

SENATE FINANCE COMMITTEE

April 9, 2013

3:34 p.m.

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CALL TO ORDER

Co-Chair Meyer called the Senate Finance Committee meeting to order at 3:34 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

William Walker, Attorney, Walker Richards LLC; Craig Richards, Attorney, Walker Richards LLC; Stewart Goering, Assistant attorney General, Department of Law; Representative Mike Hawker; Representative Mike Chenault

SUMMARY

CSSSHB 4(FIN)

ALASKA GASLINE DEVELOPMENT CORP; RCA

CSSSHB 4(FIN) was HEARD and HELD in committee for further consideration.

CSHB 30(FIN)

STATE AGENCY PERFORMANCE AUDITS

CSHB 30(FIN) was REPORTED out of committee with a "do pass" recommendation and two previously published zero fiscal notes: FN1(GOV) and

FN2(LEG); and with previously published fiscal impact note: FN3(LEG).

#hb30

CS FOR HOUSE BILL NO. 30(FIN)

"An Act relating to performance reviews, audits, and termination of executive and legislative branch agencies, the University of Alaska, and the Alaska Court System; and providing for an effective date."

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Vice-Chair Fairclough highlighted fiscal note #3. She relayed that the legislation initiated annual performance audits and reviews of Executive Branch agencies beginning with calendar year 2014, continuing annually on a 10-year cycle.

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Co-Chair Meyer stated that the note represented the basic costs and expenses associated with performing the numerous audits of state agencies.

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Vice-Chair Fairclough MOVED to REPORT HB 30 out of committee with individual recommendations and the accompanying fiscal note(s). There being NO OBJECTION, it was so ordered.

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Co-Chair Meyer noted that Co-Chair Kelly had joined the meeting.

CSHB 30(FIN) was REPORTED out of committee with a "do pass" recommendation and two previously published zero fiscal notes: FN1(GOV) and FN2(LEG); and with previously published fiscal impact note: FN3(LEG).

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AT EASE

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RECONVENED

#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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WILLIAM WALKER, ATTORNEY, WALKER RICHARDS LLC, requested permission to speak to the sponsor's response following the presentation. He noted that he a supported pipeline project; however, he could not support the project proposed in HB 4.

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Mr. Walker began a presentation titled "City of Valdez-Presentation on the In-State Gas Pipeline Bill (HB 4)" (copy on file). He shared that in crafting the presentation he had drawn upon his knowledge of TAPS. He discussed Slide 2, "Problems with HB 4 and AGDC Concept":

- Cheaper Alternatives Like LNG Import
- Unclear Whether AGIA Violated by H.B. 4
- Circumvents Existing Regulatory Structure
- FERC open season regulations
- RCA and not FERC regulated
- No common carriage in-state
- Just and reasonable rates not required
- Expansion costs on new entrants
- Cost Estimate Not Transparent
- Wrong Project Scope
- State Loses if H.B. 4 Structure Used for Big Project

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Mr. Walker addressed Slide 3, "Background - HB 369." He related that HB 369 had been the predecessor to HB 4:

- HB 369 Sec. 4.
AS 38.34.099 to read:
"(1) 'in-state natural gas pipeline' means a pipeline for transporting natural gas that runs from the North Slope to tidewater in the state"
- HB 369 Sec. 9.
Amended AS 41.41.990(3)to read:
"'project' means the gas transmission pipeline, together with all related property and facilities, to extend from the North Slope of Alaska or other regions of the state to a market in the state, or be available to a market in the state, and to tidewater at a point on Prince William Sound or Cook Inlet, and includes planning, design, and construction of the pipeline and facilities as described in AS 41.41.010(a)(1)-(5)."

Mr. Walker stated that a direction of HB 369 had been for the state to participate in an export process; to encourage the application for a license, or to encourage those with a license to get an extension. He said that with the passage

of HB 369 it had been anticipated that a large volume line would be built that could provide for all of Alaska. Additionally, the bill discussed adding an export piece, should the increased volume lower the cost of energy to Alaskan consumers.

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Mr. Walker spoke to Slides 4 and 5, "Potential Benefits to Alaskans from a Large Volume State-Owned Gasline/LNG Project by PDC Harris Group LLC (November 3, 2011)," which highlighted the cost of energy to Alaskans outside of the Rail belt:

Natural Gas vs. Diesel Fuel Costs
Fairbanks natural gas cost = \$5.29/mmbtu

vs

Fairbanks diesel fuel cost (2021) = \$27.23/mmbtu
Represents energy cost reduction of 80%
Total value of fuel savings of over \$2.4 billion to Fairbanks residents

Energy Cost Savings: Bethel and Fairbanks

Bethel energy cost savings of up to 65%

Equates to potentially \$886 million in fuel savings cost for Bethel residents (over 30 years)

Fairbanks energy cost savings up to 80%

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Mr. Walker shared that the entire study could be made available to the committee.

Mr. Walker spoke to Slide 6, which offered a slide from a 2011 Wood/Mackenzie presentation. The slide, "Access to currently re-injected gas upstream puts the Alaska LNG liquefaction project in an economically competitive position relative to others..." used the numbers for the cost of gas delivered to Japan from Prudhoe Bay in an attempted to develop key assumptions:

Key Assumptions

- All data from "TransCanada XOM Alaska Pipeline Project Open Season Notice, 2010, Valdez LNG Case" except below items:
- Liquefaction:
 - CapEx: \$1,200/ton; est. rate covers CapEx, Opex, 12 percent nom. ROE.
 - Alaska LNG losses 9.65 percent
- Shipping Assumptions:
 - Ship: 155,000 m³
 - CapEx/ship: \$200 million
 - OpEx: \$15,000/day; 2.33 percent annual escalation
 - 8 percent ROE after tax
- LNG Processing Losses:
 - estimated from AGIA NPV Report, Fig. 7.2
 - Liquids credit determined using \$80/bbl netback price for LNG and volumes provided by AGPA (88,000 MMBtu/d; ~20,000 bpd)

Mr. Walker noted that the chart illustrated that the cost of putting gas into the pipe was .26 cents, which was unique to Alaska. He reminded the committee that numbers on the slide had been provided by third party interests and from the open season.

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Senator Bishop asked if the price of putting gas in the pipe according to the slide was because there was no required in-field drilling for Prudhoe Bay.

Mr. Walker replied yes. He added that it was associated gas that was extracted with the oil and then re-injected. He offered the comparison of projects in British Columbia where it was nearly \$3 to put gas in the pipe.

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Mr. Walker discussed Slide 7, "...and it competes favorably with both proposed Australian and other North American export facilities which have yet to reach FID." He said that the slide reflected where Alaska landed among a handful of projects in Australia, British Columbia and the U.S Gulf Coast. He relayed that Alaska's estimated cost would allow the state to compete based on price.

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Vice-Chair Fairclough stated that the slide made Alaska look very competitive. She wondered if there were projects with lower cost than Alaska.

Mr. Walker replied that there were "brown field" projects that only required the addition of another train. He stated that on a "green field" project, such as the one under discussion, were typically found to have a higher export price.

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Vice-Chair Fairclough inquired the current market price for gas.

Mr. Walker responded that the Henry Hub price was just under \$3. The Asian Market Price ranged between \$12 and \$14.

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Vice-Chair Fairclough remarked that gas was selling on the open market for less than the \$8.50 reflected on the slide.

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Co-Chair Meyer welcomed Governor Sheffield to the gallery.

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Senator Dunleavy understood that \$8.50 was the cost to ship Alaska gas to Japan.

Mr. Walker replied in the affirmative.

Senator Dunleavy queried the difference in distance between Alaska and Japan versus Kitimat to Japan.

Mr. Walker responded that he believed they were similar in distance.

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Co-Chair Kelly inquired if the \$8.50 included the purchase price.

Mr. Walker replied no. He explained that it was the delivery price at the wellhead.

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CRAIG RICHARDS, ATTORNEY, WALKER RICHARDS LLC, interjected that the \$8.50 was calculated on a netback basis and included taxes and royalty; the purchase price would be the difference between \$8.50 and the price of \$13 in Japan.

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Mr. Walker spoke to Slide 8. He shared that from an economic perspective, Alaskan LNG exports were competitive, viable across scenarios, and could generate between \$220 and \$419 billion for the state. He stressed the importance of remembering that the analysis had been done assuming an export volume of 2.7 mcf, which was what the market could take at the time of the study. He related that the AOGCC had determined that while there had been no applications submitted to apply for an off-take from Prudhoe Bay for a large gas sale, no reason had been found to alter the 2.7 mcf limitation.

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Mr. Walker stated that the initial open season held by TransCanada in 2010 had been unsuccessful and that TransCanada and Exxon Mobile had sent a letter to FERC stating as such. He shared that under the terms of AGIA, the companies needed to have additional expressions of interest every two years. He addressed Slide 9, TransCanada/Exxon AIGA Solicitation of Interest Results September 14, 2012." He said that the expression of interest was non-binding and the slide reflected that Korea, Thailand, Indonesia and Japan showed interest. He relayed that letters of intent from the Asian market had been positive. He said that what the companies found attractive about Alaska's natural gas was the Btu content; they liked the wet gas. He explained that in many locations around the world dry gas was imported and blended with propane which was not a necessity for Alaska gas.

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Mr. Walker felt that a response to the open season that did not involve exporting would send a negative message to the

world market. He stressed that the Asian market was serious about doing business with the state.

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Vice-Chair Fairclough noted that Slide 9 had represented a good showing for the proposed diameter of pipe. She wondered how much gas would need to come through a large diameter pipe to make it cost effective.

Mr. Walker responded that 2.7 bcf would be the most beneficial to the state.

Vice-Chair Fairclough asked if the 2.7 bcf was at the price of \$8.50.

Mr. Walker replied that the assumption used Asian market prices.

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Mr. Richards interjected that at 2.7 bcf, \$8.50 would be the breakeven point. He noted that the current market price in Asia was substantially higher than \$8.50.

Vice-Chair Fairclough understood that \$3 would need to be added for the product.

Mr. Richards replied that it was generally assumed under the Wood/Mackenzie analysis that the producer would also be shipper, which would indicate netback pricing. He explained that it had not been assumed that the gas would be purchased at the wellhead, but that the producer's price was the difference between the cost and what was received at the point of delivery.

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Vice-Chair Fairclough ask what size of pipe would have 2.7 bcf pushing through it.

Mr. Walker responded that 2.7 bcf could be put through a 48 inch pipe with very little compression, provided it was X80, heavy wall pipe. He relayed that analysis done by Bechtel Corporation had advised building the largest pipe possible.

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Vice-Chair Fairclough queried how the life cycle of the pipe informed the economic viability of the pipeline.

Mr. Walker responded the pipe would be there for a long time. He said that the concern was that the basin held the largest untapped gas field in the world and necessitated a large pipe.

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Vice-Chair Fairclough explained that her question was more about depreciation cycles and the lifecycle of the pipe.

Mr. Walker responded that the assumption was that it would be a 30 year project.

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Mr. Walker added that the open season costs included the teardown of the pipe.

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Mr. Walker addressed Slide 10, "HB 4 Problems-LNG Import":

- "If ASAP can't beat the cost of imported LNG then we are on a fool's errand."
- 2006 ANGDA Study (see Exhibit 3)
 - \$62.2 million to convert the existing LNG facility to receiving terminal
 - Volumes imported would match shortfall demand
- Nobody predicts a 100% shut down of Cook Inlet (see Exhibit 2)
- Blended price predicted lower than the 100% volume from ASAP concept
- Closure of exports from Cook Inlet will cause increase in gas availability in South Central

Mr. Walker opined that the challenge with HB 4 was that the state had two significant energy problems: the immediate energy crisis statewide and the long-term fiscal need of the state. He felt that HB 4 did not solve or address

either of the problems. He worried that the market would continue to be confused by the state's lack of activity on a large line, and would continue to sign-up for long-term contracts elsewhere. He urged the committee not to consider the import price alone. He said that HB 4 created pressure for producers to build a small volume line. He thought that importing LNG would be unwise given that there was so much gas already on the North Slope.

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Mr. Walker spoke to Slide 11, "HB 4 Problems-Does it Violate AGIA?":

- Legal opinion by Legislative Counsel obtained by the sponsor of H.B. 4 (February 15, 2013) (see Exhibit 4) raises unanswered questions
- Does a 1.6 bcf/d pipeline violate the assurance clause in AGIA?
 - If H.B. 4 is in violation of AGIA, then the fiscal note needs to be doubled or tripled
 - AGDC potential capacity above .5 bcf/d, tax exemption and state financial support "could result in liability under the assurances." Opinion at 9-11
- Is AGIA license out of compliance? If so, why are we discussing a low volume pipeline?
 - The TransCanada project was a highway project
 - On May 2, 2012 Administrated modified original project plan to allow LNG alternative (see Exhibit 5)
 - "A strong argument may be made that the licensee's assessment of an in-state natural gas pipeline is a different project and not a modification of the project licensed under AGIA." Opinion at 8

Mr. Walker stated that the opinion questioned whether or not AGIA was currently valid. He said that the AGIA process was for a line to Alberta, and a letter to FERC had been issued stating that the open season for that project was done. He noted that the opinion questioned the validity of the amendment made in May 2012 under the dual commissioners of AGIA to discuss LNG; if AGIA was a project into Alberta, and the project no longer existed, it could not be amended.

He mentioned that volume was another issue. He said that it was clear that the AGIA line had the potential of 1.6 bcf on a 36 inch line, but unclear if it should be based upon the measurement of initial throughput or the maximum throughput. He said that if AGIA was still currently valid then there was reason to be concerned that HB 4 was in violation of AGIA.

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Mr. Richards discussed his experience in the area oil and gas.

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Co-Chair Meyer noted that Senator Hoffman had joined the meeting.

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Mr. Richards spoke to Slide 11. He asserted that Legislative Legal had advised the legislature that HB 4 ran the risk of violating AGIA, which could cost the state a considerable amount of money under the Exclusivity Provision. He countered that if the bill did not violate AGIA, and if TransCanada was no longer in compliance, then considering a small volume line was questionable. He believed that it was understood that a larger line was in the best interest of the state. He contended that the justification for HB 4 in pursuing a small volume line was that AGIA prevented the state from doing an alternative large volume project. He stressed that if AGIA was not in effect, as the legal opinion suggested, then the larger line was in the state's best interest.

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Mr. Walker spoke to the handout, "Import-Export-LNG Trade Flows Map" (copy on file), which compared the shipping distances from place of production to import destination. He believed the map illustrated Alaska's geographical advantage.

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Mr. Richards spoke to Slide 12, "HB 4 Problems - Circumvents Existing Regulatory Framework - History of Regulatory Treatment":

- LB&A Briefing Paper on FERC Open Season Regulations (November 9, 2004) (see Exhibit 6)

- "Rational economic behavior suggests if the Big Three or similarly situated companies own the Alaska gas pipeline, they [will] use their vertically-integrated market dominance to limit competitor access to the pipeline, as well as extract a high tariff from those who do gain access - more income for them, higher costs for their competitors, and lower wellhead values on which royalties and taxes are payable to the State of Alaska. In fact, this is the story of the Trans-Alaska oil pipeline (TAPS), except that with TAPS its status as a common carrier has thwarted any effort to use market dominance to limit access. TAPS tariffs, however, have proven to be an obstacle to competition, and have been cited by more than one company as a reason for withdrawing from efforts to commercialize Alaska's resources."

- "The challenge for the Commission, then, is to create rules that give birth to competition, even in the face of an Alaska gas pipeline that will be a natural monopoly and may be owned by those with production interests better served by suppressing competition."

- "The Alaska Legislators conclude that, unlike the situation in the lower 48, there is no existing or foreseeable competitive environment in Alaska, where the North Slope Producers not only control the known gas reserves, but also may become the sponsors of the Alaska pipeline. Therefore, the Commission was right to not rely on market forces in Alaska to ensure the developments, routing, sizing and timing of an Alaska pipeline." FERC Order 2005-A ¶ 29 (June 1, 2005)

Mr. Richards believed that it was important to mention that regulations were already in place and HB 4 would be a fundamental rewrite of gas pipeline regulations. He furthered that the bill was inconsistent with federal jurisdiction treatment and existing state jurisdictional

treatment. He queried why the state would change the way off-slope gaslines were regulated.

Mr. Richards spoke to Slide 13, "HB 4 Problems-Circumvents Existing Regulatory Framework-FERC Regulation":

- In 2004 Congress required FERC to adopt open season regulations that provide access for non-Prudhoe Bay and Point Thomson gas

- In 2005 FERC adopted Alaska natural gas pipeline open season regulations (see Exhibit 7)

- "[W]e are well aware of the risks to competition imposed by a project that is owned or primarily sponsored by a small group. Thus, we are imposing strict requirements on all proposals, and particularly on affiliate-owned project, with respect to public disclosure of information, to ensure that there is a level playing field. . . We will require applicants for an Alaska pipeline project to provide detailed information as to project design, how capacity is to be allocated, and proposed rates, terms and conditions. This will allow us to be in a position to monitor whether competition for capacity is fair. In addition, while we are permitting pre-subscription for 'anchor' shippers, we are requiring that contracts with such shippers be made publicly available, and that all shippers seeking the same type of capacity be offered service on the same terms and conditions."

Mr. Richards shared that the concern of Congress had been that the state would build a capacity constrained line that would not allow further development of the basin. He said that FERC designed the regulations to ensure that Alaska's North Slope Basin would be opened up in the most efficient way possible; through an Alaska natural gas pipeline transportation project. He relayed that the FERC regulations were challenged by producers. He asserted that Alaska, because it was dominated by three producers that had demonstrated a history of high tariffs and anticompetitive behavior, needed to have open season regulations in place that would ensure an open process for independence should the state expect further development of the gas basin beyond Prudhoe Bay and Point Thomson. Mr. Richards elaborated on FERC regulations.

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Mr. Richards discussed Slide 14, "HB 4 Problems-Circumvents Existing Regulatory Framework-Regulatory Commission of Alaska and not FERC Jurisdiction":

- FERC has said no jurisdiction over an Alaska LNG export project that does not ship interstate. Yukon Pacific Corporation, 39 F.E.R.C. ¶ 61,216 (1987) (see Exhibit 8)

- AGDC is also a political subdivision of the State, and thus not subject to FERC jurisdiction under the Natural Gas Act. Tennessee Gas Pipeline Co., 69 F.E.R.C. ¶ 61,239 (1994); Somerset Gas Serv., 59 F.E.R.C. ¶ 61,012 (1992)

- Since RCA and not FERC will regulate this pipeline, it is critical the RCA be empowered to exercise maximum regulatory oversight

Mr. Richards highlighted that provided it treated an export project consistent with past FERC actions, FERC would not have jurisdiction over an export or and in-state project. He said that if AGDC owned the pipeline it would be exempt from FERC jurisdiction. He noted that the RCA was competent to handle rate and access matters in the state, but without FERC jurisdiction access, rates and expansion could be mismanaged.

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Mr. Richards believed that HB 4 disemboweled the regulatory authority of the RCA. He stated that the first change in the law that HB 4 would enact would be the change in treatment of common carriage versus contract carriage for in-state pipelines. He explained that if an LNG project was going to be built it would have to be a common carrier for in-state volumes according to current Alaska law. He shared that for export volumes the state could be a contract carrier. He said that the state should want common carriage status for in-state volumes because it ensured that new production on the North Slope could get into the pipeline and that utilities that did not have gas purchase contracts in place at the time of the open season could get gas into the pipeline.

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Senator Bishop wondered why pipelines in the Lower 48 were moving more toward contract carriage.

Mr. Richards replied that FERC had decided to deregulate because in the Lower 48 there were competitive markets and competition between pipelines. He added that due to Alaska's lack of competition, FERC was going to allow contract carriage in Alaska, but that the state had regulatory concerns about access in addition to those of FERC and wanted to use common carriage for in-state volumes.

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Vice-Chair Fairclough understood that HB 4 suggested contract carriage.

Mr. Richards replied yes.

Vice-Chair Fairclough noted that HB 4 suggested pushing .5 bcf per day in order to comply with AGIA.

Mr. Richards said that state demand was 250 mcf per day, which was 50 percent of a volume restricted pipeline and 10 percent of a three train project. He added that HB 4 was designed to handle capacity substantially larger than .5 bcf per day. He said it was anticipated to handle 1.6 bcf per day.

Vice-Chair Fairclough asserted that 1.6 bcf per day would be out of compliance with AGIA.

Mr. Richards said that it was unclear whether AGIA was still in effect and whether the HB 4 sponsors were limited to it.

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Vice-Chair Fairclough contended that the sponsor had presented a project that was in compliance with AGIA. She believed that the scenarios in the presentation reflected the opinions of Mr. Richards and Mr. Walker, rather than making a true comparison to HB 4. She expressed the desire for clarity; she had understood that Alaska would use, in-

state, approximately 200 to 250 mcf per day, which would be 50 percent volume under the HB 4 proposal.

Mr. Richards clarified that 10 percent would be the three train project out of Valdez with a 42 or 48 inch pipe.

Vice-Chair Fairclough requested that the presenter note other places in the presentation where the numbers reflected a pipe size different than in HB 4.

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Mr. Walker interjected that HB 4 did not designate a particular pipe size. He asserted that the pipe could be 48 inches as the size was undetermined in the legislation.

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Vice-Chair Fairclough remarked that HB 4 presented a scenario based on AGIA and that AGIA set the limit of .5 bcf.

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Mr. Richards said that it was in the interest of the state to have common carriage for in-state volumes. He continued to Slide 15, "HB 4 Problems - Circumvents Existing Regulatory Framework - Common Carriage In-State":

- AS 38.35.120 - Off slope gas pipeline
 - Common carrier for in-state volumes
 - Either Contract or common carrier for volumes to LNG terminal
- Common carrier pipelines ideal
 - Ensures late entry
 - Financed all the time (e.g., TAPS)
- Contract carrier status helpful to financing
 - Contract for export volumes already a compromise
 - In-state demand less than 10% of likely capacity
 - Minimum level of common carriage for in-state volumes will not substantially impact financing

Mr. Richards explained that currently oil pipelines throughout the U.S., including TAPS, were all common carriers and were financed all the time. He said that in

that scenario the shipper is not part of the financing. He explained that the advantage of having contract carrier status was the credit worthiness of the project developer and the shipper. He felt that contract carriage helped financing for independent pipelines; however, affiliated pipelines had a substantially reduced contract carriage guarantee.

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Vice-Chair Fairclough asked which type of carriage was most popular in the Lower 48.

Mr. Richards replied that gas pipelines were typically contract carriers and oil pipelines were always common carriers.

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Vice-Chair Fairclough asked how common carriage was a better deal for Alaska when the state could get better financing as a contract carrier.

Mr. Richards replied that a common carrier project would ensure future access for non-Prudhoe Bay and Point Thomson fields. He added that it ensured that product could get to market.

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Vice-Chair Fairclough wondered if the recourse fee that would be established by the RCA would protect the state.

Mr. Richards replied no. He said that having the recourse fee would be useless as there would be no capacity in the pipeline or rolled in rates.

Co-Chair Meyer requested that members hold their questions until the end of the presentation.

Mr. Richards looked at Slide 16, "AGDC Problems - Circumvents Existing Regulatory Framework - Rolled In Rates":

- Expansion by rolled-in or incremental rates
 - "incremental pricing puts all of the costs associated with an expansion on the parties who

caused the expansion . . . [while] rolled-in pricing spreads the costs of the expansion over all customers - existing and new" (see Exhibit 9 at 1)

- FERC Order 2005 ¶ 123 (see Exhibit 7)
 - "We conclude that there should be a rebuttable presumption in favor of rolled-in pricing for project expansions. Our existing lower-48 states policy favoring incremental rates for expansions does not apply in the case of an Alaska natural gas transportation project. There is likely to be only one Alaska pipeline, so there will be little or no opportunity for competition between pipelines. Incremental pricing of expansion could put expansion shippers at a significant rate disadvantage compared with initial shippers, and accordingly could discourage exploration, development and production of Alaska natural gas."

- Rolled-in rates an AGIA "must have" (see Exhibit 10)

Mr. Richards stated that FERC had found the presumption for rolled in rates was important for development of the basin. He noted that Slide 17 gave further details:

- Expansion occurs in two ways (see Exhibit 9 at 3)
 - Low cost compression, which reduces rates
 - High cost looping, which increases rates

- H.B. 4 states rolled-in rates available if maximum rate under negotiated agreements not exceeded
 - Initial shipper (under negotiated terms) gets rate benefit of compression, but does not pay for looping?

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Mr. Richards discussed Slide 18, "HB 4 Problems - Circumvents Existing Regulatory Framework - 'Just and Reasonable' Rates":

- Under State royalty and tax netback regime producers have immense incentive to maximize tariffs to minimize government take
 - 1977 BP Memo explains producer "highest possible tariff" strategy (see Exhibit 11)

- History demonstrates State negotiations are no substitute for just and reasonable rates

- 1985 TAPS Settlement Agreement resulted in \$13.5 billion (1997 dollars) in tariff overcharges. 2007-2009 Gleason Decision at ¶ 76

- Independents frozen out:

- Tariffs above "just and reasonable" rates have resulted in independents leaving the Slope

- "It broke my heart to trade Milne Point, but we had to do it. All the values of that property was taken away from us in the pipeline tariffs. It was a valuable strategic lesson[.]" Archie Dunham, CEO Conoco (August 1996) (see Exhibit 12)

Mr. Richards relayed that under FERC precedents, as well as current RCA law, rates on oil and gas pipelines must be just and reasonable. He shared that "just and reasonable" meant that that rate had to be based on providing the actual cost of service plus an allowed rate of return. He said that just and reasonable rates were current law in the state for oil and gas pipelines, and the law for oil pipelines in the Lower 48. He stated that the law applied to gas pipelines in the Lower 48, with the exception of pipelines that filed a negotiated tariff on gas pipelines before 1996. He said that the problem with HB 4 was that it had a recourse rate that was just and reasonable, but history had demonstrated that shippers wanted high rates. He explained that tariffs were not an economic cost to integrated shipper/owners but a pocket-to-pocket transfer. He said that the true cost of service was the actual money spent by an owner shipping the affiliated product.

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Mr. Richards spoke to Tab 11 of members binders which was a BP memo from 1977 that explained why an affiliated shipper in the state would want to file the highest possible tariff. He offered that having a high tariff allowed for control of the basin and reduced the taxable value of the oil and gas for the purposes of production taxes and royalty payments.

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Mr. Richards spoke to Slide 19, "HB 4 Problems - Circumvents Existing Regulatory Framework - 'Just and Reasonable' Rates":

- AS 42.06.370(a): "All rates demanded or received by a pipeline carrier . . . shall be just and reasonable."
- "Just and reasonable" standard means FERC and RCA set under cost of service methodology
- FERC allows negotiated rates on gas pipelines so long as customers electing the recourse rate will be no worse off as a result of the use of negotiated rates
 - Negotiated rates subject to FERC review

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Mr. Richards discussed Slide 20, "Pre-Subscription Agreements":

H.B. 4 Rules

Confidential and filed under seal
Individually negotiated
Precedent agreement capacity not reduced to accommodate open season volumes
Deemed "just and reasonable" unless unlawful/unfair dealing; affiliated owner/shippers okay if similar to one with unaffiliated party

FERC Alaska Rules

All public within 10 days
All shippers can chose terms of any precedent agreement
Precedent agreement capacity reduced pro rata if open season volumes not accommodated
Late bid provision allows shippers to obtain capacity after the expiration of the open season
Subject to FERC negotiated rate review

[4:55:08 PM](#)

Mr. Richards spoke to Slide 21, "HB 4 Problems - Project Scope - Pipe Size Not Critical Cost Driver":

- Example - see Exhibit 13 - Alyeska 2013 cost study reported direct costs of replacing TAPS (plus owner, management and engineering costs) less marine terminal(*) at

- 30" pipe with 440,000 bbl/d capacity () ~ \$8.9 billion
- 48" pipe with 750,000 bbl/d capacity (+) ~ \$9.7 billion
- Shared cost estimating team
 - TAPS RCN: Stantec, Michels, Micheal Baker, Price Gregory, Alyeska
 - AGDC: "Michael Baker Jr., Inc. (Baker), Price-Gregory International, Inc., Ward Whitmore & Associates, Larkspur Associates, and DoyonEmerald." (7/15/10 AGDC Project Update at 12)
- Conclusion: Cost of large diameter pipe likely not critical cost driver
- (*)AGDC reports direct costs plus owner, management and engineering costs at ~ \$7.7 billion
 - () 650,000 with drag reducing agent
 - (+) 1,000,000 with drag reducing agent

[4:58:24 PM](#)

Mr. Richards addressed Slide 22, "HB 4 Problems-Project Scope-Cost of Expandable Capacity Relatively Small":

- Gas conditioning, compression and liquefaction facilities can be added after initial construction
- But if thin walled, small volume pipe State trapped
 - Minimum 10 years from project start to expand pipe
 - Cost of large thick walled pipe 10-20% more???
 - Not defined given public cost estimate not transparent

[4:59:44 PM](#)

Mr. Richards spoke to Slide 24, "HB 4 Problems - If it Becomes the Large Project, Alaska Loses":

- Be wary that the State will negotiate bad agreements, or project transferred to producers without regulatory checks and balances

- Sec. 32.25.030(e): Four board members make major decisions
- If AGDC proposal becomes the "big line," it will be without regulatory safeguards
 - No FERC jurisdiction
 - RCA disempowered
 - No in-state common carriage
 - No rolled-in rates
 - Negotiated rather than just and reasonable rates
- For all project concepts
 - Mandate RCA regulatory structure supplemented with FERC open season rules
 - Reserve to the Legislature final approval before project transferred or shipping agreements finalized

[5:00:50 PM](#)

Mr. Richards strongly suggested that the existing regulatory structure not be changes via HB 4 without further vetting and analysis.

Mr. Walker interjected the importance of LNG trucking in Fairbanks. He added that the 'must haves' for the state that had been written into AGIA would be stripped away by HB 4. He believed that passing HB 4 would not be in Alaska's best interest.

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[5:09:16 PM](#)

STEWART GOERING, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF LAW, related that he had been assigned to represent and advise the Regulatory Commission of Alaska.

[5:11:04 PM](#)

Vice-Chair Fairclough asked if the RCA currently monitored any pipelines in the state.

Mr. Goering responded that the RCA regulated several pipelines under AS 42.06; the Pipeline Act.

[5:11:42 PM](#)

Vice-Chair Fairclough inquired whether the pipelines were contract or common carriage.

Mr. Goering replied that all natural gas pipelines in Alaska were common carriers. He noted that AS 42.04 had been amended to allow for contract carriage-like provisions in order to provide firm and interruptible service.

[5:12:29 PM](#)

Co-Chair Meyer understood that the pipeline proposed in HB 4 would fall under RCA and not FERC jurisdiction.

Mr. Goering said that that was his understanding.

[5:13:00 PM](#)

Co-Chair Meyer inquired if it would be the responsibility of the RCA to ensure that independents had access to the pipeline.

Mr. Goering explained that under HB 4 access to pipeline capacity would be through the open season process overseen by the RCA as specified in AS 42.08.300. He said that the concept of a recourse tariff, and the responsibility for reviewing the tariff by the RCA, under was contained in HB 4. He said that the concept was not identical to the FERC practice, but that he did not believe that it had been the sponsor's intention to duplicate FERC practices.

[5:14:29 PM](#)

Senator Olson asked if the department agreed that if the export line went to 48 inches in diameter it would fall under FERC jurisdiction.

Mr. Goering responded that he did not have enough information to take a position on the question.

[5:14:58 PM](#)

Senator Olson asked if a gasline could be both a common and a contract carrier.

Mr. Goering thought that it was possible for capacity to be reserved for common carriage within a contract carrier line.

Senator Olson wondered how the RCA would handle to a split carrier line.

Mr. Goering responded that as long as the legislature made it clear what the RCA should do, the RCA would work to implement the policy decisions made by the legislature.

Senator Olson probed for any unforeseen problems with the gasline that had yet to be discussed.

Mr. Goering thought that the question was open-ended. He said that the RCA currently operated under jurisdictional limits; any delivery of petroleum products by truck, tank or similar conveyance, were not within the RCA's jurisdiction.

Senator Olson asked if the circumstances applied to barging.

Mr. Goering replied yes.

[5:18:43 PM](#)

AT EASE

[6:04:38 PM](#)

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Senator Dunleavy inquired what the minimum size of pipe would be to suit the needs of the project proposed in HB 4.

Mr. Walker referred the question to Bechtel Corporation.

[6:07:05 PM](#)

Vice-Chair Fairclough inquired if Mr. Walker had an export license.

Mr. Walker replied no. He added that the parent company of the Yukon Pacific Corporation, CSX Corporation, chose not to renew the license.

[6:08:23 PM](#)

Senator Dunleavy inquired if the venue for tidewater mattered.

Mr. Walker replied that it was not location specific, but that it needed to be a world class export project to meet the world class volume.

[6:09:17 PM](#)

Senator Olson questioned the accuracy of the estimates of \$8 billion for a smaller line and \$9.7 for a larger line.

Mr. Richards pointed out that the cost estimates in the presentation reflected only direct costs, owner's costs and management engineering.

Senator Olson asked how much money would be spent before the state generated revenue from the line.

Mr. Walker said that revenue for a large volume project would begin as soon as gas began flowing.

[6:10:10 PM](#)

Mr. Richards stated that the cost estimate in the presentation was not for a gas pipeline project, but one conducted by Alyeska to determine the cost of possible rebuilding the oil pipeline.

[6:12:36 PM](#)

Senator Olson asked how the LNG project was different than other big energy projects that had been proposed in the past.

Mr. Walker responded that the difference with the LNG was that it was pre-sold. He stated that the financing would never happen without first having customer lined up. He stated that it was not a "build it and they will come" scenario.

[6:15:02 PM](#)

Mr. Richards recommended following the FERC model for the RCA. He said that the surest way not to get stuck with a

small pipeline would be to leave the regulatory authorities with mandatory design change jurisdiction and to require rolled-in-rates.

[6:15:59 PM](#)

Vice-Chair Fairclough asked how a larger pipeline could be financed.

Mr. Richards replied that if the line were to be build over-capacity it would be financed by the tariff. He said that ideally the participants would be lined up at the beginning of the process.

Vice-Chair Fairclough understood that the larger pipe would increase tariffs and increase the cost of gas to Alaskans.

Mr. Richards reiterated that the state should leave the regulatory agency with the jurisdiction to mandate the design change and maintain rolled-in-rate provisions.

[6:18:23 PM](#)

Co-Chair Kelly noted if the pipe was high-pressure it would require a straddle tank in order run the gas into the utility system, which would cost \$250 million and that the rate payers would suffer the cost. He said that if the state wanted to run the high-pressure pipe to rural areas, additional straddle plants would need to be built. He wondered how residents would be able to bear the cost of the additional straddle plants. He did not believe that a high-pressure line made sense for the state.

Mr. Walker replied that the cost of the tariff in a high-pressure, high-volume line would be significantly lower than a smaller line because more people would share in the cost of the gas.

[6:21:01 PM](#)

Co-Chair Kelly asked what project should replace HB 4 in order to solve the state's energy needs.

Mr. Walker replied that something needed to happen in the interior right away. He believed that trucking was a good start. He expressed concern that without an export angle, HB 4 would not put any revenue into the state and did

nothing to help in the short-term. He felt that HB 4 missed that mark for the current crisis and into the long term. He said his biggest concern with the legislation was that the line could be turned over to a third party entity, such as one of the current producers on the North Slope, which he believed did not protect Alaskans.

[6:23:54 PM](#)

Senator Dunleavy asked Mr. Walker how AGIA should be handled when developing a gasline.

Mr. Walker responded that it should begin with a discussion with TransCanada.

[6:25:52 PM](#)

REPRESENTATIVE MIKE HAWKER, asserted that Walker and Richards LLC had just delivered a million dollar ad campaign to defeat HB 4 as hosted by the City of Valdez. He noted that there had been no other gas pipeline legislation moving forward. He contended that the testifiers were lawyers who were paid to instill doubt and shake committee support for HB 4. He warned the committee that the presentation was factually misleading and comprised of offensive inflammatory rhetoric. He related that the sponsors would work to alleviate any concerns that had been raised by the presentation. He wished to formally respond at a later date to the questions raised by the presentation concerning the regulatory sections of the bill. He stated that he did not agree with the testifier's characterization of HB 369. He relayed that HB 4 and HB 369 were about getting Alaska's gas into the hands of Alaskans. He said that AGDC would have the authority to work with communities to assure that gas was available to all communities. He noted that the presentation had spoken to projects that did not exist and that some claims made in the presentation were technically questionable.

[6:33:19 PM](#)

Representative Hawker related that HB 4 was not only about one project. He offered that HB 4 would not violate AGIA as the "sharp lawyers" had asserted. He requested the committee to read the full legal opinion from Mr. Bullock. He shared that ADGC was prohibited from doing anything that would violate AGIA. He suggested that HB 4 was a good

solution to Alaska's energy need if for no other reason than it was a project that existed. He believed that AGIA had failed the state. He concluded that the sponsors were about negotiating solutions for Alaska's energy problem and not about fighting over differences.

[6:37:27 PM](#)

Vice-Chair Fairclough noted that time was limited.

[6:37:45 PM](#)

REPRESENTATIVE MIKE CHENAULT, was upset about the presentation. He reiterated the previous testimony that the bill did not violate AGIA and asserted that the governor supported HB 4. He said that the bill had been completely vetted. He stated that if there was fear at the table that a state corporation, under the leadership of the administration would give away state assets for nothing, then HB 4 should not pass out of committee.

[6:42:15 PM](#)

Representative Chenault opined that projects were frequently being killed in Alaska. He asserted that aside from TAPS, every project that FERC had been involved with in Alaska had been unsuccessful in getting pipe in the ground.

Vice-Chair Fairclough requested further discussion of the Bullock legal opinion.

[6:44:25 PM](#)

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[6:45:47 PM](#)

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Vice-Chair Fairclough requested further discussion on rolled-in rates and other challenges to the legislation.

Representative Hawker asked if the rebuttal testimony should be given personally or in written form.

Vice-Chair Fairclough requested that it be submitted before the committee so that it could be recorded for the permanent record. She asked the sponsors to prepare an

official rebuttal to present to the committee at a later meeting.

[6:48:02 PM](#)

#

ADJOURNMENT

The meeting was adjourned at 6:48 p.m.