

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 29, 2007

5:09 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

OTHER LEGISLATORS PRESENT

Senator Hollis French
Senator Joe Thomas

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
 03/22/07 (S) Heard & Held
 03/22/07 (S) MINUTE(RES)
 03/23/07 (S) RES AT 1:30 PM BUTROVICH 205
 03/23/07 (S) Heard & Held
 03/23/07 (S) MINUTE(RES)
 03/24/07 (S) RES AT 1:00 PM SENATE FINANCE 532
 03/24/07 (S) Heard & Held
 03/24/07 (S) MINUTE(RES)
 03/24/07 (S) RES AT 3:00 PM SENATE FINANCE 532
 03/24/07 (S) Heard & Held
 03/24/07 (S) MINUTE(RES)
 03/26/07 (S) RES AT 3:30 PM BUTROVICH 205
 03/26/07 (S) Heard & Held
 03/26/07 (S) MINUTE(RES)
 03/27/07 (S) RES AT 3:00 PM BUTROVICH 205
 03/27/07 (S) Heard & Held
 03/27/07 (S) MINUTE(RES)
 03/28/07 (S) RES AT 3:30 PM BUTROVICH 205
 03/28/07 (S) Administration's Gas Team will be
 03/29/07 (S) RES AT 5:00 PM BUTROVICH 205

WITNESS REGISTER

Kirk Morgan, President
 Kern River Gas Transmission Co., Wholly-owned Subsidiary
 MidAmerican Energy Holdings Co.
POSITION STATEMENT: Supported SB 104.

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Resources Standing Committee meeting to order at [5:09:31 PM](#). Present at the call to order were Senator Wagoner, Senator Stevens, Senator Stedman, Senator McGuire, Senator Green, Senator Wielechowski, and Chair Huggins.

SB 104-NATURAL GAS PIPELINE PROJECT

[5:09:53 PM](#)

CHAIR HUGGINS announced the consideration of SB 104 and asked Mr. Morgan to put himself on the record. He asked him if he also speaks for MidAmerican.

[5:11:18 PM](#)

KIRK MORGAN, President, Kern River Gas Transmission Co., wholly-owned subsidiary of MidAmerican Energy Holdings Co., said he also speaks for MidAmerican. He said MidAmerican has \$37 billion in assets and an employee base of 18,000. Through Kern River and its sister company, Northern Natural Gas, MidAmerican owns and operates more than 17,500 miles of inter-state natural gas transmission pipelines with combined capacity exceeding 6.4 bcf/d. MidAmerican's pipelines deliver approximately 8.3 percent of the natural gas delivered in the United States. The Kern River pipeline, which was built by MidAmerican in 1991, brings natural gas from the Rocky Mountain supply basins across 926 mile of rugged mountainous and remote desert terrain to customers in Utah, Nevada, and California. Kern River was the largest gas pipeline project to have been built in the United States in more than a decade.

MR. MORGAN said in 2003, Kern River expanded the pipeline more than doubling its capacity - adding 717 miles of 36-inch and 42-inch diameter pipeline. The \$1.2 billion-project was completed on time and \$87 million under budget and helped restore stability to energy markets in the western United States. MidAmerican is a subsidiary of Berkshire Hathaway, Inc., which is one of only a few companies in the world with an AAA credit rating and has a market capitalization in excess of \$160 billion. It is recognized worldwide for financial strength, investment acumen and integrity. He said:

The development of Alaska's huge natural gas reserves is essential to both Alaska and the United States. Projected market growth combined with a decline in North American production has created a growing supply/demand imbalance that cannot be adequately addressed by traditional gas supply basins, alone. Alaska's natural gas is needed to help insure energy security, reliability and price stability in the United States. The Alaska natural gas pipeline project is unprecedented in its scale and complexity. The successful development of the project will require an alignment of stakeholder interests including the State

of Alaska, the North Slope producers, future North Slope explorers and producers, a pipeline developer, shippers and the federal government. Projects of this scale can easily be delayed and that has been the history of this project. Only through proper planning, organization and execution can the project achieve its' goals to accelerate development of Alaska's natural gas resources and transport gas to the Lower 48 markets at the lowest reasonable cost. To do otherwise will relegate this project and development of this resource to a reaction to the next energy crisis where goals are frequently compromised in the interests of expediency.

MidAmerican has a serious interest in developing this project in a manner that is consistent with the State of Alaska's interests. From our perspective, the negotiations conducted by the previous administration under the Stranded Gas Act were not fruitful for many reasons. Foremost among these were that they produced proposals not supported by the people of the state; they failed to give serious consideration to alternative proposals for development and they consumed years without advancing the project.

We believe that AGIA is a positive step towards revitalizing the gas pipeline development process in a way that will move the project forward. The bill allows consideration of competing proposals and ideas for developing the pipeline and the state benefits from such competition. The bill offers positive inducements to those who have already discovered gas to commit to the pipeline while defining tariff provisions that will encourage new exploration. And the bill offers inducements to a pipeline developer to advance the project in a manner that the state defines as in its best interest. Perhaps most importantly, the bill establishes a process where each party that proposes to develop the line must make meaningful commitments to development milestones for the legislature and the public to see what it will and will not do and by what dates.

AGIA is a good first step. AGIA is an open transparent and a competitive process designed to advance the project on a delivered schedule and in a manner that achieves the overarching goals of the state, which are

to: 1) encourage new exploration on the North Slope, 2) provide for expansion of the pipeline as new reserves are brought into production, 3) to achieve the lowest cost commercially reasonable tariff, 4) to create jobs for Alaskans, and 5) to provide natural gas to Alaskans for instate use.

AGIA recognizes the magnitude of the front-end development risks and offers to share that risk in a significant way by offering dollar-for-dollar matching of initial development expenditures by offering worker training for Alaskans and by committing to expedite state permitting requirements. These, plus separate inducements offered to resource owners are significant commitments which signal to the marketplace that the project is moving on a serious and credible path towards completion. In the absence of such progress, markets will have no alternative than to seek other means to meet market demand.

The most significant alternative would be to allow imported LNG even greater market access uncontested by the development of Alaska's natural gas resources. While LNG is certainly a necessary part of the natural gas resource mix, it makes little policy sense to unnecessarily increase our reliance on foreign energy from many unstable and unpredictable regions around the world. This project in MidAmerican's view is undeniably necessary and the time is now to push it forward. The key to moving the project forward is to determine the appropriate balance of risks and rewards for all stakeholders.

There is an alternate approach. The North Slope producers have for years articulated their must-haves before advancing the project. You have heard these prerequisites before including 1) tax and royalty certainty on gas and on oil, 2) regulatory certainty in both the U.S. and Canada, 3) cost reductions through technological advancements, and 4) federal enabling legislation. This approach is effectively saying that the project will get started if and when all the preconditions have been met and all concessions have been extracted. This approach has proven to be ineffective in advancing the project.

MidAmerican's approach is different. We believe that the project can be advanced concurrent with resolutions of issues that today remain outstanding. I want to emphasize that MidAmerican's view that alignment of stakeholder interests is essential. Parties will understandably act in their self interest and in their own business interest. That is why stakeholder alignment is critical to a successful project. That alignment must clearly set forth the roles and responsibilities of each party as well as the commercial structure, which will balance the risks and rewards such that investment expectations will be known upfront.

Our approach does not exclude interested parties or discount new ideas which may be offered to help manage project risks. We know that if a pipeline is developed by an independent developer, the North Slope producers will play the critical role as shippers on the line and sellers of gas to other shippers. MidAmerican is an independent pipeline, is impartial and is in a unique position to help facilitate solutions when stakeholders' interests diverge. We are confident that an appropriate capital structure and rate design coupled with our low-cost-of-capital and project experience can result in a project structure with appropriate allocations of risk and reward for all stakeholders including the State of Alaska and the producers.

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Indeed, MidAmerican believes that an independent pipeline provides the best alignment of interests. National energy policy promotes, in fact requires, competition and unbundling of market segments. For example, the market structure in the United States typically requires that exploration and production, interstate transportation, marketing, and distribution be performed by separate companies. Competition, not market concentration, will lead to efficient markets.

MidAmerican has no upstream, downstream, or global commercial interests that will create any conflict of interest or raise any type of market power concern with respect to this project. Accordingly, MidAmerican's interests align extremely well with the State of Alaska and include: 1) accelerating

development of this critically important project, 2) achieving the lowest cost commercially reasonable tariff, 3) offering a commercial structure that encourages new exploration and production to both expand and extend the life of the pipeline - 35 tcf, the amount of proven reserves, implies only a 22-year project life and new discoveries are critical to fill the pipeline over its useful life, 4) providing open access, nondiscriminatory transportation services to insure both receipts and deliveries are provided for instate use, and 5) insuring Alaskan jobs and workforce development. The state's commitment to workforce training and development is extremely important. Skilled labor shortage is one of the contributing factors in construction cost increases throughout the industry. A skilled Alaskan workforce will not only insure jobs for Alaskans, but will help address an industry-side demand for these workers.

The process set forth in AGIA will allow these ideas, and all parties' ideas and proposals, to be advanced and tested in an open and transparent manner. We support that process and while we can understand the debate over what constitutes the best pipeline development proposal, it's harder to understand why parties would object to a process that calls for an open and transparent comparison of proposals. We urge the legislature to approve this legislation this session so that a pipeline developer can be selected in a timeframe that will allow for a productive 2008 field season for engineering and environmental programs to be conducted.

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SENATOR WAGONER asked what kind of pipeline MidAmerican envisioned building. Would it build to the Hub in Alberta or go through to Chicago, for instance?

MR. MORGAN replied that when MidAmerican first came to Alaska and had negotiations with the prior administration, its vision was to build the Alaska segment working with TransCanada who would build the Canadian segment - and it would end at Boundary Lake, which is near the border of British Columbia and Alberta. Getting the gas to a liquid trading point, the Acho Hub, is what is required and would save the cost of building all the way to Chicago.

He said that both western Canadian sedimentary basin production and import capacity to the U.S. are declining primarily due to the increase in gas in the tar sands area. Existing pipelines going in multiple directions have excess capacity and gas could flow either on TransCanada's system further east or on Northern Border's; it could flow on Alliance or on the pre-build section owned as Gas Transmission Northwest, but what used to be Pacific Gas Transmission. This is an important point, he said, because 4.5 bcf of gas is a large amount to be integrated into the market at one time. If it's all dumped into one spot like Chicago, the price will collapse. Sending it in multiple directions would keep the price of the new gas stable; therefore the netback would be better.

He said that MidAmerican's proposal goes only to Alberta.

SENATOR WAGONER asked if MidAmerican would build a spur line to Southcentral Alaska as part of its project or would that be a separate item altogether.

MR. MORGAN replied that their proposal is focused on the interstate pipeline and the spur line is considered as an intrastate pipeline that may well be necessary. Part of their proposal is to provide instate delivery points, as is required by AGIA, and that could be one. But they do not envision building that portion of the pipeline.

SENATOR WAGONER asked if TransCanada's permits are exclusive or can other people receive permits to build a line through Canada.

MR. MORGAN replied that TransCanada owns those permits, which were issued to Foothills, but they are transferable. They are based on a body of environmental and engineering data, some of which is public and some not. Likewise, some of the information is stale and some not. He believes they are exclusive to TransCanada and that is part of the reason for partnering with them. The permits resolve a lot of the access issues along the ANGTS route.

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SENATOR STEDMAN said the bill caps rolled in rates at 15 percent and some have testified that the tariff would look like a J-curve going from 4 bcf/d to 7 bcf/d. He asked if his firm had done any modeling on that.

MR. MORGAN replied that it has done some preliminary modeling assuming the initial size of the project is 4.3 bcf/d - 4.5

bcf/d. Their initial design would be expandable through compression additions only up to about 5.9 bcf/d. Compression-only expansions will generally be much cheaper and the rolled in rate would be lower. Beyond that, you get into adding a second pipeline or a loop and then it depends on what increments of expansion they are looking at. They have not modeled expansions beyond 6.5 bcf/d.

He stated that a tariff has a lot of elements and a lot of things could drive rates higher or lower. As he mentioned, the 35 tcf of proven reserves has implied a 22-year life. Adding new reserves extends the life and allows those costs to be amortized over a longer period. This has been done on the Kern River pipeline where shippers came in and then they elected to extend the term of their contract by 5 or 10 years and the rates were leveled and debt was refinanced. The depreciable life of those assets was extended causing a 34 percent decrease in rates on Kern River. He thought there was a lot of opportunity to design rates that will produce a low cost commercially reasonable tariff and they look forward to doing that.

He said that AGIA uses the initial recourse rate as a benchmark that allows up to a 15-percent increase life-time cap, but he thinks it frustrates the tariff design to base it only on recourse rates. He said that negotiated rates are probably more the norm in any large project. FERC policy on this has changed over the years. It used to be a presumption that anything that had only a 5-percent increase in overall system rates would receive rolled in treatment; today the policy is no-subsidy. He repeated that whatever cap is selected, it should be off any rate, whether it's a recourse or a negotiated rate.

5:33:00 PM

CHAIR HUGGINS asked for an overview of the business model Kern River used to build the pipeline from Wyoming to California through Utah and Nevada.

MR. MORGAN replied that the original pipeline was built in 1991 and it was a producers' pipeline. It took natural gas, which producers owned in Wyoming, which didn't have an outlet, and transported it to the heavy oil fields in Bakersfield, California. That gas was used to produce steam, which was injected directly into the ground resulting in thermal-enhanced oil recovery. The injected steam heated up the entire reservoir and allowed what is very heavy crude oil, almost tar-like, to be produced. That was the fundamental reason for building the project.

As they've expanded in 2001, 2002 and 2003, the shipper mix has changed. The 2003-expansion doubled the size of their system and the market for it was entirely different. It became merchant-generated.

CHAIR HUGGINS asked who built the pipeline to begin with.

MR. MORGAN answered that originally Kern River was a partnership of the Williams Companies and Tenneco Companies. The Williams Companies owns several transcontinental pipelines in this country. Northwest Pipeline that serves the Pacific Northwest does a lot of gathering and processing in the Rockies and the Gulf. It owns 50 percent of the Gulf Stream pipeline that goes into southeast Florida. It has some exploration and production, as well; meaning it has various business segments.

CHAIR HUGGINS asked him where he started.

MR. MORGAN answered that he started with Northwest Alaskan when this project was first proposed in 1978. This is his third turn at trying to commercialize it. He said that Northwest Alaskan was purchased along with Northwest Energy by the Williams Companies in 1983. In 1985, the Kern River pipeline started being developed. In 1996 the other 50 percent was acquired from Tenneco and in 2002, MidAmerican Energy purchased the Kern River pipeline from the Williams Companies.

CHAIR HUGGINS asked how the Kern River business model was brought together.

MR. MORGAN replied that Kern River was just a green field project that was created through the marketing efforts of both Williams and Tenneco who were separately looking to develop a project out of the Rocky Mountains. There was excess production and not enough pipeline take-away capacity. He added that in the Rocky Mountains, or anywhere for that matter, if production exceeds take-away pipe, the price of that commodity goes way down. So, in effect it was "pipeline constrained" out of the Rocky Mountains.

CHAIR HUGGINS said that would be called stranded in Alaska. He asked what the original tariff on the pipeline was.

MR. MORGAN replied about \$.69 cents per/mcf (1000 cubic feet) and probably \$.67 cents per decatherm.

CHAIR HUGGINS asked what it is today.

MR. MORGAN answered that the 2001 and 2002 expansions were rolled in and the 2003 expansion was priced incrementally. Within each of those systems, they have 10-year rates and 15-year rates. The differences in rates are maybe from \$.33 to \$.58. The assets associated with a firm capacity position have 70 percent of their costs recovered over the term of the contract. Their rate design is based on recovering the debt portion of their investments - 70 percent - over the term of the contract. Then the Period 2 rates are for the equity recovery period, so those rates will step down significantly at the end of the term of the contract.

CHAIR HUGGINS asked him to reflect back on that model to see if it had any of the traits of AGIA.

MR. MORGAN AGIA replied that AGIA has a limitation on the capital structure - 70 debt/30 equity. This is the same initial capital structure they used on Kern River. But MidAmerican uses a levelization model for its rates. He explained there are two types of rate making. One is levelization and the other is traditional rate making. Levelization is a process of averages, so that rather than starting with the initial very high rate base, you use the rate base over whatever the levelization period is.

It allows the initial rate to be much lower and you do that so you gain market entry with other competitors. Generally, if you're competing in a competitive market, old pipe meets new pipe. Old depreciated pipe will generally have a lower rate. So we developed the levelization rate methodologies so we could compete into the California markets.

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CHAIR HUGGINS said AGIA has potentially \$500 million available for risk sharing and he asked what it was for Kern River.

MR. MORGAN replied that the risk sharing was between the partners, Tenneco and Williams; the state did not contribute to risk sharing in that instance.

CHAIR HUGGINS questioned whether the state was asked to share the risk.

MR. MORGAN replied the closest thing to that was the Wyoming Pipeline Authority that was formed at that time. It was given \$1 billion worth of bonding authority and it offered to finance the project using those bonds. At the time, the interest rate would have been very favorable, but it ended up depending on how much gas was sourced from Wyoming. He added that Kern River sources gas from Utah, Colorado, and Wyoming and at that time it was bringing gas from Canada also. So they elected not to go with that state-sponsored financing.

CHAIR HUGGINS asked for his thoughts on the 15-percent roll in provision in AGIA.

MR. MORGAN replied that is really a policy matter for the state. The pipeline has an interest in assuring that the tariffs to the Lower 48 are very competitive. There isn't enough proven gas and new exploration must fill up the pipe so the life of the project can be extended resulting in a better rate. They have an interest to the extent that they keep the tariff low. Roll in goes both ways - initially for the first 1 bcf/d of expansion, it will produce a lower rate for all shippers and then it could turn around. Expansion cases above 6.5 bcf/d haven't been modeled. He added: "Roll in is the rule in Canada. That's what all of their expansions do. That isn't necessarily the rule in the Lower 48. It's a no-subsidy rule right now."

However, he said if their interest is to develop the overall resource, having rolled in rates, even when they are going up, produces a price signal that will encourage production. It will not affect cost recovery for the pipeline; it affects the rates the individual shippers will pay.

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CHAIR HUGGINS asked if MidAmerican had bumped up against the 10 percent factor in expansions in the Lower 48.

MR. MORGAN replied that the rate differential between their lowest rate and their highest rate is more than 15 percent.

CHAIR HUGGINS asked when MidAmerican did expansions, did they expand to the 15 percent. The reason he asks is because to date the people he has talked to didn't see any scenarios in the near term and mid term that 15 percent would even be a potential factor.

MR. MORGAN responded that their first two expansions were compression expansions and they were rolled in which produced

lower rates. Their looping project that doubled the size of the system - 717 miles out of 926 miles were looped - are more than 15 percent higher. But he didn't know what they would have been if they had been rolled in, because the FERC policy today is no subsidy on an inclusive demand charge plus fuel rate. He said that fuel is actually different on the expansion than on the "vintage system."

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SENATOR STEDMAN asked if his firm had ever asked this administration or the past one for any type of incentive like the \$500 million. Is it needed?

MR. MORGAN replied that they did not ask for the \$500 million incentive, although he thought it was a good idea. The state would get a lot for its \$500 million.

It gets to control the key elements of project structure. It gets to accelerate the project; it gets to have control of the project schedule and development. It is a big deal to have a mandated capital structure that will not exceed 30 percent equity. Those are big deals, but it also signals to the marketplace that the state is serious; it's taking a risk. They're going to push this project forward and the marketplace will hear that message. I think as far as integrating the Alaska gas resources into the market, that's an important deal. Because otherwise markets will go somewhere else for their gas and right now the only other choice is LNG.

We're entering - there is a raging political debate on green house gases. It's pushing everybody to gas. The gas market is - I mean they could go to nuke that doesn't have any emissions. They could go to renewables that just can't be developed with the scale that's necessary. Coal is increasingly frowned upon. California, frankly, has essentially outlawed coal in its state. And gas is the way things are going. The Lower 48 market needs more gas. Alaska can provide that resource unless we just concede that market opportunity or market growth to LNG - and it will fill 100 percent of that if that's allowed.

There's another thing about that - is LNG - once it's there, it's scalable. It's a lot easier to add another tank or another train than it is to initially site an

LNG plant and the incremental costs are lower than what the costs will be to develop the Alaska pipeline. So, we feel it's important to get going now.

5:49:48 PM

SENATOR STEDMAN asked how else the state could show commitment to the project other than writing a check for \$500 million.

MR. MORGAN replied that all the other commitments in AGIA are also very important. It's very important to have a trained Alaskan workforce. MidAmerican is committed to Alaska-hire and even more committed if those workers are trained. He said he flies welders in from Texas for their projects in Wyoming where there is a shortage of welders right now.

He said that nobody can say definitively today whether this project is economic or not. The last real cost estimate from the bottom up was done in 2001 and since then factors have changed like increased steel prices, devaluation of the U.S. dollar, interest rates and inflation. The cost estimate for the Mackenzie Valley pipeline just more than doubled.

He said MidAmerican's intuitive belief is that this project is economic and that the floor gas prices in the Lower 48 have permanently ticked up explaining that the cost of domestic drilling is what really sets the floor price of gas in the Lower 48. About 50 bcf/d of gas is produced domestically and 10 bcf/d is imported from Canada. The cost of recovering that next tranch of production has gone up. If gas prices fall to \$4, people quit drilling because you can't drill for \$4.

MidAmerican would present a view of what it thinks the long-term price of natural gas will be in the Lower 48, what the cost of developing this project will be and a tariff structure that balances risks and rewards making sure they are commensurate with the risk that is being taken.

Whether the taxes are high or whether the taxes are low, the overall project feasibility, the economic feasibility, will take that into account. But changing the game midway through, bating and switching, giving you low taxes for 10 years and then an unknown after that - investor expectations are set when we make this investment. I am not willing to accept, MidAmerican is not willing to accept, you know, whatever return that we propose in our application - we're not willing to say you can change that after 10 years and knock 200

basis points off our return on equity. When we make the investment, we want those expectations to be known and to be durable.

I said in the Oil and Gas Committee, rather than tying tax certainty to time - being 10 years, why don't you tie it to the resource being committed. Maybe that's 15 tcf, maybe it's 25, maybe it's all 35 tcf. When they commit that resource to the project, they're looking for durability and investment certainty on that. And changing that is a hard thing to do. So, what can the state do to offer an incentive? That is one thing.

SENATOR STEDMAN said the state is committed, but if it decides not to write them a check for \$500 million and tried to come up with some other way to show commitment, he asked would everybody just walk away. How can it show commitment other than writing a check out of the treasury?

MR. MORGAN replied that he didn't know if the check would influence MidAmerican's decision. It is willing to take a risk to develop the project and they are looking for alignment with the state and with producers.

"Having skin in the game is important to us," Mr. Morgan said. When MidAmerican was up in 2003, it asked the state to be its partner and was told no. They went out and got other partners - CIRI, Pacific Star Enterprises and others. The \$500 million does a lot of things, he acknowledged. It gets project structure on major elements that will lower the tariff no matter who is selected; it gets an expedited schedule; it gets pipeline investors, like MidAmerican, to the table to pursue a very risky project, but it also all flows right through to the resource owner in terms of a lower tariff. Back to his earlier answer that MidAmerican didn't ask for the \$500 million, but they do think it is a good idea.

SENATOR STEDMAN asked him to explain how their risk level is structured in the pipeline business going forward.

MR. MORGAN replied that there are a lot of areas of risk now. As he mentioned earlier they don't know if the project is economic. Their belief is based on intuition and they are willing to make a bet with a substantial amount of money. Advancing the project to a state where you can actually be market-responsive is smart. They do that on their existing pipelines. He has 6 or 7

expansion scenarios on the shelf ready to go when the market signals are there. So, all of the initial development dollars are at risk. Ever since the Alaska Natural Gas Transportation System (ANGTS) happened in the late 70s, that project had capital cost overrun discipline formula in the tariff and he fully expected that pipeline proposals would have a risk component in its tariff. Supply risk needs to be looked at. They hope to depreciate their facility over 35 years, but there isn't 35 years of gas. The risk of credit defaults is also substantial. He said many people you wouldn't think would default like PG&E, a shipper on the Kern River system that went bankrupt and turned back a contract. Calpine, one of the largest consumers of gas in the country, went bankrupt and it was a shipper on Kern River.

SENATOR STEDMAN asked if the risk is linear or does it change.

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MR. MORGAN replied that the development risks up front are very high, execution risk is very high. At some point after enough operating history, things become more efficient and the risks will go down.

SENATOR STEDMAN asked if it's fair to say the most risk is between now and a binding open season.

MR. MORGAN replied that the risks will change, but the dollars will change, too. Upfront development risk is risky - when the project has spent maybe \$500 million. When you get to project execution expenditures might be \$20 billion, a substantially higher sum of dollars. So even if the risk is different, it is on a much larger pot of dollars. When risk decreases there are more dollars at stake. They need to keep the costs competitive in the marketplace.

SENATOR STEDMAN asked if the state should allocate its \$500 million to the end of the pipeline project instead of to the beginning to help control risk.

MR. MORGAN answered that MidAmerican supports it being upfront to jump-start the project because time is an extremely important thing in terms of the net present value to the state.

SENATOR STEDMAN asked if the state were to help in getting them to a binding open season, how much would it cost.

MR. MORGAN replied that an open season could be held tomorrow. But people will have no more information than they have today and that's not enough information to make a binding commitment. So, lots of work has to be done to "shore up" what the costs of this project will be. He didn't see a binding meaningful open season until a couple of years of studies have been made that validate costs and schedule. He commented that if a project is not economic it will fail and separate provisions in AGIA deal with an uneconomic project.

SENATOR STEDMAN rephrased that question to a nonbinding open season.

MR. MORGAN answered that a nonbinding season doesn't tell you much. A lot of people are like tire-kickers and just sign up knowing it's nonbinding so they can stay involved and informed on it. You aren't going to base any investment on people that are just playing the game for some period of time.

In two years if they have demonstrated the project to be economic, he rhetorically asked why the producers wouldn't decide to make money by either selling gas at the wellhead or shipping it. He has heard it suggested that the producers might boycott the open season, but he has not heard any of the producers say that. He hasn't heard them say they would withhold gas and warehouse it either.

[6:05:41 PM](#)

SENATOR STEDMAN asked if he didn't have an estimate of getting to an open season, could he come up some estimate so the state has some way of figuring out how much capital to expense out.

MR. MORGAN replied the work commitment and the schedule of spending are all in the application criteria. If MidAmerican is selected, the first thing it would do is a gap analysis with state resource agencies and FERC to determine what new work needs to be done. Their engineers have to look at all the frost heave test data, all the ice damming data, the bore hole data that is in possession of TransCanada, seismic, et cetera. A field work program would have to be put together for 2008 and 2009 to figure out what needs to be done. He apologized that it's not easy to throw out a number.

[6:08:56 PM](#)

SENATOR WIELECHOWSKI asked if MidAmerican plans to put in an application under AGIA and if it has partners in mind.

MR. MORGAN replied that MidAmerican is very interested in submitting a proposal. They must see what how AGIA looks if the legislature changes it. It doesn't answer every question. He would want to see the request for applications and how evaluation criterion is described.

One of the things he thinks should be an evaluation criteria has to do with something that is less tangible, but identifiable. He said he is often asked what MidAmerican brings to the table, because it is not in Alaska all the time and doesn't have a large operation here. And part of what it brings to the table is what it doesn't bring - it has no conflicts. It has no up stream or down stream or global commercial revenue streams. They think being independent is important because they can be impartial and help facilitate issues of risk/reward, balance between stakeholders.

He explained when the President and the Congress went through this same process of reviewing competing applications in 1976 and selected the Alaska Natural Gas Transition System (ANGTS), producer-ownership was precluded in an anti-trust provision of that bill. Producers were not allowed to have an ownership or management control interest in this project, because the Congress wanted competition. The market structure is moving to being unbundled and not having vertically integrated market concentration. So, MidAmerican thinks a lot of weight should be given in the evaluation criteria to presence or absence of conflicts and that concept could fall under the general term of "alignment."

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SENATOR McGUIRE said she wanted to clarify that other pipeline companies have told the legislature they would not be interested in submitting an application if they are required to go all the way to the FERC certificate. MidAmerican said it would be interested and she wanted to know their thoughts on it.

MR. MORGAN replied that he has a couple of thoughts about that. MidAmerican is willing to go past a failed open season, but it would look seriously at the reason it failed. If it failed because the project is uneconomic, another provision in AGIA deals with that and that might be a legitimate reason to walk away. If all the market and cost studies they have done show that the project is economic, he couldn't think of a reason it would fail. If the producers withhold their gas, it is critically important to advance the project to certification. AGIA has a period of time in which to sanction the project after

certification. They don't want to make it easy for producers to boycott the project and then it's only MidAmerican's project again. He honestly didn't think if the project is demonstrated to be economic that the producers would withhold gas. If they do, he didn't understand how they could stand the scrutiny of the U.S. Congress, the Alaska Legislature, having to comply with the lease covenants, shareholders and the public.

SENATOR MCGUIRE said she heard that a MidAmerican subsidiary owns about 4 percent of a steel company and that might be an interesting thing to bring to the table.

MR. MORGAN replied that he didn't believe MidAmerican owns any part of a steel company, but he wasn't completely knowledgeable about the assets in the Berkshire Hathaway portfolio. He would check.

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CHAIR HUGGINS said a neighbor commented: "If Warren Buffet doesn't need tax breaks, why does he need \$500 million?"

MR. MORGAN reiterated that MidAmerican didn't ask the state for the \$500 million commitment; the state is offering that to achieve several of its own goals. Those goals include getting the project started quickly, controlling the time and schedule of the project, controlling the key commercial structural issues, and it gets a two/for - it induces a pipeline developer to move a risky project forward now, which is not happening without it and two, it helps reduce the overall tariff.

CHAIR HUGGINS asked if the \$500 million is a show stopper for MidAmerican and if it isn't in AGIA, but it does include the less tangible evaluation criteria, would MidAmerican still apply.

MR. MORGAN apologized and said he just couldn't answer today, but he stated that MidAmerican is interested in long-term investment protection. When they tried to negotiate this project before, the state didn't use a \$500-million carrot. He reiterated that the \$500 million creates alignment that is important to them and to the marketplace. It gives the project much more credibility and further, he said "It will not be my personal decision."

CHAIR HUGGINS asked what happens if there is a failed open season and the state says this is an economic project.

MR. MORGAN AGIA replied that AGIA provides for that situation with a third-party arbitrator.

CHAIR HUGGINS asked his thoughts if the arbitrator sides with state.

MR. MORGAN replied that they would know a lot more facts by the time they would have time to review them and make that decision.

CHAIR HUGGINS said it would be a tough situation to have to go all the way through to FERC certification with a failed open season. "It may be a tough swallow."

MR. MORGAN said he needed to study that point more.

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CHAIR HUGGINS asked if he saw anything in AGIA that would be must-haves for MidAmerican.

MR. MORGAN replied that investment protection is a must-have. To the extent they go down the road partnering with the state and the state changes courses, there is a provision for treble damages. That is long-term protection for them as well as the 5 years for project sanction. Alignment is very important as well and he thought the \$500 million commitment really helped align the parties to make this happen and happen in the most expeditious manner possible.

SENATOR WAGONER how fast MidAmerican could get to an open season.

MR. MORGAN replied that having a meaningful binding open season will require nailing down costs, schedule, and what the tariff will be. He thought it could be done within the three-year timeframe and possibly two. In their Stranded Gas Act application, they were looking at two field seasons in six months to accumulate a package that would be available to file with the FERC. He added that holding an open season before applying for FERC certification demonstrates market support for your project. So, he thought it would take 2 to 3 years for a meaningful one and surmised it could be done in one year, but without defensible costs, he didn't know who would come to the party.

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CHAIR HUGGINS asked him to explain his experience with utility customers in the Lower 48 making pre-purchase agreements.

MR. MORGAN replied that his experience goes a long way back. When ANGTS was passed, Northwest Alaskan (who he worked for) was a consortium of 11 natural gas pipeline companies. They were still bundled back in the 80s. Each one of those pipelines had a merchant function - it had a captive customer market. Northwest Energy had the Seattle, Portland, Boise markets. It bought gas on behalf of its customers and passed it through to them. All that changed with FERC Order 436 that unbundled the industry. It separated merchant functions, separated exploration and production, and made Northwestern transmission-only pipelines. So, the marketing has become much more challenging.

MR. MORGAN said there was a gas bubble for a lot of years and people became very short term focus. Everything was bought on a monthly, yearly and five-year at the most basis. Nobody was taking long-term commitments. The pendulum is starting to swing the other way as the gas bubble is gone and supply is short.

The level of taxes - the project can adjust to, but the volatility - it can't. So utility companies and large users like Dow Chemical or some of the major industrials, they want to take out the volatility. So, they're looking more today at terming up contracts. Nobody really likes to hold long-term firm contracts. It's a pretty item to hang on your balance sheet. A lot of utilities will hold firm capacity back to the closest liquid trading point. You know, it's common for them to hold gas to, you know, the Wyoming hubs, for instance. We call it O-PAL. It's common for them to hold firm capacity to, say, Acho in Alberta. It's common for them to hold firm capacity into the Permian Basin or into the Gulf. Holding firm capacity for a utility all the way to the wellhead - that would be another matter. It will require some pick and shovel work to get that done. Marketers might, you know, utilities, ummm, I don't know. For what reason?

[6:30:02 PM](#)

CHAIR HUGGINS asked if MidAmerican got the license based on what he knows today could he go to the Lower 48 and get significant financing based on a customer base - assuming a price of \$35 billion for the project.

MR. MORGAN replied that he did not know that today, but he was willing to bet a significant amount of money in doing the

development work that would show him what he needs to know to do that.

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SENATOR STEDMAN went to page 2 where the bottom paragraph talks about the separate inducements offered to resource owners. He asked what inducements should be on the table.

MR. MORGAN explained that he assumed the royalty provisions of timing and switching between royalty in-kind and royalty in-value were valuable or they wouldn't be in AGIA. He was offering the resource commitment as an alternative inducement for the tax certainty piece. He reasoned that ten years of investment certainty on this project is not that long and he thought there might be other constitutional limitations that might be driving that shorter period of time. Defining the certainty around a quantity of gas rather than period of time could get around that.

The separate inducements that he was talking about - the one that induces both the midstream owner, pipeline owner, and the resource owner is the \$500 million, because it acts to lower the tariff, which not only induces a pipeline developer to come to the table, but it also flows through to the resource owners. The \$500 million is large and it's equity dollars. He suggested they might have an allowance for funds used during construction (AFUDC) component. It's actually a bigger benefit to the tariff than just the \$500 million.

His other point was that it's really the durability and stability of the taxing regime that he thinks is important, because no one knows today for certain that this project is wildly economic, marginal or uneconomic. He didn't know how to set the level that would provide inducements on taxes. What is important is that investors know up front before they make the commitments what the regime will be over the life of the investment. What he would like the resource owners to be asked to do is commit the entirety of their proven reserves. This is just another way to try to avoid whatever constitutional issue might be there.

SENATOR STEDMAN asked if this project is wildly in the money, did he feel the chances the state would be leveraged for a lower gas tax was slim to none.

MR. MORGAN replied that he can't make that absolute statement now, because he didn't know that it was economic.

The only statement I'm making is we are willing to invest upfront development dollars with the state to prove that's the case. If I didn't think it were economic, I wouldn't be up here. We intuitively believe it is.

[6:35:36 PM](#)

CHAIR HUGGINS asked him wrap up so he could catch his plane.

MR. MORGAN thanked him for the invitation to appear here. If other questions arise, he asked them to contact him.

CHAIR HUGGINS noted that Senators French and Thomas were present.

There being nothing further to come before the committee, Chair Huggins adjourned the hearing at [6:36:52 PM](#).