HB

2003

HOUSE COMMITTEE REPORT

(7)
Date Referred to Committee: May 31, 2006 **FURTHER REFERRALS: Finance**

Date of Committee Action: 06/03/06

The JUDICIARY Committee considered: **HB 2003**

HOUSE BILL NO. 2003 **NATURAL GAS PIPELINE CORPORATION**

"An Act establishing the Alaska Natural Gas Pipeline Corporation to finance, own, and manage the state's interest in the Alaska North Slope natural gas pipeline project and relating to that corporation and to subsidiary entities of that corporation; relating to owner entities of the Alaska North Slope natural gas pipeline project, including provisions concerning Alaska North Slope natural gas pipeline project indemnities; establishing the gas pipeline project cash reserves fund in the corporation and establishing the Alaska natural gas pipeline construction loan fund in the Department of Revenue; making conforming amendments; and providing for an effective date."

Recommends it be replaced with [ ] HCS *or* [X] CS *for* HB 2003 (JUD)
For Senate Bills with new title: [ ] Technical Title [ ] New Title: HCR_____ **[X] Same Title [ ] New Title**

[ ] attach amendments
[ ] add new referral to _____Committee
[ ] Letter of Intent_____Committee

List of Abbrev for Depts.:
ADM
CED
COR
CRT
EED
DEC
DFG
GOV
HSS
LEG
LAW
LWF
MVA
DNR
DPS
REV
DOT
UA

NEW FISCAL NOTES *Assigned by Chief Clerk's Office

List by Dept(s):	*FN#	Fiscal	Indet.	Zero
REV		X		
DNR				X

PREVIOUS FISCAL NOTES

List by Dept(s):	FN#	Fiscal	Indet.	Zero

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
	Gara				✓
John Cobb	Cogliati			✓	
Peggy Wilson	WILSON	✓			
	KOTT			✓	
	Gruenberg			✓	
Chair:				✓	
Chair:					

Questions from Legislators to Consultants

1.) What are, (if any), "show stoppers", in the proposed Gas Line Contract? Please limit to the top three. What, in your opinion, are the "fixes"?

Response from James Barnes:
Most of the "concerns" would be value judgments that may be unusual but acceptable if there was only one or two but that may not be acceptable if there are too many. Separate and apart from the concerns that are value judgment are the concerns which are not currently permissible under the SGDA. The proposed SGDA Amendments are intended to remedy these impermissible items.

2.) Given Alaska has a "Gas Reserve Tax" initiative on the ballot in November, what are the impacts on the proposed Gas Line Contract/Gas Pipeline construction economics, if it passes?

3.) Given the term "diligence" in the proposed contract, what are your recommendations to tighten parameters?

Response from James Barnes:
See JB memo on "work commitment". In addition the State might consider making the Participants' commitment to actually build the gas pipeline as a condition precedent to the grant of benefits under the fiscal contract.

4.) What is the highest state risk under the proposed contract and your recommended fixes?

Response from James Barnes:
No way to answer what would be the hierarchy of values for another person.

5.) Will the State be getting a "good deal" economically under the current contract provisions? If the answer is "no" what fixes do you recommend?

6.) I have heard multiple Alaskans say "the contract panders to oil companies". In your opinion what aspects (if any support) this theory?

Response from James Barnes:
See JB memo on the effect of the fiscal contract on the regulatory regime; fiscal stability for oil, the uncertainties about the State participation; and the work commitment. In addition the provisions concerning pipeline expansion seem weak.

7.) Are there any entity agreements or drafts of entity agreements? If entity agreements exist, are they available for review?

Response from James Barnes:
Not so far.

8.) If no drafts or agreements are available, how will the legislature know how cost and tax items will be allocated among the Participants?

Response from James Barnes:
The project entity agreement will hopefully set out most of the governance matters such as ownership, voting, Operatorship, etc.

9.) If the legislature assumes that the entities will not be taxable entities (like a corporation) but will be non-taxable at the entity level (like an LLC), then how will items of income, expense, deduction etc. be allocated by the Participants?

Response from James Barnes:
In general LLC's distribute income and loss in the same manner as a partnership, ie a conduit. However, disproportionate distributions would have to be explicitly set ot in the governance documents.

10.) For instance, if there is an item of investment tax credit, will it apply at the entity or Participant level? If the investment tax credit applies at the Participant level, will any portion of ITC/depreciation, be allocated to the State?

Response from James Barnes:
ITC's would be an example of an item that may be disproportionately allocated, but without the governance and related agreements there is o way to tell.

11.) If State owns 20% of GTP, and there is a 35% ITC on the GTP, will the State get 20% of the 35% or will all 35% be allocated to the taxable Participants?

Response from James Barnes:
Don't know. It may in part depend on whether the AK Pipeco is set up as a tax bearing entity.

12.) For a regulated utility, under RCA regulation, if there is a tax savings resulting from a difference in tax vs. regulatory treatment of say depreciation, the tax (cash) benefit of that difference results in a benefit to the rate payer. For instance, based upon my simple understanding, if a utility can depreciate an asset over 40 years for regulatory purposes and can depreciate an asset over 7 years for tax purposes, there is a substantial tax savings resulting from the shorter depreciation. That tax saving goes into a deferred tax account and reduces the rate base of the utility for purposes of determining return on investment. Does this same type of treatment apply under FERC regulation?

13.) If the treatment does apply under FERC, then if the entity owning the pipeline can depreciate the pipeline over 7 years, and the rate base is reduced then the State's return on its investment will be reduced and the State will get no direct benefit from the accelerated depreciation. Is this correct?

14.) Stated ditferently, if it is assumed there will be only one tariff on the gas pipeline, and that the tariff rates will be determined based upon the entities' books and records, not the Participants' books and records. If this is correct, then can it be assumed since the State only owns 20% of an entity, the State will have little or no control over how the decisions are made. One can envision relatively few decisions where the result of the allocation or tax treatment decision will fall evenly on the State as a non-taxable entity, versus the taxable entities owning 80%. Therefore one can assume that the Producers will chose the tax treatment that increases cash flow and IRR, to them, even at the expense of lowering the return on investment incorporated in the tarriff rate. The State will lose twice because its investment in the pipeline will be reduced, causing a lower "return" and its net from the

income tax side of the equation will be reduced because of the enhanced deductions or tax credits. Are these assumptions flawed?

15.) In the *Fairbanks Daily News Miner* this morning, May 23, 2006, an administration spokesperson was quoted as saying, "Fairbanks will the municipality in the United States with the lowest price for natural gas". Is there anything in the contract that supports this statement?

Response from James Barnes:
The fiscal contract provides that the Mainline will have several offtake points and explicitly states that the building of the off-take point is the extent of the Participants responsibility.

16.) Is it correct that the price of natural gas in Fairbanks is not "regulated" but is competitively priced compared with other fuel alternatives. If Fairbanks doesn't get the lowest price gasoline with a refinery in its backyard, what assures us that we are going to get the lowest price for natural gas in the United States?

Response from James Barnes:
The fiscal contract does not specify any local supply obligation. If the price at any offtake point is competitive with gas prices at the pipeline terminus the gas owners would probably sell, but there is no obligation even at a competitive price.

17.) My question is how the surrender of our taxing authority (disclaimers to the contrary, not withstanding) relates to existing outstanding General Obligation bonds and our future ability to issue GO debt? Same question as to the overall financial risk associated with the financial obligations associated with the gas contract apart from the question of our inability to raise taxes in the future. While there may be technical and legal reasons why neither is a breach of existing covenants, it would seem to me that at a practical level our ability to raise taxes to meet obligations might be seriously impaired if things do not go well and that our bond holders would be concerned about that. Do the bond markets respond to things such as this?

Response from Phillip Gildan:
First, without copies of the State's outstanding General Obligation Bond Resolutions, we cannot provide a definitive response to the questions. We can

address a generic response from a standard general obligation bond (GO Bond) perspective applied to the proposed gas contract financial terms.

Generally, in a GO Bond financing the issuing government provides the bondholders a pledge to pay the annual interest and principal due on the GO Bonds from general tax revenues with the agreement that the issuing government will unconditionally and irrevocably levy such taxes as necessary to pay the interest and principal on the GO Bonds as they come due. The GO Bonds are backed by the full faith and credit of the government vis-a-vis a revenue bond which is backed solely by the revenues generated from a particular enterprise or non-general tax source. Generally, a GO Bond resolution does not dictate how the government should meet its tax pledge obligation, utilizing a more broadly based pledge to do all that is necessary to meet its payment obligations to the bondholders.

Therefore, it would not generally be a default in a GO Bond resolution if the government chose to limit its taxing authority for a particular taxable activity, so long as that limitation did not materially impact or impair the government's overall taxing pledge and ability to meet its financial obligations to the bondholders. That materiality test would have to be analyzed on case by case basis.

Again, to undertake such an analysis of the State of Alaska's GO Bond obligation would require review of the GO Bond resolutions together with an economic analysis of the level of outstanding GO Bond debt and the available coverage provided by existing net State tax revenues.

On a practical level, however, the Bond Ratings Agencies and the bond markets generally undertake these same analyses with a much broader perspective than a "breach of covenants" standard of review. They undertake a more relative risk assessment based on a given point in time and current circumstances. In this regard, if the State imposes limits on its ability to unconditionally raise tax revenues, such limitation, depending on its materiality, will have a negative impact on the State's credit rating, with the more material the limitation and the greater the outstanding and anticipated GO Bond debt, the more negative the impact. That impact may not result immediately in increased interest rates or change in current credit rating, but may instead impact the cost and sizing of future debt financings.

Applying this general review to the specifics of the proposed gas contract, two areas of the gas contract come into play; the proposed limitation on revising oil and gas related taxes for the term of the contract, and the State's participation as an owner in the pipeline project. The above discussion addresses the oil and gas tax limitation issues, which again would require a specific analysis of the GO Bond resolutions and financial circumstances of the State. One unknown, however, is how the Ratings Agencies and the bond markets will analyze the potential market risk associated with a decision by the State to take in-kind gas in lieu of taxes. The impact of the State taking such market risk may not be felt immediately, but could have a significant impact in the future as the pipeline project commences operations and the market risks are better quantifiable.

The provisions regarding the State's participation as an owner in the pipeline project adds a number of other issues to the discussion. As the Administration's financial consultants discussed in the just completed Contract Presentations, the State's debt participation in the pipeline project will be predominantly revenue bond based, with no anticipation to utilize GO Bond debt or a full faith and credit pledge of the State. Once the pipeline project is completed and operational, the revenue bond debt obligations of the State would not be expected to have a material impact on the State's GO Bond credit ratings or the State's ability to borrow GO debt. As the Administration's consultants well described, until the pipeline project is completed, the risk of completion and the means/methods the State chooses to address the funding of its pre-completion obligations could have a negative impact on how the State is viewed by the Ratings Agencies and the bond market.

While the use of a GO pledge is apparently not anticipated, even a moral pledge to budget and appropriate to meet the pre-completion obligations can be viewed negatively. Mitigating factors on the pre-completion risk and the means/methods of addressing funding could minimize or substantially reduce any negative impact on the bond markets during the pre-completion stage of the project. The funding of the equity side of the State's participation could also have a short term impact on the bond market. To the extent that State reserves are reduced to fund the equity participation or that such funding has a negative impact on the State's budget or other project funding, the Ratings Agencies and bond market could raise short term concerns. This again will be dependent on the overall State financial picture and the materiality of the equity funding amount relevant to the overall State financial picture and the level of outstanding and anticipated GO debt. Once the pipeline has been completed and operational revenues commence, then the risk and impact of these items should be

eliminated. At that time, to the extent that net revenues inure to the benefit of the State as part owner of the pipeline project, such revenue generation should enhance the State's perception by the Ratings Agencies and the bond market.

Since we do not have sufficient information to provide more than this general discussion responding to this query, you may want to suggest having a dialogue with the Ratings Agencies to obtain their view on the pipeline project and the proposed gas contract as it may impact their rating of the State. While it may be too early to get a definitive response, such a discussion could provide preliminary insight into the Ratings Agencies' views that could be useful.

18.)

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
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Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM June 2, 2006

SUBJECT: Confirmation of members of the board of directors of the Alaska Natural Gas Pipeline Corporation (amendment to SB 2003, Work Order No. 24-GS2056\A.1)

TO: Senator Con Bunde
Attn: Lynne Smith

FROM: Tamara Brandt Cook
Director TBC

Here is the requested amendment making the public members of the board of directors of the Alaska Natural Gas Pipeline Corporation subject to confirmation by the legislature. The legislature has only a limited power to confirm appointees to boards or commissions under Article III, sec. 26 of the state constitution. (Bradner v. Hammond, 553 P.2d 1 (Alaska 1976) Only members of a board or commission that is at the head of a principal department or a regulatory or quasi-judicial agency are subject to confirmation. The board of directors of the Alaska Natural Gas pipeline Corporation does not fall within the types of boards for which confirmation is required, so this amendment will not be legally effective in imposing a confirmation requirement.

TBC:lmb
06-180.lmb

Enclosure

Greenberg Traurig

Memorandum

TO: Senator Gene Therriault and Representative Ralph Samuels

FROM: Donald C. Shepler

DATE: June 2, 2006

RE: SGDA Contract issues

As requested in your May 23 Memorandum, set out below is a summary of my primary concerns about the May 24, 2006, Stranded Gas Development Act ("SGDA") Draft Contract ("Contract") between the State of Alaska and subsidiaries of ExxonMobil, ConocoPhillips and BP--the three largest North Slope producers ("Producers").

EXECUTIVE SUMMARY

I am primarily concerned about the following aspects of the Contract:

- Failure of the Administration to provide the principal Limited Liability Company ("LLC") agreements to the Legislature for evaluation and approval (page 3);
- The absence of any provision requiring that the State consent to any material change in the Qualified Project Plan as part of the work commitments associated with the Contract (page 7);
- The absence of any provision in the Contract that adequately assures reasonable expansions of the line (page 10);
    - The absence of any commitments regarding voluntary expansion of the pipeline (page 12);
    - The failure of the Contract to require that the entities owning the pipeline will file for and support the use of rolled-in pricing for pipeline expansions (page 16);
    - The absence of any "sole risk" right under which the State could expand the pipeline over the objection of the other parties (page 17);

- The weakness of the "State-initiated expansion" language in Section 8.7 of the Contract (page 19);

- The absence of any commitments regarding capital structure to be used for tariff purposes, including commitments to maximize the available federal loan guarantees (page 22); and

- The failure of the Contract to specify that previously used assets that are acquired by the pipeline LLC will be valued at net book value for ratemaking purposes (page 24).

Overall, I believe the draft Contract has fundamental flaws that could result in delays in completing a pipeline and could unnecessarily raise the cost of shipping on the pipeline. I also fear that the Contract as drafted provides inadequate assurance that the pipeline will ever be expanded to its full potential capacity.

Since the Administration has drafted a new set of proposed amendments to the SGDA (*See*, SB2004, introduced May 31, 2006) I suggest that further amendments could be added to mandate changes in the governing documents (or the Contract) that could remedy many of these problems.

BASIS FOR ANALYSIS

My analysis is predicated upon my 30-plus years of experience in the area of Federal regulation of interstate gas pipelines. I have also been guided by Congressional policy as set forth in the 2004 Alaska Natural Gas Pipeline Act ("ANGPA") 15 U.S.C. § 720 *et seq.* There Congress articulated a policy that favored the promotion of competition in the exploration, development and production of Alaska natural gas and also contemplated future expansions of the pipeline to accommodate gas from supply sources other than the Prudhoe Bay and Point Thomson units.

I also considered the Contract in light of the positions that the Legislative Budget and Audit Committee ("LB&A") took in its comments to the Federal Energy Regulatory Commission ("FERC") in its proceedings establishing open season rules for an Alaskan pipeline. There LB&A stressed the importance of pipeline expansion:

> The key to unlocking the true potential of this pipeline lies in facilitating expansions of the initial pipeline to accommodate access by as many exploration and production companies as possible. If explorers have reasonable assurances that they (or others) can obtain capacity on the pipeline they will be able to commit the hundreds of millions of dollars and years of exploration and development necessary to exploit the resources. Certainly the reverse is true: Without assurances of access to capacity the new explorers will not invest in Alaska and only the currently proved reserves may ever be developed.
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> While [the known] resources are adequate to fill a 4.5 Bcf/d pipeline for approximately twenty years, by adopting the right regulations the Commission can set the stage for an 8 or even 10 Bcf/d pipeline which can provide service for another generation, thereby helping to satisfy the nation's growing energy needs. (Initial Comments of LB&A in FERC Docket No. RM05-1, filed December 17, 2004, at 3-4, emphasis added).

In addition, I have analyzed the Contract with a view to the express terms of the SGDA. That statute recites that the purpose of the Act is to "encourage new investment to develop the state's stranded gas resources" and to "maximize the benefit to the people of the state of the development of the state's stranded gas resources." (AS 43.82.010 (1) and (2)).

DISCUSSION

LLC Agreement(s) should be provided to the Legislature for evaluation and approval:

The Contract envisions the creation of several Project Entities (Limited Liability Companies ("LLCs") as described during the Legislative briefings) to administer the Project related terms of the Contract. These Project Entities will undertake the Project planning under the Qualified Project Plan, will update and amend the Qualified Project Plan, will undertake the FERC and NEB application and review processes, will determine whether to proceed with construction, will determine whether to terminate the Project or proceed to operation, will determine financing plans for the Project and capital contribution obligations, will structure the Pipeline tariff, will decide whether to Expand or Extend the Pipeline, and will own and operate the designated segments of the pipeline system.

However, the Contract contains scant direction regarding the Project Entities, and the Legislature has not been provided with drafts of any of the proposed Project Entity agreements. It is my understanding that negotiations are still on-going to develop the first of these agreements—an agreement among the Producers and the State providing for the creation, governance, management, financing, capital contributions, operations and administration of the "Mainline Entity," and providing the structure and implementation criteria for the Qualified Project Plan.

The importance of the LLC agreements to the implementation of the project and ultimate completion of a pipeline can hardly be overstated. The foregoing list of the types of decisions and responsibilities delegated to the Project Entities under the Contract demonstrates the point. The apparent difficulty the Producers and the Administration are having in finalizing the first of the these agreements for the Mainline Entity, and their inability to complete such negotiations in time for submittal with the proposed Contract proves the importance of the terms and conditions of the Project Entity agreements.

While we are told that the terms of the Mainline Entity LLC agreement are still being negotiated it is not clear that any of the Project Entity agreements will be provided to the Legislature for comment or for approval. Indeed, the proposed amendments to the SDGA contained in the Fiscal Interest Findings and most recently in SB2004 provide that the Commissioners of Revenue and Natural Resources will be authorized to enter into "collateral agreements" (including LLC agreements) after execution of the Contract without any provision for review or approval by the Legislature (*See* Section 11 of both the draft amendments and SB 2004).

This is troubling since the specific terms of the Project Entity LLC agreements can limit the rights and actions of the State with respect to critical decisions affecting the project. For example,

it would be expected that the Mainline Entity LLC agreement will specify the voting rights of the participants with respect to approving the filing of the application for a FERC certificate. Likewise, it would be expected that the agreement will specify the voting rights of the State with respect to the decision to accept or reject a certificate and to proceed with construction of the project or terminate. Decisions with respect to voluntary expansions of the line will also presumably be addressed in the LLC agreement, as will decisions with respect to the pricing of expansion capacity (*i.e.*, whether it will be priced incrementally or on a rolled-in basis).

Even such a basic decision as where to establish the Mainline Entity can have significant impact on the likelihood of success of the Project. The state law in which an LLC is established can establish or negate certain duties among the parties which serve to protect minority members. As noted in a memorandum from my colleague, Mr. Phil Gildan (a Greenberg Traurig shareholder) dated May 22, 2006, (copy attached for your convenience) the Alaska LLC law imposes a much greater duty of care and fair dealing upon owners of an LLC than does the Delaware LLC law—which the Administration has indicated it intends to be the state in which the Mainline Entity LLC will be established. Such a duty of care and fair dealing is important where, as here, the State is a minority interest owner of the LLC. Without such duties being imposed by law the managing members of the LLC or the majority owners would be free to pursue their own self interests, and pursue activities contrary to the interest of the LLC and the Project. The choice that the Administration seems to have made with respect to the state in which to establish the LLCs is not

optimal from the State's standpoint as a minority interest owner.[1]

However, unless the Legislature can see the LLC agreements and unless the Legislature can approve such agreements it cannot be assured that the State's vital interests in these fundamental decisions will be protected. Indeed, the State's 20% ownership share suggests that to the extent the State even has a vote on such decisions; it may well be outvoted by the Producer-owners.

Nothing in either the Alaska law or the Delaware law requires that voting rights must equal ownership interests. Thus there is no compelling reason that the State could not have a larger voting interest in critical decisions than its equity ownership percentage.

For example, the State might hold a 50% voting interest in decisions regarding whether to seek a FERC certificate, accept a certificate, commence construction and on future expansions. This would reflect the State's unique interest as the sovereign in ensuring that the pipeline is built in a timely manner and expanded so as to maximize the development of the State's gas resources.

Such terms may or may not be included in the pending Project Entity agreements, but the fact that they have not been provided and the likelihood that they may never be provided to the Legislature if the proposed SGDA amendments are adopted is a significant area of concern.

One way the Legislature might address this deficiency is by modifying the proposed SGDA amendments to include a requirement that any Project Entity agreements negotiated by the Commissioner of Revenue or any other State official must be subject to review and approval of the Legislature (if it is in session at that time or the review and approval of the Legislative Budget and Audit Committee if the Legislature is not in session) prior to their becoming effective.

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[1] In the Legislative briefings we were told that Delaware law was chosen since there is a substantial body of law interpreting that statute and wide experience regarding its application to individual cases. However, these justifications for the choice of law pale by comparison to the benefits that the State, as a minority interest member, obtains under the fair dealing and good faith duties that the Alaska law requires, but that the Delaware law does not require, and have little impact or benefit under the alternate dispute resolution process set forth in the Contract.

Alternatively, the Legislature could provide direction and guidance in the SGDA amendments on minimum terms, standards and conditions that must be incorporated into the Project Entity agreements. A draft of possible language options to achieve these goals has been prepared by Mr. Phil Gildan in a memo dated June 2, 2006, which is attached hereto.

No provision for State consent to or approval of material changes to the Qualified Project Plan:

The Stranded Gas Development Act requires that the Qualified Sponsor Group provide the State with a "Qualified Project Plan." (AS 43.82.130). The Contract recognizes this fact and adopts by reference the Project Plan contained in the Sponsor Group's January 23, 2004, application for a SGDA Contract. Section 5.3 of the Contract authorizes the Mainline Entity (*i.e.*, the LLC yet to be formed) to amend the Qualified Project Plan annually or more frequently as such entity determines to be necessary.

As discussed above, there is no assurance that the State will have any greater control of the Mainline Entity LLC than its 20% ownership share in the project. Nor is there any assurance that the majority owners must even act in the best interests of the LLC (if Delaware law is used). Thus, there is a risk that the Qualified Project Plan will be modified in ways that are objectionable to the State. These modifications could include delaying the project or modifying the pipeline route, size or any other aspects of the project.

Inasmuch as the State, through the Contract, is making material and long-term tax and royalty concessions to the Producers and these concessions will become effective when the Contract is signed rather than when the project is completed prudence dictates that the State should

have some assurance that it is getting the type of effort and results it expects from the Contract.[2] Requiring that the State consent to any material change in the Qualified Project Plan would protect the State against these risks. As long as the State is merely a minority owner, however, that degree of control simply cannot be assumed nor assured.

Requiring that the State have approval authority over material changes to the Project Plan is not only a prudent action under the circumstances, but given the text of the SGDA, an argument can be made that as a mater of law the State must specifically approve any change in the Project Plan. Under the SGDA a Project Plan must be included in the Contract.[3] Since the State is a signatory party to the Contract and since the Project Plan must be part of the Contract it can be argued that changes to the Plan amount to contract amendments. As such, the State would necessarily have to consent to the amendment. That, however, is not contemplated by the Contract.

There are any number of reasons why material changes to the Plan might be warranted: Steel costs could increase, for example, or gas prices might decline. In such instances it is clear that the State would not unreasonably withhold its consent to a material change in the Plan. However, prudence and common sense suggest that the Producers might seek material changes to the Plan for reasons having to do with their own business strategies or other world-wide commitments. As presently written, though, the Contract provides the State with no effective control over such circumstances.

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[2] At the Legislative briefings we were told by Dr. Van Meurs that there is at least a 20% to 30% chance that no pipeline will be built, even with the State's tax and royalty concessions.

[3] AS 433.82.270 provides that, "[a] contract under AS 43.82.020 must include the qualified project plan approved under AS 43.82.140 and provisions for updating the plan at reasonable intervals until the commencement of commercial operations of the approved qualified project."

The only remedy available to the State in such circumstances is to seek contract termination through the arbitration proceedings. This remedy can only be pursued if it is grounded upon a claim that the Producers failed to proceed with "diligence." While I understand that other Legislative consultants will address the strength of this standard, the fact is that the Contract places substantial burdens on the State in this process. The Contract (§ 5.5 (b)) contains a list of events which the arbitrators cannot even consider in assessing performance (including errors of judgment) and it also establishes presumption that the Contract continues in effect (*i.e.*, cannot be terminated).[4] Thus, the State has little ability under the Contract to ensure that it obtains the benefit of its bargain. Amending the Contract to require that the State's LLC entity must approve or consent to any material modification of the Project Plan would eliminate this risk to the State. Similarly, conditioning the authority of the Administration to enter into an LLC agreements that does not give the State this authority would also address this concern, as would giving the State voting power in excess of its ownership interest as discussed above.

The State is providing its tax and royalty concessions to the Producers <u>now</u>, at the time the Contract is executed, and those commitments will be effective potentially for decades. The State may not be getting what it has bargained for, however, in the event that the Plan is changed materially. By providing that the State must consent to or approve any change to the Plan, however, the State could ensure that its tax and royalty concessions are actually getting the State a pipeline rather than the mere promise of a pipeline.

By amending the SGDA to require that the State must consent to changes in the Project Plan as part of any Contract the Legislature could effectively require that the Administration obtain

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[4] The term "errors of judgment" may be broad enough to include acts of negligence and may even include gross negligence.

a change to the Draft Contract presently being reviewed. This proposal is included in the Memo by Mr. Gildan which is attached to this memorandum.

The Contract inadequately addresses expansion issues:

As mentioned at the beginning of this Memo, LB&A has advocated that the key to unlocking Alaska's gas resources is in an expandable and expanding pipeline. In that same vein LB&A urged that as a means to ensure maximum expansion of the system the FERC require that expansion capacity on this unique pipeline system be priced on a rolled-in basis rather than on an incremental basis (which is FERC's policy on Lower-48 pipeline systems).

FERC responded to LB&A's recommendations in two very important ways. First, FERC indicated that it would order design changes necessary to make the initial pipeline appropriately expandable if it concluded in the certificate preceding the system had not been engineered with opportunities for low-cost expansions.[5] Second, the FERC established a rebuttable presumption that future expansions (including looping expansions) would be priced on a rolled-in basis. Thus, FERC accepted LB&A's positions regarding the need for the line to be expandable and economic for all shippers regardless of whether the expansion is achieved through low-cost compression or much more expensive looping.

With these positions serving as a point of comparison, it is my conclusion that the Contract fails to address expansion issues adequately. It fails to address voluntary expansions at all. It fails to commit the parties to use rolled-in pricing for looping-based expansions, it fails to provide the State with any right to expand the pipeline at its sole risk. Lastly, to the extent the Contract does address expansion—in the "State-initiated expansion" section appearing at Section 8.7—the

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[5] The Producers have appealed this holding to the United States Court of Appeals for the District of Columbia Circuit (*ExxonMobil Corp. V FERC*, Case No. 05-1299). Briefing of that appeal is now underway.

Contract erects numerous barriers to expansion.[6] All of these deficiencies are discussed in greater detail below.

Before addressing specifics, however, it is necessary to observe that the State and the Producers share some, but not all, goals with respect to the project. The State and Producers are certainly aligned on the desirability of getting a pipeline. Even on this point, though, the parties may diverge on the issue of timing. The Producers' individual and collective interests may or may not be aligned with the State on whether the pipeline should come sooner or should wait till later.

On the issue of expansion, though, it seems clear that the State and these three producers are not at all aligned. The State clearly favors (or should favor) expansions of the line to promote access for explorer producers. Those explorer producers, though, are the direct competitors of the three producers who will be majority owners of the line. Consequently, on expansion issues the State, in furtherance of its policies of encouraging development of resources and maintaining a level competitive playing field for all stakeholders, will clearly favor early expansion of the line and its eventual build-out to its ultimate capacity somewhere between 8 and 10 Bcf/day. The Producers' needs, though, are to move their gas to market and they have no particular interest in having the line expanded, especially if such expansion will serve their competitors or may put downward pressure on gas prices in destination markets by increasing overall gas supply.

Consequently, while expansion is vital from the State's standpoint it is not likely to be a high priority item to the Producers, and they may even view expansions to be antithetical to their best business interests. Thus it seems imperative that the State obtain agreement from the

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[6] In this section the Contract also guarantees the right of the "Mid-stream Entity" to reject any expansion certificate that departs in any material way from what was proposed *e.g.*, if the FERC requires rolled-in pricing after the Sponsors have proposed to use incremental pricing).

Producers now on expansion issues since it is now that the State is granting its many fiscal concessions to the Producers to induce them to build the line. The Contract does not do this, however. As a result, I have to conclude that in this regard the contract is deficient for several reasons as discussed below.

Silence of the Contract on voluntary expansions:

There is a long lead time between when an explorer producer would start exploring for gas and the time at which such a producer would be capable of commercializing its discoveries. Thus, it is likely that many explorer producers will not be in a position to bid for capacity in the initial open season for the pipeline. Without periodic expansions of the line, these producers will be forced to wait 20 or more years—until the expiration of the initial shippers' contracts—for access to the line. This would not be a desirable result from the State's standpoint. Early expansion of the line will be critical to the ultimate exploitation of the State's vast resource base.

Unfortunately, the Contract is completely silent regarding future voluntary expansions of the line.[7] This absence is very problematic given that the project sponsors are themselves gas producers and do not have the same economic motivation to favor expansions as does the State or as would an independent pipeline company.

The State's motivations for expansion are discussed above and are comparable to the interest of an independent pipeline company in pursuing system expansions. Such companies, need little or no external incentive to expand their systems other than shipper commitments to sign firm contracts for the expansion capacity. This is a direct result of the way pipeline rates are set.

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[7] The Contract does provide for "State-initiated" expansions, but for reasons discussed later in this memo, such expansions are severely constrained and probably offer little practical opportunity for explorer producers to obtain any expansion of the system.

Under FERC ratemaking practices, any pipeline company's profit is a function of the size of its "rate base." Rate base can best be thought as the value of all the capital assets of the company. The company's profit is the allowed rate of return on equity multiplied by the equity portion of the rate base. Since rate base is eroded year-to-year by depreciation, over time the company's profits decline. The best way to avoid this problem is through pipeline expansions, which increase the rate base and hence the profit to the company.

In the current case, though, the Producers have far more economic incentive to move their own gas through the pipeline than they do in the pipeline company's profits. This can easily be seen by looking at the anticipated netback price of gas at the wellhead over the life of the project and comparing that profit source against the regulated rate of return that will flow to the Producers in their roles as owners of the line. We were told at the briefings that the State expects an average gas price of around $5.50 per Mcf in Chicago over the life of the project. We were also told that the project could well involve an end-to-end tariff of $2.00 per Mcf.[8] This leaves $3.50 of wellhead value for the Producers (or slightly less using Econ One's estimates). Multiplied by 1.6 Tcf/year (4 Bcf/day times 365) the Producers' wellhead netback represents a tremendous profit source for them.

By contrast, out of the $2.00 tariff, only a small portion can be thought of as profit to the pipeline. Econ-One has advised me that even with an end-to-end tariff in the $2.50 range, the equity return available to the Producers (i.e., their "profit") is in the 20- to 25-cent per Mcf range. Further, the additional profit obtained through pipeline expansions would of course, be much less since it would consist only of the additional equity rate base being multiplied by the equity return

[8] Econ One estimates an end-to-end tariff rate somewhat higher than this—in the range of $2.50.

allowance. Thus, pure economics dictate that the Producers have much more to gain by moving their own 1.6 Tcf/year off of the North Slope than they do by expanding the pipeline to accommodate new gas supplies developed by their competitors in the exploration and production business.

Independent pipeline companies, however, make all of their profit through the regulated business—and for them expansions represent a critical form of profit maintenance and enhancement. As a consequence independent pipeline companies need little if any incentive to expand their systems aggressively.

Accordingly, one would not necessarily expect that an SGDA contract with an independent pipeline company would need to address the terms under which voluntary expansions would be undertaken. The pipeline company would have every incentive to expand and nothing further would be required. Obviously, however, the Contract under review is with three Producers who have very little incentive to expand the pipeline in order to serve their rivals. Thus, provisions that would detail the terms under which voluntary expansions of the line would occur are critical in a contract with the Producers. Also, the fact that the State and the Producers are not "aligned" on expansion issues suggests that it is important to resolve those matters now, as part of the give-and-take negotiations for tax and royalty concessions by the State.

There are several aspects of voluntary expansion that should have been included in this agreement. These include: Commitment to hold periodic open seasons (even non-binding open seasons) to assess the market for new capacity; Commitment to expand in any reasonable

engineering increment to accommodate demand by creditworthy shippers for new capacity;[9] Commitment to undertake even smaller expansions if the customers would make an appropriate capital contribution that would make the expansion economic (referred to as a "contribution in aid of construction"): and, Commitment to pursue rolled-in pricing for expansion capacity.[10]

Because the Contract contains no provision dealing with the terms under which the line would be expanded voluntarily, expansions of the line cannot be assured. This is a material deficiency in the Contract. If such provisions had been included, many of the concerns about access by explorer producer could be eliminated, and some of the concerns arising from the failure to provide the LLC agreements for legislative review and approval could be reduced.

The absence of provisions governing expansions of the line is ultimately a matter of policy. It is up to the Legislature to determine whether Contractual guarantees regarding future expansions are sufficiently important to the State.

Assuming, though, that the Legislature determines that future expansion commitments are important to the State the question occurs as to what the Legislature can do. Obviously, the Legislature could submit formal comments to the Administration on this issue, leaving it to the discretion and negotiating ability of the Governor's team to add such provisions to the Contract. Another remedy would be for the Legislature to modify the proposed SDGA amendments to require expansion commitments to be included in a SDGA contract or it could pass legislation

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[9] There are optimal minimum sizes for expansions depending on the nature of the expansion (compression or adding pipe) and the location of the new supplies. Requests for less than a minimal engineering increment could be inefficient and it would not be reasonable for even an independent pipeline company to undertake such expansions.

[10] Because rolled-in pricing keeps large expansions economic for the expansion customer, independent pipelines seek such rate treatment whenever it can be justified. In the Lower-48, FERC policy precludes the use of rolled-in pricing for pipeline expansions that result in rate increases to existing shippers, but that policy is grounded on trying to maintain a level playing field when pipelines compete against each other for expansion projects. Further, rolled-in pricing appears to be the policy of the NEB with respect to pipeline expansions in Canada.

requiring that expansion commitments be contained in any LLC agreement which the State accepts. Here again, a draft of such an amendment is included in the attached memo by Mr. Gildan

Failure to provide for rolled-in pricing of expansions:

The Contract does not commit the parties to any form of pricing for expansion capacity.[11] Rolled-in pricing is crucial to the ultimate sizing of the pipeline (and hence the commercializing of the State's gas resources). It is generally held that the line can be expanded to a capacity of about 6-Bcf/day through the addition of compression. Such expansions will generally reduce the unit rate for service on the line. However, to expand beyond the 6 Bcf/day level, more expensive looping will be required. Unless this capacity is priced on a rolled-in basis it will be prohibitively expensive—perhaps twice the rate for the then-existing system users. Even with rolled-in pricing, though, it can be assumed that existing shippers' rates will be increased somewhat.

The FERC has established a rebuttable presumption in favor of using rolled-in pricing for expansions of the Alaskan pipeline—an important departure from their policy in the Lower-48. There, FERC now requires that pipeline expansions and extensions be priced incrementally whenever rolled-in pricing increases the rates to existing shippers. This policy, however, is based on concerns surrounding pipelines competing for new markets and is designed to ensure that incumbent pipelines competing with other pipeline companies do not have an inherent competitive advantage by being able to roll-in the cost of new facilities and thus mask the true cost of providing the new service. The Alaska line, however, will be a monopoly and the FERC concluded that its Lower-48 policy had no applicability on this pipeline.[12]

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11 Indeed, the Contract is silent with respect to any aspect of the pipeline's tariff. This defect is discussed later in this memo.

12 In addition, rolled-in pricing appears to be the policy of the NEB for Canadian pipeline expansions.

FERC policy only goes so far, however. Pipeline sponsors must propose rolled-in pricing and must support it in future expansion filings. However, nothing in the Contract obligates the pipeline to file for or support rolled-in pricing for expansions. The fact that the Producers opposed FERC's adoption of the presumption in favor of rolled-in pricing it is doubtful that they will voluntarily support its use unless it is a condition for obtaining tax and royalty concessions from the State.[13]

Given that rolled-in rate treatment is vital to the ultimate exploitation of the State's gas reserves, the silence of the Contract on this issue represents a fundamental defect in the agreement. This is especially true given that the stated purposes of the Legislature in enacting the SGDA included encouraging "new investment to develop the state's stranded gas resources" and maximizing "the benefits to the people of the state" by development of its gas resources.

Here again, the Legislature could mandate that an SGDA contract provide for the use of rolled-in pricing for all expansions or that any LLC agreement entered into by the State make such a provision. A draft amendment to the Administration's proposed SGDA amendments is contained in the attached memo from Mr. Gildan.

Failure of the Contract to provide the State with the right to expand the system at the State's sole risk:

There is precedent for each party in jointly owned pipelines (or pipeline segments) to have the right to expand the system at its own expense and risk. This is sometimes referred to as a "sole risk" provision. One example of such a provision is contained in the ownership agreement between Maritimes & Northeast Pipeline LLC and Portland Natural Gas Transmission System. There, in

[13] The Producers initially appealed the FERC policy to the court, but that appeal was dismissed by the D.C. Circuit as premature. In the pending appeal the Producers did not contest this aspect of the FERC's rulings.

certificate proceedings the FERC required that two competing pipeline companies utilize one single pipeline segment due to environmental concerns. The two companies agreed that each should at all times have the right to expand the joint facilities if, after giving notice to the other party, the two did not agree to jointly expand the line. In such event the ownership share of the party expanding the facilities would be would be increased to reflect the new investment.[14] By this means either party was free to meet its own, unique requirements even when its co-owner had no reason to invest in an expansion of the jointly owned facilities.

In the case of the Alaskan pipeline, as discussed above, it is clear that the State has interests in having the line expanded that differ from, and may even be adverse to the interests of the Producers. State investment in expanding the line at its sole cost and risk could represent one way of satisfying the State's unique interest in expansion while requiring no investment by the other project sponsors.

A sole-risk expansion addresses the issue of capacity only. It does not dictate how the expansion capacity would be priced. Presumably, though, if the State had the right to pursue such an expansion under the Contract it would have the right to argue for that expansion capacity to be priced on a rolled-in basis even if the sponsors retained the right to oppose such pricing. Under the Contract at hand, however, the State has no such right, and appears to be subject to both reasonable and unreasonable refusals by the Producers to expand. The Legislature could amend the SGDA to require that in any Contract or LLC agreement covering a gas pipeline jointly owned by the State the State must have the right to expand the line at its sole expense and risk. Language for doing so is included in the memo from Mr. Gildan that is attached.

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[14] *See* Order of Chief Judge Certifying Definitive Agreements issued October 9, 1997 in FERC Docket No. CP97-238.

The "State-initiated expansion" provisions contained in Section 8.7 of the Contract fail to provide future shippers with adequate assurance of expansion capacity.

The Contract includes a lengthy provision under which a potential shipper who has been unable to secure capacity can request that the State cause an expansion to be undertaken on that shipper's behalf. Unfortunately, there are so many conditions that must be satisfied under this mechanism that it pro[illegible]tle reason to expect that it will result in an expansion.

As was noted in the briefings, this method for obtaining an expansion is one of three. First, there is the alternative of a voluntary expansion (which is not addressed in the Contract at all). Second, there is the "FERC-mandated" expansion that is available under Section105 of ANGPA (15 U.S.C. § 720c). The Contract does not address this expansion vehicle, but that is not unusual. I would not expect to find anything discussing this mechanism in this type of agreement. The "State-initiated expansion" represents a third vehicle by which the pipeline can (at least theoretically) be expanded.

To appreciate the limits of this section it is necessary to understand the terms under which FERC can mandate expansion of the Alaska pipeline. Prior to enactment of ANGPA the FERC never had the authority to order the expansion of any pipeline over the objection of the line's owners. Thus, the new authority granted to FERC by ANGPA is significant.

FERC's authority, however, is not unconstrained. It must find, for example, that adequate take-away capacity will be available before ordering such an expansion.[15] More importantly, however, it may not order an expansion unless it determines that the rates will not result in existing

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15 By contrast ANGPA dictates that FERC may assume such capacity exists for purposes of the initial line.

customers "subsidizing" the expansion shippers.[16] In other words, the statute prohibits only a rate subsidy and does not preclude FERC from mandating an expansion that results in a rate increase so long as FERC finds that such increase does not constitute a "subsidy." Obviously, lawyers will disagree on whether a particular rate increase represents a "subsidy," but clearly the Congress did not preclude FERC from requiring an expansion of the line simply because existing shippers would bear a rate increase as a consequence.

Section 8.7 of the Contract, however, eliminates the possibility of the State obtaining an expansion if it: (1) results in a subsidy by the existing shippers; (2) results in a "rate increase" to existing shippers; or (3) results in existing shippers being assessed a "higher fuel retention percentage" than would have been assessed absent the expansion. (*See* § 8.7(a)(iv)(B)). Thus, this provision is even more restrictive than the new law permitting FERC for the first time to mandate a pipeline expansion!

In addition, there are even more restrictions. Under the Contract the State can not seek to initiate an expansion if it has exercised that authority within the five preceding years. (*See*, § 8.7 (a)(i)). There are also minimum quantities of capacity that can be used to justify a State-initiated expansion—50,000 Mcf/day in the case of a Gas Transmission Pipeline and 125,000 MMBtu/day in the case of a mainline expansion or expansion of the GTP.

Only limited looping can be required for a State-initiated expansion (not more than a total of 100 miles of loop), and no lateral pipeline from the mainline can be required. The expansion shipper must also pay in advance its proportionate share "as determined by the *Project Entity*, of all costs related to the filing of the application and to activities required to complete the application,

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[16] The statute provides that the Commission shall, "ensure that the rates do not require existing shippers on the Alaska natural gas transportation project to subsidize expansion shippers."

including engineering studies and design and environmental reviews."[17] Further, the party requesting the State to initiate an expansion on its behalf must then actually win the capacity requested by bidding in an open season to be conducted by the Project Entity. (*See*, 8.7(a)(ii)(C)). The party initially starting the process may have to accept a pro-rated share of capacity if there are bids for sufficient capacity in the open season.

Given these many conditions—which are even more restrictive than those that constrain the FERC in ordering a mandatory expansion—this provision of the Contract does little to assure explorer producers that they can obtain expansion capacity by this vehicle.

However, these are not the only aspects of § 8.7 that are troubling. Section 8.7(a) provides as follows:

> Article 8.7 is effective unless *FERC* determines that any of its provisions are contrary to *Law*. If *FERC* issues a certificate on a basis different than the expansion proposal filed by the *Project Entity*, then the *Project Entity* shall reject the certificate unless any such difference is minor or all the members of the *Project Entity* vote otherwise. (Emphasis added).

This means, for example, that if the Project Entity filed to implement an expansion (presumably a voluntary expansion, as well as one initiated under this provision) and proposed incremental rate treatment (to ensure that existing shippers would not bear a rate increase) the State and the Producers have agreed, in advance, that the Entity is authorized to reject the certificate if FERC approves it but, for example requires rolled-in pricing rather than incremental pricing. Such a requirement would be entirely consistent with FERC's policy regarding this pipeline. This provision also means that if the FERC were to evaluate the expansion to ensure that it was adequately sized (or could itself be economically expanded) and were to require a design change

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17 Such costs may be recoverable under another section of the agreement, however.

(actions it has promised to undertake in the context of the initial pipeline certificate process, and which the Producers have appealed) the State has agreed to the rejection of the certificate.

Thus, even if the Producers lose their appeal on FERC's authority to require a design change for initial capacity, this provision of § 8.7 assures them that they will not be forced to accept any expansion certificate that departs in any meaningful way from the as-filed application. This amounts to yet another potential roadblock to expanding the pipeline and undercuts § 8.7 as a meaningful tool to assure robust expansion of the system. Given the number of conditions that limit its ever being used it is doubtful that any State-initiated expansion will ever be undertaken. It must simply be recognized that § 8.7 does not provide a meaningful opportunity for expansion of the line.

Section 8.7 creates a mechanism by which shippers may attempt to obtain an expansion but does not diminish the possibility of obtaining a voluntary expansion or even a FERC-mandated expansion. Thus, its presence in the agreement is relatively benign and there is no obvious need to modify the Contract or eliminate this provision.

Failure of the Contract to specify a capital structure to be used for rate-making purposes:

In the FERC ratemaking process the mix of debt and equity that make up the capitalization of the entity has a substantial effect on the overall cost to be recovered through rates. This is because debt costs less than equity in the first place and because payment of interest on debt gives rise to a federal income tax deduction which reduces rates. On the other hand, equity is more risky than debt and carries a higher cost, and the equity return is subject to federal and state income taxes (which are themselves reflected in the overall cost of service and thus increase rates).

In the case of an Alaskan pipeline federal loan guarantees are available for up to $18 billion (or 80% of the capital cost of the project). Such guarantees will reduce the amount of interest that lenders will require since they can look to the U.S. government for payment in the event that the borrower defaults on its loans. Thus, federally guaranteed loans represent the lowest cost capital that will be available for this project.[18]

In order to ensure the lowest possible cost for the project it would be necessary for the sponsors to maximize their use of such guarantees. This would dictate that 80% of the capital (up to $18 billion) should be in the form of debt guaranteed by the U.S. government with only the remaining 20% of capital consisting of equity contributions by the parties. However, the Contract does not commit the parties to this or any other financial structure.

Since the State only has a 20% stake in the ownership it does not appear to have any effective control over the financing of the project. However, the State, with its unique interest in maximizing the exploration and production by new gas explorers, and in its role as a shipper has a great interest in assuring that the pipeline's rates are as low as possible.

The Producers, however, do not as clearly share this same objective. While the Producers (through affiliates) will be rate-payers shipping gas through the system, any "excessive" tariff charges resulting from higher-than-required costs are effectively being paid by the Producers (as shippers) to the Producers (as owners). By contrast, companies that compete with the Producers in the exploration and production of gas are more completely aligned with the State since they would be competitively disadvantaged by higher-than-necessary tariff rates. Thus, the State has a unique

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[18] Obviously, the absolutely lowest cost financing would be for the State of Alaska to own or finance the project since it is not subject to any State or Federal income taxes and its bonds would be generally tax free (at least to Alaska taxpayers). However, State ownership is not presently on the table as an option which means that maximizing the use of Federal loan guarantees would result in the lowest capital cost for the project.

interest vis-à-vis the Producers in dictating through the Contract that a lowest reasonable cost strategy be used to set tariff rates for the system.

One way that can be achieved is through assurance that debt capital is used in preference to equity capital and by assurance that federally guaranteed debt be used to the maximum extent possible. This can be achieved through amendments to those proposed by the Administration and as reflected in the attached memo by Mr. Gildan.

Failure of the Contract to specify that previously used assets be valued at their net book cost for ratemaking purposes:

Section 8.6 of the Contract is quite short, but potentially costly to all shippers on the pipeline. This section provides: "Each *Participant* shall follow *FERC* policy regarding treatment of previously used assets for *FERC* ratemaking purposes." Its significance arises in the context of the potential inclusion of the original costs (or even some potentially higher acquisition cost) of the currently existing central gas facility at Prudhoe Bay in the rates of either the GTP and/or an NGL plant.

It is my understanding that when it was constructed this facility cost approximately $1 billion. It is presently used for removal of some NGLs and provides missible injectant for enhanced oil recovery at Prudhoe Bay. It is also my understanding that pursuant to a royalty settlement with the State, the Prudhoe Bay producers deduct about $1 per barrel for royalty NGLs based on the cost of that facility. It is also my understanding that the facility will be largely depreciated by the time a gas pipeline goes into service.

I have been advised by Econ One that if $1 billion of investment (*i.e.*, approximately the original cost of the facility) is included in the calculation of end-to-end tariff rates the cost of shipping on the line will go up by roughly 10 cents/Mcf. Thus, if under FERC policy the

Producers are able to write-up the value of this previously used asset to its original cost or some higher acquisition cost it will materially affect the pipeline system's overall cost of service.

FERC's policy generally precludes one regulated entity from writing up the value of assets acquired from another regulated entity. FERC typically requires that the new owner include only the net book value of such assets in its rate base. However, an exception exists where the asset has previously not been used for utility service or has been used for other services, with different customers (*e.g.*, an oil pipeline being converted to gas service). In that case the previously used asset can be included in rate base at its acquisition cost.[19] FERC's rational is that there is no "double recovery" of depreciation costs since the new group of customers will not have been paying for the depreciation when used by a different group of customers. Thus, because this facility has not been used in gas utility service Section 8.6 of the Contract could well result in as much as $1 billion (or even more if the facility is valued at its replacement cost or some as yet unknown acquisition cost) being included in rate base for part of the pipeline system. Since the Prudhoe Bay producers (who now own the central gas facility) will be selling the asset to an LLC owned 80% by their affiliates the issue of purchase price might be an issue at FERC. However, whatever level of purchase price the FERC ultimately establishes as reasonable, a substantial cost burden could be placed on system users by relying on "FERC policy."

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[19] *See, Cities Service Gas Company* 4 FERC ¶ 61,268 (1978) ($18.5 million purchase price for oil pipeline approved for rate purposes upon conversion to gas service where depreciated book value was approximately $3 million); *Natural Gas Pipeline Co. of America, et al*, 29 FERC ¶ 61,073 (1984) ($20 million acquisition cost for crude oil pipeline approved for rate purposes related to seller's depreciated original cost of approximately $6 million where line was to be converted to natural gas service. FERC noted *Cities Service* decision and determination that gas customers would not be burdened twice for the cost of depreciating the facilities since the facilities had not previously been devoted to gas utility service.). FERC policy appears to be the same in the context of oil pipeline regulation as for natural gas pipeline regulation. *See, Energy Law and Transactions* § 85.04[4][b][ii]. *See also, Rio Grande Pipeline Co. v. FERC* 178 F.3d 533(D.C. Cir. 1999); and *Enbridge Energy Co., Inc.* 110 FERC ¶ 61,211 (2005).

Clearly the terms of the Contract do nothing to prevent the Producers from seeking to write-up the value of any assets that may be converted to gas service as part of the pipeline system. Such a write-up is arguably a mere application of "FERC policy" to such previously used assets. However, the fact that the State has acquiesced in this section could be interpreted to preclude the State from arguing against a write-up in future FERC rate proceedings.

Section 8.6 should best be revised to require the use of net book value for previously used assets. It is my understanding that this was in fact proposed by the State in the negotiations. Alternatively, given how this provision could possibly be interpreted against the interests of the State in FERC proceedings, the section should be eliminated. It adds nothing to the rights of the Producers to argue for a write-up in the value of such assets since FERC policy can be assumed to apply in the absence of this provision. Thus, Section 8.6, though innocuous on its face is quite pregnant with meaning. This section does nothing to reduce the cost of service for the Alaskan pipeline system. Instead, it creates an opportunity for the Producers to argue for a substantial write-up in the value of all previously used assets that are converted to gasline service. As such it should be deleted. A better solution, though, would be for the Contract to be amended to provide for the use of net book value notwithstanding FERC precedent.

If nothing else, the Legislature should consider enacting legislation to require the use of net book value for purposes of pricing previously used assets that become part of the pipeline system or should at least prohibit the Administration from agreeing to a contract that addresses this issue and does not require the use of net book value.

CONCLUSION

As discussed herein, there are a number of important deficiencies and flaws in the Contract given Congressional policy, the policies underlying enactment of the SGDA, as well as policies that the Legislature has previously advocated. I have focused here on the issues of greatest concern to me.

However, the Contract (with attachments) now runs for almost 500 pages. It has only been public since May 24, 2006 in its present form. Additional review of the draft is necessary to provide a comprehensive analysis of the document. However, I do believe that there are a number of additional areas of concern that need to be addressed prior to the close of the public comment period on the Contract. For example, I am concerned that in a number of ways there does not appear to be a proper balance between the commitments of the Producers and the obligations of the State. In the time available, however, I have not been able to address each such instance. I am continuing to evaluate this document and plan to address as many of the other concerns as possible prior to the close of the public comment period relating to the Contract.

Please feel free to contact me with any questions you or any Legislators may have regarding my assessments as reflected in this Memorandum.

ATTACHMENTS

Memo Prepared by Mr. Phil Gildan of Greenberg Traurig
May 22, 2006 Memorandum on LLC choice of law
and
June 2, 2006 Memorandum proposed SGDA amendments

Greenberg Traurig

Memorandum

TO: Don Shepler

FROM: Phillip C. Gildan

DATE: May 22, 2006

RE: Alaska Natural Gas Pipeline: Form of Ownership Entity
Limited Liability Company/Choice of Laws

The choice of utilizing a Limited Liability Company (LLC) as the form of ownership entity for the Alaska Natural Gas Pipeline appears to have been agreed to among the Producers and the State negotiating team. This memorandum does not discuss the conclusion to use the indirect ownership structure of an LLC, vis-à-vis a direct ownership structure of an undivided joint interest (UJI) form of project ownership. Instead, this memorandum addresses only the question of choice of law as to formation of the LLC, and implications to the State from such choice. (Note: this memorandum does not address tax implications from choice of formation law).

From the Gas Pipeline Contract Presentations by the State negotiating team, it has been represented that the Producers and the State negotiating team have agreed upon use of the Delaware Limited Liability Company Act, Delaware Code, Title 6, Subtitle II, Chapter 18 ("Delaware Act") in lieu of the Alaska Revised Limited Liability Company Act, AS Chapter 10.50 ("Alaska Act").

Why choose the Delaware Act to form an Alaska Pipeline LLC instead of using the Alaska Act? In broad general terms, the business community maintains the perception that Delaware Courts provide a more developed body of case law affecting business entities than other states, and accordingly provide greater certainty of prediction of outcome in the event of business disputes. The corollary of this perception holds that Delaware Chancery Court Judges have a greater expertise in resolution of business disputes than judges in other states, again leading to greater certainty of prediction of outcome. An undercurrent of the perception of Delaware superiority, from both a body of law and judiciary, is that decisions by Delaware courts on business entity issues more often favor management/majority owners over minority owners. These perceptions may or may not prove out on a case by case analysis, but help explain the prevalent practice in the corporate world to establish business entities in Delaware.

Significant Differences Between Acts/Implications to Alaska

The Delaware Act represents one end of the spectrum of LLC enabling acts. It provides less mandatory entity terms, rights and obligations in favor of flexibility of the parties to freely set their own terms, rights and obligations by contract. The Alaska Act falls in the middle of the

spectrum. It provides significant freedom for the parties to set their own terms, rights and obligations, but imposes certain minimum memb . protections that cannot be contracted away. These minimum member protections afforded the Alaska Act can be incorporated into a Delaware Act LLC by negotiation between/amo the member parties, but absent such negotiation, those member protections will not exist. Two of these protections will be discussed below.

1. Duty of Managing Members to Entity:

The Delaware Act imposes no duty on managing members to either the company or to the other members of the company. It permits the members to contractually eliminate or create duties for managing members, with the exception that the general contract law which implies a duty of good faith and fair dealing, which can not be eliminated. The statute states:

§ 18-1101. Construction and application of chapter and limited liability company agreement.

> (a) The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.
> (b) It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.
> (c) To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

The Alaska Act, however imposes an express duty on managing members to act in the best interest of the company and adopts an ordinary prudent person standard of care. This duty is imposed as statutory protection of minority members (and other managing members) rights from a manager or managing member acting in its own self-interest which may be contrary to the business of the entity and the investment backed interests of the other members. It states:

AS 10.50.135. Duty of care.

> (a) A person who is a manager or a managing member of a limited liability company shall perform the duties of management in good faith, in a manner the person reasonably believes to be in the best interests of the company, and with the care, including reasonable inquiry, that an ordinarily prudent person in a like position would use under similar circumstances.

Without the duty of care that the Alaska Act provides, a manager or managing members controlling an entity could act in their own self interest and contrary to the interest of the entity's business, with only the implied covenant of good faith, which is a significantly lower standard of care and more difficult to apply if the parties have contractually elected not to impose a duty to the entity.

2. Indemnity of Managing Members.

The Delaware Act grants broad discretion to the members to indemnify and hold harmless any member from and against any claims and demands without limitation. It states:

§ 18-108. Indemnification.

> Subject to such standards and restrictions, if any, as are set forth in its limited liability company agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever.

The Alaska Act also provides the right to indemnify members, but imposes specific limitations on the ability to indemnify members, with material procedural terms enumerated. It states (with emphasis added):

AS 10.50.148. Indemnification of managers, managing members, employees, and agents; insurance.

> (a) A limited liability company may indemnify a person who was, is, or is threatened to be made a party to a completed, pending, or threatened action or proceeding, whether civil, criminal, administrative, or investigative, other than an action by or in the right of the company, by reason of the fact that the person is or was a manager, managing member, employee, or agent of the company, or is or was serving at the request of the company as a manager, managing member, employee, or agent of another limited liability company, partnership, joint venture, trust, or other enterprise. Indemnification may include reimbursement of expenses, attorney fees, judgments, fines, and amounts paid in settlement actually and reasonably incurred by the person in connection with the action or proceeding ***if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the company, and, with respect to a criminal action or proceeding, the person had no reasonable cause to believe the conduct was unlawful.*** The termination of an action or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, does not create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests of the company, and, with respect to a criminal

action or proceeding, the person had reasonable cause to believe that the conduct was unlawful.

(b) A limited liability company may indemnify a person who was, is, or is threatened to be made a party to a completed, pending, or threatened action by or in the right of the company to procure a judgment in its favor by reason of the fact that the person is or was a manager, managing member, employee, or agent of the company, or is or was serving at the request of the company as a manager, managing member, employee, or agent of another limited liability company, partnership, joint venture, trust, or other enterprise. Indemnification may include reimbursement for expenses and attorney fees actually and reasonably incurred by the person in connection with the defense or settlement of the action ***if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the company. Indemnification may not be made in respect of any claim, issue, or matter as to which the person has been adjudged to be liable for negligence or misconduct in the performance of the person's duty to the company except to the extent that the court in which the action was brought determines upon application that, despite the adjudication of liability, in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for expenses that the court considers proper.***

(c) To the extent that a manager, managing member, employee, or agent of a limited liability company has been successful on the merits or otherwise in defense of an action or proceeding referred to in (a) or (b) of this section, or in defense of a claim, issue, or matter in the action or proceeding, the manager, managing member, employee, or agent shall be indemnified against expenses and attorney fees actually and reasonably incurred in connection with the defense.

(d) ***Unless otherwise ordered by a court, indemnification under (a) or (b) of this section may only be made by a company upon a determination that indemnification of the manager, managing member, employee, or agent is proper in the circumstances because the manager, managing member, employee, or agent has met the applicable standard of conduct set out in (a) and (b) of this section. The determination shall be made by the members.***

Without these limitations on indemnification, indemnity protection could be contractually provided even in those instances where the indemnified party acted against the interests of the entity, had causal or contributing negligence, or committed a crime.

3. **Dispute Resolution/Venue:** Neither the Delaware Act nor the Alaska Act dictates any particular form of dispute resolution or the location of venue for any dispute resolution proceeding involving companies organized under their respective acts. Under both of the acts, the parties may seek resort to the courts of each respective state to resolve disputes, but such resort is not mandated.

As presented in the proposed Alaska Stranded Gas Fiscal Contract, the parties are proposing a structurally developed alternative dispute resolution process and procedures. Under

the Contract, the substantive law of the State of Alaska applies with the Alaska Superior Court the venue for award judgment of matters arising out of the Contract. This may mitigate towards aligning the dispute resolution processes under the Contract and the LLC into a single integrated process, as disputes that might be anticipated to arise under the LLC or the Contract would likely implicate the other necessitating a global resolution under both.

From the Administration's presentations, however, it appears that the parties may be considering a traditional dispute resolution procedure for LLC related disputes, with venue in the Delaware Chancery Court, under the argument discussed above that Delaware judges would be more proficient in adjudicating claims arising from the Delaware LLC statute. Aside from an inconvenient forum arguments as the project and many of the participants will be located in Alaska, the likelihood of conflicting dispute resolution procedures and forums would likely eliminate any perceived superiority of Delaware Judges over Alaska Judges in interpreting Delaware LLC laws, particularly where the Delaware Act essentially waives statutory protections in lieu of contract agreement – such that no particular expertise in the Delaware Act may be necessary, but only expertise with contract interpretation in the context of pipeline project issues, in which the Alaska courts may have superior experience and proficiency.

Greenberg Traurig

Memorandum

TO: Don Shepler

FROM: Phillip C. Gildan

DATE: May 22, 2006

RE: Alaska Natural Gas Pipeline: Form of Ownership Entity
Limited Liability Company/Choice of Laws

The choice of utilizing a Limited Liability Company (LLC) as the form of ownership entity for the Alaska Natural Gas Pipeline appears to have been agreed to among the Producers and the State negotiating team. This memorandum does not discuss the conclusion to use the indirect ownership structure of an LLC, vis-à-vis a direct ownership structure of an undivided joint interest (UJI) form of project ownership. Instead, this memorandum addresses only the question of choice of law as to formation of the LLC, and implications to the State from such choice. (Note: this memorandum does not address tax implications from choice of formation law).

From the Gas Pipeline Contract Presentations by the State negotiating team, it has been represented that the Producers and the State negotiating team have agreed upon use of the Delaware Limited Liability Company Act, Delaware Code, Title 6, Subtitle II, Chapter 18 ("Delaware Act") in lieu of the Alaska Revised Limited Liability Company Act, AS Chapter 10.50 ("Alaska Act").

Why choose the Delaware Act to form an Alaska Pipeline LLC instead of using the Alaska Act? In broad general terms, the business community maintains the perception that Delaware Courts provide a more developed body of case law affecting business entities than other states, and accordingly provide greater certainty of prediction of outcome in the event of business disputes. The corollary of this perception holds that Delaware Chancery Court Judges have a greater expertise in resolution of business disputes than judges in other states, again leading to greater certainty of prediction of outcome. An undercurrent of the perception of Delaware superiority, from both a body of law and judiciary, is that decisions by Delaware courts on business entity issues more often favor management/majority owners over minority owners. These perceptions may or may not prove out on a case by case analysis, but help explain the prevalent practice in the corporate world to establish business entities in Delaware.

Significant Differences Between Acts/Implications to Alaska

The Delaware Act represents one end of the spectrum of LLC enabling acts. It provides less mandatory entity terms, rights and obligations in favor of flexibility of the parties to freely set their own terms, rights and obligations by contract. The Alaska Act falls in the middle of the

spectrum. It provides significant freedom for the parties to set their own terms, rights and obligations, but imposes certain minimum member protections that cannot be contracted away. These minimum member protections afforded by the Alaska Act can be incorporated into a Delaware Act LLC by negotiation between/among the member parties, but absent such negotiation, those member protections will not exist. Two of these protections will be discussed below.

1. Duty of Managing Members to Entity:

The Delaware Act imposes no duty on managing members to either the company or to the other members of the company. It permits the members to contractually eliminate or create duties for managing members, with the exception that the general contract law which implies a duty of good faith and fair dealing, which can not be eliminated. The statute states:

§ 18-1101. Construction and application of chapter and limited liability company agreement.

> (a) The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.
> (b) It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.
> (c) To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

The Alaska Act, however imposes an express duty on managing members to act in the best interest of the company and adopts an ordinary prudent person standard of care. This duty is imposed as statutory protection of minority members (and other managing members) rights from a manager or managing member acting in its own self-interest which may be contrary to the business of the entity and the investment backed interests of the other members. It states:

AS 10.50.135. Duty of care.

> (a) A person who is a manager or a managing member of a limited liability company shall perform the duties of management in good faith, in a manner the person reasonably believes to be in the best interests of the company, and with the care, including reasonable inquiry, that an ordinarily prudent person in a like position would use under similar circumstances.

Without the duty of care that the Alaska Act provides, a manager or managing members controlling an entity could act in their own self interest and contrary to the interest of the entity's business, with only the implied covenant of good faith, which is a significantly lower standard of care and more difficult to apply if the parties have contractually elected not to impose a duty to the entity.

2. Indemnity of Managing Members.

The Delaware Act grants broad discretion to the members to indemnify and hold harmless any member from and against any claims and demands without limitation. It states:

§ 18-108. Indemnification.

> Subject to such standards and restrictions, if any, as are set forth in its limited liability company agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever.

The Alaska Act also provides the right to indemnify members, but imposes specific limitations on the ability to indemnify members, with material procedural terms enumerated. It states (with emphasis added):

AS 10.50.148. Indemnification of managers, managing members, employees, and agents; insurance.

> (a) A limited liability company may indemnify a person who was, is, or is threatened to be made a party to a completed, pending, or threatened action or proceeding, whether civil, criminal, administrative, or investigative, other than an action by or in the right of the company, by reason of the fact that the person is or was a manager, managing member, employee, or agent of the company, or is or was serving at the request of the company as a manager, managing member, employee or agent of another limited liability company, partnership, joint venture, trust, or other enterprise. Indemnification may include reimbursement of expenses, attorney fees, judgments, fines, and amounts paid in settlement actually and reasonably incurred by the person in connection with the action or proceeding ***if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the company, and, with respect to a criminal action or proceeding, the person had no reasonable cause to believe the conduct was unlawful.*** The termination of an action or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, does not create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in or not

opposed to the best interests of the company, and, with respect to a criminal action or proceeding, the person had reasonable cause to believe that the conduct was unlawful.

(b) A limited liability company may indemnify a person who was, is, or is threatened to be made a party to a completed, pending, or threatened action by or in the right of the company to procure a judgment in its favor by reason of the fact that the person is or was a manager, managing member, employee, or agent of the company, or is or was serving at the request of the company as a manager, managing member, employee, or agent of another limited liability company, partnership, joint venture, trust, or other enterprise. Indemnification may include reimbursement for expenses and attorney fees actually and reasonably incurred by the person in connection with the defense or settlement of the action ***if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the company. Indemnification may not be made in respect of any claim, issue, or matter as to which the person has been adjudged to be liable for negligence or misconduct in the performance of the person's duty to the company except to the extent that the court in which the action was brought determines upon application that, despite the adjudication of liability, in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for expenses that the court considers proper.***

(c) To the extent that a manager, managing member, employee, or agent of a limited liability company has been successful on the merits or otherwise in defense of an action or proceeding referred to in (a) or (b) of this section, or in defense of a claim, issue, or matter in the action or proceeding, the manager, managing member, employee, or agent shall be indemnified against expenses and attorney fees actually and reasonably incurred in connection with the defense.

(d) ***Unless otherwise ordered by a court, indemnification under (a) or (b) of this section may only be made by a company upon a determination that indemnification of the manager, managing member, employee, or agent is proper in the circumstances because the manager, managing member, employee, or agent has met the applicable standard of conduct set out in (a) and (b) of this section. The determination shall be made by the members.***

Without these limitations on indemnification, indemnity protection could be contractually provided even in those instances where the indemnified party acted against the interests of the entity, had causal or contributing negligence, or committed a crime.

3. **Dispute Resolution/Venue:** Neither the Delaware Act nor the Alaska Act dictates any particular form of dispute resolution or the location of venue for any dispute resolution proceeding involving companies organized under their respective acts. Under both of the acts, the parties may seek resort to the courts of each respective state to resolve disputes, but such resort is not mandated.

As presented in the proposed Alaska Stranded Gas Fiscal Contract, the parties are proposing a structurally developed alternative dispute resolution process and procedures. Under the Contract, the substantive law of the State of Alaska applies with the Alaska Superior Court the venue for award judgment of matters arising out of the Contract. This may mitigate towards aligning the dispute resolution processes under the Contract and the LLC into a single integrated process, as disputes that might be anticipated to arise under the LLC or the Contract would likely implicate the other necessitating a global resolution under both.

From the Administration's presentations, however, it appears that the parties may be considering a traditional dispute resolution procedure for LLC related disputes, with venue in the Delaware Chancery Court, under the argument discussed above that Delaware judges would be more proficient in adjudicating claims arising from the Delaware LLC statute. Aside from an inconvenient forum arguments as the project and many of the participants will be located in Alaska, the likelihood of conflicting dispute resolution procedures and forums would likely eliminate any perceived superiority of Delaware Judges over Alaska Judges in interpreting Delaware LLC laws, particularly where the Delaware Act essentially waives statutory protections in lieu of contract agreement – such that no particular expertise in the Delaware Act may be necessary, but only expertise with contract interpretation in the context of pipeline project issues, in which the Alaska courts may have superior experience and proficiency.

Greenberg Traurig

Memorandum

TO: Joe Balash

FROM: Phillip C. Gildan

DATE: May 23, 2006

RE: Proposed Alaska Natural Gas Pipeline Corporation Legislation

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At your request we have reviewed the proposed Alaska Natural Gas Pipeline Corporation Legislation (the "ANGPC Act") attached as Appendix K to the Preliminary Findings and Determination issued by the State of Alaska Department of Revenue, dated May 10, 2006 (the "FIF"). This memorandum provides a synopsis of the ANGPC Act, comments as to the ANGPC Act's provisions in relation to the proposed Alaska Stranded Gas Fiscal Contract between the State of Alaska and BP Exploration (Alaska), Inc., ConocoPhillips Alaska, Inc. and ExxonMobil Alaska Production, Inc. (the "ASGF Contract"), and suggested revisions/additions to the ANGPC Act. Since the Legislature has not yet been provided the proposed Limited Liability Company Agreement for the proposed Pipeline Project Mainline Limited Liability Company Entity ("Mainline LLC") (or Limited Liability Company Agreements for the other proposed Pipeline Project related entities ("Ancillary LLCs")), we can not comment on the ANGPC Act as it relates to such agreements. When we receive the proposed Limited Liability Company Agreements we will update this memorandum.

Synopsis of ANGPC Act

The ANGPC Act creates the Alaska Natural Gas Pipeline Corporation (the "ANGPC") as a public corporate entity to act as the State's surrogate to acquire the membership (ownership) interests in the Mainline LLC and Ancillary LLCs, as called for in the ASGF Contract, and to exercise the State's rights and meet the State's obligations as a member in each of those respective LLCs.

In its form and in most of its material terms, the ANGPC Act mirrors other Alaska public corporations established by the Legislature to execute Legislative project goals and programs. (See, for example, the Alaska Natural Gas Development Authority, AS Chapter 41.41; the Alaska Energy Authority, AS Chapter 44.83; the Alaska Industrial Development and Export Authority, AS Chapter 44.88; and the Alaska Municipal Bond Bank Authority, AS Chapter 44.85)

As with these other public corporations, the ANGPC will be a separate governmental entity, with delegated governmental powers and responsibilities. While an independent governmental entity, it will have no home rule governmental powers, but only those accorded it in the ANGPC Act. The Act incorporates standard governmental instrumentality language to bring the ANGPC within the broad cloak of governmental privilege and protection afforded to government instrumentalities (for example, federal, state and local tax-exempt status, access to municipal bond market and federal tax-exempt financing).

The ANGPC Act's corporate stricture, procedural and administrative provisions are standard and unremarkable (for example, appointment and removal of board members, board meeting requirements, board compensation).

Two areas of the ANGPC Act diverge from the generic public corporation mold, and should be noted. One, the ANGPC is essentially exempted from public meeting requirements (AS 41.42.030(d) and AS 41.42.530). This represents a policy decision, with pros relative to the corporation acting in a proprietary capacity, and cons relative to diminished transparency of the corporation's actions. Two, the ANGPC (and other Pipeline LLC member/owners) are exempted from the public policy against indemnification agreements (AS 45.45.905). This also represents a policy decision, as discussed by the administration during its briefing of the legislature.

Finally, somewhat unusually for Public Corporation Acts, the ANGPC Act delegates to the ANGPC the power to establish its own subsidiary public corporations (AS 41.42.220). As noted below, this provision relates to the ASGF Contract and the extra-territorial aspects of the Pipeline project. Such a power can be a useful corporate tool to segregate liability and fiscal accountability in the appropriate circumstances. Suggested revisions to AS 41.42.200 are set forth below to better implement the purpose of such a structural tool and provide enhanced accountability for such entities, if created. Note, the creation of subsidiaries is not mandated, but merely authorized as the board of the ANGPC sees fit.

Comments Relative to the ASGF Contract

The ASGF Contract delegates the implementation of the Project and a material segment of the parties' agreements to the Mainline Entity (and affiliated Project entities). The State's ownership participation in the Mainline Entity and exercise of its ownership rights is, in turn, effectuated through the creation of the ANGPC, as proposed in the ANGPC Act. Under the ASGF Contract program structure, implementing AS 43.82, the Stranded Gas Development Act, the Mainline Entity and the Producers are the dog and the ANGPC is its tail. Recognizing this minority position and the lack of expectation that the tail will be wagging the dog, the terms of the ANGPC nonetheless have importance to the legislature to assure that the tail of the dog is as strong as possible, with the flexibility to react quickly to the dynamic nature of the Project, without compromising the State's multi-faceted interests as minority owner of the Project The suggested revisions below enhance the ANGPC's strength and flexibility, while retaining necessary reins of control. The ultimate key for protection of the State's interests, however, will be in the proposed structure of the Mainline Entity and the minority rights protections afforded

the State. When the Mainline Entity structure is unveiled by the Administration, additional changes to the ANGPC Act may be necessitated depending on the level of protections afforded.

Suggested Revisions/Additions to the ANGPC Act

While the ANGPC Act mirrors the other Public Corporation Acts, it is not identical to them. A number of provisions in the other Acts would be beneficial to incorporate into the ANGPC Act. In addition, based upon the terms of the ASGF Contract and the stated goals of the State set forth in the FIF, there are a number of other provisions which could provide the ANGPC greater flexibility and strength in meeting the project goals and adjusting for changes that the dynamic nature of the Pipeline Project will inevitably generate.

1. Revise Sec. 2 of the Act, Article 2, Purposes and Powers, AS 41.42.210 by adding thereto new subsections (25), (26), (27), (28), (29) and (30) as follows:

(25) to acquire, hold, use, operate, maintain, repair, replace, mortgage, encumber, lease, rent, convey, or acquire real and personal property as may be necessary or in furtherance of the project or its corporate purpose, and to transfer, license, lease, contribute as a contribution to capital or in-kind payment, or otherwise convey all or any of such property, permanently or for a term of years to any owner entity of the project; without limiting the foregoing, it may acquire such property by purchase, gift or eminent domain; to charge and collect fees, rentals or other forms of remuneration for the use of its properties;

(26) to sell, give, lease, or otherwise supply to any owner entity of the project such personnel or services as may be in furtherance of the project or its corporate purpose; to act as managing member of any owner entity of the project;

(27) to make capital contributions and loans to any owner entity of the project; to acquire any or all membership or other ownership interests in any owner entity of the project from any other person or legal entity that has a membership or ownership interest in an owner entity of the project;

(28) to retain or engage such advisers, consultants, and professional service providers as may be in furtherance of the project or its corporate purpose, including, but not limited to financial advisors to negotiate the bonds and financial obligations of the corporation, engineering and geo-technical consultants to review and report on the status of the project, accounting consultants to analyze or audit the financial reports of the owner entities of the project, and legal service providers to provide specialized legal counsel and representation of the corporation as desired to supplement the legal counsel of the attorney general pursuant to AS 41.42.070;

(29) to implement such other duties and directives as may be authorized by the legislature from time to time, including, but not limited to, if approved by the legislature,

acting as State Capacity Holder, as defined in the Alaska Stranded Gas Fiscal Contract approved by the legislature pursuant to AS 43.83.435.

(30) to negotiate collateral agreements pursuant to AS 43.83.437 that are required to implement the corporation's acquisition of an ownership interest in the project that is the subject of a proposed contract developed under this chapter. Such collateral agreements shall be subject to review and approval by the Legislative Budget and Audit Committee, and upon such approval may be entered into by the corporation.

2. Amend Sec. 2 of the Act, Article 2, Purposes and Powers, AS 41.42 by adding thereto AS 41.42.090 as follows:

Sec. 41.42.090. Corporation Representative. The board shall appoint such representatives and alternate representatives for each owner entity of the project to exercise the rights of the corporation as member or owner of the owner entity of the project. The representatives and alternate representatives serve at the pleasure of the board and may be removed and replaced by the board without notice, and without cause, at any time. The board shall direct the representatives and alternate representatives as to the exercise of the corporation's rights as member or owner of the owner entity of the project, provided the board may delegate to the representatives and alternate representatives authority to act on behalf of the corporation in the event that an exercise of the corporation's rights as owner of the owner entity of the project is required during the interval between board meetings of the corporation.

3. Amend Sec. 2 of the Act, Article 2, Purposes and Powers, AS 41.42.220(c) by deleting said subsections (c) and (d) and replacing it with the following subsections (c) and (d):

(c) The members of the governing body of a subsidiary entity organized under this section shall be the members of the board of the corporation. The provisions of AS 41.42.020-41.42.50 and AS 41.42.080-41.42.090 shall apply to the governing body of each subsidiary entity organized under this section. The executive director, staff, and legal advisor of the corporation shall act as the executive director, staff and legal advisor of each subsidiary entity organized under this section, subject to the provisions of AS 41.42.060-41.42.070. Notwithstanding that a subsidiary entity organized under this section shall be wholly owned by the corporation and shall have interlocking governing bodies, executive director, staff and legal advisor as provided in this subsection (c), the corporation shall not be liable for a debt, obligation, or liability of such subsidiary entity, unless expressly assumed by the corporation in a written instrument, or as otherwise provided in this chapter.

(d) The provisions of AS 41.42.400-41.42.530 apply to a subsidiary entity established under this section as if the subsidiary entity was a corporation established under this chapter. The provisions of AS 39.25.110(11), AS 39.30.200(a)(9), AS 39.50.200(b), AS 42.06.230 and AS 45.45.905 apply to a subsidiary entity established under this section as if the subsidiary entity was the Alaska Natural Gas Pipeline Corporation.

4. Amend Sec. 2 of the Act, Article 4, Purposes and Powers, by adding thereto AS 41.42-450 as follows:

Sec. 41.42.450. Coordination with AS 43.82. (a) Unless specifically provided otherwise in this chapter, in the event of a conflict between the provisions of AS 43.82 and this chapter, the provisions of AS 43.82 shall control.

(b) In the event of a dispute between or among the corporation, a subsidiary entity of the corporation, an owner entity of the project, and any other person or legal entity that has a membership or ownership interest in an owner entity of the project, such dispute shall be subject to the dispute resolution terms and procedures set forth in the Alaska Stranded Fiscal Contract as approved by the legislature pursuant to AS 43.82.435. The term "dispute" shall mean a dispute, matter, controversy or claim arising out of or relating to any owner entity of the project, to any ownership interest in the project, to any agreement between or among the members or owners of any owner entity of the project arising out of or relating to such owner entity of the project, or to the operation, management, or implementation of the project, including its interpretation, construction, performance, enforcement, privileges, rights or obligations.

(c) In furtherance of the purpose set forth in AS 43.82.010 and the implementation of the Alaska Stranded Fiscal Contract as approved by the legislature pursuant to AS 43.82.435, each owner entity of the project shall be deemed to impose on its managing members and owner representatives a duty to act in the best interest of the entity and perform its duties in good faith towards the goal of implementation of the project.

5. Renumber Section 14 of the Act as Section 15, and add a new Section 14 as follows:

Sec. 14. AS 42.06.230 is amended by adding a new subsection (c) to read:

AS 42.06.230. Jurisdiction of Commission

(c). The commission's jurisdiction and authority does not extend to the Alaska Natural Gas Pipeline Corporation. To the extent that the performance of any duties of the commission affects the Alaska Natural Gas Pipeline Corporation, the performance of its duties may not, as to that corporation, conflict with AS 41.42, AS 43.82, or applicable federal laws, regulations, orders, or other requirements.

Greenberg Traurig

Memorandum

TO: Alaska State Legislature
Legislative Budget and Audit Committee
Attention: Senator Gene Therriault and Representative Ralph Samuels

FROM: Phillip C. Gildan

DATE: June 2, 2006

RE: Alaska Stranded Gas Fiscal Contract:
Summary of Concerns Regarding Structure/Governance/Operation of Entities to Be Formed to Own And Operate the Various Elements of the Pipeline Project
Legislative Options

We have been requested to summarize our primary concerns with the dr... Alaska Stranded Gas Fiscal Contract, dated May 24, 2006 (the "SGFC") and to review SB 2004, the SGDA Conforming Amendments proposed by the Administration ("SB 2004 Amendments"), for legislative options to address our concerns. This memorandum addresses one of those concerns; the lack of specificity of terms and conditions addressing the structure, governance and operation of the various Project Entities referenced in the ASGFC to be created to implement the Project, and own and operate the various Project elements (the "Entities Concern").

For purposes of this memorandum and for continuity of review, unless otherwise defined, the capitalized terms we have used in this memorandum have the same meaning given such terms in the SGFC.

Article 4 of the SGFC provides a general Project description, identifying the following Project elements: Gas Transmission Pipelines, GTP, Mainline, NGL Plant, Alaska to Alberta Project, and Alberta to Lower 48 Project. Within Article 5, Article 6, Article 7 and Article 9, the drafters of the SGFC provide that separate legal entities will be created to develop, own and operate each of the Project elements, and to implement the general terms of the SFGC (an "Entity" or collectively the "Entities"). The SGFC, however, provides little guidance or direction as to the structure, governance and operation of such Entities, the coordination between and among the Entities and the parties to the SGFC, or the interface of the terms and obligations set forth in the SGFC with the as yet unknown terms and conditions in the Project Entity agreements. As an example of some of the fundamental terms and conditions omitted from the SGFC are the following:

- form of entity and choice of establishing law;

- terms of Entity governance controlling the relationships among the interest holders, management and the entity;
- terms of Entity ownership, including initial and periodic capital contributions, duties among members and to the Entity, member transfer and buy-out issues. accounting and tax allocations, liquidation and dissolution, reporting and record keeping, audit and review;
- terms of Project implementation, including management, member voting, minority protections, staffing, procurement, vendor selection, asset acquisition and divestiture, amendment of Qualified Project Plan, creation of sub-entities, milestone triggers and approvals;
- terms of Project operating agreements addressing how the Project will be administered, termination and replacement of operators, compensation;
- terms regarding Project Tariff design, FERC applications, initial and continuing Open Seasons, expansion and extension, contracting with shippers;

The significance of these missing terms and conditions can be seen based on the duties and responsibilities which the SGFC delegates to the Project Entities. The Project Entities are charged to undertake the Project planning under the Qualified Project Plan, to update and amend the Qualified Project Plan, to structure and process the FERC and NEB project application and certification review, to determine whether to proceed with construction, to determine whether to terminate the Project or proceed to operation, to determine financing plans for the Project and capital contribution obligations, to structure the Pipeline tariff, to decide whether to Expand or Extend the Pipeline, and to own and operate the designated segments of the pipeline system both within and without the state.

However, the Contract contains scant direction regarding the Project Entities, and the Legislature has not been provided with drafts of any of the proposed Project Entity agreements. It is our understanding that negotiations are still on-going to develop the first and primary of these agreements—an agreement among the Producers and the State providing for the creation, governance, management, financing, capital contributions, operations and administration of the "Mainline Entity," and providing the structure and implementation criteria for the Qualified Project Plan.

The importance of the Project Entity agreements to the implementation of the intent of the Legislature set forth in the SGDA to assure the construction of the Project can hardly be overstated. Just listing the breadth and depth of the decisions and responsibilities delegated to the Project Entities under the Contract demonstrates the point. The apparent difficulty the Producers and the Administration are having in finalizing the first of the these agreements for the Mainline Entity, and their inability to complete such negotiations in time for submittal with the proposed Contract, proves the importance of the terms and conditions of the Project Entity agreements.

While we are told that the terms of the Mainline Entity LLC agreement are still being negotiated it is not clear that any of the Project Entity agreements will be provided to the

Legislature for comment o for approval. Indeed, SB2004 provides that the Commissioners of Revenue and Natural Resources will be authorized to enter into "collateral agreements" after execution of the Contract, and expressly without required approval of the Legislature (*See* Section 11 of SB 2004).

This is troubling since the specific terms of the Project Entity agreements can limit the rights and actions of the State with respect to critical decisions affecting the project. For example, it would be expected that the Mainline Entity LLC agreement will specify the voting rights of the participants with respect to approving the filing of the application for a FERC certificate. Likewise, it would be expected that the agreement will specify the voting rights of the State with respect to the decision to accept or reject a certificate and to proceed with construction of the project or terminate. Decisions with respect to voluntary expansions of the line will also presumably be addressed in the LLC agreement, as will decisions with respect to the pricing of expansion capacity (*i.e.*, whether it will be priced incrementally or on a rolled-in basis).

Even as basic a decision as where to establish the Mainline Entity can have significant impact on the likelihood of success of the Project. The state law in which an LLC is established can establish or negate certain duties among the parties which serve to protect minority members. The Alaska LLC Act imposes a much greater duty of care and fair dealing upon owners of an LLC than does the Delaware LLC law—which the Administration has indicated is intended to be the state in which the Mainline Entity LLC will be established. Such a duty of care and fair dealing is important where, as here, the State is a minority interest owner of the LLC. Without such duties being imposed by law the managing members of the LLC or the majority owners would be free to pursue their own self interests, and pursue activities contrary to the interest of the LLC and the Project. The choice that the Administration seems to have made with respect to the state in which to establish the LLCs is not optimal from the State's standpoint as a minority interest owner.

These missing terms and conditions are essential contractual elements. Without an agreement among the parties on these essential contract terms and conditions, the SGFC could be interpreted as nothing more than an agreement to agree, which may not reach the level of an enforceable contract.

Attached to this memorandum as an exhibit is an illustrative legislative amendment that provides an example of the type of guidance and direction to the commissioners of revenue and natural resources regarding Entity agreement terms and conditions that the legislature could consider to address the concerns discussed above.

EXHIBIT I

ILLUSTRATIVE LEGISLATIVE AMENDMENT

TO THE SB 2004 AMENDMENTS

Amend Section 11, by replacing AS 43.82.437(a) with the following:

Sec. 11. AS 43.82 is amended by adding a new section to read:

Sec. 43.82.437. Collateral Agreements. (a) The commissioner of revenue with the concurrence of the commissioner of natural resources may negotiate collateral agreements that are required to implement the state's acquisition of an ownership interest in the project **and each project entity to be created to own and operate any part of the project** that is the subject of a proposed contract developed under this chapter. **Each such collateral agreement shall be a condition subsequent to the proposed contract developed under this chapter, shall be subject to review and authorization to execute by the legislature, or the Legislative Budget and Audit Committee if the legislature is not in session, and upon approval may be entered into by the public corporation as provided in (b) below.** The authority of the commissioner of revenue to negotiate collateral agreements on behalf of the state lapses 180 days after the effective date of the law authorizing the contract under AS 43.82.435, **provided, that with respect to collateral agreements submitted by the commissioner of revenue to the legislature or the Legislative Budget and Audit Committee within the 180 day time limit, the time limit shall be extended to 5 days after authorization has been approved. Each project entity collateral agreement to be negotiated shall incorporate the following minimum elements:**

(1) if organized to do business in the state, the project entity shall be a limited liability company organized under the Alaska Revised Limited Liability Company Act, AS Chapter 10.50 ("Alaska Act");

(2) for project entities organized under the Alaska Act, the operating agreement adopted under AS 10.50.095, or equivalent governing document for project entities organized under other jurisdictions ("Operating Agreement"), shall include the limitation that the state's obligation to fund continuing capital and operating obligations shall be subject to annual appropriation by the legislature; and provide further that the state's failure to appropriate a capital or operating obligation shall not be deemed a default of the state's obligation, but shall be deemed only to reduce the state's ownership interest on a pro rata basis based upon the amount of the failed appropriation relative to the amount of the capital or operating obligations funded by the remaining project owners.

(3) the Operating Agreement shall provide that the state shall not agree to a waiver of sovereign immunity without a reasonable monetary limit on such waiver under

the facts and circumstances; and provided further, that the state shall not indemnify, or otherwise hold harmless any person or entity that has been adjudged in a judicial, administrative, or alternative dispute resolution proceeding to be liable for negligence or misconduct in the performance of the person's or entity's duty or has been adjudged guilty of a crime or had such criminal adjudication withheld subject to probationary terms; provided further, that the state may not eliminate claims for actual damages incurred by the state, and may not eliminate the equitable rights to seek specific performance and injunctive relief; and provided further that the rights and limitations provided in this subsection shall apply to collateral agreements to be entered into under AS 43.82.437.

(4) the Operating Agreement shall provide that in the event of a dispute between or among the members of the entity, a subsidiary entity, an affiliate of a member, a member representative, and any other person or legal entity that has a membership or ownership interest in an owner entity of the project, such dispute shall be subject to the dispute resolution terms and procedures set forth in the contract as approved by the legislature pursuant to AS 43.82.435. The term "dispute" shall mean a dispute, matter, controversy or claim arising out of or relating to any owner entity of the project, to any ownership interest in the project, to any agreement between or among the members or owners of any owner entity of the project arising out of or relating to such owner entity of the project, or to the operation, management, or implementation of the project, including its interpretation, construction, performance, enforcement, privileges, rights or obligations. Such dispute resolution terms shall incorporate equivalent presumptions and burdens of proof as set forth for civil trials in Rule 301, Presumptions in General in Civil Actions and Proceedings, and Rule 302, Applicability of Federal Law in Civil Actions and Proceedings, Alaska Rules of Evidence as amended.

(5) the Operating Agreement shall provide that the managing members and member representatives owe a duty to act in the best interest of the entity and perform their duties in good faith towards the goal of implementation of the project.

(6) the Operating Agreement shall provide that the entity shall not effect a material change or amendment to the Qualified Project Plan without the review and authorization of the legislature, or the Legislative Budget and Audit Committee if the legislature is not in session.

(7) the Operating Agreement shall provide that the members of the governing body of any subsidiary entity organized by the entity shall be the members of the governing board of the entity, unless otherwise authorized by the legislature, or the Legislative Budget and Audit Committee if the legislature is not in session.

(8) the Operating Agreement shall provide the state the unilateral right to initiate expansions of the project, provided the state funds or obtains third party funding from a credit worthy customer for each such expansion or extension, and shall include terms for voluntary expansion, including:

A) holding periodic (every 3-5 years) binding or non-binding open seasons to assess market demand for expansion;

B) commit to satisfy all creditworthy demands for capacity expansion in reasonable engineering increments;

C) commit expansion for creditworthy shippers in less-than reasonable engineering increments when such shippers commit to contributions in aid of construction sufficient to keep the project entity whole, including authorized return; and

D) commit the project entity to propose and defend the use of rolled-in pricing for all expansions.

(9) the Operating Agreement shall provide that in the event the entity elects to contract with a vendor to operate the entity or implement the project, such vendor shall be independent of and not an affiliate of the members of the entity.

(10) the Operating Agreement shall provide that state member shall have the right to participate in all meetings of the governing board of the entity and vote on all decisions of the entity, including, but not limited to, decisions affecting tax allocations between or among the taxpaying members of the entity.

(11) the Operating Agreement shall provide that the state member shall have the right to review all books and records of the entity, including, but not limited to, all contracts, and to audit the finances of the entity at any time and from time to time.

(12) the Operating Agreement shall provide that upon termination, liquidation or dissolution of the entity, the state shall have a right of first refusal and option to acquire all of the assets of the entity at the then fair value of the assets.

(13) the Operating Agreement shall provide that in the event a member seeks to transfer or divest its ownership interest in the entity, the state shall have a right of first refusal and option to acquire the member's ownership interest at the then fair value of the interest.

(14) the Operating Agreement shall provide that in the event that the entity seeks to transfer or divest any or all of the project assets, the state shall have a right of first refusal and option to acquire such project assets at the then fair value of such project assets.

(15) the Operating Agreement shall include a right of first refusal and option by which the state may acquire all or any part of the project assets in the event that Federal Energy Regulatory Commission of the United States Department of Energy, the United States Department of Justice, the Federal Trade Commission, or other applicable federal or state agency or adjudicatory body orders one or more qualified sponsor or the qualified

sponsor group, or their affiliates, to divest any or all ownership interest in the project, at the then fair value of such project assets.

_____ (16) the Operating Agreement shall provide that the project entity shall utilize project financing supported by federal guarantee instruments as defined in the Alaska Natural Gas Pipeline Act to the maximum extent available from the Federal Treasury, and shall limit the equity portion of project capitalization to no more than 20% of total capital.

For purposes of this section (a), the term "fair value" means the value as agreed to by the affected members or as determined under the dispute resolution process if no agreement can be reached, provided fair value shall be determined based on original cost less depreciation, comparable sales or income approach valuation methodologies.

Greenberg Traurig

Memorandum

TO: Alaska State Legislature
Legislative Budget and Audit Committee
Attention: Senator Gene Therriault and Representative Ralph Samuels

FROM: Phillip C. Gildan

DATE: June 2, 2006

RE: Proposed Alaska Natural Gas Pipeline Corporation Legislation

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At your request we have reviewed SB 2003, the proposed Alaska Natural Gas Pipeline Corporation Legislation (the "ANGPC Act"). This memorandum provides a synopsis of the ANGPC Act, comments as to the ANGPC Act's provisions in relation to the proposed Alaska Stranded Gas Fiscal Contract dated May 24, 2006 ("SGFC"). Suggested legislative amendments to SB 2003 are set forth on an attachment to this memorandum.

Synopsis of ANGPC Act

The ANGPC Act creates the Alaska Natural Gas Pipeline Corporation (the "ANGPC") as a public corporate entity to act as the State's surrogate to acquire the membership (ownership) interests in the Mainline LLC and Ancillary LLCs, as called for in the ASGF Contract, and to exercise the State's rights and meet the State's obligations as a member in each of those respective LLCs.

In its form and in most of its material terms, the ANGPC Act mirrors other Alaska public corporations established by the Legislature to execute Legislative project goals and programs. (See, for example, the Alaska Natural Gas Development Authority, AS Chapter 41.41; the Alaska Energy Authority, AS Chapter 44.83; the Alaska Industrial Development and Export Authority, AS Chapter 44.88; and the Alaska Municipal Bond Bank Authority, AS Chapter 44.85).

As with these other public corporations, the ANGPC will be a separate governmental entity, with delegated governmental powers and responsibilities. While an independent governmental entity, it will have no home rule governmental powers, but only those accorded it in the ANGPC Act. The Act incorporates standard governmental instrumentality language to bring the ANGPC within the broad cloak of governmental privilege and protection afforded to government instrumentalities (for example, federal, state and local tax-exempt status, access to municipal bond market and federal tax-exempt financing).

The ANGPC Act's corporate stricture, procedural and administrative provisions are standard and unremarkable (for example, appointment and removal of board members, board meeting requirements, board compensation).

Two areas of the ANGPC Act diverge from the generic public corporation mold, and should be noted. One, the ANGPC is essentially exempted from public meeting requirements (AS 41.42.030(d) and AS 41.42.530). This represents a policy decision, with pros relative to the corporation acting in a proprietary capacity, and cons relative to diminished transparency of the corporation's actions. Two, the ANGPC (and other Pipeline LLC member/owners) are exempted from the public policy against indemnification agreements (AS 45.45.905). This also represents a policy decision, as discussed by the administration during its briefing of the legislature.

Finally, somewhat unusually for Public Corporation Acts, the ANGPC Act delegates to the ANGPC the power to establish its own subsidiary public corporations (AS 41.42.220). As noted below, this provision relates to the ASGF Contract and the extra-territorial aspects of the Pipeline project. Such a power can be a useful corporate tool to segregate liability and fiscal accountability in the appropriate circumstances. Suggested revisions to AS 41.42.200 are set forth below to better implement the purpose of such a structural tool and provide enhanced accountability for such entities, if created. Note, the creation of subsidiaries is not mandated, but merely authorized as the board of the ANGPC sees fit.

Comments Relative to the ASGF Contract

The ASGF Contract delegates the implementation of the Project and a material segment of the parties' agreements to the Mainline Entity (and affiliated Project entities). The State's ownership participation in the Mainline Entity and exercise of its ownership rights is, in turn, effectuated through the creation of the ANGPC, as proposed in the ANGPC Act. Under the ASGF Contract program structure, implementing AS 43.82, the Stranded Gas Development Act, the Mainline Entity and the Producers are the dog and the ANGPC is its tail. Recognizing this minority position and the lack of expectation that the tail will be wagging the dog, the terms of the ANGPC nonetheless have importance to the legislature to assure that the tail of the dog is as strong as possible, with the flexibility to react quickly to the dynamic nature of the Project, without compromising the State's multi-faceted interests as minority owner of the Project. The suggested revisions below enhance the ANGPC's strength and flexibility, while retaining necessary reins of control. The ultimate key for protection of the State's interests, however, will be in the proposed structure of the Mainline Entity and the minority rights protections afforded the State. When the Mainline Entity structure is disclosed by the Administration, additional changes to the ANGPC Act may be necessitated depending on the level of protections afforded.

Legislative Amendments to SB 2003 for Consideration

While the ANGPC Act mirrors other Public Corporation Acts, it is not identical to them. A number of provisions in the other Acts would be beneficial to incorporate into the ANGPC Act. In addition, based upon the terms of the SGFC and the stated goals of the State set forth in the FIF, there are a number of other provisions which could provide the ANGPC greater flexibility in meeting the project goals and adjusting for changes that the dynamic nature of the Pipeline Project will inevitably generate.

1. Revise Sec. 2 of SB 2003, AS 41.42.210, Article 2, Purposes and Powers, by adding thereto new subsections (25), (26), (27), (28), (29) and (30) as follows:

(25) to acquire, hold, use, operate, maintain, repair, replace, mortgage, encumber, lease, rent, convey, or acquire real and personal property as may be necessary or in furtherance of the project or its corporate purpose, and to transfer, license, lease, contribute as a contribution to capital or in-kind payment, or otherwise convey all or any of such property, permanently or for a term of years to any owner entity of the project; without limiting the foregoing, it may acquire such property by purchase, gift or eminent domain; to charge and collect fees, rentals or other forms of remuneration for the use of its properties;

(26) to sell, give, lease, or otherwise supply to any owner entity of the project such personnel or services as may be in furtherance of the project or its corporate purpose; to act as managing member of any owner entity of the project;

(27) to make capital contributions and loans to any owner entity of the project; to acquire any or all membership or other ownership interests in any owner entity of the project from any other person or legal entity that has a membership or ownership interest in an owner entity of the project;

(28) to retain or engage such advisers, consultants, and professional service providers as may be in furtherance of the project or its corporate purpose, including, but not limited to financial advisors to negotiate the bonds and financial obligations of the corporation, engineering and geo-technical consultants to review and report on the status of the project, accounting consultants to analyze or audit the financial reports of the owner entities of the project, and legal service providers to provide specialized legal counsel and representation of the corporation as desired to supplement the legal counsel of the attorney general pursuant to AS 41.42.070;

(29) to implement such other duties and directives as may be authorized by the legislature from time to time, including, but not limited to, if approved by the legislature, acting as State Capacity Holder, as defined in the contract approved by the legislature pursuant to AS 43.83.435.

(30) to enter into collateral agreements subject to AS 43.83.437 that are required to implement the corporation's acquisition of an ownership interest in the project that is the subject of a Alaska Stranded Gas Fiscal Contract approved by the legislature pursuant to AS 43.83.435. Such collateral agreements shall be subject to review and authorization by the legislature, or by the Legislative Budget and Audit Committee when the legislature is not in session, and upon such authorization may be entered into by the corporation.

2. Amend Sec. 2 of SB 2003, AS 41.42, Article 2, Purposes and Powers, by adding thereto AS 41.42.090 as follows:

Sec. 41.42.090. Corporation Representative. The board shall appoint such representatives and alternate representatives for each owner entity of the project to exercise the rights of the corporation as member or owner of the owner entity of the project. The representatives and alternate representatives serve at the pleasure of the board and may be removed and replaced by the board without notice, and without cause, at any time. The board shall direct the representatives and alternate representatives as to the exercise of the corporation's rights as member or owner of the owner entity of the project, provided the board may delegate to the representatives and alternate representatives authority to act on behalf of the corporation in the event that an exercise of the corporation's rights as owner of the owner entity of the project is required during the interval between board meetings of the corporation.

3. Amend Sec. 2 of SB 2003, AS 41.42.220, Article 2, Purposes and Powers, by deleting subsections (c) and (d) and replacing them with the following subsections (c) and (d):

(c) The members of the governing body of a subsidiary entity organized under this section shall be the members of the board of the corporation. The provisions of AS 41.42.020-41.42.50 and AS 41.42.080-41.42.090 shall apply to the governing body of each subsidiary entity organized under this section. The executive director, staff, and legal advisor of the corporation shall act as the executive director, staff and legal advisor of each subsidiary entity organized under this section, subject to the provisions of AS 41.42.060-41.42.070. Notwithstanding that a subsidiary entity organized under this section shall be wholly owned by the corporation and shall have interlocking governing bodies, executive director, staff and legal advisor as provided in this subsection (c), the corporation shall not be liable for a debt, obligation, or liability of such subsidiary entity, unless expressly assumed by the corporation in a written instrument, or as otherwise provided in this chapter.

(d) The provisions of AS 41.42.400-41.42.530 apply to a subsidiary entity established under this section as if the subsidiary entity was a corporation established under this chapter. The provisions of AS 39.25.110(11), AS 39.50.200(a)(9), AS 39.50.200(b), AS 42.06.230 and AS 45.45.905 apply to a subsidiary entity established under this section as if the subsidiary entity was the Alaska Natural Gas Pipeline Corporation.

4. Amend Sec. 2 of SB 2003, AS 41.42, Article 4, Purposes and Powers, by adding thereto AS 41.42-450 as follows:

Sec. 41.42.450. Coordination with AS 43.82. (a) Unless specifically provided otherwise in this chapter, in the event of a conflict between the provisions of AS 43.82 and this chapter, the provisions of AS 43.82 shall control.

(b) In the event of a dispute between or among the corporation, a subsidiary entity of the corporation, an owner entity of the project, and any other person or legal entity that has a membership or ownership interest in an owner entity of the project, such dispute shall be subject to the dispute resolution terms and procedures set forth in the contract as approved by the legislature pursuant to AS 43.82.435. The term "dispute" shall mean a dispute, matter, controversy or claim arising out of or relating to any owner entity of the project, to any ownership interest in the project, to any agreement between or among the members or owners of any owner entity of the project arising out of or relating to such owner entity of the project, or to the operation, management, or implementation of the project, including its interpretation, construction, performance, enforcement, privileges, rights or obligations.

(c) In furtherance of the purpose set forth in AS 43.82.010 and the implementation of the contract as approved by the legislature pursuant to AS 43.82.435, each owner entity of the project shall be deemed to impose on its managing members and owner representatives a duty to act in the best interest of the entity and perform its duties in good faith towards the goal of implementation of the project.

5. Renumber Section 14 of SB 2003 as Section 15, and add a new Section 14 as follows:

Sec. 14. AS 42.06.230 is amended by adding a new subsection (c) to read:

AS 42.06.230. Jurisdiction of Commission

(c). The commission's jurisdiction and authority does not extend to the Alaska Natural Gas Pipeline Corporation. To the extent that the performance of any duties of the commission affects the Alaska Natural Gas Pipeline Corporation, the performance of its duties may not, as to that corporation, conflict with AS 41.42, AS 43.82, or applicable federal laws, regulations, orders, or other requirements.

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: HB 2003
(H) Publish Date: 5/31/06

Revision Date/Time (Note if correction):
Dept. Affected: Revenue

Title: Alaska Natural Gas Pipeline Corporation
RDU: Alaska Natural Gas Pipeline Corporati
Component: Gas Pipeline

Sponsor: Rules Committee
Requester: Governor
Component No.: 2840

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services	2,170.2	2,257.0	2,347.3	2,441.2	2,538.8	2,640.4
Travel	175.0	176.5	182.1	185.7	189.4	193.2
Contractual	218.0	222.4	226.8	231.3	236.0	240.7
Supplies	110.0	60.0	61.2	62.4	63.7	64.9
Equipment	147.0	36.3	37.0	37.8	38.5	39.3
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	**2,820.2**	**2,754.2**	**2,854.4**	**2,958.4**	**3,066.4**	**3,178.5**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
Bond Proceeds						
AK Pipe Corp Receipts	2,820.2	2,754.2	2,854.4	2,958.4	3,066.4	3,178.5
TOTAL	**2,820.2**	**2,754.2**	**2,854.4**	**2,958.4**	**3,066.4**	**3,178.5**

Estimate of any current year (FY2006) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time	17	17	17	17	17	17
Part-time	5	5	5	5	5	5
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill creates a new public corporation in the Department of Revenue, the Alaska Natural Gas Pipeline Corporation (AK Pipe) which will finance, own and manage the state's interest in the Alaska North Slope natural gas pipeline project. This fiscal note shows the operating cost of the corporation. The cost of the state's equity ownership of the project will be financed through direct capital appropriations from the state and by revenue bonds issued by ANGPC. The funding source for AK Pipe is assumed to be from cash reserves fund and it's earnings, and any other receipts of the corporation.

Prepared by: Jerry Burnett
Phone 465-2312
Division: Administrative Services
Date/Time 5/9/06 12:00 AM
Approved: Steve Porter
Date 5/9/2006
Agency: Department of Revenue

FISCAL NOTE # 2

STATE OF ALASKA **BILL NO.** HB 2003
2006 LEGISLATIVE SESSION

ANALYSIS CONTINUATION

The five part time employees shown in the fiscal note are the public members of the board of directors who will be compensated $400 per day for board meetings. We estimate that they will meet at least two days per month on average and that most meetings will be held in Anchorage.

The seventeen fulltime employees consist of the following exempt employees: Alaska Natural Gas Manager, Gas Pipeline Coordinator, Petroleum Engineer, Civil Engineer, Financial Analyst, Regulations Administrator, Commercial Analyst, Local Government Specialist, Economist, Analyst/Programer, Accountant, Project Coordinator, Administrative Manager, Labor Economist, Executive Secretary, Accounting Tech and Administrative Clerk. Personal services costs are incremented by 4% per year.

Office space, supplies and equipment needs are based on locating the corporation staff in the Atwood Building. We assume that the corporation will utilize the state's network, accounting and payroll systems and thus we have allocated costs for core services.

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: HB 2003
(H) Publish Date: 5/31/06

Revision Date/Time (Note if correction):
Dept. Affected: Natural Resources
Title: Alaska Natural Gas Pipeline Corporation
RDU: Resource Development
Component: Oil and Gas Development
Sponsor: Rules by Request of the Governor
Requester: Governor
Component No.: 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2006) cost: 0 0

Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

Under the proposed Alaska Stranded Gas Fiscal Contract, the state proposes to acquire a 20 percent equity interest in the gasline project with the remainder financed by ExxonMobil, ConocoPhillips, and BP Exploration. This bill would establish the Alaska Natural Gas Pipeline Corporation to finance, own, and manage the state's interests in the North Slope natural gas pipeline project. The Alaska Natural Gas Pipeline Corporation (Alaska Pipe) will be a public corporation within the Dept. of Revenue but with a legal existence independent of and separate from the state.

There is no anticipated fiscal impact to Division of Oil and Gas from implementation of this bill.

Prepared by: William Van Dyke, Acting Director
Phone 269-8800
Division: Oil and Gas
Date/Time 5/17/2006
Approved by: Michael Menge, Commissioner
Date 5/17/2006
Agency: Natural Resources

(Revised 9/7/2005 OMB)

ALASKA STATE LEGISLATURE

REPRESENTATIVE LES GARA

MEMORANDUM

DATE: June 2, 2006

TO: House Judiciary Committee Members

FROM: Rep. Les Gara

RE: HB 2003, Natural Gas Pipeline Corporation

Below are some excerpts from the legislature's consultant memos that relate to HB 2003, which has been referred to House Judiciary and House Finance. The memos were distributed by LB&A and are attached.

EXCERPTED FROM 5/23/06 Legal memo from Philip Gildan of Greenberg Traurig:
(Discusses how this proposed corporation is different from other public corporations)

"Two areas of the **ANGPC Act diverge from the generic public corporation mold**, and should be noted. One, the ANGPC is essentially **exempted from public meeting requirements** (AS 41.42.030(d) and AS 41.42.530). This represents a policy decision, with pros relative to the corporation acting in a proprietary capacity, and cons relative to diminished transparency of the corporation's actions. Two. the ANGPC (and other Pipeline LLC member/owners) are **exempted from the public policy against indemnification agreements** (AS 45.45.905). This also represents a policy decision, as discussed by the administration during its briefing of the legislature.

"Finally, somewhat unusually for Public Corporation Acts, the ANGPC Act delegates to the ANGPC **the power to establish its own subsidiary public corporations** (AS 41.42.220). As noted below, this provision relates to the ASGF Contract and the extra-territorial aspects of the Pipeline project. Such a power can be a useful corporate tool to segregate liability and fiscal accountability in the appropriate circumstances. Suggested revisions to AS 41.42.200 are set forth below to better implement the purpose of such a structural tool and provide enhanced accountability for such entities, if created. Note, the creation of subsidiaries is not mandated, but merely authorized as the board of the ANGPC sees fit."

January-May: State Capitol • Juneau, AK 99801-1182 • (907) 465-2647 • Fax (907) 465-3518
June-December: 716 W. 4th Avenue • Anchorage, AK 99501• (907) 269-0106• Fax (907) 269-0109
Representative_Les_Gara@legis.state.ak.us

(Pages 3-5 of the attached memo discuss suggested revisions/additions from the Public Corporation Acts that would be beneficial to the new ANGPC Act. On page 5 there is some discussion of how the new law would relate to current law, and a recommendation)

"Recommendation #5. Renumber Section 14 of the Act as Section 15, and add a new Section 14 as follows:

Sec. 14. AS 42.06.230 is amended by adding a new subsection (c) to read:

AS 42.06.230. Jurisdiction of Commission

(c). The commission's jurisdiction and authority does not extend to the Alaska Natural Gas Pipeline Corporation. To the extent that the performance of any duties of the commission affects the Alaska Natural Gas Pipeline Corporation, the performance of its duties may not, as to that corporation, conflict with AS 41.42, AS 43.82, or applicable federal laws, regulations, orders, or other requirements."

EXCERPTED FROM 5/22/06 Legal memo from Philip Gildan of Greenberg Traurig:
(Discusses the choice of Delaware LLC Law over Alaska LLC Law)

", it has been represented that the Producers and the State negotiating team have agreed upon use of the Delaware Limited Liability Company Act, Delaware Code, Title 6, Subtitle II, Chapter 18 ("Delaware Act") in lieu of the Alaska Revised Limited Liability Company Act, AS Chapter 10.50 ("Alaska Act").")p.1)

"An undercurrent of the perception of Delaware superiority, from both a body of law and judiciary, is that decisions by Delaware courts on business entity issues more often favor management/majority owners over minority owners."

"The Delaware Act represents one end of the spectrum of LLC enabling acts. It provides less mandatory entity terms, rights and obligations in favor of flexibility of the parties to freely set their own terms, rights and obligations by contract. The Alaska Act falls in the middle of the spectrum."

"Without the duty of care that the Alaska Act provides, a manager or managing members controlling an entity could act in their own self interest and contrary **to the interest of the entity's business**, with only the implied covenant of good faith, which is **a significantly lower standard of care** and more difficult to apply if the parties have contractually elected not to impose a duty to the entity."

FRANK H. MURKOWSKI
GOVERNOR
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STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

May 31, 2006

The Honorable Ben Stevens
President of the Senate
Alaska State Legislature
State Capitol, Room 111
Juneau, AK 99801-1182

Dear President Stevens:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill that would establish the Alaska Natural Gas Pipeline Corporation (Alaska Pipe) to finance, own, and manage an interest in the Alaska North Slope natural gas pipeline project (project) on behalf of the state.

Under the proposed Alaska Stranded Gas Fiscal Contract developed in accordance with the Alaska Stranded Gas Development Act (SGDA) (AS 43.82), the state proposes to acquire a 20 percent equity interest in the project with the remainder financed by affiliates of ExxonMobil Alaska, Incorporated, ConocoPhillips Alaska, Incorporated, and BP Exploration Alaska, Incorporated, the qualified sponsors of the project. The project would include a number of segments, including a large diameter pipeline from the Alaska North Slope to Alberta, Canada (with the possibility of an extension to the Lower 48), a gas treatment plant, and various gas transmission lines. The state and the qualified sponsors or their affiliates would establish limited liability companies (LLCs) or other appropriate entities to own each of the various segments of the project. Alaska Pipe would finance, own, and manage a proportionate membership interest in these owner entities.

Section 1 of the bill proposes that the Legislature make various findings that describe the critical importance of this project to the people of this state and to the nation, that explain why it is in the state's interest to participate in the project as an equity owner, and that identify the benefits that would accrue to the state from the successful development of the state's enormous gas resources. These latter benefits include increases in tax and royalty revenue, stimulation of oil and gas exploration on the Alaska North Slope, and creation of jobs and opportunities for greater in-state access to natural gas. It is hoped that these benefits will provide a sound basis for long-term growth of the state's economy.

Section 2 of the bill adds a new chapter to AS 41 that establishes Alaska Pipe as a "public corporation and instrumentality of the State of Alaska" within the Department of Revenue (AS 41.42). The corporation is structured to operate as an entity that is exempt from federal income taxation. AS 41.42 states the purposes and powers of the corporation, and otherwise provides terms that govern the administration of Alaska Pipe. Many of these provisions are similar to those of Alaska's other public corporations, including the Alaska Permanent Fund Corporation and the Alaska Railroad Corporation. However, other provisions are tailored to the unique role Alaska Pipe is expected to play in facilitating this truly historic project.

The board of Alaska Pipe will be comprised of the commissioner of the Department of Revenue and the commissioner of the Department of Transportation and Public Facilities, as well as five public members. AS 41.42.020(a). The public members must have experience and recognized competence in either finance, investments, business management, or the oil or gas industries. AS 41.42.020(a). Public members would serve six-year terms and may only be removed for cause. AS 41.42.020(c); AS 41.42.045. This combination of required expertise, extended terms, and restrictions on removal are intended to help assure that Alaska Pipe is well managed and can effectively represent the state's interest in the complex commercial environment in which it will have to operate.

AS 41.42.210 provides Alaska Pipe with a broad spectrum of corporate powers that are necessary, or may be necessary, to carry out its mission. The corporation is authorized to finance and acquire an ownership interest in the project in the United States or Canada, to issue bonds, to borrow money, and to negotiate with the United States government to secure federal loan guarantees, if appropriate. The corporation is authorized to pledge its revenue and assets to secure the payment of bonds or other obligations, and to enter into agreements necessary to establish entities, *e.g.*, LLCs, that will own portions of the project.

AS 41.42.220 would authorize Alaska Pipe to incorporate subsidiaries to carry out the purposes of AS 41.42. These entities would likely be for-profit corporations organized under the law of Alaska or of another state, or under the applicable laws of Canada. At this time, it is contemplated that at least one Canadian corporation would be established to hold Alaska Pipe's interest in a Canadian limited liability partnership that would build and own the Canadian segment of the mainline. If authorized by Alaska Pipe, these subsidiaries

would also be able to borrow money for the project or for their operations to the same extent as any other private corporation.

The state's total equity contribution to the different project LLCs is estimated to be $1.0 billion at this time. The state currently plans to finance this amount with a combination of appropriations directly or indirectly to Alaska Pipe, and the issuance of revenue bonds by Alaska Pipe. Article 3 of AS 41.42 contains revenue bonding authority that is fairly typical of other state public corporations, *e.g.*, the Alaska Housing Finance Corporation and the Alaska Industrial Development and Export Authority. Alaska Pipe would have the authority to issue what the market refers to as "moral obligation" revenue bonds. AS 41.42.320. Such bonds are supported by the establishment of a capital reserves account, which provides an added measure of security for the debt service on the bonds. The Alaska Pipe board would annually notify the Legislature of the status of the capital reserve account. AS 41.42.320(d). If a deficiency is reported, the Legislature may appropriate money to restore the capital reserve account but it is not compelled to do so. This "moral obligation" approach can only be invoked if the corporation finds that it will enhance the marketability of the bonds.

AS 41.42.340 specifies that any bonds issued by the corporation are not the indebtedness of the state, but are solely payable from the revenue and assets of the corporation. The state does pledge to the owners of the bonds that the state will not limit or alter the rights and powers of the corporation and that it will not impair the rights and remedies of bondholders until the bonds are fully paid. AS 41.42.350.

Article 4 of AS 41.42 establishes a cash reserves fund, which initially will be made up of any appropriations made to Alaska Pipe by the Legislature. The money in the fund can be used to meet capital call requirements and otherwise guarantee or secure debt incurred by the corporation. AS 42.42.400. The article also clarifies which laws of general application to state agencies apply to this new public corporation. For example, Alaska Pipe is exempted from the State Procurement Code under AS 41.42.430, its operating budget but not its capital budget is subject to the Executive Budget Act under AS 41.42.410, and it is largely exempt from laws relating to public works, fiscal procedures, and management of public funds under AS 41.42.440.

Article 5 of AS 41.42 relates to financial statements, reporting requirements, and the applicability of the Public Records Act to the corporation. The corporation is required to provide quarterly and annual financial statements to the governor and the Legislative Budget and Audit

Committee. AS 41.42.500. The corporation can be audited by the committee. In addition to the financial information, the corporation is to prepare an annual report on the operations of the corporation. AS 41.42.510. Although the corporation is subject to the Public Records Act, AS 41.42.520 provides broad exemptions from disclosure relating to proprietary and other commercial information. These broader exemptions from public disclosure are modeled upon similar provisions in the Alaska Stranded Gas Development Act (AS 43.82). The open meetings laws of the state do not apply to the corporation. AS 41.42.530. However, the corporation is required to conduct at least one meeting a year in public. AS 41.42.030.

Section 6 of the bill would establish the Alaska natural gas pipeline construction loan fund in the Department of Revenue. This fund would consist of money appropriated to it by the Legislature. The Legislature may choose to finance all or part of Alaska Pipe's equity obligations by loans from this fund. The construction loan program would be administered by the commissioner of the Department of Revenue, who is given broad discretion to fashion appropriate terms and conditions of the loans. Specifically, depending upon the final ownership structure in Canada, our Canadian advisors have indicated that there may be tax advantages in Canada if any loans to Alaska Pipe's Canadian subsidiaries are made directly by the state and not through Alaska Pipe.

Sections 12 and 13 of the bill establish a narrow exception to the rule barring indemnification agreements covering a party's own negligence or misconduct in construction contracts and precludes any potential application of the common law doctrine barring enforcement of indemnification agreements that might serve to increase the risk of negligence by a party that owes a duty to the public. This exception would allow an entity that constructs, owns, or operates the project, or any portion of the project, to indemnify an operator and the members of a limited liability company, including Alaska Pipe, for losses caused by those parties' own negligence or misconduct. Similar indemnities are made available to affiliated entities that either lend employees to the operator to work on the project or that provide technical consulting services to the operator to facilitate the project. The primary reason for such an approach is to hold down the costs charged by the operator to the owner entity and consequently the members.

Section 7 of the bill clarifies that officers and employees of the corporation are in the exempt service. Sections 8 and 9 of the bill specify that the board members and staff of the corporation are public officials for purposes of the financial disclosure laws. Section 10 of the bill provides that board

members of Alaska Pipe will be subject to the Alaska Ethics Act, except that board members of Alaska Pipe's subsidiaries are not subject to the Act unless they are also members of the board of Alaska Pipe.

I urge your support of this important legislation.

Sincerely yours,

Frank H. Murkowski
Governor

Enclosure

Greenberg
Traurig

Memorandum

TO: Senator Gene Therriault and Representative Ralph Samuels

FROM: Donald C. Shepler

DATE: May 22, 2006

RE: Choice of Alaska LLC versus Delaware LLC for gas line project

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At last evening's briefing of Alaska legislators I was asked by Senator Therriault to discuss the apparent decision by the gas line negotiators to use the Delaware LLC statute as the basis for the Midstream Project Entity as compared with the use of the Alaska LLC statute. As I indicated, Greenberg Traurig had previously examined that question. Accordingly, I asked Mr. Phil Gildan (one of Greenberg Traurig's shareholders) to review his prior research and prepare a short memorandum that compares the two statutes. His memo is attached.

As you will see, there are material differences in the duty of care that the Alaska LLC statute imposes on members of an LLC both to the entity itself and to the other LLC members. In addition, there are material differences in the indemnification of managing members by the entity.

These differences suggest that the choice of governing law should be carefully considered in the establishment of the LLC. Of course, we do not have available a draft of the LLC agreement which is apparently still being negotiated.

Should you have any further questions on this matter please let me know.