

SENATE FINANCE COMMITTEE

April 7, 2013

2:05 p.m.

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CALL TO ORDER

Co-Chair Meyer called the Senate Finance Committee meeting to order at 2:05 p.m.

MEMBERS PRESENT

Senator Pete Kelly, Co-Chair  
Senator Kevin Meyer, Co-Chair  
Senator Anna Fairclough, Vice-Chair  
Senator Click Bishop  
Senator Mike Dunleavy  
Senator Lyman Hoffman  
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Daniel R. Fauske, Chief Executive Officer and Executive Director, Alaska Housing Finance Corporation, Department of Revenue and President, Alaska Gasline Development Corporation; Frank Richards, Manager, Pipeline Engineering, Alaska Gasline Development Corporation; Rena Delbridge, Staff, Representative Mike Hawker; Joe Dubler, Vice President and Chief Financial Officer, Alaska Gasline Development Corporation and Director of Finance, Alaska Housing Finance Corporation, Department of Revenue; Daryl Kleppin, Commercial Manager, Alaska Gasline Development Corporation.

PRESENT VIA TELECONFERENCE

Ken Vassar, General Counsel, Alaska Gasline Development Corporation, Anchorage.

SUMMARY

CS SS HB 4(FIN)

ALASKA GASLINE DEVELOPMENT CORP; RCA

CS SS HB 4(FIN) was HEARD and HELD in committee for further consideration.

#hb4

CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 4(FIN)

"An Act relating to the Alaska Gasline Development Corporation; establishing the Alaska Gasline Development Corporation as an independent public corporation of the state; establishing and relating to the in-state natural gas pipeline fund; making certain information provided to or by the Alaska Gasline Development Corporation and its subsidiaries exempt from inspection as a public record; relating to the Joint In-State Gasline Development Team; relating to the Alaska Housing Finance Corporation; relating to judicial review of a right-of-way lease or an action or decision related to the development or construction of an oil or gas pipeline on state land; relating to the lease of a right-of-way for a gas pipeline transportation corridor, including a corridor for a natural gas pipeline that is a contract carrier; relating to the cost of natural resources, permits, and leases provided to the Alaska Gasline Development Corporation; relating to procurement by the Alaska Gasline Development Corporation; relating to the review by the Regulatory Commission of Alaska of natural gas transportation contracts; relating to the regulation by the Regulatory Commission of Alaska of an in-state natural gas pipeline project developed by the Alaska Gasline Development Corporation; relating to the regulation by the Regulatory Commission of Alaska of an in-state natural gas pipeline that provides transportation by contract carriage; repealing the statutes relating to the Alaska Natural Gas Development Authority and making conforming changes; exempting property of a project developed by the Alaska Gasline Development Corporation from property taxes before the commencement of commercial operations; and providing for an effective date."

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DANIEL R. FAUSKE, CHIEF EXECUTIVE OFFICER AND EXECUTIVE DIRECTOR, ALASKA HOUSING FINANCE CORPORATION, DEPARTMENT OF REVENUE AND PRESIDENT, ALASKA GASLINE DEVELOPMENT CORPORATION, introduced himself.

Co-Chair Meyer noted that Senator Bishop had joined the committee.

FRANK RICHARDS, MANAGER, PIPELINE ENGINEERING, ALASKA GASLINE DEVELOPMENT CORPORATION, observed that in addition to the upcoming PowerPoint presentation, committee members had been provided with a project plan update that specified how the Alaska Gasline Development Corporation (AGDC) had moved forward with and made optimizing changes to the project. He discussed the PowerPoint presentation, "ASAP Scope, Schedule and Budget" (copy on file).

Mr. Richards looked at slide 2, "ASAP Project Scope."

- Mainline
  - 36" diameter pipe
  - 737 miles long
  - 1,480 psi max operating pressure
- Fairbanks Lateral
  - 12" diameter pipe
  - 35 miles long
  - Tie-in w/mainline at MP 458
- North Slope Gas Conditioning Facility (GCF) at Prudhoe Bay
- More off-takes possible

Mr. Richards stated that the Alaska Stand Alone Pipeline (ASAP) project had originally been given to the Alaska Housing Finance Corporation (AHFC) under HB 369 and offered that the project's purpose had been to deliver gas to Alaskans at the lowest possible cost and at the earliest possible date. He explained that as a result of a project plan amendment at the end of 2012, ASAP had shifted from the original plan to what was referred to as the "optimized" plan. He discussed slide 2's second bullet point and stated that it would deliver utility grade gas into a "college gate"; from this point, the gas could be put into a distribution system that would "hopefully" be

built out in order to provide gas to the Fairbanks and North Pole areas. He spoke to the slide's third bullet point and stated that the gas conditioning facility (GCF) was a major component of the project through which gas would be provided by the producers and impurities would be removed. He relayed that the GCF would deliver a gas composition of methane with a small amount of propane. He explained that a major compression station would be added to the GCF. He shared that as a result of the optimized plan, the intermediate compressor stations had been removed and elaborated that there would only be one compressor station on the North Slope; the major compressor would push the gas at 1480 pressure per square inch (psi) with a pressure drop of approximately 500 psi. He expounded that the utility contract amount would be about 950 psi. He spoke to the slide's fourth bullet point and shared that the optimized plan also enabled take-off points along the line. The take-off points would allow communities, industrial users, etc. to tap into utility grade gas at a fairly low cost; the original plan would have required a more expensive facility that would have caused the price of the gas to be higher coming into Fairbanks than it would have been in Anchorage and South Central Alaska.

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Mr. Richards discussed slide 3, "Scale of Construction Activities."

- Considerable construction workforce
  - Over 8,000 direct jobs
  - Over 15,000 indirect jobs
- 335,000 tons of steel for the pipeline
- 9,000 truckloads of pipe travelling 4 million miles
- 10 million cubic yards of earthwork
- 15 construction camps

Mr. Richards spoke slide 3 and related that ASAP would be a multi-year project that would employ a large number of Alaskans.

Mr. Richards highlighted slide 4, "ASAP Project Schedule & Highlights." He related that the top portion of the slide's chart represented the schedule that was given to AHFC as mandated by HB 369 and pointed out that it had the first gas flowing in 2015. He offered that HB 369's schedule was extremely aggressive. He stated that AHFC had done its due diligence work, provided a project plan, and developed the optimized schedule that was represented on the bottom part of the chart and showed a gated or front-end loaded (FEL) approach. He discussed the chart on the bottom of the slide and pointed out that the FEL Phase 1 work had been conducted prior to the July 2011 project plan. He stated that the current work was in FEL Phase 2 and was progressing towards an open season. He shared that AHFC had completed a final environmental impact statement (EIS) and had received an unconditional 604 miles of state right-of-way. He added that AHFC was currently awaiting a decision by the Bureau of Land Management (BLM), which would lead to the next 100 miles of federal right-of-way. He mentioned that AHFC was working on the major federal and state permits that were required for the next phase of the project. He pointed out that the FEL Phase 2 would terminate during the end of 2014 to the beginning of 2015 when the open season began. He explained that during the open season, the cost of transporting the gas would be determined and delivered to potential shippers and buyers; at this time, the economics would "come into play" and the market would dictate whether or not ASAP was a viable project. He stated that with a successful open season, ASAP would enter into FEL Phase 3, otherwise known as the bridge engineering phase; during this phase, desired design changes by the shippers or buyers could be addressed. He explained that the class 3 estimate would be a more defined estimate that consisted of approximately 30 percent engineering; at this point, a decision would be made on whether to move forward with the project. He discussed the chart's timeline for procurement, construction, and culmination of the project.

Mr. Richards discussed slide 5, "Stage Gate Approach." He related that each of the slide's individual gates had a decision point at the end that allowed the project to be refined to the next stage. He stated that the timelines were depicted on the bottom of the trumpet curve.

Mr. Richards displayed slide 6, "Stage Gate Approach."

- Forces logical planning sequence
- Requires deliverables to be complete before starting new tasks
- More effective, timely process with issue identification and an evaluation framework early in the process—avoids cycles back-to-start-of-project causing delays and added costs
- Provides clear opportunities to stop project at gates if not meeting business objectives
- Improves communication with stakeholders
- Provides a clear path for project team

Mr. Richards addressed slide 6's first bullet point and related that it represented a logical sequence that had successfully been used by all kinds of mega projects; furthermore, it allowed the decision makers, financial markets, and engineering to have definitive opportunities to evaluate the economics and make a decision on whether to proceed at the gates.

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Mr. Richards discussed slide 7, "ASAP Budget."

- Cost to Alaskans: \$400M up-front budget (~5 percent of Total)
- Cost Benefit: Long term natural gas supply for Alaskans
- Project Cost: \$7.7 Billion\* in 2012 dollars, +/- 30 percent

Mr. Richards addressed slide 7's first bullet point and reported that the state would usually pay for 15 percent of the design efforts and 15 percent of the construction management. He concluded that the state would normally fund 30 percent of the total project costs. He spoke to the slide's second bullet point and pointed out that the project would provide in-state use for consumers and industry, but also would hopefully provide more economic

opportunities for Alaskans in the future. He discussed the shaded blue table on the bottom of the slide and indicated that the components of the project were the GCF, which would cost approximately \$2.8 billion and the pipeline section from the GCF to Dunbar. He explained that Dunbar was an Alaska Railroad site west of Fairbanks and was where the lateral into Fairbanks would be started; the lateral was expected to cost \$70 million. He furthered that the pipeline would also proceed south from Dunbar to Big Lake and would cost an additional \$1.8 billion. He addressed the red colored text on the bottom of the slide and related that it depicted that an inflation rate of 2.5 percent equaled about \$210 million of additional costs for every year of delay. He offered that the inflation would represent a considerable sum of money that would be borne by the consumers of the gas.

Mr. Richards spoke to slide 8, "ASAP Cost to Consumers."

Cost of Gas To Consumers (burner tip)

Anchorage

- Optimized \$9 to \$11.25/MMBtu in 2012 dollars
- Base case \$9.63/MMBtu in 2011 dollars

Fairbanks

- Optimized \$8.25 to \$10/MMBtu in 2012
- Base Case \$10.45/MMBtu in 2011 dollars

Mr. Richards discussed slide 8 and relayed that the reduction in Fairbanks was due to the elimination of the straddle plant. He concluded that the consumers in Fairbanks would be playing less than those in Anchorage because they would be closer to the source.

Mr. Richards highlighted slide 9, "AGDC Budget to Project Sanction." He related that the total state appropriations to the project had been \$72 million, which left approximately \$328 million needed to advance to project sanction. He offered that the slide depicted the major engineering functions that would be needed over the next 2 years in order to advance the project and refine the cost levels to industry standards. He discussed the slide's

facilities engineering component and related that it would have the highest cost because it had received the least amount of effort. He explained that AGDC had conducted environmental and pipeline work, but had only done very preliminary engineering work. He pointed out that a facility that had a cost of over \$2 billion would require a significant amount of engineering in order to advance to the level of detail that would meet the open season requirements. He addressed the slide's pipeline engineering component and explained that AHFC would be looking at the route, composition, and hazards associated with it. He discussed frost heaving issues with a potential pipeline. He spoke to the program management component and explained that rather than creating an organization within AGDC to operate the project, an outside consulting team would be brought in for project management. He discussed other industries and projects in which outside consultants were brought in for project management and relayed that it was a common and successful practice. He explained the merits of project management and briefly discussed the slide's other components.

Mr. Richards displayed slide 10, "Funding Required to Advance."

- Achieving legislative objectives to advance an in-state natural gas pipeline for Alaskans is contingent on legislative funding
- Full funding will keep project on schedule
  - Advance facilities and pipeline engineering
  - Regulatory permitting activities and agency engagement
  - Engineering field investigations
- Partial funding will cause schedule delays
  - Limited pipeline and facilities engineering
  - Limited field investigation

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Senator Bishop directed the presentation back to slide 2 and queried the shortest distance from the pipeline to Minto, Alaska. Mr. Richards agreed to provide the requested information.

Senator Bishop inquired which technical experts in the areas pipeline and facilities engineering were used to determine the project's calculations. Mr. Richards replied that AGDC had recently consummated a contract with a joint partnership, Arctic Solutions, which was a joint venture of Fluor and WorleyParsons. He explained that Fluor and WorleyParsons were two preeminent process engineering companies that had conducted a lot of work in the Arctic; the two companies had experience with large projects, Arctic conditions, and in particular, Prudhoe Bay. He added that Fluor and WorleyParsons had been working in Prudhoe Bay since the beginning of the oil and gas industry there.

Co-Chair Meyer inquired if Mr. Fauske had a comment to add to the record. Mr. Fauske wondered if Senator Bishop was interested in the firms that AGDC currently used to gather data.

Senator Bishop thought that H.C. Price might have been contracted for the "cross country" numbers. Mr. Richards responded that Senator Bishop was correct. He elaborated that Michael Baker, which was AGDC's primary pipeline-engineering company, had used H.C. Price for some of the cost estimating work.

Senator Bishop queried if AGDC's construction schedule spanned the winter, summer, or a combination thereof. Mr. Richards responded that the work would be conducted via a combination of summer and winter work. He explained that AGDC wanted to keep the ground frozen in the areas of permafrost and discussed the challenges of winter work along areas of wet ground.

Vice-Chair Fairclough inquired if HB 4 had been formulated in response to a recommendation by ASAP's advisory board. Mr. Richards replied that ASAP was the project that was in the inception of HB 369, which had given the responsibility to AHFC to deliver a project plan in July 1, 2011. He explained that the project plan provided the concepts, suggestions, recommendations, and in particular, the legislation that was necessary to move forward. He discussed HB 9 from the previous year, which had evolved into the current bill before the committee.

Mr. Fauske interjected that AGDC was a subsidiary of AHFC and that ASAP was the project name. He apologized for any confusion regarding the acronyms and explained that the

project's current governing board was AHFC's board of directors.

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Vice-Chair Fairclough inquired if HB 4 was consistent with the recommendations made to move ASAP forward. Mr. Fauske replied in the affirmative.

Vice-Chair Fairclough further inquired if there was anything in HB 4 that was inconsistent with the direction that AGDC had recommended for moving ASAP forward. Mr. Fauske responded that although AGDC was in support of the changes, he wanted to make people aware of the 6 month shift to the project's schedule that had arisen through discussions in the House. He explained that the original tariffs were based on a 30-day review model and that he wanted people to be aware of the change to the schedule. He added that he was not condemning or opposing the schedule change, but that he wanted people to be aware of it because it was the one significant change from the recommendations. He expounded that the recommendations regarding the Regulatory Commission of Alaska (RCA) and other fine tuning of the bill represented a good, thorough review. He explained that normally the RCA reviewed projects from scratch; however, in the case of ASAP, most of that work would already have been completed. He stated that although the period of review was extensive, AGDC was confident that supplying good and accurate data would enable the RCA to conduct a timely review. He discussed the large scope of the project and the effects of delays.

Vice-Chair Fairclough surmised that an amendment had been added to HB 4 that created a 30-day RCA review. She requested further explanation of the amendment, as well as the changes it enacted. Co-Chair Meyer interjected that he had heard the review would be a 90-day period and requested further explanation. Mr. Fauske deferred the question to Rena Delbridge.

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Vice-Chair Fairclough requested an explanation of the amendment to HB 4, as well as why the House made the change.

RENA DELBRIDGE, STAFF, REPRESENTATIVE MIKE HAWKER, explained that that the amendment would add a suspension period timeline of 90 days to the review of the initial recourse tariff. She expounded that in the version of HB 4 that had passed the House Resources Committee, there had been a 30-day timeline for the RCA to review the initial recourse tariff. She explained that the review would cover whether or not the cost-based rate had an appropriate capital structure, rate of return, the depreciation method, as well as whether or not the terms and conditions were unduly discriminatory. She recalled that during the time that HB 4 was between the House Resources and House Finance Committees, the sponsor had taken the bill to the RCA for a public hearing in Anchorage; the hearing was for discussion and soliciting input from the RCA regarding timelines, clarity, and whether the legislation provided the tools it needed fulfill its charged tasks. She related that she would be happy to provide the committee with a transcript of the public hearing, but stressed that the RCA had been clear that the 30-day review for the initial recourse tariff was too short a period for it to fulfill its charges; as a result, the sponsors had recommended changing the 30-day period to a 90-day one. She stated that the House Finance Committee had added the 90-day period to the bill; by recommendation of the administration, the committee also added an additional 90-day, optional suspension period. She explained that if the RCA found that, in the review of the initial recourse tariff, it needed to conduct further investigation, it would be able to add the additional 90-day period on.

Ms. Delbridge continued to respond to Vice-Chair Fairclough's question and related that the sponsor understood the RCA's desire to have adequate time. She expressed a concern that the uncertainty of the additional time might create some problems. She stated that ASAP would be waiting for a decision in order to hold its open season and conduct commercial activities and pointed out that currently, the pipeline would be waiting the 90-day initial review period; furthermore, at the end of period, the RCA may decide to extend the process by an additional 90 days. She stated that although potential delays would add costs to the project, the sponsor also wanted the RCA to have adequate time and tools to conduct its review.

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Vice-Chair Fairclough recalled that at least two RCA decisions had cost Anchorage possible opportunities at a secured supply of natural gas. She queried if "the same change" was made the bill that had been made to the RCA and if the RCA would not only be required to consider costs in its decision, but also the consequences of not approving a contract. Ms. Delbridge surmised that Vice-Chair Fairclough was referencing a provision in the Cook Inlet Recovery Act, which essentially gave the RCA the statutory authority to add to their decision making process the concept that there might be consequences of failing to approve a contract that was before them, beyond the immediate prices or rates involved in the contract. She related that there was a reference to the Cook Inlet Recovery Act within HB 4 that pertained directly to the RCA's consideration of contracts between affiliated parties that underwent the heightened review; this might come into play in an instance in which a large anchor tenant had negotiated a better rate because of its large volume and great exposure to risk. She explained that the RCA would now be required to consider the consequences of failing to approve the contract in its deeper review of the aforementioned anchor tenant; however, a provision for contracts pertaining directly to public utilities was not specifically included in HB 4 because the RCA had a different standard for a contract carrier pipeline than the rate review process that was in a typical public utility regulation. She observed that in "this case" there was the initial recourse tariff and an RCA approved cost-based rate as the backstop and that if there was a different rate in the contract between a carrier and utility, it would likely be less than the cost-based rate; in this situation the utility would be presumed to be negotiating a better deal for its rate payers.

Co-Chair Meyer inquired if the request to change the review period from 30 days to 90 days came from the RCA, the attorney general, the Department of Law, or all of the above. Ms. Delbridge replied that the request had been made by the RCA in a public hearing on the legislation. She added that the bill's sponsor had sent her to anchorage to appear before the RCA for the public hearing; furthermore, the RCA had made 3 other recommendations at the hearing that had been addressed and enacted in the House Finance Committee.

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Co-Chair Meyer expressed concern that extending the review period to 90 days might encourage people to use the whole 90 days. He recalled a recent bill in committee regarding a possible Liquid Natural Gas (LNG) route. He referenced slide 8 and its cost per million British thermal units (MMBTu) figures and inquired if HB 4 would result in lower costs per BTU than the LNG bill proposed. Ms. Delbridge replied that she did not recall specifically what the LNG costs would be, but believed that they were \$15-\$19 per MMBTu. She added that she did not recall with certainty what the components of the LNG trucking were. She stated that AGDC's estimate had an assumption of \$2 gas per MMBTu, as well as \$2 in local distribution charges. She explained that slide 8 depicted the tariff to the burner tip and that if the \$2 per MMBTu and the \$2 in distribution charges were subtracted, the actual pipeline tariff to the city gate could be determined.

Co-Chair Meyer noted that Ms. Delbridge was very knowledgeable on the bill's subject matter.

Senator Bishop recalled that the last LNG trucking estimate to the burner tip in Fairbanks was \$13.90-\$15 per MMBTu.

Senator Dunleavy wondered how the diameter of the HB 4's pipeline had been decided upon. Mr. Fauske deferred the question Frank Richards.

Mr. Richards replied that the design premise was based on limitations placed by the Alaska Gasline Inducement Act (AGIA) statute, which specified a maximum flow rate of 500 million cubic feet (Mcf) per day; based on the limit and expressed interest, the legislation's pipeline was designed to flow rate of 500 Mcf per day. He stated that there was tradeoff between pipeline diameter, strength, and compression and that AGDC had examined various options from a 24 inch, a 32 inch, and a 36 inch pipe in order to determine the lowest cost for pipe diameter and compression. He stated that a sole compressor station married to a 36 inch diameter pipe had been determined to be the lowest cost diameter pipe at a flow rate of 500 Mcf per day.

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Senator Dunleavy inquired if the AGIA agreement was a driver behind some aspect of ASAP. Mr. Richards replied

that AGIA dictated the maximum flow rate of 500 Mcf per day.

Mr. Fauske noted that the pipeline would be capable of flowing more than 500 Mcf per day, which was not depicted on the slides because AGDC did not want to indicate that it was designing something to exceed the 500 Mcf per day limitation.

Mr. Richards interjected that at 1480 psi and the 1 compressor station, the pipeline would flow 500 Mcf per day.

Senator Dunleavy queried if the assumption was that the AGIA agreement would be in place for some time, given that a pipeline was being based "to some extent" on limitations of the agreement. Mr. Richards responded that because the AGIA licensee was working with the state administration on moving forward with a project and because the AGIA statute was still in place, AGDC was required to comply with the AGIA limitations.

Senator Dunleavy inquired if it would be possible to have a 48 inch pipeline that only delivered the amount of gas just under the AGIA limit. Mr. Richards replied that theoretically, AGDC could use a 48 inch pipeline, but that it would have additional costs associated with it that would have to be borne by the state. He surmised that the RCA would not want to put additional costs on Alaskan rate payers.

Senator Dunleavy inquired why HB 4's route was chosen as opposed to another route. Mr. Richards responded that the route was given to AGDC by its predecessors on the project. He explained that the ENSTAR Natural Gas Company had originated the concept for ASAP, which in turn had handed the project off to the governor's office and the Department of Natural Resources (DNR). He continued to explain that when HB 369 had passed into law, AHFC and its subsidiary, AGDC, were given ASAP.

Senator Dunleavy queried if ASAP was designed for the purpose of delivering gas in state and not for exporting. Mr. Richards responded that the concept of ASAP was to deliver gas for Alaskans needs, which included consumers and industries. He pointed out that the in-state use of natural gas was approximately 240 Mcf per day, which left a

capacity of about 260 Mcf per day that could be consumed by other large industrial uses; these large industrial uses could include mining developments, export facilities, or reestablishing a fertilizer facility.

Senator Dunleavy inquired if the pipeline could theoretically be geared for export as the project neared the build phase. Mr. Richards responded that the "proof in the pudding" would be when ASAP went to an open season.

Senator Dunleavy inquired if the pipeline was designed so that if things changed with AGIA, it could also be used for exports in order to generate revenue for the state. Mr. Richards replied that the open season would reveal who was interested in shipping and buying gas and would represent a decision point to see if there would be additional accommodation required.

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Mr. Fauske interjected that AGDC had held an expression of interest in July of 2011, which was a non-binding, confidential hearing in which firms and other interests in the project attended; AGDC had signed documents that it would not divulge who was at the meeting. He noted that AGDC knew that there was approximately a 240 Mcf to 260 Mcf per day use in Alaska and that at the end of the hearing, there was more than 500 Mcf per day in non-binding agreements; in other words, there was an "absolute" stated interest by commercial or industrial users for the gas. He observed that AGDC viewed the commercial interest in the gas very positively because it indicated that even at a smaller scale, there was an opportunity. He noted that if ASAP could fill the 500 Mcf per day limit, it would drive the tariffs down for everyone.

Mr. Fauske recalled working on AGIA a number of years back and noted that the original plan had been to ship 4 billion cubic feet (Bfc) or 5 Bfc of gas per day down through Canada; the plan had since been restructured. He pointed out that when the route for ASAP had been handed to AGDC, HB 369 specified that gas would be brought to Alaskans at the lowest possible costs; although there had already been a route established, AGDC had conducted analysis that revealed that the current route satisfied the language in HB 369. He acknowledged that there had been questions regarding why the pipeline would not go to Valdez. He

explained that Valdez was another 110 miles and that at a cost of \$5 million per mile the lowest possible cost calculation would be quickly exceeded. Secondly, the line did not extend to Valdez because at the time, AGIA was already proposing to export 3.5 Bcf of gas per day out of Valdez. He concluded that beyond the distance and the mandates of HB 369, AGIA's significant export plans in Valdez discouraged the line being extended to the city. He observed that ASAP was looking for what was referred to as an "anchor tenant" that would take care of Alaskans and hopefully expand abilities and capacity in some of the state's rural areas; the project would be selling the excess gas that was not needed on an immediate basis. He stated that ASAP's pipeline could be used for exports if that was what one of the customers wanted to do with the gas.

Mr. Fauske observed that there had been concerns raised that the ASAP pipeline would not transport liquids and stated that the original 24 inch line was design to run at maximum pressure to sustain the liquids at a state where they could be transported down the line. He explained that the straddle plants that were mentioned earlier in the meeting had a cost \$250 million each and were where all the liquids were pulled out of the line; after the liquids were removed, utility grade gas, or methane, was left over. He stated that the advancement of the shale oil market in the Lower-48 had changed the industry drastically and that AGDC was not opposed to a liquids market; however, the liquids market was extremely difficult currently due to the "feedstock" or abundance of gas. He shared that AGDC had conducted a study on LNG, Natural Gas Liquids (NGL) [NGLs are the liquids that Mr. Fauske is referring to for industrial use.], and Gas to Liquids (GTL) and that the analysis had revealed that LNG was the most likely candidate for marketing; he surmised that AGDC had been proven correct in its analysis. He concluded that AGDC had left itself the option of entertaining activities like NGLs at the open season if there was stated interest. He noted that there were a lot of good ideas out there and that it be ideal if there was 3.5 Bfc to 4 Bcf of gas for export sales. He offered that if the "big line" was successful, it would be a wonderful day for state; however, oil filled the treasury, while gas should supply for the security of its residents. He stated if Alaska could sell enough gas to add to treasury, it would be a wonderful thing, but indicated

that it was difficult to move forward in all those directions.

Mr. Fauske observed that oil and gas represented a world-market driven enterprise that involved large numbers. He referenced a letter released by an alignment of North Slope producers and applauded Governor Sean Parnell for setting benchmarks. He discussed the producers' schedule to have a 42 inch pipeline that would flow up to 3 Bcf per day by the year 2025 or 2026. He stated the urgency of getting gas to Alaska's residents.

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Co-Chair Meyer wondered if the governor's proposal for the big line would follow the same route as ASAP. Mr. Richards thought that the big line, which was currently known as the South-Central Liquefied Natural Gas (SCLNG) Project, would share a route with ASAP from Prudhoe Bay to Livengood. He indicated that the route from Livengood would depend on where the destination point was for the LNG facility. If the SCLNG Project's LNG facility was in Prince William Sound, the route would veer off with the Trans-Alaska Pipeline System (TAPS); however, if the facility was in the Cook Inlet Basin, the route might be parallel to that of ASAP's across Minto Flats.

Co-Chair Meyer wanted to make sure that the money being spent on ASAP wouldn't be wasted if the state opted for the bigger line. Mr. Fauske observed that AGDC had been concentrating its work on the route from Livengood and south. He stated that AGDC had promised the legislature that it would not duplicate other work being done with the idea in mind that the two projects might be aligned one day. He offered that if the SCLNG Project line went through, the work that AGDC had conducted would not be wasted and could be utilized.

Co-Chair Meyer inquired if the military was part of AGDC's due diligence work regarding potential in-state needs for gas. Mr. Fauske replied that AGDC had based the Fairbanks model on absolute military use. He added that the Fairbanks model assumed 70 Mcf per day, which included the military bases.

Mr. Richards furthered that the 70 Mcf per day included the Fairbanks North Star Borough. He explained that the number

AGDC had come up with had been derived from a study that was done for Alaska Pipeline Project (APP) for in-state needs.

Mr. Fauske added that AGDC had briefed military leaders on ASAP and indicated that they had expressed a great deal of interest.

Vice-Chair Fairclough inquired if Mr. Fauske had previously stated that extending ASAP's route to Valdez would add 110 miles to the current route. Mr. Fauske replied in the affirmative.

Vice-Chair Fairclough queried the cost of adding the additional 110 miles of route to Valdez. Mr. Fauske responded that he had been referencing the large cost of adding 110 miles of route at a cost of \$5 million per mile.

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Senator Hoffman directed the presentation back to slide 9, "AGDC Budget to Project Sanction" and indicated that he was trying reconcile the budget on the slide with the fiscal notes that were attached to the bill. He referenced page 6 of fiscal note number 2 and pointed out that the facilities engineering costs of the note were \$182.962 million, while slide 9 listed the same costs at \$105.984 million. [Fiscal note number 2 has since been renumbered to number 4; it is the note showing an appropriation to AGDC.] He continued to discuss page 6 of the fiscal note and pointed out that it showed pipeline engineering costs of \$93.784 million, while the slide showed \$69.139 million; additionally, the total costs for project sanction/construction on page 4 of the note was \$330 million, while the slide showed a figure of \$328.331 million. He inquired if the \$330 million on page 4 of the fiscal note represented the same figure as the \$328.331 million on slide 9 and further queried how the differences between the fiscal note and AGDC's slide could be reconciled. Mr. Richards replied that fiscal note number 2 was very comprehensive and that the \$400 million on page 4 of the note was the total target that AGDC had recommended for developing the engineering work through project sanction. He continued to discussed page 4 and the table of additions and subtractions that ultimately led to a total of \$330,000. He stated the numbers shown on page 6 of the note had been provided in the original project plan and identified in gross terms the four major components of

project plan completion, commercial operations, pipeline engineering, facilities engineering, as well as support activities; these totaled \$400 million. He shared that what was depicted on slide 9 were detail cost estimates on all the major activities as the project had advanced toward project sanction. He added that the \$400 million on page 6 of the note represented gross numbers and related that a portion of it had already been spent. He pointed to the \$72 million in prior year appropriations on page 4 of the note and shared that it accounted for the reduction to the \$400 million on page 6. He offered apologies for any confusion regarding the fiscal notes. He concluded that the "detail going forward" was on slide 9.

Senator Hoffman wondered if the fiscal note's cost figures included or excluded the \$25 million in the governor's request. Mr. Richards stated that the request represented the actual need going forward, as opposed to what the appropriation would be.

Senator Hoffman inquired from what starting date the actual need of the project was calculated. Mr. Richards responded that the date range was from FY14 through FY16 and represented only the funding needed for AGDC.

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Senator Hoffman observed that the bottom of page 4 of the fiscal note showed that the funds needed to project sanction were \$330 million and inquired if that was correct. Mr. Richards replied in the affirmative.

Senator Hoffman queried if the \$330 million on the fiscal note represented the same number that was shown on slide 9. Mr. Richards responded in the affirmative.

Senator Bishop requested a ballpark cost estimate for the permitting costs from Fairbanks to Prince William Sound and then to Valdez. Mr. Richards inquired if Senator Bishop was requesting the costs for AGDC to go through the National Environmental Policy Act (NEPA) process, which included an EIS, from Livengood to Valdez. Senator Bishop responded on the affirmative. He observed that AGIA had probably done some of the permitting work to Big Delta and that the information might be available. Mr. Richards replied that AGIA had done some of the work and had published a

considerable amount of data through its resource reports through the Federal Energy Regulatory Commission (FERC).

Senator Bishop added that Mr. Richards might just supply the permitting costs from Big Delta to Valdez. Mr. Richards requested a clarification and inquired if the request was for the permitting for a lean-gas pipeline or a rich-gas pipeline. Senator Bishop replied that he wanted the permitting costs for a LNG export pipeline.

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Vice-Chair Fairclough remarked on Senator Hoffman's line of question regarding fiscal note number 2 and felt that there might need to be more clarity on the issue. She observed that the fiscal note included other agency needs and requested an explanation of the note for the purpose of clarity. Mr. Richards apologized for any confusion and replied that the fiscal note was all inclusive of costs for not only AGDC, but also for the Department of Law (DOL), DNR, the Department of Environmental Conservation (DEC), the Department of Transportation and Public Facilities (DOT), and many subdivisions within those agencies. He explained that slide 9 of the presentation represented a detailed look at AGDC's costs alone going forward to project sanction.

Senator Olson mentioned AGDC's work on right-of-ways and wondered if the project had secured the right-of-ways on federal and private lands. Mr. Richards referred to a pending right-of-way decision from the BLM and stated that there were approximately a 100 miles of federal land that AGDC was currently awaiting a decision on. He stated that there were about 70 miles of remaining lands that consisted of Native regional and village corporations, other private holdings, and several Native allotments. He added that other than Native lands, private holdings only accounted for approximately 2 percent of the entire line; he added that the non-Native, private holdings probably represented about 12 miles of actual right-of-way alignment.

Senator Olson inquired if AGDC was planning on exercising its right of imminent domain on some of the private lands along the line. Mr. Richards responded that currently, AGDC had not even entered into discussions with the private land holders because ASAP was not yet at the stage of actually defining the actual center line. He added that it was a little premature in the process to enter into those discussions with the private land holders.

Senator Olson inquired if it was in the realm of consideration that AGDC might exercise its right of imminent domain. Mr. Richards replied that HB 4 provided the imminent domain authority to AGDC.

Senator Olson directed the presentation back to slide 3. He remarked on the 335,000 tons steel that needed to be shipped in for the project. He inquired if the road maintenance had been taken into consideration and queried if the increased maintenance would be shouldered by DOT. Mr. Richards replied that while the port of entry had not been determined, the 335,000 tons of steel would likely be transported by the Alaska Railroad. He reported that other loads, including construction loads, would be hauled on the state highway. He related that AGDC hoped to enter into a highway-use agreement with DOT; he noted that DOT was included in the fiscal note. He stated that AGDC would conduct a condition survey before the initiation of the work, as well as a survey at the end; the agreement would be worked out with DOT in advance of the project.

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Senator Olson pointed out that some bridges might not be able to carry the increased loads over an extended period of time and inquired if the state would be bearing the costs to upgrade bridges. Mr. Richards replied that the bridges along the Parks Highway and Dalton Highway routes had been upgraded over the last 10 years; these bridges were sufficient to allow module hauls of up to almost 450,000 lbs. He stated that AGDC did not expect a load as heavy as 450,000 lbs. to be associated with ASAP and furthered that the major modules for the GCF would likely be sea-lifted.

Senator Olson discussed ASAP's proposed terminus in Big Lake, as well as issues surrounding HB 4's pipeline route versus alternate routes. He inquired if AGDC was open to

using an alternative route and not going to Big Lake. Mr. Richards replied that the route that had been worked through EIS was given to AGDC by its predecessors. He explained that the route would bring gas to the south-central market and would provide gas to residents where it was needed; currently, there were potential gas shortages from the Cook Inlet system. He related that the open season would be the determining factor of where the shippers and buyers wanted the pipeline to be and the product to flow to.

Senator Olson inquired if the route down to Big Lake was etched in stone. Mr. Richards responded that as it currently stood, the current route was what AGDC had been provided with and it was the route that it had the right-of-way alignments and federal EISs on.

Senator Bishop urged AGDC to use the University of Alaska system for engineering research services whenever possible and noted that he would appreciate the use of in-state services for that work. Mr. Richards replied that AGDC had summer field work to conduct and that it was exploring all the in-state options to do the work, including the University of Alaska.

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JOE DUBLER, VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, ALASKA GASLINE DEVELOPMENT CORPORATION AND DIRECTOR OF FINANCE, ALASKA HOUSING FINANCE CORPORATION, DEPARTMENT OF REVENUE, discussed the PowerPoint, "ASAP, Financing Mega Projects" (copy on file).

Mr. Dubler looked at slide 2, "Financing Overview."

- Objective is to achieve the lowest cost of financing possible for a given project
- Look at financing from the other side--that of the investor
- Structure financing package to attract as many investors as possible
- Typically two sources of funding a project - equity and debt, each of which has its own advantages and disadvantages

- Rates of return for both debt and equity are determined based upon several factors that basically reward investors for taking on risk
- Investment yield = inflation rate + risk factor + liquidity factor

Mr. Dubler addressed slide 2 and related that the financing on mega projects was not much different than other projects, except that the numbers were a lot larger. He discussed the fifth bullet point and stated that equity investors tended to take on more risk and received a higher yield; the bond holders typically took less risk and received a lower yield.

Mr. Dubler discussed slide 3, "Equity Financing."

Equity is riskier (and higher cost) due to:

- Equity investors usually put the first dollars into a project often with no guarantee the project will even make it to a sanction decision
- Equity shares are not very liquid. It is much more difficult to sell equity in a project than a bond issued for the same project

For these reasons it is advantageous to a project's overall cost of funds to keep the equity portion as small as possible and the debt portion as large as possible

Mr. Dubler spoke to slide 3. He discussed the first bullet point and related that bond holders were hesitant to lend at the beginning of a project because they took completion risk in doing so. He explained that bond holders did not like to take completion risk; completion risk is the risk that the project is never finished and never generates revenues. He discussed the second bullet point and related that a bond traded on a national market, while equity shares typically did not. He spoke to the last paragraph on the bottom of the slide and offered that the paragraph's conclusion was why the state had specified a debt to equity ratio in the AGIA legislation; the prescribed ratio was

meant to keep producers from setting a higher equity to debt ratio in order to increase investment returns.

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Mr. Dubler highlighted slide 4, "Equity Financing."

- Equity financing options include 100 percent state-owned, 100 percent private owned, or some combination of the two
- One of the advantages of a State-owned pipeline is that the State would have more control over the components of the pipeline
- Some might say this is also a disadvantage of a State-owned pipeline as the private sector is better equipped to own and operate large projects
- The main advantage to a privately owned pipeline is that the private sector may be best equipped to complete such a project. There are many companies whose only business is to build, own and operate pipelines, and they are very good at doing so
- The disadvantage is that the State loses the control it would otherwise have with the State ownership option

Mr. Dubler addressed slide 4 and discussed the first bullet point. He related that the Knick Arm Bridge and Toll Authority (KABATA) was an example of an entirely state-owned project; AGIA and APP were examples of two entirely private owned projects.

Mr. Dubler discussed slide 5, "Debt Financing."

- While there are many different vehicles available to finance a project, we will focus on three today: general obligation bonds; project finance bonds; and state moral obligation bonds
- General Obligation Bonds

- o would get the State's rating, which would lower the cost and make for a more straightforward credit analysis
- o However, general obligation bonds require voter approval and a general fund appropriation in the future (which will be offset by project revenues)

Mr. Dubler spoke to slide 5 and discussed the second main bullet point. He stated that general obligation bonds were typically used for state infrastructure projects and added that Alaska's credit rating was currently AAA. He discussed the slide's final sub-bullet point and shared that a majority vote of the people for bond issuances have been historically difficult to achieve in Alaska. He stated that AGDC was not recommending a general obligation bond issuance for ASAP because it did not feel that it was necessary.

Senator Hoffman inquired when the last time was that the voters turned down a state-wide general obligation bond. Mr. Dubler responded that he had been referring more to local, municipal elections and mentioned Anchorage's difficulties getting bonds passed.

Senator Hoffman surmised that state voters had never turned down a general obligation bond. Mr. Dubler responded that he was not aware of state voters doing so.

Co-Chair Meyer agreed with Senator Hoffman and added that he could not recall a state-wide general obligation bond failing. He noted that locally, the general obligations bonds failed to pass votes from time to time.

Co-Chair Meyer inquired if the general obligation bonds referenced on the slide would be state bonds. Mr. Dubler responded in the affirmative.

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Mr. Dubler highlighted slide 6, "Debt Financing."

- Project Financing
  - Would have no impact on the State of Alaska as the project would be rated as a stand-alone

credit; therefore no general fund appropriation would be required.

- State Moral Obligation Bonds
  - Would have similar benefits of general obligation bonds in that they would result in lower interest rates and a simpler credit analysis based upon the State's credit rating.
  - Likewise, the negative effects of moral obligation bonds would be similar to the general obligation bonds in that there would be a potential State downgrade resulting in a real cost to the State of Alaska and its political subdivisions.

Mr. Dubler discussed slide 6. He addressed the first main bullet point and stated that AGDC was recommending the project financing model for ASAP; in this model, the revenues of the project were at risk to make the debt service on the bonds. He stated that with project financing, the debt was structured to match the revenues off of the project, which in this case were the tariffs from customers that were signed during an open season.

Mr. Dubler discussed slide 7, "Ownership Model."

- The goal for project financing is to strike an appropriate balance between debt and equity components such that the lowest overall yield (cost) can be achieved.
- A typical ownership model could include a pro rata equity for shippers in the share of the gas in that they are shipping in the line.
- This allows shippers a percentage control in line with the risk their taking in committing their gas to the project.
- A target capital structure of 75 percent-25 percent is consistent with the APP and Denali Pipelines' assumptions used in their Open Seasons.

Mr. Dubler addressed slide 7 and discussed the fourth bullet point. He pointed out that the debt to equity ratio of 75 percent to 25 percent was a higher debt to equity ratio than the AGIA ratio; AGDC had used a higher ratio to decrease the amount of equity and increase the amount of debt in order to keep gas as the lowest possible costs.

Senator Bishop requested more information about the ownership model of AGDC. He specifically wondered what revenue could be returning to AGDC, as well as potential dividends from the revenue that could benefit Alaskans. Mr. Dubler replied that in the case of the ownership model, the state would not get dividends from the pipeline because it was not making an investment as an equity partner. He continued that since an eight of the gas would be the state's royalty share, the state might be able to invest an eight of the equity in the pipeline and receive the return on one-eighth of the equity ownership. He added that the return was anticipated to be 10 percent to 13 percent.

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Co-Chair Meyer wondered if AGDC was recommending one finance model over another. Mr. Dubler replied that AGDC felt the financing model could be best determined after the open season; ideally, if the open season was successful, he felt that the private sector would be best suited to build the pipeline. He explained that optimally, the project would be at a point where it had enough customers to fill the pipe, had firm transportations agreements, was ready to go, and would be taken over by a pipeline company.

Co-Chair Meyer inquired if there would be options at some state ownership if the pipeline were taken over by a private company. Mr. Dubler responded in the affirmative.

Vice-Chair Fairclough surmised that Alaska was taking 100 percent of the risk in moving ASAP through the first 2 gates. She observed that Alaska was completely risking \$400 million and queried why the state was not already an equity owner in the project. She pointed out that including the AGIA funding, Alaskans had made a significant investment and had covered all of the risk up front. Mr. Dubler replied that Alaska was taking all the risk with both AGIA and ASAP. He explained that typical gaslines would have a very large source, which Alaska had, and very large use, such as Los Angeles or Chicago; all a pipeline company did

was look as uses and sources and connected the two. He explained that the use that Alaska had in the south-central and Fairbanks areas was only 240 Mcf per day, which was substantial, but not in the context of a \$7 billion to \$8 billion project. He expounded that companies were not willing to put a \$400 million risk upfront and hope that they would get customers. He offered that for a much larger market, companies might be willing to risk \$400 million up front; however, to date, companies had been unwilling to do so in Alaska. He responded to the second part of Vice-Chair Fairclough's question and stated that Alaska was a 100 percent owner of ASAP currently; the project would not be handed over to a third party gratis, but would be sold. He concluded that the project was currently generating assets to the State of Alaska and pointed out that if the project went forward after a successful open season, those assets would be sold to the project.

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Vice-Chair Fairclough noted that the intent of providing energy to Alaskans was to do so at the lowest possible cost. She inquired if Alaska was not the full owner of the project, if it would be beneficial to have all of Alaska's investments in the project reduce the overall burner tip cost in order to try and recoup the state's investment. Mr. Dubler replied that it would have to be a policy at the time on what amount, if any, the state wanted to negotiate in a sales price for those assets.

Vice-Chair Fairclough discussed the fourth bullet point on slide 7. She requested an explanation on how a 75 percent to 25 percent ratio would save on overall project costs versus a 70 percent to 30 percent split. Mr. Dubler responded that the return on equity on a project like ASAP was expected to be in the 10 percent to 13 percent range, while debt would be roughly in the 5 percent to 7 percent range. He explained that the more debt that was sold, as opposed to equity, the lower the overall cost of funds would be. He stated that because the project was financed over 30 years, a major component of the project was the cost of the capital.

Vice-Chair Fairclough inquired if the state would receive more money in interest as an equity owner versus the interest it would pay on borrowing the money or whether it was the opposite. Mr. Dubler replied that the project would

not be receiving money on the equity, but would be paying the equity investors. He concluded that the project would pay more to the equity holders than it would to the bond holders. He concluded that having 30 percent of the total capital in equity versus 25 percent would result in a higher cost.

Senator Olson inquired if HB 4 allowed the issuance of bonds by AGDC or whether AGDC had to return to the legislature for a "go or no go" situation. Mr. Dubler responded that bond issuance by AGDC was allowed for on pages 16 through 20 of the bill.

Vice-Chair Fairclough recalled that the legislation specified that AGDC, or the future owner of the project, would only be able to bond its own assets and not the State of Alaska's. Mr. Dubler responded that no entity could issue general obligation bonds for the State of Alaska without a vote of the people. He pointed out that the language that gave AGDC the option of utilizing the moral obligation of the State of Alaska in issuing its debt had been in the bill; however, the legislation had since been modified in the other body to require AGDC to return to the legislature for approval to use that tool. He concluded that the State of Alaska would not have liability on any bonds issued by ASAP without further action by the legislature.

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Vice-Chair Fairclough requested more information regarding the validity of pledge. Mr. Dubler deferred the question to Ken Vassar.

Vice-Chair Fairclough directed the committee's attention to page 20, Section 31.25.180 of the bill. She pointed to the validity of pledge and read from lines 12 and 13 on page 20. She pointed out that while a lien was not a bond, it was still a liability and requested additional explanation of the validity of pledge.

KEN VASSAR, GENERAL COUNSEL, ALASKA GASLINE DEVELOPMENT CORPORATION, ANCHORAGE (via teleconference), explained that Section 31.25.180 was a standard section included in bond statutes; it served the purpose of allowing AGDC to pledge whatever revenues may be available as security for the bonds that it issued, as well as to give the purchasers of

the bonds confidence that the pledge was a valid lien against the revenues. He shared that the essence of a revenue bond was the revenue that was available to repay the bond holders/lenders; therefore, there would be a very clear description in the bond documents of what that revenue was, as well as a clear statement of the lien on that revenue. He concluded that the section assured the bond holders in writing that the pledge of revenues was valid and could not be removed.

Senator Hoffman remarked that it had been previously stated that the debt to equity ratio for AGIA was fixed in statute. He surmised that ASAP's ratio was a target of 75 percent to 25 percent and was not set in statute. Mr. Dubler replied that Senator Hoffman was correct and that the only thing that HB 369 fixed in statute was that AGDC bring gas to Alaskans at the lowest possible cost; the split of 75 percent to 25 percent was derived from HB 369's directive to bring gas to Alaskans at the lowest possible cost.

Senator Hoffman reiterated his question and asked if the 75 percent to 25 percent debt to equity ratio for ASAP was fixed in statute. Mr. Dubler replied that it was not.

Mr. Richards recalled several questions from Vice-Chair Fairclough during the prior hearing that Mr. Dubler would be able to answer, specifically regarding the interest on the project's capital fund.

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Vice-Chair Fairclough directed the committees page 13, Section 31.25.100 of the bill, which dealt with an in-state natural gas pipeline fund. She discussed the use of the word "may" on line 15 and inquired where an appropriation to the fund would reside.

Vice-Chair Fairclough wondered if an appropriation to the natural gas pipeline fund would stay in the General Fund and would be managed by the Department of Revenue (DOR) or if it would be managed by an outside organization. She further inquired if the interest earned off the fund would return to the general fund if that was where fund was housed or if the interest would go in a sub-account. Mr. Dubler replied that for budgetary and accounting purposes, the natural gas pipeline fund would reside under AGDC and

the money would be reported on AGDC's financial statements and budget reports; however, investments from the fund, which is what was referenced on page 13, line 15 of the bill, were treated differently. He explained that DOR had a fund called General Fund and Other Non-Segregated Investments (GEFONSI), which worked as an internal fund that state agencies could utilize. He explained that currently, all of the assets of the Alaska Housing Capital Corporation were invested in GEFONSI; even though the corporation's financial statements listed the investments, they were actually invested by DOR's Treasury Division. He expounded that AGDC recognized and had decided to utilize DOR's expertise. He pointed out that DOR charged very little for the services it provided and related that DOR had achieved a very good return on investments in the past. He concluded that the actual location of the cash for accounting purposes was within AGDC; however, it would be invested in DOR.

Vice-Chair Fairclough inquired why the legislation was using the word "may" on page 13, line 15 instead of the word "shall." Mr. Dubler believed that the intent of the wording was to give flexibility to AGDC. He pointed out that AHFC had been investing with DOR with positive results for about 10 years. He furthered that there was no reason that AHFC would not invest with DOR, but thought that the language was there to maintain flexibility.

Vice-Chair Fairclough pointed out that Alaskans trusted the Permanent Fund Board, the rate of return on the permanent fund, as well as the ability to receive a permanent fund dividend on a regular basis. She pointed out that DOR had done a good job on rates of return for the Permanent Fund. She inquired what the other options for investment besides DOR were and why there needed to be flexibility, given that DOR had such a good track record with investments. Mr. Dubler explained that DOR currently provided the investment services; however, if the DOR stopped its investment services, AGDC would be unable to invest the money if the word "shall" were put in place of "may" on page 13, line 15 of the legislation. He offered that the language allowed AHFC to invest the in-state natural gas pipeline fund somewhere else if DOR ever stopped providing the services without having to come back for a statutory revision.

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Vice-Chair Fairclough inquired if Alaska would earn the interest returns from the in-state natural gas pipeline fund if the fund were managed and invested by a third party or whether in this case, the money would be managed, for all practical purposes, by the State of Alaska. Mr. Dubler responded that as long as AHFC had the money, it would be under the governance of the state. He related that the interest earnings on the fund were subject to appropriation by the legislature every year. He explained that there was a state constitutional clause regarding dedicated funds and dedicated fund prohibitions that prevented the state from designating how the revenue from a specific chunk of funding would be spent.

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Vice-Chair Fairclough noted there was lapse money in the Building Fund for the state that was looped around even though it was appropriated every year. She recalled that the committee had recently heard a bill that would create a building fund for the University of Alaska and that it had language that showed the lapse funds as circular; the legislation did not dedicate the funds because it stated that the money rolled through with each successive legislature. She assumed that the project wanted the money rolled back over, but was allowing flexibility by having it go in the General Fund, which would give the legislature control over the funds. She inquired if her assumption was correct. Mr. Dubler replied that the bill's sponsor would be better suited to answer questions regarding intent, but added that the language came from AHFC statutes and very cleanly addressed the constitutional issue at hand.

Ms. Delbridge responded that the language in the bill was specifically recommended by Legislative Legal Services in order recognize the constitutional prohibition on dedicated funds, while also ensuring that the legislation had language that indicated the current legislature's intent without legally binding the reappropriation of the funds; the language was on page 13, line 19 of the bill and read "and may be appropriated to the fund." She related that the language was a de facto indication to future legislators that the intent of the current legislature was that the money be returned to the fund; furthermore, the language did so without violating the constitution. She stated that she was not aware of the particular differences between HB 4 and the recently referenced university bill, but that she

would be happy to look in the matter to see if it could be beneficial.

Vice-Chair Fairclough noted that HB 4 and University of Alaska building fund legislation were for different purposes, but that both made sure that the state was in constitutional compliance.

Vice-Chair Fairclough inquired if the \$330 million request reflected the total project cost or whether the time value of money included the interest that the project expected to receive. Mr. Richards replied that the amount shown represented the total request through project sanction. He stated that AGDC had worked the time value of money into its tariff calculation and that the numbers were not inflated.

Vice-Chair Fairclough inquired if the project would still have the funding to get to project sanction if the legislature did not appropriate the interest from the General Fund back to the project. Mr. Richards responded that the amount shown was the cost to project sanction and was exclusive of interest.

Co-Chair Meyer asked about the next section.

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DARYL KLEPPIN, COMMERCIAL MANAGER, ALASKA GASLINE DEVELOPMENT CORPORATION, related that the tariff model was where all the costs on a project came together and that it determined the costs for building, owning, and operating a pipeline throughout its useful life. He pointed out that AGDC did have some estimates, but that uncertainty factors had been calculated into the tariff model. He stated that a pipeline carrier was the shipper of the gas, but would not be the owner of the gas.

Mr. Kleppin discussed the PowerPoint, "ASAP, Tariff Model Presentation" (copy on file).

Mr. Kleppin discussed slide 2, "Tariff Model Purpose."

- Estimate the cost of building, owning, and operating a gas pipeline over its useful life

- Estimate tariff rates that need to be charged to recover the cost of service
- Assure that financial commitments obtained during the open season will cover all required costs

Mr. Kleppin spoke to slide 3, "Primary Factors Impacting Tariff Rates."

- Capital costs
- Operating costs
- Volume (throughput)
- Currently all are estimates and in the early phases of engineering

Mr. Kleppin discussed the first bullet point on slide 3. He indicated that the uncertainty around the capital cost estimates were plus or minus 30 percent, but shared that the estimates would be more accurate as more engineering was conducted. He stated that the current estimate of capital costs was about \$7.7 billion. He discussed the slide's second bullet and stated that the operating costs were things like staffing, maintenance, supplies, etc. over the life of the pipeline; at the current stage, the operating costs estimate was based on an industry-standard rule-of-thumb based on the percentage of total the capital costs. He spoke to the slide's third bullet point and shared that for the purposes of the AGDC's model, the tariff was calculated in BTUs; 1 MMBTu was roughly 1,000 cubic feet of gas.

Mr. Kleppin discussed slide 4, "Tariff Model Structure."

- Cost of service model
- Capital cost estimates input into FERC code of accounts and broken down by segment
- Industry standard
- RCA familiar with cost categories & FERC accounts

- Operating cost estimates based on industry standards
- Gas volume/usage and allocated based on in-state demand study (2010)

Mr. Kleppin spoke to slide 4 and related that the first bullet point included capital costs, the cost of financing that capital, and the operating costs; in AGDC's tariff model, the costs were input into a standard code of FERC accounts. He added that FERC used the standard code of accounts that all the pipelines in the Lower-48 used. He pointed out that FERC regulated about 200,000 miles of liquids pipelines in the Lower-48 and a similar mileage of gas pipelines; the tariff model calculation was very commonly used in the Lower-48. He reiterated that the operating costs were an estimate at this stage. He discussed the final bullet point and related that the in-state demand study was used in the APP open season, as well as the Denali open season; AGDC had input similar usage data into its cost model.

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Mr. Kleppin detailed slide 5, "Key Financial Assumptions."

- Depreciation methodology and depreciable life
- Capital structure: percent debt and percent equity
- Cost of capital components

Mr. Kleppin spoke to the first bullet point on slide 5 and related that the methodology that was typically used was straight-line depreciation; the other component was the length of the depreciable life. He discussed the second bullet point and stated that AGDC's tariff model used a 75 percent to 25 percent debt to equity ratio; AGIA statutes specified that the equity could not exceed 30 percent. He explained that a lower percentage of equity would tend to drive the tariff lower because the cost of equity was more than the cost of debt. He stated that the current tariff model used 5.7 percent as the cost of debt and an 11 percent cost of equity. He shared that the APP and the Denali projects assumed a cost of debt of 5.1 percent and

was lower than that of AGDC's model; the two projects' cost of equity ranged from about 12 percent to 14 percent.

Senator Bishop asked if the differential in the increase in equity was a direct result of the 70 percent to 30 percent debt to equity ratio of the APP project. Mr. Kleppin replied that AGDC's tariff model assumed a 75 percent debt to 25 percent equity ratio and that the AGIA limit was a 70 percent to 30 percent ratio. AGDC's original calculation in the 2011 project plan had used the 70 percent to 30 percent ratio; however, the APP and Denali projects used a 75 percent to 25 percent split, which was why AGDC's model had opted for that ratio.

Mr. Kleppin detailed slide 6, "Model Outputs."

- Revenue requirements calculated for each segment
- Volume (billing units) estimated for each segment
- Recourse tariff calculated

Mr. Kleppin spoke to slide 6 and discussed where and what the different segments were. He explained that one segment was all the capital and operating costs associated with the GCF on the North Slope; another segment was essentially the cost of the pipeline from the North Slope to Dunbar. One segment was the cost of the Fairbanks lateral and another was the cost of the pipeline from Dunbar to Anchorage. He explained that AGDC did not currently know how many offtake points there would be and that there could be other segments that depended on where the offtake points were. He discussed a hypothetical scenario of how another segment could be formed. He stated that AGDC had allowed for a large number of offtake points because it would not know how many there would be until open season; furthermore, AGDC was not constrained to 5 offtake points like AGIA. He addressed the billing units component, which was measured in MMBTu and was a function of the composition of the gas. He explained that there was a small amount of propane in the gas and that there could be a separate calculation on that. He addressed the final bullet point and related that the recourse tariff would represent the list price for the service if the tariff was not negotiated.

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Mr. Kleppin discussed slide 7, "Recourse Tariff."

- Initial tariff that is based on Class III estimates for gas conditioning facility/compressor and pipeline
- Sticker price
- Ceiling not floor
- Shippers can negotiate for better rate
- Who would use recourse tariff
  - Small volume shipper
  - Shipper with short term need

Mr. Kleppin discussed the fourth bullet point on slide 7 and noted that a shipper that was moving a large volume of gas might be able to negotiate a tariff that was lower than the recourse tariff. He explained that a long-term use commitment, such as a 40-year period, might enable a shipper to negotiate a lower tariff. If the shipper chose not to negotiate the tariff, the recourse tariff, which would be reviewed and approved by the RCA under HB 4, could be utilized.

Senator Hoffman inquired if there would be one recourse tariff for the line, or if there would be different recourse tariffs at the different off take points. Mr. Kleppin responded that the rates for the recourse tariff would differ depending on where the offtake point was.

Senator Bishop inquired if there would be distance sensitive rates built into the pipeline. Mr. Kleppin replied in the affirmative.

Senator Dunleavy queried if a negotiated price could become higher than the recourse tariff. Mr. Kleppin responded that it was possible that a negotiated rate would become higher than the recourse tariff if an entity wanted a particular specialized service, but that this was not typically the case.

Mr. Kleppin discussed slide 8, "Updated ASAP Tariff Assumptions."

- Longer term
  - 30 year levelized vs. original 20 years
- Updated capital cost estimates
  - Now \$7.70 Bn
    - was \$7.52 Bn (all estimates +/- 30 percent)
- More appropriate contingency
  - Pipeline now 10 percent vs. 5 percent (facilities 30 percent)

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Vice-Chair Fairclough addressed slide 8 and inquired if the pipe would be depreciated over 30 years in order to levelize the tariff. Mr. Kleppin replied in the affirmative.

Vice-Chair Fairclough queried what using the 30-year versus the 20-year depreciation was based on. She assumed that leveraging longer years would result in a lower tariff for Alaskans. She further inquired if there was a standard reason that ASAP was using a 30-year schedule and noted that TAPS was already more than 30-years old. Mr. Kleppin responded that the 30-year schedule was consistent with what other pipelines had done. He added that the pipeline could be depreciated over a longer life and confirmed that the longer the life, the lower the tariffs would be. He explained that the typical depreciation life in the Lower-48 was 30 to 45 years and in some cases reached 60 years. He pointed out that the issue with smaller contracts regarded the risk of obtaining another contract when the shorter one ran out.

Vice-Chair Fairclough inquired if there was something unique in the projects that had a 45-year depreciation life cycle that made them choose that length. She noted that a 45-year cycle might not be reasonable with smaller deposits

of gas. She further requested more information on why ASAP had chosen a 30-year depreciation life cycle and offered that it was a conservative estimate. Mr. Kleppin responded that a 30-year depreciation life seemed to be consistent with the original assumption in TAPS; the Denali and APP projects used a similar life of 25 years for roughly 80 percent of the depreciation. He stated that Vice-Chair Fairclough brought up a fair point and that AGDC could fine-tune the issue with the tariffs going forward.

Mr. Dubler added that the depreciation methods and depreciable lives tended to be driven by the tax code and that companies did not want to have large differences between their book depreciation and tax depreciation. He explained that because the project would use a straight-line depreciation for its books, there was already an accelerated depreciation under the taxes. He added that AGDC had been trying to keep a lot of things in mind and that 30 years was a number that seemed to work out well in many instances.

Vice-Chair Fairclough pointed out that a longer depreciation life cycle would mean lower rates for Alaskans. She understood the concept of aligning with straight-line depreciation, but was trying to understand if it was reasonable to have a longer depreciable life.

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Senator Hoffman inquired if the depreciation life depended on the ownership and further queried if the state having more interest in the line would warrant extending the depreciation. He queried if there was any correlation between ownership and the depreciation life. Mr. Dubler replied that if the state had 100 percent ownership of the line, it could decide what life it wanted to depreciate the line over. He explained that the state did not have tax implications associated with any depreciation and observed that if Alaska was the sole owner of the line, it could elect to not depreciate the line at all and just donate the capital. He offered that Alaska would have many options if was a 100 percent owner. He reported that if the state was a minority or majority owner in the line, it would have to take its partners' fiscal options under consideration in any determination.

Vice-Chair Fairclough inquired if the estimated 18 trillion cubic feet (Tcf) of natural gas on the North Slope from known resources would last more than 30 years at ASAP's flow rate. Mr. Kleppin replied that if 500 Mcf per day were moved through the line over 30 years, the total volume would be a little over 5 Tcf of gas.

Vice-Chair Fairclough surmised that there was a possibility of the gas lasting much longer than 30 years.

Senator Hoffman inquired about the extent of the proven reserves on the North Slope. Mr. Kleppin cautioned to be careful how reserves versus resources were viewed. He stated that Prudhoe Bay had roughly 25 Tcf to 30 Tcf of gas and that Point Thomson had roughly 10 Tcf to 12 Tcf. He concluded that the Prudhoe Bay and Pt. Thomson numbers were ones that he had heard. He did not want to speak to the two fields' exact volumes, but offered that the numbers were reference points.

Senator Bishop wondered how much propane would come down the line at a flow rate of 500 Mcf of gas per day. Mr. Kleppin replied that the percent of propane in the gas was 1.5 percent and that the line would supply roughly 3,500 to 4,000 barrels per day, depending on how it is processed.

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Mr. Kleppin discussed slide 9, "Updated ASAP Tariff Assumptions."

- Equity share and return on equity adjusted
  - Debt/equity split now 75/25 vs. 70/30
  - ROE 11 percent vs. 12 percent
- Year delay (\$2011 -> \$2012)
  - 2.5 percent inflation per year (\$200 mm)
- Fewer billing units (MMBTUs)
  - 523 MMBTUs vs. 584 MMBTUs

Mr. Kleppin discussed the final main bullet point on slide 9. He stated that with the lean gas scenario, which would

not inject NGLs into the stream, the BTU content of the pipeline was lower and resulted in fewer billable units. He stated that all of the slide's bullet points worked together in a revised tariff calculation and explained that a BTU was amount of energy that was required to raise the temperature of 1 gallon of water 1 degree Fahrenheit; it was the standard unit for heat.

Mr. Kleppin discussed slide 10, "Updated ASAP Tariffs." He related that the slide showed the tariff calculations that were completed at the end of 2012 that were based on the new cost estimate assumptions. He stated that the slide depicted the tariff in constant dollars, as well as nominal or inflated dollars; it also reflected a range in the tariff because of the uncertainty in a lot of the estimates. He related that the tariff, which was the cost of shipping the gas from the North Slope to Fairbanks, would be between \$4.25 and \$6 per MMBTu; the tariff to Big Lake would be \$5 to \$7.25 per MMBTu. He related that the tariff numbers in the last several sentences were in constant, 2012 dollars; the tariffs were the cost in shipping the gas and did not include its cost or the cost of local distribution. He stated that if you added the \$4 cost of the gas and local distribution [Each had a \$2 dollar cost.], the Fairbanks cost of gas at the burner tip would be between \$8.25 and \$10 per MMBTu; the burner tip cost to anchorage would be between \$9 and \$11.25 per MMBTu. He discussed the blue section titled "Cost Drivers" and related that the next column underneath it showed rules-of-thumb that reflected what would happen to the tariff if the cost of capital went up by roughly \$1 billion; in this case, the tariff would go up roughly 50 cents to 80 cents, depending on several factors. He explained that the next column down depicted what would happen if Alaska put in a \$1 billion contribution that was not included in the tariff. The next column down added a sensitivity to return on equity of 1 percent. The next column down depicted what would happen if the bond length was extended.

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Mr. Dubler compared slide 9's burner tip cost estimates to the current costs. He explained that Fairbanks was currently playing about \$23 per MMBTu and that Anchorage was paying about \$9.70 per MMBTu.

Senator Bishop inquired if the Fairbanks burner tip price under ASAP would be in the range of \$8 to \$10 per MMBTu. Mr. Kleppin replied in the affirmative, but related that it would be in the range of \$8.25 to \$10 per MMBTu.

Co-Chair Meyer requested clarification and wondered if the rates would double if the open season only achieved commitments for 250 Mcf per day instead of 500 Mcf per day. Mr. Kleppin replied that if the line only secured 250 Mcf and did not change its cost structure, it would have the same capital costs and the tariff would effectively double.

Vice-Chair Fairclough discussed the anticipation of a 6 month delay going to the RCA and remarked on the costs of project delays to Alaskans. She pointed out that the committee was looking for consumer protection and inquired if the RCA would set the segment-based recourse tariff rate once, or whether the agency would be responsible multiple times during the process to examine the number. Mr. Kleppin responded that as it was currently outlined in the bill, the RCA would be required to look at the recourse tariff prior to an open season and then approve that tariff; the legislation also allowed for revisions at the project startup, when the project had actual costs. The bill also allowed for expansions of the pipeline. He discussed a hypothetical scenario under which gas was discovered in the Nenana Basin and the pipeline was expanded to incorporate the discovery; in the case of an expansion, if there had not been a revised recourse tariff in the last 2 years, a new tariff would have to be recalculated and offered during an open season for that expansion.

Vice-Chair Fairclough wondered if there were risks associated with a gas discovery the Nenana Basin, which the state was currently incentivizing, to the segmented delivery cost to Fairbanks. She observed that if the state went "all in" on the project but found producible gas in the Nenana Basin or another closer source, the project would not have to extend or build the Fairbanks component. She inquired if this was an option. Mr. Kleppin replied in the affirmative and added that it could be a possible option.

Senator Bishop surmised that it was important to get the right pipeline contractor with the right experience to bring ASAP in or below the advertised price, so that there was not a disparity between the first recourse rate and the

true up after project completion; this would keep the tariff where it should be. Mr. Kleppin responded that Senator Bishop was correct and that if the actual costs were higher than the initial estimates, the recourse tariff would typically have a mechanism to incorporate how costs overran or came under with flow through to the tariff.

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Senator Bishop observed that it would make sense to have the project come in on budget so that the consumer was not paying for the overrun. Mr. Kleppin responded in the affirmative.

Vice-Chair Fairclough wondered if there was a reclamation clause in the bill. Ms. Delbridge responded that part of the terms of the lease covenants for the state right-of-way lease included dismantle, remove, and restore (DR&R) provisions. She pointed out that because natural gas pipelines were underground and operated for a long period of time, the process for DR&R was usually less costly; it was less environmentally damaging to leave the line in the ground, empty it, and cap it at its ends than it was to excavate it for removal.

Vice-Chair Fairclough wondered how a possible reclamation could affect the tariff rate and inquired if there was a cost or number that was established inside the tariff that included the reclamation cost. She further inquired if the money for the reclamation would reside with the owner of the asset, as with TAPS, or with the State of Alaska. Mr. Kleppin replied that AGDC needed to acquire a better estimate for what the DR&R cost would be in the tariff; typically the DR&R cost would be included in the tariff. He added that normally, the money collected in the tariff for the reclamation would reside with the pipeline company.

Senator Hoffman queried the cost of acquiring the right of way for the project. Mr. Kleppin replied that there were estimated costs for the right-of-way, but that he was unsure of the exact estimates.

Senator Hoffman requested AGDC to provide the estimated costs for the project's right-of-way. Mr. Kleppin agreed to provide the requested information.

Senator Hoffman inquired how detailed the estimate of the right-of-way costs was. Mr. Richards explained that the estimate was based on the project's current alignment and that he would be glad to provide the committee with the requested information.

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AT EASE

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RECONVENED

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Co-Chair Meyer commented that the state's investment of \$330 million could be at risk if there a large gas discovery in the Cook Inlet that resulted in non-participation at the open season. He added that neither he nor the utility companies thought there was that much gas in the Cook Inlet. He thought that Ms. Delbridge also had the answers to some previous questions asked in committee.

Ms. Delbridge discussed Co-Chair Meyer's concern regarding a gas discovery in the Cook Inlet risking the state's investment of \$330 million. She acknowledged that the co-chair's concerns could be seen as a risk, but added that because the \$330 million would bring the project to sanction, the state would potentially not have spent the entire amount if the open season did not bring sufficient shipper commitments to finance the pipeline; the state would also have valuable assets in form of right-of-ways, leases, and other data. She observed that Speaker Chenault and Representative Hawker, who were the bill's sponsors, had approached the legislation carefully in order to prevent harm to the Cook Inlet oil and gas industry. She stated that the bill's sponsors had heard non-objection and support from the producers in Cook Inlet regarding the legislation; some of the companies in the Cook Inlet had also stated that providing that the state did not subsidize a pipeline from the North Slope, the other companies should not be in business in the inlet if they were unable to provide a better price than Cook Inlet gas. She noted that if there was a large discovery in Cook Inlet, there might be an opportunity to re-open an export mark in the Inlet, through which North Slope gas could still play a beneficial role after its journey through Fairbanks, the Interior, and other communities.

Senator Meyer observed that some believed that the state should build a pipeline from Cook Inlet to Fairbanks, but that he was not one of those people.

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Ms. Delbridge discussed a question from the previous day's committee meeting regarding the repositioning of AGDC from a subsidiary corporation of AHFC into a stand-alone corporation of the state. She also recalled a question from the current meeting regarding how much of the current legislation in HB 4 was in direct response to what AGDC's recommendations were. She stated that the shift of AGDC to a stand-alone corporation and its empowerment to look beyond ASAP to consider other pipelines in the future was a significant policy call that was made during the crafting of the legislation and was not necessarily part of AGDC's recommendations. She believed that the transition was something AGDC was supportive of, but stated that AGDC would have needed a number of the corporate authorities and permissions that were attached to it. She concluded that the change was not in AGDC's recommendation. She pointed out that the bill's sponsors believed that AHFC was a strong state entity in which to incubate an idea and concept to advance in-state gas pipelines; with the release of the project plan in 2011, which demonstrated that the project had merit, the sponsors believed that it was the prudent choice to create an independent entity with own strong, mission-specific board of directors and its own mission-specific duties and responsibilities. She added that AGDC had also experienced confusion from potential bond markets and others from the financing world regarding its placement within AHFC; the shift would help the rest of the world see that Alaska had a strong intent and meant business with creating a corporation that was going out to advance the mission that it had been given. She stated that the final component to the legislation's transition of AGDC to a stand-alone corporation was the desire to make sure that AHFC was able to continue the strong course that it had maintained in its keys functions, particularly as ASAP grew in intensity; the sponsors did not want the project to inadvertently affect AHFC's ability to pursue its mission.

Senator Hoffman wondered where the 32 positions in the bill's fiscal note would be employed. He inquired if the positions would be housed in AHFC's office or whether space

would be leased. Ms. Delbridge deferred the question to AGDC.

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Mr. Dubler explained that the positions in the fiscal note, some of which were from other state agencies, would be housed within AGDC and not AHFC. He stated that AGDC had many options available regarding where the location for the positions would be, one of which was a building that AHFC fully owned on International Avenue in Anchorage.

Co-Chair Meyer noted that there had been a request to hear some opposing views to HB 4 and asked that the names of potential testifiers be supplied to his office.

CS SS SB 4(FIN) was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

[4:46:58 PM](#)

The meeting was adjourned at 4:46 p.m.