

11978 SENATE RESOURCES

**Appendix R: Summary of Public Comments on the FIF and Fiscal Contract**

<b>General Area of Concern</b>	<b>Issue</b>	<b>Issue Code</b>	<b>Number of Submissions</b>	<b>Percent of Submissions</b>	
<b>State Ownership</b>	LLCs Between State and Partners	LLC	87	4.1	
	Dispute Resolution between State & Partners	DISP	36	1.7	
	Regulatory Conflict	REGCON	19	0.9	
	State Management of Natural Resources	NATRSC	126	5.9	
	Financing of Alaska's Portion of the Project	AK_FINC	71	3.3	
	Permanent Fund Concerns	PFD	44	2.1	
	All Comments within General Area			383	18.1
	Multiple Comments within General Area			88	4.2
	Unique Submissions within General Area			295	13.9
	<b>Project Risks</b>	State Ownership Risks	OWNRISK	78	3.7
Political Risks		POL_RSK	41	1.9	
Risks Related to Gas-In-Kind		INKIND	55	2.6	
Resource Risks		RSC_RSK	7	0.3	
Market Risks		MRKT	111	5.2	
Environmental Risks		ENVR	45	2.1	
Cost Overrun Risks		OVERRUN	17	0.8	
<i>Force majeure</i>		FRCE	7	0.3	
All Comments within General Area			361	17.0	
Multiple Comments within General Area			68	3.2	
Unique Submissions within General Area			293	13.8	
<b>Canadian Issues</b>	Ownership Rights in Canada	CAN_OWN	3	0.1	
	Canadian Regulatory Issues	CANREG	5	0.2	
	Issues Regarding the Alberta Hub	ALB	2	0.1	
	Mackenzie Valley Pipeline	MCKZ	5	0.2	
	Indigenous Peoples in Canada	INDG	5	0.2	
	All Comments within General Area			20	0.9
	Multiple Comments within General Area			3	0.1
	Unique Submissions within General Area			17	0.8
<b>Other Transportation Alternatives</b>	Other Transportation Alternatives	OTA	88	4.2	
	The AGPA Alternative	AGPA	157	7.4	
	The Y-Line Alternative	YLINE	10	0.5	
	All Comments within General Area			255	12.0
	Multiple Comments within General Area			21	1.0
Unique Submissions within General Area			234	11.0	



## **3 Response to Public Comments**

The remainder of this report contains the state's responses to the concerns raised during the comment period. The following list shows the initial ordering of the responses by general area of concern.

1. Public Process
2. SGDA and Constitutionality
3. General Comments on the Contract and the FIF
4. Work Commitments
5. State and Local Impacts
6. Gas for In-state Use
7. Regulatory Issues
8. Capacity Management and Access
9. Taxes and Incentives
10. State Ownership
11. Risks
12. Canadian Issues
13. Other Transportation Alternatives

To find a response to a specific submission use either the Name Index, the Organization Index, or the Legislative Index (all found in Attachment 1 of this document) to look up the name of the commenter and note the Submission ID number, noting the SOC's that are listed. Then, turn to the Table of Contents at the beginning of the document to find the specific page where each group of SOC's begins. Those readers that wish to see the entire submission of a particular commenter should refer to the instructions for looking up submissions shown on page R-9 of this document.

While the administration believes that the existing contract fairly protects the state's interests, it has agreed to propose certain changes to the contract to respond to concerns raised in the public process. It should be emphasized that while the current administration is recommending these changes, negotiations with the sponsor group have not advanced and they have not accepted these changes. In addition, in many of its responses to public comments the state indicated that it will be making changes to the Preliminary FIF. These changes will be incorporated in the Interim FIF, which at the time this document was printed is scheduled to be published in November 2006.

### **3.1 Public Process**

Issues in this general area of concern included the period for the public and legislature to comment on the proposed contract and FIF; public presentations on the proposed contract

and FIF; and Internet access to the proposed contract and related documents, including the FIF.

### 3.1.1 HEARINGS: Public Hearings Process—SOC and Responses

This issue category addresses comments regarding the public presentations and hearings on the proposed contract and the commissioner's preliminary findings and determination.

#### HEARINGS\_02: (2 Comments)

**Statement of Concern:** Statements inquiring about how to get access to information generated during public presentations/hearings.

**Response:** The Alaska Gas Pipeline Presentation is available online at [www.gov.state.ak.us/gasline/basics.php](http://www.gov.state.ak.us/gasline/basics.php). The most current information presented to the Alaska Legislature on the gas pipeline project is available online at [www.gov.state.ak.us/gasline/legis.php](http://www.gov.state.ak.us/gasline/legis.php). All comments received during the public comment period are posted online at <http://commador.ursokr.com/>. Responses to individual comments will also be posted online.

#### HEARINGS\_02: (2 Comments)

**Statement of Concern:** Statements requesting for more discussion and more Q & A during public hearings/presentations regarding the risks of the projects.

**Response:** The duration of the public hearings was constrained by logistical considerations. Project risks are described in detail in *Section 6 Mitigating Project Risk* of the Preliminary FIF. Questions and concerns on project risks that were raised during the public comment period as well as responses to these concerns are summarized in the *Risks* section of this report.

#### HEARINGS\_03: (5 Comments)

**Statement of Concern:** Statements expressing the importance and the need for public presentations and public hearings regarding the project/contract to increase awareness and understanding of the project/contract issues.

**Response:** Our complete agreement with this comment was demonstrated by an extensive public outreach effort. From May 19 to June 15 formal public hearings were conducted in major Alaska communities. To provide more opportunities for the public to comment on the gas pipeline project the state conducted additional public question-and-answer forums throughout the state. In addition to these public hearings and forums, three statewide teleconferences at Legislative Information Offices and dozens of "community outreach" briefings were conducted across the state. During the entire process, more than 70 community presentations were held throughout the state, some of which were attended by the governor, chief of staff, commissioners, and department directors. A schedule of all hearings, teleconferences and briefings can be found on the state's Alaska Gas Pipeline web site.

**HEARINGS\_04: (1 Comment)**

**Statement of Concern:** Statements indicating that the public process will determine that the contract is indeed a fair deal for all stakeholders.

**Response:** The administration is hopeful that this comment will prove correct after the contract is fully discussed and analyzed by the public and the Alaska Legislature. The state notes that 65 percent of the comments were in favor of the fiscal contract and the Preliminary FIF. In addition, the legislature made a number of suggestions for change to the contract and FIF. The administration believes that the existing contract fairly protects the state's interests, but in response to concerns from the public process it has agreed to propose certain changes to the contract. It should be emphasized that while the current administration is recommending these changes, negotiations with the sponsor group have not advanced and they have not accepted these changes. The administration believes these changes will result in a contract that the majority of Alaskans will determine to be fair and beneficial to the state.

**HEARINGS\_05: (5 Comments)**

**Statement of Concern:** Statements expressing concern that the public hearings were disingenuous, characterized more by the administration and the sponsor group promoting the proposed deal, than by an exchange of ideas.

**Response:** The intent of the hearings and other public outreach efforts was to provide for extensive public education on the contents of the contract. At the same time, the public was encouraged to provide comments on the contract, not only at public hearings, but also online, in writing, during statewide teleconferences at Legislative Information Offices, and via a toll-free telephone number.

**HEARINGS\_06: (2 Comments)**

**Statement of Concern:** Statements suggesting that there should be a public debate on the pros and cons of the project/contract.

**Response:** The public forums were designed to address these issues. In addition the legislature debated these issues and the public was able to see and listen to the hearings on Gavel-to-Gavel.<sup>4</sup>

**HEARINGS\_07: (3 Comments)**

**Statement of Concern:** Statements expressing concern that the public comments may be based on speculation, conjecture, or propaganda due to the lack of understanding about the facts; televised educational sessions would be helpful.

**Response:** The many insightful, well-informed comments that were submitted during the public review process suggest that a large segment of the public has an adequate understanding of the proposed contract and preliminary findings and determination. Information on the proposed contract and preliminary findings and determination was presented at public hearings and forums, and in dozens of "community outreach" briefings conducted across the state. In addition, details of the proposed contract and related

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<sup>4</sup> As of the printing of this document the presentations were available on Gavel-to-Gavel and could be accessed at <http://www.kt00.org/gavel/videos.cfm> or at <http://www.kt00.org/gavel/audio.cfm>.

documents can be found online at the state's Alaska Gas Pipeline Web site: [www.gaspipeline.alaska.gov](http://www.gaspipeline.alaska.gov). These sessions were also presented on Gavel-to-Gavel and were available to the general public throughout Alaska.<sup>4</sup>

**HEARINGS\_08: (11 Comments)**

**Statement of Concern:** Statements indicating concern that since there are many parts of the contract that are not complete, it is difficult to make useful comments.

**Response:** The contract is complete, although the state is still reviewing the Accounting Procedures in Exhibit A and Example Calculations in Exhibit F to ensure they accurately implement or illustrate the provisions of the contract. The contract that was posted on May 10th included all terms with the exception of the complete integration of the terms associated with PPT, which required Legislative approval. The updated contract posted on May 24th added provisions in Article 11, 20.3, and in Exhibits P, Q, R, X, Y, and Z to implement these provisions. No other changes were made to the contract. As the governor and the producers announced on May 24th, the parties are prepared to sign the contract released on that date.

**HEARINGS\_09: (1 Comment)**

**Statement of Concern:** Statements expressing concern that Governor Murkowski is not listening to public comments at hearings and is not returning phone calls regarding the gas pipeline.

**Response:** During the public review process, more than 70 community presentations were held throughout the state, some of which were attended by the governor, chief of staff, commissioners, and department directors. In addition, the public was encouraged to provide comments online, in writing and via a toll-free telephone number. A summary of all public comments received during the public comment period has been prepared by the commissioner of revenue. Each of those comments has been responded to by members of the governor's gas team, either in this document or in previously issued response letters (included as Attachment 2).

The governor and his staff have listened closely to these comments and are proposing a number of changes to the contract based on this input. These changes are described briefly in the Executive Summary and in Section 5 of this document, and more thoroughly in the Interim FIF.

The administration sincerely appreciates the public's involvement in the comment process, and credits the public and the public process with many of the improvements that will be made to the Interim FIF and many of the recommendations they are proposing for changes to the fiscal contract.

### 3.1.2 COMM\_PER: Comment Period Issues—SOC and Responses

This issue category covers comments regarding the duration of the public comment period and the public comment process.

#### COMM\_PER\_01: (26 Comments)

**Statement of Concern:** Statements expressing concern that a 45-day comment period is too short.

**Response:** Once a contract is negotiated, the Stranded Gas Development Act requires at least a 30-day period for the public and members of the legislature to comment on the proposed contract and the commissioner's preliminary findings and determination. The public comment period began May 10, 2006, and was initially scheduled to last 45 days. However, the comment period was extended to 75 days to provide the public and legislators more time to understand the contract and submit comments. The public comment period was closed on July 24, 2006, and responses to the public comments received are contained in this report.

#### COMM\_PER\_02: (8 Comments)

**Statement of Concern:** Statements expressing concern that the contract and associated documents are too long and complicated.

**Response:** Given the complexity and magnitude of the fiscal issues associated with a decades-long fiscal contract for a \$20 billion project, the length of the contract is both reasonable and appropriate for protecting the state's interests by carefully documenting the negotiated resolution of the rights and privileges of the parties to the contract. The amount of supplementary information provided was essential to provide relevant background material, economic analyses, review of contract provisions and legal issues, and other material to support the preliminary findings and determination that the contract is in the long-term interest of the state. The state arranged for extensive public education on the contents of the contract and the Preliminary FIF, both on the Internet and through numerous public hearings and presentations throughout Alaska. To facilitate public understanding of the fiscal contract a "contract at a glance" sheet has been posted on the Internet, and is available at <http://www.gov.state.ak.us/gasline/basics.php>. The sheet describes the highlights of the contract and defines important terms used in the contract.

#### COMM\_PER\_03: (5 Comments)

**Statement of Concern:** Statements of concern about 3-minute limit on length of time to testify during hearings.

**Response:** A three-minute time limit on individual oral testimony was imposed so that there would be adequate time for all public hearing attendees to provide comments. Longer comments could be submitted online, or in writing.

#### COMM\_PER\_04: (13 Comments)

**Statement of Concern:** Statements expressing concern about not enough time between release of documents and the scheduled hearings, and about hearing process itself.

**Response:** The proposed contract and related documents, including the commissioner's preliminary findings and determination, were released on May 10, 2006. Soon thereafter these documents were published on the state's Alaska Gas Pipeline Web site: [www.gaspipeline.alaska.gov](http://www.gaspipeline.alaska.gov). On May 24 an amended version of the contract was released, which added provisions to two Articles and six Exhibits related to the proposed PPT (see *Hearings\_08*). From May 19 to June 15 formal public hearings were conducted in major Alaska communities. To provide more opportunities for the public to comment on the gas pipeline project, the state conducted additional public question-and-answer forums throughout the state. The public forums began on July 17 and ended on July 24. In addition to these public hearings and forums, three statewide teleconferences at Legislative Information Offices and dozens of "community outreach" briefings were conducted across the state.

During the entire process, more than 70 community presentations were held throughout the state, some of which were attended by the governor, chief of staff, commissioners, and department directors. The public comment period and the timeline for revising the contract and the Preliminary FIF are all specified in the SGDA. The public comment period was extended from 45 days to 75 days to accommodate additional presentations and to give the public additional time to comment on the issues. The extension of the public comment period was particularly important given that the amended fiscal contract was released on May 24, 2006—two weeks after the official beginning of the comment period.

**COMM\_PER\_05: (1 Comment)**

**Statement of Concern:** Statements indicating that unless the public makes their thoughts and concerns known, the contract could be signed without changes.

**Response:** During the public review period, the department of revenue received a total of 2,120 valid comment submissions. This report summarizes the public comments received. As indicated in the SGDA, a list of proposed amendments have been prepared if needed, after consultation with the commissioner of natural resources and the pertinent municipal advisory groups. Then a final findings and determination is made about whether the proposed contract and any amendments meet the requirements and purposes of the SGDA. If the commissioner of revenue determines that the contract is in the long-term fiscal interests of the state, the commissioner of revenue submits the contract to the governor. The governor may transmit the contract to the legislature with a request for authorization to execute the contract. The contract is not binding or enforceable against the state or other parties unless the governor is authorized by the legislature to execute the contract. The state and other parties to the contract may execute the contract within 60 days after the effective date of the law authorizing the contract.

**COMM\_PER\_06: (3 Comments)**

**Statement of Concern:** Statements indicating that the public comment process could help allay suspicions about the contract and the negotiating process that was undertaken. Comments included requests for full disclosure of contract and project details.

**Response:** In accordance with the Stranded Gas Development Act, the state made available to the public copies of the proposed contract, the commissioner's preliminary findings and determination, and, to the extent the information is not required by law to be kept

confidential, the supporting financial, technical, and market data, including the work papers, analyses, and recommendations of any independent contractors. Details of the proposed contract and related documents, including the commissioner's preliminary findings and determination, are available online at [www.revenue.state.ak.us/gasline/contractDocuments/](http://www.revenue.state.ak.us/gasline/contractDocuments/).

**COMM\_PER\_07: (2 Comments)**

**Statement of Concern:** Statements expressing concern about advocacy groups making unsolicited calls to the public.

**Response:** The state does not approve of the use of unsolicited telephone calls as a way of educating the public about the proposed contract.

**COMM\_PER\_08: (2 Comments)**

**Statement of Concern:** Statements indicating that individuals wish to be added to the mailing list.

**Response:** The fiscal contract, the Preliminary FIF, and a large volume of related information materials compiled by the state were made available for public review via the state's website at <http://www.gov.state.ak.us/gasline>. Other information materials were also distributed during the public hearings that were conducted all throughout the state. No mailing list was developed as information materials were not distributed by mail.

**COMM\_PER\_09: (2 Comments)**

**Statement of Concern:** Statements requesting that independent university economists and/or federal regulators review the contract and the FIF.

**Response:** All members of the public were invited to comment on the proposed contract and the commissioner's preliminary findings and determination.

We also note that the advice of outside experts has not been ignored in drafting the terms of the proposed contract. Technical changes to the contract (e.g., how the Effective Date is determined, better description of the project and its route) have been made based on advice from those experts. The state's website at <http://www.gov.state.ak.us/gasline> provides an extensive listing of outside experts which were engaged as needed throughout the evaluations and negotiation process.

**COMM\_PER\_10: (2 Comments)**

**Statement of Concern:** Statements requesting a response to comment by email.

**Response:** Responses to comments will be posted online at <http://www.revenue.state.ak.us/gasline/ContractDocuments/>.

**COMM\_PER\_11: (6 Comments)**

**Statement of Concern:** Statements expressing concern about the use of state funds to generate public support for the fiscal contract negotiated between the state and the sponsor group.

**Response:** The state is required by law to make available to the public copies of the proposed contract, the commissioner's preliminary findings and determination, and, to the extent the information is not required by law to be kept confidential, the supporting financial, technical, and market data, including the work papers, analyses, and recommendations of any independent contractors. The state met this requirement by undertaking an extensive public outreach effort that included more than 70 community presentations were held throughout the state, some of which were attended by the governor, chief of staff, commissioners, and department directors. The SGDA requires the state to make the contract and the Preliminary FIF available to the public. The state believes that spending money to educate the public furthers this mandate.

**COMM\_PER\_12: (2 Comments)**

**Statement of Concern:** Statements asking about the process that will be used to respond to individual comments.

**Response:** The process used to respond to comments is described in Section 1.4 of this document.

**3.1.3 WEB: Internet Access to Information and Web-Based Comments—SOC and Responses**

This issue category addresses comments regarding access to information materials published on the state's gasline website.

**WEB\_01: (2 Comments)**

**Statement of Concern:** Statements supporting the use of the web for its ability to make large volumes of information available to the public.

**Response:** The state is required by law to make available to the public copies of the proposed contract, the commissioner's preliminary findings and determination, and, to the extent the information is not required by law to be kept confidential, the supporting financial, technical, and market data, including the work papers, analyses, and recommendations of any independent contractors. One of the most effective ways of disseminating this information is through use of the Internet. Details of the proposed contract and related documents can be found online at the state's Alaska Gas Pipeline Web site: [www.gaspipeline.alaska.gov](http://www.gaspipeline.alaska.gov).

**WEB\_02: (1 Comment)**

**Statement of Concern:** Statements requesting comments and responses be available online to engender public debate.

**Response:** Presently and in the foreseeable future, all of the submissions can be accessed online through the State of Alaska's Gas Pipeline web-site. All of the submissions are available on CD or in a printed hard-copy (968 pages) by sending a request to the commissioner of revenue. Indexes of these submissions are provided for interested individuals and organizations in Attachment 1 of this document.

To view submissions on the internet take the following steps:<sup>5</sup>

1. Log onto the internet using your internet browser;
2. Enter <http://www.gov.state.ak.us/gasline> as the URL and hit return;
3. Click once with your mouse on the "Public Comments" section of the gas pipeline web-site;
4. Click once on the text "Review comments submitted on the Fiscal Interest Findings";
5. Click on the arrow at the right of any one (or more) of the search boxes<sup>6</sup> and select the item you wish to find;
6. Click on continue;
7. After the screen refreshes, scroll to the bottom of the page and click on the submission number of the comment you wish to review;
8. If the comment was entered directly into the web the full comment will appear when the screen refreshes.

If the comment was submitted as an attachment, click on the attachment file name to see the comment. This document, which contains responses to the concerns generated in the public process, is online <http://www.revenue.state.ak.us/gasline/ContractDocuments/>. Requests for copies of this document should be made to the commissioner of revenue.

**WEB\_03: (2 Comments)**

**Statement of Concern:** Statements concerned that it is difficult to locate documents on the web-based comment site.

**Response:** The State of Alaska Web site at <http://state.ak.us/> offers a primary navigation link to information through "The Alaska Gas Pipeline" button. Details of the proposed contract and related documents, including the commissioner's preliminary findings and determination, are online at [www.revenue.state.ak.us/gasline/contractDocuments/](http://www.revenue.state.ak.us/gasline/contractDocuments/).

**WEB\_04: (1 Comment)**

**Statement of Concern:** Statements indicating that information in the state's Q&A may be misleading—in particular, Q&A on the RCA issues.

**Response:** A question has been raised about the accuracy of the information on the state's website about RCA jurisdiction. The suggestion has been made that the state has ceded away RCA jurisdiction in Sections 8.1 through 8.3 of the Contract. The question shows a misunderstanding of federal and state jurisdiction over interstate gas pipelines and the provisions of the contract. Federal jurisdiction of interstate gas pipeline is preemptive and exhaustive; the federal government regulates every aspect of the authorization and operation of an interstate gas pipeline. The RCA properly has no legal authority over the Mainline or

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<sup>5</sup> To view the submissions from the CD, place the CD in the drive of your computer and follow the directions that are shown on the CD.

<sup>6</sup> Note that submissions from individuals that are associated with organizations do not necessarily represent the views of that particular organization—because individuals were given the option to indicate the organization with which they were associated.

the GTP. Thus, there was no jurisdiction to cede away. If the law changes, however, and the RCA has some legal and legitimate authority over the pipeline, then Sections 8.1 to 8.3 do not affect that authority. This is because the RCA is excluded from the definition of "state" in the contract and is not bound by any obligations or limitations of the contract. Sections 8.1 to 8.3 require the state as a contracting party, but not the RCA, to support appropriate regulatory jurisdiction in the U.S. and Canada. Nothing has been ceded away.

**WEB\_05: (7 Comments)**

**Statement of Concern:** Statements indicating that more information is needed before commenting on the contract and that the administration's public information materials do not include enough facts and figures that would help the public make informed decisions.

**Response:** On May 10, 2006, the state released the proposed fiscal contract and a Preliminary FIF that provided a review of the contract, an analysis of the contract provisions, and substantive discussion of issues related to the Stranded Gas Act, the negotiations, implications on state revenues, regulatory processes, and other relevant material. As indicated in the Preliminary FIF the state went through a careful process of investigation with expert assistance on a host of issues. A large amount of material was made available at the start of the comment period on the state's gas pipeline Web site: [www.gaspipeline.alaska.gov](http://www.gaspipeline.alaska.gov). These documents included:

- Documents from the sponsor group
- Documents from state agencies
- Documents from federal agencies
- State statutes
- Federal statutes
- Documents from contractors

### **3.2 SGDA and Constitutionality**

Issues in this general area of concern included whether or not ANS gas meets the SGDA definition of stranded gas; the legality of the contract terms; the openness of the contract negotiation process; the consistency of the proposed contract with the SGDA; legislative review of the proposed contract and FIF; and the propriety of negotiating with ExxonMobil.

#### **3.2.1 STRND: Is the Gas Stranded?—SOC and Responses**

This issue category addresses concerns regarding the definition of stranded gas and whether ANS gas meets the SGDA definition of stranded gas.

**STRND\_01: (26 Comments)**

**Statement of Concern:** Statements on the determination of stranded ANS gas, including (1) the gas is stranded, (2) the gas is not stranded, (3) the gas is stranded only until a contract is signed, and (4) the decision to declare the gas stranded is a policy decision rather than an empirical one.

**Response:** "Stranded" is defined in the Stranded Gas Development Act as not being marketed due to prevailing cost and market conditions. We interpret "prevailing" to mean during the construction and operation of the project – which means the next 45 or more years. After review of expert analyses, the commissioner of revenue made his preliminary determination in November 2003 that the gas on the North Slope is stranded. It should be noted that the gas on the North Slope was discovered in 1967 and has not been developed during the last 40 years – prima facie evidence that the gas is stranded. The commissioner's preliminary determination was based on a November 11, 2003 Henry Hub price of \$4.52/mmbtu. On October 1 2006 the Henry Hub price was \$3.63/mmbtu.

Aside from the price of gas, other factors that can cause the ANS gas to be stranded include anticipated long term cost, high risks associated with possible project execution, gas marketing difficulties and effective competition from non-Alaskan gas project. Among all these factors, the competition from non-Alaskan gas projects is the most significant.

Regardless of price, any ANS gas project has to compete against other projects throughout the world for construction materials, priority and financing. Corporations have finite budgets. Only the best projects get funded subject to portfolio management constraints. Under the 2005 fiscal terms, the Alaska gas project's IRR would have fallen into the lower quartile among IRRs of oil or gas projects throughout the world.

According to the memo dated March 10, 2006 from Dr. Pedro Van Meurs, it is likely that the North Slope gas will remain stranded for a considerable time without a stranded gas contract.

In his opinion, this is primarily due to the following factors:

- The high risks associated with a long lead time and the very large Alaska Gas Project;
- The market dynamics that will induce investors to give priority to smaller projects with a shorter lead time over the Alaska Gas Project;
- The inherent unpredictability of the gas price for the period 10 – 25 years from now;
- The relative high transport costs; and
- The relatively low IRR of the project compared to other projects under stress price conditions.

*Appendix C Is Alaska's Natural Gas Stranded*, in the Interim FIF, will contain more details on this issue.

#### **STRND\_02: (2 Comments)**

**Statement of Concern:** Statements expressing concern about the enforcement of existing gas lease terms.

**Response:** The contract provides for specific lease terms to be superseded only for the term of the contract. The result of this provision is certainty of availability of the reserves base which will allow the sponsor group and the state to move forward with the long-term, enormous financial commitments necessary to make the pipeline a reality. If the contract terminates for any reason, all lease terms would be restored. Lease terms not specifically addressed by the contract are unaffected by the contract, and their enforcement is unaffected.

Concerning Point Thomson Unit (PTU), in particular, each of the above statements is true. During contract negotiations, it became clear the producers felt very uncertain about the status of PTU, particularly given its critical importance to the gas pipeline economics. The amended DNR decision of October 27, 2005 found the PTU Agreement to be in default. That decision did not call for the return of the PTU leases to the state, but it did call for "a plan to bring the PTU into commercial production within a reasonable time frame" and provided dates for initiation of development operations, commencement of drilling, and commencement of production. Because these dates are inconsistent with the work commitments contained in the contract, extensions of the time period within which the operator can appeal that default decision have been given, pending conclusion of deliberations on the contract by this legislature. The contract provides for a PTU development schedule which is consistent with and which supports gas pipeline development. PTU development, as an integral part of the gas pipeline project, is thereby subject to the same diligence standard, and is subject to the contract being terminated for failure to meet that diligence standard.

The decision to include PTU in the contract was a reasonable and necessary step, given the critical importance of PTU reserves and deliverability to the contract. That step was taken, while imposing specific requirements upon the producers:

- Each producer must commit PTU gas reserves to the gas pipeline project;
- The producers must apply to the AOGCC within 6 months for issuance of pool rules;
- In addition, the contract requirement that the gas pipeline project be pursued "with diligence" exists, and applies to PTU development, as well as the rest of the gas pipeline project – if the contract is terminated for any reason; according to the contract terms, the producers' rights to Pt. Thomson expansion leases terminate unless they initiate development within one year of the contract termination. In addition, DNR can also pursue other steps, including termination of the unit, and initiating procedures to revoke the leases.

Finally, nine months after startup of the gas pipeline, commitments to DNR Plans of Development resume, which will allow DNR to continue to manage development of PTU oil and gas reserves.

Historically, continuance of the PTU unit and leases has, until the latter half of 2005, been with the concurrence of DNR commissioners of several administrations of varied political perspectives. The companies have invested significant amounts of money over several decades in exploring this acreage and in addressing major technical issues. In recognition of those facts, each of these administrations has been a party to extending these leasehold interests. The amended DNR decision of October 27, 2005 has placed these companies on notice that development must now proceed. The contract provisions concerning PTU provide a specific context for that development.

### 3.2.2 CNSTL: Constitutionality Issues—SOC and Responses

This issue category addresses comments regarding the legality of the contract terms.

#### **CNSTL\_01: (46 Comments)**

**Statement of Concern:** Statements indicating that: 1) the proposed contract is unconstitutional because it requires the state's power of taxation to be surrendered and locks in oil/gas taxes for 30/45 years; and 2) the tax structure under the contract would create two distinct tax systems—payments in lieu of "taxes" and tax exemptions—and not a tax system with exemptions, and this is unlikely to withstand judicial review.

**Response:** The commissioner of revenue requested an opinion from the Attorney General on the issue of whether the Alaska Constitution would permit the legislature to approve a binding tax contract under the Stranded Gas Development Act. The Attorney General concluded that, while, under Article IX, section 1 of the Alaska Constitution, the power to tax may not be surrendered, it may be suspended or subject to contract for a specific period of time under certain circumstances. (The *Attorney General's Opinion* can be accessed at [www.law.state.ak.us/departement/civil/gasline.html](http://www.law.state.ak.us/departement/civil/gasline.html))

In fact, this would not be the first time that the state has authorized contractual tax incentives to encourage development of Alaska's resources. In 1949, 1957, and 1968, the state offered industrial incentive tax credits that had the binding effect of contracts. Those tax credits were limited to a period of ten years and the investments sought were quite small compared to the unprecedented investment that will be necessary to construct the proposed gas pipeline. The huge investment necessary to build a gas pipeline necessitates long-term financing and risk reduction. The commissioner concluded in the preliminary findings and determination that the periods set out in the contract are commensurate with depreciation schedules and other relevant financial factors (see for example page ES-11 of the Preliminary FIF).

Any term shorter than 30 to 45 years would also be in the interest of the state in that it would reduce the contractual period for which the state's taxes would be stable. The administration supports shortening the period of fiscal stability along the lines of the provisions included in last version of SB 3002 considered by the Senate Special Committee on Natural Gas Development during the third special session of the Twenty-Fourth Legislature. The administration acknowledges that the general public also made extensive comments on this issue.

#### **CNSTL\_02: (19 Comments)**

**Statement of Concern:** Statements that the contract would prevent Alaskans from using the initiative process to propose new tax laws.

**Response:** The contract does not affect the people's power to propose new tax laws. However, pre-existing state law and the federal and state constitution may operate to delay or neutralize the effect of taxes levied by initiative. The law making powers assigned to the legislature may be exercised by the people subject to certain limitations imposed by the Alaska Constitution. Initiated laws operate in the same manner as laws passed by the legislature, except that they may not be repealed for two years after enactment. The SGDA gives the governor the power to propose a contract that grants fiscal stability to certain

taxpayers. The federal and state constitution forbids the enactment of laws that impair the obligations of contracts. This constitutional prohibition applies to initiatives as well as laws enacted by the legislature. After the effective date of the fiscal contract, a taxpayer subject to a tax levied by initiative could either decline to pay the tax, or could pay the amount assessed and seek reimbursement from the state. The tax law remains on the books and could be assessed against a taxpayer who withdraws from the fiscal contract or is otherwise not covered by the fiscal stability provisions.

**CNSTL\_03: (10 Comments)**

**Statement of Concern:** Statements that the contract is unconstitutional because it does not maximize the benefit to the people of the state; and the contract will significantly infringe on the open access values in Article VIII of the Alaska Constitution.

**Response:** In developing a contract under the SGDA, the commissioner is directed to "maximize the benefit to the people of the state of the development of the state's stranded gas resources." This broad policy directive is similar to the policy expressed in Article VIII § 2 of the Alaska Constitution, which provides that natural resources belonging to the state be utilized, developed, and conserved "for the maximum benefit of its people."

In following the broad directive to "maximize the benefit to the people of the state", the proposed contract includes consideration involving benefits other than solely revenue. While revenue opportunities should be, and were, seriously considered, there is no requirement that the meaning of "maximize the benefit" be limited to an evaluation of revenue potential. By progressing development of Alaska's stranded gas resources, the proposed contract provides revenue benefits to the people of the state as well as additional quantifiable and qualitative benefits.

The proposed SGDA contract complies with this policy directive by providing significant benefits to the state through progressing development of the state's stranded gas resources. The three key ingredients of the proposed gas pipeline contract—fiscal certainty, state equity participation, and the state taking gas in-kind and committing to ship it on the pipeline—improve the project's internal rate of return, thus making it more likely that the gas pipeline project will be built. Under the proposed contract, the state will receive significant oil and gas revenues that will be comparable to those the state would have received under the 2005 fiscal regime.

A gas pipeline will encourage development of the vast ANS gas resources and will extend the life of the Trans Alaska Pipeline System. In addition, Alaska and Alaskans will receive significant benefits through revenues from the sale of the state's share of the gas (tax and royalty), additional jobs both during construction and after the construction phase with local hire to the extent allowed under law, and the availability of gas supplies from in-state pipeline offtake points. Alaska needs to transition from an oil based economy to a gas based economy over the next 10 to 20 years. If we are able to do so within 10 years the adverse impact to state revenues will be less than if revenue receipts from the state's gas are deferred for 20 years or more.

The state's discretionary budget is currently about \$3 billion a year. Fortunately, unprecedented high oil prices have created budget surpluses in recent years. However, oil

prices are expected to decline to a long-run average of \$35. At that price the State would currently be running a \$1 billion deficit.

Moreover, TAPS is now running 60 percent empty, despite investment in recent years of nearly \$1 billion annually. The Department of Revenue estimates that \$1.8 billion is required annually to keep production at a constant level. This is nearly twice the amount being spent in recent years.

Current production is about 800,000 barrels per day and is expected to be about 100,000 less by 2015.

In addition, with 2 percent annual growth the budget would be \$4 billion by 2015. Yet the two percent is conservative; increased state debt, Medicaid, unfunded pension liabilities, and government operating expenditures could very well cause higher growth.

Thus there are three major forces driving toward massive budget problems: declining oil prices, declining oil production, and a growing budget. (Non-oil revenues may add another \$0.5 billion annually.) In the absence of a gasline or new budget sources, such as broad-based taxes, annual deficits will grow to \$1.5 billion annually by 2015; a cumulative deficit of \$10 billion from now to then. Under these assumptions the Constitutional Budget Reserve Fund (CBRF) will be depleted by 2009.

Furthermore, natural gas production would not start until 2016, were the proposed contract to be executed in 2006. In other words, the state revenue stream from gas will not occur until 10 years after the execution of the proposed contract. The delay of building the gasline would only lead to the delay of the state revenue stream from gas, which would deepen the state deficit until the first gas flows.

All discussed above underscore the need to get the gasline constructed soon. At a mid-range forecast of \$5.50/mmbtu in Chicago, the proposed contract terms would generate annual revenues to the State between \$2 to \$3 billion.

Not only would the gasline allow the continuity of essential state services while minimizing the tax burden of its citizens, it would also extend the oil life of the ANS, bringing in additional billions of dollars over time, as well.

#### **CNSTL\_04: (33 Comments)**

**Statement of Concern:** Statements expressing a general concern that the contract may be illegal because the SGDA must be amended in order to accommodate proposed contract terms, and thus the project may not be qualified under the SGDA and should not be approved.

**Response:** This is incorrect. In his letter dated October 27, 2005, to the commissioner of natural resources, the attorney general set forth a detailed analysis of this specific question and advised that the administration's course of conduct on the SGDA negotiations, including the proposal of supplemental legislation needed to implement provisions of the proposed contract, was both authorized and lawful. Further, because the contract cannot be executed without legislative authorization, no proposed contract (or accompanying implementing legislation) could violate the SGDA.

**CNSTL\_05: (2 Comments)**

**Statement of Concern:** Statements suggesting that the contract should be voted on by Alaskans.

**Response:** The state election code controls what may be placed on the general election ballot. Existing state law does not authorize a vote of the people on the execution of the fiscal contract. The legislature would need to pass a law authorizing such a vote. In the past, the legislature has authorized advisory questions on the ballot on various subjects. Other than the delay occasioned by scheduling an advisory vote, it is within the discretion of the legislature to determine whether to seek the advice of the people through a public vote. Beyond an advisory vote, it may be possible for the legislature to tentatively authorize the fiscal contract subject to it taking effect upon an affirmative vote of the people. This method carries with it a possible legal challenge that, by allowing such a vote, the legislature would be improperly delegating its legislative function to the people. In any case, as explained earlier, there is presently no authority for a vote of the people being a part of the process to authorize the fiscal contract.

**CNSTL\_06: (5 Comments)**

**Statement of Concern:** Statements indicating that the contract is unconstitutional because the contract changes the lease provisions upon which the original leases were granted.

**Response:** Any change to an existing lease would be at the option of the sponsors of the project. They will voluntarily accept the changes in order to receive the benefits of the fiscal contract. Under the contract, the sponsors could add new leases to the contract if they desire to receive fiscal certainty as to oil and gas produced from those leases provided that a model upstream contract law in the form of Attachment 1 to the May 24 contract is enacted. Other ANS leaseholders may take advantage of the uniform upstream fiscal contract if the conditions of that program are followed. The process contemplated by the SGDA provides adequate notice to the public of the changes in existing leases necessary to implement the fiscal contract. For these reasons it is believed the Alaska Constitution would not be violated if the commissioner were allowed to negotiate terms which alter the provisions of existing oil and gas leases.

**CNSTL\_07: (8 Comments)**

**Statement of Concern:** Statements concerned that the contract prohibits court action on the constitutionality of the contract and that prohibits municipalities or political subdivisions from initiating any court action with respect to the contract.

**Response:** The proposed contract does not prohibit court action on the constitutionality of the contract or prohibit municipalities and political subdivisions from initiating lawsuits with respect to the contract. Except for the parties to the contract, any person, including an incorporated municipality, may challenge the constitutionality of the contract as provided in AS 43.82.440 and other applicable law. For instance, under AS 09.65.080, a public corporation may bring an action in its corporate name on a cause of action accruing to it in its corporate character.

**CNSTL\_08: (2 Comments)**

**Statement of Concern:** Concerns with the scope of Article 41.2

**Response:** Article 41.2 states that “. . . any right, privilege, or obligation of a Party in a lease, other agreement, regulation, rule, order or decision is amended for the Term only to the extent necessary to conform with the provisions of this contract. . . .” Other terms of those leases, unit agreements, or other documents are not affected by the contract. The language, ‘only to the extent necessary to conform’ was explicitly included to limit the scope of this provision. Given that, the sponsor group was concerned that other agreements, regulations or decisions could be used to undermine commitments made within this contract. If the contract terminates, due to lack of diligence or for any other reason, this provision also terminates.

**CNSTL\_09: (1 Comment)**

**Statement of Concern:** Statements concerned about third-party lawsuits that may be brought to delay or halt construction, and advocating contract language to prevent them.

**Response:** The proposed contract states that it does not create any third-party rights. If such a judicial challenge is filed, however, the proposed contract provides that work on project planning and development will continue. The contract provides that work on the project cannot be suspended by the sponsors until fifteen months has elapsed while the judicial challenge proceeds.

**CNSTL\_10: (1 Comment)**

**Statement of Concern:** Statements suggesting that before approving the proposed contract, the legislature require documentation of ownership, governance management, and control of the state’s participation.

**Response:** The administration intended that the legislature would have an opportunity to review the terms of the state’s proposed mainline LLC agreement prior to the approval of the fiscal contract in order to fully understand how the state’s decision to acquire an ownership interest in the project would be implemented in practice. The administration has acknowledged the legitimacy of this concern and worked hard to complete the LLC negotiations with the sponsor group so that the state’s proposed mainline LLC agreement could be reviewed by the legislature prior to any vote approving the fiscal contract. These negotiations were not completed, but the state intends to release to the public the state’s proposed LLC agreement. The proposal represents what the state believes it could accept in an ownership agreement. Although the negotiations with the sponsor group were productive and many issues were resolved, the parties could not resolve some significant final points. As a result, the sponsor group has not accepted the proposed LLC agreement.

**CNSTL\_11: (1 Comment)**

**Statement of Concern:** Statements expressing concern that, in the terms of the fiscal contract, the state waives its presumption of correctness.

**Response:** Certain value judgments were made concerning the fairness of dispute resolution procedures. It was determined to adopt arbitration as the preferred method to achieve fairness on the side of the state and the sponsor group. It was also thought fair to remove presumptions in favor of the state that tip the scales of justice slightly in the state’s favor. The

parties to the fiscal contract are sophisticated and capable of prosecuting enforcement actions and mounting effective defense without having to contend with a presumption of correctness.

All disputes under the contract are subject to arbitration according to a carefully balanced set of rules modeled on the rules of the International Center for Dispute Resolution ("CPR"). Arbitration is widely utilized in U.S. and international commercial contracts to resolve disputes. In a number of existing contracts the state has agreed to an arbitration clause and has successfully invoked it. One example is the ANS Royalty Settlement Agreement (RSA) among Atlantic Richfield Company, ARCO Alaska, Inc., and the State of Alaska.

**CNSTL\_12: (2 Comments)**

**Statement of Concern:** Statements indicating that (a) the debate centers on our constitution's explicit prohibition against surrendering, suspending, or contracting away the power of taxation; (b) our courts have consistently defined "general law" to mean "statute"; and (c) two of Alaska's constitutional founding fathers have weighed in on the subject. No delegate would have considered turning over Alaska's oil and gas resources or stripping the legislature and voters of the right to control the state's tax system.

**Response:**

(a) See CNSTL\_01 response.

(b) The Attorney General's May 10, 2006 Memorandum<sup>7</sup> interprets "general law" to mean a statute which authorizes a tax exemption. If that statute grants an exemption for a set period of time, then the contract Clause of the United States Constitution will likely prevent a subsequent legislature from retreating from the provided exemption. The statement concludes that a tax exemption granted by statute for a period of time necessarily means that the exemption can be repealed by any subsequent statute. The Attorney General believes the better view is that if there is no blanket constitutional prohibition against the contracting away of the power to tax and if a tax exemption is set forth in a statute in an unmistakable manner and is intended to last for a set period of time, then the exemption will not be subject to change due to the operation of the contract Clause.

(c) Over thirty years ago, the Alaska Supreme Court determined that "subsequent testimony of even the prime sponsor of a bill as to either his own understanding or the legislature's understanding of the meaning of the bill should not be considered." The Court has reiterated this position on several occasions. While statements made on the official record by delegates during the constitutional convention would be entitled to significant weight in determining the meaning of the Constitution, post-adoption comments made fifty years later are entitled to little, if any, weight. The question of the constitutionality of any Alaska law will ultimately be decided by the Alaska Supreme Court, and so it is appropriate to look to the evidence that the court would find relevant. The Court has made clear on multiple occasions, that the subsequent statements of a lawmaker about what a law was intended to do has no weight in a judicial proceeding.

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<sup>7</sup> Attorney General's Memorandum to the Commissioner of Revenue re: *Effect of Article IX, Sections 1 and 4 of the Alaska Constitution on Proposed Stranded Gas Development Act Contract Terms*. File No: 661-03-0485. May 10, 2006

### 3.2.3 CNFDL: Confidentiality and Secrecy—SOC and Responses

This issue category addresses concerns regarding the openness of the contract negotiation process.

#### **CNFDL\_01: (9 Comments)**

**Statement of Concern:** Statements expressing concern that the legislature was asked to vote on the PPT before the contract was released.

**Response:** PPT legislation, while related to the contract, was an independent legislative decision, and was not dependent on the release of the contract. In any event, the PPT legislation that passed in August 2006 was passed well after the contract was released in May 2006.

#### **CNFDL\_02: (72 Comments)**

**Statement of Concern:** Statements expressing concern that the contract was negotiated in secret and that secrecy has replaced open discussions of oil and gas policies.

**Response:** Negotiations were conducted under the confidentiality provisions of the SGDA, which were meant to protect confidential information of the sponsors from being made public during the negotiation process. The state simply was not free to conduct public negotiations even if it wanted to.

#### **CNFDL\_03: (7 Comments)**

**Statement of Concern:** Statements indicating that the state government did not follow a court-ordered mandate to release the contract.

**Response:** The contract was released in accordance with law.

#### **CNFDL\_04: (15 Comments)**

**Statement of Concern:** Statements expressing support of how the negotiations were conducted. This SOC also includes statements indicating that negotiating the contract in secret does not necessarily mean it is not in the best interest of the state.

**Response:** In this case, we agree that confidential negotiations were in the best interest of the state, and they were required by the SGDA. There simply would not have been any negotiations with the sponsor group, or any other applicant, had they been in public. No negotiations would mean no contract, which would mean no gas pipeline.

### 3.2.4 SGDA: SGDA Concerns—SOC and Responses

This issue category covers comments and responses regarding the Stranded Gas Development Act (SGDA), particularly on issues such as legality of the contract, changes to statutes, negotiating with the sponsor group, and other legal issues.

#### **SGDA\_01: (14 Comments)**

**Statement of Concern:** Statements that the contract may be in violation of the SGDA because it includes changes in taxes and incentives for oil production and development.

**Response:** The Attorney General of Alaska has examined this question and has concluded that, with certain legislative changes to the SGDA, the contract will not be in violation of the law. See response to CNSTL\_04.

**SGDA\_02: (9 Comments)**

**Statement of Concern:** Statements asserting that the sponsor group holds the leases and own the production infrastructure, and therefore it makes sense to develop the contract with the sponsor group.

**Response:** The state agrees provided that contract terms acceptable to all parties can be reached.

**SGDA\_03: (2 Comments)**

**Statement of Concern:** Statements expressing concern that the laws could possibly be changed to allow the over-the-top route.

**Response:** Federal law presently prohibits an over-the-top route. While in theory the law could be changed, that is highly unlikely. To guard against such a change, the Fiscal contract also prohibits an over-the-top route so that even in the unlikely event that the law was changed, the sponsor group would face a strong deterrent to changing the route. A change in route would be a breach of contract that would cause the sponsor group to lose the favorable tax treatment and other incentives afforded by the fiscal contract.

**SGDA\_04: (2 Comments)**

**Statement of Concern:** Statements indicating that the state should not negotiate with the oil companies because of the way they manipulated tariffs on TAPS.

**Response:** The FERC and RCA have overseen TAPS tariffs since the opening of the pipeline and any "manipulation" has been resolved through decisions of those agencies and tariff settlements that the state has voluntarily entered into. Further, to the extent that the state is an owner of the entity that will set the tariffs on the Alaska gas pipeline, it will be in a better position to guard against what some might call rate manipulation.

**SGDA\_05: (5 Comments)**

**Statement of Concern:** Statements asserting that the oil companies are using the SGDA process/contract to change the industry's fiscal structure without any real intention to build the gas pipeline.

**Response:** The sponsor group has already spent more than \$125 million on a pipeline feasibility study. Under the work commitments section of the fiscal contract, the sponsor group is committed to begin the planning process (the first steps to build the line) within 90 days of the effective date of the contract. A series of specifically enumerated steps will then follow such that a pipeline could begin operation some 10 years from now.

If the sponsor group signs the contract but then do not take the necessary steps to build the pipeline, the state has the right to terminate the fiscal contract. If termination occurs, the sponsor group will lose all the fiscal rights they have under that contract. In the end, no gas pipeline means no change in the industry's fiscal structure. To strengthen the contract's work

commitments clause, the state is proposing to incorporate the May 10, 2006 project summary timetable into the contract; to create a new remedy of a diligence order which gives the tribunal options in addition to termination; to require participants to provide collectively a \$1 billion letter of credit and allow the state to draw on it if project sanction has not occurred by the fourth contract year; and to create a presumption within the contract that if sanction does not occur within five years of the effective date, there is lack of diligence. It should also be noted that with the passage of the PPT, the ANS producers are paying a premium for fiscal certainty that is not beneficial to them unless they move forward with the development of ANS gas.

**SGDA\_06: (2 Comments)**

**Statement of Concern:** Statements expressing concern that the specifics of the Qualified Project are not defined by route, by extent, by scope, by investment, by participation, by timing, by operation, or by generally any other means.

**Response:** The state is proposing changes in Articles 4.1 and 39.1 to specifically reflect the qualified project plan (QPP) with respect to route, dimensions, pressure, and expandability. The state is also proposing that the timing of various phases of the project be added to Article 5.4 incorporating the May 10, 2006 project summary in the fiscal contract as Exhibit S.

**SGDA\_07: (3 Comments)**

**Statement of Concern:** Statements concerned about the lack of state control over changes to the qualified project plan and the absence of any provision in the contract requiring state consent to changes in the Qualified Project Plan as part of the work commitments associated with the contract.

**Response:** The state does not believe that it (or any member of the sponsor group) should have veto power over changes to the project plan. This project will not be built more rapidly by giving anyone the ability to unilaterally block a plan change. The state is partnering with the sponsor group to get this line built; it is not the sponsor group's antagonist. Any veto power recommendation reflects a fundamental distrust of the sponsor group's commitment to build the project in a timely manner. The state does not share that distrust and thus does not agree that additional contractual language of the type suggested is necessary or even desirable. The present language that allows for 1) the state to initiate termination of the contract if the project has not progressed in a diligent manner, 2) the sponsor group to cure any deficiency in a timely manner, and 3) actual termination if there has been a lack of diligence and a failure to cure, is sufficient.

The work commitments contained in the contract were crafted to ensure that the next stage of the project is started promptly, and that a disciplined, thorough project management process is implemented and maintained to control development and construction of the pipeline, ensuring the most cost-effective and timely project completion possible, and minimizing the risk to both the state and the sponsor group. As a 20 percent owner of the mainline LLC and a member of the LLC's management committee, the state through Alaska PipeCo will participate in the project planning and oversight of the operator that builds the pipeline. State ownership will provide Alaska PipeCo a continuing opportunity to know what is going on inside the project company, be heard on key issues and influence the course of the project development. If, at any time, the state does not believe that the project is being advanced

diligently, it can terminate the contract. The potential for terminating the very deal that the parties have spent three years negotiating is significant leverage over the sponsor group, as the sponsor group will lose all of the benefits of fiscal certainty if this contract is terminated by the state.

**SGDA\_08: (2 Comments)**

**Statement of Concern:** Statements indicating that it is unlawful to include a petroleum production tax (PPT) in the contract.

**Response:** As noted in CNSTL\_04, it was not unlawful for the administration to include provisions in the contract that would require legislative changes to implement. See the October 27, 2005, opinion of the Attorney General. The parties included a PPT provision in the contract knowing that 1) the legislature would have to change existing law; and 2) the PPT provision in the contract would have to be changed to conform to whatever PPT law the legislature enacted. Now that the legislature has passed and the governor has signed the PPT legislation, the state expects that the contract will be revised as appropriate.

**SGDA\_09: (1 Comment)**

**Statement of Concern:** Statements saying the contract is not consistent with the SGDA termination provisions.

**Response:** Article 5 and Article 28 together address all of the termination requirements of AS 43.82.445. Separately, each article does not cover all the statutory requirements but together they do. The specific administration termination terms were negotiated and agreed to in the contract. As part of addressing the overall dispute resolution issues, the procedure for administrative termination, however, was changed to be subject to approval by the legislature.

**SGDA\_10: (1 Comment)**

**Statement of Concern:** Statements indicating that the state is disadvantaged in the negotiations because the state does not have the same breadth and depth in resource pool as the sponsor group.

**Response:** We do not agree with that assessment. In addition to its "in-house" talent within the Departments of Natural Resources, Revenue, Law and Labor, the state has hired various top-quality financial and legal outside experts to aid it in negotiations. The end result, in our opinion, is a fiscal contract and the state's proposed mainline LLC agreement that contain fair and reasonable terms for all parties, including the state.

**SGDA\_11: (1 Comment)**

**Statement of Concern:** Statements indicating that the state should not be negotiating with the sponsor group because of their environment record on the ANS.

**Response:** Regardless of one's view on the sponsor group's environmental record on the ANS, the fact is that the sponsor group holds leases for approximately 98 percent of the proven ANS gas reserves. There will not be a gas pipeline without negotiations with the leaseholders of the very gas that must travel through that pipeline to get to markets in the lower 48. To make the gas pipeline become a reality, the state has chosen to become actively

involved in negotiations. Overall, over the last 40 years, the members of the sponsor group have proven to be some of the most prudent and responsible operators in the world of oil and gas exploration, production and transportation.

**SGDA\_12: (1 Comment)**

**Statement of Concern:** Statements advocating the inclusion of an Appendix to the contract that specifies the project design for the "Qualified Project" as a pipeline capable of transporting between 4 and 4.5 bcf/d; initially expandable through infill compression to 6 bcf/d.

**Response:** The state is proposing to include in the fiscal contract itself such a description from the May 10, 2006 Project Summary. The project summary addresses pipeline dimensions and expandability, although we expect these to be refined as project engineering advances.

**SGDA\_13: (1 Comment)**

**Statement of Concern:** Comments expressing concern that because the contract terms are not final and the legislature may require changes that the public may not be able to adequately comment.

**Response:** The public comment/legislative approval process is required by the SGDA. That process contemplated a public comment period followed by a renegotiation period reflecting the comments received, and then legislative approval of a final contract. That is the process being followed. Once renegotiations have been completed, the parties will submit the contract to the legislature for final approval. The public has a right to petition their legislators and in that manner comment on the terms of the fiscal contract.

**SGDA\_14: (4 Comments)**

**Statement of Concern:** Statements concerned that the contract allows the participants (but not the state) to amend the project plan each year. (Section 5.3) page 65, "The mainline entity shall coordinate and update the Qualified Project plan....each year thereafter until the commencement of operations..."

**Response:** No project, especially one this large, can be expected to go exactly as initially planned and, therefore, there should be an ability to amend a project plan. The state has protected itself by contract provisions that allow it to either seek termination of the fiscal contract or to bring a dispute, depending on the circumstances, in the event that it disagrees with a change to the project plan.

The state itself cannot change the project plan. The mainline LLC that will own the main pipeline is responsible for updates and changes. The state will be a 20 percent owner of that mainline LLC, and thus will have a voice in any proposed updates/changes.

**SGDA\_15: (2 Comments)**

**Statement of Concern:** Statements concerned that the contract terms have ignored the advice and expertise of many outside experts hired by both the Department of Natural Resources and the Legislative Budget & Audit Committee. Many millions of dollars were spent soliciting their guidance and to have it ignored is a travesty to the state's best interest.

**Response:** The advice of outside experts has not been ignored. Much of the consulting work done by experts hired by the DNR or the Legislative Budget and Audit Committee were taken into account in developing and evaluating the contract and its impact on the state. Technical changes to the contract (e.g., how the effective date is determined, better description of the project and its route) have also been made based on advice from those experts. Notwithstanding, there are substantive areas of disagreement with those experts and, while the state has not ignored them, it has chosen not to accept all of their recommendations.

**SGDA\_16: (3 Comments)**

**Statement of Concern:** Comments expressing concern that the lack of material information renders the commissioner's findings, as stated in the Preliminary FIF, deficient.

**Response:** The commissioner determined he had sufficient information in the Preliminary FIF to satisfy his obligations under § 42.83.400 of the SGDA whether the proposed (and agreed upon) fiscal terms in the contract are in the long-term interest of the state.

**SGDA\_17: (1 Comment)**

**Statement of Concern:** Statements indicating that the fiscal contract is not ripe for consideration because other related contracts have not yet been revealed.

**Response:** The SGDA grants the commissioner to authority to negotiate a proposed contract, the terms and scope of which are specified in AS 43.82.200. They include:

1. terms concerning periodic payment in lieu of one or more taxes;
2. terms relating to royalty pursuant to AS 43.82.220;
3. terms regarding the hiring of Alaska residents and contracting with Alaska businesses under AS 43.82.230;
4. terms regarding periodic payment to, or an equity or other interest in a project for, municipalities under AS 43.82.500;
5. terms regarding arbitration or alternative dispute resolution procedures;
6. terms and conditions for administrative termination of a contract under AS 43.82.445; and
7. other terms and conditions that are:
  - a. necessary to further the purposes of this chapter; or
  - b. in the best interest of the state.

The proposed contract incorporates the essential fiscal terms required by the SGDA. There are other documents that may have an impact on the project but were neither required nor contemplated by the SGDA. The project entity governance agreements are a good example of this. Although the state's proposed mainline LLC agreement will be helpful in making a determination as to whether the state should consider an ownership interest in the pipeline, it is not required to be negotiated or presented to the public in advance a decision to approve the contract as part of the SGDA process. While there are many other contracts that will be negotiated and executed by the state from the time the fiscal contract is first approved until the production of first gas, the critical step is to consider and approve a fiscal contract that

fully meets the scope and intent of the SGDA and that has been presented to the legislature and the public for review.

The other documentation that will need to be finalized in order to implement the larger project will be based on the essential principles of the deal set forth in the fiscal contract and is not anticipated to have an impact on the commissioner's findings set forth in the Preliminary FIF or the Interim.

**SGDA\_18: (1 Comment)**

**Statement of Concern:** Statements indicating that the contract should be limited to only those leases and properties necessary to secure gas supplies to meet shipping commitments on the initial capacity of the pipeline.

**Response:** To encourage producers other than the sponsor group to explore and develop presently non-proven gas reserves, and to promote a level playing field, the state believes that it is the state's best interest to provide the fiscal benefits to anyone else willing to make a firm transportation commitment to ship gas on the pipeline. Hence, the state is asking the legislature to pass a Uniform Upstream Fiscal contract law that will accomplish that goal.

**SGDA\_19: (1 Comment)**

**Statement of Concern:** Statements indicating that Chevron should be included as an additional party to the contract prior to its execution.

**Response:** The state is aware that Chevron has inquired about ownership in the project and is willing to consider that possibility.

**SGDA\_20: (1 Comment)**

**Statement of Concern:** Statements suggesting that to avoid a debate on the separation of power argument discussed by the administration, a solution that may accommodate both the legislature's prerogatives under the Stranded Gas Development Act ("SGDA") and the administration's prerogatives to execute the legislature's directives, would be for the legislature to amend the SGDA to require that the template LLC agreement be included as an exhibit to the SGDA contract. In this way, the terms of the template LLC agreement may be reviewed and encompassed within the legislature's approval of the overall SGDA contract. The administration would then be able to finalize and execute the various required LLC agreements based upon the approved template LLC agreement without further review and approval of the legislature.

**Response:** The state's proposed draft mainline LLC agreement will be attached to the Interim FIF as Appendix O. An article-by-article review of the proposed draft LLC agreement will also be provided in Appendix P of the Interim FIF.

### **3.2.5 LEGIS: Legislative Process—SOC and Responses**

This issue category covers comments regarding the legislative review of the proposed contract and the commissioner's preliminary findings and determination.

**LEGIS\_01: (8 Comments)**

**Statement of Concern:** Statements expressing concern that the governor will make changes according to what industry wants without regard to the legislative process.

**Response:** The governor respects the role of the legislature in the public review process. He has listened to the concerns expressed by the legislature and is proposing several amendments to the fiscal contract consistent with what they recommended.

**LEGIS\_02: (2 Comments)**

**Statement of Concern:** Statements suggesting that there should be an independent/bipartisan panel to ensure that Alaskan interests are addressed and not the interests of the governor.

**Response:** To ensure that Alaskan interests are addressed, the SGDA requires authorization by the legislature before the contract becomes binding on the state. It is up to the legislature and the governor as elected officials to assure that Alaska's interests are met.

**LEGIS\_03: (6 Comments)**

**Statement of Concern:** Statements indicating that the deal does not have to be decided during this legislature.

**Response:** The parties have reached a tentative deal and waiting for a new administration and/or legislature can only serve to stop the momentum needed to finalize the deal. To partially start over next year could set the project back several years. Meanwhile, as the state's fiscal experts have repeatedly pointed out, any delay increases the risk that LNG imports may fill the void left by a delayed project or that escalating resource costs will dramatically raise the cost of completing a pipeline, thereby jeopardizing its very viability.

The federal government has also recently emphasized the need to get the project started immediately – not next year or even later. Our energy security hinges in part on ANS gas reserves and delay only exposes this nation to continued dependence on foreign energy sources.

In addition, any delay will further exacerbate the state's looming fiscal gap that threatens the future of the state. The state's discretionary budget is currently about \$3 billion a year. Fortunately, unprecedented high oil prices have created budget surpluses in recent years. However, oil prices are expected to decline to a long-run average of \$35. At that price the state would currently be running a \$1 billion deficit.

Moreover, TAPS is now running 60 percent empty, despite investment in recent years of nearly \$1 billion annually. The Department of Revenue estimates that \$1.8 billion is required annually to keep production at a constant level. This is nearly twice the amount being spent in recent years.

Current production is about 800,000 barrels per day and is expected to be about 100,000 less by 2015.

In addition, with 2 percent annual growth the budget would be \$4 billion by 2015. Yet the two percent is conservative; increased state debt, Medicaid, unfunded pension liabilities, and government operating expenditures could very well cause higher growth.

Thus there are three major forces driving toward massive budget problems: declining oil prices, declining oil production, and a growing budget. Non-oil revenues may add another \$0.5 billion annually. In the absence of a gas pipeline or new budget sources, such as broad-based taxes, annual deficits will grow to \$1.5 billion annually by 2015-- a cumulative deficit of \$10 billion from now to then. Under these assumptions the Constitutional Budget Reserve Fund (CBRF) will be depleted by 2009.

Furthermore, natural gas production would not start until 2016, were the proposed contract to be executed in 2006. In other words, the state revenue stream from gas will not occur until 10 years after the execution of the proposed contract. The delay of building the gas pipeline would only lead to the delay of the state revenue stream from gas, which would deepen the state deficit until the first gas flows.

All discussed above underscore the need to get the gas pipeline constructed soon. At a mid-range forecast of \$5.50/mmbtu in Chicago the proposed contract terms would generate annual revenues to the state between \$2 to \$3 billion.

Not only would the gas pipeline allow the continuity of essential state services while minimizing the tax burden of its citizens, it would also extend the oil life of the ANS, bring in additional billions of dollars over time, as well.

**LEGIS\_04: (6 Comments)**

**Statement of Concern:** Statements expressing concern that the legislators are not standing up to the governor and that the contract would pass due to political pressure.

**Response:** To date, those concerns appear to be quite unfounded.

**LEGIS\_05: (1 Comment)**

**Statement of Concern:** Statements expressing concern that the legislators with a conflict of interest with the project should recuse themselves.

**Response:** We are not aware of any legislators who have a conflict of interest requiring them to refrain from taking action on the fiscal contract. This is a matter for the legislature to decide.

**LEGIS\_06: (4 Comments)**

**Statement of Concern:** Statements expressing concern that the legislators are not discussing contract issues with their constituents.

**Response:** The commissioner of revenue acknowledges these comments, but notes that this is a matter for members of the legislature to address.

**LEGIS\_07: (17 Comments)**

**Statement of Concern:** Statements suggesting that information on the details and analyses of the contract are important in order for the legislature to make informed decisions; the legislature has the responsibility for due diligence; efforts should be made to share information.

*Response:* We agree and have made significant amounts of contract-related information available to the legislature and the public. In addition, state and outside expert personnel have appeared extensively before legislative committees and have met with legislators in public and private. We are not aware of any claims that information or personnel has been withheld.

**LEGIS\_08: (3 Comments)**

**Statement of Concern:** Statements indicating the legislature will and should have the final say.

*Response:* That is consistent with present law and the governor has stated many times that he wants the legislature to have the final say on the contract.

**LEGIS\_09: (2 Comments)**

**Statement of Concern:** Statements indicating that the contract should require that any change to the project must be subsequently approved by the legislature to be effective; otherwise it undermines the initial legislative approval process and public input.

*Response:* The parties have heard this concern expressed by several commenters and the administration is proposing to amend the contract so that the legislature will have an opportunity to consider certain appropriation related amendments to the contract.

**LEGIS\_10: (9 Comments)**

**Statement of Concern:** Statements expressing concern that the legislature wants to increase the tax burden of the oil companies and this will cause a decrease in future investments in the state.

*Response:* That very issue has been debated extensively during the past legislative session and the subsequent special sessions. The legislature has now passed, and the governor has now signed, a new PPT law that is designed to create further incentives for gas exploration and development in Alaska.

**LEGIS\_11: (72 Comments)**

**Statement of Concern:** Statements expressing concern that the legislature will not pass the contract due to political posturing, and/or disagreements over small differences in the PPT.

*Response:* To date, the legislature has not authorized the governor to execute the contract. We believe that it is neither possible nor appropriate to speculate on the motives of the legislature.

**LEGIS\_12: (2 Comments)**

**Statement of Concern:** Statements indicating the governor should sign the contract even without legislative approval.

*Response:* Present law does not permit this and the governor has said on many occasions that he wants the legislature to have the final say on the contract.

### 3.2.6 XOM: Exxon Settlement and Negotiating with Exxon—SOC and Responses

This issue category deals with comments concerned about the propriety of negotiating with ExxonMobil.

#### XOM\_01: (34 Comments)

**Statement of Concern:** Statements indicating that the state should not negotiate with ExxonMobil due to the oil spill and expressing concern that Exxon has yet to settle on damages from the spill.

**Response:** First, while the state remains concerned that the Exxon Valdez oil spill case remains open, the fact is that ExxonMobil is validly exercising its rights under our legal system. Second, members of the sponsor group control nearly 98 percent of the proven ANS gas reserves and ExxonMobil is one of them. It is not realistic to negotiate a gas pipeline contract just with the other two producers. It is equally unrealistic to stop doing business with a company on everything, including negotiating a gas contract, because of conduct over an accident that occurred some 16 years ago. Finally, the present issues with regard to BP's operation of some of the transit oil pipelines on the ANS further emphasize that it makes no sense to cease doing business with a company that has allegedly acted improperly. Together, BP and ExxonMobil control nearly two-thirds of the ANS gas reserves and the state must negotiate with both of those companies if it hopes to see a gas pipeline built.

### 3.3 General Comments on the Contract and the Preliminary FIF

This general area of concern included general comments that agreed or disagreed with the FIF that the proposed contract terms are in the long-term fiscal interests of the state and further the purposes of the SGDA. Also included were editorial comments on the Preliminary FIF.

#### 3.3.1 FIF: General Comments on the Preliminary FIF—SOC and Responses

This issue category covers general comments indicating agreement or disagreement with commissioner's preliminary findings and determination.

##### FIF\_01: (1090 Comments)

**Statement of Concern:** Statements in general agreement with the Preliminary FIF that the contract is in the best interest of the state.

**Response:** The commissioner of revenue agrees with this statement for the reasons detailed in *Section 9.2.2 Contract is in the Long-Term Fiscal Interest of the State* in the Preliminary FIF.

##### FIF\_02: (251 Comments)

**Statement of Concern:** Statements in general disagreement with the Preliminary FIF that the contract is in the best interest of the state.

**Response:** The commissioner of revenue disagrees with this statement for the reasons detailed in *Section 9.2.2 Contract is in the Long-Term Fiscal Interest of the State* in the Preliminary FIF.

### 3.3.2 EDI: Editorial Comments and Corrections—SOC and Responses

This issue category covers editorial comments on the commissioner's preliminary findings and determination.

#### **EDI\_01: (1 Comment)**

**Statement of Concern:** Statements suggesting the contract be reviewed for consistency with the governor's six principles.

**Response:** In the contract negotiation process, the state negotiating team was guided by the governor's six principles intended to ensure that its grand concept for the development of a natural gas industry goes beyond just a pipeline project. These principles are also used in *Section 4 Analysis of the Contract* in the Preliminary FIF to analyze the contract terms and the merits of the proposed pipeline project.

#### **EDI\_02: (5 Comments)**

**Statement of Concern:** Statements expressing concern that the contract is being falsely portrayed as the only option Alaska has to build a gas pipeline.

**Response:** The basic premise of the state was to negotiate a contract, satisfying the governor's six principles, that will bring Alaska a pipeline in as timely a manner as possible and avoid litigation delays. The sponsor group, under leases granted by the state, controls the gas on the ANS that the pipeline will transport to market. Sponsor group cooperation is necessary for the pipeline to be constructed or financed because they are the parties that must take the risk of signing firm transportation agreements to ship their gas on the pipeline. They are also the parties that will pay for any cost overruns through their payment of the tariff. Without their commitment to ship gas on the pipeline, the project applicant cannot obtain the financing necessary to build the gasline.

If the state resorts to forcing them through litigation to sell or ship the gas on a pipeline owned by a third party, it will be time consuming, expensive and the outcome of the litigation will be uncertain. With this as background the state has considered all applications received under the SGDA. A review of the record shows that the state engaged in serious dialogue with all applicants and seriously considered all proposals. Based on the state's discussions and negotiations with all SGDA applicants, it became clear that because the sponsor group control the gas, were willing to negotiate and had the technical and financial capability to build a pipeline as well as market the gas, pursuing a contract with the sponsor group would be the most expeditious way to secure a project under terms favorable to the state.

MidAmerican Energy Holdings Company submitted an SGDA application and negotiations followed. MidAmerican's demanded the exclusive right to build, own, and operate the pipeline, yet it had no commitment from the sponsor group to ship on the pipeline. In the state's view, such a sponsor group commitment is essential and without it, the pipeline can not go forward. The exclusivity provision would have precluded the state from negotiating

with any other party who submitted a SGDA application. MidAmerican's demand for exclusivity was non-negotiable from its point of view and MidAmerican therefore withdrew its application when the state refused to grant such exclusivity. Given that the SGDA is supposed to provide fiscal terms with respect to ANS gas, the proposal by Mid-America—a proposal to simply build the pipeline—does not meet the standards required in a fiscal contract.

Similarly, the state engaged in numerous and serious discussions with SGDA applicant, TransCanada. While the state and TransCanada achieved a conceptual understanding on many major issues and began development of a contract, the state determined that it was in Alaska's long term interests to concentrate on the sponsor group's application because they have the rights to gas, and were intent on building their own pipeline rather than making the capacity commitment and shipping their gas on a third party pipeline. TransCanada has pipeline rights in Canada which, they claim, are essential for a pipeline to transit Canada. The state has always sought TransCanada's involvement in the Canadian portion of the project and the state believes that TransCanada's involvement in the Canadian portion will expedite project completion.

Enbridge, Inc. also submitted an application and the state held preliminary talks with it. Enbridge was not willing to incur significant expenditures related to its application and did not, therefore, enter into a reimbursable agreement with the state. A reimbursable agreement would have enabled the state to retain independent contractors to review the Enbridge proposal. Thus, negotiations with Enbridge did not advance beyond the application stage.

**EDI\_03: (1 Comment)**

**Statement of Concern:** Statements suggesting that the contract/FIF should put definitions at the bottom of the pages to make reading easier for the public.

**Response:** In the Preliminary FIF, definitions to terms are provided as footnotes the first time the term is mentioned in the document. In addition, a glossary of terms is also provided in the front-end section of the document.

**EDI\_04: (1 Comment)**

**Statement of Concern:** Statements requesting clarification on total estimated revenues from oil and gas under the proposed fiscal terms.

**Response:** Cumulative total state revenues (including proceeds to municipalities) from all sources under the fiscal contract, including the PPT, would be expected to range from \$86 to \$306 billion, depending on future sustained prices for gas and oil. This translates to between \$16 and \$70 billion, respectively, in discounted net present value terms. The total amount of estimated state oil and gas revenues depends on future prices for gas and oil and discount rates. For example, the estimated total oil and gas revenues of \$35 billion under the proposed fiscal terms are based on \$5.50 per mmBtu of gas (Chicago city gate), \$35 per barrel of crude oil West Texas Intermediate (WTI) and a discount rate of 6 percent. See details in *Section 4.1.2 Total Revenue from Project* in the Preliminary FIF.

**EDI\_05: (1 Comment)**

**Statement of Concern:** Statements indicating that Alaskans need to have information about the potential range of Alaska's projected total and annual cash liability for the pipeline project. It is insufficient just to have economic models that project estimates of annual revenues. The use of different discount rates as well as the mixed use of nominal and real dollars is confusing in the FIF. The public should see charts that project a reasonable range of how much the state will be required to spend/forgo/invest annually for the next 40 years. The public likewise should see charts that project a range of the total revenue the state can annually reasonably expect in return for the next 40 years. Some projection of the likelihood of such costs and revenues is also appropriate.

**Response:** Cost and revenues accruing to the State of Alaska are accounted for in the economic models developed during the negotiation process. These models provide year-by-year outputs of costs and revenues [see Figure 7 and Figure 8 of the Preliminary FIF for example]. The FIF document has the potential to be overrun with tables if all the scenarios were presented in tabular form. In fact, some of the most reasonable ways to understand the flow of revenue and costs – taking into account the value of time – is to compute Net Present Value [NPV] and the Internal Rate of Return [IRR]. These metrics combine 50 years of revenue, costs and time into statistics that are relatively easy to understand and can be compared to other projects. In fact, Chapter 5 presents these metrics for the gas pipeline project and other projects. In addition, various prices and costs are used in the analysis to get a sense of the potential net revenue under different scenarios.

- Analysis is done using prices of \$3.50 per mmBtu [the stress case, or low price], \$5.50/mmBtu and \$8.50/mmBtu.
- Analysis is conducted using capital costs at six different levels – no cost overrun, cost overrun of 20 percent, 50 percent, 100 percent and 150 percent. See Table 9 page 78 of the Preliminary FIF.

The various cost overruns are combined with the different price scenarios to get a sense of the potential risk the project faces.

With respect to the use of different discount rates for the sponsor group than used for the state and municipalities, the state notes that different types of entities do have different discount rates: private business will in general require higher discount rates because they must balance the return on investments against its next highest use; governments on the other hand, will utilize a lower discount rate than the private sector because they are responsible not only for the well-being of constituents in the short-run, but also the well-being of future generations. For more information on this issue see the Preliminary FIF in *Section 4.1.1.2 Discounting Policy for Proposal Evaluation*.

**EDI\_06: (15 Comments)**

**Statement of Concern:** Statements concerning various data, including the standardization of base years, how data is compared, projected commodity prices, where revenues and costs are accrued, and the importance of certain costs.

**Response:** The state receives oil and gas revenues from a variety of sources. The categories for oil and gas revenues are: royalties; production tax; hazardous release fund contributions;

property taxes; corporate income taxes; and combined bonuses, rents and interest. All of the annual revenue categories are presented, both historically and projected, in the Revenue Sources Book published bi-annually and available on the internet.

Studies used to support the decision have been prepared over the past several years and therefore have different base years for economic analysis. This makes standardization of costs and revenues difficult. For instance, the producers conducted a joint, multi-year study on the feasibility of transporting gas to market. This study was based in 2001 dollars. The commissioner had a comparative analysis of the sponsor group's project and the LNG proposal prepared by Information Insights. This analysis, conducted in 2005 dollars, adjusted cost estimates to be comparative and to similar base dollars. Therefore, while results from individual studies may be difficult to compare due to different reference base years, the comparison study is standardized. While 2006 has seen changes in costs and prices, they have not changed disproportionately enough to require yet another updating of the base year for the studies.

The ELF or economic limit factor severance tax system in use during most of the analysis is sometimes difficult to understand. This is particularly the case for Kuparuk, the second largest oil field in North America which, beginning in 2005, paid no severance tax at all. The reason for this seeming inconsistency of size and revenue is due to the two decade old ELF system. Through a complex mathematical formula the ELF allowed 300 tax free barrels of oil per well per day. The exemption was instituted to allow for fixed operating cost recovery before taxes were assessed. Over time, technology and well dynamics changed to the point that productive fields with many wells paid little to no severance tax. That system was revised in August 2006 with the legislature's historic approval of a new Petroleum Profits Tax or PPT. The Interim FIF will contain an analysis that shows the economic and fiscal effects of the PPT as approved.

Some of the analyses conducted to support the preliminary findings and determination used a variety of revenue prices to test outcome profitability. These prices reflect both historic and current prices. Within the past decade natural gas prices have been \$2 per thousand cubic feet (mcf) while oil prices have been \$12 per barrel. Relatively recent increases in prices, especially to the levels seen in the wake of Hurricane Katrina, have seen natural gas sold for over \$10 per thousand cubic feet and oil topped \$75 per barrel. This wide a variation in recent prices mandates a wide range for valuation when considering a 45 year time horizon. While average future prices projected by producers and the state fall in a much narrower range, sensitivity analysis requires broader consideration.

Tanker transportation costs for natural gas to the west coast are expected to be \$0.40 per million Btu. This cost is based on a study conducted by PFC Energy which utilized reported operating costs for LNG tankers and extrapolated capital costs for U.S. constructed ships. PFC Energy is a worldwide consulting firm and their estimate is based on their knowledge of LNG tanker costs worldwide.

One commenter stated that high pipeline tariffs are one reason that ANS oil production is declining. TAPS tariffs are lower today than they were twenty years ago. ANS price increased from \$18 a barrel in 1984 to about \$70 a barrel today. The TAPS tariff of \$5.63 per barrel was about 25 percent of the delivered price in 1984 compared to a tariff of less than \$4.00 per barrel or 6 percent in 2006. Even with a lower tariff and higher oil prices,

production has declined as the fields mature. Technology has moderated the decline, but it has not totally compensated for field depletion.

TAPS tariffs are outside of the state's control. Oil pipeline tariffs within the U.S. are regulated (set) by the Federal Energy Regulatory Commission (FERC). Each owner in the pipeline calculates their tariff according to a settlement agreement approved by FERC. In a netback calculation the tariff reduces the value of the oil at the wellhead, but certainly this has not been a determining factor over the past few years.

When the gas pipeline is complete and gas begins to flow, all operation and maintenance (O&M) costs will be incorporated into the tariff. Similarly, O&M costs for field operations will be accrued against revenues by the producer. Additionally, under the PPT tax just enacted by the state, many O&M costs for gas operations will be deducted from gross oil revenues prior to determining production taxes.

### **3.3.3 ACK: Comment Acknowledged—SOC and Responses**

Comments coded to this SOC were found to be irrelevant to the Preliminary FIF or to the Fiscal Contract

#### **ACK\_01: (69 Comments)**

**Statement of Concern:** Comments that were not relevant to the Preliminary FIF or to the Fiscal Contract

**Response:** The commissioner of revenue acknowledges these comments, and appreciates the commenter's participation in the public process.

## **3.4 Work Commitments and General Project Timeline**

Issues in this general area of concern included work commitments from the sponsor group and the timeline for the gas pipeline project.

### **3.4.1 WORK\_COMM: Work Commitments from the Sponsor group—SOC and Responses**

This issue category deals with work commitments from the sponsor group for the gas pipeline project.

#### **WORK\_COMM\_01: (124 Comments)**

**Statement of Concern:** Statements expressing concern about the inadequacy of the work commitments provision of the contract, including concerns about a lack of milestones, a commitment to build, and penalties.

**Response:** The state believes that the contract released on May 24, 2006 included adequate provisions requiring the sponsor group to diligently pursue the project. Nonetheless, in response to concerns of the public and the legislature, the state is proposing amendments to the work commitment provisions (Article 5) which would strengthen them. For example, the state is proposing the inclusion of the May 10, 2006 Project Summary, which contains timelines for the various steps involved in completing the gas pipeline, as a part of the

contract. The state is proposing to require the owners of the mainline LLC to place a \$1 billion letter of credit in an escrow account as noted in the response to SGDA\_05 above and WORK\_COMM\_05 below. If certain milestones are not reached, that money will be forfeited to the state.

**WORK\_COMM\_02: (28 Comments)**

**Statement of Concern:** Statements indicating that the work commitments provisions of the contract as agreed to by the sponsor group are adequate, require due diligence in completing the project, and protects the interests of both the state and sponsor group.

**Response:** While the state generally agrees with the statement, it is nonetheless proposing revisions to the work commitment provisions (Article 5) to strengthen them, as noted above.

**WORK\_COMM\_03: (2 Comments)**

**Statement of Concern:** Statements expressing concern that the contract inadequately defined the term "diligence."

**Response:** The parties negotiated long and intensely over the diligence standard. The standard is "Diligence means advancing the project as diligently as is prudent under the circumstances." This Article 5.1 definition contains core elements of the prudent operator standard that some have advanced as an alternative standard even though it is a standard that was developed for the different context of lease obligations. While the state is proposing revisions to the work commitment provisions in Article 5, it does not intend to seek changes to the diligence definition as we believe that the term is sufficiently clear and detailed.

**WORK\_COMM\_04: (2 Comments)**

**Statement of Concern:** Statements indicating that the sponsor group should demonstrate their commitment to the project by building the gas conditioning plant.

**Response:** The gas conditioning plant will be built at the same time as the other project facilities. There is no reason to single out this approximately \$2 billion facility and have the sponsor group construct it in advance and without an approval from the legislature of the fiscal contract.

**WORK\_COMM\_05: (1 Comment)**

**Statement of Concern:** Statements expressing concern that the termination process set out in Article 5 of the contract makes it virtually impossible for the state to terminate the contract.

**Response:** The state disagrees with the conclusion that termination is virtually impossible under the fiscal contract. The termination standard was negotiated carefully and the standard was chosen to articulate a standard that would reflect the size and importance of the project, a standard that would make termination neither too easy nor too difficult. The standard, in fact, incorporates much of the prudent operator standard often employed in oil and gas field leases.

In light of public comment, the state is proposing several amendments to the work commitments clause to clarify and expand the remedies for failure to satisfy the work commitments. The state is proposing to create a new remedy of a diligence order to give the

Tribunal an option short of contract termination. The state is also proposing the sponsor group companies commit to a \$1.0 billion letter of credit that the state could draw on if the full amount is not spent by the fourth contract year. Also, the state is proposing that if project sanction has not occurred within five years following the effective date, there would be a presumption of an absence of diligence.

**WORK\_COMM\_06: (2 Comments)**

**Statement of Concern:** Statements concerned that there is no obligation in the contract to commit reserves; develop fields; deliver volumes; maintain deliverability; etc. on the part of the sponsor group to the contract or to the project.

**Response:** The commitment of reserves and the maintenance of volumes will be part and parcel of the capacity commitment process associated with the FERC open season. That process is described in detail in Article 10. At the open season the sponsor group (and any other producer) will, through firm transportation commitments, essentially commit their reserves at specified volumes to the project.

**WORK\_COMM\_07: (3 Comments)**

**Statement of Concern:** Statements indicating that the contract should be amended so that sponsor group benefits do not accrue until project sanction.

**Response:** The state agreed in the May 24, 2006 fiscal contract to grant the fiscal certainty to the sponsor group based on the time when the sponsor group begins to incur risk in the project. The contract requires the sponsor group to initiate project planning within 90 days of execution of the contract and to pursue the development of the project with diligence. The sponsor group will spend around \$1 billion prior to project sanction in moving the project forward, including activities such as the front end engineering and design, the open season, the FERC certificate and other agencies' permitting process. It was determined that it would be in the state's best interest to grant fiscal certainty from the time of execution of the contract to encourage the sponsor group to initiate project planning on the project and to move the project forward. The public expressed concerns that the sponsor group should not receive fiscal certainty until they commit to build the pipeline, that is, until project sanction. Upon review of the comments made during the public process the state is proposing revisions to the contract that would restrict certain benefits to the period following project sanction.

**WORK\_COMM\_08: (3 Comments)**

**Statement of Concern:** Statements expressing concern that the contract makes it too easy for the sponsor group to decide not to build a gas pipeline. Under the contract's terms no gas pipeline construction is required and no penalties are imposed in the first years of the contract if the corporations do not take action to proceed with a gas pipeline.

**Response:** This is not a correct reading of the contract. Within 90 days of the contract becoming effective, the sponsor group must begin project planning and then proceed through multiple pre-construction steps with "diligence". If the sponsor group "do not take action to proceed with a gasline", the state can, and likely will, bring a termination proceeding. If the sponsor group loses, the contract is terminated and the sponsor group will lose their fiscal certainty—a very strong penalty and deterrent. The state is also proposing that the sponsor

group post a \$1 billion letter of credit that could be drawn upon as an alternative remedy if the sponsor group fails to pursue the project with "diligence".

**WORK\_COMM\_09: (5 Comments)**

**Statement of Concern:** Statements indicating that work commitments in the contract have little in the way of specific commitments and dates.

**Response:** State is proposing several amendments to the work commitments clause to clarify and expand the remedies for failure to satisfy the work commitments. The state is proposing to include the May 10 Project Summary in the fiscal contract. This summary contains timelines for the various steps involved in completing the gas pipeline project. In addition, the state is proposing to create a new remedy of a diligence order to give the Tribunal an option short of contract termination. The state is also proposing the sponsor group companies commit to a \$ 1.0 billion letter of credit that the state could draw on if the full amount is not spent by the fourth contract year. Also, the state is proposing that if project sanction has not occurred within five years after the effective date, there be a presumption of an absence of diligence.

**WORK\_COMM\_10: (1 Comment)**

**Statement of Concern:** Statements indicating that the diligence requirement in the contract is inadequate and that the sponsor group faces huge penalties if they back out of the project after the end of the open season.

**Response:** While we generally agree with the statements, the state nonetheless is looking for ways to strengthen the work commitments provisions.

**3.4.2 TIME: General Project Timeline—SOC and Responses**

This issue category deals with concerns about the timeline for the gas pipeline project.

**TIME\_01: (76 Comments)**

**Statement of Concern:** Statements expressing concern that delays in the approval of the contract could delay the project and the sooner the project is approved the sooner Alaskans would benefit from the project.

**Response:** We certainly concur in the view that contract approval delays will delay the project and its benefits. A delay in signing the contract will have several implications.

First, a natural gas reserves tax would kill the gasline project should such a tax proposal be passed this November. The administration believes that a natural gas reserves tax would result in the cancellation of cooperative gas pipeline planning, a dramatic decrease in development of new oil and gas fields, and hasten the closure of the TAPS.

Second, imported LNG to the East and Gulf Coasts of the U.S. will become a stronger competitive factor as time moves on. The imminent competition will be from new LNG facilities like the Sabine Pass LNG Terminal currently being constructed in Texas, which is expected to commence operation in 2008 with an initial capacity of 2.6 bcf/d. There are existing pipelines connecting the Gulf Coast to the Midwest, so the LNG from Sabine Pass will directly compete with ANS gas.

Third, even if the contract is approved this year by the legislature and the project begins, it will not flow "first gas" until between 2015 and 2016 at the earliest. Between now and 2015, the state's discretionary budget is expected to have a cumulative deficit of \$10 billion. The delay in constructing the gasline would increase the state's budget deficit until the first gas flows.

Fourth, such delay will diminish the favorable economic, fiscal and workforce impacts to the state and Alaskans from the pipeline. According to Information Insights' analysis, for each year of delay, the estimated present value revenue loss to state and local governments would be approximately one billion dollars per year. Furthermore, the state faces at least two other challenges from a delay in construction. With oil production in decline and gas revenue at least ten years off, a significant delay in project startup could result in a fiscal gap more serious than projected, forcing severe budget cutbacks unless other sources of revenue or savings are found. The second challenge stems from the aging of Alaska's skilled workforce. A five to ten year delay in the project could result in lower resident hire rates if Alaska's older skilled construction workers retire or leave the state.

In conclusion, the earlier the contract gets approved, the earlier the benefits from the development of ANS gas will be realized.

#### **TIME\_02: (27 Comments)**

**Statement of Concern:** Statements expressing concern that the gas pipeline project is being rushed.

**Response:** In 2001, a \$125 million feasibility study was begun. Five years later the project is still not underway notwithstanding the 2004 federal legislation encouraging the quick construction of the project and our nation's pressing need for natural gas. From that perspective, it can not be said that the project is being rushed. Further, even if the contract is approved this year by the legislature and the project begins, it will not flow "first gas" until 2015-16 at the earliest. Remember that this contract only provides the fiscal certainty under which the project itself can go forward. Project planning is committed to begin within 90 days of execution of this contract, and during that timeframe the major project management steps under which a pipeline project will be engineered, permitted and constructed will occur.

#### **TIME\_03: (1 Comment)**

**Statement of Concern:** Statements indicating that the oil companies have every intention to move the project forward and get the gas moving.

**Response:** The fact that all members of the sponsor group have, in the past, indicated a willingness to sign the May 24, 2006 fiscal contract provides the best evidence of their intention to move the project forward. Delays in the execution of the contract are a function of the state's public process as required under the SGDA.

### **3.5 State and Local Impacts**

Issues in this general area of concern included the creation of jobs for Alaskans by the gas pipeline project; anticipated benefits of the project; economic and social impacts of the project on communities; project impacts on public infrastructure; impact payments to

mitigate economic and social impacts of the project on communities; and project impacts on subsistence activities and Alaska Natives.

### **3.5.1 AKHire: Alaska Hire Provisions—SOCs and Responses**

This issue category deals with the concerns of jobs created for Alaskans by the gas pipeline project.

#### **AKHire\_01: (42 Comments)**

**Statement of Concern:** Statements expressing concerns regarding Alaska hire, including the impacts of U.S. Supreme court decisions on local hire.

**Response:** The State of Alaska's Workforce Investment Board has endorsed a construction workforce plan to prepare Alaskans for future construction jobs, including jobs associated with the Alaska gas pipeline. The Department of Labor and Workforce Development has made construction training a priority for workforce investment system funding. An Alaska hire preference must meet requirements set out by the U.S. Supreme Court in *Hicklin v. Orbeck*, 439 U.S. 518, a case stemming from a resident hire preference relating to construction of the Trans-Alaska Pipeline. The administration believes a method to maximize employment opportunities are through project labor agreements. *Interested readers should also see the response to AKHire\_03.*

#### **AKHire\_02: (26 Comments)**

**Statement of Concern:** Statements expressing concern about the lack of skilled workers needed for the project and the need for training programs and other ways that the state could assist Alaskans and Alaska contractors to better compete with non-Alaskans.

**Response:** The state is proposing a total investment in training for pipeline jobs exceeding \$35 million. This significant investment in workforce development should assure that Alaskans who need and complete the training programs are able to work on the project.

#### **AKHire\_03: (19 Comments)**

**Statement of Concern:** Statements expressing concern about the lack of a Project Labor Agreement (PLA) that promotes union hire.

**Response:** The state is proposing a new article in the contract requiring the parties to commence negotiations of a project labor agreement, which, subject to legal restrictions, includes provisions promoting the hiring of Alaska residents and establishing hiring halls in rural and urban Alaskan communities. Additionally, the state is proposing an article in the contract requiring the parties to enter into negotiations with the Canadian government concerning a cross-border labor agreement.

The objective of the PLA should be to ensure that every qualified, ready and available Alaskan has an opportunity to work on the project. To this end the state will not commit to a union or non-union only agreement and expects that whatever terms are negotiated are the same for all workers.

**AKHire\_04: (17 Comments)**

**Statement of Concern:** Statements indicating that language in the contract appears to provide a preference for hiring non-Alaskans.

**Response:** Article 6, which addresses Alaska hire, was crafted to demonstrate a commitment to Alaska hire recognizing the constraints placed on an Alaska hire preference by federal law. An Alaska hire preference must meet requirements set out by the U.S. Supreme Court in *Hicklin v. Orbeck*, 439 U.S. 518, a case stemming from a resident-hire preference relating to construction of the Trans-Alaska Pipeline.

**AKHire\_05: (6 Comments)**

**Statement of Concern:** Statements indicating that the contract exempts a failure to hire Alaskans from the conditions triggering a breach of the contract, which is contrary to the governor's sixth gas pipeline principle (jobs for Alaskans).

**Response:** This concern stems from the provision in the fiscal contract that... "Any failure to comply with, or breach of, Article 6 does not constitute a material breach justifying the termination of this contract." It is our understanding that there was some concern among the negotiators of this agreement that the provisions of this section, while not mandating Alaska hire, may raise legal questions at the federal level. Since this section was thought to present such issues, it was decided through the negotiation process to make this section subject to the Tribunal established under Section 26 of the contract. Language attempted to recognize the desire to exhaust the pool of resident workers while understanding that hiring non-residents is expected.

**AKHire\_06: (2 Comments)**

**Statement of Concern:** Statements indicating that project employment benefits will be limited to areas close to the pipeline.

**Response:** The draft contract includes an agreement that all available positions will be advertised through the Alaska Job Center Network, including DOLWD's on-line labor exchange system, meaning available positions will be advertised and available to applicants statewide.

**AKHire\_07: (13 Comments)**

**Statement of Concern:** Statements of concern that the Alaska hire provisions apply only to the Alaska portion of the project; the contract and the FIF should also address construction jobs for Alaskans in the Canadian portion of the gas pipeline project.

**Response:** The State of Alaska has begun discussions with the Canadian provincial and territorial governments about the possibility of cross-border labor agreements. We are confident such agreements will be reached and will benefit qualified Alaskan workers.

**AKHire\_08: (1 Comment)**

**Statement of Concern:** Statements indicating that the \$5 million provided by the sponsor group for training programs is inadequate. More work should be done to determine the optimal level of job training the state and corporations need to provide to ensure that the highest number of trained Alaskans are ready for work when planning and construction begin.

**Response:** The \$5 million commitment will be provided collectively by the mainline entity and the individual sponsors, and will be supplemented with a significant investment by the state and federal governments. The state is proposing that the total investment in training for pipeline jobs exceed \$35 million. This significant investment in workforce development should assure that Alaskans who need the training and are successful in completing training programs are able to work on the project. *Interested readers should also see the response to AKHire\_16.*

**AKHire\_09: (1 Comment)**

**Statement of Concern:** Statements indicating that since this is a state-sponsored project, scoring of proposals for gas pipeline project contracts should include a 5 to 10 percent bonus for Alaskan firms or individuals. This would be similar to the scoring of proposals for other state projects.

**Response:** The gas pipeline project will be developed by a the mainline LLC formed by the sponsors, including a state public corporation. The mainline LLC will be a nongovernmental entity, the majority of which will be owned by nongovernmental entities. It is expected that the state public corporation established to own the state's share of the pipeline will be exempt from procurement statutes that would require an Alaska Bidder Preference. It would not be appropriate to require a private entity to incur the additional cost of an Alaska Bidder preference. It is believed that Alaska firms will be able to compete against firms from outside the state without a preference.

**AKHire\_10: (6 Comments)**

**Statement of Concern:** Statements expressing concern about the number and distribution of post-construction jobs for Alaskans.

**Response:** The state wants to be sure Alaskans are trained in advance to take the post-construction jobs associated with operation of the gas pipeline. Furthermore, the additional state revenue associated with operation of the gas pipeline will indirectly create thousands of jobs, across many industries for the life of the system.

**AKHire\_11: (2 Comments)**

**Statement of Concern:** Statements requesting information about the number of Alaskans currently employed by the sponsor group.

**Response:** Following are the most recent data from DOLWD's Research & Analysis Section: British Petroleum employs 1,185 resident workers and 493 nonresident workers (29.4 percent nonresident). ConocoPhillips employs 828 resident workers and 151 nonresident workers (15.4 percent nonresident). ExxonMobil employs 21 resident workers and 7 nonresident workers (22.6 percent nonresident). Residency is calculated by matching workers reported by

these employers with the two most recent Permanent Fund Dividend files (2004 and 2005). Workers shown include all workers employed at any time during the year with that employer. NOTE: As is the case today on the ANS, the vast majority of construction workers on the gas pipeline project will not be employees of the sponsor group; instead, they will be employed by contractors and subcontractors of the mainline entity.

**AKHire\_12: (38 Comments)**

**Statement of Concern:** Statements requesting training and/or work on the gas pipeline.

*Response:* Anyone interested in working in construction of the pipeline should contact their local Alaska Job Center or go to the Alaska Department of Labor and Workforce Development website, "Alaska Gas Pipeline Jobs," at [www.jobs.state.ak.us/energy.htm](http://www.jobs.state.ak.us/energy.htm).

**AKHire\_13: (1 Comment)**

**Statement of Concern:** Statements asking that veterans be provided a hiring preference during construction of the gas pipeline.

*Response:* The Alaska Department of Labor and Workforce Development has in place a priority of service for veterans. This provision means that veterans are given priority for training services from the state's Job Centers through dedicated staff and job search preference. DOLWD also has an agreement with labor unions through which veterans are given priority for apprenticeship opportunities.

**AKHire\_14: (28 Comments)**

**Statement of Concern:** Statements expressing support of (and need for) the Alaska hire provisions that currently exist in the contract.

*Response:* The administration agrees that the contract must ensure that a large proportion of new positions—especially during gas pipeline construction peaks—can be filled with Alaska residents. Article 6 of the contract includes several terms that would enhance Alaska employment and content. See details in 3.3 *Project Labor Agreement/Alaska Hire and Content* in the Preliminary FIF.

**AKHire\_15: (9 Comments)**

**Statement of Concern:** Statements supporting the lack of clauses in the contract that would require a project labor agreement.

*Response:* The state is proposing that parties to the contract commence the negotiation of a project labor agreement and a cross-border labor agreement following the effective date of the contract. *Interested readers should also see the response to AKHire\_03.*

**AKHire\_16: (1 Comment)**

**Statement of Concern:** The contract should provide for Alaska hire training in each of the municipalities affected by gas pipeline development, including training facilities in the North Slope Borough and personnel offices in the Borough that can work with local residents to improve their job opportunities.

**Response:** The Alaska Department of Labor and Workforce Development planned for the potential of a mega project when it made the decision to open job centers in rural communities like Barrow. The job centers connect Alaskans with training and employment opportunities. To design, build and operate the Alaska gas pipeline will require skilled workers in many fields, including welders, heavy equipment operators, truck drivers and general laborers. Preparing Alaskans for these occupations requires specialized facilities and equipment. Congress allocated \$20 million for training workers for gas pipeline jobs. Another \$3 million in federal funding and \$3 million in state funding has been earmarked for a specialized training facility in Fairbanks. Fairbanks was chosen because of the extreme temperatures that are similar to those experienced along the proposed route and its reliable access to transportation and other infrastructure.

Alaska Job Center employees are prepared to help rural residents get training from the Fairbanks facility and elsewhere to prepare them for work on the project. Additionally, the department is developing alternative training strategies that will bring training to rural communities but still provide the same level of quality. Examples of the new training strategies are the construction academies recently held in several rural communities and regional hubs. Training provided through the Denali Commission has also been extremely effective in preparing rural Alaskans for construction jobs.

**AKHire\_17: (1 Comment)**

**Statement of Concern:** Statements indicating that the contract's Alaska hire provision (Article 6.3) allowing a participant, affiliate, or midstream entity to bring personnel in on a non-competitive basis violates the purpose and intent of "Alaska hire."

**Response:** This language was crafted to demonstrate a commitment to Alaska hire recognizing the constraints of federal law. An Alaska hire preference must meet requirements set out by the U.S. Supreme Court in *Hicklin v. Orbeck*, 439 U.S. 518, a case stemming from a resident hire preference relating to construction of the Trans-Alaska Pipeline.

**AKHire\_18: (1 Comment)**

**Statement of Concern:** Statements indicating that Alaska Native hire provisions and quotas need to be included in the contract similar to the TAPS agreement.

**Response:** The contract is designed to provide all workers in the State of Alaska with equal opportunities to work on the pipeline. This is accomplished through Alaska hire provisions for pipeline contractors and sub-contractors, funding for training centers (in both rural and urban locations), and providing apprenticeship opportunities for graduates coming out of the training centers. Specifically in regards to TAPS, there have been significant changes in Alaska's economic environment since construction of the oil pipeline. We learned from that experience that we must have a trained workforce ready to go to work on the day construction begins. Numerical requirements without an adequately trained workforce do not benefit either the worker or employer. All of the energy of the negotiating team went into obtaining the three elements mentioned at the beginning of this paragraph with the deep belief that all Alaskan's will receive maximum jobs benefit from this strategy.

The Alaska Native hire provisions and quotas referred to rely on federal law and clauses within the right of way grant for TAPS for their validity. To the extent that Congress

undertakes to authorize these provisions for the gas pipeline project, it will be possible to provide for similar Alaska Native hire under federal authority. The state constitution does not permit state law that requires jobs to be allocated based on a racial classification.

**AKHire\_19: (2 Comments)**

**Statement of Concern:** Statements indicating that the last lines in the contract's *Section E.3 Recruitment* should be removed because they circumvent Alaska hire provisions.

**Response:** This language was crafted to demonstrate a commitment to Alaska hire recognizing the constraints of federal law. An Alaska hire preference must meet requirements set out by the U.S. Supreme Court in *Hicklin v. Orbeck*, 439 U.S. 518, a case stemming from a resident hire preference relating to construction of the Trans-Alaska Pipeline.

**AKHire\_20: (1 Comment)**

**Statement of Concern:** Statements requesting clarification on how the \$5 million amount specified in the contract's Alaska hire provision (Article 6.3) was determined and whether the amount is expressed in 2006 dollars.

**Response:** This amount was derived through extensive negotiations. The commitment is for the participants in the mainline entity, either as a part of the mainline entity or collectively as a group, to spend a combined total of \$5 million dollars in funding workforce training programs in Alaska that could include:

1. informing Alaska's students about potential jobs and apprenticeship programs;
2. employing apprentices and interns;
3. working with teachers in Alaska school districts in developing curricula for courses relevant to jobs on the gasline project;
4. working with the Department of Labor in upgrading technology and equipment for training centers and developing training standards for jobs on the gasline project; and
5. providing on the job training for employees hired on the gasline project

**AKHire\_21: (2 Comments)**

**Statement of Concern:** Statements advocating that training programs be developed in locations other than at existing VocTech centers.

**Response:** Construction of Alaska gas pipeline will require skilled workers in many fields, including welders, heavy equipment operators, truck drivers and general laborers. We envision the total investment in training for pipeline jobs to exceed \$35 million. This significant investment in workforce development should assure that Alaskans who need the training and are successful in completing training programs are able to work on the project. For example, \$3 million in federal funding and \$3 million in state funding has been earmarked for a specialized training facility to be located in Fairbanks. The Alaska Legislature also appropriated \$1.0 million this year to the King Career Center in Anchorage to expand its construction training program, to include an after-school program for out of school youth and young adults. In addition, the Alaska Works Partnership is engaged with numerous apprentice training providers to deliver construction training throughout the state.

Finally, the University of Alaska and numerous private training providers offer specialized training in Anchorage and throughout the state. For a list of eligible training providers, visit the following Department of Labor and Workforce Development Web site: <http://almis.labor.state.ak.us/cgi/databrowsing/traProvidersSelection.asp?menuChoice=traProviders>.

**AKHire\_22: (1 Comment)**

**Statement of Concern:** Statements recommending that the State of Alaska re-negotiate the Alaska hire sections of the proposed contract to strengthen local hire provisions. The Municipal Advisory Group recommends the contract should include strong wage protections for Alaska workers to ensure that Alaska workers benefit foremost from the economic growth brought on by developing Alaska's natural gas reserves.

**Response:** The State of Alaska, Workforce Investment Board, has endorsed a construction workforce plan to prepare Alaskans for future construction jobs, including jobs associated with the Alaska gas pipeline. The Department of Labor and Workforce Development has made construction training a priority for workforce investment system funding. We envision the total investment in training for pipeline jobs to exceed \$35 million. An Alaska hire preference must meet requirements set out by the U.S. Supreme Court in *Hicklin v. Orbeck*, 439 U.S. 518, a case stemming from a resident hire preference relating to construction of the Trans-Alaska Pipeline. The Department of Labor and Workforce Development is analyzing strategies to stimulate the industry to maintain their high wage standards.

**AKHire\_23: (1 Comment)**

**Statement of Concern:** Statements encouraging the state to ensure that only American drivers carry freight from Alaskan ports.

**Response:** The State of Alaska in cooperation with the entities that will be involved during the construction phase will explore to the maximum extent practical under state and federal laws, use of Alaskans or U.S. citizens to carry freight from Alaskan ports.

### **3.5.2 GENBEN: General Benefits of the Pipeline—SOCs and Responses**

This issue category addresses anticipated benefits and the creation of jobs for Alaskans by the gas pipeline project.

**GENBEN\_01: (171 Comments)**

**Statement of Concern:** Statements in general agreement that the project will: 1) generate new needed revenues for the state and provide for the future; and 2) promote local and/or state-wide economic development, new industries, and general diversification of the economy.

**Response:** The administration agrees with these comments. See details in *Section 4 Analysis of the contract* and *Section 9.2.2 contract is in the Long-Term Fiscal Interest of the state* in the Preliminary FIF.

**GENBEN\_02: (236 Comments)**

**Statement of Concern:** Statements in general agreement that the project will generate new jobs in Alaska and provide jobs for future generations.

**Response:** Alaska can expect thousands of indirect jobs through the revenues associated with a gas pipeline.

**GENBEN\_03: (11 Comments)**

**Statement of Concern:** Statements asserting that regardless of the number of short-term jobs for Alaskans, the long-term jobs and benefits are more important.

**Response:** The state wants to be sure Alaskans are trained in advance to take the post-construction jobs associated with operation of the gas pipeline. The state revenue associated with operation of the gas pipeline will indirectly create thousands of jobs in Alaska every year for the life of the system.

**GENBEN\_04: (13 Comments)**

**Statement of Concern:** Statements suggesting that a new fund be established with gas revenues. It was alternately suggested that the fund be used to benefit individuals and communities, that it be kept separate from the Permanent Fund and managed using a percent of market value payout schedule, and that it be an entirely new fund.

**Response:** These suggestions have great merit and deserve wide public debate. Revenues from gas pipeline ownership, production taxes, and royalties will not flow to the state for a minimum of ten years. Therefore, we feel that there is more than enough time for this discussion to take place and a satisfactory solution found before income accrues. By separating the discussion of a revenue fund from pipeline ownership and development we will all be able to focus on them separately and give each the thoughtful attention and analysis they deserve.

To get a sense of the relative amount of revenue that will accrue to the state should the gas pipeline be developed, see the Preliminary FIF, *Section 1.1 Alaska's Long Run Fiscal Outlook*.

**GENBEN\_05: (76 Comments)**

**Statement of Concern:** Statements in general agreement that the project will strengthen existing oil and gas industry and attract new investments in oil and gas exploration or production industry.

**Response:** Agreement is acknowledged. See details in *Section 9.2.2 Contract is in the Long-Term Fiscal Interest of the state* in the Preliminary FIF.

**GENBEN\_06: (16 Comments)**

**Statement of Concern:** Statements indicating that, while the contract may not be perfect from the state's perspective, a negotiated deal is always a compromise, and waiting to get a perfect deal may mean years of delay or no deal at all.

**Response:** Time is not on our side on the pipeline. We need the pipeline to commence operations in order to address the state's fiscal situation. Imported LNG to the East and Gulf

Coasts of the U.S. will become a stronger competitive factor as time moves on. Alaska must lock up its markets before the competition gets too strong. If we wait for a perfect deal, there will be delay to the natural gas pipeline, and such delay will diminish the favorable economic, fiscal and workforce impacts to the state and Alaskans from the pipeline. Information Insights, Inc. provided a 102-page report, which includes in-depth analysis on such impacts.

According to Information Insights' analysis, for each year of delay, the estimated present value revenue loss to state and local governments would be approximately one billion dollars per year. Furthermore, the state faces at least two other challenges from a delay in construction. With oil production in decline and gas revenue at least ten years off, a significant delay in project startup could result in a fiscal gap, forcing severe budget cutbacks unless new sources of revenue or savings are found. The second challenge stems from the aging of Alaska's skilled workforce. A five to ten year delay in the project could result in lower resident hire rates if Alaska's older skilled construction workers retire or leave the state.

**GENBEN\_07: (110 Comments)**

**Statement of Concern:** Statements indicating the project will provide benefits for the U.S. as a whole including a stable supply of natural gas, improved overall environmental quality, lower energy costs, security, and jobs.

**Response:** More than 50 percent of all heated U.S. households have natural gas heat and natural gas meets one-fourth of the country's total energy needs. It is increasingly popular for use by U.S. homeowners, schools, businesses, and electric power-generation plants because it is efficient, clean, and reliable. High prices for natural gas, fueled by an inability to keep up with growing demand, has had a direct effect on American households' disposable income, and consequently on the economy as a whole. Cheaper supplies of natural gas in other countries put the United States at a competitive disadvantage and history shows that sustained economic growth and job creation depends on stable and competitive energy prices. Adding Alaska's enormous supply of natural gas to the domestic market will go a long way towards stabilizing domestic gas prices.

Currently, 20 percent of U.S. natural gas production comes from the Gulf of Mexico, production that was significantly reduced in 2005 by Hurricane Katrina. Having additional major sources of production, such as Alaska's fields, reduces the impact of temporary shutdowns in the Gulf and has a stabilizing effect on the economy. Obtaining a larger percentage of the nation's growing demand for natural gas from domestic sources also reduces U.S. dependence on supply from less stable foreign sources.

**GENBEN\_08: (15 Comments)**

**Statement of Concern:** Statements indicating that the project will lead to improvements in public infrastructure; including roads, ports, schools, training programs, etc.

**Response:** Whichever gas pipeline route is chosen, the "leave behind" infrastructure improvements are likely to be sizeable. Just as the development of Prudhoe Bay oil fields and the oil pipeline established the Yukon River Bridge and the Dalton Highway as new infrastructure for long-term state benefit, the gas pipeline project is likely to have similar

benefits. For the past two years, the state has been targeting highway development funds to projects that will better facilitate the construction of the gas pipeline. These include upgrades to substandard bridges, passing lanes and other highway improvements. The benefits of this work will flow to the general economy over the long-term as well as the pipeline project. Similar improvements are likely in a number of areas including ports, railroad improvements, highways, trade school training facilities and other improvements.

Details regarding this topic are discussed in *Section 4.7.9 Transportation Issues and the Highway Use Agreement* of the Preliminary FIF.

**GENBEN\_09: (1 Comment)**

**Statement of Concern:** Comments asking for clarification on the time period over which benefits from the contract and the pipeline can be expected to accrue.

**Response:** The contract would bring multiple benefits to the state and to the people of Alaska. Some benefits could take place right after the execution of the contract, while others start to accrue once commercial operations commence.

One benefit is that the contract would create employment and training opportunities for Alaska residents and increase economic opportunities for Alaska business. Alaska hire policies in the contract deal with prioritizing and maximizing the hiring of state residents and the contracting with state businesses during the construction of the portion of the project located in the state, as well as after the commencement of commercial operations. The contract also requires the mainline entity spend a combined total of \$5 million in funding workforce training programs and activities in Alaska. Additionally, the ANGPA provides grants of up to \$20 million for an Alaska pipeline training program to recruit and support this training. Those benefits could start right after the execution of contract.

Once commercial operations commence, the contract will generate significant state and municipal revenues over the project's life. New revenues would be from not only gas production, but also extended life of TAPS and other related oil production properties. These additional oil and gas revenues accruing to the state would be used to support education, health facilities, and other public services for Alaska residents. Another important benefit to Alaskans would be access to supplies of low-cost gas. Many areas of the state are not presently served by natural gas utilities, and several potential and current industrial uses could be served by natural gas if the project is developed. This gas could be used for commercial, industrial and residential heating needs, as well as for additional electricity generation capacity.

### **3.5.3 COMM: Community Impacts—SOCs and Responses**

This issue category covers economic and social impacts of the gas pipeline project on Alaska communities.

**COMM\_01: (1 Comment)**

**Statement of Concern:** Statements indicating support for the contract as long as the future of Valdez is secure. This SOC includes comments indicating that with oil production in decline, the Valdez economy will be under increased stress.

**Response:** With declining oil production the economy for the entire state is in jeopardy, not just Valdez. Construction of a gas pipeline develops the natural gas resource base and thereby expands the tax base. By expanding the resource base, the development of existing and future oil supplies is enhanced. Increased oil production will improve the longevity of TAPS and the municipalities that receive tax revenues from TAPS will benefit. Without a gas pipeline, TAPS throughput, as well as oil revenues to Valdez, are expected to decline steadily, and are likely to end sometime between 2018 and 2030. With a gas pipeline, the oil pipeline would continue to have an economic level of throughput and revenues are generated for Valdez beyond 2050.

**COMM\_02: (4 Comments)**

**Statement of Concern:** Statements indicating that the contract and the project give the state control over its future economic development.

**Response:** Ownership of the gas and an ownership position in the pipeline afford the State of Alaska the maximum amount of control over its own future and the use of its resources. This statement will hold true from the day of first gas until depletion of the resource decades in the future.

**COMM\_03: (8 Comments)**

**Statement of Concern:** Statements indicating that communities along the pipeline route are likely to see relatively high levels of economic development and benefits from the project.

**Response:** This is a comment that all too often seems to be lost in all the concerns over the negative impacts of the pipeline development. It is certainly the goal of all involved in the project to see as much positive economic development in the communities as possible. Besides the economic activity generated by the jobs and services created for construction of the pipeline, the infrastructure development and economic growth along the pipeline corridor should benefit the people of Alaska for decades to come.

**COMM\_04: (8 Comments)**

**Statement of Concern:** Statements expressing concern about the adverse impacts on Alaska residents and affected communities of a pipeline construction boom.

**Response:** The need to address specific impacts during construction is why the impact payment was included in the contract, with the flexibility for funds to be allocated to the areas of greatest need. Article 18.1 of the contract establishes \$125 million in impact payments to economically affected communities.

**COMM\_05: (8 Comments)**

**Statement of Concern:** Statements identifying business start-up ideas based on resources and supplies the pipeline construction project will require.

**Response:** The governor encourages the development of business start-up ideas based on resources and supplies the pipeline construction project will require. A primary goal of the governor is to increase economic opportunities for Alaska businesses. The proposed contract furthers that goal by providing that the owners of the pipeline and their subcontractors employ state residents and contract with businesses in the state to work on construction and

operation of the project to the extent these residents and businesses are available, competitively priced and qualified.

See *Section 9.2.3.3 Maximize Benefits* in the Preliminary FIF.

**COMM\_06: (3 Comments)**

**Statement of Concern:** Statements expressing concern that communities not on the pipeline route will not benefit from the project, particularly in terms of infrastructure development, impact payments, and property tax benefits.

**Response:** Certainly the impacts and benefits will be much more apparent in the areas of direct construction. However, direct and indirect benefits will be seen throughout the state, in areas like jobs and job training. As the pipeline begins producing revenue for the state, all communities within the state will benefit from the project. Whether the benefits are derived through some form of revenue sharing, increased Permanent Fund dividends, reduced taxes, or some other legislative program, the people of the state will have many opportunities to share in the economic benefit associated with the pipeline development.

**COMM\_07: (1 Comment)**

**Statement of Concern:** Statements suggesting that the distribution of revenues from the project should include direct payments to communities without going through the appropriation process every year.

**Response:** The contract cannot direct the payments to affected municipalities or to specific types of impacts since we do not now know which communities will feel what effects or how the impacts may manifest themselves. There was also a great deal of concern that a process that directed payments to specific municipalities or impacts would be subject to challenge as circumventing the constitutional process for the appropriation of funds. By allowing for the legislative appropriation process to function unaffected by contract requirements, the legislature can look at and balance relative needs and coordinate those funds with other programs and spending. With the addition of proposed legislative amendments that would allow for input by the Municipal Advisory Group in the determination of "impacts," the legislative process should be less chaotic and more accountable in allocating funds.

**COMM\_08: (1 Comment)**

**Statement of Concern:** Statements encouraging the state to hold communities harmless should the project be delayed, suspended or terminated.

**Response:** While the project is under construction, it is anticipated that local governments will incur costs for addressing local economic and social impacts resulting from construction activities, temporary population increases, and other factors. Local governments will receive an impact payment from the mainline entity to cover these increased costs associated with these economic and social impacts. The state, as a 20 percent equity owner in the project will contribute \$25 million for impact payments.

Impact payments will be paid over a 6-year period with the first payment to be made by the Mainline entity at the end of the calendar year following project sanction. Under the contract, if the Mainline entity suspends its obligations, the Mainline entity may suspend making

impact payments for the remainder of the suspension period beginning one year after a *Judicial Suspension Notice* or a *Notice of Force majeure*. If the contract is terminated before the final impact payment is made, the obligations of the mainline to make unpaid impact payments are terminated.

The state believes that because it is unlikely that significant negative impacts would occur early on in the project process it is therefore expected that the initial impact payments will suffice to cover the impacts in the event of early termination of the project.

**COMM\_09: (9 Comments)**

**Statement of Concern:** Statements advocating the use of new revenues from the project to enhance public infrastructure, including education, healthcare, roads, etc.

**Response:** The key to this statement is opportunity. Absent a pipeline project there is little chance under the current fiscal system to expand these types of programs throughout the state. It is only with the addition of \$100 billion in revenue generated from the gas pipeline and gas development that the opportunity even exists to take on infrastructure and road projects, or increase education and healthcare funding.

**3.5.4 INFRA: Local Infrastructure Needs—SOCs and Responses**

This issue category covers the impacts of the gas pipeline project on public infrastructure.

**INFRA\_01: (2 Comments)**

**Statement of Concern:** Statements indicating that the project will have a negative effect on transportation or other local infrastructure.

**Response:** The concern for adverse impacts to infrastructure is quite valid. During construction of the oil pipeline between Prudhoe Bay and Valdez, the state's infrastructure was severely taxed. This included both physical deterioration, and an extreme burden on the operations of schools, police and fire services, local government functions and other actions of government. Such services were burdened by a high level of service needed and the loss of employees attracted by the high wages related to construction of the pipeline.

The report prepared by the Municipal Advisory Group identified about \$125 million (2003\$) in costs for local governments and others to address the potential impacts from the project. In response to these costs, the draft contract calls for \$125 million in impact payments paid over a six-year period beginning in the year of project sanction.

In response to a concern for impacts to the transportation system the Department of Transportation and Public Facilities has conducted negotiations with the sponsor group on a Highway Use Agreement. In these negotiations a required upfront investment in transportation infrastructure of approximately \$400 million has been identified, including cost sharing principals to be used to allocate this cost. Likewise the cost of system rehabilitation after construction may approach \$800 million and again cost sharing principals have been discussed.

Details regarding this topic are discussed in *Section 3.2.8 Article 18 – Impact Payments*, *Section 4.1.6 Impact Payments*, *Section 6.3.2 Social Impacts*, *Section 4.7 Transportation*

*Issues and the Highway Use Agreement, and the Transportation Issues Section in the Executive Summary of the Preliminary FIF.*

**INFRA\_02: (1 Comment)**

**Statement of Concern:** Statements expressing concern that the project will create construction jobs but not manufacturing jobs.

**Response:** Most of the direct jobs associated with the construction of the gas pipeline will be in the construction and oil and gas industries. The trade and service industries will be the primary beneficiaries of indirect and induced jobs associated with the project. Longer term jobs associated with operation of the gas pipeline will likely occur in the transportation and oil and gas industries.

Alaska's manufacturing sector currently includes workers in the seafood processing, lumber and petrochemical industries. If additional gas-related petrochemical facilities are developed as a result of the availability of gas, those jobs will likely occur in the manufacturing sector.

Longer term, the tax revenue derived from the gas could support thousands of jobs through state and local government expenditures.

**INFRA\_03: (3 Comments)**

**Statement of Concern:** Statements expressing concern that the state needs supporting infrastructure (i.e. roads, ports, etc.) before building the pipeline.

**Response:** The Alaska Department of Transportation and Public Facilities (DOT&PF) has been engaged in an analysis of transportation infrastructure needs required to support the construction of the gas pipeline beginning in 2005. This analysis was done in a broad fashion and considered all possible pipeline alternatives, all modes of transportation (marine, air, highway, rail), and all possible ports of entry for the logistics of the pipeline construction. From Delta Junction northward to Fairbanks and Prudhoe Bay, all pipeline alternatives will rely on the Richardson, Steese, Elliott and Dalton Highways in that corridor. Consequently, the DOT&PF has undertaken several needed improvements on these highways including reconstruction of substandard bridges, installation of passing lanes and highway reconstruction.

The DOT&PF has also been engaged in the negotiation of a Highway Use Agreement (HUA) which sets forth the principals of how the construction of the pipeline can proceed in a manner that does not unduly impact other users and ensures that the highway network is kept in good condition both during and after construction. This agreement has identified a list of projects that are needed prior to construction that will cost in excess of \$400 million dollars. It has also identified that the follow-up repair work to transportation infrastructure that is damaged due to the pipeline project's construction activity will be a responsibility of the pipeline builder to repair.

Details regarding this topic are discussed in *Section 4.7.9 Transportation Issues and the Highway Use Agreement* of the Preliminary FIF.

**INFRA\_04: (1 Comment)**

**Statement of Concern:** Statements encouraging the state to provide infrastructure development at the Haines Port to facilitate the industry needs for the project.

**Response:** The Alaska Department of Transportation and Public Facilities (DOT&PF) has been engaged in an analysis of transportation infrastructure needs required to support the construction of the gas pipeline beginning in 2005. This analysis was done in a broad fashion and considered all possible pipeline alternatives, all modes of transportation (marine, air, highway, rail), and all possible ports of entry for the logistics of the pipeline construction including the Haines Port.

Haines is likely to be a major port of entry for pipeline construction that takes place in Yukon Territory and perhaps northern British Columbia. By some estimates, it would be the largest port of entry for the entire project and most certainly the largest port of entry among Alaska ports. Though Skagway is a potential alternate port for this traffic, the steep highway grades and relative congestion in the downtown port area especially during the cruise ship season suggest that Haines is likely to be the selected port of entry.

Through negotiations between DOT&PF and the sponsor group on the Highway Use Agreement, it is clear that the firms have identified the need for improvements in Haines as a clear priority. A logistics analysis done for the sponsor group in 2002 suggested that truck traffic on the Haines Highway would be significant and identified the Chilkat River Bridge as the top priority project to facilitate this traffic. Their analysis has also identified a need to possibly relocate the state ferry terminal at Haines in order to enlarge the Haines Port.

At this time, while no clear responsible entity for paying for improvements to the Haines Port has been identified, in all likelihood, the mainline LLC and/or the sponsor group would have primary responsibility.

Details regarding this topic are discussed in *Section 4.7.9 Transportation Issues and the Highway Use Agreement* of the Preliminary FIF.

**3.5.5 IMP\_5: Impact Payments—SOCs and Responses**

This issue category covers concerns regarding the impact payments to mitigate economic and social impacts of the gas pipeline project on communities.

**IMP\_5\_01: (3 Comments)**

**Statement of Concern:** Statements expressing concern that impact payments in the contract may be insufficient to cover all the costs in communities affected by the construction of the pipeline.

**Response:** To alleviate as much of the burden as possible on the communities economically affected by the gas pipeline project, the contract calls for \$125 million in impact funds to be paid by the project sponsors during the construction period. The state based the \$125 million estimate on a 2004 report by Information Insights that determined likely impacts to communities. The contract schedules payments to be made periodically through the construction period. If there are significant delays during construction it is possible that impact payments could be paid out prior to the pipeline being completed. In order to limit that risk, the contract allows for cessation of impact payments if construction on the project is

halted for more than a year. Since the contract does not direct the allocation of funds, the legislature can look at and balance relative needs, and coordinate those funds with other programs and spending, including funding for impacts to communities that might occur after contract impact payments cease.

**IMP\_§\_02: (6 Comments)**

**Statement of Concern:** Statements advocating that the state develop a plan or guidelines for use of the impact payments and advocating the use of impact payments for training and education and to support housing prices in years following the construction. Statements expressing concern that the contract subjects impact payments to municipalities to appropriation and debate by the legislature.

**Response:** The contract does not direct the payments to affected municipalities or to specific types of impacts since we do not now know which communities will feel what effects or how the impacts may manifest themselves. There was also a great deal of concern that a process that directed payments to specific municipalities or impacts would be subject to challenge as circumventing the constitutional process for the appropriation of funds. By allowing for the legislative appropriation process to function unaffected by contract requirements, the legislature can look at and balance relative needs and coordinate those funds with other programs and spending. With the addition of proposed legislative amendments that would allow for input by the Municipal Advisory Group in the determination of "impacts," the legislative process should be less chaotic and more accountable in allocating funds.

**IMP\_§\_03: (1 Comment)**

**Statement of Concern:** Statements indicating that socio-economic impact mitigation plans for the Upper Tanana Region are needed as this region will be affected by the segment of the pipeline that does not parallel TAPS.

**Response:** The project planning phase will begin within 90 day. of contract execution. Appropriate impact mitigation plans will be completed as a part of that planning phase, prior to the beginning of actual pipeline construction activities.

**IMP\_§\_04: (1 Comment)**

**Statement of Concern:** Statements suggesting the need to create an organized borough for the Upper Tanana Region so that this affected region can generate benefits and collect impact payments.

**Response:** Proposed legislative changes to the stranded gas act will allow for impact payments to communities regardless of whether they are incorporated or not, however there is no provision in the contract for the distribution of revenue Payments in Lieu of Taxes (PILT) to unincorporated areas of the state or to municipalities that do not levy a property tax. In order for the Upper Tanana Region to benefit directly from the PILT payments they would need to form a borough and levy a property tax. In that instance the contract provides a mechanism for new boroughs to receive a portion of the PILT associated with the gas pipeline and TAPS.

**IMP\_§\_05: (3 Comments)**

**Statement of Concern:** Statements expressing concern that the contract bases impact payment amounts on 2001 prices, with no accommodation for inflation.

**Response:** The state fully understands that all parties take certain risks in locking in the Payments in Lieu of Taxes (PILT) structure prior to completion of the pipeline. If the pipeline experiences cost overruns, the PILTs might not meet the goal of equivalent net present value (NPV). Conversely, if major expansions occur that require less capital investment per mcf than the original project, the PILT revenue could exceed the NPV of a status quo tax structure. The state was fully aware of the concerns of impacts on communities during construction. The need to address specific impacts during construction is why the construction impact PILT was included in the contract with the flexibility for funds to be allocated to the areas of greatest need. Article 18.1 of the contract establishes \$125 million in impact payments to be appropriated by the legislature to economically affected communities. The construction impact payments are based on the estimates contained in the Municipal Impact Analysis study conducted by Information Insights. They are reported in 2004 dollars with a total impact payment of \$120.6 million. The \$125 million-figure reflects inflation of the original sum to the time this provision was negotiated. The statement is correct that there is no provision for further inflation adjustment in the contract unless the project construction period exceeds the six year estimate. Although it is easy to argue that this should be considered a fiscal concession it is important to realize the general nature of the estimates makes determining the actual future costs of impacts difficult to predict at best. By allowing for the legislative appropriation process to function unaffected by contract requirements directing the allocation of these funds, the legislature can look at and balance relative needs, and coordinate those funds with other programs and spending to make sure funds are available to mitigate impacts.

**IMP\_§\_06: (1 Comment)**

**Statement of Concern:** Statements that recommend that Sec. 43.82.505 of the Stranded Gas Development Act (SGDA) be amended to read:

Sec. 43.82.505. Payments to economically affected municipalities and communities. If the commissioner executes a contract under AS 43.82.020 that will produce one or more economically affected municipalities and communities, the commissioner shall include a term in the contract that provides for a portion of the periodic impact payments to the state that may be appropriated to the Alaska gas pipeline construction impact fund established in (c) of this section to benefit the economically affected municipalities and communities under the principles in AS 43.82.520.

Statements also recommended that impact payment funds be available both to municipal governments that extraterritorially serve areas of the unorganized borough, and to nonprofit organizations that serve areas of the unorganized borough, and recommended an amendment to the SGDA to that effect.

Statements also recommended that the SGDA be amended to prohibit grant money received under AS 43.82.505 from being used for the retirement of municipal debt unrelated to gas pipeline impacts.

*Response:* We agree and have supported the addition of similar language in amendments to the SGDA in order to put into place the mechanism for the distribution of impact payments.

**IMP\_5\_07: (1 Comment)**

**Statement of Concern:** Statements recommending an amendment to the SGDA conforming amendments. The proposed amendment calls for the establishment of a special account (AK Natural Gas Pipeline Construction Impact Fund) in the general fund into which the Department of Revenue shall deposit impact payments received by the state. The proposed amendment also describes the arrangements for appropriating funds to municipalities and communities.

*Response:* Article 18 of the contract establishes that not less than \$125 million dollars in impact payments will be made to the state by the sponsors. It is the state's job to then use, either through distribution to economically impacted communities or through other devices to mitigate those impacts. Although we must be mindful of the prohibition on dedicated funds in our constitution, current legislative practices allow for the establishment of special non-dedicated accounts. In the third special session, the governor introduced SB 3002 which included such an account. However, that provision was not included in the bill that was reported out of committee.

**3.5.6 SUBST: Subsistence—SOCs and Responses**

This issue category deals with concerns regarding subsistence issues.

**SUBST\_01: (1 Comment)**

**Statement of Concern:** Statements indicating that the contract will enable the continued ability of rural residents to participate in subsistence activities and lifestyles.

*Response:* The contract is designed to get a gas pipeline built as soon as possible while obtaining the maximum value of gas to the state. When this is accomplished the state will have the ability to assist all Alaskans in maintaining a way of life that is important to all of them.

**SUBST\_02: (2 Comments)**

**Statement of Concern:** Statements indicating that the state should require specific protection measures to preserve aboriginal lands and hunting grounds; an item that is noticeably absent from the proposed contract.

*Response:* The contract as it now stands is a fiscal agreement designed to establish the economic framework upon which a gas pipeline can be built. Environmental protection standards will be addressed in the various federal environmental impact statements and State of Alaska Best Interest Findings that will follow during the project permitting phase. That is the appropriate place for those important issues to be addressed.

### 3.5.7 AK\_NATV: Alaska Native Issues—SOCs and Responses

This issue category addresses Alaska Native issues.

#### **AK\_NATV\_01: (3 Comments)**

**Statement of Concern:** Statements expressing concern about the lack of dialog between the state and Alaska Natives with respect to the contract and the project.

**Response:** The fiscal contract was designed to set the fiscal structure under which the sponsor group's tax and royalty regime would be set for a specific period of time. It was an agreement negotiated between the State of Alaska as sovereign and three private companies under the terms and conditions set down in the Stranded Gas Development Act (passed by the Alaska Legislature). The process was pursued with the goal of providing all the people of Alaska with a contract that resulted in construction of a pipeline and provided the maximum economic benefit to the state. Those entities directly affected by the contract (Boroughs and communities through which the pipeline passes) were provided with seats on the Municipal Advisory Group (MAG) Board which provided the negotiating team with their views and opinions throughout the process. In addition, the state designated the Tanana Chiefs Conference (TCC) as representative of the unorganized borough on the MAG. It was anticipated that Alaska Native and rural concerns would be represented through the TCC.

#### **AK\_NATV\_02: (1 Comment)**

**Statement of Concern:** Statement indicating if Alaska Natives are for the pipeline then the state should approve the contract.

**Response:** The contract is designed specifically for the benefit of all Alaskans. Because it sets the stage for the majority of financial benefit coming into the state for a long period of time, the majority of Alaskans must feel confident that the contract is in the best interest of the entire population. By getting a pipeline without lengthy litigation and protecting the maximum wellhead value of the gas being produced, we believe it serves both native and non-native Alaskans.

#### **AK\_NATV\_03: (1 Comment)**

**Statement of Concern:** Statements expressing concern that there is not enough discussion of appropriate language representing the interests of Alaska Natives.

**Response:** By getting a pipeline as soon as possible and placing in the contract provisions that protect the maximum value of the gas at the wellhead, it is believed all interests are protected. Specific division of the benefits derived from the pipeline can and should be addressed when we know how much is available and the timeframe in which it will be available. It is important to remember that if the state pursues a course of action that leads to protracted litigation or a diminishment of the value of the gas produced, all Alaskans (both native and non-native) will have to deal with the consequences.

#### **AK\_NATV\_04: (1 Comment)**

**Statement of Concern:** Statements indicating that Alaska Native hire provisions and quotas need to be included in the contract similar to the TAPS agreement.

**Response:** The contract is designed to provide all workers in the State of Alaska with equal opportunities to work on the pipeline. This is accomplished through Alaska hire provisions for pipeline contractors and sub-contractors, funding for training centers (in both rural and urban locations), and providing apprenticeship opportunities for graduates coming out of the training centers, and the proposed Project Labor Agreement. Specifically in regards to TAPS, there have been significant changes in Alaska's economy since construction of the oil pipeline. We learned a lot from that experience, principal of which is that we have to have a trained workforce ready to go to work on the day construction begins. Numerical requirements without an adequately trained workforce do not benefit either the worker or employer. All of the energy of the negotiating team went into obtaining the three elements mentioned at the beginning of this paragraph with the deep belief that all Alaskan's will receive maximum jobs benefit from this strategy. *Interested readers should also see the response to AKHire\_21.*

**AK\_NATV\_05: (1 Comment)**

**Statement of Concern:** Statements advocating inclusion of "Section 29" in the pipeline contract not just as an agreement. This will ensure adherence to Section 29 for all Alaskan Natives as an equal opportunity for those distressed communities. Section 29 should encompass the whole State of Alaska and not just the geographical areas of operation.

**Response:** "Section 29" within the TAPS Federal Right-of-Way specifically refers to quotas for native hire. The Stranded Gas Development Act contract is designed to provide all workers in the State of Alaska with equal opportunities to work on the pipeline. This is accomplished through Alaska hire provisions for pipeline contractors and sub-contractors, funding for training centers (in both rural and urban locations), and providing apprenticeship opportunities for graduates coming out of the training centers. Specifically in regards to TAPS, there have been significant changes in Alaska's economic environment since construction of the oil pipeline. We learned a lot from that experience principal of which is that we have to have a trained workforce ready to go to work on the day construction begins. Numerical requirements without an adequately trained workforce do not benefit either the worker or employer. All of the energy of the negotiating team went into obtaining the three elements mentioned at the beginning of this paragraph with the deep belief that all Alaskan's will receive maximum jobs benefit from this strategy.

### **3.6 Gas for In-state use**

Issues in this general area of concern included the provision of natural gas for in-state use; off-take point locations to meet in-state needs; and provision of natural gas to support future in-state industrial uses.

### 3.6.1 AK\_DMD: In-State Demand—SOCs and Responses

This issue category covers concerns about the provision of natural gas for in-state use.

#### **AK\_DMD\_01: (123 Comments)**

**Statement of Concern:** Statements expressing concern about the availability and cost of ANS gas for in-state use, ensuring all Alaskans benefit, calling for priority to be placed upon availability of ANS gas for in-state use, and unavailability of information for potential in-state users for planning purposes.

**Response:** Providing for in-state gas demand will be strictly a state decision in accordance with the provisions of the federal ANGPA legislation, FERC regulatory requirements, the provisions of the fiscal contract, in-state utility and commercial interests, and state policies regarding development of in-state infrastructure and in-state gas pricing.

The state's concerns about ensuring access to the pipeline for needs within Alaska were addressed in ANGPA in three ways. Working with the U.S. Congress, the state made sure that the ANGPA created special provisions directed at in-state service. First, ANGPA requires that a pipeline project study in-state needs, "including tie-in points along the Alaska natural gas transportation project for in-state access" (Section 103(g)). Second, ANGPA requires that the commission provide for "reasonable access" to the pipeline for transportation of royalty gas of the state "for the purpose of meeting local consumption needs within the state" (Section 103(h)). Third, in section 109, ANGPA confirms that a lateral (spur line) from the mainline serving in-state needs shall be regulated by the RCA, not FERC. Section 109 also states that FERC will consult with the state regarding mainline rates that transport gas for delivery within Alaska.

FERC built upon this foundation in the open season regulations. FERC requires the pipeline to offer an intrastate transportation rate in the open season and in its tariff, based on mileage, separate and apart from any interstate rates. The intrastate rate is to be constructed without reference to the costs of making deliveries outside of Alaska. In-state users who commit at an open season to take gas deliveries will not subsidize deliveries outside of Alaska. Second, FERC requires the pipeline to propose in-state delivery points as determined by the required study of in-state needs. The pipeline must also include an estimate of how much capacity will be used in state (18 CFR Section 157(b) and (c) (1), (8), and (14)). In addition, the FERC authority provided specifically for the Alaska gas pipeline project to mandate an expandable pipeline design to further enhance the ability to obtain future increments of in-state gas capacity during expansion open seasons.

Within the terms of the fiscal contract are eight specific provisions which ensure the availability of gas for in-state needs at reasonable costs. To begin with, the contract ensures that the pipeline traverses Alaska, providing cost-effective, local access to the gas – but that provision alone adds almost 20 percent to the length of the pipeline (and about 13 percent to the total cost), compared with a route directly into Canada to Chicago. The fiscal contract also sets a timetable for the pipeline to complete its study of gas consumption needs and offtake points in Alaska and requires consultation with the state on the location of these offtake points. The contract requires the mainline LLC to construct and pay for facilities at four

offtake points agreed with the state. It confirms that in the open season, the pipeline will offer mileage sensitive service and offer segmented capacity to facilitate in-state service.

The contract requires the mainline LLC to cooperate with any person wanting to connect facilities to the pipeline for in-state service. The contract also requires the mainline LLC to conduct a study of NGL processing opportunities in Alaska before the open season. Alaska will gain useful knowledge of the feasibility of processing natural gas liquids in Alaska because of this study. The contract also provides that the state – and any other party – can bid separately at an open season for in-state capacity, and that these bids will be evaluated separately from bids for capacity beyond the state.

Finally, all parties can sell gas within Alaska. Concerns have been raised by the fiscal contract provision (Article 9.4) which states, “. . . no party is required to sell Gas to an Alaska Purchaser.” When reading this, it is important to include the preceding clause: “Any Party may supply Gas to Alaska purchasers. . .” In the interests of clarification however, the state proposes to delete the language “but no Party is required to sell Gas to an Alaska Purchaser.” The proposed revision reads “The State and each Producer may supply Gas to Alaska purchasers, and may establish terms for the sale of its Gas for in-state use.”

The purpose of this provision is twofold; first, to ensure competition will exist, ensuring the best competitive prices are available in-state; and second, to protect the companies from a legal doctrine known as “implied covenants”. This provision was carefully crafted to provide a predictable, competitive, level playing field for both Alaskans and the members of the sponsor group.

The Alaska portion of the Alaska gas pipeline project is the Mainline through the state, including the four offtake points, and the upstream elements delivering gas to the Mainline. The infrastructure necessary to deliver gas from the Mainline to Alaskans will be developed by in-state interests developing projects in parallel with the Alaska gas pipeline project. In-state interests include private concerns, public corporations and utilities. In all cases, an economic business case must be developed to ensure that the proposed project is economically justifiable, provides the expected in-state benefits, and is in the best interests of all Alaskans. Individual proposals must be reconciled to arrive at optimum economic solutions. In particular, the role of public entities, such as ANGDA, as aggregators of gas purchase commitments or as developers of in-state infrastructure must be clarified. In addition, the role of such agencies as AIDEA, APA, AVEC, and the Denali Commission in encouraging development of in-state infrastructure or in meeting commercial credit and capital requirements should be evaluated.

Taking of state gas in-kind provides the state with policy options to meet Alaskan needs and to provide Alaskan job opportunities and economic growth. Both direct and indirect benefits from Alaska gas must be considered when developing in-state gas use policies. Such policy decisions critical to ensuring availability of ANS gas for these in-state uses include: 1) setting pricing policy for in-state deliveries of state gas; 2) providing creditworthiness supports necessary to allow in-state shippers to bid for firm capacity; and 3) planning for and encouraging infrastructure development.

The state's in-state gas pricing policy must be designed to meet the constitutional requirement to use state resources to maximize the benefit to all Alaskans. Various pricing policies and their impacts on Alaskans and the Alaska economy can be considered – from

simply allowing market forces to dictate prices, to tracking lower-48 prices, to ensuring users benefit from the transportation cost differences between the lower-48 and Alaska ("netback pricing"), to direct subsidies for some or all Alaskan users. In addition, the health of the in-state projects undertaken is likely to be affected by the in-state gas pricing policy developed.

Availability of in-state gas holds the promise of ensuring Southcentral's long-term energy supply, of drastically reducing energy costs for the Fairbanks area, and providing Alaska's many rural areas with reasonable energy alternatives. The result is likely to be greatly reduced costs of living in the interior and in rural Alaska, and the development of economic opportunities previously unavailable to Alaskans due to energy costs.

The administration has drafted the following gas policy as a guideline for the state's policy makers to use as they decide upon an in-state gas use policy for Alaska:

**In-State Gas Use Policy:**

It is the policy of the state to take its gas royalties and production taxes in-kind for the general welfare of the state and to encourage construction of the Alaska gas pipeline. In accordance with Article 8 of the Alaska Constitution, the state's in-kind gas will be used for the maximum benefit of Alaskans. In particular, Alaska's in-kind gas will be used:

- To ensure availability of adequate gas and energy resources to South-Central Alaska
- To provide cost-effective gas and energy supplies to the Fairbanks-North Star region
- To provide dependable energy supplies to rural Alaska at reasonable costs
- To grow the Permanent Fund, on behalf of all Alaskans
- To ensure availability of gas and energy resources to meet in-state needs, and to foster economic opportunity and diversity

Toward these policy goals, it is also the policy of the state to foster in-state infrastructure development and creditworthiness support, as well as to ensure gas and energy supplies are available and distribution infrastructure is dependable and adequate to provide access to those supplies.

In terms of pricing of gas for in-state use, the State of Alaska has two options: 1) to ensure pricing of in-state gas and gas-liquids supplies at levels which do not exceed the actual netback value of ANS reserves plus costs of delivery to Alaskan markets; or 2) to price in-state gas at the cost of alternative fuels (prevailing market price of alternative fuels). This policy decision depends on whether the state would like to offer favorable prices for in-state use in areas proximate to the pipeline or to maximize the returns to the state by selling gas at the highest achievable price. This policy decision will be made by a future administration.

FERC and mainline LLC-mandated creditworthiness standards will require that those entities taking in-state deliveries have the financial stability to make long-term transportation commitments. State policy must be considered and developed to ensure that appropriate in-state entities exist with such adequate credit capabilities.

Finally, the ability for in-state users to make commitments to take long-term deliveries from the Alaska gas pipeline depends upon the infrastructure available within the state, and the ability to dovetail development of needed infrastructure with Alaska gas pipeline development. Needed in-state infrastructure is likely to include a spur line to Southcentral,

additional pipeline capacity in Southcentral, pipeline and distribution capacity to other in-state markets, additional power generation and expanded distribution capacity, gas storage capabilities in both the Fairbanks area and in Southcentral, in-state compression and distribution facilities for service to remote areas, and a gas liquids operation for in-state distribution and export purposes. As specified in Section 108(a) of ANGPA, regulation of facilities in Alaska downstream of the Alaska gas pipeline offtake points would be the responsibility of the RCA.

Currently, due to lack of a gas pipeline, all ANS gas produced is consumed as fuel or re-injected. ANS producers have never been allowed to flare ANS gas, except to meet operational and emergency needs. Once the Alaska gas pipeline is operational, some of the re-injected gas will be diverted to sales via the pipeline, along with gas from other ANS, and possibly other Alaskan sources. The remainder of Prudhoe Bay Unit (PBU) gas will continue to be re-injected to maintain pressures for oil operations.

Information concerning the Alaska gas pipeline project was made available by the sponsor group in their application under the SGDA, and was updated in their 2006 Project Summary. Once this fiscal contract has been approved, further information will become available as the project progresses. Ultimate control will be exerted by FERC in ensuring adequate information availability for conducting the open season – including FERC's authority under ANGDA to require the pipeline owners to consider late bids after the open season. Such a prospect will serve to ensure the pipeline owners can demonstrate early and easy access to information, in order to forestall being forced to accommodate late comers.

**AK\_DMD\_02: (1 Comment)**

**Statement of Concern:** Statements indicating that it would be appropriate for economic models to be created to project at least the range of costs Alaskans may reasonably expect to pay to use any of its gas in-state. Several issues need to be addressed including (1) loss of revenue to the entire state from gas used in-state; (2) the likely differences in cost of subsidizing use of Alaska's gas in Fairbanks, or Anchorage bowl, or rural Alaska or Southeast; (3) should Alaska's public policy be to make cheaper energy available to all or parts of the state or to maximize its rate of return on its investment; or (4) should the state make its gas available for in-state use at the same netback wellhead value as gas delivered to Alberta or Chicago? These policy issues must be resolved before Alaska makes its first open season commitment as to how much gas it will ship how far along the pipeline.

**Response:** The idea of selling natural gas to Alaska residents at a discount is a policy decision and not part of the contract. If and when ANS gas is developed, there will be ample opportunity for the Department of Revenue and other organizations to conduct analysis and determine the benefits and costs of subsidizing natural gas usage in the State of Alaska.

### 3.6.2 OFFTAKE: Off-take Points—SOCs and Responses

This issue category addresses the off-take point locations to meet in-state needs.

#### **OFFTAKE\_01: (79 Comments)**

**Statement of Concern:** Statements indicating that offtake points at Fairbanks and for gas distribution to southeast Alaska and Valdez will require development of other infrastructure in order for Alaskans to benefit.

**Response:** The fiscal contract provisions include a commitment, in Article 9.1, to support funding of four gas offtake points in Alaska at locations selected after consultation with the state, to be included in the initial construction design. This commitment includes incorporating the offtake points in the original pipeline design; and including in the base pipeline cost, the costs of offtake point piping and flanges to the point of allowing a downstream project to connect to the Alaska gas pipeline and divert gas from the mainline to in-state deliveries. The fiscal contract provisions also include commitment on the part of the pipeline owners to cooperate in planning and design with sponsors of downstream facilities.

With these provisions, the contract assures offtake points will be available and best located to meet in-state needs. The state will need to determine where each of those offtake points should be located, although initial presumptions have been that those points would likely be located at the Yukon River, Fairbanks, Delta or Delta Junction, and in eastern Alaska toward the Canada border. In response to concerns that an offtake point may be needed in Canada to serve Southeast Alaska and in recognition that the state's proposed mainline LLC agreement contains a voluntary expansion clause, the state proposed changes to the definition of "offtake point" and to Article 9.1 to alleviate that concern. The proposed change clarifies that one of the four offtake points could be in western Canada near the Alaska border in order to serve Alaskan communities on the other side of that border.

Incremental costs downstream of the offtake points will be part of separate projects developed and implemented by entities separate from the Alaska gas pipeline owners. The state may or may not participate in those entities, and the state will determine the policies under which those in-state projects will be allowed to progress. These decisions are separate from considerations relative to the Alaska gas pipeline project itself. Taking of state gas in-kind provides the state with policy options to meet Alaskan needs and to provide Alaskan job opportunities and economic growth. The state must be actively engaged in establishing the policies and implementing efforts to plan for and encourage infrastructure development.

The ability for in-state users to make commitments to take long-term deliveries from the Alaska gas pipeline depends upon the infrastructure available within the state, and the ability to dovetail development of needed infrastructure with Alaska gas pipeline development. Needed in-state infrastructure is likely to include a spur line to Southcentral, additional pipeline capacity in Southcentral, pipeline and distribution capacity to other in-state markets, additional power generation and expanded distribution capacity, gas storage capabilities in both the Fairbanks area and in Southcentral, in-state liquids compression and distribution facilities for service to remote areas, and possibly a gas liquids operation for export purposes.

FERC and mainline LLC-mandated creditworthiness standards will require that those entities taking in-state deliveries from the mainline have the financial stability to make long-term

transportation commitments. State policy should be considered and developed to ensure that appropriate in-state entities exist with such adequate credit capabilities to both make long-term transportation commitments and to finance construction of needed in-state gas, liquids, and power distribution infrastructure.

In-state interests which will build these in-state gas distribution projects include private concerns, public corporations and utilities. In all cases, an economic business case must be developed to ensure that the proposed project is economically justifiable and that it provides the expected in-state benefits. Individual proposals must also be reconciled to arrive at optimum economic solutions. In particular, the role of public entities, such as ANGDA, as aggregators of gas purchase commitments or as developers of in-state infrastructure should be considered. In addition, the role of such agencies as AIDEA, APA, AVEC, and the Denali Commission, in encouraging development of in-state infrastructure or in meeting commercial credit and capital requirements should be evaluated. Finally, successful state policy development, particularly with respect to credit support and infrastructure development, requires that it be integrated with planning of commercial development projects.

### 3.6.3 INDST: Future Alaska Industrial Uses—SOCs and Responses

This issue category covers the provision of natural gas to support future in-state industrial uses.

#### INDST\_01: (1 Comment)

**Statement of Concern:** Statements expressing concern about preserving the option for the separation of natural gas liquids in Alaska.

**Response:** Both the sponsor group and the state will own its share of the gas liquids. Each owner retains the opportunity to commercialize the gas liquids in a way that best suits their purposes. Once separated, liquids and gas are treated as two different products. The contract calls for a study to be completed before open season. The results of that study will influence what each party chooses to do with its liquids. The state can choose to market its liquids in Alaska or elsewhere. We will control our own economic future if we own the gas.

#### INDST\_02: (13 Comments)

**Statement of Concern:** Statements advocating development of a gas liquids industry in Alaska and/or that gas liquids from the project be reserved for use in Alaska. Comments included statements advocating development of a propane distribution system for rural Alaska.

**Response:** The contract provides for four off-take points, mileage sensitive rates, and state ownership of the gas. These three things will allow the state to do anything it wants with its gas and liquids. The governor has advocated on many occasions for using a portion of our gas to establish a propane distribution system at the Yukon River crossing and down on the Kenai. He has also indicated a desire to establish a liquids processing capability in Alaska. Each of these desires can be achieved. Each, however, will have a cost. It will be up to the serving governor and legislature to determine the economics of such proposals and make the decision as to how to proceed.

**INDST\_03: (1 Comment)**

**Statement of Concern:** Statements indicating that the state should extract value from the "impurities" in natural gas—these impurities include CO<sub>2</sub>, sulfur, and sulfur-coated urea.

**Response:** Because the state will own its gas, it can use it (and its components) in any way it chooses. It is safe to assume that each component will be utilized in the best interest of the state.

### **3.7 Regulatory Issues**

Issues in this general area of concern included the regulations of the Federal Energy Regulatory Commission (FERC) relating to the gas pipeline project and the role of the Regulatory Commission of Alaska (RCA) with respect to the project.

#### **3.7.1 FERC: FERC Process—SOCs and Responses**

This issue category addresses concerns regarding FERC jurisdiction, FERC and RCA interactions, FERC and NEB interactions, federal takeover of the pipeline, open season commitments, expansion and rate structure, and tariff terms.

**FERC\_01: (7 Comments)**

**Statement of Concern:** Statements questioning the scope of FERC and RCA jurisdiction and concerns over a possible regulatory gap.

**Response:** With regard to the scope of RCA jurisdiction, neither the state nor the sponsor group envision RCA rate regulation of any project facilities. Unquestionably, FERC will exclusively regulate the main pipeline (mainline). It is essentially certain for several reasons that FERC will also regulate the \$2 billion plus GTP. First, in its open season regulations for the Alaska gas pipeline, FERC made clear that the gas treatment service and the transportation service must be unbundled and offered separately in an open season. Order 2005-A at §87-88. Were FERC not contemplating regulating the GTP, it would not have made such a statement.

Second, FERC's general jurisdictional test is whether a treatment plant is used primarily to render raw gas fit for transmission or to extract liquids and liquefiables for their economic value. Venice Gathering Co., 97 FERC §61,045 (2001); Columbia Gas Transmission Corp., 79 FERC §61,041 (1997). Plants that are used to treat or condition gas to bring it up to pipeline quality so that it can be transported safely and efficiently are classified as jurisdictional transportation facilities, while plants that operate principally to extract liquids and liquefiables for their economic value (i.e., gas processing plants) are classified as non-jurisdictional facilities. 79 FERC at 61,185. Northern Natural Gas Co., 69 FERC §61,264, at 62,016-17 (1994); Texas Eastern Transmission Corp., 43 FERC §61,044, at 61,129 (1988). The GTP will be a plant that will be used to treat or condition gas to bring it up to pipeline quality, and thus a jurisdictional facility subject to FERC's regulation.

Third, the Alaska Natural Gas Pipeline Act (ANGPA), Section 102(2), defines the term "Alaska natural gas transportation project" as "any natural gas pipeline system that carries Alaska natural gas to the border between Alaska and Canada (including related facilities subject to the jurisdiction of the Commission)..." And, while President Carter's 1977

Decision selecting the Alaska Highway route defined the Alaska Natural Gas Transportation System ("ANGTS") as beginning at the discharge side of the conditioning plant facilities, in 1981 then-President Reagan signed six waivers of law, one of which included the conditioning plant within the ANGTS. The administration synopsis accompanying the waivers said that "[a]s a practical matter, the economic effect of including the conditioning plant in the system is the same as treating the plant as a separately certificated facility and providing a conditioning cost allowance sufficient to provide for the recovery of the gas conditioning cost." Report of the Senate Committee on Energy and Natural Resources November 10, 1981, at 33 (No. 97-272, 97th Congress, 1st Session).

With regard to gas transmission lines that will feed into the GTP or the Mainline, the definition of non-jurisdictional gathering lines versus jurisdictional transmission lines has turned on an examination of various physical and operational factors, which have changed over time. Because several of these lines are yet to be built, one cannot say with certainty that they will be FERC-regulated. The parties contemplate that those facilities qualify as jurisdictional transmission lines. For example, it would be highly likely that the large diameter transmission lines from Pt. Thomson will be determined to be FERC-jurisdictional as well as lines feeding from the NPRA. If, however, any lines are not determined to be FERC-jurisdictional, nothing in the contract bars the RCA from regulating those lines if it has the power to do so under its jurisdictional statutes.

#### **FERC\_02: (2 Comments)**

**Statement of Concern:** Statements indicating that the FERC process precludes the transportation system from controlling the oil and gas activities in the basin.

**Response:** FERC over the past two decades has put in place increasingly stringent regulations to separate the transportation functions from the production and marketing functions, and to provide everyone fair and equal opportunity to access pipelines and related facilities. The Alaska Natural Gas Pipeline Act of 2004 and the subsequently enacted FERC open season regulations provide even further equal access protections for all ANS producers.

For a detailed discussion of FERC's extensive powers to ensure access and preclude basin control, see "Access to Alaska Gas Pipeline and 'Basin Control'" by Robert Loeffler, dated July 13, 2006 in Attachment 3. This was a presentation made by Mr. Loeffler to the Senate Special Committee on Natural Gas Development in response to basin control concerns raised by legislative counsel from Greenberg Traurig. Interested readers should also see the administration's response to concerns regarding this issue in Attachment 2 of this document in the letter dated August 23, 2006 from Jim Clark, Chief of Staff to Senator Seekins and Senator Therriault.

#### **FERC\_03: (1 Comment)**

**Statement of Concern:** Statements indicating concern that if the contract is not signed by a certain date, the federal government could take over the development of the pipeline.

**Response:** The state shares this concern and for good reason. Under Section 109 of ANGPA, if no application for a FERC certificate has been made within 18 months of the passage of ANGPA, the DOE Secretary must conduct a study of alternative approaches to the construction of the project, including establishing a federal government corporation to do the

construction. The 18 month timetable elapsed in April 2006 and the DOE Secretary is presently conducting such a study. The Bush administration has made the development of ANS gas a highest priority energy policy and the state cannot rule out the possibility of the federal government moving forward unilaterally in the event the contract is not approved by the Alaska legislature.

**FERC\_04: (3 Comments)**

**Statement of Concern:** Statements indicating that the contract should specify detailed ratemaking terms such as capital structure, cost of debt, and rolled-in tariff rates, so as to eliminate ambiguity and avoid future disputes.

**Response:** The state and the sponsor group did discuss several detailed ratemaking terms and conditions during negotiations. However, the parties were unable to agree upon either the need to include those terms and conditions in the contract or the parameters of such terms and conditions. The contract therefore is silent on them, leaving it open for future resolution. It should be kept in mind that Article 8.4 fully protects the state's right to intervene in any proceeding and argue for whatever terms and conditions it advocates. While FERC will have the final say, the state will have the opportunity to get a full and fair hearing before that agency. In any event, it is FERC's duty to ensure that all tariff terms and conditions are just and reasonable.

**FERC\_05: (2 Comments)**

**Statement of Concern:** Statements expressing concern that the open season be fair to all, and that shippers must commit to pay for a specific volume of pipeline capacity for a term of years and must do so long before the first piece of pipe is laid or compressor is installed.

**Response:** In order to allocate pipeline capacity in a fair and non-discriminatory manner, FERC policy requires that all interstate gas pipelines hold an open season where prospective shippers, pursuant to non-discriminatory criteria, can bid on the available capacity. With regard to the Alaska gas pipeline, FERC codified the open season requirements in detailed regulations issued last year. The proposed regulations were changed in several aspects to ensure that the final regulations are fair to all prospective shippers.

The lead times necessary to build the Alaska gas pipeline require that an open season be held several years in advance of the commencement of commercial operations. However, payments for the capacity won in an open season do not begin until that first operational date.

**FERC\_06: (4 Comments)**

**Statement of Concern:** Statements questioning whether previously used assets that will be used on the project will be valued for rate purposes at their original cost or at their depreciated original cost.

**Response:** The answer to those questions is that it will depend upon the facts and circumstances surrounding the assets. Article 8.6 requires the sponsor group to follow FERC policy regarding the treatment of previously used assets for ratemaking purposes. Under present FERC policy, the issue of whether previously used assets should be valued at 1) their original cost, 2) an even higher cost if the assets were acquired in a purchase, or 3) depreciated original cost is very fact specific. That policy has also changed over time. The

parties to the contract found it difficult to consider all the hypothetical previously used assets that might become a part of the project and therefore determined that the most even-handed way to address the issue now was to simply require conformity with FERC policy. FERC will then decide what rate treatment is in the public interest.

**FERC\_07: (1 Comment)**

**Statement of Concern:** Statements indicating that contract commitments on expansion and rate structure should not intrude upon FERC jurisdiction.

**Response:** Some commenters suggest that the fiscal contract or the entity governance agreements should address the topics of expansion generally, and rate design (rolled-in vs. incremental pricing) in particular, and that addressing these issues in the contract is not at odds with FERC's duties. With regard to the rate design issue, neither the contract nor the state's proposed mainline LLC agreement resolves that issue. It is no secret that the state and the sponsor group have been unable to agree on this issue and have debated it publicly. Hence, the contract leaves the issue open for future resolution. However, Article 8.4 fully protects the state's right to intervene in any expansion proceeding and to argue for rolled-in pricing and, therefore, the state will be able to get a full and fair hearing before the FERC. FERC, of course, will have the final word on the type of pricing. Hence, if the state's argument for rolled-in pricing convinces FERC, that will be the result regardless of what is said or not said in the contract. If it doesn't, then FERC will hold in favor of incremental pricing regardless of what is said or not said in the contract. It should also be remembered that FERC has created a presumption in favor of rolled-in pricing for expansions.

With regard to voluntary expansion, it is correct that the contract does not set forth the terms and conditions under which a voluntary expansion can be undertaken by the mainline LLC. The reason is that those terms and conditions are a part of the proposed mainline LLC agreement. That agreement provides for a series of Management Committee votes to approve the various steps of an expansion, including authorization of a feasibility study, filing of a FERC certificate, and actual construction of the expansion.

**FERC\_08: (1 Comment)**

**Statement of Concern:** Statements concerning whether in the interactions between FERC and the Canadian regulators which organization would have precedence.

**Response:** FERC will have exclusive jurisdiction over rate regulation for those portions of the pipeline in the United States, and the NEB will likewise have exclusive rate jurisdiction over those portions of the pipeline in Canada. That said, the state expects that there will be extensive consultation and close coordination between the two agencies over rate and other (e.g., environmental) matters. In addition, memoranda of understanding exist between the NEB and FERC concerning how trans-border pipeline regulation is coordinated. Several historical examples exist of gas pipelines which cross the border between the lower-48 US and Canada – so, the precedents exist for NEB and FERC cooperation and coordination of trans-border pipeline regulations such as will be necessary for the Alaska gas pipeline.

**FERC\_09: (1 Comment)**

**Statement of Concern:** Statements asking whether, if the State is not satisfied with some aspect of the system design submitted to FERC, it can object to that design at FERC, and that there should be advance notice of the terms for open season.

**Response:** Under the FERC's open season regulations, a prospective applicant must file, for FERC approval, a detailed plan for conducting the open season, and do so no later than 90 days prior to providing the notice of its open season. Interested person can then comment on that plan which necessarily will include detailed design information. Hence, if the State (or anybody) is not satisfied with the proposed design, it can communicate that concern directly to FERC and do so well before the open season takes place. FERC will be in a position to then order design changes before the open season begins.

With regard to the advance notice point, the detailed plan that must be filed at least 90 days prior to the open season notice, will serve as that advance notice. Then when the open season is noticed, there will be another advance notice. A still further opportunity to voice concerns about the system design will occur when the pipeline files its application to FERC for a certificate of public convenience and necessity.

**FERC\_10: (1 Comment)**

**Statement of Concern:** Statements and questions about miscellaneous FERC and RCA jurisdictional matters.

**Response:** The contract's regulatory clauses, particularly those concerning the role of the RCA, have been misunderstood and misinterpreted. First, the RCA is not bound by the terms of the contract. The contract binds the state and the RCA is excluded from the definition of the state and hence the contract's obligations. To make this absolutely clear, the state is proposing to amend the contract to state that the regulatory powers of the RCA are not affected by the terms of Article 8. In addition, the state proposes to amend the contract to exempt from its provision any public corporation of the state such as ANGDA. Thus, ANGDA will be free to take any position that its Board decides.

1. The RCA would be free to review gas transmission charges if an Alaskan utility proposed to include such charges in its rate base for two reasons. First, the FERC does not have direct jurisdiction over the rate base of local distribution companies in Alaska or elsewhere; this is a matter reserved to the states under the Natural Gas Act. This also is not an issue under the contract which concerns the project. The project definition does not include local distribution companies. Section 8.4 preserves the right of the state as the owner of a large amount of gas to be shipped through the pipeline to protest tariffs and participate in regulatory proceedings regarding the project despite its ownership interest. Only Alaska PipeCo would be restricted from taking such actions. Thus, there is no contradiction.
2. The Department of Law represents the state in federal regulatory proceedings; the Regulatory Affairs and Public Advocacy's role is limited to participating in state proceedings and providing support to the Department of Law in federal proceedings. The Department of Law is part of the state and would be bound by the state's obligations under the contract.

3. Section 108 of the Alaska Natural Gas Pipeline Act confirms the RCA's authority over any lateral that serves in-state needs. Such a lateral is not part of the project as Section 9.3 of the contract makes clear. The mainline LLC must, however, cooperate with interconnection arrangements with in-state laterals.
4. NGL straddle plants are not normally subject to FERC regulation. If an NGL plant is built in Alaska, it would be part of the Project and the state would own a 20 percent share. As a part owner of the NGL plant the state will possess contractual and statutory privileges, rights and obligations with respect to the development, construction and operation of the NGL plant. ANGDA would have none since it is not a party to the contract and does not want to be bound by it per its comments. If an NGL plant is built elsewhere, it is not part of the Project. ANGDA would have such rights as it could negotiate in any such plant.

### 3.7.2 RCA: Regulatory Commission of Alaska—SOCs and Responses

This issue category covers the role of the Regulatory Commission of Alaska (RCA) with respect to the gas pipeline project.

#### RCA\_01: (18 Comments)

**Statement of Concern:** Statements indicating that there is no legitimate reason to eliminate regulatory protections for shippers, that the GTP, if not regulated by FERC, should be regulated by the RCA, and that there is no benefit to allowing arbitrators to determine just and reasonable rates which are established according to commercial agreements no one will see.

**Response:** The contract does not prohibit the regulation of the project by the RCA. If the FERC does not regulate a portion of the project, the contract does not prohibit (nor could it) the RCA from asserting jurisdiction. However, as stated in Articles 8.1 and 8.2, the parties expect that the entire project will be regulated by the FERC (or by the NEB in Canada). With regard to the unlikely situation where rates would be set through commercial agreements, the state is proposing to add language to the contract that would require rates to be set consistent with FERC ratemaking principles.

#### RCA\_02: (7 Comments)

**Statement of Concern:** Statements expressing concern that the contract requires the state to reimburse other participants if RCA takes certain regulatory actions.

**Response:** As presently drafted, Article 8.3 requires the state in certain circumstances to reimburse each participant for a loss caused by RCA action inconsistent with the principles of FERC policy for jurisdictional facilities or the principles of commercial agreements for non-jurisdictional facilities. Loss is a defined term under the contract and because of that definition, the state's obligation to reimburse does not include lost profits or consequential damages. The state is proposing to amend the requirement of Section 8.3 to limit reimbursement to circumstances where there is a loss caused by RCA action inconsistent with the principles of FERC policy for jurisdictional facilities or commercial agreements consistent with FERC principles for jurisdictional facilities. See proposed contract amendments in the Interim FIF.

### 3.8 Capacity Management and Access

Issues in this general area of concern included access to the gas pipeline by future explorers and gas pipeline expansion, and use of gas to increase oil production.

#### 3.8.1 ACC: Access for Other Companies—SOCs and Responses

This category issue deals with concerns about the access to the gas pipeline by future explorers and the gas pipeline expansion.

##### ACC\_01: (27 comments)

**Statement of Concern:** Statements expressing concern that the contract does not require expansion of the pipeline.

**Response:** The contract does not require expansion of the pipeline for two primary reasons: 1) such a commitment transfers a significant amount of risk to the pipeline owners, and 2) under the Alaska Natural Gas Pipeline Act of 2004, FERC was granted unprecedented powers to order expansions. FERC also has adopted especially friendly open season rules, specifically a presumption favoring rolled-in pricing of expansion capacity. Pipeline expansions will be subject to FERC rules, regardless of whether there is a contractual commitment. Independent producers and explorers provided strong feedback that they are willing to rely upon FERC's mandatory expansion powers. It is the responsibility of FERC to balance the interests of pipeline owners, shippers, explorers and the public.

##### ACC\_02: (4 comments)

**Statement of Concern:** Statements expressing various concerns about Article 8.7, State-Initiated Expansion.

**Response:** Concerns about Article 8.7 may best be resolved by deleting this article. The original intention of Article 8.7 was to provide a third avenue to expansion, in addition to FERC mandated expansion (established under ANGPA), and voluntary expansion by the mainline LLC (the terms of which are contained in the state's proposed mainline LLC agreement). The specific provisions within Article 8.7 were intended to apply only to state-initiated expansion, and to not affect either FERC mandated or voluntary expansions. Acceptance of Article 8.7 in the first place was strenuously opposed by the sponsor group during negotiations. Deletion of Article 8.7 seems to be generally supported by non-sponsor group producers and explorers, and by legislative consultants.

##### ACC\_03: (6 comments)

**Statement of Concern:** Statements suggesting that Article 10 be revised to provide for state transportation capacity to be reserved for common transport by intrastate independent shippers, to allow unused state capacity be made available on a priority basis to independent shippers, and to post all unused state capacity on a bulletin board service.

**Response:** These comments contemplate arrangements clearly inconsistent with FERC and NEB regulation. The goal of Article 10 is to achieve equity in the transportation risks incurred by the state in accepting shipping commitments. Article 10 provides this equity to the state with respect to both the sponsor group and with any additional producers who sign

up for open season shipping commitments and sign the Uniform Upstream Fiscal contract. The contract also specifies that open seasons must be held for in-state service, and that these open seasons must be separate from the full-haul open seasons. By this, both intrastate and other independent shippers are guaranteed equal access to transportation capacity. All unused capacity will be posted according to FERC regulations. If Article 10 is found acceptable by FERC and if unused capacity exists which is subject to Article 10 provisions, that reallocation will occur first.

**ACC\_04: (3 comments)**

**Statement of Concern:** Statements that the state should provide capacity for the independents/explorers.

**Response:** This suggestion is a major transfer of risks and costs to the state from independents/explorers. These companies make their living by managing risk. The fiscal contract and the upstream contract provide these companies a level playing field to explore, enjoy the fiscal benefits of the contract, and to obtain capacity at open seasons or on the secondary markets. The suggestion that the state should pick up the risk of obtaining and holding capacity for these companies is a proposal that the state underwrite these companies' activities. We question whether this would meet the public purpose requirement for the expenditure of state money imposed by the Alaska Constitution.

**ACC\_05: (5 comments)**

**Statement of Concern:** Statements arguing the merits of 52" pipe vs. 48" pipe vs. dual 36" pipes.

**Response:** This discussion of the merits of various pipe diameters or pipe configurations is premature. This contract is a fiscal contract, intended to set the stage for project planning to begin. Project planning will result in an open season being held, to identify the magnitude of gas delivery commitments shippers are willing to make. Only then can a final decision be made concerning gas pipeline diameter and configuration. Regardless of the final decision, FERC retains authority to mandate that the pipeline design be expandable, that it accept gas deliveries from all qualified shippers, and that in-state needs be met.

**ACC\_06: (1 comment)**

**Statement of Concern:** Statements indicating that there should be parity with the Canadian system on mandatory pipeline expansions and rolled-in tariffs.

**Response:** Expansions and tariffs for the Canadian portion of the Alaska gas pipeline are under the jurisdiction of Canada's National Energy Board (NEB), just as expansions and tariffs for the Alaskan portions are under the jurisdiction of FERC. No contract language can override those authorities. NEB regulations include a strong preference for rolled in tariff pricing. The state, as well as all shippers, and other interested parties will have the opportunity to respond before the NEB, as well as FERC, to all filings by the pipeline entity, or to attempt to obtain pipeline expansions. In addition, memoranda of understanding exist between the NEB and FERC concerning how trans-border pipeline regulation is coordinated. Several historical examples exist of gas pipelines which cross the border between the lower-

48. U.S. and Canada—the precedents exist for NEB and FERC cooperation and coordination of trans-border pipeline regulations, such as will be necessary for the Alaska gas pipeline.

**ACC\_07: (5 comments)**

**Statement of Concern:** Statements indicating that the pipeline should be sized bigger so that non-affiliated explorers and producers have motivations to explore, and that front-end engineering and design be completed before an open season is held.

**Response:** The first portion of this comment serves to shift a significant amount of risk onto the pipeline owners – including the state. The tool for properly sizing the pipeline system is the open season. Until open seasons are held, total expected deliveries to the pipeline are a matter of conjecture. The project documentation to-date includes an updated project summary which includes a timeline, estimating open seasons will be held two years after contract execution. Only at that time will firm data and commitments be available with which to size the pipeline and complete final design. In addition, FERC has the authority to require the pipeline owners to consider latecomers who miss the open seasons – an authority which motivates the pipeline owners to ensure clear information is available early to all potential shippers. FERC also has the authority to mandate pipeline expansions to accommodate future exploration by third parties.

**ACC\_08: (1 comment)**

**Statement of Concern:** Statements indicating that commitments on expansion and rate structure not intrude upon FERC.

**Response:** FERC will have the final authority in the U.S. on pipeline expansion and rate structure issues, regardless of the provisions in the contract. The negotiating teams believe the contract provisions will be acceptable to FERC.

**ACC\_09: (2 comments)**

**Statement of Concern:** Statements expressing concern that pipeline ownership by the sponsor group will result in antitrust issues and anti-competitive behavior.

**Response:** FERC has acknowledged that antitrust issues must be addressed. Much of the development and transition in FERC regulation over the last two decades has been directed at ensuring that such anti-competitive behaviors do not occur. The state, by having a seat at the table with pipeline ownership, will have greatly enhanced ability to identify and prevent anti-competitive behaviors from occurring.

**ACC\_10: (1 comment)**

**Statement of Concern:** Statements expressing concern that there is no provision in the contract for sole-risk expansions.

**Response:** A sole-risk provision was not included in the contract. For the state, existence of a sole-risk provision could be viewed as a predisposition in the contract of the state to do sole risk expansions—a serious transfer of risk onto the state. In addition, it is believed the FERC's mandatory expansion powers protect all explorers, shippers, and the state adequately.

**ACC\_11: (5 comments)**

**Statement of Concern:** Statements indicating that the provisions of Article 10 inhibit access to initial and expansion capacity, particularly to non-owner shippers. In addition, the sponsor group is not liable to the state for losses arising from failure to perform obligations regarding capacity.

**Response:** The terms of Article 10 do nothing to inhibit access to initial and expansion capacity by any party. Access to capacity is regulated exclusively by the FERC, and any contract terms affecting such access would be overridden by FERC authority. The provisions of Article 10 were demanded by the state negotiators in order to ensure that the state, by taking royalty and payment in lieu of production tax in the form of gas, does not bear disproportionate risks due to the fact that the state is not a producer of gas and does not make exploration or development decisions. The fact is that the gas delivered to the state is a share of the gas produced by each producer. The state has no direct control over these volumes delivered. The terms of Article 10 ensure that, throughout the term of fixed transportation commitments, the state obtains shipping capacity to transport state gas to market when it is produced, and that the state does not hold a share of shipping commitments disproportionate with the state's share of production. Mechanisms are defined within Article 10 which adjust shipping commitments between the state and a producer to maintain this equity. Although complex, the terms of Article 10 are clearly and specifically constrained to ensure that parity is maintained individually between the state and each member of the sponsor group delivering in-kind gas to the state. The terms of Article 10 specifically do not provide the state or any member of the sponsor group with 'first-call' to capacity rights beyond maintaining this parity.

The state and the sponsor group have acknowledged that the provisions of Article 10 are unique, and will require scrutiny by FERC. Precedent suggests that FERC will be responsive to the state's position as a shipper, as well as our very different upstream position with respect to the sponsor group, when they deliberate to ensure an 'even playing field' exists for capacity rights. If FERC fails to approve all of the Capacity Management provisions, it is expected that it will provide the state and sponsor group guidance to satisfy both FERC requirements and state needs. The sponsor group is committed in Article 10.8 to negotiate in good faith in an attempt to develop a mutually acceptable alternative provision that remedies the defect.

The argument that sponsor group is not liable to the state for losses arising from failure to perform obligations regarding capacity arises from the language of Article 10.10. This argument represents a failure to comprehend the full context of the statement. The sponsor group does have a commitment to perform in Article 10. Failures can be remedied through arbitration or through court if fraud occurs; however, the sponsor group will be making their capacity management decisions based on their own business interests and expectations. Their individual business interests may at times be perceived as not coinciding with the state's interests regarding capacity management issues. They may also simply make a capacity management decision which proves to be wrong. By the sponsor group's commitments to Article 10, the state has agreed to 'ride their coattails' regarding capacity management decisions, and accept the state's share of the benefits and costs of those decisions – no more and no less. In return for that benefit, the sponsor group insisted on being indemnified against further action by the state over individual decisions or the results of those decisions.

Furthermore, as time goes on, the state always retains the unilateral right to cancel Article 10 and manage capacity on our own if we decide circumstances are such that the state benefits more from that independence.

**ACC\_12: (1 comment)**

**Statement of Concern:** Statements indicating that the state must ensure fair and reasonable terms on all facilities.

**Response:** All facilities which are part of the Alaska gas pipeline project are expected to be regulated by FERC and the NEB. The terms of access will be determined by each. The FERC has already adopted a comprehensive set of open access regulations that apply to all of the project. As a shipper of gas, and separately as a sovereign, Alaska has unfettered rights to litigate at the FERC over any issue of access, including tariff terms. (See Article 8.4 of the fiscal contract). Also, the Alaska member of the entities that own the facilities will participate in the internal processes that set the tariff and terms of access that will be submitted to the FERC for approval. Any facilities of the project that are not subject to FERC or NEB jurisdiction are to be governed by commercial agreements that are consistent with FERC policies for jurisdictional facilities. To the extent that the RCA has jurisdiction over any element of the project, which is not anticipated, its jurisdiction is undisturbed by the contract.

**ACC\_13: (1 comment)**

**Statement of Concern:** Statements expressing concern that the fiscal terms will not be available to all shippers.

**Response:** The administration has drafted a Uniform Upstream Fiscal contract (Attachment A to the fiscal contract). The UUFC ensures that all shippers who commit to ship on the Alaska Gas Pipeline enjoy equitable upstream fiscal terms. It is entirely under the purview of the Alaska Legislature to ensure that this legislation is implemented with provisions which provide for this equitable treatment of all producers and shippers.

**ACC\_14: (1 comment)**

**Statement of Concern:** Statements indicating that the rights of first refusal for existing shippers impair access to new shippers.

**Response:** Rights of first refusal are subject to FERC regulation. Offering of rights of first refusal by pipeline companies to holders of firm transportation capacity at the end of that FT term is normal in the pipeline business. It is unreasonable to expect that those shippers who have made the initial financial pipeline transportation commitments—in addition to the upstream investments necessary—should be denied rights of first refusal to continue to deliver gas and monetize their investments. New shippers are protected by FERC's power to mandate expansions if voluntary expansions cannot be accommodated and fiscal contract expansion terms are not implemented.

**ACC\_15: (1 comment)**

**Statement of Concern:** Statements advocating AOGCC authorizations prior to holding of an open season.

**Response:** This is a practical issue, not a concern which should be addressed contractually. The issue in the contract is establishment of fiscal certainty, which will allow project planning to go forward. Part of that planning process will be obtaining AOGCC offtake authorizations in time to commit PBU and PTU reserves at the open season.

**ACC\_16: (1 comment)**

**Statement of Concern:** Statements suggesting that Articles 8 and 10 of the Gas contract may be modified to require (a) that the owners have a contractual obligation to undertake an economic expansion based upon a clear definition of an economic and uneconomic expansion, (b) that expansion shippers have the right to contribute the necessary funds to make an uneconomic expansion meet the definition of an economic expansion, (c) that the owners acknowledge the right of either the FERC or the RCA to require an expansion deemed to be in the public interest, (d) that the State of Alaska have the clear and unrestricted right to require an expansion if it contributes the funds necessary to make that expansion an economic expansion.

**Response:** This concern requires a four-part response:

1. Contract provisions requiring "clear definition of an economic expansion" are very difficult to agree upon, and resulting obligations are more difficult to impose on an unwilling party. Even if agreement is obtained under such provisions, how is cooperation to complete such an expansion to be measured? It is much clearer to rely upon FERC jurisdiction to mandate expansions, and to require that they be completed.
2. Contribution of funds is not foreclosed by the voluntary expansion provisions of the state's proposed mainline LLC agreement, and could certainly be included as a requirement by FERC prior to mandating an expansion. Inclusion of such a provision in the fiscal contract begs the question of how the magnitude and timing of contributions should be determined, and what should happen if the expansion scenario changes or goes awry. The value of such a provision in the fiscal contract is, at best, questionable.
3. FERC has the authority to mandate expansions, whether the owners acknowledge that authority in the fiscal contract or not. Presently, RCA does not have that authority — one more reason the state wants to ensure the entire Alaska project is under FERC jurisdiction.
4. This answer is the same as in (2) above. In addition, contribution of funds by the state to a pipeline expansion—to which apparently neither explorers nor the pipeline owners were willing to contribute—transfers the risk related to that expansion to the state. Such an action is a policy decision which the state should carefully consider prior to making such a decision.

### 3.8.2 OIL\_Px: Oil Production Issues—SOCs and Responses

This issue category covers the use of gas to increase oil production.

#### **OIL\_PX\_01: (12 comments)**

**Statement of Concern:** Statements indicating that gas production will result in lower oil recovery and that there are alternatives to gas injection to enhance oil recovery. In addition, oil companies are intentionally reducing oil production and exaggerating their intent to leave in order to enhance their bargaining position for the pipeline contract.

**Response:** Production from ANS oil fields is declining but we have already produced more oil than was originally projected with years of recoverable reserves still present. An axiom of oil production is that as soon as a reservoir is tapped its production rate begins to decline. This relates to the physical aspects of oil reservoirs including pressure, interspatial flow, and other factors. Over time, petroleum engineers have developed techniques to recover more and more of the oil present. Some of the methods consist of lateral drilling while others consist of injecting gas, water, or CO<sub>2</sub> to maintain reservoir pressure (referred to as EOR). The use of CO<sub>2</sub> for carbon sequestration is being used more and more around the world and the technology is improving yearly. The results of all these EOR methods has been increased recovery from about 35 percent to 45 percent or more of in-place reserves. Techniques that were impossible years ago became doable, but expensive and now they are commonplace and an expected normal cost of operations.

The state monitors oil field production and reserve status on an ongoing basis. We have found no reason to believe that production rates are being purposefully reduced or reserves underestimated. We have found that technically recoverable reserves are increasing as a percentage of total reserves and that more and more oil is economically recoverable. While there is discussion about total technically recoverable reserve volumes twenty years from now, there is also total agreement that recovery rates will be higher than they are now.

We all agree that at some point ANS oil fields will no longer be economic. In the end, total oil production will be related not only to technology, but also to the price of oil. At a higher price, more oil will be recovered. The length that a company will go to for an additional barrel of oil from a reservoir depends on the price of the barrel relative to the cost of recovering the barrel. A major factor will be the economic viability of the oil pipeline (TAPS). Current estimates suggest about 200,000 barrels per day is the minimum flow necessary to keep the line in operation. If this volume can be reduced, then oil production will continue for a longer period.

Without the development of the gas reserves, oil production declines to an uneconomic level by 2030 and the volume will be below the minimum necessary to keep TAPS flowing. If the gas reserves are developed oil production and TAPS operation are expected to extend beyond 2050. When gas production begins (that is transporting to market rather than re-injection) we expect increased oil production from new fields. In addition, some existing oil fields will have lower production due to reduced pressure from gas removal but they will produce oil economically for a longer time (the same amount of oil may well be produced, it will just take longer). Also, with gas production some production costs such as the natural gas handling facility will no longer be borne by oil, making it more economic to produce.

In addition, any delay in the gas project will further exacerbate the state's looming fiscal gap that threatens the future of the state. The state's discretionary budget is currently about \$3 billion a year. Fortunately, unprecedented high oil prices have created budget surpluses in recent years. However, oil prices are expected to decline to a long-run average of \$35. At that price the state would currently be running a \$1 billion deficit.

Moreover, TAPS is now running 60 percent empty, despite investment in recent years of nearly \$1 billion annually. The Department of Revenue estimates that \$1.8 billion is required annually to keep production at a constant level. This is nearly twice the amount being spent in recent years.

Current production is about 800,000 barrels per day and is expected to be about 100,000 less by 2015.

In addition, with 2 percent annual growth the budget would be \$4 billion by 2015. Yet the two percent is conservative; increased state debt, Medicaid, unfunded pension liabilities, and government operating expenditures could very well cause higher growth.

Thus there are three major forces driving toward massive budget problems: declining oil prices, declining oil production, and a growing budget. Non-oil revenues may add another \$0.5 billion annually. In the absence of a gas pipeline or new budget sources, such as broad-based taxes, annual deficits will grow to \$1.5 billion annually by 2015-- a cumulative deficit of \$10 billion from now to then. Under these assumptions the Constitutional Budget Reserve Fund (CBRF) will be depleted by 2009.

Furthermore, natural gas production would not start until 2016, were the proposed contract to be executed in 2006. In other words, the state revenue stream from gas will not incur until 10 years after the execution of the proposed contract. The delay of building the gas pipeline would only lead to the delay of the state revenue stream from gas, which would deepen the state deficit until the first gas flows.

All discussed above underscore the need to get the gas pipeline constructed soon. At a mid-range forecast of \$5.50/mmbtu in Chicago the proposed contract terms would generate annual revenues to the state between \$2 to \$3 billion.

Not only would the gas pipeline allow the continuity of essential state services while minimizing the tax burden of its citizens, it would also extend the oil life of the ANS, bring in additional billions of dollars over time, as well.

For additional detail see *Section 1.2.2 Impacts of Gas Production on Oil Production* in the Preliminary FIF.

**OIL\_PX\_02: (3 comments)**

**Statement of Concern:** Statements indicating that oil need not be that important to the economic wellbeing of Alaska.

**Response:** Petroleum taxes provide 86 percent of state Unrestricted General Fund revenues and almost all Permanent Fund contributions. Petroleum is vitally important to the economic wellbeing of this state. It is true that this has not always been the case. Many remember that until the first payments from Cook Inlet and certainly until the first lease payments from the ANS, petroleum played a relatively minor role in state finances and wellbeing. It is likely

that some day this will be the case again. However, petroleum related revenues have allowed Alaska to develop infrastructure, jobs and culture. It also provides its citizens with dividends and the option of living free of state taxes. Diversification of state revenues and economy is important; and development of our gas resources is the critical next step toward that diversification and growth of our economy.

### 3.9 Taxes and Incentives

Issues in this general area of concern included establishing fiscal terms for the duration of the contract (fiscal certainty); the petroleum profits tax (PPT) legislation; state provision of investment incentives to industry; gas pipeline project impacts on local taxation; incentives for exploration and development of new sources of gas and oil in Alaska; development of the Point Thomson unit (PTU); the Uniform Upstream Fiscal Contract (UUFC); and a tax on certain leases having known resources of natural gas.

#### 3.9.1 FISC: Fiscal Certainty—SOCs and Responses

This issue category deals with the establishment of fiscal terms for oil and gas for the duration of the contract (fiscal certainty), worldwide comparisons of fiscal certainty terms, and concerns on the effect of higher oil taxes.

##### **FISC\_01: (142 comments )**

**Statement of Concern:** Statements expressing concern about the proposed fiscal certainty terms, including the duration and lack of a re-opener clause.

**Response:** The Alaska natural gas pipeline project will be the highest capital cost project ever proposed to be constructed in North America. It is by far the largest, most costly project in the portfolios of any of the members of the sponsor group. In enacting the SGDA, the legislature recognized that it could facilitate development of the gas pipeline and encourage the significant benefits that result by providing a stable and certain fiscal environment for a term of years. In AS 43.82.250 the legislature set the boundaries they determined were appropriate for a contract of this magnitude. The term "may not exceed 35 years from the commencement of commercial operations of the approved qualified project, excluding suspensions of contract obligations that are covered by *force majeure* terms of any contract developed under this chapter. However, the term of contract may not exceed 45 years from the effective date of a contract . . ." The term of the fiscal contract is consistent with the requirements of the SGDA.

The term for fiscal certainty has been identified as an important issue in the legislative and public hearing process. The state is proposing to amend the contract. The administration supports a proposal adopted in the Senate that would shorten the general term for fiscal certainty to 25 years from the commencement of commercial operations and provide that the term of the contract will not to exceed 35 years in total. The administration also supports a proposal that would divide the certainty term for the petroleum production tax (PPT) into three parts. Up to the date the project is sanctioned the tax laws in effect at the time would govern. From the date of project sanction and for the ensuing 14 years, the PPT PILT payments would be paid based on the tax rates and related regulations in effect as of the later of (i) the last day of the 2011 legislative session, or (ii) the date of the FERC application. For

the remaining period out to the 25<sup>th</sup> year from project sanction, there would be a stability period during which the petroleum tax laws could change, but the sponsors could receive offsets that maintain their tax obligations as of the date their tax obligations were fixed. The term of fiscal certainty for ad valorem taxes (Article 17) and SCIT (Article 19) also would be shorter than the general term.

**FISC\_02: (84 comments)**

**Statement of Concern:** Statements indicating agreement with the fiscal certainty terms.

**Response:** We agree with the comment. In addition, the state is proposing an enhancement to the fiscal certainty terms as indicated in FISC\_01 response.

**FISC\_03: (2 comments)**

**Statement of Concern:** Statements indicating that the tax terms (and Alaska's total take) should be stable and should not be changed when petroleum prices change or when there's a budget deficit.

**Response:** The legislature recently changed the petroleum production tax law. It provides for higher rates and an upward adjustment in the tax rate when petroleum prices rise above a certain reference point. The state proposes to change the scope of fiscal certainty in the fiscal contract to freeze the tax rates and related regulations for the PPT as they stand as of the later of (i) the last day of the 2011 legislative session, or (ii) the FERC Application Date. The companies would then begin payments at those rates as of the calendar year that includes project sanction. They would pay those rates for a period of 14 years. After that 14 year period and up to twenty-five (25) calendar years from the effective date of the contract, their tax obligations would be determined by the law of the day subject to an overall ceiling that their tax obligation, individually determined, would be the same as it was at immediately before the date the tax obligations were fixed.

**FISC\_04: (1 comment)**

**Statement of Concern:** Statements indicating that locking in the oil tax structure is unacceptable and that the oil tax rate is too low.

**Response:** In August 2006, the legislature passed the PPT that changed the oil tax structure. In addition, the state is proposing to revise Article 3.2 (Fiscal Certainty Term) to reflect the length of fiscal certainty terms recommended by the Alaska Legislature. The state is further proposing that the term for fiscal stability related to oil taxes would be adjusted as outlined in FISC\_01 above.

**FISC\_05: (1 comment)**

**Statement of Concern:** Statements that the contract imposes too many fiscal obligations on the state and that all fiscal obligation provisions should be revisited to limit the state's liability as much as possible.

**Response:** The state has carefully considered and evaluated the fiscal obligations and risks that it has assumed and weighed them against the fiscal benefits it will receive. The state believes that a fair balance has been reached. This issue is more extensively discussed in the Interim FIF.

**FISC\_06: (1 comment)**

**Statement of Concern:** Statements expressing concern about the state's comparison between Alaska's oil and gas arrangements with other jurisdictions' oil and gas arrangements.

**Response:** There are two parameters to compare Alaska's oil and gas arrangements under the contract with other oil and gas jurisdictions: (1) from the Producer's prospective, are the economics of the gas line project under the terms of the contract competitive with other investment opportunities around the world available to them and (2) how does total government take (Federal, State and municipal) compare with other foreign government oil and gas regimes. Section 5 of the Preliminary FIF analyzes each question. In Section 5.12 seven profitability indicators (internal rate of return, present value of cash flows, profitability ratio, undiscounted net cash flow, net present value per equivalent barrel of oil, net present value of undiscounted capital expenditures and net cash flow per equivalent barrel of oil) of the gas line are compared with similar information for 60 other projects around the world over a range of gas prices to see if they exceeded the target value. The target value indicators are those which fall in the upper 80 percent of those 60 projects. The conclusion was that the project was generally competitive on a non-risk adjusted basis. When risks such as cost overruns are introduced into the comparison, the project does not fare so favorably. In Section 5.17 the total government take was compared the Northwest Territories of Canada, Australia, Indonesia, Qatar, Trinidad & Tobago and Venezuela. Comparatively, Alaska comes out in about the middle over a wide range of gas prices as shown in Table 32 and Figure 33 of the Preliminary FIF. Thus, the Administration feels comfortable with the basic oil and gas arrangements or terms included the contract.

**FISC\_07: (2 comments)**

**Statement of Concern** Statements indicating that the contract contains no fiscal certainty (or predictability) for the state.

**Response:** This is incorrect. The contract provides complete certainty that the state will receive from the sponsor group the multiple payments that have been agreed to (*Section 3 Fiscal Terms of the Deal* of the Preliminary FIF provides more detail about these payments). In addition, political subdivisions will also have stability in the portion of PILT payments made directly to them.

**FISC\_08: (1 comment)**

**Statement of Concern:** Statements that long-term fiscal stability is not necessary as even large increases on production taxes have no impact on the internal rate of return by the 15th year of operations.

**Response:** In considering the investors' economics, the upstream and midstream elements of the project have to be jointly considered for profitability and risk analysis. The upstream elements consist of the development and production of the ANS gas fields. The PTU and other gas fields that will come on line in the future will be the most important upstream investments. The midstream elements of the project consist of the transmission lines from the fields to the GTP, the GTP, the Mainline (Alaska to Alberta project) and the Alberta to Chicago project in case that pushes through. The midstream elements are going to require huge upfront capital investments. Based on an analysis conducted by Pedro van Meurs (the state's fiscal advisor), on a real basis the midstream internal rate of return (IRR) is only 4.5

percent. This IRR is not sensitive to the Chicago city-gate price because the IRR is only created through the transmission line, GTP, and pipeline tariffs. The upstream IRR on the other hand is highly attractive—above 20 percent even at a gas price of \$2.50 per mmBtu (Chicago city-gate). The IRR improves significantly with higher price levels. The reason for this is that the investments required for this element are low. Prudhoe Bay requires very minimal incremental investment to make the gas available to the project; PTU requires full development but this initially only represents about one-third of the gas volumes.

The sponsors (and the state) have to make large firm transportation (FT) commitments to sell the gas downstream at the outlet of the pipeline. These commitments have a “ship or pay” nature. These commitments relate to the capacity charge of the gas for a lengthy period of time, possibly 20 years. The sponsor group may have to commit for the transportation of 24 tcf of gas at a capacity charge of \$2.5 per mcf; this represents a \$60 billion commitment. The sponsor group, will have to make this commitment and this commitment has to be reflected in the upstream economics—for IRR purposes, this commitment is capitalized. For instance, van Meurs’ analysis notes that for the stress price of \$3.50 per mmBtu, the upstream IRR of 37.2 percent is now averaged by the midstream IRR of 4.5 percent. The upstream and midstream cash flow are combined in a single cash flow and results in an IRR of 13.5 percent. *Section 6.1.13* of the Interim FIF will also address the issue of investor economics for both the upstream and midstream elements.

The sponsor group is seeking fiscal certainty due to the risks involved in the Alaska gas project. This project is two to three times larger in capital costs and is higher risk than most international projects. Specific risks associated with the Alaska gas project include: (1) the inherent size and cost of the project and its impact on labor and material markets, (2) the distance from market, (3) the rugged terrain and harsh construction conditions, (4) the limited infrastructure support, (5) the required coordination with multiple government jurisdictions, and (6) the volatility of gas prices. In fact, at an assumed investment of \$20 billion, the Alaska pipeline project would be the largest private investment in North America and is significantly larger than most “model” worldwide oil and gas projects.

Fiscal certainty on a \$20 billion-plus gas pipeline project is critical to the advancement of the project. If everything goes according to the success-based plan contained in the project summary provided to the commissioner on May 10, 2006, the gas pipeline project is anticipated to take 9-10 years from the start of project planning until the commencement of commercial operations. The term of the contract would then remain in effect for an additional 35 years for a maximum of 45 years. The hard line of 45 years accomplishes two things. First, it ensures that if the construction phases of the project extend beyond ten years, the fiscal terms, including fiscal stability, are not extended. This is one more reason that the sponsor group will advance the project as diligently as is prudent under the circumstances. Any delay results in a shorter fiscal stability period following commencement of commercial operations. Second, since the fiscal contract cannot extend beyond 45 years, it makes clear that the fiscal stability is temporary, not permanent. Thirty-five years of fiscal certainty during production is not uncommon in large oil and gas related projects. Dr. Pedro Van Meurs, analyzed a number of international agreements and noted that many countries offer contracts for fiscal stability that include 30 years or more of production.

The term provided for in the Fiscal contract will facilitate many years of continued investment and exploration. It could mean the development of a new gas exploration business

and the corresponding upstream developments. The project itself is based on having at least 50 tcf of gas produced on the ANS. Production of this gas will take the full term of the Fiscal contract. In fact the project is dependent on those gas volumes to ensure that the economies of scale are achieved.

Furthermore, in light of concerns voiced by members of the legislature and the public, the State is proposing to shorten the fiscal stability period both for gas and oil, with the latter being shortened even more as explained in FISC\_01.

**FISC\_09: (1 comment)**

**Statement of Concern:** Statements that higher oil taxes will discourage development of new oil reserves and thus the associated gas reserves to fill the gas pipeline.

**Response:** In August 2006, the legislature made its judgment that a new PPT law should contain higher taxes than the previous law. The new PPT law is based upon net revenues, rather than gross severance, and it includes credits intended to create an incentive for north slope producers and explorers to reinvest in oil and gas exploration and development in Alaska. If the new investment occurs, this should lead to new oil and gas reserves being discovered which will extend the life of existing oil fields and extend the life of the oil pipeline and gas pipeline.

**FISC\_10: (1 comment)**

**Statement of Concern:** Statements that there should be no fiscal certainty terms for oil in the contract and that the gas fiscal certainty terms should be limited to no more than 5 to 15 years after the pipeline becomes operational.

**Response:** The fiscal contract is designed to give the sponsor group stability on both their oil and gas ANS production. Stability on just gas would leave the sponsor group vulnerable to future oil tax increases in the event a future legislature felt that the locked-in tax rates were too low. In other words, stability on gas alone really is no stability at all.

The original term of fiscal stability was comparable to the term in other international contracts and also reflects the long lead time necessary to develop the project and the likely duration of the FT commitments and term of the financing for the mainline. See Preliminary FIF at 115-117.

With regard to the period of fiscal stability, the legislature and the public have questioned the need to have the time period be as long as it is in the contract. The state proposes to change the scope of fiscal certainty in the fiscal contract by shortening the overall term of the contract by ten years with the exception of certain tax items and by freezing the tax rates and related regulations for the PPT as they stand as of the later of (i) the last day of the 2011 legislative session, or (ii) the date of the FERC application. The companies would then begin payments at those rates as of the calendar year that includes project sanction. They would pay those rates for a period of 14 years. After that 14 year period and up to twenty-five (25) calendar years from the effective date, their tax obligations would be determined by the law of the day subject to an overall ceiling that their tax obligation, individually determined, would be the same as it was at immediately before the date the tax obligations were fixed. After the 25 year period, the law of the day will determine all PPT obligations. The time when fiscal stability for state corporate income tax (SCIT) commences also would be altered.