but it's hard to find someone that has \$35 billion to lend or that can syndicate a loan that big for a project-financed multi-national pipeline. So, the open season can still be successful, but that doesn't necessarily mean you have everything you need to get financing. "As Vince was saying yesterday, this project will make its own weather. It will define and change the world just by it moving forward."

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SENATOR STEDMAN asked about the linkage of the PPT to gas, which was set up under another scenario under another administration, should be reviewed or left alone.

MR. LEMIEUX replied that he needs more time to think about it. The tax rate on gas is going to be a hugely sensitive issue, depending on how you view the economics.

MR. HOUSTON commented that an example of a confusing or uncertain part in addition to the tax rate is basing the progressivity on oil price. Trying to understand the tax rate on the gas one produces when the gas and oil prices aren't necessarily related adds multiple layers of complexity to the evaluation. "It makes it a lot harder, once you've even computed a number, to feel confident that it has any validity."

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SENATOR STEDMAN asked if that should be reviewed and possibly modified before or after open season.

MR. LEMIEUX replied that taxation is a touchy subject, but he would recommend leaving the PPT in place as it is for a period of time - just so people get a sense of how it works.

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SENATOR STEDMAN said he was not referring to the oil portion of the PPT, but to the progressivity linkage with gas. "How would your company deal with such linkage if it's left in there when you walk into an open season with that type of a gas structure tax?"

MR. LEMIEUX responded that Chevron would have to work on that for a suitable answer.

CHAIR HUGGINS reminded them that yesterday, one of the Chevron representatives made the statement, "Bill can't change the fundamental economics of project." Then somebody later on took a red pen and circled that like it was important.

MR. LEMIEUX responded from his perspective the value of a project is based on some very basic things - the investment, the timing, the product and the market and the price of the product on that market. All of those create value. Being able to take gas from one area and sell it to somebody else in another area is a basic economic engine. The context of the comment was that the bill, in and of itself, doesn't necessarily change the economics. It will start to work on how that value is shared, how the risk is managed, or how alignment is created. "But it doesn't really change the underlying economics."

4:49:07 PM

SENATOR STEDMAN asked what Chevron's thoughts were on the two-year requirement for open season. Should it be lengthened or shortened.

MR. HOUSTON replied that the timeframe for an open season is important for running a good one:

So if you want the customers to be convinced this is a realistic schedule being proposed and realistic costs being proposed and the project has been scoped; they've selected a good platform for it so that there's the right amount of expandability there to

meet future and growing needs, then you would potentially need more time.

Whether two years is enough, it sounds like it should be, but do you want to write a hard restriction in that would potentially limit you if two and half years winds up being what is actually needed? So if you make the commitment potentially a little too tight, then you run the risk of having an open season being run under less than ideal conditions with less than ideal information being shared and then not getting the results that you'd desire.

So, I'd suggest the pipeline companies that you talk to would have a lot more experience on what level of information they feel would best meet everyone's needs. I'm more of a customer in those open seasons than actually the provider; so I only really offer the customer perspective. But, when I go into the open season, if you put a gun to my head and give me 90 days to decide, I'd like the best information reasonably possible in order to use in that position.

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SENATOR STEDMAN said the bill requires an open season every two years.

MR. HOUSTON apologized for answering the wrong question and said he was thinking of the requirement that you have to run the open season a set number of years after the license is given. Answering the correct question, he said the two-year requirement is worded well in that the pipeline is free to do it as frequently as it feels the market needs, so long as it is done once every two years. So, if industry activity or other requirements mean they need to be run more frequently, they can respond. Running one every two years should not be an undue burden in order to make sure the pipeline is considering all the potential needs for capacity in its long-term planning. Having an open season at least every two years for expansion capacity makes sense and it probably makes sense to have those running before construction is completed.

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CHAIR HUGGINS said someone characterized a perfect pipeline building storm in which multiple producers team with one or more pipeline companies, maybe other parties, and get on with the project. He asked him to reflect on that concept.

MR. HOUSTON reflected that the perfect storm means there's a real opportunity to get the best producers and pipeline companies together to create the most efficient project possible. That is a possibility, he said. It would be important to think through how this team would build alignment and share the risk between the various partners. He didn't know exactly how to do that.

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SENATOR WAGONER asked what kind of an effect the federal loan guarantee of \$18 billion would have on overall corporate risk for this project.

MR. HOUSTON replied that it depends on how the pipeline designs its rates and allocates them. If that \$18 billion is cheaper than the rest of the money they have to borrow and if that flows through to the shippers, then there's a small benefit in rate reduction. But if there's still the same requirement on making payments and the same financial structure and rates comparable to the value of gas at the other end of the pipeline, whether there is a loan guarantee on a piece of the borrowed money or not might not make a big difference to the underlying risk.

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SENATOR STEDMAN said the bill calls for five delivery points and asked what Chevron would recommend for take off delivery points that would be advantageous to the state over the next 50 years.

[4:57:19 PM](#)

MR. LEMIEUX replied that focusing on the major [indisc.] of Alaskans seemed like the best answer. He hesitated to say much more, since he wasn't qualified from the perspective to comment on how the delivery would work. Fairbanks would certainly be one of them.

SENATOR STEDMAN turned to the 70/30 equity/debt split and how challenged the Mackenzie project has been in dealing with the prices of steel and labor and asked once the state has a proposal and there's a handful of years for construction with some clear risk for cost, how he would recommend the state structure this bill to not put the project at a disadvantage if there were a 30 to 40 percent cost overrun.

MR. HOUSTON replied that the developer will need to have control of the project and be able to fund the equity requirement at whatever the cost winds up being. If there is an applicant that

can fund the equity component of 30 percent at whatever the estimated costs are and if you do get into a cost overrun situation, that's the wrong time for that entity to go out and try to borrow money - because the story isn't all that good:

So, part of the selection has got to be that you want a proponent or group of proponents that have the balance sheet needed that they can fund their equity piece of the pipeline and there being no doubts about that. If that's a concern you've got, it sounds like you might have picked the wrong applicant in that situation.

CHAIR HUGGINS thanked Chevron on behalf of the legislature for its candid testimony. The committee adjourned at [5:01:27 PM](#).