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David Boies
Robert Silver
John F. Cove, Jr.
Kenneth F. Rossman IV
BOIES, SCHILLER & FLEXNER LLP
333 Main Street, Armonk, NY 10504
(914) 749-8200; (914) 749-8300 (fax)
dboies@bsfllp.com; rsilver@bsfllp.com
jcove@bsfllp.com; krossman@bsfllp.com

William M. Walker (SBN 8310155)
WALKER & LEVESQUE, LLC
731 N Street, Anchorage, AK 99501
(907) 278-7000; (907) 278-7001 (fax)
bill-wwa@ak.net

Charles E. Cole (SBN 5503004)
LAW OFFICES OF CHARLES E. COLE
406 Cushman Street, Fairbanks, AK 99701
(907) 452-1124; (907) 456-2523 (fax)
colelaw@att.net

Attorneys for Plaintiff

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ALASKA

THE ALASKA GASLINE PORT AUTHORITY,

Plaintiff,

v.

EXXONMOBIL CORPORATION, a New Jersey corporation; EXXONMOBIL ALASKA PRODUCTION, INC., a Delaware corporation; BP P.L.C., a United Kingdom corporation; and BP EXPLORATION (ALASKA) INC., a Delaware corporation,

Defendants.

F05-0026 CIV
CASE NO:

COMPLAINT

(Seeking Relief under 15 U.S.C. §§ 1, 2, 15, 18, and 26; AS 45.50.471 *et. seq.*; Common Law; Breach of Contract)

DEMAND FOR JURY TRIAL

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Plaintiff Alaska Gasline Port Authority ("AGPA" or "Authority"), through its undersigned attorneys, by and for its Complaint, upon personal knowledge as to its own acts, and on information and belief as to all others, based upon its own and its attorneys' investigation, alleges as follows:

I. SUMMARY OF THE ACTION

1. This action arises from illegal contracts, combinations, and conspiracies by and between Defendants ExxonMobil Corporation and BP p.l.c. to artificially maintain and increase natural gas prices in Alaska and the continental United States, to boycott competitive pipeline proposals that would increase competition, and to secure and maintain control over Alaska's vast natural gas resources. Defendants have acted with the purpose and effect of artificially constricting supply as a means of inflating prices and of maintaining and extending their control over natural gas distribution.

2. As a result of a series of mergers and acquisitions, Defendants, the world's two largest energy companies, directly own over two-thirds of the proved natural gas resources on Alaska's North Slope and control the development of almost all of the known North Slope gas resources they do not own.

3. Over the past several years, the price of natural gas has been rising sharply and steadily. This trend has already imposed severe costs on the U.S. economy as a whole, including harm to the economy's least powerful and most vulnerable participants. If not checked, those costs and harm will continue and increase.

4. The U.S. Department of Energy projects that in 2005, average residential natural gas prices will increase more than 43% over last year, to an average cost of $1,096 for each

American household. Prices for natural gas for commercial and industrial use have also increased sharply.

5. This year was not an anomaly. Natural gas prices in the United States have been rising steadily for several years. In 2004, natural gas prices increased 14.2% over the previous year. The winter of 2003-2004 saw natural gas prices rise 15.1%. And during the winter of 2002-2003, natural gas prices increased by 21.5%. In fact, the consumer price of natural gas in the United States has risen more than 150% over the last six years.

6. Last winter was a mild winter, but it was far from easy on the pocketbooks of millions of Americans. People who struggle with their winter heating bills go without food, without medical or dental care, take less medicine, or miss mortgage payments. Low-income Americans are hit hardest of all by rising natural gas costs. Last year four million households received financial assistance with their energy bills. This year, an estimated six million of the 30 million eligible households are expected to apply for assistance. Low-income Americans are not alone in bearing the costs of record high natural gas prices; the price of natural gas is a burden to all but the most wealthy and increasingly threatens the economy.

7. In the face of these increasingly acute problems, the Defendants have concertedly undertaken a series of acts and agreements to prevent the free market from responding to the demand for natural gas. Defendants have acted with the purpose and effect of eliminating competition that could threaten their control over the development, marketing, and pricing of natural gas, including by blocking the development and marketing of Alaska's North Slope gas.

8. Although vast resources of natural gas exist beneath Alaska's North Slope, and although Defendants cannot avoid extracting gas as they extract oil, Defendants have jointly acted and agreed not to market this gas. Defendants' conduct not only aggravates the problem of

rising gas prices but also – and with the same goal – jointly excludes all actual and potential competitors from building a pipeline system.

9. The Plaintiff, which was created in 1999 to build a gas pipeline system to transport natural gas from Alaska's North Slope to Valdez for liquefaction and shipping to market, is one of those injured by the Defendants' illegal conduct

10. Defendant BP is the Unit Operator for the largest and most productive oil and gas unit on the North Slope, and indeed in the United States, the Prudhoe Bay Unit ("PBU") The PBU contains a proved 25 to 30 trillion cubic feet ("TCF") of natural gas, as well as hundreds of millions of barrels of oil Although small quantities of this gas are used to fuel operations on the North Slope, none of this gas is transported off the North Slope. Natural gas amounting to approximately eight billion cubic feet per day ("BCFD") is extracted in connection with oil production Instead of permitting this gas to be marketed, Defendants require the gas to be re-injected back into the ground.

11. Defendants' conduct with respect to Alaska North Slope natural gas is part of a pattern of manipulating and constricting supply in order to raise prices and increase their control of relevant markets. For example, in the mid-90s, BP sold Alaska oil in Asia at prices lower than it could have gotten in the U.S. in order to tighten U S oil supplies and raise the price of crude shipped to refineries in California and Washington State As reported in the press, this scheme was set out in a June 2, 1995 email exchange between BP managers Robert Aicher and Linda Adamany, in which they discussed "shorting the West Coast market" to achieve "West Coast price uplift scenarios" and "leverage up" prices. In the email, one of the managers stated: "Even if [Far East] netback is slightly below [West Coast] netback, we may choose to export some to [the Far East] in order to 'leverage up' our [West Coast Alaska North Slope crude] prices."

Adamany called the plan a "no-brainer." Indeed, BP went so far as to use a computer program called "the optimizer" to determine the optimum market "trigger points" for its manipulations. BP's conduct resulted in high prices at the pump for gasoline across the West Coast.

12. Defendant ExxonMobil is the Unit Operator for the second largest gas unit on the North Slope, the Point Thomson Unit ("PTU"), which contains an estimated eight TCF of natural gas. Although ExxonMobil has been the designated unit operator of the PTU for almost 30 years, no commercial sale of either the gas or oil in the PTU has ever taken place. In an effort to maintain its leases and the leases of its co-conspirators in spite of the failure to market the resources, ExxonMobil has repeatedly claimed that development of the proved resources at Point Thomson would be uneconomic due to the absence of a gas pipeline system.

13. Defendants also control a number of other smaller units and leases on the North Slope that contain gas resources. None of this gas has been brought to market.

14. Despite the critical importance of developing a means to transport to market the proved gas resources in the PBU and PTU, as well as elsewhere on the North Slope, the Defendants have engaged in a systematic, joint campaign to derail any competitive gas pipeline. This campaign has had and will continue to have the effect of withholding sorely needed Alaska natural gas from domestic markets in the United States and elsewhere and sustaining higher prices for consumers and higher profits for Defendants – each of which reported record profits last quarter.

15. Natural gas from Alaska's North Slope could moderate the steady climb in natural gas prices by supplying at least four to six BCFD (equivalent to approximately seven to ten percent of current natural gas consumption in the United States) for at least the next 35 years if there were a pipeline system to transport this gas to market. The only obstacle blocking this

pipeline system is Defendants' concerted conduct to prevent the commitment of North Slope gas to such a pipeline.

16. Over the last 20 years, several well-qualified firms have made a number of efforts to develop a pipeline to free the gas on the North Slope and bring it to market. In order to construct a pipeline, however, commercial realities dictate that the pipeline sponsor have in hand commitments to supply the pipeline with gas As ExxonMobil's CEO Lee Raymond bluntly stated when discussing an Alaska natural gas pipeline project:

> Then you have these competing pipeline proposals, which is fine if that's what you want to do. But the reality is, nobody is going to build a pipeline without the producers. You and I know how pipelines get built. The pipeline goes to the bank. The guy at the bank says, what are you going to put in your pipeline? Gas Do you own the gas. No, I don't own the gas. Well, who does own the gas, and do you have a commitment from them that they are going to put it through the pipeline? Well, no, we don't have that. Then I don't think I'm going to give you much money to build a pipeline.

17 In order to prevent competing pipeline sponsors from obtaining financing and building a pipeline, the Defendants have entered into a series of agreements to block the sale of Alaska natural gas, the purpose and effect of which has been to eliminate competition in the exploration, development, and marketing of natural gas resources on the North Slope and to prevent the competitive transport of natural gas from the North Slope to markets in lower Alaska and the continental United States These agreements and related conduct have been undertaken with the purpose and effect of preventing the tremendous resources of Alaska natural gas from reaching the lower Alaska and continental U S. markets, and thereby maintaining artificially high prices in those markets.

18. The Authority has developed or acquired significant senior permits, engineering studies, cost estimates, and plans necessary to build a natural gas pipeline. In addition, it has

available to it approximately $18 billion in federal loan guarantees for the project. At this point, it requires only one significant element to commence the pipeline project: a commitment by at least one of the Defendants to sell the North Slope gas that they are already obligated to develop under their leases.

19 Earlier this year, the Authority made a detailed offer to the Defendants and others to purchase Alaska North Slope gas and transport it to market. Despite repeated efforts by the Authority, the Defendants refused to discuss prices or terms regarding the sale of gas. The Authority's offer still remains open, but the Defendants have refused to engage in serious negotiations in an effort to kill the Authority's proposal.

20. Defendants' concerted effort not to deal with the Authority violates their duty to develop and market the resources arising from their agreements with the State, as well as the antitrust laws. Because this conduct involves: (1) the loss of profits on sales of the gas; (2) the risk that the State will default their leases; and (3) the risk that either Defendant will be shut out of market opportunities by the other producer if such other Defendant deals with a competitive pipeline, this conduct would be contrary to each Defendant's self interest in the absence of an agreement not to compete.

21 In addition to their direct efforts and agreements to restrict the marketing of gas from the North Slope, Defendants in further violation of the antitrust laws have exchanged their plans for other gas production and/or pipeline projects from gas production sites other than the North Slope, including what capacity from which locations will be delivered to the United States markets and when. The purpose and effect of these communications has been to enable Defendants to reach an understanding as to when and how major gas sources would be brought to market; to facilitate and support their agreement not to develop and market Alaska gas; to

avoid competition that would increase the supply of gas beyond what the Defendants have jointly concluded was in their collective best interest; and to maintain gas prices at an artificially high level

22 Defendants' agreement to boycott the Authority affects not only the natural gas controlled by Defendants, but the natural gas controlled by other producers. Because the Defendants control such a large share of North Slope gas, the boycott by them alone is enough to stop the Authority's pipeline. Moreover, independent producers have little incentive to explore or develop new gas resources without a pipeline to bring the gas to market.

23 Defendants' boycott of the Authority also prevents Alaska from receiving its royalty gas. Alaska is entitled to a 12.5 to 20% royalty on all gas produced on its lands. It is entitled to receive this royalty "in-kind" in the form of the gas extracted or "in value." However, the State cannot collect this royalty gas in-kind or in-value unless and until the Defendants bring their own gas to market.

24 In addition to the agreements not to compete, the Defendants have engaged in a series of mergers and acquisitions that have substantially reduced competition in bringing the untapped natural gas resources of the North Slope to market. These acquisitions have included huge corporate transactions such as Exxon's merger with Mobil and BP's acquisitions of Amoco Corporation and Atlantic Richfield Co., as well as the acquisition of various leaseholds and other interests that have reduced competition. These mergers and acquisitions have substantially lessened competition and have enabled the Defendants to cartelize gas resources and collude without the fear that non-cartel members will disrupt their cartel. Many of the producers who sold to the Defendants would have preferred to maintain their interests but were forced to sell

because the Defendants' market dominance, including control of the oil pipeline monopoly, prevented these producers from realizing the value of their holdings.

25. The Defendants' conduct has had the following effects, among others:

(a) competition for the transport or purchase of natural gas from the North Slope has been eliminated;

(b) incentives for exploration and development of North Slope natural gas resources have been reduced or eliminated; and

(c) the supply of natural gas to lower Alaska and the rest of United States has been artificially reduced and the price of natural gas maintained at artificially high levels.

26 Defendants' conduct has violated every major provision of the federal antitrust laws, including Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act. In this action, the Authority seeks to recover damages for Defendants' illegal conduct; to prevent the Defendants from continuing their joint and unlawful anticompetitive conduct – excluding the Authority from the gas transport market on the North Slope, blocking the development and marketing of North Slope natural gas, artificially reducing the output of natural gas on the North Slope, and restricting the supply and raising the prices for consumers of natural gas in lower Alaska and throughout the continental United States; and to restore competitive conditions.

II. JURISDICTION, VENUE, AND COMMERCE

27 The Court has jurisdiction over this action under Section 4 of the Sherman Act, 15 U.S.C. § 4, and 28 U.S.C. §§ 1331, 1337.

28. The Court has supplemental jurisdiction over the state law claims asserted in this action pursuant to 28 U S C § 1367. The federal and state law claims asserted in this action arise from a common nucleus of operative facts.

29. Venue is proper in this District under Section 12 of the Clayton Act, 15 U S C. § 22, and 28 U S C § 1391. The Plaintiff and all Defendants transact and are registered to do business in, reside in, and/or are found within this District.

30. A substantial part of the events giving rise to the claims stated below occurred in this District, and a substantial part of the property that is the subject of the action is situated in this District.

31 Defendants operate significant facilities in this District. Plaintiff is a political subdivision of the State of Alaska

32 Numerous other businesses and persons affected by this action are located within this District Competing producers in Alaska of oil and gas on the North Slope have been harmed and will continue to be harmed by Defendants' anticompetitive conduct Similarly, Alaska consumers who purchase natural gas have been or will be injured by the higher prices and reduced supply that have resulted and will continue to result from Defendants' anticompetitive conduct.

33 The Defendants' anticompetitive conduct has affected and is affecting a substantial volume of interstate and foreign commerce, including commerce in this District.

III. THE PARTIES

34 Plaintiff AGPA is a political subdivision of the State of Alaska with its principal place of business in Fairbanks, Alaska. AGPA was created in 1999 under Alaska Statutes 29.35.600-29.35 730 to facilitate construction of a gas pipeline system from Alaska's North

Slope to the port at Valdez, where North Slope natural gas will be distributed, including by being liquefied and shipped by tanker.

35. The Authority's pipeline (which will run parallel to the Trans Alaska Oil Pipeline System ("TAPS")) and its accompanying liquid natural gas ("LNG") facility will permit natural gas to be transported by tanker to LNG receiving facilities on the Pacific Coast, where it will be distributed throughout the United States by means of the existing natural gas distribution infrastructure. The Authority's pipeline will also include a spur line from Glennallen to the Palmer area to provide gas to the Southcentral Alaska gas grid, as well as to other areas of Alaska not currently accessible to gas

36. Defendant BP p l.c. is incorporated under the laws of the United Kingdom with its principal place of business in London, England BP has extensive rights to oil and gas in Alaska and elsewhere and is one of the owners of TAPS. It is the largest oil company in the world and reported profits of $6 463 billion in the last quarter alone It ranks behind only Wal-Mart as the world's largest corporation. BP is currently, and has consistently been since at least 2001, the largest producer of natural gas in the United States

37. Defendant BP Exploration (Alaska) Inc is a BP p l c. subsidiary that holds oil and gas interests on the North Slope It is a Delaware corporation with its principal place of business in Anchorage, Alaska. BP Exploration (Alaska) Inc. is the largest producer of oil on the North Slope, and has similarly large interests in North Slope natural gas resources BP Exploration (Alaska) Inc. is the alter ego of BP p.l c

38. Defendants BP p.l.c. and BP Exploration (Alaska) Inc. are referred to jointly in this Complaint as "BP."

39 Defendant ExxonMobil Corporation is incorporated under the laws of New Jersey with its principal place of business in Irving, Texas. ExxonMobil has extensive rights to oil and gas in Alaska and elsewhere and is one of the owners of TAPS. It is the largest oil company in the United States and the second largest oil company in the world. It reported profits of $9.92 billion in the last quarter alone. According to Fortune Magazine's 2005 Global 500, ExxonMobil is the most profitable corporation in the world, with profits of $25.33 billion last year. ExxonMobil is currently the second largest producer of natural gas in the United States.

40. Defendant ExxonMobil Alaska Production, Inc. is a Delaware corporation with its principal place of business in Houston, Texas. ExxonMobil Alaska Production is an ExxonMobil Corporation subsidiary that holds oil and gas interests on the North Slope. ExxonMobil Alaska Production, Inc. is the alter ego of ExxonMobil Corporation.

41. Defendants ExxonMobil Corporation and ExxonMobil Alaska Production, Inc. are referred to jointly in this Complaint as "ExxonMobil" or "Exxon."

IV. DEFENDANTS' ANTI-COMPETITIVE CONDUCT

42. Since the 1960s, massive reservoirs of natural gas have been known to underlie the North Slope. Proved resources of natural gas are conservatively estimated at 25-30 TCF under the Prudhoe Bay Unit and eight TCF under the Point Thomson Unit.

43. In addition, there are substantial additional gas reservoirs on land, in offshore state waters, and in the outer continental shelf. The U.S. Geological Survey recently assessed 23,000 square miles of the central North Slope, and estimated there is 63.5 TCF of undiscovered, technically recoverable natural gas in that area, with an additional 32 TCF in the Beaufort Sea region. The Minerals Management Service has indicated that undiscovered gas resources in arctic Alaska could be as high as 156 TCF. Similarly, in February 2005, the American Gas

Foundation estimated Alaska's total gas reserve potential at 251 TCF. Alaska's Department of Natural Resources has estimated potential resources in the same range.

44. Bringing this gas to market would have a profound effect on the supply of natural gas in the United States. One producer has estimated that "[i]f developed, North Slope gas resources would increase total U.S. gas reserves by about 20 percent."

45. At the wellhead, Alaska is already among the largest gas producing states in the United States. Since 1995, wellhead gas production in Alaska has averaged over eight billion cubic feet per day. However, almost all (more than 92%) of this production is re-injected into the ground. None of the gas produced is transported from the North Slope.

46. Defendants' conduct has also ensured that no wells are developed to extract natural gas, despite the relative ease of doing so.

47. Recognizing the importance of developing a means to transport the North Slope's gas reserves to market, a number of entities, beginning in the 1970's, developed competing proposals for the construction of a gas pipeline. Each effort to construct a pipeline has been blocked by the collective action of the Defendants, who have engaged in a systematic campaign to derail efforts to construct a gas pipeline in Alaska in order to: (1) withhold Alaska natural gas from domestic markets; (2) sustain higher prices to consumers and higher profits to the Defendants; and (3) secure and maintain control over the development, movement, and marketing of Alaska gas.

A. THE DEFENDANTS ILLEGALLY AGREED AMONG THEMSELVES NOT TO DO BUSINESS WITH THE AUTHORITY AND TO DELAY THE DEVELOPMENT AND MARKETING OF THEIR ALASKA GAS.

1. No Pipeline Can Be Built Without A Commitment To Supply Gas.

48 A practical reality of the pipeline business is that no major pipeline can be built without commitments to supply gas for the pipeline because it is impossible to obtain financing for a pipeline without such commitments, both for regulatory and commercial reasons.

49. The CEO of ExxonMobil, Lee Raymond, understands the power that the Defendants hold over anyone interested in developing a natural gas pipeline in Alaska. He recently stated during an interview that:

> Then you have these competing pipeline proposals, which is fine if that's what you want to do But the reality is, nobody is going to build a pipeline without the producers You and I know how pipelines get built The pipeline goes to the bank The guy at the bank says, what are you going to put in your pipeline? Gas Do you own the gas No, I don't own the gas. Well, who does own the gas, and do you have a commitment from them that they are going to put it through the pipeline? Well, no, we don't have that Then I don't think I'm going to give you much money to build a pipeline.

2. Defendants Recognized That Neither Could Economically Refuse To Develop And Market Alaska Gas Unless It Knew That The Other Would Also Refuse.

50 Defendants recognized that neither of them could forestall the development and marketing of Alaska gas without the other Moreover, Defendants were aware from their participation in TAPS of the competitive disadvantage that either would have if the other entered into a long-term commitment with the Authority.

51. The Defendants together own a majority interest in TAPS. They use this control over TAPS to charge artificially high rates for transportation of oil through the pipeline. The high pipeline tariff rate does not affect the Defendants because they are essentially paying themselves. The high rate does, however, impact competing North Slope producers who do not own a share

in TAPS. These supra-competitive transportation costs make production uneconomical for non-owner producers and discourage the development of resources that would compete with those already developed by the owner-producers

52 Also, because pipeline tariffs are subtracted from the price of oil before calculating state royalties and severance taxes, every tariff dollar paid by shippers costs the State approximately $0.20. At one million barrels per day, that amounts to $70 million per year in lost state royalties and severance taxes.

53 The consequences of producer control of TAPS are dramatically illustrated by Conoco's withdrawal from the North Slope, which was a direct result of the artificially high tariffs charged by TAPS. Prior to its 2002 merger with Phillips, Conoco lacked a major interest in TAPS. In 1993, it gave up its interests in the North Slope altogether because its dependence on the pipeline prevented it from obtaining reasonable value for its oil.

54. Conoco owned a 70% interest in Milne Point, a North Slope field about 25 miles west of Prudhoe Bay. At full production, Milne Point is responsible for slightly over 5% of North Slope oil. In 1993, however, Conoco was forced to sell its interest in Milne Point because the pipeline tariff imposed by the TAPS owner-producers rendered its continued operation of the field uneconomical. Conoco President and CEO Archie Dunham candidly admitted: "It broke my heart to trade Milne Point, but we had to do it. All the value of that property was taken away from us in the pipeline tariffs." At the same time, Conoco sold its 70% interest in the Badami field, 35 miles east of Prudhoe Bay. These assets were purchased by BP, which had an almost 50% interest in TAPS. Today, BP owns 100% of both the Milne Point Unit and the Badami Units

55 Conoco's experience was not unique. In 1991 there were a number of producers on Alaska's North Slope that did not share an ownership interest in TAPS These included such major oil companies as Texaco, Shell, Marathon, and others. At least seven of these producers cut back their production or departed entirely from the North Slope With a single exception, these producers sold their North Slope assets to one of the producers with a substantial share of TAPS.

56. Because of the competitive disadvantage that they would otherwise suffer, neither BP nor ExxonMobil could in their individual self-interest refuse to commit gas to the Authority unless they were assured that the other would also refuse.

57. Moreover, critical purposes of refusing to deal with the Authority were to prevent AGPA's pipeline from becoming a viable competitive delivery option and to prevent Alaska gas from being delivered to domestic markets, with the relief of scarcity (and the high prices that scarcity causes) that would flow from such delivery. Since those purposes would be frustrated if either Defendant undertook to deal with AGPA, neither could accomplish their objective without the other's cooperation

3. The Defendants Have Entered Into A Series Of Express Agreements To Prevent Competition In Marketing North Slope Natural Gas And To Enforce, Support, And Facilitate Their Overall Agreement To Prevent The Development And Marketing Of Alaska Gas.

58. Defendants have agreed that neither will develop or market their Alaska gas reserves without the other's consent, and that neither would commit gas to the Authority

59. Unitization refers to the process of combining different leaseholders with interests in one reservoir into a single unit for exploration and development purposes When used properly, unitization can facilitate the efficient development and utilization of oil and gas resources. In Alaska, unitization agreements are approved and agreed to by the State.

60. By contrast, unit operating agreements and various ancillary agreements are contracts among the leaseholders and are not approved by the State.

61. The Defendants have entered into formal and informal unit operating and other agreements among themselves and with others, the purpose and effect of which is to keep the North Slope gas reserves, including gas owned by others, from reaching the market until Defendants jointly decide that they wish to place this additional gas into the market.

62. Further, the Defendants have entered into formal and informal agreements among themselves and with others, the purpose and effect of which is to prevent others from constructing a gas pipeline capable of delivering gas from the North Slope to the market.

63 These agreements are not approved by the State of Alaska, are not justified by any efficiency or pro-competitive concerns, and have the purpose and effect of unnecessarily and unreasonably restricting competition among themselves and others with interests in North Slope gas and oil. The purpose and effect of these agreements is not to develop energy resources efficiently, but instead to block and delay that development

64 In order to conceal the anticompetitive nature of the written agreements, the Defendants have routinely withheld them or delayed giving them to the State, as required under various statutes and regulations.

65. The purpose and effect of these agreements is illustrated in the Point Thomson Unit. Although the Defendants have held leases and known of significant oil and gas reserves in this Unit for nearly thirty years, they have jointly refused to develop these resources and have done nothing to bring these resources to market.

66. In addition, the Defendants have illegally agreed and coordinated among themselves to give priority to certain gas projects off the North Slope and to delay marketing their North

Slope gas in order to ensure that what they perceive as too much gas does not reach the United States markets at the same time.

67. Some of the anticompetitive agreements reached by the Defendants are memorialized in various written agreements. Some are unwritten understandings that have not been memorialized in formal documents. Among the anticompetitive and unnecessary agreements the Defendants have made are:

(a) agreeing not to deal individually with pipeline companies for the marketing, transportation, or sale of North Slope gas;

(b) agreeing on "rules of engagement" for dealing with pipeline companies;

(c) agreeing not to take steps to develop or sell gas from their leases in the Prudhoe Bay unit;

(d) entering into a series of agreements that: (1) eliminated the ability of individual leaseholders to bring their gas to market without the consent of the Defendants; and (2) reduced the incentives of individual leaseholders to market their gas resources;

(e) agreeing not to take steps to sell gas from the Point Thomson Unit;

(f) agreeing not to submit any meaningful development plans for the Point Thomson unit;

(g) agreeing not to sell, or to commit to sell, gas from any location on the North Slope for off-Slope transport to any pipeline company not controlled by the Defendants; and

(h) agreeing to withhold North Slope gas in order to give priority to other gas projects the Defendants are pursuing.

68. These agreements do not have any legitimate purpose and are solely for the purpose and effect of limiting competition. To the extent that any of these agreements can be said to relate to a legitimate purpose, they are unreasonably restrictive of competition and unnecessary to achieve their legitimate purposes.

B. IN ACCORDANCE WITH THEIR AGREEMENTS, THE DEFENDANTS HAVE STIFLED ALL POTENTIALLY COMPETITIVE PIPELINE PROPOSALS.

1. Alcan/Foothills.

69. In light of the delays and other problems associated with the construction of TAPS, and concerned about ensuring that the lower 48 states had access to Alaska gas, Congress enacted the Alaska Natural Gas Transportation Act in 1976. The Act was designed to ensure that regulatory review and certification would not serve as an undue barrier to the construction of a gas pipeline.

70 The President considered several competing proposals and selected a path through Alaska and Canada This proposal was endorsed by both the United States and Canada, and was memorialized in a September 20, 1977 Agreement on Principles about the pipeline project, which would travel down from the North Slope and then through Canada. The Alcan Pipeline Company was responsible for the Alaskan portion – with the U.S. rights later transferred to the Alaskan Northwest Natural Gas Transport Company ("ANNGTC") – and Foothills Pipe Lines ("Foothills") was responsible for the Canadian portion of the line Both ANNGTC and Foothills are wholly owned subsidiaries of TransCanada Pipeline Corporation, a Canadian energy and natural gas transportation company.

71. In the meantime, however, a series of price controls and restrictions on permissible uses for natural gas came into effect. These restrictions had the effect of creating a gas surplus

and depressing the price. Because of this, in or about April 1982, the sponsors decided to postpone the project

72 Since that time, price controls and use restrictions have been lifted, and demand for, and the price of, natural gas has increased significantly. With a resurgent market for gas, there have been a number of different efforts to construct a natural gas pipeline in Alaska, each of which has been blocked by the Defendants

2. Yukon Pacific Corporation.

73 In 1982, the Yukon Pacific Corporation ("YPC") began developing a plan to construct a pipeline from the North Slope, along the TAPS right-of-way, to Valdez. YPC was partially owned by CSX Corporation, a major railroad transportation company and one of the largest natural gas pipeline operators in America. Among other early investors in YPC were ARCO and former Alaska Governors Hickel and Egan YPC intended to construct a full pipeline system with a liquefied natural gas terminal in Valdez, which would cool and liquefy the gas for shipment on LNG tankers. YPC succeeded in clearing significant regulatory hurdles; it secured senior permits, important rights of way, obtained an acceptable environmental impact statement, and gained permission to export the gas. YPC also succeeded in establishing that a viable market for Alaska gas existed overseas The only thing that YPC was not able to secure was the natural gas itself, because Defendants jointly refused to sell it.

74 Starting at least as early as 1989, YPC attempted to negotiate with the producers to purchase the necessary natural gas Although some producers had originally supported the project, they withdrew their support when Defendants realized that they would be unable to obtain the same degree of total control over the pipeline infrastructure that they maintained over TAPS, and they made it clear that they would not support the project.

75. After they withdrew their support, the Defendants in concert steadfastly refused to commit to sell gas to YPC, fully understanding that this meant that as a result YPC would not be able to bring their gas to market.

76. While YPC was developing plans for a pipeline through Alaska to a liquefied natural gas terminal in Valdez, the Foothills group responded to the increased demand for gas by restarting its efforts to construct a pipeline running through Alaska and into Canada, where it would connect with the existing gas distribution infrastructure in Alberta, allowing gas to flow to markets in Canada and the lower 48 states.

77. Although it is generally recognized that these two designs, *i.e.*, tracing the TAPS route to Valdez or following the Alaskan Highway to Alberta, are the only practical means of transporting North Slope gas to market, the Defendants refused to commit gas to either of these projects. Even though providing gas to either of these alternatives would have been a profitable venture for each of the Defendants, they both refused to provide either project with the necessary gas commitments because they did not want any pipeline project that they did not own and control to succeed and because they did not want North Slope gas to enter the lower Alaska and continental U.S markets because of the effect such gas would have on gas prices in such markets. Without a committed supply of gas for the pipeline, neither project could begin construction. The investors in YPC, realizing that Defendants would continue to insist on monopoly control of the pipeline, ultimately suspended their efforts.

3. MidAmerican Energy Holdings Company.

78. MidAmerican Energy Holdings Company, a subsidiary of Warren Buffet's Berkshire Hathaway, Inc., and its subsidiary Kern River Gas Transmission Company, have extensive experience in the construction and operation of gas pipelines. For example, MidAmerican constructed and now operates the Kern River pipeline system. That pipeline system de-

bottlenecked the natural gas infrastructure in the Rocky Mountain region, enabling gas produced in, and east of, the Rocky Mountains to be transported freely to the Western United States.

79. MidAmerican embarked on a major effort to construct a pipeline from the North Slope to existing pipelines in Canada, with plans to serve primarily the Upper Midwest. MidAmerican proposed an Alaskan gas pipeline in the Fall of 2003. MidAmerican ultimately abandoned its efforts to build a North Slope gas pipeline because Defendants made it clear that they would not commit to provide the MidAmerican pipeline with gas. As Steve Porter, Deputy Commission for the Alaska Department of Revenue, stated at the time, "If the oil and gas companies decided they didn't want to work with MidAmerican, every penny MidAmerican spent would be lost."

4. TransCanada.

80. TransCanada is a Canadian energy company that operates a system of natural gas pipelines in Canada, lines that serve gas markets in both the United States and Canada. TransCanada, through its subsidiaries ANNGTC and Foothills, was the sponsor of the original pipeline project to bring natural gas from the North Slope, the project approved by the governments of the United States and Canada in 1977. TransCanada has been working for over 25 years to construct an Alaskan natural gas pipeline to the North Slope, and in recent years, it has renewed its efforts. For example, in early 2002, TransCanada, through its subsidiary Foothills, presented a detailed, three-volume proposal to the Defendants outlining the merits of its pipeline. After MidAmerican withdrew, TransCanada submitted another proposal for a gas pipeline from the North Slope. In each case, it was confronted with the same joint refusal to deal as the other potential pipeline competitors. Although selling gas to TransCanada would clearly be a profitable venture, Defendants have jointly refused to commit to selling any gas to TransCanada.

C. THE AUTHORITY HAS PUT TOGETHER AN ALASKA NATURAL GAS PIPELINE PROJECT THAT REQUIRES ONLY A GUARANTEED SUPPLY OF GAS TO BEGIN CONSTRUCTION.

81 Federal loan guarantees available under the Alaska Natural Gas Pipeline Act of 2004, 15 U.S.C. § 720n, give the Authority and, potentially, other competitors the ability to obtain financing for a gas pipeline. The availability of federal loan guarantees eliminates a significant obstacle to financing, but any pipeline project still requires commitments to supply at least some of the necessary gas before construction can begin.

82. The Authority was created in 1999 under Alaska Statutes 29.35.600-29.35.730 to facilitate construction of a gas pipeline system from Alaska's North Slope to the port at Valdez, where North Slope natural gas will be liquefied and shipped by tanker.

83 The Authority has proposed construction of a 48-inch, buried pipeline from Prudhoe Bay to Valdez. In addition, the Authority will construct and operate a liquefaction/fractionation, storage, and loading plant in Valdez.

84. From Valdez, the Alaska natural gas in LNG form will be shipped to receiving facilities on the Pacific Coast for transport throughout the existing North American gas distribution networks (or "grids"), and potentially elsewhere.

85. The Authority has received several Memoranda of Understanding ("MOU") from Pacific Coast LNG receiving terminals interested in receiving LNG from Alaska, including Kitimat LNG, the Northern Star Natural Gas/LNG receiving terminal, Penguin LNG, and the Crystal Energy LNG regas terminal. It has also received an MOU from Totem Ocean Trailer Express for the shipment of LNG from Alaska to the Pacific Coast.

86. Under the Authority's proposal, a 24-inch spur line would connect the gas pipeline from Glennallen to the existing Southcentral Alaska gas grid near Palmer, ensuring a ready

supply of natural gas for the greater Anchorage area. Gas would also be made available to serve other areas of Alaska not currently served by North Slope natural gas, such as Fairbanks.

87. The Authority has also developed plans for construction of a separate line to the Canadian border to permit connection to a Canadian line upon its eventual construction.

88. The Authority's proposal would result in delivering Alaskan gas to Midwest and West Coast markets, as well as Southcentral and Interior Alaska markets by the 2011-2012 timeframe.

89. The Authority has obtained a private letter ruling from the IRS confirming that the Authority is tax exempt. This provides billions of dollars in tax savings to those involved over the life of the project

90. The Authority has an exclusive option to purchase YPC and its portfolio of senior permits along with all project data collected since 1982. This enables the Authority to complete a pipeline project much more quickly than any of its competitors.

91. The Authority has a project cost estimate from Bechtel Corporation that was updated as recently as May 2005.

92. The Authority's gas transportation project assumes a phased development, reaching full capacity at 4.3 BCFD. The volume phasing allows for rapid development of an initial phase to capture Midwestern markets in a relatively short time horizon.

93. The initial phase will deliver LNG to the Kitimat, British Columbia, terminal. From there, this gas will be delivered to the Midwestern United States through the existing gas pipeline network

94. The Authority plans to deliver 0.5 BCFD in state to service Southcentral and Interior Alaska's increasing natural gas requirements.

95. Assuming a Chicago gas price of $5.00 per MMBTU (a conservative assumption well below the current market price), the Authority projects annual netback revenue to gas suppliers of $4.5 billion in 2005 dollars. At today's natural gas prices in the lower 48 states, the netback revenue would be more than triple that.

96. The Authority has filed an application with the State under the Alaska Stranded Gas Development Act, AS 43.82 *et seq.*, making it one of three applicants under the Act, and is currently in negotiations with the Governor regarding its proposal.

97. In the past year, Congress amended the Alaska Natural Gas Pipeline Act of 2004, 15 U.S.C. § 720n, to make the Authority's LNG Project qualify for the $18 billion federal loan guarantee gas pipeline incentive package. Alaska Natural Gas Pipeline Act, Pub. L. 108-325, 118 Stat. 1265.

98. The construction and operation of the Authority's proposed gas pipeline and related facilities would directly result in the creation of at least 6,000 new jobs during construction and 5,000 jobs following construction.

99. The Authority estimates that under its proposal, it would receive and distribute to the State of Alaska and its municipalities $370 million per year in net revenue after expenses, in addition to the revenue that the State would receive from its royalty gas, property taxes, income tax, and severance taxes.

100. The only impediment to the Authority's plan is Defendants' concerted refusal to supply natural gas.

D. AS THEY HAVE DONE WITH OTHER COMPETITORS, DEFENDANTS HAVE JOINTLY REFUSED TO NEGOTIATE WITH THE AUTHORITY ON THE SALE OF NORTH SLOPE GAS.

101. The Authority has repeatedly attempted to engage the Defendants in good faith negotiations regarding the purchase of gas from the Defendants' resources on the North Slope.

102. On April 1, 2005, the Authority, working with Sempra Energy LNG, made a detailed offer to the Defendants, to other producers, and to the State of Alaska to purchase Alaska North Slope gas on a wellhead netback basis and to transport the gas to market. Sempra Energy is a major distributor of natural gas in the lower 48 states, but does not own significant gas producing properties itself.

103. During the several months that followed, the Defendants declined to sell the Authority North Slope gas or even to discuss prices or terms. Despite repeated efforts by the Authority to discuss prices or terms, including letters and meetings in Alaska and elsewhere, the Defendants continue to refuse to provide terms to sell gas to the Authority or any other Alaska gas pipeline project.

104. Sempra Energy recently withdrew from the Authority's project based on its concern that the producers would never sell gas to the Authority.

105. As of today, the Authority's offer to purchase North Slope gas remains open, but the Defendants have refused to engage in good faith negotiations and have declined to sell any North Slope gas to the Authority.

E. THE DEFENDANTS' JOINT REFUSAL TO MARKET THE VAST GAS RESOURCES UNDER THEIR CONTROL VIOLATES THEIR DUTY TO DEVELOP NORTH SLOPE GAS RESOURCES AND BRING THEM TO MARKET AND IS CONTRARY TO THEIR INDIVIDUAL SELF INTERESTS.

1. Duties To Develop And Market.

106. Under oil and gas leases and unit agreements, lessees have a duty to drill, produce, and market gas in a reasonably diligent manner.

107. Since early in the 20th Century, American courts have read into oil and gas leases a series of implied covenants in order to assure that a lessor's rights are protected. Holding leases for speculative purposes is not permitted. Defendants' leases with the State contemplate exploration and development, and not the bottling up of land for speculative or other purposes or the postponement of reasonable development. Thus, courts use implied covenants to ensure a lessee does not act opportunistically towards a lessor whose best interests might otherwise be held hostage by a lessee's unwillingness to explore, develop, produce, or market oil or gas from a leasehold

108 Compliance with these implied covenants is governed by the "prudent-operator standard," which requires a unit operator to act as a reasonably prudent operator. This is an objective standard

109. The implied covenant to market the product provides that, upon discovery of oil or gas, the lessee is under an implied duty to use due diligence to market these resources as a reasonably prudent operator, which includes marketing the product if there is a reasonable expectation of profit. Moreover, when there is evidence that additional development would probably be profitable, the lessee is under an implied duty to use due diligence to develop the leasehold as would the reasonably prudent operator.

110. Failure to comply with the implied duty to market the product or to develop the premises constitutes breach and is grounds for termination of oil and gas leases or unit agreements.

111. The Defendants are violating these contractual duties to develop the natural gas on their North Slope leaseholds. Moreover, they are using their anticompetitive refusal to deal as an excuse to forestall termination of their leases for non-performance, relying on the lack of a pipeline, a condition that they brought about, as a reason to be excused from their duty to develop and market the gas from their leases.

2. BP's Obligation To Negotiate In Good Faith With Independent Pipeline Providers.

112. In 1999, in order to address the State of Alaska's competitive concerns about the concentrated control of natural gas leases on the North Slope, BP and Atlantic Richfield Co ("ARCO") agreed to a "Charter for Development of the Alaskan North Slope" that required them, among other things, to negotiate in good faith to make North Slope gas available to any third party in sufficient quantities to support a treatment and transportation project. BP's continued refusal to negotiate with the Authority and others to sell gas violated this legal obligation.

113. Under the Charter, if a third party, as the Authority did, put forward a proposed project with the demonstrated ability to obtain construction financing, provide reasonable financial security, and obtain necessary approvals from other producers, BP and ARCO were committed to negotiate in good faith with that third party to make sufficient quantities of North Slope natural gas available at a commercially reasonable fair market price or transportation charge. In addition, BP and ARCO committed to make reasonable efforts to assist third parties,

including specifically the Authority, YPC, the State, and others, in obtaining necessary approvals for the sale of North Slope natural gas from other producers.

114. The Charter specifically required BP and ARCO to give fair consideration to all reasonable treatment and transportation projects to deliver gas to market "proposed by the newly established port authority" (referring to the Plaintiff is this action)

115. The Charter required BP and ARCO to evaluate these projects based on both the wellhead value for the State and other benefits to Alaska, such as the creation of infrastructure for delivery of gas to communities within the State By specifically naming the Authority, a political subdivision of the State, as a qualified third party with which BP and ARCO were required to negotiate in good faith, the parties intended for the Authority to obtain the benefit of the Charter

116 BP violated its legal obligations under the Charter, including by participating in the joint refusal to negotiate in good faith with the Authority and others.

3. The Defendants' Refusal To Deal Is Contrary To Their Self Interest In The Absence Of An Agreement.

117. In the absence of a conspiracy, it would be in each producer's self interest to attempt to make the best deal possible with the Authority in order to obtain the most favorable terms of sale for its gas. This is particularly true because, due the prevalence of long-term contracts in the natural gas industry, it is possible that a latecomer to market could be substantially delayed or even shut out if other producers secure market opportunities with long-term supply contracts

4. The Defendants Have Failed To Develop And Market Known Natural Gas Resources In The Prudhoe Bay Unit.

118 Over the last two and a half decades, the Prudhoe Bay Unit ("PBU") has been one of the most productive oil fields in the world. The Unit has comparable gas resources, which are

extracted as a result of the oil recovery. Yet the producers have done nothing to bring the Unit's massive gas resources to market

119. Exxon Mobil and BP collectively own over 60% of the gas resources in the PBU. BP is the unit operator for the PBU.

120. Defendants have entered into a number of different agreements and undertakings, both formal and informal, which have had, and continue to have, the purpose and effect of preventing the Defendants from competing in the sale of gas from the Prudhoe Bay unit and from committing gas to any competitive pipeline. To the extent that these agreements had a legitimate purpose, the restraints on competition were not necessary to achieve the legitimate purposes of the agreement. As a result of these agreements, Prudhoe Bay's vast gas resources have never been exploited commercially.

121. The Defendants generate approximately three TCF of natural gas on the PBU per year as a byproduct of crude oil production. After a small amount of gas is extracted for in-field and North Slope use, approximately eight BCF of gas is re-injected daily into the PBU reservoir. While this re-injected gas provides pressure for crude oil production, the re-injection process is costly and a number of alternative efficient and cost-effective means are available to maintain pressure for oil production, means that would free up the gas for commercial sale if there were a pipeline to transport the gas to market. The producers have never offered a proposal to market this gas because of their illegal agreement not to do so.

5. The Defendants Have Failed to Develop and Market Known Natural Gas Resources in the Point Thomson Unit.

122. The Point Thomson Unit is located on the eastern side of the North Slope Defendants began obtaining oil and gas leases on this unit from the State of Alaska in the 1960s

123 One of Defendants' duties under their leases was to develop the oil and gas resources and bring them to market The U.S. Department of Energy estimates that there are currently eight TCF of proved natural gas resources in the Unit These resources are a valuable resource belonging to the State and its citizens.

124 According to ExxonMobil, because of extraordinarily high gas pressure at the Point Thomson unit, re-injection of the gas in connection with oil drilling, as is done at Prudhoe Bay, would be difficult and inefficient. It would, therefore, be inefficient and contrary to Defendants' self interest (other than Defendants' interest in maintaining their control and monopoly prices) to extract oil without simultaneously extracting gas

125. ExxonMobil and BP own over 75% of the working interest ownership in the PTU leases. ExxonMobil is the Unit Operator.

126 All the leases in the PTU except one are beyond their primary term and are listed by the Alaska Department of Natural Resources ("DNR") as "expired" Accordingly, the PTU leases remain in effect today solely because they are incorporated into a unit.

127 No gas from the Point Thomson Unit has ever been produced or marketed.

128 Despite repeated requests over the years from DNR for drilling in the PTU, ExxonMobil has submitted, and continues to submit, annual plans for the PTU that include no drilling, development, or marketing of the PTU's gas resources

129 On October 27, 2005, the DNR Director of Oil and Gas issued an amended denial of ExxonMobil's proposed plan for the development of the PTU because it did not set out a plan to bring the PTU into commercial production within a reasonable time frame

130. The Director's denial of ExxonMobil's development plan is grounds for termination of the Unit under the PTU Agreement and the state oil and gas unitization regulations, and

ExxonMobil has 90 days to cure the default or DNR may proceed with termination. Following the recent resignation and replacement of DNR Commissioner Tom Irwin, ExxonMobil requested and received an extension until May 31, 2006 to submit an appeal of this ruling.

131 There are currently 45 state oil and gas leases committed to the PTU. All but one are beyond their primary term and are themselves subject to termination once the Unit is terminated.

132 If the PTU Agreement terminates and the leases expire, the Defendants will lose valuable assets that they have reserved for development at some future date. This would force the Defendants to abandon the PTU or to pay significantly higher bid bonuses and higher royalty rates to enter into new lease agreements with terms imposing work commitments.

133 Lack of a pipeline is the sole rationale proffered by the producers for not marketing gas from Point Thomson. With a pipeline, the Defendants would have no excuse not to develop their leases and market their gas. Defendants' joint refusal to market their gas is an anticompetitive agreement with the purpose and effect of keeping this resource from the market while maintaining their leases. The Defendants' conduct is not justified by any plausible efficiency rationale.

F. DEFENDANTS ENTERED INTO A SERIES OF MERGERS THAT CONSOLIDATED THEIR CONTROL OF THE NORTH SLOPE AND FACILITATED THEIR ANTI-COMPETITIVE GOALS.

1. Exxon And Mobil.

134. On December 1, 1998, Exxon Corporation and Mobil Corporation announced their merger to form the largest publicly traded oil company in the world. Only Saudi Arabia and Iran produce more oil. This merger, consummated on November 30, 1999, reunited the two biggest pieces, constituting 52%, of John D. Rockefeller's Standard Oil trust, which was broken up by the federal government in 1911.

135. The merger of Exxon Corporation and Mobil Corporation created not only the world's biggest oil company and largest retailer of gasoline, but also the world's third largest corporation by revenue. Although ExxonMobil has since been overtaken by BP as the world's largest oil company, it remains the largest oil company in the U S.

136. Through its subsidiary, ExxonMobil Pipeline, Co , ExxonMobil also has significant interests in Alaska crude oil pipelines. ExxonMobil has a 20 34% interest in TAPS, a 21 02% interest in the 25-mile E: licott pipeline, and a 20% interest in the 55-mile Cook Inlet pipeline.

137 Prior to the merger, Mobil held significant interests in oil and gas resources on the North Slope, including in the Prudhoe Bay and Point Thomson Units. Those interests were consolidated with Exxon's as part of the merger

138. ExxonMobil currently has substantial interests in North Slope oil and gas fields With its 36.4% interest, ExxonMobil is the largest resource owner in the Prudhoe Bay Unit. ExxonMobil also has the largest working interest ownership in the Point Thomson Unit, with 48.22% of the unit's estimated resources of eight TCF of natural gas Also on the North Slope, ExxonMobil holds smaller interests in the Kuparuk River and Duck Island Units.

2. BP And Amoco.

139. On December 30, 1998, BP and Amoco Corporation merged to form BP Amoco Corporation (later renamed BP p l.c.). Amoco owned oil and gas interests on the North Slope that were consolidated in this merger As a result of the merger, BP has prime positions in key oil and gas producing areas, retail markets, petrochemicals and emerging regions.

3. BP And Atlantic Richfield Co.

140 On April 1, 1999, BP and Atlantic Richfield Co. ("ARCO") announced that the two oil companies had reached a merger agreement Both the Federal Trade Commission and ExxonMobil objected to the merger on the grounds that it would lead to an unacceptable

concentration of market power with respect to ownership of the Prudhoe Bay gas and oil field Ultimately an agreement was reached between ExxonMobil, Phillips, and BP under which ExxonMobil acquired a 36.4% stake in Prudhoe Bay, Phillips acquired a 36.6% stake, and BP received a 26.35% stake and BP became the sole operator.

141. The merger between BP and ARCO was consummated on April 18, 2000, making it the world's largest non-state oil producer, which it remains to this day.

142. BP operates facilities that account for more than half of all oil production in Alaska. As a result of the deal reached between BP, Phillips, and ExxonMobil in connection with BP's merger with ARCO, BP became the sole operator of Prudhoe Bay, Alaska's largest oil field and the largest oil field in the United States. BP also operates twelve other North Slope oil fields and four North Slope pipelines. In addition, BP owns a significant interest in six other producing fields and about 47% of TAPS. Production from BP's fields averages 720,000 barrels of oil equivalent per day.

143. BP has been the largest producer of natural gas in the United States since at least 2001. With BP's 26.35% stake in Prudhoe Bay's natural gas resources and its 28.4% stake in the Point Thomson Unit, North Slope gas remains one of the largest undeveloped resources in BP's global portfolio.

144. The impact of the BP-ARCO merger upon development of North Slope natural gas was a great concern to the State of Alaska. To address that concern, as discussed above, BP and ARCO guaranteed that any party capable of commercializing North Slope gas would have access to natural gas controlled by these parties. The "Charter for Development of the Alaskan North Slope" with BP and ARCO required, among other things, that BP and ARCO negotiate in good faith to make North Slope gas available to any third party in sufficient quantities to support a

treatment and transportation project. As discussed above, BP and ARCO ignored this obligation in refusing to negotiate with the Authority.

4. Other Mergers And Acquisitions.

145. In addition to the mergers discussed above, the producers have engaged in a series of mergers and/or acquisitions of stock and assets, including acquisition of other producers' North Slope assets. These mergers and/or acquisitions have substantially increased Defendants' market power and their ability to successfully block the development and marketing of Alaska gas.

146. For example, as discussed above, because the pipeline tariff imposed by the TAPS owner-producers rendered its continued operation of its fields uneconomical, Conoco was forced to sell its 70% interest in the Milne Point field and its 70% interest in the Badami field, 35 miles east of Prudhoe Bay, to BP.

147. Similarly, when BP bought Conoco's interest in Milne Point, it also purchased Chevron's 27% interest in this field. Soon after, Chevron transferred its 50% interest in two leases in the Alpine development to ARCO.

148. Prior to its merger with Chevron, Texaco also left the North Slope. Texaco sold its 25% share of the production rights to three leases in Colville Delta to ARCO. Texaco also assigned to ARCO its 25.25% interest in the Alpine field, on the western end of the North Slope.

149. Shell transferred its production interest in Prudhoe Bay to ARCO in 1996, and ARCO, in turn, assigned half of this acquisition to Exxon. Shell and others also sold their interests in the Northstar field to BP.

150. A further example of this pattern is Amerada Hess. Amerada Hess was one of the largest holders of oil and gas leases in Alaska, but between 1993 and 1996, it shed over 99% of the acreage it held, including its North Slope leases, largely assigning them to ARCO and BP. Amerada Hess had a negligible interest in TAPS – 1.5%, an interest that prevented the company

from exercising any control over the pipeline's operation and from mitigating the effects of the artificially high tariff rates charged by the TAPS owners.

151. These and other mergers and acquisitions have increased the Defendants' market power and substantially reduced competition in the relevant markets. With more players in the market, companies other than Defendants would have had a better ability and incentive to break from the cartel and sell gas to new competitors. This is turn would have reduced Defendants' power and control and their ability and incentives to collude.

152. Also, because the remaining players have a greater presence in the production of natural gas for the North American market, they have a stronger incentive and ability to withhold production in concert, in order to maintain high prices.

153. Industry analysts evaluating these mergers have recognized that the companies' interests in controlling natural gas was a key factor influencing the mergers:

> I think natural gas was a key driver behind the formation of super-major energy companies like BP Amoco, Exxon and Mobil and now the BP Amoco-Arco merger. Executives of all the companies involved in the transactions have cited creation of a greater natural gas presence as a significant factor in their decisions to combine.
>
> For example, a top item on BP Amoco's list of reasons for acquiring Arco is control over development of the 26 TCF of natural gas in Alaska's Prudhoe Bay field. BP Amoco, Arco and Exxon are the field's principal stakeholders. BP Amoco owns 21% of Prudhoe Bay's gas, while Arco and Exxon have 32% each

Barbara Shook, Houston Bureau Chief, Energy Intelligence Group, "Outlook for Global Gas and Electricity and Other Musings," Commonwealth North, June 8, 1999.

V. RELEVANT MARKETS

154. Defendants' improper conduct affects several relevant markets, including: (1) the market for transport of natural gas from the North Slope; (2) the market for purchase of gas from

the North Slope; (3) the market for sale of natural gas within the United States/North America; and (4) the market for sale of natural gas within Southcentral and Interior Alaska.

A. MARKET FOR THE TRANSPORT OF NATURAL GAS FROM THE NORTH SLOPE.

155 As noted, Alaska's North Slope contains massive quantities of natural gas that would have tremendous value if this gas could be transported to existing distribution infrastructure in Southcentral and Interior Alaska and Canada, which in turn is connected to the infrastructure in the lower 48 states. As further noted, over the last twenty years, a number of entities have taken substantial steps to enter the market for the transportation of natural gas from the North Slope. Although no pipeline operator currently provides pipeline service from the North Slope because the Defendants jointly refused to deal with any new entrant, there is no question that such a pipeline would be economical if the Defendants would commit to supplying some of their gas for such a pipeline.

156 There is no reasonably interchangeable substitute for a pipeline to transport natural gas from Alaska's North Slope. Trucking or train carriage of this commodity would be massively inefficient. Access to the sea on the North Slope is impractical due to ice. To the extent that gas is currently used for oil production on the North Slope, the gas needed to power North Slope operations is only a small fraction of what can be produced.

157. The market for the transportation of natural gas from the North Slope for commercial distribution elsewhere is a relevant market for antitrust purposes.

Market Power

158. The Defendants have monopoly power in this market because, by their own admission, they can exclude competition: (1) by refusing to sell gas to competitors; and (2) by

refusing to allow gas owned by others, including the State of Alaska, found on units they control to be brought to market.

B. MARKET FOR THE PURCHASE OF NATURAL GAS FROM THE NORTH SLOPE.

159. Another related relevant market affected by the Defendants' conduct is the market for the purchase of gas from the North Slope. In addition to acting as a carrier providing transportation services, the pipeline's operator acts as a purchaser of gas for its own account on the North Slope, which it then transports to market and sells. The structure and market dynamics of this market are essentially the same as the market for transportation of gas from the North Slope. Just as no producer can transport gas without a pipeline, no purchaser can purchase gas without a pipeline to bring the gas to market. There is no reasonable substitute for the purchase of gas capable of being transported on the pipeline because the on-site demand and use for North Slope natural gas is far less than the potential supply that is not being exploited

160. The Authority is a prospective purchaser of North Slope gas. It has made repeated entreaties to the Defendants to discuss the terms under which they would sell gas. While Defendants have on occasion held "courtesy meetings" with representatives of the Authority, including its construction contractor and investment bankers, and with other potential new entrants, the Defendants have steadfastly refused to discuss the prices or terms under which they would sell gas, or permit gas from units that they control to be sold, to anyone outside the Defendants' cartel. Without a commitment by at least one Defendant, neither the Authority nor anyone else will be able to compete in this market

Market Power

161. The Defendants, acting as a cartel, also possess monopoly power in this market because they can exclude competition by refusing to sell gas to a new entrant, and without a

commitment from at least one of the Defendants to sell gas, no new entrant could successfully build a pipeline.

C. MARKET FOR THE SALE OF NATURAL GAS IN NORTH AMERICA.

162. Another relevant market affected by this transaction is the market for the sale of natural gas in North America. Because of transportation costs, North America forms a separate market for the sale of natural gas from the rest of the world. This is reflected in the relative differences in the price of natural gas between the United States and the rest of the world

163. The Department of Energy estimates that the United States consumed approximately 22 TCF of gas in 2004. A gas pipeline from the North Slope supplying four to six BCFD would have added close to 1 5 to 2.25 TCF to national supply, or seven to ten percent of total American consumption. The producers already have a large share, a share that has been substantially increased by the mergers and acquisitions discussed above, of the domestic natural gas market and have been able to charge artificially inflated prices for that gas because North Slope gas has been excluded from that market. Had this North Slope gas been available to purchasers in the lower 48 states, the price of gas would have been at a significantly lower competitive price.

164. Because North Slope gas has been unavailable for use off the North Slope, the price of natural gas in the United States and the rest of North America has been maintained at an artificially high level for some time. If the Defendants' illegal conduct continues, it will continue to maintain the price of gas in the United States at artificially high levels for the foreseeable future. Because the Defendants have substantial interests in natural gas from other sources, they have an economic incentive to keep North Slope gas out of the North American market in order to maintain supra-competitive prices for the sale of gas throughout the United States and the rest of North America.

Market Power

165. The Defendants have market power in this market because they can exert sufficient influence over the supply of natural gas to affect the price of gas throughout the United States. The Defendants also have strong incentives to limit the supply of gas in the United States in order to maintain supra-competitive prices for all their gas operations

D. MARKET FOR THE SALE OF NATURAL GAS TO SOUTHCENTRAL AND INTERIOR ALASKA.

166 Southcentral and Interior Alaska, defined for the purposes of this complaint as that part of Alaska south of the North Slope, constitutes a separate geographic market for the sale of natural gas. Southcentral Alaska has an existing gas distribution infrastructure that is important to the economic vitality of southern Alaska Historically, the gas needs of Southcentral Alaska have been met by supplies of gas from production areas in Southcentral Alaska itself because the area has no infrastructure in place to: (1) access gas produced on the North Slope; or (2) access gas distribution sources outside Alaska Interior Alaska currently does not have a natural gas distribution infrastructure. There is, however, a high demand for natural gas in Interior Alaska and there is no doubt that an infrastructure would be created upon receipt of assurances that gas from the North Slope would be supplied.

167. The supply of accessible natural gas from existing production fields in Southcentral Alaska is currently on the downward part of the supply curve, and prices have been rising This has had profound effects in Southcentral Alaska. For example, a major fertilizer plant in the Kenai area has recently announced that it will need to transition from natural gas to coal or another source of energy for the production of fertilizer due to the increasing costs and decreasing supply of Alaska natural gas, and may shut down without its needed feedstock of natural gas If a pipeline is not completed within the next ten to twelve years, the situation will

become even more severe At that point, without a new source of supply, the supply of natural gas in Southcentral Alaska will take a sharp downturn. Alaska businesses and consumers will also be forced to use more expensive and less efficient and less desirable energy sources because they do not have access to the tremendous unutilized gas resources on the North Slope.

168. There is a separate market for the sale of natural gas in Southcentral and Interior Alaska because there are no reasonably interchangeable substitutes. While coal and other energy sources can provide heat and power, the direct and associated costs of transitioning to and using those alternatives are so high that a natural gas user would not switch to these alternatives in response to a significant increase in the cost of natural gas over the competitive price.

169. As noted above, the Authority will provide North Slope gas to Southcentral Alaska by means of a spur line to the Palmer area

Market Power

170. As with the other markets, the Defendants have the market power to exclude competition in the market for the sale of gas in Southcentral and Interior Alaska by refusing to cooperate with transportation companies or purchasers who intend to transport or sell North Slope gas to Southcentral Alaska.

VI. ANTICOMPETITIVE EFFECTS

171. The Defendants' anticompetitive conduct has had the following anticompetitive effects, among others:

(a) competition for the transport of natural gas off the North Slope has been reduced or eliminated;

(b) competition for the purchase of North Slope natural gas has been reduced or eliminated;

(c) incentives for exploration and development of North Slope natural gas resources have been reduced;

(d) the supply of natural gas to Southcentral Alaska and the rest of United States has been artificially reduced and the price of natural gas maintained at artificially high levels; and

(e) gas purchasers may be forced to lock into long-term, high-price gas contracts for gas from other sources, locking Alaska gas out of the market even after a pipeline is built

A. REDUCED COMPETITION FOR THE TRANSPORT/PURCHASE OF NATURAL GAS.

172. The actual and potential competitive effects if the Defendants are permitted to continue to monopolize and attempt to monopolize the market for transportation of gas from the North Slope are profound.

173. If not stopped, the Defendants' anticompetitive conduct will eliminate competition from independent pipeline producers and further delay construction of a pipeline. This will further discourage investment in exploration and development of this resource and impede the commercialization of Alaska's gas resources, further inflating the price of natural gas.

B. REDUCED INCENTIVES FOR THE DEVELOPMENT OF ALASKA'S GAS RESOURCES.

174. Left unchecked, the Defendants' anticompetitive conduct will continue to impede exploration for and development of North Slope natural gas

175. As the former Director of Alaska's Department of Natural Resources, Division of Oil and Gas, Mark Myers, recently wrote: "The explorer's inability or uncertainty in obtaining access to unregulated [processing and pipeline] facilities through commercial agreements has

dramatically slowed the pace of exploration on the North Slope. . While [the high pipeline and processing] fees clearly benefit the pipeline owners, they dramatically increase cost and risk to explorers and lower the North Slope's overall worldwide competitiveness."

176. Director Myers also warned that without independent access to transport at a fair and reasonable cost "there may be no room for explorer's gas for 25 years or more Under this scenario, exploration for gas on the North Slope and in several of the Interior basins wouldn't be very viable for a generation."

177. Similarly, another North Slope producer, Anadarko Petroleum Company ("Anadarko"), has discussed the critical link between access to a transportation pipeline and the ability to develop natural gas. In a November 12, 2001, letter encouraging the State of Alaska to make its royalty gas available for sale, David D. Anderson, Anadarko's Manager, International Commercial Development, stated that, "Securing access to the proposed natural gas pipeline from the North Slope is a necessity for the continued exploration for natural gas within the State of Alaska." Concerned that a proposed pipeline might not have sufficient capacity to transport gas from developers such as his company, he added, "failure to secure firm transportation now could result in Anadarko's prospective gas discoveries being stranded without any means to produce and sell the gas." In testimony related to this proposed sale of royalty gas, Anadarko's Mark Hanley repeated this point. "It is critical that we obtain capacity [on a gas pipeline]. If we cannot obtain capacity, it makes no sense to explore for gas."

C. REDUCED OUTPUT AND HIGHER PRICES FOR GAS IN ALASKA AND THE REST OF THE UNITED STATES.

178. As noted above, with a pipeline, the North Slope could supply approximately seven to ten percent of the United States' current natural gas needs. In the absence of the Defendants' anticompetitive conduct, a pipeline would be substantially further along, if not already

constructed by now. The Defendants' joint refusal has kept and will keep this gas out of the market, the ultimate and inevitable result being that consumers will continue to pay higher prices than they would otherwise.

D. ALASKA GAS COULD BE LOCKED OUT OF THE MARKET EVEN AFTER A PIPELINE IS BUILT DUE TO THE DEFENDANTS' EFFORTS TO DELAY.

179. In addition, because natural gas supply contracts are often long-term contracts, further delay in the construction of the pipeline could cause large gas purchasers in the United States to lock into contracts to purchase gas from overseas suppliers, including the Defendants, at prices that are higher than would prevail in a competitive market. Not only would consumers be locked into high price gas contracts, this could have the effect of foreclosing North Slope gas from these markets even after the pipeline is constructed.

VII. CLAIMS FOR RELIEF

FIRST CLAIM FOR RELIEF
Concerted Refusal to Deal and Group Boycott in Violation of Section One of the Sherman Act.

180 The Authority repeats and realleges all of the allegations in all the paragraphs above as if set forth fully herein.

181. Defendants' agreements not to deal with the Authority or other competitive pipeline companies are a group boycott and concerted refusal to deal by competitors with market power that deprives the Authority of an essential input needed to compete in the markets for the purchase and transport of natural gas from the North Slope, and in the markets for the sale of natural gas in Southcentral and Interior Alaska and the United States. Defendants' agreements and boycott are a *per se* violation of Section One of the Sherman Act.

182. Defendants' concerted refusal to deal and group boycott also unreasonably restrain competition and foreclose a substantial share of the markets for the purchase and transport of

natural gas from the North Slope in violation of Section 1 of the Sherman Act, and unreasonably restrain competition in the Southcentral and Interior Alaska and United States markets for the sale of natural gas in violation of Section One of the Sherman Act. It is unlawful whether judged by a *per se* standard or by the rule of reason.

183. The purpose and effect of Defendants' concerted refusal to deal and group boycott is to restrain trade and eliminate competition in all the relevant markets identified above.

184. Defendants' concerted refusal to deal and group boycott have a substantial effect on interstate and foreign commerce.

185. Defendants' agreements violate Section 1 of the Sherman Act, 15 U.S.C. § 1.

186. By reason of Defendants' violations of Section 1 of the Sherman Act, the Authority has been injured in its business or property, including through the loss of future profits, by the loss of customers and potential customers, and by the prospective destruction of its business.

187. The Authority has suffered irreparable injury by reason of the acts, practices and conduct of the Defendants alleged above, and will continue to suffer such injury until and unless the Court enjoins such acts, practices and conduct.

SECOND CLAIM FOR RELIEF
Agreements Not To Compete
in Violation of Section One of the Sherman Act.

188. The Authority repeats and realleges all of the allegations in all the paragraphs above as if set forth fully herein.

189. Defendants' agreements described above, taken together, constitute naked agreements not to compete with each other in supplying gas for purchase or transport off the North Slope to the Southcentral and Interior Alaska and United States markets for natural gas. As such, these agreements are *per se* violations of Section One of the Sherman Act.

190. Defendants' agreements not to compete with each other also unreasonably restrain competition and foreclose a substantial share of the markets for the purchase and transport of natural gas from the North Slope in violation of Section One of the Sherman Act, and unreasonably restrain competition in the Southcentral and Interior Alaska and United States markets for the sale of natural gas.

191 Defendants' agreements not to compete with each other, as described above, are unnecessary to accomplish the stated purposes of the Unitization Agreements or any lawful agreements, and they restrict competition in an unreasonable and unnecessary way Defendants' agreements unreasonably restrain trade and restrict the access of the Authority and others to the markets for the transport, purchase and sale of natural gas, thereby restraining competition in those markets and foreclosing substantial interstate and foreign commerce Defendants' agreements are unlawful whether judged by a *per se* standard or by the rule of reason.

192. The purpose and effect of Defendants' agreements are to restrain trade and competition in the relevant markets described above.

193. Defendants' agreements violate Section 1 of the Sherman Act, 15 U S C. § 1.

194. By reason of Defendants' violations of Section 1 of the Sherman Act, the Authority has been injured in its business or property, including through the loss of future profits, by the loss of customers and potential customers, and by the prospective destruction of its business.

195. The Authority has suffered irreparable injury by reason of the acts, practices and conduct of the Defendants alleged above, and will continue to suffer such injury until and unless the Court enjoins such acts, practices and conduct.

THIRD CLAIM FOR RELIEF
Conspiracy to Monopolize Markets for the Transportation and Purchase of Natural Gas from the North Slope in Violation of Section 2 of the Sherman Act.

196. The Authority repeats and realleges all of the allegations in all the paragraphs above as if set forth fully herein.

197. By such acts, practices, and conduct, Defendants have conspired to monopolize the markets for the transport and purchase of natural gas on the North Slope by jointly refusing to deal with any competitive pipeline, all in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2. By establishing joint control over the most productive oil and gas units on the North Slope, and agreeing with each not to deal with other pipeline suppliers, Defendants have monopolized the supply of natural gas from the North Slope.

198. Defendants have likewise maintained that monopoly through the practices described herein

199. By reason of Defendants' violations of Section 2 of the Sherman Act, the Authority has been injured in its business or property, including through the loss of future profits, by the loss of customers and potential customers, and by the prospective destruction of its business.

200. The Authority has suffered irreparable injury by reason of the acts, practices, and conduct of Defendants alleged above, and will continue to suffer such injury until and unless the Court enjoins such acts, practices, and conduct.

FOURTH CLAIM FOR RELIEF
Attempted Monopolization of Markets for the Transportation and Purchase of Natural Gas from the North Slope in Violation of Section 2 of the Sherman Act.

201. The Authority repeats and realleges all of the allegations in all the paragraphs above as if set forth fully herein.

202. The markets for the sale of gas transportation services from the North Slope of Alaska and for the purchase of natural gas from the North Slope of Alaska are relevant antitrust markets. Defendants have willfully engaged, and are illegally engaging, in a cumulative course of conduct intended to monopolize those markets, including without limitation: agreeing among themselves not to commit gas resources; failing to develop known natural gas resources in the Prudhoe Bay and Point Thompson Units; and entering into a series of mergers and asset acquisitions that consolidated control of the North Slope natural gas resources.

203 These practices have no legitimate business justification They restrict competition in an unnecessary and unreasonable way, and are far broader than necessary to effectuate any legitimate purpose they might have

204. Defendants have undertaken this course of conduct with the specific intent of monopolizing the markets described above. There is a dangerous probability that, unless restrained, Defendants' course of conduct will succeed, in violation of Section 2 of the Sherman Act, 15 U S C § 2.

205. By reason of Defendants' violations of Section 2 of the Sherman Act, the Authority has been injured in its business or property, including through the loss of future profits, by the loss of customers and potential customers, and by the prospective destruction of its business

206 The Authority has suffered irreparable injury by reason of the acts, practices, and conduct of Defendants alleged above, and will continue to suffer such injury until and unless the Court enjoins such acts, practices, and conduct.

FIFTH CLAIM FOR RELIEF
Unlawful Purchase, Holding and Use of Stock or Assets in Violation of Section 7 of the Clayton Act.

207. The Authority repeats and realleges all of the allegations in all the paragraphs above as if set forth fully herein.

208. Defendants' previous mergers, acquisitions, holding, and use of other companies' stock and assets have substantially lessened competition in relevant markets for the transportation and purchase of natural gas from the North Slope. Such mergers, acquisitions, holding, and use have foreclosed, and will foreclose, substantial interstate and foreign commerce, and violate Section 7 of the Clayton Act, 15 U.S.C. § 18.

209. The Authority has been and will continue to be injured as a result of Defendants' unlawful acquisition, holding, and use of these acquired assets. Without injunctive relief, the Authority will continue to suffer irreparable injury as a result of Defendants' unlawful conduct, for which there is no adequate legal remedy.

SIXTH CLAIM FOR RELIEF
Violation of Alaska Unfair Trade Practice and Consumer Protection Act, AS 45.50.471 *et seq.*

210. The Authority repeats and realleges all of the allegations in all the paragraphs above as if set forth fully herein.

211. Defendants are engaged in trade and commerce. In the conduct of trade and commerce, Defendants have engaged in unfair and deceptive acts or practices. The Defendants have in the past wanted to avoid appearing unwilling to sell gas to the Authority or other pipeline sponsors because, among other reasons, the Defendants did not want to risk the State's termination of their oil and gas units and leases or to foster a negative public image. In order to avoid the appearance that they were unwilling to sell gas resources, the Defendants intentionally

misled the Authority and other pipeline sponsors that the Defendants were willing to evaluate the Authority's and other pipeline sponsors' plans on the merits and were willing to negotiate in good faith with pipeline sponsors. In fact, Defendants knew that they had no intention of engaging in serious negotiations because they had agreed they would not market gas to any pipeline operator not controlled by Defendants.

212. In the conduct of trade and commerce, Defendants have also engaged in unfair acts or practices, as described above, including by agreeing with others not to compete in the sale of natural gas from the North Slope and agreeing not to sell natural gas to the Authority and others.

213. The foregoing conduct constitutes unfair conduct under the Alaska Unfair Trade Practice and Consumer Protection Act because it offends public policy as expressed through statutes and regulation, it is unethical and oppressive, and it has caused substantial injury to consumers and competitors

214. By reason of Defendants' violations of the Alaska Unfair Trade Practice and Consumer Protection Act, the Authority has been injured in its business or property, including through the loss of future profits, by the loss of customers and potential customers, and by the prospective destruction of its business The Authority has been injured and suffered damages in an amount to be proved at trial and, without injunctive relief, the Authority will continue to suffer irreparable injury as a result of Defendants' unlawful conduct. The Authority has no adequate remedy at law

SEVENTH CLAIM FOR RELIEF
Tortious Interference with Prospective Business Opportunity.

215. The Authority repeats and realleges all of the allegations in all the paragraphs above as if set forth fully herein.

216. Defendants have undertaken a willful and malicious course of conduct to foreclose the Authority from conducting its business

217. Through its negotiations with major North Slope producers and the State of Alaska, the Authority had a prospective economic relationship with each such working and royalty interest owner for the sale and purchase, or other commitment, of gas to be transported in the Authority's pipeline.

218. Defendants knew about the Authority's efforts to obtain gas from producers for transportation in a pipeline and sought to prevent the Authority from realizing the benefits of any such agreement with any producer, including each other.

219. Sempra Alaska is a wholly owned subsidiary of Sempra LNG, which is in turn a wholly owned subsidiary of Sempra Energy (collectively "Sempra"), the largest retail gas distribution company in the United States and the second largest gas trading company in the United States. Sempra is developing LNG regasification facilities in Mexico for delivery of natural gas into the United States.

220. The Authority entered into a contract with Sempra whereby Sempra committed to assist in the development of the initial phases of the pipeline project and to fund or finance a portion of the project. The Authority also negotiated for Sempra to buy and market all of the gas processed by the Authority's facilities.

221 Defendants knew about the Authority's agreements with Sempra regarding the development of the pipeline project and the sale and marketing of gas to be transported by the pipeline and sought to prevent the Authority from realizing the benefits of those agreements

222. But for Defendants' anticompetitive conduct, there was a reasonable probability that the Authority would have been able to successfully secure business relationships with producers

or the State of Alaska for the purchase or commitment of gas to be transported in the Authority's pipeline

223. Because of Defendants' conduct, however, neither the State of Alaska nor any producer was or are willing to sell or otherwise commit gas to the Authority.

224. But for Defendants' anticompetitive conduct, there was a reasonable probability that the Authority would have been able to successfully secure business relationships with Sempra for development of the pipeline and for the purchase of gas from the Authority

225 Because of Defendants' conduct, however, Sempra has discontinued its business relationship with the Authority and has withdrawn its agreements to support development of the pipeline and to purchase gas from the Authority

226. Through the anticompetitive and unjustifiable means described above, Defendants intentionally interfered with and frustrated the Authority's efforts to benefit from its prospective business relationships with the producers, the State of Alaska, Sempra, and the LNG gas purchasers

227. Defendants have engaged in the anticompetitive and unjustifiable means described above without legitimate justification or excuse

228. By reason of Defendants' violations, the Authority has been injured in its business or property, including through the loss of future profits, by the loss of customers and potential customers, and by the prospective destruction of its business. The Authority has been injured and suffered damages in an amount to be proved at trial and, without injunctive relief, the Authority will continue to suffer irreparable injury as a result of Defendants' unlawful conduct The Authority has no adequate remedy at law. The Authority is also entitled to punitive damages for Defendants' willful and malicious conduct

EIGHTH CLAIM FOR RELIEF
Against BP – Breach of Contract

229. The Authority repeats and realleges all of the allegations in all the paragraphs above as if set forth fully herein.

230. As set forth above, BP entered into a contract – "Charter for Development of the Alaskan North Slope" – under which it agreed, among other things, to:

(a) negotiate in good faith to make North Slope gas available to third parties at a commercially reasonable fair market price or transportation charge in quantities sufficient to support a treatment and transmission project;

(b) make reasonable efforts to assist in obtaining approval for a qualified transportation project, such as the Authority's, from the other gas producers and field interest owners; and

(c) give fair consideration to any reasonable project to deliver gas to market, specifically including projects sponsored by the Authority, YPC, the State, and others

231. The Authority was an intended beneficiary of that contract. As a political subdivision of the State, the Authority's purpose is to benefit the State of Alaska and its citizens by the construction of an independently owned gas pipeline system to transport natural gas from Alaska's North Slope to market BP's continued refusal to negotiate with the Authority and others to sell gas constituted a breach of the contract, and frustrated the Authority from accomplishing its intended purpose. As a result of these breaches, the Authority, an intended beneficiary of the contract, has been injured in its business or property, including through the loss of future profits, by the loss of customers and potential customers, and by the prospective destruction of its business. The Authority has been injured and suffered damages in an amount

to be proven at trial and, without injunctive relief, the Authority will continue to suffer irreparable injury as a result of Defendants' unlawful conduct. The Authority has no adequate remedy at law.

VIII. PRAYER FOR RELIEF

WHEREFORE, Plaintiff requests that the Court:

A Adjudge and decree that Defendants have violated Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2; and Section 7 of the Clayton Act, 15 U.S.C. § 18; that Defendants have violated the Alaska Unfair Trade Practice and Consumer Protection Act, AS 45.50.471 *et seq.*; that Defendants have tortiously interfered with the Authority's prospective economic advantage; and that BP's conduct constitutes breach of contract;

B On the Authority's First through Sixth Claims, enter judgment against Defendants for treble the amount of the Authority's damages as proven at trial in accordance with Section 4 of the Clayton Act, 15 U.S.C. § 15, and the Alaska Unfair Trade Practice and Consumer Protection Act, AS 45.50.531;

C. On the Authority's Seventh and Eighth Claims, enter judgment against Defendants for the amount of the Authority's damages as proven at trial and, on the Authority's Sixth and Seventh Claims, for punitive damages;

D. Grant the Authority injunctive relief pursuant to 15 U.S.C. § 26, sufficient to restrain Defendants' continuing violations of 15 U.S.C. §§ 1 and 2;

E Grant the Authority injunctive relief pursuant to 15 U.S.C. § 26, sufficient to restrain and prevent Defendants' violations of 15 U.S.C. § 18, including but not limited to injunctive relief requiring divestiture of some or all of the assets acquired, and/or imposing conditions on Defendants' use of some or all of the assets acquired;

F. Award the Authority its costs and expenses of litigation, including attorneys' fees and expert witness fees; and

G. Enter judgment against Defendants for such other and further relief as the Court deems just and proper.

DEMAND FOR JURY TRIAL

Plaintiff AGPA hereby demands trial by jury in this action on all issues so triable.

Dated: Monday, December 19, 2005

Respectfully submitted,

David Boies
Robert Silver
John F. Cove, Jr.
Kenneth F. Rossman IV
BOIES, SCHILLER & FLEXNER LLP

William M Walker
WALKER & LEVESQUE, LLC

Charles E. Cole
LAW OFFICES OF CHARLES E. COLE

Counsel for Plaintiff Alaska Gasline Port Authority

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TransCanada
In business to deliver

July 13, 2006

VIA FAX: (907) 465-3889

Governor F H Murkowski
550 West 7th Avenue, Suite 1700
Anchorage, Alaska 99501

TransCanada Corporation
450 – 1ST Street S. W
Calgary, Alberta T2P 5H1

tel 403 920-7700
fax 403 920-2413
email hal_kvisle@transcanada com
web www.transcanada com

Hal Kvisle
President and CEO

Dear Governor Murkowski:

Re: Letter from Governor Frank H. Murkowski to the Honorable Ben Stevens, dated June 22, 2006 regarding a Pipeline to Transport Natural Gas from the Alaska North Slope to North American Markets (the "Project")

I am writing to provide comments on your June 22nd letter to Senator Ben Stevens, in which you encourage Senator Stevens to support the ratification of the agreement that your Administration has reached with the Alaska North Slope ("ANS") producers, regarding the construction of a gas pipeline and related facilities for the movement of ANS natural gas to market

TransCanada, its predecessors and the State of Alaska have enjoyed a constructive working relationship since the Project was first conceived some thirty years ago TransCanada has worked particularly closely with your Administration in recent years, and we value the relationship we have developed with you and your Administration. We have also worked closely with many members of the Alaska State Legislature, and we value those relationships as well.

It is within the long term context of TransCanada's relationship with the State of Alaska that I wish to provide comments on three issues:

(i) The gas pipeline agreement you have reached with the ANS producers
(ii) Provisions regarding Canada, contained within that agreement
(iii) The viability of independent pipelines, as referenced in your June 22nd letter to Senator Ben Stevens

1 Gas Pipeline Agreement Between the State of Alaska and the ANS Producers

TransCanada recognizes the importance of the agreement you have reached with the ANS producers – it is difficult to see how a gas pipeline from the North Slope to North American markets could proceed expeditiously without the agreement and support of the ANS producers. As you will recall, TransCanada has consistently advised your Administration to be wary of independent pipeline proposals that would seek to develop a pipeline without the agreement and

support of the ANS producers You will also recall that TransCanada declined to join various consortiums seeking to develop independent pipelines without ANS producer support

TransCanada recognizes the technical, financial and regulatory challenges of building a single high volume gas transmission system from the North Slope to the Alberta Hub While we are prepared to lead and manage the entire Project, we recognize that our unique expertise lies on the Canadian side of the border We hold significant rights, extensive technical and environmental information and other assets within Alaska, which we are willing to convey to a producer-led Project that involves TransCanada on the Canadian side of the border We remain willing to do that

There is much debate around the specific terms of your agreement with the ANS producers. These are issues to be resolved between the State of Alaska and the ANS producers, and we do not wish to take a position on any specific covenants, except as noted under section 2 of this letter

To the extent that your agreement with the ANS producers would lead to the expeditious construction of the Project, and provided that the matters addressed in section 2 are resolved, we are generally supportive of the gas pipeline agreement which you have reached with the ANS producers We encourage the State of Alaska to resolve the outstanding issues, ratify the agreement and move forward

2 Provisions Regarding Canada, contained within the Gas Pipeline Agreement

Notwithstanding our general support for the agreement you have reached with the ANS producers, TransCanada is concerned that specific provisions within that agreement will lead to difficulty in Canada Specifically, we object to provisions that specify joint State-producer ownership within Canada, as well as provisions that commit the State to an NEB regulatory process within Canada As you know, TransCanada holds valid property rights to build and own the Canadian section of the Project, and we have no option but to defend those rights on behalf of our Canadian shareholders We have invested several billion dollars to pre-build and pre-engineer the Project within Canada, and we will take all necessary actions to protect investments that were reviewed, approved and implemented pursuant to Canada's Northern Pipeline Act

Most recently, TransCanada has developed commercial proposals for the construction, ownership and operation of the Canadian section of the Project, and we continue to discuss those proposals with the ANS producers. We believe commercial negotiations will lead to a reasonable "win-win" outcome in Canada, if the determination of ownership of the Canadian section can be deferred until matters in Alaska are finalized Alternatively, we are prepared to engage immediately to negotiate a commercial framework for the Canadian section, with the intention of including that framework in your agreement with the producers, prior to State ratification

We respectfully ask that you consider amending your agreement with the ANS producers, to either defer determination of ownership in Canada or to reflect the key elements of a commercial agreement with TransCanada Either approach would minimize the risk of delay within Canada

3 The Viability of Independent Pipelines

Your June 22nd letter to Senator Stevens states that neither an "All Alaska Gas Pipeline" nor "independent pipeline proposals" are "economically sound", or "based on the realities of the gas transmission business" The Letter concludes that neither are "viable alternatives" for the movement of ANS natural gas to market

TransCanada owns and operates the largest natural gas transmission facilities in North America, and has been a leader in the gas transmission business for over 50 years We have an enviable track record, having developed successful pipeline projects in Canada, the United States and internationally The independent pipeline commercial arrangement that TransCanada proposed and diligently negotiated with the State over many months is both realistic and economically sound I would note that our proposal was developed at your Administration's request, as a competitive alternative, available at the State's election, to assist the State in unlocking its stranded natural gas reserves

TransCanada has at all times recognized that our independent pipeline proposal could lead to delay and litigation if the ANS producers were unwilling to commit their gas to an independent project. At all times, we stressed the need to seek and obtain ANS producer support for our independent pipeline proposal – in that way, our proposal was different from those put forth by parties who would seek to build an independent pipeline without producer support Our proposal was specifically designed to encourage the ANS producers to participate in the Project by offering them a commercially viable arrangement and an opportunity for ownership in the Alaska portion of the Project

Our independent pipeline proposal was developed and presented to the State as a constructive alternative that remains available to the State in the event the current State-producer arrangement does not proceed Our proposal does reflect the realities of the North American gas transmission business – I would note that the vast majority of North American gas moves to market through independent gas transmission systems The shipping terms and risk sharing mechanisms contained in our proposal were innovative, competitive and economically sound We continue to see our proposal as a realistic alternative in the event you are not able to reach closure on your current arrangement with the ANS producers

In Conclusion

TransCanada looks forward to working with the State of Alaska and the ANS producers to move this important project forward We look forward to discussing, negotiating and concluding a

commercial arrangement for the movement of Alaska gas from the Alaska border to the Alberta Hub, and on to Lower 48 markets. We would welcome your support for the early commencement of commercial negotiations

Governor Murkowski, I would again emphasize that TransCanada remains willing and able to devote its proven expertise, financial strength and proprietary Canadian rights to the development of an Alaska-Canada pipeline that will deliver enormous economic benefits for all Alaskans

Sincerely,

TRANSCANADA CORPORATION

Hal Kvisle
Chief Executive Officer

cc: Senator Ben Stevens
Alaska State Legislators
Mr J. Mulva, ConocoPhillips
Mr R Tillerson, ExxonMobil
Mr B Frank, BP Canada

TransCanada
In business to deliver

TransCanada Corporation
450 - 1st Street S.W
Calgary, Alberta, Canada T2P 5H1

tel 403 920 2011
fax 403 920 2412
email dennis_mcconaghy@transcanada.com
web www.transcanada.com

June 8, 2006

Department of Revenue
Commissioner's Office
P.O Box 110430
Juneau, AK 99811-0430

Attention: William Corbus

Dear Mr. Corbus:

Re: Comments on the May 23, 2006 Draft Alaska Stranded Gas Development Act Contract between the State of Alaska and the Alaska North Slope Producers Submitted by TransCanada Corporation ("TransCanada")

TransCanada appreciates the opportunity (i) to provide comments on the draft Stranded Gas Development Act ("SGDA") contract (the "Gas Line Contract" or the "Contract") between the State of Alaska (the "State") and BP Exploration (Alaska) Inc., ConocoPhillips Alaska, Inc. and ExxonMobil Alaska Production Inc. (the "ANS Producers"), and (ii) to set forth its views on the most effective and expeditious way to place a pipeline for the delivery of Alaska North Slope gas, through Canada, to market (the "Alaska Highway Pipeline Project" or the "Project") into service.

TransCanada recognizes this important next step toward the eventual in-service date of the Project, the commencement of the flow of Alaska North Slope Gas to Alaska and North American markets, and the flow of important revenues to the citizens of Alaska. TransCanada is ready and eager to participate in the ultimate success of the Project by constructing and operating the Canadian segment of the Project, in accordance with valid and exclusive authorizations issued to it by the Canadian Government, and by contributing important assets to the Project, in both Canada and Alaska. If the legitimate interests of TransCanada are respected and accommodated and the important contributions of TransCanada welcomed, everyone will benefit. However, if TransCanada's interests are ignored, the Project will be threatened by protracted litigation and extensive delay that could and should be avoided.

TransCanada believes that the choice is simple for the State of Alaska – it should bring all parties with legitimate interests to the table – the State itself, the ANS Producers, producers of future gas reserves, and TransCanada – to meld the Alaska and Canadian portions of the Project into a single pipeline that is placed in service soon and brings benefits to all.

To that end, TransCanada offers the following comments:

I. TransCanada's Interest

TransCanada has a significant economic and legal interest in the Project:

1. TransCanada's wholly-owned subsidiary, Foothills Pipe Lines Ltd. ("Foothills") holds valid and exclusive certificates, issued under the *Northern Pipeline Act* (Canada) (the "NPA") for the construction and ownership of the Canadian portion of the Project;

2. A general partnership wholly-owned by TransCanada, the Alaskan Northwest Natural Gas Transportation Company ("ANNGTC"), holds the certificate issued by the United States Federal Regulatory Energy Commission under the Alaska Natural Gas Transportation Act ("ANGTA") and under the Natural Gas Act for the Alaska portion of the Project, which regime was enhanced and confirmed under the enabling legislation;

3. TransCanada holds key land and environmental permits in Alaska, including significant Corps of Engineers Clean Water Act wetlands permits, existing right of way over Federal lands along the route in Alaska, and a completed application for right of way over State lands along the route, that is pending, awaiting final decision by the State;

4. TransCanada's rights in Yukon pursuant to the NPA include the easement for the entire route in Yukon, which easement is recognized in the Umbrella Final Agreement amongst the Government of Canada, the Government of Yukon and the Council of Yukon First Nations, acting on behalf of the 14 First Nations of the Yukon;

5. TransCanada has invested 1.7 billion dollars[1] in the so-called "Pre-build Facilities" (the "Pre-build"), which were constructed pursuant to the NPA by Foothills in the early 1980's (and have been expanded pursuant to the NPA five times since, most recently in 1998) as the southern-most segments of the Alaska Highway Pipeline Project in order to allow for the delivery of much needed Canadian natural gas supplies to U.S. markets, pending the flow of Alaska gas;

6. TransCanada is North America's largest gas transmission company, owning approximately 30,000 miles of natural gas transmission infrastructure in Canada and the United States, including approximately two thirds of the take-away gas transmission capacity which is likely to be utilized to transport Alaskan gas from the Alberta hub to markets; and

7. TransCanada has world renowned expertise in the construction and safe, reliable operation of large diameter, cold weather pipe.

[1] All references in this Public Comment to dollars are referenced in Canadian dollars.

2. TransCanada's Facilitation of the Project

TransCanada has worked hard over several decades, and particularly since the gas commodity price has risen to a level that supports the Project, to ensure the readiness of those aspects of the Project within its control To that end, it has (i) constructed and maintained its significant physical assets in the Project; (ii) increased its ownership in the Project both in Canada and in Alaska; (iii) continued to invest in maintaining the Project; (iv) resolved potential impediments to the Project in Canada; and (v) created and supported the development of momentum for the Project in Alaska, Washington, D.C. and in Canada. TransCanada and its subsidiaries have invested 1.7 billion dollars in the Prebuild in Canada, and an additional 0.4 billion dollars to develop the Project, including most recently, 8 million dollars spent on two Alaska initiatives—an application for the right of way easement over State lands along the route, and the development of a contract with the State of Alaska under the Stranded Gas Development Act.

TransCanada believes the Project is of critical importance to Alaska, Canada, and the Lower 48 States. Therefore, TransCanada made the difficult but strategic choice not to oppose the initiative of the ANS Producers to seek U.S. Federal enabling legislation (the "Alaska Natural Gas Pipeline Act" or "ANGPA"). This decision was made notwithstanding that another of TransCanada's wholly-owned subsidiaries, ANNGTC, already holds the certificate for the Alaska portion of the pipeline pursuant to the existing ANGTA law.

This was a deliberate choice made by TransCanada in the spirit of compromise In that same spirit, TransCanada has publicly indicated to the ANS Producers and to others, including the State of Alaska, that it is prepared to forego its rights in Alaska and contribute its valuable assets to the Project, provided that its rights in the Canadian portion of the Project are respected and accommodated in a commercial resolution.

TransCanada has respected the rights of Alaskans to determine the manner in which they choose to develop the Project in Alaska It has taken major steps in Alaska only by invitation of the State Such steps have included TransCanada's application for right of way over State lands along the route of the Project in Alaska, and our application under the SGDA. Both of these steps were taken by TransCanada, and pursued vigorously and at some considerable expense, pursuant to a Memorandum of Understanding between the State of Alaska and TransCanada dated April 19, 2004 which is part of the public record In the spirit of advancing the Project, without reducing the State's flexibility regarding the ultimate outcome, TransCanada agreed to convey any assets granted pursuant to those initiatives, to a third party (such as the ANS Producers or a project jointly pursued by the ANS Producers and the State) entitled to own and construct the Project in Alaska, if that third party would contractually agree to connect the natural gas transmission facilities within Alaska at the Alaska/Canada border with pipeline facilities to be constructed by TransCanada along the highway route in Canada. That offer remains on the table today.

The State's process for reviewing TransCanada's right of way lease application (including the public hearing process) was completed at the end of 2004. The application awaits only a final

decision by the State. Vigorous negotiations between the State and TransCanada to develop a contract under the Stranded Gas Development Act were substantially completed in principle in May of 2005, before the State chose to suspend such negotiations in order to focus its efforts on finalizing the Contract with the ANS Producers. Both of these initiatives have substantially assisted the State in its efforts to progress the Project.

3. *TransCanada's Comments on Ownership and Regulation of the Canadian Portion of the Project*

TransCanada does not choose at this time to comment on the majority of the provisions of the Gas Line Contract that Alaskans must evaluate. Our comments will be confined to the issues that directly affect TransCanada's interest in Canada -- ownership of the Project in Canada and regulation of the Canadian portion of the Project.

The manner in which the Gas Line Contract deals with ownership and regulation of the Canadian portion of the Project will have a significant impact on the success of the Contract in ensuring an early Project. To fully evaluate the Contract, Alaskans must understand; (i) the conflict between the proposed provisions of the Contract and existing law in Canada relating to the Canadian portion of the Alaska Highway Pipeline Project; (ii) the history and status of TransCanada's existing rights to own and construct the Canadian portion of the Project; (iii) our corporate obligation to defend our rights to the Canadian portion of the Project for the benefit of our shareholders; and (iv) the potential for impact on the Project, if those rights are disregarded in the final Gas Line Contract adopted by the State.

I <u>*Ownership*</u>

a. <u>*Contract Ownership Provisions*</u>

The Contract provides for ownership of what is defined in the Contract as the "Alaska to Alberta Project" on an 80/20 basis; 80% to be held in the aggregate by the ANS Producers and 20% to be held by the State. Ownership in the remainder of the Canadian portion of the Project – defined in the Contract as the "Alberta to Lower 48 Project" is provided for in the Contract as follows:

> "The State shall own, directly or indirectly through a State-owned entity, an interest in the Alberta to Lower 48 Project, if newly built or acquired by any Person in which Affiliates of all the Producers have an ownership interest, in a share commensurate with the expected throughput of State Gas, as estimated when that Project Entity is formed."

Ownership in the Alaska to Alberta Project is proposed in the Contract in the same manner as the ownership structure being proposed for the Alaska portion of the Project (the "Mainline", as defined in the Contract). It should be noted that there is no reason that the ownership structure in Canada and Alaska must be the same. In fact, since the Project's original conception, ownership of the Canadian and Alaskan portions of the Project have been different, with ownership in Alaska being held principally by American interests and ownership in Canada being held

principally by Canadian interests. This difference is a fundamental element of the Agreement between Canada and the United States on Principles applicable to a Northern Natural Gas Pipeline (the "Canada/US agreement" or the "Treaty") that allows for a pipeline to transit one natural gas producing nation in order to transport American gas to market.

b. Canadian Law

The aforementioned Contract provisions propose an ownership structure that is inconsistent with the rights conveyed by existing Canadian law to TransCanada's wholly-owned subsidiary, Foothills and the investments made in reliance on those rights. They ignore the fact that the Government of Canada has awarded to Foothills, the exclusive rights to build the Canadian segments of the Alaska Highway Pipeline Project. These rights were granted to Foothills after a lengthy, competitive regulatory proceeding before the National Energy Board (the "NEB" or the "National Energy Board"). (The full history of these rights is described Appendix "A"). Briefly:

- The decision of the NEB in favour of Foothills was enshrined by an Act of the Canadian Parliament in the *Northern Pipeline Act* (the "NPA" or the "Northern Pipeline Act"), which statute specifically names Foothills as the party entitled to own and construct the Canadian portion of the Project;
- The "Canada/US Agreement" was entered into between the Government of the United States and the Government of Canada specifically naming Foothills as the party entitled to own and construct the Canadian portion of the Project;
- The NPA remains in full force and effect in Canada and the Treaty remains in full force and effect in both the U.S. and Canada; and
- Neither the NEB's decision in favour of Foothills nor the NPA contains a "sunset" provision or termination date for the certificate granted to Foothills (as the National Energy Board would normally have done in awarding a certificate).

This is a unique regulatory, legislative and treaty structure, created because of the importance of Canadian ownership of the Canadian segment and the certainty required by the Project. There is no evidence that either the Canadian or the United States governments intend to change this regime in Canada. The Canadian Government has, in the past, reaffirmed the continued vitality and importance of the regime and the U.S. government has maintained that the ownership of the Canadian portion of the Project is a matter for Canadians to decide.

Reopening this structure would adversely affect the Project in two ways. First, the parties and the Governments of Canada and the U.S. would need to negotiate significant issues related to the Project between Canada and the U.S. afresh. Second, any such negotiations would be accompanied by TransCanada's defence of its existing rights, which rights TransCanada would rather use to further the Project. Delay to the Project would be the inevitable and unfortunate result.

c *The Project is Precisely the Project Originally Conceived*

The Project envisaged under the Contract, after much debate and study by the ANS Producers on route selection, is precisely the project that was first envisaged under both the NPA and the Treaty, that being, as defined under the NPA, a "pipeline for the transmission of natural gas from Alaska across Canada along the route set out in Annex I to the Agreement" (which route is the Alaska Highway route). Complications related to the delivery of natural gas from the Mackenzie Valley that existed at the time have now been resolved by a separate Mackenzie Valley pipeline, making the provisions of the NPA that allowed such gas to be addressed in the future, if required, unnecessary. The Foothills certificate, as issued under section 21 of the NPA, relates to precisely the facilities that are required today.

Foothills has already constructed what has now become known as the Pre-build of the Alaska Highway Pipeline Project, under its NPA certificates. These facilities have transported Alberta gas while awaiting the economic conditions under which Alaskan gas would flow. Since the Pre-build was constructed, the Northern Pipeline Agency has approved, and Foothills has constructed, five expansions to these facilities pursuant to the Northern Pipeline Act, the latest of which was awarded in 1998. These investments were made in reliance on the rights awarded to Foothills pursuant to the NEB decision, the NPA and the Canada/US Agreement.

d *The Passage of Time Has Not Undermined the Predicates of the NPA Approvals*

Economics confirm that connecting Alaskan gas to existing natural gas transmission facilities at Boundary Lake, on the British Columbia/Alberta border as contemplated under the NPA routing, creates the lowest pipeline transportation tolls to deliver Alaska gas through Alberta to North American markets. The existence of spare capacity on TransCanada's Alberta System is forecast to reduce to minimal levels the need for any new facilities to transport Alaska gas within the Province of Alberta and beyond. TransCanada, as the owner of the Alberta System, is uniquely positioned to make these lower costs and lower tariffs available to increase netbacks to the ANS Producers, and the State of Alaska as the owner and shipper of royalty gas.

Some parties have argued that the NPA authorized only a narrowly defined project and cannot be used to construct the Project or to make the adjustments necessary to allow the use of the Alberta System to reduce costs and tariffs. This view is simply not consistent with the statutory provisions of the NPA. The Project approved in the NPA did not dictate or freeze design, pipe size, operating pressure or gas volumes. Instead, the NPA is a flexible regime that calls for approval, upon rigorous review, of a design that meets current requirements and provides, as well, for the meeting of modern standards in all areas, including environmental and First Nations consultation. Discretion is specifically granted to the Designated Officer appointed from the NEB pursuant to the Act, to approve the specific plans for the pipeline as they are developed. The Canadian part of the Project would be developed and constructed by TransCanada pursuant to the NPA to meet all modern standards; in the same manner as all Phase I construction (the Prebuild and all five subsequent expansions) has met such modern standards.

e. The Canadian Portion of the Project Should Be Built Pursuant to the NPA

Whether the Alaskan portion of the pipeline is built under either the existing ANGTA regime, which remains valid and was affirmed under ANGPA, or constructed under the Natural Gas Act pursuant to ANGPA, TransCanada's rights to construct the Canadian portion of the Project along the Alaska highway route under the NPA remain valid with respect to the ownership and construction of the Canadian portion of the Project.

The fact that the Project has not yet been constructed is due to the fact that the Project has simply been suspended because, due to natural gas prices, the ANS Producers have taken the gas that was to have been transported on the Project as originally conceived and re-injected it for decades. It is in no way attributable to any fault or omission on the part of Foothills, or as some would suggest, to the age or applicability of the U.S. and Canadian approvals which Foothills holds for the Project. Those approvals, and the rights they provide Foothills, remain valid, intact, and in force.

In summary, the ownership of the Canadian portion of the Project has already been determined by the NEB in favour of Foothills and acted upon by the Northern Pipeline Agency in relation to the Prebuild segment of the Project as recently as 1998. The Contract should not be ratified unless and until ownership of the Canadian portion of the Project is resolved to the satisfaction of Foothills as the holder of the existing certificates in Canada. TransCanada has made clear that it stands ready to collaborate with Alaskan interests to move the Project forward.

II NEB Jurisdiction under the Contract

Article 8.2 of the Contract requires the State and the ANS Producers to "seek and support the exclusivity of ... NEB's jurisdiction as described in Article 8.1 in any agency or court proceeding" relating to the Canadian portion of the Project. No mention is made anywhere in the contract of the existing regulatory regime in Canada or of the Northern Pipeline Agency, which was created specifically and solely for this Project pursuant to the Northern Pipeline Act.

a. Obligation to Seek "Exclusivity of NEB Jurisdiction"

Article 8.2 of the Contract completely disregards the Canadian legislation that was specifically designed to establish both ownership and regulation of the Canadian portion of the Project. The covenant of the parties to seek the exclusive jurisdiction of the NEB for the Canadian portion of the Project either dismisses or ignores the fact that the NEB already has conducted and concluded a competitive proceeding for the right to own and construct the Project, which resulted in a decision in favour of Foothills, as described in Appendix "A". The provisions of the NPA enshrine the regulatory rights of Foothills statutorily, and grant to the Northern Pipeline Agency sole authority over the further development of the Project by Foothills, pursuant to an expeditious, single window regulatory regime. Any residual jurisdiction of the NEB for the initial Project, is confined to the regulation of tolls and tariffs for the pipeline, once the Project is in service, as specifically provided for under the NPA.

In addition, a covenant to seek regulatory approval for the Project in Canada from the NEB is inconsistent with the history of regulatory approvals granted by the Northern Pipeline Agency pursuant to the Northern Pipeline Act for the Pre-build and five expansions.

b *No Canadian Enabling Legislation*

It must be stressed that the Government of Canada has not chosen to enact any legislation in Canada that is parallel to the U.S. ANGPA, nor has it signalled that it has any intention to do so or to repeal the NPA. Enabling legislation was identified by the ANS Producers as a prerequisite for the development of the American portion of the Project. The ANS Producers may also seek similar special legislative and regulatory procedures in Canada.

There can be no assurances that Canada will enact legislation that undermines the NPA or creates a special regulatory structure for the Project. The last formal statement by the Canadian Government reaffirmed the NPA. Furthermore, TransCanada would vigorously oppose any such legislation in Canada and would pursue its legal remedies for compensation for its lost opportunity and other damages.

c *NEB Jurisdiction Does Not Provide Project Expedition*

The covenant of the proposed Contract that would bind the parties to seek the exclusivity of NEB jurisdiction would deny the Project proponents the unique benefits of the expedited, single window regulatory regime of the Northern Pipeline Agency, created under the Northern Pipeline Act, as well as the significant advantage of the existing determination under the NPA regime that the Project is in the public interest in Canada. In addition, it would deny the Project the benefits of the land rights and environmental permits held by Foothills for the Project including, significantly, right of way over Federal lands in Alaska (and potentially State lands, if the pending right of way is issued to Foothills), and the easement across Yukon, which has been acknowledged in the Umbrella Final Agreement by the Council of Yukon First Nations.

The benefits of the NPA are real and significant. Absent the benefits of the NPA, the Mackenzie Valley pipeline project regulatory process is anticipated to take up to 48 months in total, with 12 months of oral public hearings. Even if the NEB could be made applicable to the Project, it does not provide the same unique, expediting regulatory features that are available under the NPA and would have to adjudicate the fundamental issue of the public interest of the Project.

III *Alaskans Will Bear the Consequences of These Regulatory Impediments under the Contract*

The subject of work commitments is dealt with in Article 5 of the Contract. The ANS Producers are required to proceed with "due diligence", but they are relieved of any obligation to proceed by sub-sections (ii) and (iv) of Article 5.5(b) of the Contract, which state:

"(ii) Project planning and other Project development activities may be adversely impacted by Canadian regulatory processes or Canadian aboriginal issues. If the State seeks to terminate this Contract, and delays or other Project impacts are related to Canadian regulatory processes or Canadian aboriginal issues, the Tribunal shall be instructed that in determining whether the Participants have not acted by Diligence that other major pipeline projects have experienced delays in Canada "

"(iv) A Party is not required to enter into a commercial arrangement or settle a dispute with another Person. The failure to take such action may not be used as evidence to support termination of this Contract "

Thus, the State of Alaska will lose the benefit of the work commitments until regulatory issues are resolved in Canada. In sharp contrast, a project in which TransCanada owns the Canadian section can provide the State of Alaska with the benefits of the NPA structure and maintain the continuing obligation of the ANS Producers to pursue their work commitments with due diligence. The provisions of the Contract requiring the State and the ANS Producers to own 100% of the Canadian portion of the Project and obligating them to seek the exclusive jurisdiction of the NEB for the Project in Canada are certain to cause confrontation in Canada, unless changed to accommodate the rights of Foothills under existing certificates Such confrontation can reasonably be anticipated to delay the Project The provisions of Article 5 provide the State with no remedy if that delay occurs. The Project could be stalled indefinitely for the length of the term of the Contract without recourse by Alaskans.

4. TransCanada Must Defend its Rights in Canada

In reliance upon the rights that were bestowed upon Foothills pursuant to the NEB hearing, the Treaty and the NPA and in anticipation of the exercise by Foothills of its rights to complete the Project, TransCanada has invested billions of dollars in:

(i) existing Pre-build infrastructure, for which only half of TransCanada's investment has been recovered to date;

(ii) maintaining permits and existing land rights;

(iii) research and development costs for completion of the Project;

(iv) maintaining aboriginal relations along the route; and

(v) completing acquisitions which have provided TransCanada with a 100% per cent interest in Foothills.

The lost opportunity cost that would result if TransCanada was to be deprived of its right to complete the Project, is significantly higher.

It is not TransCanada's desire to reduce this issue to a legal adjudication of its rights in Canada. However, if the interests of TransCanada in the Canadian part of the Project are not

accommodated in a satisfactory manner through good faith commercial negotiation, TransCanada will be compelled, on behalf of its shareholders, to defend those interests, both in regulatory, judicial and other public forums. Litigation would embroil the Project in delay, which is not in the interests of any of the stakeholders. More importantly, it would have the effect of hardening the parties against the creation of the optimal commercial outcome.

5. TransCanada Remains Ready, Willing and Able to Expedite the Project by Constructing, Owning, and Operating the Canadian Segment of the Project

TransCanada continues to initiate, as it has for some number of years, the negotiation of a reasonable commercial resolution with the ANS Producers in the context of its NPA rights in Canada We have proposed to add significant value to the Project, not only through the conveyance to the Project of certain substantial land rights and environmental permits (including those that are pending in the State of Alaska), but as well through commercial mechanisms for risk mitigation and sharing, appropriate to the relative risk and reward of pipeline investments. Those proposals are well known to the ANS Producers and the State of Alaska.

TransCanada has an enviable track record in bringing major projects in on time and on budget. The contributions that it can make to both the Alaskan and the Canadian sections of the Project will ensure that the Project is delivered faster, better and cheaper than any alternative that excludes TransCanada ,

It is time for the parties to come together to bring this important energy infrastructure project to fruition as soon as possible in a way that will provide the anticipated benefits to both Canada and the United States and to meet the growing demands in North America for gas supply. Alaskans should insist on amendments to the Contract or should set aside the Contract until the parties are finally brought together.

TransCanada looks forward to working with the State of Alaska, the ANS Producers and others to achieve, at long last, the agreements and cooperation needed to enable the Project to take its next steps.

Yours truly,

Dennis McConaghy
Executive Vice-President,
Pipeline Strategy and Development

Appendix "A"
Historical Background on TransCanada's Rights under the Northern Pipeline Act

a. *The NEB Proceeding*

The principal objectives of the initial NEB process were to establish whether or not to permit the construction of a gas pipeline in the Western Arctic, and if so, to determine the Canadian routing for the Project, the successful Project proponent, and whether the Project met the NEB statutory standard of being in the "public convenience and necessity". A process to determine essentially the same issues for the American part of the pipeline was unfolding in the United States, where an additional option of an "all-American" route was considered. Without complementary findings on these critical issues on both sides of the border, the pipeline could not have proceeded to the next stage of international agreement.

The NEB found in favour of the Alaska Highway route, it found in favour of Foothills as the party entitled to hold the ownership and development rights for the Project and it resulted in a finding that the Project met the NEB's standard of public convenience and necessity. Shipping agreements had not yet been entered into for the Project, pending the establishment of the unique bilateral framework between Canada and the United States that was required to establish the benefits to Canada of a project that would transit its territory. Pending the commitment of natural gas volumes to the pipeline, it was not possible in the initial NEB proceeding to definitively finalize all matters such as those related to size and design The framework for finalizing those matters later was therefore explicitly created under the NPA

b *The Canada/US Agreement and the Enactment of the NPA*

Following the NEB hearing, a bilateral agreement relating solely to the Project, was then entered into between the Governments of Canada and the United States which specifically recognized the rights of Foothills to own and construct the Project (the "Canada/US Agreement" or the "Treaty", which was made part of the NPA, as Schedule I of that Act). The specific recognition of Foothills' rights within the Canada/US Agreement is a significant fact. It would not have been necessary to enshrine an acknowledgement of Foothills' rights within the Treaty, if the selection of that particular Canadian entity for the Canadian portion of the Project had not been an important outcome for the Canadian negotiators of that Treaty The Treaty "evergreens", allowing for termination after a period of 35 years, only in the event that one of the Governments provides at least one year's notice to the other of a desire to terminate.

It was not until the NEB hearing had been concluded, and the Treaty entered into, that the NPA was enacted. The NPA statutorily enshrined the selected routing, and the successful proponent, being Foothills. It also created the single window regulatory regime of the Northern Pipeline Agency that would apply to the approval of all matters required for the further development of the Project. The regulatory regime created pursuant to the Northern Pipeline Act was designed to be flexible enough to allow for a rigorous review of all such matters, including environmental matters, subject only to not revisiting the fundamental finding that the Project is in the public interest and will proceed. Further, there was no "sunset" or expiry date placed on the certificates granted to Foothills by either the NEB

(which would have been the norm) or under the NPA, doubtless in recognition of the fact that the commitment of natural gas volumes to the pipeline had not yet been made.

Subsequent to the completion of the NEB hearing, the execution of the Treaty and the enactment of the NPA, the parties that had competed in the hearing and lost did not choose to pursue any legal or regulatory remedy to challenge the result. Such parties recognized the finality of the outcome, not only as evidenced by the NEB decision, but as evidenced as well by the highly unusual enshrining of the rights of Foothills in both the Canada/US Agreement and the Act. Property rights had been bestowed, a unique regulatory regime had been created which would govern the development of the Project indefinitely, and the matter was closed.

c. *Complementary Applicability of Two Regulatory Regimes*

The two processes of the NEB and the Northern Pipeline Agency are integrally related for this unique Project. Separate jurisdiction of the two regulatory regimes over different aspects of the Project is recognized in the NPA framework, and the jurisdiction of the two regimes is complementary in design. The NEB presided over the original hearing of this matter. It will preside over the Project again in relation to matters related to the approval of tolls and tariffs, once the Project has been constructed and it will preside over any approvals of subsequent expansions. The Northern Pipeline Agency has jurisdiction over the development of the initial construction of the Project, which involves such unique bilateral aspects and requirements for expedition that it is codified statutorily separately from the standard NEB processes.

Administratively, the regimes of the NPA and the NEB are linked. The NPA provides that the designated officer appointed to administer the Northern Pipeline Agency will be a member of the National Energy Board. Subsection 5 of Section 12 of the NPA, provides for the secondment to the Northern Pipeline Agency, at the Minister's direction, of any officers and employees from any department or agency of the Government of Canada.

The drafters of the NPA framework created a unique regulatory regime that is practical, and at the same time, nothing less than visionary, for the Project.

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STATE OF ALASKA

SARAH PALIN, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

P.O. BOX 110400
JUNEAU, ALASKA 99811-0400
TELEPHONE: (907) 465-2300
FACSIMILE: (907) 465-2389

The Honorable Ralph Samuels
House Majority Leader
Alaska Representative
State Capitol, Room 204
Juneau, AK 99801-1182

March 23, 2007

Dear Representative Samuels:

Attached to this letter are memoranda prepared by Greenberg Traurig prior to the introduction of AGIA.

As you'll recall, the January 17, 2007 agreement between the administration and legislature sets out the conditions under which written communication between the Administration and Greenberg prior to the AGIA's introduction are to be handled.

> "Prior to the introduction of the legislation, GT's work product provided to the Administration would not be disclosed to the legislature. After the legislation is introduced, GT's written communications to the Administration would be provided to the Legislature by the Administration (subject to any confidentiality requirements deemed appropriate by the administration) and GT would be free to advise the Committee regarding that legislation."

Consistent with that agreement, the legislature may release the documents attached to this memo as it desires, with the understanding that the administration and legislature are waiving their right to attorney/client privilege with respect to the attached material only.

Greenberg has also produced a number of documents relevant to AGIA since the bill's introduction. Because the administration and legislature have common interests and have both retained Greenberg for similar tasks related to AGIA, the administration will also provide access to written communications generated by Greenberg related to AGIA produced after AGIA's introduction. However, because these documents may raise issues of protected attorney/client communications, if the legislature desires the public release of any particular post-introduction documents, please contact me to discuss whether release is appropriate. The administration will, of course, endeavor to provide the widest dissemination of relevant analyses concerning AGIA consistent with protecting the attorney/client privilege.

As I described above, although the agreement only applies to documents prepared by Greenberg prior to the introduction of AGIA, the administration is prepared to provide documents produced by Greenberg after introduction, but in a manner that does not inadvertently waive privileges.

Please let me know if you have any questions or comments.

Sincerely,

Patrick S. Galvin
Commissioner

Enclosures: Alaska Correspondence

cc: Larry Ostrovsky, Assistant Attorney General, Department of Law, Alaska
Don Shepler, Attorney, Greenberg and Traurig

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ATTACHMENT

Attachment 1

Greenberg Traurig

Memorandum

TO: Larry Ostrovsky, Chief Assistant Attorney General

FROM: Phillip C. Gildan
Marvin A. Kirsner

DATE: February 7, 2007

RE: Alaska Gasline Incentive Act: Commerce Clause Issues

PRIVILEGED AND CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION AND ATTORNEY WORK PRODUCT

You have requested we review the potential impact of the United States Constitution Commerce Clause, U.S. Const. Art. § 8, cl. 3 (the "Commerce Clause"),on potential options to incentivize the construction of a natural gas pipeline that could be considered for inclusion in an Alaska Gasline Incentive Act ("AGIA").

Over the last thirty years most States have enacted various laws creating incentives for businesses to locate, remain, and expand in the State ("Business Incentives"). Most States have also enacted laws imposing State hire and State resource obligations ("Local Preferences") on government related or funded infrastructure projects. Each of these laws potentially have an impact on interstate commerce, with such potential implicating the Commerce Clause.

In general terms, the Commerce Clause authorizes Congress to regulate commerce among the States, and implicitly limits States from enacting laws that impede interstate commerce. Generally States may not levy discriminatory taxes on interstate economic activity, with taxes broadly to include not just tax levies, but tax exemptions or their equivalent. Despite this broad scope, a body of Federal case law has developed over the last 30 years that has permitted certain Business Incentives and Local Preferences, and has defined what is impermissible under the

Commerce Clause. The following sets forth a brief discussion of certain of the more recent Federal cases addressing these Commerce Clause standards and how they may inform the crafting of Business Incentives and Local Preferences for the AGIA.

I. *Cuno v. DaimlerChrysler, Inc.*, 386 F. 3d 738 (6th Circuit 2004)

The State of Ohio adopted an investment tax credit against the state's corporate franchise tax if a business bought machinery and equipment and installed it at a business location in Ohio. DaimlerChrysler sought to utilize the investment tax credit, together with a property tax exemption from the City of Toledo and two local school districts. Ohio taxpayers challenged the investment tax credit and the property tax exemption as violating the Commerce Clause because they had the effect of "coercing businesses already subject to the Ohio franchise tax to expand locally rather than out-of-state." *Id.* at 743. The Sixth Circuit Court of Appeals agreed as to the investment tax credit and disagreed as to the property tax exemption. The Court approved use of a property tax exemption because the favorable tax treatment was "related to the use or location of the property itself." *Id.*, at 746. Notably, in invalidating the investment tax credit, the Court compared the invalid tax credit with a direct state subsidy, suggesting that a direct subsidy from the state would not have violated the Commerce Clause because it doesn't regulate interstate commerce through the state's power to tax. While not an issue before the Court and thus not binding as case law precedent, there appears to be strong indication that if the issue of a direct subsidy were to come before the federal courts, that direct subsidies would likely be upheld as not violative of the Commerce Clause.

II. *DaimlerChrysler, Inc. v. Cuno*, 126 S. Ct. 1854 (2006)

DaimlerChrysler appealed the Sixth Circuit Court's opinion above (Cuno I) to the Supreme Court. The Supreme Court reversed the Sixth Circuit Court's decision on procedural standing grounds, without getting to the merits of the Commerce Clause challenge (Cuno II). While this decision restored the DaimlerChrysler tax credit, one could anticipate that the Sixth Circuit Court would again invalidate an incentive tax credit program under the Commerce Clause if a party with standing were to challenge it. The notable aspect of this decision is the elimination of a class of potential challengers to a business incentive tax credit program. The Supreme Court ruled that neither state nor local taxpayers had standing to challenge the Ohio investment tax credit. The implication from the Court's ruling was that only businesses directly impacted by the discriminatory tax credit (presumably business competitors who did not receive the reduced cost benefits of the tax credit) would have standing to raise the Commerce Clause challenge.

III. *New Energy Co. of Ind. v. Limbach*, 108 S. Ct. 1803 (1988)

In another Ohio business incentive program, Ohio had enacted a tax credit against the state motor vehicle fuel sales tax for each gallon of ethanol sold if the ethanol was produced in Ohio. This time an out-of-state ethanol competitor brought a Commerce Clause challenge, and accordingly the Court reached the merits of this claim. The Supreme Court agreed with the competitor that the incentive tax credit violated the Commerce Clause. It stated the standard for review as, "[t]his "negative" aspect of the Commerce Clause prohibits economic protectionism-that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors. . . .Thus, state statutes that clearly discriminate against interstate commerce are routinely struck down . . . unless the discrimination is demonstrably justified by a valid factor

unrelated to economic protectionism. . ." *Id.*, at 1807 (citations omitted). The Court further suggested that incentives utilizing the state's taxing power would have a difficult time passing muster, "[o]ur cases leave open the possibility that a State may validate a statute that discriminates against interstate commerce by showing that it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives. . . . This is perhaps just another way of saying that what may appear to be a "discriminatory" provision in the constitutionally prohibited sense-that is, a protectionist enactment-may on closer analysis not be so. However it be put, the standards for such justification are high." *Id.*, at 1810. Notable in this decision is the Court's discussion about subsidies versus tax credits: "[d]irect subsidization of domestic industry does not ordinarily run afoul of that prohibition [interference with interstate commerce]; discriminatory taxation of out-of-state manufacturers does." *Id.*

IV. *White v. Massachusetts Council of Construction Employers, Inc.*, 103 S. Ct. 1042 (1983)

This case involves a challenge to a Local Preferences law enacted by the Mayor of the City of Boston for all construction projects funded in whole or in part by city funds or funds the city had authority to administer under federal grant programs for urban development. While the Court rejected a Commerce Clause challenge related to those projects funded by city funds under a "market participant" exception, the notable aspect of the case was the Court's decision rejecting the Commerce Clause challenge for those federally funded projects the city was administering under the federal grant programs. Here the Court announced a different exception, stating, "[w]here state or local government action is specifically authorized by Congress, it is not subject to the Commerce Clause even if it interferes with interstate commerce." *Id.*, at 1047. Accordingly, if Congress

enacts a law that would allow or be compatible with local preferences (or arguably Business Incentives), then the State or local government enacting such a program would not be subject to a Commerce Clause challenge.

This aspect of the Court's decision may have implications to the potential incentive options under AGIA based upon the provisions of the Alaska Natural Gas Pipeline Act enacted by Congress ("ANGPA"). Arguably, ANGPA represents Congress's intent to incentivize the construction of the natural gas pipeline. Such intent, under the ***White*** decision, could be enough to justify most if not all Business Incentive options that could be envisioned for AGIA. Certainly, the more direct statements of Congressional intent in ANGPA regarding Local Preferences would appear to be sufficient to support most if not all Local Preferences options for inclusion in AGIA. As no case interpreting ANGPA has been brought to date, there remains the risk that a Court would not reach the same interpretation of the ***White*** decision as to a potential Commerce Clause challenge to potential incentive options eventually enacted under AGIA.

Conclusion

Based on the apparent current state of the case law as summarized above, it appears that a cash grant incentive program, properly crafted legislatively, would have the best likelihood of avoiding a potential Commerce Clause challenge. While we have found no decisions directly on point, the case law discussion regarding grant programs would appear to apply equally to a loan incentive program. Given the Congressional statements of intent in ANGPA to incentivize the development of a natural gas pipeline, good arguments exist under White to defend a properly crafted pipeline development/operations tax credit incentive program against a Commerce Clause challenge. However, while the Supreme Court in Cuno II has eliminated general tax-payer

Commerce Clause challenges to a tax credit incentive program, an Tax Credit incentive program enacted by the State could still face a Cuno I based Commerce Clause challenge from a competing pipeline company or other specially impacted business not able to benefit from the incentive program.

The foregoing conclusions reflect our best judgment on the Commerce Clause implications associated with Business Incentive and Local Preference program options. There can, however, be no guarantee that the courts or the appropriate authorities will agree with these conclusions if a challenge is brought, nor that any of the matters on which we relied will not change.

Attachment 2

Greenberg Traurig

Memorandum

TO: Larry Ostrovsky, Chief Assistant Attorney General

FROM: Phillip C. Gildan and Tim Wolfe

DATE: February 7, 2007

RE: Follow-up to U.S. Senator Ted Stevens Comments on Alaska Natural Gas Pipeline Project Development

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On Monday, February 6, U.S. Senator Ted Stevens commented on the recently released FERC report that suggested the State's schedule for developing the Alaska Natural Gas Pipeline had "slipped considerably." He was quoted as stating, "I'm very concerned about it; it concerns me in that it lays out a problem that can't be solved here in Washington.." Senator Stevens has emphasized previously the Federal Government's continued strong support for the Natural Gas Pipeline project and the importance of the project National Security, and his continuing pledge to assist the State in its efforts to complete an agreement with all deliberate speed.

Towards that end, this memorandum sets forth a number of suggestions for Federal Government initiatives that could further enhance the economics and certainty of a Pipeline project, and work hand in hand with the incentive options proposed for the Alaska Gasline Inducement Act (AGIA).

Suggestion 1. Federal Authorization of Pipeline Project Finance as Tax-Exempt Bonds/Exempting Project Bonds from Private Activity Bonds State Cap

Under the current Federal Tax Code, debt financing for a Pipeline Project would not qualify for tax-exempt status on interest paid on the debt portion of a financing of a Pipeline Project (with the possible exception of a government-entity sponsored project) . If a Pipeline Project debt financing could be qualified for tax-exempt status, the cost of debt might be significantly reduced, thus improving the economics of the Project. For example, under an 80% debt to equity financing program, such reduction in interest payments, due to the difference in

interest rate between taxable and tax-exempt debt, could significantly reduce the overall cost the Project.

To authorize tax-exempt status on a Pipeline Project debt financing, possible suggested changes to the Federal Tax Code are set forth below. The first change (A) would include the project within the definition of exempt facility bonds. The second change (B) would remove the state private activity bonds volume cap from applying to the project. The third change (C) would exempt the project from restrictions on private activity bond issuance necessary given the multi-national/jurisdiction elements of the project.

A. Amend TITLE 26, Subtitle A, CHAPTER 1, Subchapter B, PART IV, Subpart A, Sec. 142 of the Federal Code to add natural gas pipeline projects to section 142(a) and a new section 142(n):

> (a) General rule
> For purposes of this part, the term "exempt facility bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide -
>
> (16) Alaska natural gas pipeline projects.
>
> (n) Natural Gas Pipeline Projects.- For purposes of subsection (a)(16), the term "Alaska natural gas pipeline project" means a qualified infrastructure project as defined in 15 U.S.C. 720n(g)(4), including facilities located outside of the governmental unit or the United States.

B. Amend TITLE 26, Subtitle A, CHAPTER 1, Subchapter B, PART IV, Subpart A, Sec. 146, to add an Alaska natural gas pipeline project as an exception to the private activity bond state volume cap.

> g) Exception for certain bonds
> Only for purposes of this section, the term "private activity bond" shall not include -
>
> (3) any exempt facility bond issued as part of an issue described in paragraph (1), (2), (12), (13), (14), (15) or (16) of section 142(a)

C. Amend TITLE 26, Subtitle A, CHAPTER 1, Subchapter B, PART IV, Subpart A, Sec. 147(f) to add a new paragraph (5).

(5) Special Rule For Approval Of Alaska Natural Gas Pipeline Projects.- In the case of an Alaska natural gas pipeline project bonds issued for facilities located inside or outside the State issuing the bonds (or in which the governmental unit issuing the bonds is located) or outside of the United States, the State issuing the bonds (or in which the governmental unit issuing the bonds is located) shall be deemed to be the only governmental unit having jurisdiction over such facilities for purposes of this subsection.

Suggestion 2. Clarification and Enhancement of the Federal Loan Guarantee Program.

From the round-table discussions with the Administration and the Producers during last year's Legislative Special Sessions, it became apparent that certain important elements of the Federal Loan Guarantee program authorized under 15 U.S.C. 720n, remain uncertain, which uncertainty has diminished the potential utility and economic benefit of such program and could negatively impact structural elements of a proposed Pipeline Project. Elimination of this uncertainty and further clarification of the Loan Guarantee program benefits could enhance the project economics and provide greater flexibility regarding Pipeline Project structural elements. Possible suggested clarifications at the Federal level are set forth below:

A. Amend 15 U.S.C. 720n(f) to read as follows:

(f) Authorization of appropriations

There are authorized to be appropriated such sums as may be necessary to cover the cost of loan guarantees under this section, as defined by section 661a(5) of Title 21. Such sums shall remain available until expended. The Secretary shall not charge or pass-through the cost of loan guarantees under this section as a condition for issuing a Federal guarantee instrument.

B. Amend 15 U.S.C. 720n(b)(3) to read as follows:

(3) The Secretary shall not require as a condition of issuing a Federal guarantee instrument under this section any contractual commitment, guarantee or other form of credit support of the sponsors or project owners (other than equity or non-Federal guaranteed debt contribution commitments in amounts not more than the percentage of total capital costs of the project not covered by a Federal debt guarantee under this section), or any throughput, minimum volume, or other guarantee from prospective shippers greater than such guarantees as shall be required by the project owners.

Attachment 3

Greenberg Traurig

Memorandum

TO: Larry Ostrovsky, Chief Assistant Attorney General of the State of Alaska

FROM: Phillip C. Gildan
Marvin A. Kirsner

DATE: February 7, 2007

RE: Constitutional and Statutory Questions Raised As to Alaska Gasline Incentive Act: Can AGIA Propose to Provide Loans to Qualified Applicants? Can Loans be Provided Interest-Free? Can AGIA Propose to Provide Cash Payments to Qualified Applicants?

PRIVILEGED AND CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION AND ATTORNEY WORK PRODUCT

You have requested we review a number of questions arising out of the State of Alaska's ("State's") review of potential incentive options that could be available for inclusion in a Alaska Gasline Incentive Act ("AGIA"). The issues you have presented fall into two broad categories:

(1) whether, and under what circumstances, the State could provide loans (including interest-free loans) or direct cash payments as incentives ("Incentive Program") to applicants proposing to construct a pipeline(s) that would deliver natural gas from the Alaska North Slope to Lower 48 markets, in-State markets or overseas markets ("Pipeline Project"); and

(2) how such Incentive Program loans or direct cash payments would be treated for Federal Tax Purposes by the recipient of such loans or direct cash payments.

State Constitutional/Statutory Issues

A number of State Constitutional and Statutory provisions ("Laws") could impact the Incentive Program options listed in Issue 1 above. In summary, it appears that the Laws should not

present an impediment to utilization of loans or cash payments as part of an Incentive Program, provided appropriate legislation is enacted by the Legislature and approved by the Governor. A more detailed discussion of the impacts of the Laws is set forth below.

Constitutional Provisions

Article IX, § 6 of the Alaska Constitution provides: "No tax shall be levied, or *appropriation of public money made, or public property transferred, nor shall the public credit be used*, except for a public purpose" (emphasis added). This constitutional limitation applies as the use of interest free loans or direct cash payments to a private entity to incentivize the construction of a Pipeline Project would require the appropriation of public money (loan proceeds or cash payments), the transfer of public property (cash payments) and the use of public credit (loan proceeds). Accordingly, a public purpose for the use of loans and cash payments as part of an Incentive Program must be identified to overcome this constitutional barrier.

One such statement of public purpose for an Incentive Program that could potentially be utilized is set forth in Article XIII, § 2 of the Alaska Constitution which provides: "The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people." Presuming that the Alaska Legislature enacts appropriate and defensible preliminary findings concerning the public purpose of the Incentive Program, the public purpose requirement of the Alaska Constitution should be satisfied.

Statutory Provisions

While the provisions of Article IX, § 6 of the Alaska Constitution appear not to pose an insurmountable barrier to enactment of the Incentive Program, an existing Alaska statutory

provision could facially impose an additional barrier to the Incentive Program. AS 37.10.085 appears to raise a statutory limitation to the State providing loan proceeds or cash benefits to a private entity, notwithstanding a public purpose. It provides in pertinent part:

> (a) Except as provided in (c) or (d) of this section, *neither the state nor a political subdivision of the state may*
> (1) make a subscription to the capital stock of a corporation;
> *(2) lend its credit for the use of a corporation; or*
> *(3) borrow money for the use of a corporation.*
>
> . . .
>
> (d) This section does not apply to
> (1) the financial assistance program established under AS 37.17.500 - 37.17.690; or
> (2) investments of the assets of the public employees' retirement system established under AS 39.35 or the teachers' retirement system established under AS 14.25, to the extent the investments are made in the stocks, bonds, and other securities of
> (A) a corporation licensed under AS 10.13; or
> (B) a corporation attempting to become licensed under AS 10.13 if the corporation intends to use the proceeds to fulfill the tasks necessary to become licensed under AS 10.13.
> (emphasis added)

While the Incentive Program does not at this point deal with a subscription to the capital stock of a corporation, a broad interpretation of AS 37.10.085(a)(2) and (3) could implicate the Incentive Program. However, as can be seen from AS 37.10.085(d), the Legislature has previously created a number of exemptions to the prohibition AS 37.10.085(a), and presumably any proposed AGIA legislation could include an additional exemption for the Incentive Program. [Notably, AS 10.13, referenced in AS 37.10.085(d)(2), the Alaska BIDCO Act, establishes an existing loan and financial assistance program for private entities not unlike that proposed for consideration in the Incentive Program.]

Aside from AS 37.10.085, there does not appear to be any other overriding statutory provisions that would negatively impact the use of loan proceeds or cash payments as part of an

Incentive Program, except, perhaps, AS 43.82, the Alaska Stranded Gas Development Act. It is possible that the Legislative findings that would support the enactment of AGIA and the Incentive Program could be contradictory in whole or in part to the Legislative findings supporting AS 43.82. To avoid confusion and the potential for interpretive ambiguity, it may be prudent to synchronize the findings of the two Acts or perhaps repeal such provisions of AS 43.82 that are no longer applicable or would not be beneficial after enactment of AGIA.

Our initial review likewise did not uncover any obvious State statutory prohibitions against providing an "interest-free" loan option for the Incentive Program (although we have not reviewed State regulations which could potentially be pertinent to the issue). From a practical perspective, however, providing for repayment of an incentive loan without an accrual of interest, could alternatively be viewed as the State providing a "grant" to the private entity of the interest that would otherwise be due on a traditional loan (and as discussed below, it is possible that the Internal Revenue Service would so treat it for tax purposes). Seen from this perspective, the "grant" of interest should be treated like any other business development grant program that the State would put in place, provided again that sufficient Legislative findings and exemptions were enacted as above.

Another area that could raise a potential issue is the funding source for the Incentive Program, *i.e.*, where will the money come from to fund the program loans and cash payments (*e.g.*, dedicated tax revenues, general fund surpluses, bond proceeds, Alaska Permanent Fund, etc.). Depending on the source of the money, a number of other statutory provisions could be implicated. While examination of sources of funding is outside the scope of our current review, we would

recommend the State's bond counsel review these potential funding sources and any statutory limitations that may be attendant to the use of such sources.

Finally, with respect to Issue 1, as referenced above, the Alaska BIDCO Act, and the provisions of AS 37.17.500 - AS 37.17.690, may provide a useful template for crafting the administrative procedures attendant to an Incentive Program utilizing loans and cash payments.

Tax Treatment of AGIA Grants

We received a copy of the January 16, 2007, Black & Veatch Memorandum to Antony Scott from John Rohrbach re: Corporate Tax issues related to Alaska Gasline Inducement Act ("B&V Memorandum"). We were requested to comment on the B&V Memorandum regarding AGIA incentives received by companies proposing to construct a natural gas pipeline project ("Pipeline Entity"), and provide any additional insights on the issues the B&V Memorandum raised. A new development has occurred since the B& V Memorandum was prepared which requires additional discussion.

Many ventures that have received government grants have relied on Section 118 of the Internal Revenue Code to take the position that such government grants are not reportable as taxable income. As noted in the B&V Memorandum, Section 118 is the provision allowing tax-free contributions to the capital of the corporation. As also noted in the B& V Memorandum, the case law has allowed tax free treatment for many types of government grants in cases where the governmental entity giving the grant is not a shareholder of the corporation receiving the grant. Based on these cases, partnerships and limited liability companies which are pass-through entities for tax purposes, have also relied on Section 118 to avoid paying tax on governmental grants, even though they are not taxed as a corporation.

However, the IRS recently announced that it will disallow Section 118 treatment for receipt of non-shareholder contributions to partnerships, joint ventures and limited liability companies. The announcement, contained in LMSB-04-11 06-0 16 (dated December 28, 2006), states that Section 118 only applies to corporations, and therefore is not applicable to pass-through entities, such as

partnerships and limited liability companies. (See copy of LMSB-04-1106-016 attached as Appendix A.)

This means that the IRS would likely challenge Section 118 tax-free treatment on the receipt of government grants if a Pipeline Entity is structured not as a corporation, but as a partnership or limited liability company. [Note that the Pipeline Entities under Governor Murkowski's proposed Fiscal Contract were limited liability companies]. Because such entities are pass-through entities for tax purposes and have the benefit of a corporation's liability protection for its members, these entities have become an entity of choice in major infrastructure projects.

This new announcement from the IRS directed at non-corporate pass-through business entities, could be quite problematic for the potential Pipeline Entities that the State is seeking to target with AGIA incentives. Having to recognize an incentive grant as ordinary income for Federal tax purposes would undermine the potential value of a grant. Of course, from a practical perspective, any non-corporate entity accepting an incentive grant may likely have significant tax losses from early development expenses to potentially offset such income recognition, but the tax impact would become a factor in the business entity's Project economics analysis.

If, on the other hand, to deal with the IRS pronouncement, potential Pipeline Project joint venturers, (such as the major Alaskan oil companies, a group of independent pipeline companies, or a combination of the such entities and other financial partners (the "Investment Group")), form their entity as a corporation, then such corporation could receive a grant from the State that would be non-taxable as a contribution to capital by a non-shareholder under Section 118, as set out in the B& V Memorandum. However, in such a case, the Investment Group which would be the shareholders of the Pipeline Entity would not be able to file consolidated returns with the Pipeline

Entity, because to file a consolidated return, the filing company must own at least 80% of a subsidiary in order to file a consolidated return. If each member of the Investment Group owns a proportionate share of the stock of the Pipeline Entity, none would satisfy this 80% requirement for filing a consolidated return (which generally accounts for the use of limited liability companies for joint participation in major infrastructure projects). Thus, having to utilize a corporate entity to qualify for the Section 118 treatment would make a grant significantly less meaningful as an incentive.

Alternatively, it might be possible to structure a transaction where each member of the Investment Group forms its own wholly-owned pipeline subsidiary company. The state would award grants to each of the pipeline subsidiary companies. Since each of the pipeline subsidiary companies would be corporations, the benefits of Section 118 should be available to avoid payment of federal income taxes on the award of the grant. Each pipeline subsidiary company would, in turn, form a limited liability company, and contribute to the capital of the limited liability company its share of the state grant, plus other required capital contributions. The limited liability company, would then construct the gas pipeline. If this proposed structure is practical from a business prospective, then it would need further detailed review to have a reasonable certainty that this such structure would be accepted by the Internal Revenue Service. It is possible that the IRS might argue that the "Step Transaction Doctrine" would apply in such a case and treat the grant as a contribution directly from the State to the limited liability company, and disallow Section 118 treatment.

The IRS announcement could also be problematic for another set of potential participants in a Pipeline Project that the State may determine to target, private hedge funds. Private hedge funds

have recently been increasing their participation in major public infrastructure projects. Such private hedge funds are, for the most part, structured as either partnerships or limited liability companies that are pass-through entities and not treated as a corporation for tax purposes. Much of the economic benefit of an incentive program could be lost to such project participants if grants are treated as taxable income, absent utilization of a restructured program that would pass IRS muster, as discussed above.

Tax Ramifications From Interest Free Loans

If the Incentive Program is structured as an interest-free loan to the Pipeline Entity, then the federal income tax ramifications of below-market interest loans should be considered. These rules are found in Section 7872 of the Internal Revenue Code (the "Code"). This Code provision provides that certain types of loans (known as "7872 Loans") must provide a minimum yield. The minimum yield is known as the applicable federal rate or AFR. If a 7872 Loan does not provide for a yield at least equal to the AFR, interest will be deemed to have been paid by the borrower to the lender. In order to explain the fact that interest was not in fact paid, the Code deems a transaction[1] to have occurred with the interest essentially having been paid back from the lender to the borrower. The treatment of the deemed transaction back depends on the type of 7872 Loan. There is an exception from the application of the rules contained in Section 7872 for loans from a state, but only if the loan is a "type made available under a program of general application to the public."

Section 7872 Loans include compensation related loans.[1] A compensation related loan includes a loan between an independent contractor and the person on whose behalf the services are

[1] A corporation/shareholder loan is also subject to Section 7872. If the Pipeline Entity is structured as a corporation, there is a possibility that the IRS might try to classify the loan as a corporation/shareholder loan, even though the State might not technically be a shareholder. The IRS could conceivably make the argument that the nature of the State's interest in the Pipeline Entity could elevate the State to the position of a quasi-shareholder, if the final agreement gives

performed. Depending on the conditions to obtain a loan, it is possible that the IRS could take the position that an interest free loan to the Pipeline Entity is a compensation related loan. Even if the loan is not deemed a compensation related loan, there are two catch-all provisions that could cause the Section 7872 imputed interest rules to apply: (i) the tax avoidance loan rules and (ii) the significant effect rules.

A tax avoidance loan under Section 7872 is a below market interest loan where one of the principal purposes of the arrangement is the avoidance of any federal tax. A loan will be considered to have a principal purpose of tax avoidance where a principal motivation in structuring the transaction as a below market loan is to reduce the tax liability of the lender or borrower. If the Pipeline Entity is structured as a partnership or limited liability company, then the IRS could assert that the interest free loan is a tax avoidance loan. It is possible that the recent I.R.S. announcement indicating it will not allow Section 118 tax-free contribution to capital treatment for government grants to partnerships or LLC's is signaling an I.R.S. intent to crack down on tax-free treatment of all types of government grants. If this is the case, the I.R.S. might assert that an interest free loan to the Pipeline Entity as a tax avoidance loan.

A significant effect loan under Section 7872 is a loan arrangement that may have a "significant effect" on the tax liabilities of the parties involved. The IRS has been given the authority to publish regulations that would characterize an arrangement as a significant effect loan.

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the State some type of corporate oversight or equity rights. The State would need to carefully review the proposed structure of the relationship between the Pipeline Entity and the State once the structure has been determined, to analyze the risks of re-characterization as a corporation/shareholder loan. If the interest free loan is classified as a corporation/shareholder loan, then the deemed payment from the State to the Pipeline Entity would be characterized as a contribution by the State to the Pipeline Entity as a contribution to capital. This deemed contribution to capital should not be treated as taxable income as a contribution to capital as discussed in the B&V Memorandum, if structured properly. However, it would be necessary to carefully review the proposed Pipeline Entity and interest free loan structure in order to be certain of this result.

It is possible that the I.R.S. might publish regulations classifying interest free loans from government entities for economic development purposes as a "significant effect loan." In such a case, the proposed loan to the Pipeline Entity could become a 7872 Loan. It is far from clear how the deemed payment from the State to the Pipeline Entity would be characterized if the loan failed to be treated as a compensation related loan, but was treated as a significant effect or a tax avoidance loan.

If the loan is characterized as a compensation related loan (or one of the other types of loans subject to Section 7872), then the tax consequences to the owners of the Pipeline Entity would depend upon whether the loan is treated as a demand loan or a term loan. A loan with a definitive term will not be treated as a term loan if the benefits of the interest arrangements are (i) not transferable and (ii) conditioned on the future performance of substantial services by the borrower. If the loan is treated as demand loan under this rule, the foregone interest would be treated as a payment to the Pipeline Entity for services (or something else), followed by an interest payment to the State, in each year. These amounts will generally match but, as of the current time, there are substantial limitations on the ability of a corporation to deduct interest and the additional interest expense could have foreign tax credits consequences.

If the loan is treated as a term loan, the difference between the amount loaned and the present value of the obligation to repay the loan is treated as compensation (again, or something else) to the service provider in full in the year that the loan is made. This compensation would then offset by interest deductions over the duration of the term loan. Here, the owners of the Pipeline Entity would have a timing disadvantage: they would be required to include the full compensation element in income in the year that the loan was made and would have deductions in the future.

Again, there are substantial limitations on the ability of a corporation to deduct interest and the additional interest expense could have foreign tax credits consequences.

In the event an interest-free loan to the Pipeline Entity is classified as a Section 7872 Loan, resulting in the deemed receipt of interest by the State, this should not result in any taxable federal income to the State, because the State is exempt from federal income tax. The state, however, would have an information reporting obligation to report the deemed payment for services to the I.R.S.

Furthermore, beginning in 2011, state and local governments will be required to withhold three percent (3%) of all payments made to government contractors, pursuant to the Tax Increase Prevention and Reconciliation Act of 2005(Pub. L. No 109-222). This provision is codified in Section 3402(t) of the Code. See copy of Section 3402(t) reproduced as Appendix "B." If the loan is characterized as a demand loan, the imputed payment to the Pipeline Entity would not be treated as having been paid entirely in the year the loan was made. Thus, the withholding obligation (beginning in 2011) could have very negative tax consequences to the State, since the withholding obligation would be an out-of-pocket cash payment by the State (because there is no cash actually changing hands). It should also be noted that although these new withholding rules are not scheduled to go into effect until 2011, proposals are being floated in Congress to accelerate this date.

The details of the arrangement with the Pipeline Entity would need to be reviewed in detail in order to determine whether it might be subject to these rules. The impact to the Pipeline Entity cannot be ascertained until the details of the transaction are analyzed. Because there are many uncertainties regarding the federal tax consequences in connection with 7872 Loans to the Pipeline

Entity and to the State (such as a possible withholding obligation if the loan is classified as a compensation related 7872 Loan), the State should consider requesting a ruling from the I.R.S. once the structure of transaction has been finalized. Alternatively, the State could ask Congress to adopt legislation to exempt an interest free loan to the Pipeline Entity from the rules of Section 7872.

In the event an interest free loan from the State to the Pipeline Entity is characterized as a 7872 Loan, there is the possibility that another state (the "Taxing State") might seek to assert that Alaska is subject to the Taxing State's income or gross receipts tax in connection with any imputed interest that might be connected to the Pipeline Entity's activities in the Taxing State (there may also be similar Canada tax law implications, and accordingly you may wish to consider inquiring with Canada tax counsel regarding potential tax implications). For example, if the Pipeline Entity undertakes construction activities in a Taxing State, that Taxing State might argue that a portion of the imputed interest deemed to be received by Alaska should be allocated to the Pipeline Entity's activities in the Taxing State. Although a state government is immune from the payment of Federal income tax on its interest income, a state government that engages in business activities in another state might be required to pay income tax to such other state. This situation occurs in cases where a state pension fund engages in business activities in another state. In these cases, the state pension fund might be subject to taxation in a Taxing State. Likewise, a Taxing State could argue that interest income imputed to the State under Section 7872 could be allocated, in part, to the conduct of business in the Taxing State, if the Pipeline Entity has activities in the Taxing State. The actual details of the loan between to the Pipeline Entity would need to be reviewed in detail in order to

determine what, if any, state tax consequences such arrangement might create in another Taxing State.

One potential method to protect the State in such a situation would be for the Pipeline Entity to indemnify Alaska in connection with a claim by another Taxing State for any taxes due to such Taxing State. Alternatively, the State could ask the Taxing State for a tax ruling from the Taxing State. The ultimate solution to this risk would be to seek federal legislation that would prohibit a Taxing State from imposing a tax in connection with any matters arising from the Pipeline Project.

Tax Advice Disclosures:

This discussion only addresses United States tax issues, and does not address the tax ramifications of any other country, such as Canada. Canadian counsel should be engaged to determine the tax consequences of the transaction discussed in this memorandum.

To ensure compliance with requirements imposed by the IRS under Circular 230, we inform you that any us. federal tax advice contained in this communication (including any attachments), unless otherwise specifically stated, was not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another party any matters addressed herein.

APPENDIX "A"

Date: Dec. 28, 2006

Full Text Published by [redacted]"

INDUSTRY DIRECTOR DIRECTIVE ON SECTION 118 ABUSE

LMSB Control No. LMSB-04-1106-016
Impacted IRM 4.51.2

December 28, 2006

MEMORANDUM FOR
INDUSTRY DIRECTORS
DIRECTOR, FIELD SPECIALISTS
DIRECTOR, PREFILING AND TECHNICAL GUIDANCE
DIRECTOR, INTERNATONAL COMPLIANCE
STRATEGY AND POLICY

FROM:
Patricia C. Chaback
Industry Director
Communications, Technology and Media

SUBJECT:
Tier I Issue -- Section 118 Abuse Directive #1

This memorandum is intended to provide field direction on a Tier I issue relating to Section 118 abuse. While the core issue relates to whether or not income qualifies as a non-shareholder contribution to capital under I.R.C. § 118, this memorandum is intended to provide guidance relating to the applicability of this code section to payments received by partnerships.

Background/Strategic Importance:

Taxpayers operating in corporate and partnership form are using I.R.C. § 118 to exclude certain payments from gross income. The field should disregard I.R.C. § 118 arguments by a taxpayer operating in partnership form. I.R.C. § 118 is only applicable to corporations. I.R.C. § 118(a) provides that "[i]n the case of a corporation, gross income does not include any contribution to the capital of the taxpayer." Thus, taxpayers operating in partnership form cannot benefit from the use of I.R.C. § 118.

Issue Tracking:

UIL: 118-01-02 Non-shareholder Contributions

Planning and Examination Guidance:

Issue Identification: The issue can be identified via review of the Schedule M for income recorded on books but not included on Schedule K.

Planning and Examination Risk Analysis: The field should challenge all arguments by taxpayers operating in partnership form that I.R.C. § 118 allows them to exclude payments from gross income.

Audit Techniques: A generic Information Document Request should be issued asking the taxpayer for a list of all I.R.C. § 118 exclusions from income.

This Directive is not an official pronouncement of law or the position of the Service and can not be used, or cited, or relied upon as such.

cc: Commissioner, LMSB
Deputy Commissioner, LMSB
Division Counsel, LMSB
Commissioner, SBSE
Chief, Appeals
Director,
Performance, Quality and Audit Assistance

Tax Analysts Information

Code Section: Section 118 -- Contributions to Capital
Jurisdiction: United States
Subject Area: Corporate taxation
Partnership taxation
Institutional Author: Internal Revenue Service
Tax Analysts Document Number: Doc 2007-371 [PDF]
Tax Analysts Electronic Citation: 2007 TNT 4-32

APPENDIX "B"

Code Sec. 3402. Income tax collected at source.

* * * * * * * * * * * * *

[1](t) Extension of withholding to certain payments made by government entities.

(1) General rule.
The Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies) making any payment to any person providing any property or services (including any payment made in connection with a government voucher or certificate program which functions as a payment for property or services) shall deduct and withhold from such payment a tax in an amount equal to 3 percent of such payment.

(2) Property and services subject to withholding.
Paragraph (1) shall not apply to any payment—

(A) except as provided in subparagraph (B), which is subject to withholding under any other provision of this chapter or chapter 3,

(B) which is subject to withholding under section 3406 and from which amounts are being withheld under such section,

(C) of interest,

(D) for real property,

(E) to any governmental entity subject to the requirements of paragraph (1), any tax-exempt entity, or any foreign government,

(F) made pursuant to a classified or confidential contract described in section 6050M(e)(3),

(G) made by a political subdivision of a State (or any instrumentality thereof) which makes less than $100,000,000 of such payments annually,

(H) which is in connection with a public assistance or public welfare program for which eligibility is determined by a needs or income test, and

(I) to any government employee not otherwise excludable with respect to their services as an employee.

(3) Coordination with other sections.
For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, payments to any person for property or services which are subject to withholding shall be treated as if such payments were wages paid by an employer to an employee.

Attachment 4

Greenberg Traurig

Privileged and Confidential
Attorney/Client Communication
And Attorney Work Product

Memorandum

TO: Larry Ostrovsky

FROM: Donald C. Shepler

DATE: February 8, 2007

RE: Meeting with FERC Staff

On February 1, 2007, Antony Scott, Ken Minesinger and I met with senior FERC Staff members. FERC Staff in attendance were: Robert Cupina, Richard Foley ,John Katz and Richard Hoffmann. Mr. Cupina is Deputy Director of FERC's Office of Energy Projects, Mr. Foley is a Regulatory Gas Utility Specialist in the Office of Energy Projects, Mr. Katz is an attorney in the Commission's Office of General Counsel and Mr. Hoffmann is the Director the Division of Gas—Environment and Engineering of the Office of Energy Projects.

The meeting was arranged in order to keep the FERC Staff generally informed about the current Administration's activities to facilitate the construction of an Alaskan gas pipeline to the Lower-48.

Antony started the discussion by expressing concern that the FERC's January 31 Report to Congress indicated that the prospects of a certificate application were more remote than a year ago and that the schedule for an Alaskan pipeline had slipped considerably along with the conclusion that the main obstacle to progress on the project is a failure to resolve state issues. He noted that the Previous Administration's draft contract with the major North Slope producers did not contain any commitment to build a pipeline or to dedicate gas to such a pipeline. He further noted that

there were potential state Constitutional issues raised by the contract that would have to be resolved over time through litigation. He offered to provide the Staff with a detailed briefing on the contract if they would like. Staff declined that offer.

Discussion then turned to a general description of what the Administration was contemplating—legislation that would provide a project sponsor with a substantial contribution by the State in exchange with commitments to meet appropriate milestones. We explained to the Staff that we wanted to get their input on what types of milestones there are from the standpoint of FERC's jurisdiction. We noted that the filing of a certificate application was certainly an essential milestone, but were hopeful to identify other, intermediate activities that would evidence commitment to the project through either the level of effort required or the level of expenditures necessary to meet such milestones.

We identified the completion of an open season consistent with all of the requirements that the Commission had established in Order No. 2005 and Order No. 2005-A would evidence good faith by an Applicant. FERC Staff agreed that this was clearly a meaningful milestone. It was noted that under Orders 2005 and 2005-A a sponsor is basically required to delineate a complete project in the open season process. With all of the information that is required Staff indicated they would expect to see a virtually complete "*pro-forma*" tariff—containing good faith estimates of rates, identification of types of services to be offered (essentially "rate schedules") as well as the general terms and conditions that would apply to service on the pipeline.

We asked whether Staff would consider initiation of the Commission's so-called "pre-filing" process (See 18 CFR §157.21) to be a meaningful milestone. Staff was very clear that initiation of this process evidenced a substantial commitment of time and money on the part of an

applicant. This is because it requires the applicant to hire an environmental contractor (at an estimated cost in millions of dollars) to be approved by the FERC and directed by the Staff to conduct the EIA/EIS for the project. Also, all affected state and federal agencies have to have been contacted and have to agree to work with the FERC Staff under the pre-filing process.

After further discussion Mr. Cupina noted that the pre-filing process could be initiated at the same time as initiating the Order 2005 open season. This would save time in the long run according to Mr. Cupina. Mr. Cupina advised that under FERC's regulations use of the pre-filing process for pipeline projects (as opposed to LNG projects) is voluntary. However, most pipeline projects are going this route. The Alaskan project "cries out" for the use of the pre-filing process he said due to the enormous complexity of the project and the number of agencies that will be involved. In addition, he noted that the FERC has to agree to use this process as well. They make their decision based upon whether there is evidence to suggest that the project is "real." Thus, obtaining FERC's agreement to go forward under the pre-filing process is the meaningful milestone that evidences good faith by the applicant.

Mr. Hoffmann noted that the Federal government has an Alaskan pipeline coordinator whose job it is to keep all federal agencies cooperating and suggested that the State should consider a similar office to facilitate cooperation by all State agencies.

We discussed alternative certification routes. The concept of a "conditional certificate" (conditioned upon *e.g.*, obtaining financing or contracts) was "not a good term" at FERC owing to the use of that term for different purposes in the past. We discussed the prospect that the Commission might stifle a project by placing the sponsor "at risk" for all unsubscribed capacity. After some discussion of the potential problem of an applicant making a certificate filing without

having obtained substantial commitments FERC Staff indicated that they would grant waiver of the 30-day acceptance requirement with respect to certificates in the case of an Alaskan project if asked. They said an extension of as much as 5-years would not appear to be a problem (citing experience with an Altamont pipeline project). This would suggest that FERC would actually accept and approve a certificate application where there were few if any Firm Transportation agreements, and allow the sponsor up to 5-years to obtain a "critical mass" of such commitments before having to make the decision of whether or not to accept the certificate. This was a significant suggestion given the potential of less than full subscription of a proposed project.

Before FERC had the pre-filing process it used to bifurcate certificates and issue a "Preliminary Determination" (referred to as a "PD") on non-environmental issues (i.e. all other aspects of the proposal) and later issue a final certificate once the environmental review was complete. This allowed all issues of rates, services, engineering and the like to be resolved at the same time as the environmental evaluations were on-going. The idea of using a "PD" process was discussed with Staff. They much preferred the pre-filing process but acknowledged that a "PD approach" might also be viable if that was deemed essential by the applicant. This process could also address the potential problem of inadequate subscriptions of capacity.

It was significant that the FERC Staff expressed willingness to work with a certificate applicant to allow more than the normal amount of time to accept the certificate or to go forward with the project.

Our meeting lasted about 2 ½ hours.

Attachment 5

Greenberg Traurig

PRIVILEGED AND CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION AND ATTORNEY WORK PRODUCT

Memorandum

TO: Don Shepler

FROM: Ken Minesinger
Howard Nelson

DATE: February 8, 2007

RE: Levelized Initial Recourse Rates

The State has asked whether the Federal Energy Regulatory Commission has ever approved levelized rates as a pipeline's initial recourse rates. The answer to this question is yes, in several certificate cases over the past 15-20 years.

As the name implies and by way of background, "levelized" rates are designed to achieve a level rate over the life of the pipeline project. By contrast, traditional, non-levelized rates typically begin at a higher level and decline over time as the pipeline's rate base is depreciated. In a recent rate case order involving Kern River Gas Transmission Company, the Commission described levelized rates as follows:

> Generally, under Kern River's levelization methodology, annual depreciation recovery in rates starts very low and increases during the levelization period as the return component of the cost-of-service decreases (in tandem with the declining total rate base) to obtain a constant or "level" annual cost of service.[1] In the early years of the

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[1] In discussing Kern River's levelized methodology as set forth in its certificate application, the Commission observed:

> [t]he above plant costs recoveries vary from year to year because they are calculated using a present value methodology. The varying plant cost recoveries are analogous to the principle repayment on a fixed rate mortgage on a house. In the early years of the mortgage, most of the payment is applied to the interest and very little goes toward

> levelization period, regulatory depreciation (*i.e.*, the amount of depreciation expense approved for recovery in rates) is less than book depreciation (the product of the approved book depreciation rates times gross plant in service), and the cumulative differences in those amounts are recorded as a regulatory asset.[2] The benefits of using a levelized methodology are that shippers benefit from rates being lower during the early years after the project goes into service, than they would be under a traditional rate design. The pipeline benefits by securing construction loans as well as competing with other well established pipelines in the area charging low rates.

Kern River Gas Transmission Co., 117 FERC ¶ 61,077, at P 40 (2006).

In the early 1990s, the Commission approved levelized rates for the initial recourse rates to be charged by Kern River and by Mojave Pipeline Company. *See Kern River Gas Transmission Co., et al.*, 50 FERC ¶ 61,069, at 61,150 (1990) (authorizing levelized rates for Kern River "in recognition of demand considerations in the marketplace"); *see id.* at 61,152 (authorizing levelized rates for Mojave). The Commission's authorization of levelized initial recourse rates for Kern River and Mojave was based on its prior approval of levelized recourse rates for the "WyCal" project. *See Wyoming-California Pipeline Co.*, 45 FERC ¶ 61,234 (1988).

A recent example where FERC approved levelized initial recourse rates is *Corpus Christi LNG, L.P., et al.*, 111 FERC ¶ 61,081 (2005). There, the Commission stated: "Cheniere Pipeline may design its initial rates based on a levelized cost of service over the entire ... operational life of the project consistent with its sole firm shipper's contract.

> principle [sic], whereas, in the latter years, most of the payment goes toward the principle [sic], and the interest portion is relatively small. 58 FERC ¶ 61,074, at 61,244 n.38.

[2] The regulatory asset is a rate base account that represents invested capital that has not yet been recovered in rates. In the latter years of levelization, when annual regulatory (rate) depreciation begins to exceed book depreciation, the regulatory asset is gradually reduced and, eventually, exhausted. Thereafter, annual regulatory depreciation that exceeds book depreciation will be recorded as a regulatory liability, which will be a reduction to rate base.

In the alternative, it may design its initial rates using conventional ratemaking practices and offer discounts to the maximum tariff rates, if necessary. Finally, because Cheniere Pipeline has proposed negotiated rate provisions in [its FERC-approved tariff], it may choose to offer negotiated rates to its shipper." *Id.* at P 32.

Other recent examples where FERC has also approved levelized initial recourse rates include, *inter alia*: *TriState Pipeline, L.L.C.*, 88 FERC ¶ 61,328 (1999) ("TriState's proposed recourse rates are levelized.... We will accept the proposed recourse rate design and rates because they are consistent with Commission policy and are reasonable."); *Greenbrier Pipeline Company, LLC*, 101 FERC ¶ 61,122 (2002); *Tractebel Calypso Pipeline, L.L.C.*, 103 FERC ¶ 61,106 (2003), *order issuing certificates, section 3 authorization, and presidential permit*, 106 FERC ¶ 61,273 (2004); and *AES Ocean Express, L.L.C.*, 103 FERC ¶ 61,030 (2003), *order issuing presidential permit and NGA sections 3 and 7 authorizations*, 106 FERC ¶ 61,090 (2004) (approving levelized rates consistent with the term of the shipper's contract).

In sum, levelized rates are a well-established option which the pipeline may use as its initial recourse rates in a FERC certificate proceeding.

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DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM May 23, 2006

SUBJECT: Authority of legislature to approve or reject an executive branch contract (Work Order No. 24-LS1939)

TO: Representative Les Gara

FROM: Theresa Bannister
Legislative Counsel

You have stated that the oil companies or the governor may argue that legislative approval is not needed for the Alaska Stranded Gas Fiscal Contract (Contract) because that legislative role violates the separation of powers doctrine of the state constitution. You have asked what the likelihood is that the argument would prevail.

Based on current authority, it is my opinion that the legislative approval required by AS 43.82.435 would probably be held to violate the separation of powers doctrine of the state's constitution. Notwithstanding this conclusion, however, the legislature's inherent power over the fiscal matters of the state, the size and uniqueness of the contract, and a limited line of authority in New Jersey and Virginia, do provide some basis for arguing that the approval does not violate the separation of powers doctrine.

Contracts to implement and execute the laws of the state are normally considered to fall within the province of the executive branch, so requiring the approval of an executive branch contract by the legislature appears to be an intrusion into executive branch powers. While the legislature may enact standards for the exercise of an executive power, it may generally not reserve the power to approve or authorize a particular action. For example, former AS 37.05.280, which required legislative approval of certain leases of state office space, was held to violate the doctrine of separation of powers.[1]

Although some executive and legislative powers overlap (e.g., regulations are legislative in nature), the Supreme Court in this state has held that the separation of powers doctrine requires that the blending of governmental powers will not be inferred in the absence of an express constitutional provision.[2] Although the legislature has extensive power over

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[1] Marine View Chapter Juneau Tenants Association v. Alaska State Housing Authority, Superior Court, First Judicial District, 1JU-80-1037 Civ., Nov. 3, 1981.

[2] Bradner v. Hammond, 553 P.2d 1, 8 (Alaska 1976).

the purse strings of the state, there is no express authority in the state constitution that allows the legislature to approve executive branch contracts or requires the executive branch to submit its contracts to the legislature for approval.

The executive branch has, for many years, taken the position that the requirement for legislative approval of royalty oil contracts is unconstitutional.[3] However, while the executive branch has consistently asserted that legislative approval provisions are unconstitutional, it has often complied with these requirements as an accommodation to the legislative desire for oversight.

The Department of Law has held fairly consistently to the position that negotiation of contracts is the prerogative and obligation of the administration, to the exclusion of the legislature, citing separation of powers principles:

> [O]ur office [that is, the Department of Law] has noted that a statute requiring legislative approval of an individual contract . . . was possibly constitutionally infirm. 1987 Inf. Op. Att'y Gen. (April 1; 663-87-0392); 1985 Inf. Op. Att'y Gen. (Aug. 13; 166-065-86); 1981 Inf. Op. Att'y Gen. (Nov. 3; J66-159-82); 1976 Inf. Op. Att'y Gen. (Feb. 11; Boness).[4]

In addition, the attorney general has stated:

> In approving individual contracts, the legislature does not exercise a lawmaking function. Consequently, in the absence of a constitutional grant of such power or some unique circumstance that we cannot presently contemplate, a statute requiring legislative approval of an individual contract is a violation of the separation of powers.[5]

However, from the inception of consideration of the bill that eventually became the Alaska Stranded Gas Development Act, the Knowles administration (eventually acknowledging that because the contractual payments in lieu of taxes provisions are potentially troublesome, legislative involvement "might not only be permissible, but necessary, under the constitution"[6]) drew a clear line between the process of negotiation

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[3] See Governor's transmittal letter for SB 164 dated April 22, 1995, Senate Journal, pages 1190-1191.

[4] Quoted in Opinion of the Attorney General 1988-2, August 30, 1988.

[5] 1981 Inf. Op. Att'y Gen. (Nov. 3; J66-159-82), at 4 - 5.

[6] The source of the quoted language is the bill analysis letter for SCS CSHB 393(FIN) (Alaska Stranded Gas Development Act), pp. 5 - 6, prepared by the Office of the Attorney General, May 29, 1998, and reads in part:

of the terms and conditions of a proposed contract, an activity reserved to the executive, and exercise of a power of approval of a contract as proposed (expressed in terms of an "authorization to execute") that has been transmitted to the legislature for review and approval before the contract's final execution. Under this approach it could be argued that while legislative approval of a contract is exceptional, the circumstances under which payment in lieu of taxes is to substitute for actual tax receipts is also unprecedented and could justify this intrusion into executive branch powers. The size and uniqueness of the proposed contract may tempt one to conclude that the separation of powers doctrine is not violated in this situation, but there does not appear to be much authority to support that conclusion.

There is a line of reasoning that would allow a legislature more leeway in this regard where there is no possibility of significant interference with the executive branch's discretion, as in this case where the governor presents the contract to the legislature for an up or down vote. This line of reasoning regarding legislative oversight appears in New Jersey where the court recognized the importance of legislative oversight where projects require continued budget appropriations.[7] In that case, the court seemed to place importance on the limited potential that the legislative action had to interfere with executive action and emphasized that the legislature had no control over the agency's projects unless the Governor first approved them.[8] However, there was a vigorous dissent in the case, and the dissent cited an Alaska case to support its position.[9] This case

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> . . . We . . . note that it is far from clear that the legislature's approach would, in fact, violate the separation of powers doctrine. The legislature arguably has not usurped an executive function, but rather has divided its delegation of authority into two steps, rather than the traditional one. It should be noted, moreover, that both the negotiation of the contract and its submission to the legislature are discretionary. Finally, it is relevant that the contract that is to be provided to the legislature involves the state's fiscal regime, a subject substantially within the purview of the legislative branch under art. IX of the Alaska Constitution. Since the contractual payments in lieu of taxes authorized by this bill could be characterized as, in essence, a new tax, the legislature may well be required to levy the new tax by law. Viewed in this light, the legislature's approach might not only be permissible, but necessary, under the constitution.

[7] Enourato v. N.J. Building Auth., 448 A.2d 449, 453 (New Jersey 1982).

[8] Enourato at 453 - 454.

[9] Enourato at 461.

was cited by a Virginia court to hold that a legislative approval requirement (in a situation similar to that in Enourato) did not violate the separation of powers doctrine.[10]

In conclusion, while it may be possible to successfully make a case in this situation that the legislature's approval does not violate the separation of powers doctrine, there seems not to be much authority for that position.

If I may be of further assistance, please advise.

TLB:med
06-392.med

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[10] See Baliles v. Mazur, 297 S.E.2d 695, 700 - 701 (Virginia 1982) (emphasizing the reasonableness of legislative oversight for major projects).

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LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM April 14, 2006

SUBJECT: SB 316, eliminating the opportunity for judicial review of the findings and determination of the commissioner of revenue made under the Alaska Stranded Gas Development Act on which are based legislative review of a proposed contract for payments in lieu of taxes and for other purposes described in that Act (Work Order No. 24-LS1842\F)

TO: Senator Hollis French

FROM: Jack Chenowe
Assistant Revisor

Tam Cook has asked me to respond to your questions about the above-captioned bill.

IS ELIMINATING THE RIGHT OF REVIEW AT THE ADMINISTRATION LEVEL CONSTITUTIONAL, OR DOES IT DEPRIVE THE PUBLIC OF ACCESS TO COURTS OR SOME OTHER RIGHT?

The measure asks the legislature to eliminate the opportunity for judicial review of the commissioner of revenue's final findings and decision made under the Alaska Stranded Gas Development Act that serve as the basis for the submission to the legislature of the administration's negotiated contract(s).[1]

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[1] The Stranded Gas Development Act currently provides two opportunities for judicial review.

Under AS 43.82.435, the Act declares that the commissioner of revenue's final findings and decision, the basis of a submission to the legislature for review and legislative authorization of contract execution under AS 43.82.435, are "final agency decisions under this chapter," AS 43.82.430(c); under the state's Administrative Procedure Act, AS 44.62.560(a),

> Judicial review by the superior court of a final administrative order may be had by filing a notice of appeal in accordance with the applicable rules of court governing appeals in civil matters. . . . .

Separately, the Act expressly authorizes judicial review of provisions of the executed contract:

Elimination of the opportunity for judicial review in advance of the execution of any contract proposed under the Act should, in my view, stand.

Court decisions conclude that administrative decisions are presumably subject to judicial review. However, the court will respect the legislature's decision to limit opportunity for review. [2]

But only to a point.

The court's view of judicial review when the legislature has expressly precluded that review was formulated by the court in *K&L Distributors v. Murkowski*, 486 P.2d 351 (Alaska 1971). The principle derived from that decision holds that courts have the power to look for administrative compliance with constitutional requirements. In *Murkowski*, the court had to decide whether the commissioner of economic development's grant of an industrial incentive tax credit was subject to judicial review in the face of a statute, AS 43.26.040(e), which provided that "all decisions and findings of the [commissioner]. . . . are final and no judicial or administrative appeal or other proceeding lies against them . . . ." :

> It is the constitutionally vested duty of this court to assure that administrative action complies with the laws of Alaska. We would not be able to carry out this duty to protect the citizens of this state in the exercise of their rights if we were unable to review the actions of administrative agencies simply because the legislature chose to exempt their decisions from judicial review. The legislative statement of finality is one which we will honor to the extent that it accords with constitutional guarantees. But

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> **Judicial review.** A person may not bring an action challenging the constitutionality of a law authorizing a contract enacted under AS 43.82.435 or the enforceability of a contract executed under a law authorizing a contract enacted under AS 43.82.435 unless the action is commenced within 120 days after the date that the contract was executed by the state and the other parties to the contract.

AS 43.82.440.

SB 316 only affects the first of the two provisions. No amendment has been proposed as to the second.

[2] See, in this respect, *Bethel Utils. Corp. v. Bethel*, 780 P.2d 1018 (Alaska 1989):

> Unless the legislature provides otherwise, administrative decisions are presumed to be judicially reviewable.

780 P.2d at 1022, citing 5 K. Davis, Administrative Law §§ 28.1; 28.4 (2d ed. 1984).

> if the administrative action is questioned as violating, for example, the due process clause, we will not hesitate to review the propriety of the action to the extent that constitutional standards may require.

Murkowski, 486 P.2d at 357.[3]

Thus, the court has indicated that, while it will "honor" -- in the sense of respect --"[a] legislative statement of finality," it reserves to itself the review of attendant constitutional questions.[4]

Because AS 43.82.440, another part of the Stranded Gas Development Act, retains the opportunity for judicial review as to an executed contract negotiated under the Act or the enforceability of the contract negotiated under the Act, I conclude that the court would respect the decision of the legislature, in enacting SB 316, to preclude the public from obtaining judicial review of an agency decision made before final authorization of the contract. I say that because, once the contract has been executed, the Act preserves to the public the opportunity to ask the court to consider constitutional questions arising out of a law authorizing the execution of the contract and questions as to the contract's enforcement.

IF THE RIGHT [OF JUDICIAL REVIEW BASED ON FINAL FINDINGS AND DECISION] IS DELETED, IS THERE ANY MEANINGFUL CHANCE TO GAIN REVIEW AFTER THE CONTRACT IS EXECUTED?

Yes. Under AS 43.82.440, there is a right of review of the executed contract. The text of the section is set out elsewhere in this memo in a note. This section would not be affected by the amendment proposed by SB 316. Questions involving whether the terms and conditions of a contract are consistent with the state constitution and whether they may be enforced or compliance with them may be compelled can be reached in litigation brought within the period provided by law for initiation of a civil action.

JBC:ljw
06-199.ljw

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[3] See, also, *Johns v. Commercial Fisheries Entry Commission*, 699 P.2d 334 (Alaska 1985) (rejecting CFEC argument that refusal to hear challenge to the regulations is not judicially reviewable).

[4] In addition, at least one attorney general has concluded, citing the decision in *Murkowski*, that judicial review remains available to ensure that administrative decisions are not made arbitrarily or irrationally. See, in this regard, 1995 Op. A.G. File No. 883-95-0111 (June 14, 1995) (concluding that "court review is always available to protect against arbitrary or irrational administrative action").