

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 30, 2007

1:45 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
 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)
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 03/26/07 (S) RES AT 3:30 PM BUTROVICH 205
 03/26/07 (S) Heard & Held
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 03/27/07 (S) RES AT 3:00 PM BUTROVICH 205
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 03/29/07 (S) RES AT 5:00 PM BUTROVICH 205
 03/29/07 (S) Heard & Held
 03/29/07 (S) MINUTE(RES)
 03/30/07 (S) RES AT 1:30 PM BUTROVICH 205

WITNESS REGISTER

COMMISSIONER PATRICK GALVIN
 Department of Revenue (DOR)
 Juneau AK

POSITION STATEMENT: Commented on SB 104.

MARCIA DAVIS, Deputy Commissioner
 Department of Revenue (DOR)
 Juneau AK

POSITION STATEMENT: Commented on SB 104.

KEVIN BANKS, Acting Director
 Division of Oil and Gas
 Department of Natural Resources (DNR)
 Anchorage AK

POSITION STATEMENT: Commented on SB 104.

MARTY RUTHERFORD, Acting Commissioner
Department of Natural Resources (DNR)
Juneau AK

POSITION STATEMENT: Commented on SB 104.

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Resources Standing Committee meeting to order at [1:45:05 PM](#). All members were present at the call to order.

SB 104-NATURAL GAS PIPELINE PROJECT

CHAIR HUGGINS announced SB 104 to be up for consideration and members of the administration would be testifying and would begin on page 8, Section 43.90.150 of the original bill.

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COMMISSIONER PATRICK GALVIN, Department of Revenue (DOR), and Deputy Commissioner Marcia Davis introduced themselves.

COMMISSIONER GALVIN explained that Section 150 is about the initial application review time where the commissioners determine if additional information is needed. It ties in with the next section on page 9 dealing with criteria information and the use of confidential information as part of the application. He then let Ms. Davis comment on their ideas about dealing with confidential information.

MARCIA DAVIS, Deputy Commissioner, Department of Natural Resources (DNR), explained that they tried to balance what confidential information the state needs to thoroughly evaluate the merits of an application while not placing them at a competitive disadvantage. Industry is very guarded about how it structures rates among other items although that information eventually comes out once a pipeline is successful in being produced, but until that happens they are all competing with one another to think outside the box and come up with novel ways of doing that. That is balanced against that is the desire of the public to want to know the information and to "see the full goods" on the successful applicant.

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MS. DAVIS said that language was added in the CS that says the information in an application will remain confidential and

proprietary unless the applicant is a successful licensee. However, all the information from the successful licensee will come out including the confidential and proprietary information under the theory that you beat out the competition and now let the people see what you are doing.

If the information is submitted and the commissioners decide it is not a trade secret or proprietary, the applicants will have a short period of time in which they can decide to pull it back and not rely on it in their application or decide that it is important enough to waive whatever detriment would be caused by its release. The commissioners would not protect the information from disclosure.

MS. DAVIS said a provision was added that says if an unsuccessful applicant wants to challenge the award, its application will be opened up to the public including its confidential and proprietary information. So the challenged award would not be at a disadvantage.

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She said the department would like to add a definition of what is proprietary and confidential, but they don't have it at this time. She said they are mindful that the legislative process is important and people are looking at the timeliness and ability to evaluate what the commissioners are evaluating. So the department is open to suggested language about legislative members or their delegates signing confidentiality agreements that would let them into the inner circle that would allow them to access applicant information that has been designated confidential and trade secret subject to protection under the confidentiality agreement.

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SENATOR STEVENS said he could see some concerns on the industry side from a challenger having to release confidential information.

CHAIR HUGGINS said he could a scenario where a challenger could limit the provisions they are challenging.

MS. DAVIS said the department didn't want to get too complicated in terms of confidentiality. They aimed for simplicity and clarity.

CHAIR HUGGINS said he assumed that proprietary information would be withheld, but the remainder of the application would be public.

MS. DAVIS replied that was correct. In addition, the department is recommending that the summary of the confidential and proprietary information be made by the applicant so there is no question about the fairness of how it was written.

COMMISSIONER GALVIN said this idea transitions into the next section which is the evaluation criteria. He said deciding which application is better than another is an integrated decision. Any aspect of it that would be challenged would ultimately affect the whole.

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MS. DAVIS said eight factors in the current bill's application evaluation criteria struck people as being too broad and not very instructive of the actual process that the commissioners would use. So, she asked her technical people to describe what they would mechanically do with the factors and what emerged very clearly was identified as a net present value (NPV) meaning the income stream that the state would receive from a proposed project. The factors included in the NPV would be the timing of the project and how quickly it would be delivered (to get the net present value factor), the volume of the gas (the design criteria), and the destination value minus the cost to deliver the gas (essentially a netback, although some people might call it a wellhead value).

The likelihood of success or probability would also be considered. In other words, one project could yield \$500 billion to the state and have a 10 percent probability. So, they must weigh and decide what is in the state's best interest.

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MS. DAVIS explained that they took the application criteria and organized it around those two factors. So their recommended CS language would be something that says the applications would be ranked (ordinal) based "according to the net present value to the state of its anticipated cash flow from the applicant's project weighted by the project's likelihood of success." The factors relating to the net present value are listed in (B)(1) and the factors relating to probability of success are listed in (B)(2).

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SENATOR WIELECHOWSKI asked if enacting more precise evaluation criteria is probably enhancing the state's likelihood of getting sued by an unsuccessful applicant.

MS. DAVIS replied that was considered and she believed that there are positives and negatives that balance each other out. The factor of having the net present value, which the department would calculate anyway, is more clearly articulated in their recommendation and it will be much clearer to track and easier to verify. The probability factors are still there, but they have been identified as a weighting, not a precise mathematical formula. This gives the commissioners some discretion.

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SENATOR STEVENS asked how one goes about deciding the likelihood of success. In the end, isn't it sort of a gut feeling?

COMMISSIONER GALVIN agreed and clarified that they don't anticipate assigning percentages to the likelihood of success, but they will have some form of number system that can be calculated given variables to get a sense of a relationship between two projects in terms of their value. When they get to the likelihood of success piece, they would then have to determine if the difference between the two applicants in terms of their relative likelihood of success is enough to change the ranking of their values. He explained:

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It is a move towards something that creates a better understanding of how we see the valuation actually taking place. It gives both applicants and, I think, the public an idea of how we're actually going to evaluate these things against each other. It provides an opportunity for everyone to see the more objective numbers part of it and how that isn't the end result - because it's the project that promises the world isn't going to be the one that we want to necessarily go with. And so the balance of that is we're also not going to give anybody the impression that we can peg a particular project and say you score a 30 percent on likelihood of success and so your overall score is X-value. It's strictly a comparison between the projects that we get.

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SENATOR WIELECHOWSKI asked if the commissioners would be able to use outside information that is not supplied to them.

MS. DAVIS replied yes, absolutely; the ability to determine the state's netback value requires them to look at the project, what its destination is and make the forecast of what they think the market value of the gas will be at those points - so they can calculate what the state's revenue ultimately could be from that project.

SENATOR WIELECHOWSKI asked how they would evaluate a scenario, for instance, where a pipeline company comes forward and doesn't have the easements or permits to go through Canada, but they think that they can get them, although others disagree. It's basically one's word against another.

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COMMISSIONER GALVIN answered that in addition to the department's ability to hire experts to do the quantitative analysis, it would also need experts on the likelihood of success. Senator Wielechowski hit on a big one - which is having expertise on the Canadian evaluation of whether or not a particular project can show they know how they are going to get their authorizations and how much a particular delay in some aspect of that is going to affect their overall work plan. The department will make a number of other assumptions will with regard to overcoming hurdles and other expertise will have to be brought in to evaluate those. That is why other provisions allow the department to do that without the formal RFT process.

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SENATOR STEVENS asked how the evaluation takes in cost overruns.

COMMISSIONER GALVIN replied the commissioners will look at the track record component of an applicant. One aspect is if a company can stay on-budget and another one is if the project is feasible and within the parameters of industry norms. For instance, will a new type of steel need to be developed creating cost overruns or detract from the ability to bring the project in as designed.

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MS. DAVIS added that this one criterion actually shows up in both sides of the analysis. In the net present value piece, they are mindful that pipeline companies can enter into negotiated rates for commitments and assume the risk of cost overruns over a certain threshold. So, to the extent a project does that, that can be factored into the state's NPV model. The probabilities and likelihood piece is the more subjective one.

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CHAIR HUGGINS asked (for a constituent) who would actually choose the applicant.

MS. DAVIS said this question probably came from discussion in this committee that two commissioners will choose the applicant and it's the Governor's job to insure they don't disagree.

COMMISSIONER GALVIN added that the House Oil and Gas Committee today injected the AGIA project coordinator as a third-party to be a tie-breaker on selection of a project. Someone suggested that would be the Governor since she is the one who hires the two commissioners.

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COMMISSIONER GALVIN noted a valid observation that the sequence of some of the sections may misrepresent what the actual process is intended to be and having the evaluation criteria come before the public notice and public comment period is one of those. So he anticipated the opportunity to switch those around.

In the public notice provisions, he said the main thing is reference to the confidential information and the need for a summary submitted by the applicant to cover any information they want to be held confidential so the public would at least be aware that there is confidential information and what its nature is.

CHAIR HUGGINS asked if he envisioned having a traveling road show that would go to some demographic centers.

COMMISSIONER GALVIN replied they are not anticipating doing that during those 60 days.

CHAIR HUGGINS encouraged them to consider that because of the expectation has been created among communities and some organizations.

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SENATOR STEDMAN went back to net present value calculations and asked how they would handle delays in implementation of cash flows - particularly in getting through a failed open season or getting to an open season and then having to drive for the certificate versus going to a binding open season fairly quickly.

COMMISSIONER GALVIN replied that they are not assuming that everything will go smoothly and basing the value on that, but they would use some probabilistic aspect to the evaluation at certain junctures and bring those back to the overall value for that particular project. An element of judgment is also built into the net present value calculation that is inherent in trying to determine where the cash flows are going to come from and what the likelihoods are of each aspect of it.

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MS. DAVIS addressed the open season question more specifically and said based on testimony from pipeline companies and producers it's very clear that AGIA is geared around having a successful initial open season. That is why the resource inducements are tied to it. Because of that bias, the evaluation process stresses the amount of front-end work a company does leading up to an open season and that will be part of weighting the probability of success.

SENATOR STEDMAN assumed the highest net present value would be given to the volume of gas being committed.

MS. DAVIS replied, "Exactly, sir."

CHAIR HUGGINS took the scenarios of a 20-inch line to Point MacKenzie and the project that goes to Chicago through Canada and asked how Point MacKenzie could ever compete against the Canada route if the pipe carried 4.5 bcf/day.

MS. DAVIS replied that it would first appear that a 4.5 bcf/day line to Chicago should be superior to a 20-inch line to Point MacKenzie, but expert evaluation of the probability of success as part of the NPV might find hang-ups - in the Canadian processing, for instance. And Point MacKenzie might start up in a year or two and that would also affect the NPV of the cash stream to the state. This is how the different projects might level out on paper.

CHAIR HUGGINS said an expansion would tilt a project radically and asked if she has an estimate in mind for allocation of time to evaluate an application.

COMMISSIONER GALVIN replied the close of the comment period is at the middle of December and the decision will be made by the end of January. If six different applications are fairly close in terms of NPV, those judgments might take longer. All the projects don't have to be scored. He said:

All we have to do is make a determination that given the value and the likelihood of success, this one clearly outshines these other two. That could be done fairly quickly depending on the types of applications that we get.

CHAIR HUGGINS asked how long it would take to evaluate just one project if that's all they get.

COMMISSIONER GALVIN replied as long as it meets the "must haves" they wouldn't go much further than that. The commissioners also have an ultimate "out clause" that says even if an application meets the evaluation criteria, the commissioners are not obligated to give them a license - unless they determine that giving it to them is in the state's best interest. He couldn't give him a definite timeframe, but if an application is perfect it could take a week to 10 days. If further valuations are needed, it would take longer.

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COMMISSIONER GALVIN went to the legislative review process described on page 10, line 7. It provides for a 30-day review period in which the legislature can stop the commissioners' decision. No changes are proposed at this time.

CHAIR HUGGINS noted that the legislature has had some recommendations to change its role.

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MS. DAVIS went to Section 43.90.210 on page 11 that relates to the requirements of the licensee to proceed forward when a FERC or RCA certificate has been issued. There are three different requirements. First they have to accept the certificate once it has been achieved. However, criticisms have surfaced around this language because the FERC will frequently attach conditions to a certificate when it's issued and those sometimes may be viewed by the pipeline company as onerous or in appropriate. The conditions can be appealed and the FERC might modify or withdraw those conditions. The commissioners understand that process and they are not trying to force someone to have to take a certificate against their will and give up their legal rights to do whatever they can to get it shaped the way they want it shaped. So, language has been suggested that would qualify the obligation to accept that certificate to the point in time when all rights of appeal relating to the certificate have expired.

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SENATOR WAGONER asked if the companies can book the gas reserves once the certificate from FERC is granted. He asked if the certificate is appealed, does that keep the applicant from booking those reserves.

COMMISSIONER GALVIN replied that he is not familiar with those accounting principles, but he could get an answer. He thought it would depend on whether they have committed their gas to the project and the nature of how that links in the gas being already on a line that is set to go. He went back to the question of how long it would take to evaluate one good application. He said they would go through the public comment period with just that one, so the department could be ready near the close of the 60-day comment period.

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SENATOR STEDMAN asked Ms. Davis to elaborate on (c) of Section 43.90.210 on page 11. His concern is that they are trying to get to first gas without income or sales tax.

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MS. DAVIS explained that there are three areas to Section 210 and the first one is the obligation to accept. The other two, (b) and (c) relate to once a licensee has the certificate, when they are obligated as a company or consortium to sanction the project. "Sanction" has been defined in the bill as "the commitment of \$1 billion in contractual commitments to begin building the pipeline." Subparagraph (b) relates to waiting one year if they have credit support and (c) relates to waiting five years after that point if they do not have credit support.

SENATOR STEDMAN asked her to explain the difference between those two.

COMMISSIONER GALVIN answered that credit support in the context of previous testimony - is no customers, no credit, no pipeline. Their concept of credit support is a combination of customers' credit - if you get to the point of FERC certification, receive it and either you have the credit and financing ready to build the line and can begin or you're still in the process of putting that together - either because you have not had enough transportation commitments through the open seasons thus far or those haven't translated into the financing an applicant was hoping to arrange or some combination of the two.

They are trying to recognize if a party ends up at that place and needs to put together its package to get financing, the state has to provide a reasonable period of time in which to do it. What is a reasonable period of time is subject to debate and if the state wants to stick with the project, it wants to give the party enough time to pull it together. His primary concern with that period of time is to ensure that parties beginning this road with the state feel confident that they have the maximum opportunity to have success at the end. Shrinking that time, although it may be in the state's interest, might take away the comfort an applicant may have that they will have the opportunity to make good and this might end up closing out potential applicants from participating in the process.

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SENATOR STEDMAN said he was concerned that the state's timeframe might get stretched out before first gas and maybe it should consider having a shorter timeframe for the review so it wouldn't be stuck with going through a possible court process and appeal process before being able to get another pipeline in place.

MS. DAVIS replied that she found MidAmerican's testimony yesterday very instructive in understanding how pipeline companies look at their investment and how they require a certain degree of fiscal stability for it. Thinking through that scenario where the state would find itself with a licensee that doesn't have credit support by the time it has a FERC certificate in hand can happen in only two instances. The most obvious one is going to be if the project, notwithstanding their efforts at establishing a good credible project in getting FERC certification, is clearly not economic enough for shippers to want to ship and commit their gas. In that situation, the abandonment provision allows the state an out. If the project is economic, the state wouldn't be in that situation. The licensee would have the commitments and then it has one year to sanction the project. She couldn't really identify where the state would be stuck.

COMMISSIONER GALVIN elaborated that they recognized at the outset that the state has to set the timeline, because it has the imperative to get this project going. The department's slides have shown how the state loses money each time the project slips. Once a party has put its hundreds of millions of dollars into this project, then the state doesn't need to be setting the timeline with artificial motivation any more; the

party's money creates an imperative all its own that is much more pressure than the state could exert.

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CHAIR HUGGINS shared Senator Stedman's concern with the timeframe and said that he has been in the Senate for two and half years - half of this provision; and five years is a long time.

COMMISSIONER GALVIN responded that it's important to recognize that the state isn't saying it wants the company to take five years. If they are at that point in the process, they are not going to want to take more time than they absolutely have to in order to make this project work. The state wants to protect itself from being in a bad situation and so AGIA has those provisions. The department is concerned that creating too short of a timeframe would create a lack of confidence among the parties they are trying to attract to this process.

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CHAIR HUGGINS said the second half of the chill factor is that in that same two and a half years, the state spent a lot of money and it has two and half more years to go to spend a whole bunch more.

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SENATOR WIELECHOWSKI asked for an example of how a licensee would get in the situation of not having sufficient credit support at this time - such that the five-year provision (c) would kick in.

COMMISSIONER GALVIN replied that MidAmerican has stated it believes the project is economic and it will show that it's economic by putting out an offer for someone to commit gas to the project. They assume that they will get the commitments if the market works and the players make rational decisions. But, what if they don't?

SENATOR WIELECHOWSKI asked if (c) kicks in with an unsuccessful open season.

COMMISSIONER GALVIN responded, "If you have an unsuccessful initial open season, then you go to the FERC certificate and your open season at that point is still unsuccessful."

SENATOR WIELECHOWSKI said at that point, you get to the circular argument which is if it's economic, we won't have a failed open

season because rational players in the game would participate and if they don't, that raises all kinds of questions as to why they didn't participate.

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MS. DAVIS added that factors can affect the economics of a project that could be temporal especially with gas prices being volatile, but trending up. The goddess of timing might not smile on this project if the open season happens at a time of low prices. Yet it's fully anticipated that within a year, the excess supply will be sucked up, demand will continue and the pricing will go up. MidAmerican said it had six projects on the shelf waiting the economics to turn around. This tells her they work the projects in advance, anticipate the market, and work close on the margin. When they get to that point, they wait for optimum timing and they spring. Her sense is that they need this flexibility.

SENATOR WIELECHOWSKI asked if the state is forcing someone in paragraph (b) that does have sufficient credit support when the market has a downturn to go ahead with the project. In that case, even though there could be an up-tick, he asked if the state could get out on the abandonment clause.

COMMISSIONER GALVIN answered that the inherent assumption there is to get the credit support you have to show the project is economic. If the market changes to destroy the economics, you risk losing that credit support. The state puts the money in and the project gets that far, so there is the choice at that point of abandoning the project or going forward with it. They would expect a company with credit support and access to the money to begin to build within a year or the state could abandon it.

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SENATOR WIELECHOWSKI asked what they consider the likelihood is that this project that has the stamp of approval of the State of Alaska would not be looked upon as a favorable project by investors.

COMMISSIONER GALVIN said they didn't see it as very likely, but they have to recognize that the state needs to have an out.

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SENATOR MCGUIRE said she thought the provisions work in concert. But she understood that he said if the licensee has the credit support sufficient to finance the construction that would mean by definition that the project was economically viable, but she

didn't think he meant to say that. Economically viable should be a separate analysis. What she thought he meant was if the licensee has the credit support, the state wanted it to move now. If they didn't have it, the state would give them five years to get the project together. She said the ability to determine the project is not economically viable still remains.

COMMISSIONER GALVIN replied that was correct. He may have misspoken.

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SENATOR STEDMAN followed up on Senator Wielechowski's comments that maybe the state will be dealing with a successful applicant that has four or five projects on the shelf. This project is one of the longer ones in duration and the size of the cash flow is unprecedented relative to all other gas projects. He asked if it wouldn't be in the state's interest to have some flexibility in that timeframe to encourage the applicant to develop the state's project rather than one of the other ones on the shelf - so the state doesn't end up taking second or third place internally with the applicant's decision process.

MS. DAVIS replied that what Commissioner Galvin said is very truthful - that the economics of the project and the amount of money that will have been invested by this company, because of its size will probably be one of the largest capital outlays that a company will have of anything on that shelf and that the desire to drive the repayment of those funds in the here and now, not in the distant future, is going to be the strongest and the ultimate driver for how quickly they sanction this project. She would be shocked if there was anything on the shelf that was bigger and making them more exposed than this project.

SENATOR STEDMAN agreed with that.

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SENATOR MCGUIRE said it looks like the new CS (relating to AS 43.90.21 on page 17) is extending the five years a bit and she wanted to understand these words:

For purposes of this section, the effective date of the certificate of public convenience and necessity issued by FERC or the Regulatory Commission of Alaska as applicable is the date when all rights of the appeal relating to the certificate have expired.

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MS. DAVIS replied that this provision is intended to put it on parity with what they did to the first provision on Section (a) which requires the acceptance of a certificate after the final rights of appeal have expired.

Because sections (b) and (c), the one year and five year both kick off of a date certain which in the language right now states is "effective date the certificate of public convenience and necessity issued by FERC or the Regulatory Commission."

So the question is what is the effective date? And in order to insure that was a date certain, we felt it appropriate to this on par with the first section and make the date certain be the date on which all rights of appeal have expired. So that that way, again, it's an opportunity for the applicant to, especially in that short one-year timeframe, they need to make sure that that's the certificate they are going to end up with and finalize before they do a project sanction. So, we wanted to make sure that was a final certificate.

SENATOR MCGUIRE asked what the timelines are for appeal in the FERC process if an applicant qualifies under the one-year (b) and the five-year (c).

COMMISSIONER GALVIN clarified they are not the FERC experts, but said that these provisions are for administrative appeals, not court appeals. The department recognized that it is unusual for a party that is seeking a FERC certificate to be obligated to accept it. So to protect the state's interest in its investment they created a contractual right for the state to acquire the certificate if it were needed. He didn't want to be in a situation where only the licensee could accept the certificate and it didn't want to - but the state did. The licensee should be able to appeal the changes and this acknowledges that the state is not requiring it to take the first certificate that FERC issues; appeals can be exhausted before the clock starts the timelines.

CHAIR HUGGINS said they were not going to vet those provisions now.

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MS. DAVIS went to section 220 on modification of the project plan. This is intent to not allow applicants to over-inflate

what their project can do with the expectation that once they got awarded the project; they could begin to chisel it back such that it ended up being a project that was not as favorable as one of the unsuccessful applications. It's a desire to ensure honesty in the application process. She was also recommending to add in "not only diminish the value of the project to the state, but also the project's likelihood of success" since they are using two prongs to evaluate the project.

CHAIR HUGGINS asked if she anticipated this scenario happening.

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COMMISSIONER GALVIN replied that realistically circumstances occur that people don't expect and they wanted to allow for the commissioners to be able to be responsive to a concern by the licensee with certain restrictions on it such that the state's interests are not affected. He expected that there would be changes to any project of this magnitude, but he wanted to make sure that the chosen project is the one they intend to see through. The value would have to stay the same for the state.

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MS. DAVIS went to section 230 on page 12 that sets up the state's rights to audit the records and reports of a licensee to insure that the license is being complied with and specifically to insure that the funds that are being advanced under the state's matching contribution are being properly expended for their intended purposes. Industry expressed concern that because the term "licensee" is defined as including its affiliates and those affiliates include anything for which that entity holds a 10 percent interest and that this not be used as an opportunity to spring-board into wide scale review of records and audits that really didn't pertain to this project.

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MS. DAVIS said Section 240 relates to the license violations and damages and sets up an informal process by which the state and the licensee can discuss for 90 days and resolve issues or concerns.

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MS. DAVIS said Article 3 is the resource inducement section and provides primary qualification criteria which says that the lessee or some other person demonstrate that they have acquired the firm transportation capacity in the first open season of the licensed project. She is going to recommend changes relating to a lessee versus another person because she has heard from

utility companies throughout the state that they may be in a position to purchase gas on the Slope and they want to be able to get the benefit of these resource inducements even though they are the parties making the capacity commitments and not the resource owner.

MS. DAVIS said Section 310 specifies the royalty inducement and sets up the legislative mandate to the Department of Natural Resources (DNR) to implement by regulation provisions that are going to address minimization of retroactive adjustments establishing a fair mechanism for establishing market value for the gas which uses independent market indices and establishes the terms under which the state can switch between its royalty in kind (RIK) and royalty in value (RIV) in a manner that will not infringe or impair the shipper's commercial contracts.

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COMMISSIONER GALVIN added that they see this provision addresses regulation changes. He wanted to clarify that once the lessee makes the commitment, its lease can be changed to adopt the regulations.

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SENATOR STEDMAN said the RIK/RIV issue is an area that most people agree needs adjustment and asked if the state will review it and set it or can it be worked out with the producers.

COMMISSIONER GALVIN replied that the RIK issue is not a statutory problem; it's the fact that the state's leases are written to give the state the right to switch. It's just a question of whether the state wants to acknowledge that in amending its leases might put a lessee at a commercial disadvantage. They are trying to recognize that is something of value to the lessees in terms of putting it to rest. So it is being offered as an inducement. Whether the state would make a similar change in its leases outside of AGIA is another issue. It is basically changing a contract.

[3:03:51 PM](#)

SENATOR STEDMAN asked if the RIV/RIK issue is focused more on the construction and implementation of an oil basin without a gasline because oil is much easier to switch from RIK to RIV. Swapping back and forth from RIK to RIV can be problematic for delivery of long term gas contracts. He asked for that to be explained a little bit more because it's one of the major upstream issues.

COMMISSIONER GALVIN replied that the issue comes down to what deal the state has struck with the lessee. Like any contract among parties, if one party does something it has a right to, the other party can also take an action it has a right to and then that might cause the first party to lose a lot of money. So parties talk to each other to work out how it will be dealt with.

This issue has not come to fruition between the state and the producers. AGIA offers to work it out a certain way in that the state is giving up significant value and it expects a gas commitment in return. If they don't take it here, it will have to be worked out somewhere else.

SENATOR STEDMAN asked if it isn't more valuable to the state to take its royalty in kind so that gas could be diverted for instate use while waiting for a petrochemical industry to develop.

COMMISSIONER GALVIN replied, "Absolutely." The state wants the ability to meet instate needs one way or the other - cash or product. At this point, AGIA doesn't give up the right to switch and it says if the state chooses to switch, it is going to protect their commercial interest. He reminded them that the state's share of the gas is more than 12.5 percent and no projection indicates that the state will ever be close to using that much instate.

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SENATOR STEVENS asked if he was talking about taking RIK in state only and if there is any value in taking RIK out of state.

COMMISSIONER GALVIN explained that RIK means the state takes possession at the wellhead and chooses where to ship it from there. It could choose to ship it to the end of the line just like oil. The state could choose to save some space on a tanker and keep possession of it all the way down to a refinery and sell it there. It could hire the refinery to refine it and then sell it at a gas station.

However, for oil, it has been found because of the commercial forces at work that the state would probably not get the best price for each section of that chain and certain instate oil needs are not being met currently. They don't know exactly if the gas will face the same commercial forces the oil does, but he assumes that the state would not do better selling the gas itself than through the marketing that the companies can do.

COMMISSIONER GALVIN elaborated that experience has shown that taking royalty in kind does a couple of things. It makes sure the state can take advantage of some inefficiency in the market and to fill an instate need that is not being met.

SENATOR STEVENS said now he understands why it's important for the state to have that flexibility, but he asked if that flexibility won't make it hard for the producers to figure out how much it's going to cost them.

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KEVIN BANKS, Acting Director, Division of Oil and Gas, Department of Natural Resources (DNR), explained that currently most of the state's North Slope leases have provisions for switching to RIK and has to only give the lessees three months notice and can change every month for both oil and gas. If a company has taken capacity on the gasline maybe anticipating it will have RIV to move with their own gas and the state switches - even with a three-month notice, the lessee may not have the ability to accommodate that.

MR. BANKS said the state's leases work in most settings that have a vibrant marketplace. He explained that in a place like Wyoming, a lessee could accommodate a change by buying or selling gas a few counties over, but that is not how it works in Alaska where the market is pretty tight with only a few suppliers, a few lessees, and only one lessor. So the state is offering to accommodate the lessees, by giving them sufficient notice to accommodate their contracts and has also come up with some means for them to manage their reasonable costs if there are any with stranded capacity or lack of capacity as a result of the switch.

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CHAIR HUGGINS asked what is wrong with fixing RIV in statute.

COMMISSIONER GALVIN replied that the state has a right under the leases that have been issued over 30 years to something that probably can't be changed in statute because those are a pre-existing contracts. One would have to ask what the state would get back in return.

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SENATOR STEDMAN asked for a "guesstimate" of potential instate use assuming a 48-inch line.

COMMISSIONER GALVIN replied about a .5 bcf/day is the maximum instate use that has been projected.

SENATOR STEDMAN said maybe that's 10 percent of daily North Slope volume.

COMMISSIONER GALVIN replied a little less than 10 percent.

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MS. DAVIS went to Section 320 on page 16 that contains the gas production tax exemption. The only comment they have heard from folks is to fortify it against legal attacks. So, she recommends a few additional pieces of language that would "fortify that this is a contract embedded in a contract and as such should be protected under constitutional law."

She said that Section 330 is the AGIA coordinator section that calls for that position to be filled by the governor and will serve much like the federal pipeline coordinator but only with respect to coordinating the activities within the state between state agencies and the federal coordinator.

COMMISSIONER GALVIN clarified that the position stays, not the person who is appointed, because the drafting was ambiguous.

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SENATOR STEDMAN said he missed the discussion on Section 43.90.320 on tax stability.

MS. DAVIS said that section provides for a 10-year timeframe for tax stability and it addresses gas production tax solely and the benchmark year is the point in time in which the producer makes a commitment of its gas to the capacity that they arrange in the first initial open season.

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SENATOR STEDMAN asked for her to estimate how many years it would take at different gas prices for the gross value of the gas going through the pipe to equal a capitalized project of \$20 billion to \$30 billion to get a feel of where they will be in 10 years. Quite a bit of testimony from the producers as well as the midstream folks has indicated that 10 years would be short and he thought some points of reference were needed to strike a balance.

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COMMISSIONER GALVIN said the Judiciary Committee chair said he intends to look at this also.

[3:25:31 PM](#)

SENATOR MCGUIRE said she thinks it's important for the state to have the ability to take royalty in kind versus royalty in value particularly looking at the country over 50 years. She would not be comfortable with anything that would change the overall statutes and she thought it was critical that it remain an incentive that's given exclusively to induce this to go forward.

Third, she wanted to be sure about a previous discussion on why the application evaluation criteria which is narrower didn't provide for in-state gas availability. However, the application requirements are broader and talk about the five take-off points and the commitment to making gas available to the state, etc. She started thinking about making sure there is gas for Alaskans. So, she wanted to know why the application evaluation criteria are narrower than the application requirements.

MS. DAVIS replied the before they get to point of applying the application evaluation criteria, the commissioners first evaluate the applications to make sure they contain all of the must-have provisions. So it would not get to first base with the state unless it has satisfied the requirement that it have the off-take points for instate use.

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MS. DAVIS went to Section 340 on page 17 that mandates the requirement for all state agencies to expedite their review of projects. It allows the pipeline coordinator to step in and apply only the strict requirements of law to the project so it is not unnecessarily delayed. The pipeline coordinator uses this as the hammer to insure that agencies are moving in an expedited fashion, but still be within the confines of the law.

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CHAIR HUGGINS asked them to ponder this question during a break. Say the state gets a bid under AGIA and another from a company that says it's going to build the pipeline independently. He asked if the federal coordinator works with one or both.

[3:28:59 PM](#) recess [3:44:52 PM](#)

MS. DAVIS explained that the AGIA project doesn't preclude a parallel or collateral pipeline project and the federal pipeline

coordinator is free to help both projects or any project that fits within the criteria of the Alaska Natural Gas Policy Act.

CHAIR HUGGINS asked if AGIA modeled that position after the Act.

MS. DAVIS replied that those provisions were pulled from that Act, but this bill designs it as an additional inducement for participants to apply to the AGIA process. As written now, it has the pipeline coordinator and the expedited agency provisions applying to the licensed project only.

CHAIR HUGGINS said it is important to the state to consider viable or even superior pipelines and that the pipeline coordinator's office could hire a couple of people to help doing that.

MS. DAVIS agreed.

[3:47:11 PM](#)

MARTY RUTHERFORD, Acting Commissioner, Department of Natural Resources (DNR) said everything that has been said is accurate. She looked further at the Title 38.04.020 (b) (9) provision, which is an existing statute that allows the DNR to lead and coordinate all matters relating to the state's review and authorization of resource development projects, to determine when it has acted as a coordination streamlining process on projects other than large mines. One was the Anchorage fuel line from the Port of Anchorage to the airport; another was the Bullen Point Road and right-of-way, which is basically from TAPS towards Pt. Thomson; and two oil and gas projects - Liberty and Alpine. Liberty is an offshore drilling facility and Alpine was three or four drill sites and the associated roads. Currently it is coordinating the Knik Arm Bridge and Toll Authority project and the northern rail extension project spur line from Fairbanks to Delta. These sometimes are full-fledged teams and use this authority regularly to exercise something very similar to what is embedded here. That is why they proposed this to be a distinct inducement for AGIA.

CHAIR HUGGINS asked if it is good enough for one project; why not adopt it for AGIA.

COMMISSIONER GALVIN responded that the primary difference in their views is the linkage between the expedited review and agency actions and the coordinator position. Those two go hand in hand in AGIA to provide for the streamlined process. The expedited review provisions don't apply to a project that comes

under the reference that Ms. Rutherford eluded to that just deal with coordination and hiring a project lead. The other concern is making it clear that AGIA is designed to get a project to come forward and meet the state's must haves. It would be a mixed message to offer alternatives.

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CHAIR HUGGINS commented that his point is that the average Alaskan would appreciate if they were the competitor and they really had a robust agile potentially revenue superior project, that the department could evaluate it.

MS. DAVIS went to the next section that makes it clear that the pipeline employment development program is freestanding and available at large. ConocoPhillips said it would be hard to say they were developing jobs and employment programs only for the licensed project and those people couldn't be used for other projects.

MS. DAVIS went to Article 4, miscellaneous provisions. Section 400 deals with the mechanical act of setting up the matching contribution fund within the Department of Revenue and how that would be established and audited. She said Section 410 section deals with the authority to issue regulations by both commissioners. Section 420 deals with statute of limitations; section 430 addresses interest rates.

3:54:36 PM

CHAIR HUGGINS went back to the regulations of concern to the producers and asked if those had been resolved to most people's satisfaction.

COMMISSIONER GALVIN replied yes. The concern about the regulations was linked to the royalty provision that appeared to allow the state to change its terms every couple of years. The CS addressed that by locking it in when the lessee accepts that term.

MS. RUTHERFORD added that the locking in process happens through a lease amendment.

3:55:48 PM

MS. DAVIS said Section 440 deals with license project assurances and target only the royalty, the tax or the monetary treatment as being elements that could give rise to the 300 percent damages for lending that type of support to a competing natural gas pipeline project.

COMMISSIONER GALVIN stressed that they wanted to clarify how long the assurance is in place by adding language that it terminates whenever gas is flowing. So the state would be free to go after other projects once gas is flowing on the first project.

[3:56:35 PM](#)

MS. DAVIS said section 450 deals with assignments of the license issued under AGIA and separately the assignment of the right to receive the royalty inducements.

COMMISSIONER GALVIN added that Chair Huggins heard a detailed discussion of the process of assigning a FERC certificate and that first it has to be abandoned and then have somebody else apply for it. Abandonment was captured in the sections that deal with the transfer of the FERC certificate. The FERC folks have said the process was described properly.

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CHAIR HUGGINS asked if the issue of brokering a certificate was resolved.

COMMISSIONER GALVIN replied that FERC requires abandonment before a certificate could be transferred to someone else, because the commission didn't want to have people brokering them. A side deal would be frowned upon.

SENATOR STEVENS commented that this would be a very lengthy and serious matter.

MS. DAVIS replied absolutely. That is the reason for a second criterion that insures that a transfer would not increase or decrease the obligations created by the licensee or diminish the value of the license to the state. It is a technical assignment as opposed to a full scale one such as what would happen in an asset sale or a bankruptcy.

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SENATOR STEVENS asked what the options are if transfer of ownership has occurred.

COMMISSIONER GALVIN replied if the state denies a company's ability to assign and it goes ahead and does it anyhow, it is in the violation provision. He said the state's primary interest is not where another company gobbles up the licensee, but over the issue of alignment with the various parties. What was most

clearly presented by the MidAmerican is that an economic project is often what drives alignment. He anticipates that as this project moves forward, it will draw interest. Most pipelines end up with a large number of third parties to share the risk associated with it and he anticipates that even if only one applicant comes in for the AGIA license, further down the road there would be more than just that one involved. The assignment allows for that to take place through the incremental addition of the different players.

[4:02:14 PM](#)

MS. DAVIS said Section 460 relates to conflicting laws and is essentially boiler plate. At the end of this section, she will be recommending a provision that deals with severability because several legislators were concerned if one provision was found unconstitutional that wouldn't cause the whole bill to fail. The structure of AGIA places the risk of unconstitutionality on the applicant. A severability clause establishes that very clearly.

She said that Article 5 contains the definitions and she is recommending two changes. A legislative attorney pointed out that the word "controlling" isn't used so that was deleted and a definition for North Slope was added that comes out of the tax regulations.

[4:03:17 PM](#)

MS. DAVIS added that the definition of sanction was changed also because one of the producers was concerned that the use of the word "procurement" was somewhat limiting. Their FERC certificate might have a requirement for them to hire environmental reviews and other things that might not be strictly procurement like buying a pipe or materials. So the commissioners are suggesting using "financial commitment", which doesn't change the tenor of the contract.

MS. DAVIS said Section 2 continues the extraction of this process from the procurement code for purposes of entering into contracts. It also specifies a three-party panel through the American Arbitration Association for the impartial arbitration panel. "And that's the bill."

CHAIR HUGGINS asked what the timings for the \$500 million are.

[4:05:17 PM](#)

MS. DAVIS replied that the logistics are under Section 400 on page 17 of the original bill.

COMMISSIONER GALVIN said that the fiscal note had the \$500 million depending on what kind of proposals come in. But they don't know what ultimately the applicant would draw. A \$300 million appropriation in last year's budget put money into the Alaska Housing Finance Corporation for purposes of the gasline and if that slid over to AGIA it would hold the state for a number of years until it knows what they are looking at. The rest could be addressed later once they know what the obligation is.

CHAIR HUGGINS said they are probably not talking about using the entire \$300 million at once.

COMMISSIONER GALVIN replied they have estimated maximum state participation for getting to an open season would be 50 percent and that would indicate a low of \$50 million and ConocoPhillips said \$400 million. So, that could work out to \$200 million over the next four years on the high side.

CHAIR HUGGINS asked if there were any other concerns.

[4:07:56 PM](#)

COMMISSIONER GALVIN said he had one that wasn't in the bill, but the project labor agreement needs to be addressed in the CS and he wanted a commitment from the applicant to negotiate a project labor agreement as part of their obligations under the AGIA license.

CHAIR HUGGINS said that most members are anticipating that, but it's just a matter of timing and the sooner the better within reason.

COMMISSIONER GALVIN said he has provided language for the CS.

CHAIR HUGGINS said the committee will meet at noon tomorrow and start the amendment process. There being no further business to come before the committee, he adjourned the meeting at [4:12:20 PM](#).