

ALASKA LEGISLATURE COMPTROLLER, 2000-2001

11979 SENATE RESOURCES

Members of the sponsor group have not agreed to this change and opposed the concept when it was raised in the Senate Special Committee; therefore, this issue would have to be negotiated with the sponsor group.

### 3.9.2 PPT: PPT Legislation—SOCs and Responses

This issue category covers issues regarding the petroleum production tax (PPT) legislation.

#### **PPT\_01: (86 comments)**

**Statement of Concern:** Statements indicating that the PPT tax rate is too high or too low or the rate should increase over time or in conjunction with higher oil prices. Comments also indicated that the tax rate of 20 percent was too low; and that tax rates higher than 20 percent would adversely impact the gas pipeline project or would impede future oil industry investments.

**Response:** The PPT plan proposed by the governor in the regular legislative session, as well as in the two special sessions, set the production tax rate at 20 percent. This is because the governor believed that 20 percent was the appropriate level of taxation that would maximize revenue to the state, while not hampering industry investment.

As the PPT measure worked its way through committees in the House and in the Senate, the tax rate changed from its original value of 20 percent to as high as 25 percent (Senate Resources Committee), before it was finally enacted at a rate of 22.5 percent. Many members on both sides of the legislative aisle thought that the rates chosen were either too high or too low. It remains to be seen what effect the tax rate will have on industry investment, if any. The tax rate appeared to be, however, a compromise between those who preferred a tax rate of 25 percent and those, including the governor, who lobbied for a tax rate of 20 percent. A progressive surcharge of 0.25 percent for every dollar that the "production tax value" exceeds \$40 was added to the bill to capture additional revenues when oil prices are in the range of \$55 or higher.

#### **PPT\_02: (11 comments)**

**Statement of Concern:** Statements asking how the PPT tax rate compares to other countries and how it compares to tax rates on other natural resources.

**Response:** As a petroleum-producing state, Alaska competes with other jurisdictions all over the world for oil company investments in exploration, development and production. When making investment decisions, oil companies consider a variety of costs that can impact profitability of their projects. The fiscal system, including taxes on oil and gas, is a major cost that companies must consider.

In December 2005, Dr. Pedro van Meurs, an internationally recognized petroleum expert and consultant to the State of Alaska, reviewed the fiscal systems of major petroleum-producing jurisdictions. Dr. van Meurs found that profits-based taxes are widely used in other jurisdictions that compete with Alaska for oil company investment, including Norway, the United Kingdom, Alberta and the Gulf of Mexico. A brief summary of the key elements of the fiscal systems of these jurisdictions follows.

- In Norway, there is a 28 percent corporate income tax and a 50 percent hydrocarbon tax. The effects of Norway's fiscal system on development decisions for hypothetical oil fields was compared to the effects of Alaska's fiscal system, with the former ELF-based production tax and with a change to a PPT production tax. It was found that implementation of the PPT increases Alaska's competitiveness relative to Norway by increasing the internal rate of return on development projects. The PPT makes Alaska particularly more attractive for new investments in small fields.
- The fiscal system of the United Kingdom is one of the most attractive in the world, with a corporate income tax, rentals and a corporate income tax surcharge amounting to a tax rate of about 50 percent. In general, the U.K. would still be more attractive than Alaska under the PPT. However implementation of the PPT will raise Alaska's attractiveness in relative terms, bringing Alaska closer to the U.K. especially for small fields.
- In the deep waters of the Gulf of Mexico, a direct alternative to Alaska within the United States, companies pay a 12.5 percent royalty as well as federal corporate income tax, rents and bonuses. Based on analysis of hypothetical fields, the Gulf of Mexico is much more attractive than Alaska and will remain so under the PPT. However the PPT will help narrow the gap in attractiveness between Alaska and the Gulf of Mexico.
- Alberta's oil sands require the higher of a 25 percent profit share or a 1 percent royalty, in addition to a total federal/state corporate income tax of 33.62 percent. With the PPT enacted, Alaska would be more attractive for small fields, but still less attractive for large fields.

To summarize, even with the PPT, Alaska still lags behind other jurisdictions in terms of attractiveness, partly because of the high fixed costs and lower oil value in Alaska. However, according to Dr. van Meurs, the PPT is an improvement for Alaska in terms of attractiveness for oil company investment. The PPT generally makes the most difference in attractiveness when considering small, high-cost fields, which could be significant sources of new production in Alaska in the future.

PPT tax rates compare favorably to tax rates on other natural resources, such as fishing, mining and timber. The oil and gas industry in Alaska pays a state corporate income tax with a maximum rate of 9.4 percent. Effective oil and gas industry state corporate income tax rates are in the 4 to 5 percent range. There are also royalties of 12.5 percent (on most leases), a petroleum property tax and the production tax.

The fishing industry is subject to either the Fisheries Business Tax or Landing Tax on the value of fisheries resources processed or landed in the state at tax rates of 1 percent to 5 percent. There are also various seafood assessments that are self-imposed by the industry for marketing or management of the industry. Corporations in the fishing industry are subject to corporate income taxes. The mining industry in Alaska pays a royalty for mines that are on state land as well as a mining license tax of up to 7 percent based on net income. Corporations in the mining industry are subject to corporate income taxes. The timber industry does not pay any targeted taxes to the state; however corporations in the timber industry are subject to corporate income taxes.

It is more accurate to view Alaska's fiscal system for oil and gas as consisting of several components, one of which is a royalty and one of which is a production tax. All petroleum

producing properties in the state are subject to both of these fiscal components, in one form or another.

**PPT\_03: (130 comments)**

**Statement of Concern:** Statements indicating that a profit-based tax is a bad idea because companies will overstate costs to reduce tax liability; that credits should not be allowed; and that the PPT terms are too generous.

**Response:** Over the past several years, the governor, lawmakers and the public have become increasingly aware that Alaska's production tax system, based on the Economic Limit Factor (ELF), was in need of repair. The production tax system in place was broken for a number of reasons, among them the fact that it was not responsive to recent high oil prices, and that it did not provide incentives for exploration and increased oil production. There was general consensus among policymakers that the oil production tax system needed an overhaul.

The governor enlisted the assistance of a world renowned petroleum fiscal systems expert, Pedro van Meurs, to advise the state on the restructuring of Alaska's production tax. Dr. van Meurs strongly encouraged the state to adopt a profits-based tax system, very much like production tax systems that exist in many petroleum-rich countries throughout the world. It was suggested that a profits-based system would reap substantial benefits for the state when prices are high and would encourage re-investment within the state.

The PPT as proposed by the governor was a tax at a rate of 20 percent on profits, and a credit of 20 percent on capital expenditures. The credit portion of the PPT was a necessary component to encouraging further investment. In comparison to the ELF-based tax system, the nominal PPT tax rate of 20 percent is 5 percent higher than nominal tax rate on the ELF-based system; this comparison, however, has little merit since the base to which the tax applies is different. A more fair comparison is that of effective tax rates: whereas the ELF-based tax was projected to return an average effective tax rate of 4.9 percent from 2007-2016, the PPT was projected to return 10 percent when prices average \$40 per barrel and 14.5 percent when prices average \$70 per barrel. Effective tax rate is a better measure of the tax revenue that can be expected under certain oil price and production conditions, and the revenue estimates under the governor's PPT plan show significant increases in production tax revenue over the ELF-based tax when prices are \$30 per barrel or higher.

Other tax mechanisms, such as a standard deduction and transition provisions, were added to the tax system to ease the tax burden on small producers and producers who had made substantial investments over the past several years. A progressive surcharge was added to the bill by the legislature in order to capture more tax revenues when oil prices are unusually high.

The PPT will require additional auditing staff to monitor the upstream costs claimed by oil companies. Auditors from both the Departments of Natural Resources and Revenue already audit downstream costs, such as pipeline and marine transportation costs, and these costs are currently deductible from sales price of oil for tax and royalty payment purposes. Upstream costs, while requiring additional scrutiny from the Department of Revenue, are also independently monitored by oil companies that partner with oil field operators. Oil field operators regularly bill joint interest owners through statements that detail costs for operating

oil fields. The use of these statements, which are audited by joint interest partners, will assist greatly in the auditing of PPT deductible upstream costs.

**PPT\_04: (2 comments)**

**Statement of Concern:** Statements asking about production tax value and how it relates to other measurable values such as market price and government take.

**Response:** The production tax value is a value calculated by deducting all costs (both the upstream capital and operating lease expenditures, and the downstream transportation costs, as well as state royalties and property taxes) from the market price. It is roughly equivalent to the term "net income."

The value to which a production tax may be applied as a percentage of market price will depend on the market price. For instance, if costs are \$15, and the market price is \$25, the production taxable value will be \$10, or 40 percent of the market price. If the market price is \$60, the production taxable value will be \$45, or 75 percent of the market price. Since costs (except State royalties) are relatively fixed regardless of price, as market prices go up, the production taxable value as a percentage of market price goes up more.

Government take is the state and federal governments' share of the "economic rent," (the net income before taxes). This will include state royalties, and production, property, conservation, and state income taxes, as well as federal income taxes.

Again, government take will depend on costs, tax rates, and market prices. However, because many of the taxes themselves depend on price, government take increases only very slowly with price. We estimate that the government take is 60 percent at a \$30 market price, and 63 percent at \$80.

**PPT\_05: (2 comments)**

**Statement of Concern:** Statements expressing concern that a federal tax increase may reduce Alaska revenues.

**Response:** The Alaska statutes that the contract adopts by reference do not allow corporations to deduct federal income tax. Therefore, increases in a corporation's federal income tax liability will have no effect on the payments in lieu of Alaska corporate income tax under the contract.

**PPT\_06: (3 comments)**

**Statement of Concern:** Statements indicating that the members of the sponsor group will still have a profit at lower gas prices while having a negative profits tax.

**Response:** The PPT provides incentives for capital investment. At low gas prices this can result in credits and credit carried forward combined with no tax liability. Although the state may not receive revenue due to the credits, the members of the sponsor group will invest more in Alaska with the potential for additional production and revenue – which implies jobs in Alaska, and additional potential state revenue from additional production. Thus, this additional investment has the potential to increase overall state revenues – and analysis reveals this is likely to occur at most foreseeable gas prices. By encouraging producers to have a profit, even at lower gas prices, we will encourage additional investment in the state.

The PPT legislation recently enacted differs somewhat from that contained in the contract. However, the changes are not material in providing positive economic incentives for exploration and development and allocating a fair share of resource revenues to the state.

**PPT\_07: (1 comment)**

**Statement of Concern:** Statements expressing concerns with the PPT payment in lieu of taxes.

**Response:** In its recently completed special session, the legislature enacted a new PPT law, and the governor has signed it. The contract PPT terms will be revised to conform to the new law.

**3.9.3 INCNT: Investment Incentives in the Contract—SOCs and Responses**

This issue category covers the state provision of investment incentives to industry.

**INCNT\_01: (78 comments)**

**Statement of Concern:** Statements asking about the need for incentives.

**Response:** The gas on the ANS is stranded. It is not marketable at this time because it is too expensive to bring it to market (see STRND\_01). The pipeline will cost well over \$20 billion, making it the most expensive single construction project in North America. Such a large financial undertaking contains great financial risk. To date, no private sector consortium has shown a willingness to undertake the project without government support in the way of incentives to reduce that financial risk.

There are many, many types of fiscal incentives given to oil producers across the nation and many more that can be imagined. A list of current incentives is titled *Making a Wise Investment: The Economic Impact of Oil and Gas Incentives* compiled by the Interstate Oil and Gas Compact Commission (IOGCC) in 2004. The list of incentives includes corporate income tax credits, income tax write offs, reductions in property tax, reductions in royalties, reductions in production taxes on new wells, reductions on production taxes on old wells, and many more.

Incentives are always given with the intent of creating even greater revenues from increased oil and gas activity. Sometimes the objective is to increase employment and sometimes just to increase government revenues. These increased revenues come from employment taxes, sales taxes, property taxes, royalties, production taxes, lease fees, and other sources. The IOGCC report states that the cumulative return on incentive investment is as much as 28 to 1.

This negotiation was not about dividing up the economic rent of an already viable project. It was an attempt to create conditions under which a pipeline was more likely to be built than not. If the project is built, as the Preliminary FIF demonstrates for example in Table 6 on page 73, the government has given up no revenues. How does the contract make the project more likely? Government take is already the biggest single cash draw on this project: If prices stay high and the pipeline comes in under budget, the contract lets investors know that the state will not unilaterally up its take. If prices correct downward and there is a significant cost overrun the contract lets investors know that the state is taking on a share of those risks. This makes the project more likely to be built. People may argue about whether too much or

too little incentive was given- but we believe we have gone as far as the state should without actually reducing the state's take from the project. If, contrary to the events of the past several decades, someone believes this project was about to be built anyway, then they can argue that the state ought to have upped its take of the economic rent. We believe such an increase would make the project less likely, not more likely to be built, and therefore that is not a good starting premise.

**INCNT\_02: (6 comments )**

**Statement of Concern:** Statements expressing concern that the contract allows tax breaks to apply to the sponsor group, their affiliates and subcontractors.

**Response:** Because this is a total contract covering midstream and upstream, the production companies and the pipeline companies must both be subject to the contract. Because of the way work gets done on projects like this, to make the contract meaningful it has to apply to contractors and subcontractors.

The contract minimizes taxes on the project while under construction, recapturing that value in Payments in Lieu of Tax (PILTS) once the project is up and running and producing cash flow. To do that effectively, (and not make it less advantageous for the project sponsors to use local contractors and subcontractors) the contract is structured where a tax might increase the cost of the project, whoever is paying it in the first instance gets the "tax break." A contractor will only have the exemptions in this contract if they can demonstrate that the costs were directly passed on to the project or the properties.

**INCNT\_03: (2 comments)**

**Statement of Concern:** Statements indicating that the state should only provide tax breaks for Alaskans.

**Response:** The SGDA provides that the commissioner may develop contract terms with a qualified sponsor or sponsor group. It does not specify that an applicant must be an Alaska resident in order to qualify.

**INCNT\_04: (5 comments)**

**Statement of Concern:** Statements indicating that the state should not be the guarantor of oil company profits beyond a certain point.

**Response:** The state is never a guarantor of company profits. If the pipeline has cost overruns and the commodity price falls, the company may make no profits from the gas pipeline, and the state is not obligated to reimburse any of those losses.

**INCNT\_05: (2 comments)**

**Statement of Concern:** Statements indicating that the term "affiliates" is too broad in the contract, and the member of the sponsor group can be in a position to "grant" exemptions to various companies.

**Response:** The contract minimizes taxes on the project while under construction, recapturing that value in Payments in Lieu of Taxes (PILT) once the project begins producing revenue. To do that effectively (and not make it less advantageous for the project sponsors to use local

contractors and subcontractors) the contract is structured so that if a tax might increase the cost of the project, whoever would be paying that tax gets the "tax break." A contractor would only receive that "break" if they can demonstrate that the costs were directly passed on to the project or the properties.

The contractual provisions for tax certificate exemptions and affiliates are not as broad as the expressed concerns and are necessary to create a straightforward, easy to administer system for enforcing the negotiated tax exemptions. In any event, the commissioner of revenue retains control of the scope and terms of the Certificate of Exemption pursuant to Article 11.9. The definition of affiliate is properly tied to any entity that a participant controls directly or indirectly.

The term "affiliate" is broad because this is a total contract, covering midstream and upstream, and the production companies as well as the pipeline companies should be beneficiaries of the contract. The term "affiliate" is limited in the definition. To be an "affiliate", the entity must possess either "(a) more than fifty percent of the voting rights of a Person; or (b) the power to direct or cause the direction of the management and policies of a Person, through ownership of voting shared, by contract, or otherwise."

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

**Statement of Concern:** Statements indicating that the terms "Participant's Interests" as specified in the contract are too broad and ambiguous; this could be interpreted to include gas stations, refineries, construction companies, engineers doing oil and gas work, drilling anywhere in the state.

**Response:** While "Participants Interests" is broad, as that phrase is used in Article 11, fiscal certainty is only provided for those interests "on its oil and gas related activity in Alaska." Thus, a gas station would not be covered. There are other restrictions - for example in Article 14, where the production tax is converted to a PILT, only production from leases pertinent to the project is included, which for example would exclude Cook Inlet production from the contract.

**INCNT\_07: (1 comment)**

**Statement of Concern:** Statements suggesting that paragraph 38.3 of the contract, which eliminates all presumption that might favor the state and precludes strict interpretation against tax exemptions, should be eliminated.

**Response:** Under Article 19.10, presumptions established by federal or state tax law adopted as part of the contract under Article 19.1, continue to be applicable. To the extent that the sponsor group's payments in lieu of taxes are based on tax provisions, therefore, any presumptions arising from those tax provisions continue to apply, including any presumptions attaching to general tax exemptions. Specific contract terms, such as exemptions that are explicitly listed in the contract, however, are construed under contract law, rather than tax law, and Article 38.3 recognizes that no presumption favors either party under general contract law.

**INCNT\_08: (5 comments)**

**Statement of Concern:** Statements indicating that indemnification provisions in the contract are questionable from a constitutional point of view and have the potential to cost Alaska millions of dollars without any control by Alaskans.

**Response:** The Attorney General has considered concerns regarding various indemnification provisions in the gas pipeline contract during the course of the Stranded Gas Development Act (SGDA) negotiations. Like the fiscal certainty provisions in the contract, the indemnification provisions arguably raise constitutional issues that have not been finally decided by our Supreme Court. However, the Attorney General believes that the contract provisions will withstand constitutional challenges.

The Attorney General's Office has, over the years, interpreted art. IX, sec. 13 of the Alaska Constitution as imposing a limitation on a state official's ability to enter into indemnification agreements. Art. IX, sec 13 provides that "no money shall be withdrawn from the treasury except in accordance with appropriations made by law. No obligation for the payment of money shall be incurred except as authorized by law." These restrictions taken together have been construed as prohibiting a state official from agreeing to an indemnification term in a contract that is not funded by, and limited to, an appropriation for such purpose or that is not otherwise made subject to the appropriation authority of the legislature. The most recent opinion on this subject is to the same effect. Alaska AG OP. Aug. 2, 2005.

The answer to the question of whether the offset provisions in Article 22 of the proposed contract unconstitutionally interfere with the legislature's appropriation authority will depend on whether the Alaska court ultimately views each individual stream of payments due the state under the contract as subject to the appropriation power, or whether the court will view only the net revenue stream due the state under the contract as subject to the appropriation power of the legislature.

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

**Statement of Concern:** Statements indicating that investment tax credits will essentially be a direct subsidy on marginal projects with no increase in tax revenue and therefore a direct loss of state tax dollars.

**Response:** If these projects are marginal and the tax credit makes it more likely that they will be built, then in fact there will be an increase in tax revenue resulting from production that would otherwise not occur. We estimate that this increase is likely to more than offset any loss of tax dollars from the credit.

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

**Statement of Concern:** Statements expressing concern that the gas treatment plant (GTP) is over-subsidized by the state.

**Response:** The GTP receives no more or less of a "subsidy" under this project than any of the other midstream infrastructure. In the Preliminary FIF on page 177, Section 5.1.11 describes a "PPT credit of 35 percent on the GTP and feeder lines". No such credit was in either the governor's proposed PPT legislation or the version of the PPT that passed the legislature and was signed into law or the contract. The closest item in the contract is the commitment allowance under Article 20.3. Even with this incentive, as discussed above, the

state's financial take will be better with this project under the contract than under current rules if they carried forward unchanged for the period of the contract. And of course, the state is better off with a project than without a project and so if the commitment allowance is an important aspect of getting the pipeline, it is no subsidy at all.

### 3.9.4 LCL\_X: Local Taxation—SOCs and Responses

This issue category covers concerns on the impacts on local taxation from the gas pipeline project.

#### LCL\_X\_01: (4 comments)

**Statement of concern:** Statements indicating that it is unclear what businesses would be eligible for "tax breaks" under the contract.

**Response:** The fiscal contract addresses this concern as described below:

- In Article 11 of the fiscal contract a number of criteria are established identifying 1) who is required to pay a tax in the first instance and 2) who is required to bear the tax and who is not.
- Article 11.8 establishes that participant's affiliates are treated the same as the participant. While the determination of who is and isn't an affiliate in law is often complex, the definition of affiliate in the contract is a two part test, which we believe will be fairly straight forward. Whenever a participant is exempt from the payment of a tax, the affiliate is exempt from the payment of the tax. Whenever the affiliate pays the tax, the participant is deemed to have paid the tax.
- Article 11.10 is more complex and deals with contractors and subcontractors. If there are disputes about this provision, the general principle is set forth first: contractors and subcontractors receive no tax benefits under the contract. Generally contractors and subcontractors will be subject to taxes on their business activities just like anyone else. But if the contractor pays a tax relating to the project and bills the tax to a participant or its affiliate, that participant or affiliate is deemed to have paid the tax.

#### LCL\_X\_02: (5 comments)

**Statement of concern:** Statements expressing concern that under the contract terms the state would have to pay the participants' municipal tax above a certain cap.

**Response:** This is potentially correct: there are situations in which the state would reimburse companies that had paid certain municipal taxes above a cap, and as such the state would essentially have "paid" those taxes. In short, the fiscal regime designed by the contract essentially leaves municipalities in control of their fiscal regimes - and the impact on the project is more than bargained for when the state makes up the difference. Of course if such payments were persistent or always paid on account of certain municipalities, the state might also change the law under which municipalities are granted their taxation rights.

**LCL\_X\_03: (2 comments)**

**Statement of Concern:** Statements asking for a way to tax non-local pipeline workers (e.g. income tax) to help offset local infrastructure costs of the pipeline.

**Response:** Economic growth comes with certain costs and the decisions to pay for the associated costs are best made at the level where the costs are incurred. Tax schemes like sales tax, income tax, and excise tax, user taxes, tolls, etc. can be used to recoup the costs and should reflect the user base for the services. The required infrastructure for economic growth is easily outweighed by the costs of unemployment to the community if there is no economic growth. The income multiplier of additional jobs increases the economic base for a community and thereby provides both income and tax opportunities.

**LCL\_X\_04: (1 comment)**

**Statement of Concern:** Statements indicating that if the gas pipeline project losses money Alaskans will pay more taxes.

**Response:** It is almost certain that without the project or some other means of transporting ANS gas to market, Alaskans and Alaska communities will pay more taxes. It is clear that even with the newly enacted petroleum profits tax (PPT), revenues from oil production will decrease over time until they virtually disappear at the time of the closure of TAPS.

The project offers a higher probability of continuing oil taxes for many more years and, more importantly, of adding gas revenues. The additional state and municipal revenues generated by the project far exceed such revenues without the project.

**LCL\_X\_05: (4 comments)**

**Statement of Concern:** Statements expressing concern that municipalities, rights to tax the industry are undermined by the contract.

**Response:** Property used for oil or gas exploration, production or pipeline transportation is exempt from local assessment but subject to a state property tax of 20 mills. The state estimates the value of this property. The state does prorate taxes for municipalities that have oil and gas property located within their boundaries. The pro-ration factors are calculated from the proportionate share of the value and are taxed at the mil rate that other property within the municipality is taxed. Property tax payments made to a local government may be credited against the state. This applies to oil and gas related property that is assessed by the state and the borough, municipality or city in which the property is located. Oil and gas property is assessed by the state and the taxpayers calculate the property tax credit based on what they have paid to the local government.

**LCL\_X\_06: (1 comment)**

**Statement of Concern:** Statements indicating that the PILT distribution to communities is unsatisfactory.

**Response:** Revenue from the PILT is prorated to the political subdivisions based on the pipeline mileage within the subdivision and the respective mill rate relative to the maximum 20 mill rate assessed by the state. This method reflects the approach used for property tax on TAPS.

**LCL\_X\_07: (5 comments)**

**Statement of Concern:** Statements indicating that the communities should be held harmless from the perspective of local tax revenues by recommending the removal of oil tax concessions that lowers the 2006 value of the TAPS; if changes in oil taxation remain in the contract, the value of TAPS in the contract should be increased to the value established by the State Assessment Review Board (SARB) of \$4.3 billion.

**Response:** SARB recommended that the Division of Revenue adjust their \$3.6 billion assessed valuation for TAPS to \$4.3 billion to include capitalized interest, ad valorem tax cost and the cost of the program manager profit during construction. A rate of \$0.251 is consistent with a \$4.3 billion value. Using the \$0.251 rate for TAPS instead of the \$0.204 in the gas contract assumes that the sponsors will adjust the contract value to be consistent with the current SARB decision. Taxes will be based on the new valuation but the determination is under appeal. To be consistent, the SARB valuation of \$4.3 billion is used in both scenarios analyzed in the FIF.

In addition to the PILTs made in the contract there are also the impact payments. Together, the net present value (NPV) of the PILTs and the impact payments should combine to equal local tax revenues that were generated under the "old system" of taxation.

**LCL\_X\_08: (2 comments)**

**Statement of Concern:** Statements expressing concern that the sponsor group can require audits to be done on municipalities to make sure that taxes imposed are not "targeted taxes."

**Response:** Article 11.7 allows a participant to request an audit of the "relevant records" of the state or a political subdivision for the sole purpose of determining whether a tax is a targeted tax. To ensure that this contractual obligation is fairly applied, a participant is given the right to request an audit through a third party auditor of the relevant records subject to certain procedural protections. Note that the state is contractually obligated to repay any "targeted tax" pursuant to the terms of Article 11.3. Conversely, a participant is obligated to pay the tax to the political subdivision and may exercise its exemption only by seeking reimbursement to the state. Thus if a tax is properly classified as a targeted tax, the financial burden of that tax falls upon the state. The political subdivision collects the tax independent of the state's obligation and any audit. As explained, because of the absence of economic impact on a political subdivision, it properly has no concern with the audit of an obligation between the state and a participant.

**LCL\_X\_09: (2 comments)**

**Statement of Concern:** Statements indicating that the contract should include provisions that true up the assessments and resultant PILT payments based on actual costs of construction of the mainline, gas treatment plant, gas transmission lines, and any subsequent improvements thereto.

**Response:** The Stranded Gas Development Act gave the commissioner the authority to modify the current tax system within any gas pipeline contract developed under the Act. There is no specific language in the Stranded Gas Development Act that dictates the level of payments to municipalities that the contract must provide. The state in negotiating the contract language as it relates to municipal revenues attempted to maintain an income stream

of equivalent NPV during the life of the contract. Although the state acknowledges that the revenue stream from the GTP PILT is not equivalent to the income stream generated from a property tax on the GTP, the state estimates that the contract will make available to the North Slope Borough (NSB) an additional \$80 million in annual gas related revenues once the pipeline is completed. The contract also provides a mechanism for new boroughs to receive a portion of the PILT associated with the gas pipeline and TAPS. If in the future the gas pipeline PILTs are insufficient to fully fund payments to new boroughs the payments would be prorated under the contract but the legislature could still act to make up the difference. TAPS' PILTs are sufficient to fully fund payments to new boroughs.

**LCL\_X\_10: (1 comment)**

**Statement of Concern:** Statements indicating that the contract should ensure the North Slope Borough and other municipalities do not experience a huge loss to the net present value of property taxation due to the contract, but instead receive at least equivalent net present value to current tax law.

**Response:** The North Slope Borough is correct in pointing out that the contract does not replace all traditional tax payments with PILTs of an equivalent Net Present Value. This issue will be addressed in more detail as it relates to specific comments of the NSB. They are also correct in pointing out that under the current contract they potentially stand alone as the only local government that will sacrifice revenues during the operation of the pipeline. However the North Slope Borough is not alone in experiencing a reduction in revenues during construction of the pipeline.

Although there is no specific language in the Stranded Gas Development Act that dictates the level of payments to municipalities, the state in negotiating the contract language as it relates to municipal revenues attempted to maintain an income stream of equivalent NPV during the life of the contract. In order to determine whether the contract language met that goal, it is necessary to look at the entire PILT revenue stream rather than individual PILTs in determining the equivalency of the payments.

It is clear that the calculation of the NPV equivalency is directly related to the assumptions used in determining inflation rates, production rates, and discount rates and as such is open to debate. However, it is reasonable to estimate that the contract will make available to the North Slope Borough an additional \$80 million in annual gas related revenues once the pipeline is completed. In addition, the PILT structure for the oil related assets generates as much as \$1.5 billion in additional revenue over and above the status quo tax structure during the life of the contract.

**LCL\_X\_11: (1 comment)**

**Statement of Concern:** Statements indicating that the definition of "Targeted Tax" should be modified to allow local governments to enact taxes at rates not above those reasonable and customary for local governments in Alaska, regardless of any arbitrary percentage of effect on gas pipeline constructors or operators.

**Response:** Both the sponsor group and the municipalities acknowledged early on in the process the need to protect the project against targeted taxes. The state was also aware that the use of the 20 percent threshold as a measure of targeted taxes could create a situation

where an otherwise typical tax might be classified as targeted. To eliminate the financial risk on the municipalities while still giving fiscal certainty to the sponsor group, the state agreed in the contract to require that these taxes be paid to the municipalities regardless of whether they are targeted or not. The local taxing jurisdictions are kept whole, and can make sure they are kept whole under their own ordinances, boards of equalization and other democratic institutions. Then under the contract, if those payments have exceeded certain amounts or other tests, the state will reimburse the taxpayer. Under this contract provision, the North Slope Borough will be able to recover the revenue from the Economic Impact Assistance Payment (EIAP), but it will require the implementation of a sales and use tax to do so.

**LCL\_X\_12: (1 comment)**

**Statement of Concern:** Statements indicating that the contract should include provisions to re-evaluate the Oil Unit of Production method of assessment and the Gas Unit of Production method of assessment on a periodic basis.

**Response:** The state agrees that the "per barrel rate" cannot remain fixed and must adjust over time. Rather than provide for re-openers that would result in fiscal uncertainty to both producers and the North Slope Borough the state included annual inflation adjustments within the contract. A review of the cash flows from the PILT indicates that the inflation adjustment is sufficient to account for changing costs anticipated during the life of the contract.

**LCL\_X\_13: (2 comments)**

**Statement of Concern:** Statements indicating that any contract re-opener provisions should ensure there is no opportunity for municipalities to lose the NPV equivalency anticipated by the agreement, or for payment of all revenues foregone during the construction and capital recovery period.

**Response:** The re-opener discussed by the governor was in reference to the oil tax provisions of the contract, and most specifically the production taxes. There has been no discussion related to the renegotiation of municipal PILTs.

**LCL\_X\_14: (1 comment)**

**Statement of Concern:** Statements indicating that the contract should ensure that municipal tax departments have the right to audit and inspect records of producers and the state relevant to municipal PILT and tax payments.

**Response:** Technically, the contract is between the state and the industry sponsors. Municipalities are not third party beneficiaries under the contract. However, when the contract is read along with current law concerning mill rates, quite a bit of cash will flow to municipalities as PILTs, primarily the North Slope Borough. If the borough believes that it has not been paid appropriately, it must raise that issue with the state which will then act under the contract.

To be able to raise the issue though, the borough needs to have the information upon which payments are based. The vast majority of the NSB's payments will be driven by volumes and a close examination of the definition of "Non-confidential information" should reassure the NSB that volumetric and ownership information will be available. The only case where other

information (property valuation records) is required would be for an oil pipeline under construction under Article 17.2 (a). As that material is under the control of the commissioner there should be no problem in making it available to the borough.

**LCL\_X\_15: (1 comment)**

**Statement of Concern:** Statements indicating that the contract's inflation provisions should be adjusted to rates in line with oil and gas and construction inflation, rather than indices based on consumer prices.

**Response:** Different indices were considered and the CPI was selected because the intent is to price a commodity and maintain the earning power of the revenue stream in fact. The rate of change in the CPI is factored downward so the rate is lower but the path or trend will reflect consumer spending rather than producer prices or construction costs. Construction cost escalators are more appropriate for cost components and producer price indices are more appropriate to measure real levels of output by producers over time. The CPI is a standardized, uniform measure published by the Bureau of Labor Statistics on a regular basis and is available to the public. Construction and oil and gas indices do not meet the timely and rigorous standards required for a price index in a contract.

**LCL\_X\_16: (1 comment)**

**Statement of Concern:** Statements indicating that the contract should be amended to accommodate new local government formation by fully assessing mainline values in the unorganized borough.

**Response:** Our analysis uses a pro-ration factor of 24 percent for new political subdivisions. This factor is based on the estimated pipeline mileage and a 20 mill rate which is equal to the maximum mill rate. As described in the response to LCL\_X\_09, the contract also provides a mechanism for new boroughs to receive a portion of the PILT associated with the gas pipeline and TAPS. If in the future the gas pipeline PILTs are insufficient to fully fund payments to new boroughs the payments would be prorated under the contract but the legislature could still act to make up the difference. TAPS' PILTs are sufficient to fully fund payments to new boroughs.

**LCL\_X\_17: (7 comments)**

**Statement of Concern:** Statements expressing concern about the effect on tax revenues and school funding of changes in the valuation of oil property in municipalities.

**Response:** It was not the intent of the draft contract to result in diminishment of the school funding mechanisms. As this potential effect became clear, the administration requested a change in law to make sure the assets that, though tax free, had associated PILTs, would remain in the tax base at full and true value. While the bill did not pass out of the legislature in the special session, both the bodies of the legislature accepted it.

**LCL\_X\_18: (2 comments)**

**Statement of Concern:** Statements indicating that the contract changes how property taxes will be assessed on TAPS and other existing oil facilities. This change will possibly lead to reduced property taxes and therefore reduced municipal revenues.

**Response:** The contract does change the manner in which property taxes will be assessed on existing and future oil and gas infrastructure. The intent of this action is to bring property valuation in-line with production rather than construction costs. Commercial property is often valued based on the revenue it generates rather than its cost of construction. This is a valid property assessment method that recognizes the vicissitudes of business cycles and adjusts value accordingly. This works both ways in that an inexpensive property could pay more tax than an expensive one if it generated more business revenues.

TAPS property tax value and taxes increased greatly in the past year. This was related to valuation of the line. However, a change in statute could increase the mill levy above the current 20 mills. The sponsor group is cognizant of this and negotiated to forestall any such possible increase by the state in the future.

**LCL\_X\_19: (1 comment)**

**Statement of Concern:** Statements supporting the removal of oil tax concessions that specifically target taxes being collected by the City of Valdez; the statement suggests that all reference in the contract related to personal property tax on vessels over 95 feet be stricken in its entirety from the proposed gas contract.

**Response:** Since the purposes of the contract is to deal effectively with all known incidences of taxation of the sponsors oil and gas business on the state, then it is entirely appropriate to include the so called "vessel" tax from the city of Valdez. To strike all reference to it in the contract would leave an ambiguous situation - a further playground for the litigious minded.

**3.9.5 EXPLR: New Exploration for Oil and Gas—SOCs and Responses**

This issue category addresses incentives for exploration and development of new sources of gas and oil in Alaska.

**EXPLR\_01: (4 comments)**

**Statement of Concern:** Statements expressing concern that the timing of the fiscal contract will discourage exploration; and that the existence of in-state off-take points may adversely affect natural gas exploration in other areas (i.e., Cook Inlet).

**Response:** The state's negotiating team has negotiated the best opportunity for the state to get a sound, economic pipeline project constructed and operating in a timeframe which avoids ruinous state revenue gaps from occurring. The existing level of in-state exploration, over the last decade or more, has proven inadequate to maintain oil production levels high enough to prevent an inexorable decline in state revenues. Opening markets for Alaska gas by delivering it into the interior North American markets via a gas pipeline, as well as providing for in-state deliveries, greatly expands the economic resource potential upon which Alaska revenues are based.

For explorers, the certainty that a gas pipeline will be built allows them to attribute value to the chance that they will find marketable quantities of gas – without that certainty, potentially discoverable gas reserves have no value to explorers. As a result, exploration projects with a high likelihood of finding gas, rather than oil, are currently likely not to be drilled – and potential oil opportunities, as well as gas opportunities, are deferred.

Early oil exploration resulted in a series of major gas discoveries in Cook Inlet, providing Southcentral Alaska with a 50-year supply of very cheap gas. Low gas prices eliminated until recently the financial incentive to explore for gas in Cook Inlet. Even today, the isolated nature of the Southcentral gas market results in only lower cost (and lower potential) Cook Inlet gas prospects being drilled. Large, high cost prospects continue to be neglected because of the lack of short term, significant market potential. A spur line from the gas pipeline to Southcentral Alaska would connect Cook Inlet gas supplies to the North American gas markets. If major new Cook Inlet gas discoveries were then made, Southcentral could become a supplier of gas into the North American gas markets, as well as providing for our own Southcentral needs. The spur line has the potential of stimulating higher cost and higher potential Cook Inlet gas exploration, rather than discouraging it.

**EXPLR\_02: (1 comment)**

**Statement of Concern:** Statements expressing support for a \$25 million credit for exploration.

**Response:** The exploration development credits discussed as part of the contract were contained in the petroleum profits tax (PPT). This tax was signed into law in August 2006. We agree that exploration and development credits are important and now they are available as additional incentives.

**3.9.6 PTU: Point Thomson Issues—SOCs and Responses**

This issue category deals with the development of the Point Thomson unit (PTU).

**PTU\_01: (17 comments )**

**Statement of Concern:** Statements indicating that the contract allows the PTU leaseholders to default on their lease obligations to develop PTU (or prohibits the state from enforcing the lease requirements).

**Response:** Historically, continuance of the PTU and its leases has, until the latter half of 2005, been with the concurrence of commissioners of natural resources 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. Under the amended DNR decision of October 27, 2005 the PTU Agreement was declared 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. Since those deliberations have now ended, the companies are back to dealing directly with DNR to develop an acceptable POD which will lead to field development. On September 8, 2006, the Commissioner of the Department of Natural Resources issued a final extension of time to submit a cure to the October 27, 2005 decision placing the unit in default. That cure, with all supporting documentation, must be submitted to DNR no later than October 20, 2006. In addition, any party wishing to submit an appeal on the subject must submit all appeal documentation to the DNR offices by November 3, 2006. The commissioner of natural

resources will hold an appeal hearing on November 13, 2006. Any decision concerning the cure and any appeals will be made by the commissioner of natural resources subsequent to the November 13 hearing.

The PTU reserves and gas deliveries will play an integral part in the proposed project and the contract provisions concerning PTU provide a specific context for its development. The contract provides for a PTU development schedule which is consistent with and which supports development of the mainline.

The contract imposes specific requirements upon the producers with respect to development of the PTU:

- Each producer must commit PTU gas reserves to the project; and
- 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" applies to PTU development, as well as the rest of the mainline – if the contract is terminated for any reason the producers' rights to Pt. Thomson expansion leases terminate unless they initiate alternative development of the PTU 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 mainline, obligations to DNR Plans of Development resume which will allow DNR to continue to manage development of PTU oil and gas reserves.

**PTU\_02: (1 comment)**

**Statement of Concern:** Statements indicating that without PTU development there will be a shortage in gas resources.

**Response:** This is a correct statement. Because Prudhoe Bay will not be able to provide all the gas necessary for the project to be successful, the PTU's high pressure gas reservoir is critical. Without it there would be no way to achieve the benefit of scale associated with the proposed project.

**PTU\_03: (2 comments)**

**Statement of Concern:** Statements indicating that PTU should be developed now and that the contract prevents this development to happen.

**Response:** Nothing in the contract prevents PTU from being developed today should the leaseholders propose that action. The statement that PTU should be developed now ignores the current situation with the PTU that is described in PTU\_01 above. Without a gas pipeline in existence, the only production scenario that could work is a liquids gas recycling project. The PTU is an extremely high pressured reservoir. This means the very large very expensive compressors will be necessary to re-inject the gas after the liquids have been stripped out. There is also uncertainty about the distribution of PTU reserves and whether or not additional production platforms will be necessary. A liquids stripping project will also require the immediate construction of a liquids pipeline to Prudhoe Bay. In addition, it is unclear how the additional liquids could be further marketed from Prudhoe since TAPS is already

carrying as much natural gas liquid as it will hold. All of these issues must be fully evaluated before a statement about the appropriate production plan for PTU can be made.

**PTU\_04: (1 comment)**

**Statement of Concern:** Statements indicating that the pipeline project will encourage exploration, development, and production of gas resources in the PTU and other areas in the ANS.

**Response:** We agree.

**PTU\_05: (2 comments)**

**Statement of Concern:** Statements expressing concern that the delay in PTU development means that the gas pipeline project is not going to happen.

**Response:** Since the vast majority of the resource value of the PTU lies in its natural gas content, without a pipeline all of this value will be lost. Capturing this value can only happen when a gas pipeline is built. Therefore, the sooner we get a gas pipeline built the sooner we can realize the bulk of the value contained in the PTU.

**PTU\_06: (3 comments)**

**Statement of Concern:** Statements indicating that PTU should not be part of the contract.

**Response:** PTU must be part of the contract because it will play an integral part in building the proposed project. Because Prudhoe Bay will not be able to provide all the gas necessary to operate a project with approximately 4 bcf/d of throughput, the PTU's high pressure gas reservoir is critical. In addition, production from the PTU will allow lower offtake rates from Prudhoe Bay during the early years, allowing for greater oil recovery from Prudhoe Bay. The contract recognizes that fact and provides certainty that PTU will be produced when the gas pipeline comes into service. There are specific contract terms that require the operators at PTU to go immediately to the Alaska Oil and Gas Conservation Commission for an authorized off-take rate and that gas is committed to the project. Under terms of the contract, failure to take these steps will result in immediate loss of expansion leases. Specific contract provisions summarized in PTU\_01 above will require the operators to develop PTU gas and will penalize the producers for a failure to do so.

**PTU\_07: (2 comments)**

**Statement of Concern:** Statement indicating that Chevron, as a PTU property owner, should receive written commitments from the state and sponsor group that the gas at PTU will be developed in a manner that allows each of the PTU owners to participate in the open season process without assuming risks disproportionate to the sponsor group members.

**Response:** Because the open season will be carried out under the authorities and responsibilities of FERC, it will be done in an open and evenhanded manner. It will be conducted in such a way as to afford "all" participants with an equal opportunity to produce and market their gas. In so far as Chevron is raising issues that relate to the management of the plan for development of PTU, that is an issue to be resolved among the members or leaseholders of the PTU. Comparable terms are also available as a result of the UUFC. It should be noted that the model UUFC will be contained in the Interim FIF.

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

**Statement of Concern:** Statements expressing concern that under the proposed contract, the state suspends most of its authority to enforce development of the PTU through lease requirements, including relinquishment of the leases if work commitments are not met.

**Response:** Without a gas pipeline the vast amount of value to the state represented by PTU will never be realized. The contract is based on setting the conditions necessary to get a gas pipeline built. Without a gas pipeline the only value to the state resides in the liquids content of the reservoir and the ability to economically get those liquids to market through TAPS which is already carrying as much NGLs as it can. This being the case any statements made to the effect of value lost or received must take into consideration what conditions are necessary to get a gas pipeline built.

### **3.9.7 UUFC: Uniform Upstream Fiscal Contract—SOCs and Responses**

This issue category covers the Uniform Upstream Fiscal contract.

**UUFC\_01: (5 comments)**

**Statement of Concern:** Statements advocating changes to the UUFC to ensure that all gas producers will be entitled to the same fiscal terms as those who signed the Fiscal contract.

**Response:** The Preliminary FIF (Section 4.3.2) explains the state's general view that the Fiscal contract benefits provided to the sponsor group also should be made available to other ANS producers who are willing to enter into firm transportation commitments to ship their gas, and that therefore it intends to propose legislation that would authorize the commissioner of revenue, after consultation with the commissioner of natural resources, to develop a uniform upstream fiscal contract with provisions identical in substance to the fiscal certainty terms of the contract. Attachment 1 to the contract is that proposed legislation of general applicability. It authorizes ANS producers (other than the signatories to the contract) to sign an upstream fiscal contract provided certain enumerated conditions are met.

No commenters took issue with the state's intent to provide a mechanism for allowing fiscal certainty for all ANS gas producers. Several, in particular Chevron and Anadarko, pointed out that the proposed legislation contained in Attachment 1 to the contract does not provide fiscal certainty equivalent to that provided to the sponsor group. Concern was expressed that the contract has the potential to create two classes of gas producers—the sponsor group whose fiscal certainty is set forth in the contract, and other producers whose fiscal certainty would be set forth in a different contract based on the terms set forth in Attachment 1 to the fiscal contract. Several changes to the proposed legislation were suggested in order to create fiscal equality.

To repeat, it is the state's intent to provide a level playing field for all ANS producers insofar as fiscal certainty is concerned. Many of the technical changes appear to even that playing field and therefore the state is willing to discuss these proposed changes with the commenters in the hope of reaching a consensus on how to modify the proposed legislation to better achieve that mutual objective.

**UUFC\_02: (1 comment)**

**Statement of Concern:** Statements expressing concern about the geographic limitation on oil and gas leases eligible for the benefits of the uniform upstream fiscal contract as defined in Attachment 1 to the contract. The proposed legislation creating the uniform upstream fiscal contract limits the eligible leases to those located north of 68 degrees North Latitude. For example, the Yukon Flats sedimentary basin holds huge gas potential and lies proximate to the proposed gas pipeline, but its location south of the Brooks Range makes it ineligible for the uniform upstream fiscal contract. RDC recommends § 43.82.437 (b) of the proposed legislation as documented in Attachment 1 of the fiscal contract be deleted.

**Response:** The geographic limitation in the fiscal contract is adequate to meet the needs of the sponsor group. A similar limitation was put into the example uniform upstream fiscal contract primarily to close the issue during negotiations with the sponsor group. The decision of how access to fiscal certainty will be constrained in the UUFC is a policy decision to be made by the legislature when drafting the actual legislation. The issue which was avoided during negotiations with the sponsor group is the question of how to best define those leases and that production which should or should not receive fiscal certainty. Leases and reserves in the Interior, and certainly those in Cook Inlet can be developed and monetized, without making any commitments to the pipeline—or while making only limited commitments to the pipeline. The negotiating teams chose to leave this provision as written in this example legislation, allowing the legislature to determine the appropriate policy action to take. The administration's gas team stands ready to provide input to the legislature encouraging the "level playing field" for all producers' who underwrite the Alaska gas pipeline or expansions of that pipeline through taking out firm shipping commitments.

**3.9.8 RSRV\_X: The Proposed Reserves Tax—SOCs and Responses**

This issue category covers comments regarding the proposed gas reserves tax.

**RSRV\_X\_01: (31 comments)**

**Statement of Concern:** Statements of concern regarding a gas reserves tax

**Response:** The reserves tax would be counter-productive to constructing a pipeline. The most daunting aspect of the tax is that it is unavoidable: producers would pay it even if they do build the gasline. In that regard it can hardly function as an incentive. The credit mechanism would only allow for recovery of a small fraction of the tax, especially on a net present value basis. Thus it adds billions of dollars to the cost of the already challenged project.

Point Thomson, an undeveloped field with no income, will have to start paying a quarter-billion dollars a year. Given the uncertainties of whether there will be a gasline, when it will start, the cost, and the price of gas, the tax could very well cause the field to have a negative net present value.

Similarly with Prudhoe Bay, oil will be paying the taxes. About \$6/bbl is currently being invested there for production. In the absence of new investment, production could spiral down very rapidly, hastening the end of field life.

In addition, new gas discoveries could be subject to the tax. Thus exploration for gas and oil would probably cease. Moreover, the tax could cause a vast misalignment with the State and probably result in the termination of gas pipeline negotiations.

Finally, there are several significant constitutional problems with the tax, both on a State and federal level. It is certain the producers would litigate, and the outcome could be several years in coming. If the legality of the tax is unclear, the producers will not proceed until case is decided. Such a commercial strategy is necessary given the scale of the project. Thus advancement of the project could stop until the constitutional issues are resolved.

The delay inherent in the litigation would cause the period of the revenue gap to increase as the period between when oil revenues decline and gas revenues begin grows by the time wasted in litigation.

It is the administration's opinion 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.

No petroleum reserves tax exists anywhere in the world. We know of no examples of such a tax being instituted anywhere at any time.

Enactment of a reserves tax, even one that refunds the tax after production begins, would be counter to the purpose of fiscal stability. Establishing a reserves tax sends a message to producers that they are susceptible to additional future taxes almost without limit. One of the central tenets of the fiscal contract is the guarantee of fiscal stability for producers. This guarantee is necessary to secure the magnitude and duration of investment required for ANS gas development. The contract protects the sponsor group (and any future signatories) from increases in future taxes for this reason. The payment of refundable taxes still requires monetary outlay which would come at the expense of exploration and development expenditures.

### **3.10 State Ownership**

Issues in this general area of concern included the structure, governance and operation of the project entities to be formed to own and operate the various elements of the gas pipeline project; state regulation of the gas pipeline project; state management of resources and development of Alaska's oil and gas; state equity ownership in the gas pipeline project; and gas pipeline project impacts on the Permanent Fund.

#### **3.10.1 LLC: New Limited Liability Corporations (LLCs) Between State and Partners—SOCs and Responses**

This issue category covers various public concerns regarding state participation in the project, the role of the mainline LLC, alignment of interests, the choice of Delaware Law to govern the mainline LLC, and valuation of NGLs.

**LLC\_01: (8 comments)**

**Statement of Concern:** Statements asserting the benefits of state participation in the mainline LLC.

**Response:** Given the risks of the project, particularly the enormous up-front cost, the administration's analysis shows that in a "status-quo" world, the project rate of return is low. A low rate of return is particularly damaging to a project in which high risks are incurred and around which much uncertainty exists, because the low rate of return reveals a 'fragility' about the project such that relatively little adversity can destroy the economics of the project. By increasing the rate of return, the project becomes more 'robust' -- a much more attractive investment opportunity which has a greater ability to withstand adversity and still return positive economics. As a result the likelihood increases that the project will move forward.

An alternative was examined by the administration -- that of simply giving up state royalty value and taxes. It was determined that the state's royalty value and taxes would have to be given up entirely in order to have an effect on the rate of return that is comparable to that accomplished by accepting state ownership and state gas in-kind.

By committing to own a share of the mainline and to bear its proportionate share of the upfront costs of constructing the mainline (which the state will bear in any event because actual costs are recaptured in the gas transportation tariff rates) the sponsor group will spend less money up-front. Because of the time value of money this increases their rate of return and makes the project more competitive with other investment alternatives members of the sponsor group may have available to them. An in-depth discussion of state ownership issues is set forth in *Sections 4.5 The State Should Own a Share of the Pipeline* and *Section 5.1 Analysis of Balance of Fiscal Principles* of the Preliminary FIF.

In addition to insuring the competitiveness of the project, the state's ownership interest in the various project entities will provide numerous benefits for the state, including economic benefits, expediting construction of the project, and participation in the project development decision-making process. These benefits are detailed in *Sections 4.1.3 Estimated Earnings from State Ownership* and *4.5 The State Should Own a Share of the Pipeline* of the Preliminary FIF.

**LLC\_02: (25 comments)**

**Statement of Concern:** Statements expressing concern that the state entity would not have enough influence as a minority partner in the mainline entity to be able to effectively look after the interests of the state.

**Response:** The state's member in the mainline entity will be entitled to participate in decision making and will have approval rights on certain major decisions, important protections at other key decision points where it may be out-voted such as the decision to construct the project (see OWNRISK\_02) and a right to be heard on all decisions of the LLC management committee. Additionally, because no single member holds a majority ownership interest in the mainline entity, no single member can cause the mainline entity to take an action without the agreement of at least two other members. The state's member will thus have certain voting rights and key protections to look after their commercial interests as a part owner of the project.

**LLC\_03: (7 comments)**

**Statement of Concern:** Statements requesting clarification of the role and function of the mainline LLC.

**Response:** The mainline LLC will own and operate the Alaska portion of the pipeline, and will oversee all major development and operation decisions.

**LLC\_04: (15 comments)**

**Statement of Concern:** Statements questioning whether an investment in the project is within the mandate of the Government of Alaska.

**Response:** The state has determined that state investment in the project is in the long term fiscal interest of the state because the investment will reduce risks of the producers in developing the project and thus insure that it will be built and will also yield significant benefits for the state. Many of these benefits are set forth in detail in *Sections 4.1.3 Estimated Earnings from State Ownership and 4.5 The State Should Own a Share of the Pipeline* of the Preliminary FIF. Any investment will comply with the requirements of Alaska law.

**LLC\_05: (18 comments)**

**Statement of Concern:** Statements questioning whether the state's participation in the project will result in an alignment of interests that will be positive for all participants.

**Response:** As noted above, the state has determined that state investment in the project is in the long term fiscal interest of the state due to the benefits that are set forth in detail in *Sections 4.1.3 Estimated Earnings from State Ownership and 4.5 The State Should Own a Share of the Pipeline* of the Preliminary FIF. The voting provisions of the project entity agreements will require that there will always be alignment of at least 3 members with respect to routine decisions and of all 4 members with respect to major project decisions, so there will have to be a positive alignment of interests in order for the project to advance.

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

**Statement of Concern:** Statement expressing concern that the state cannot hire and fire employees at will as in the case of the private sector and as a project participant this could be a problem.

**Response:** Project employees will not be state employees, and therefore will not be subject to state personnel rules or collective bargaining agreements

**LLC\_07: (1 comment)**

**Statement of Concern:** Statements expressing concern that the fiscal contract does not establish a pipeline construction entity.

**Response:** The contract deals with fiscal certainty granted for the development of the project, and does not directly address the development or construction of the project, which will be the responsibility of the project entities, including the mainline LLC. It is contemplated that the members of the mainline LLC will appoint an affiliate of one of the members to serve as the operator of the project, who will, through contractual relationships with the mainline

LLC, manage construction and operation of the pipeline subject to oversight as agreed in the mainline LLC agreement.

**LLC\_08: (2 comments)**

**Statement of Concern:** Statements questioning why the ultimate parent companies of the members of the sponsor group are not party to the contract.

**Response:** The fiscal obligations addressed in the contract are the obligations of the sponsor group that actually are the lessors under the state leases. The contract further requires that the other project entities will become party to the contract promptly following their formation. The addition of the parent companies would not impact the state's ability to fully enforce the provisions of the contract. Also, the proposed contract changes strengthen the contract's requirements that the key project entity governance agreements be finalized and that those entities be formed. A failure to form these within a year of the Effective Date would be a presumptive failure of diligence under the contract. It should also be noted that these entities hold billions of dollars of assets in Alaska and are financially able to support the obligations of the contract.

**LLC\_09: (10 comments)**

**Statement of Concern:** Statements concerned by the lack of specificity of terms and conditions addressing the structure, governance and operation of the various project entities to be formed to own and operate the various elements of the pipeline project and the provision of the governance agreements to the legislature, the public and other interested parties.

**Response:** The unavailability of the mainline LLC agreement was noted as an issue by many during the public comment period and the state worked very hard to try to finalize a mainline LLC agreement so that the public and the legislature could better understand the project and the state's role in it. The LLC 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 state's proposed LLC agreement. Each project entity will be established with governance provisions substantially similar to those agreed with the sponsor group in the proposed mainline LLC agreement.

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

**Statement of Concern:** Statements expressing concern about the failure of the contract to specify that previously used assets that are acquired by the mainline LLC will be valued at net book value for ratemaking purposes.

**Response:** Votes related to FERC issues including ratemaking terms will require an affirmative vote of the state member under the state's proposed mainline LLC agreement. The contract itself further protects the state's right to intervene in any FERC proceeding and to argue for whatever terms and conditions it advocates. FERC ultimately has a duty to ensure that all tariff terms and conditions are just and reasonable.

**LLC\_11: (6 comments)**

**Statement of Concern:** Statements asking why the Delaware Act was chosen to form an Alaska Pipeline LLC instead of using the Alaska Act.

**Response:** Delaware is widely regarded as a preferred jurisdiction for the formation of commercial entities throughout the United States because of its highly developed case law, judicial experience and efficiency and promotion of contractual flexibility, all of which increase predictability of outcomes and reduce the likelihood of disputes. Additionally, the parties chose Delaware law to govern the mainline LLC in part to enable a broad waiver of duties among the members; Alaska law does not allow members to waive duties to each other and thus would impair the ability of the state's member to vote in its own interest. Finally, the choice of Alaska law and resolution of disputes in Alaska courts could create a perception of bias in favor of the state entity among the other members, financing parties and other entities contracting with the mainline entity.

**LLC\_12: (2 comments)**

**Statement of Concern:** Statements concerned with whether the value of NGLs was taken into account in negotiating applicable provisions of the contract.

**Response:** NGLs have commercial values both as primary energy products and as feedstock for numerous intermediate industrial and petrochemical product applications. Both the state and the sponsor group realize these values; NGL extraction ultimately will be necessary and potentially highly profitable. The sponsor group proposed project design includes a \$690 million NGL plant located either in Alberta or the lower 48. The state has also been evaluating the feasibility of a NGL plant in Alaska. Issues related to NGLs were taken into account in negotiating the contract and are summarized in more detail in *Section 4.2.6 Natural Gas Liquids and In-State Use* of the Preliminary FIF.

**LLC\_13: (6 comments)**

**Statement of Concern:** Statements concerned about conflicts between the contract and other agreements and the impact of the contract on the state's sovereign authority.

**Response:** The contract does not cede the state's right to use its sovereign authority to regulate the project. The contract provides that the royalty payments and other financial obligations of members of the sponsor group under ANS Leases that are identified in the contract will be incorporated into the overall fiscal certainty regime established by the contract for the term of the contract.

**LLC\_14: (1 comment)**

**Statement of Concern:** Statements requesting clarification of the use of the term "Loss" throughout the contract.

**Response:** Section 37.2 of the contract clearly states that the recovery of certain types of "losses" are not recoverable by any parties to the contract. Specifically, Section 37.2 makes it clear that lost profits and punitive damages are not recoverable losses under the contract.

**LLC\_15: (1 comment)**

**Statement of Concern:** Statements concerning the lack of accountability and legislative oversight of the public corporation and LLC.

**Response:** The mainline LLC and the other project entities that are private companies would be subject to governmental oversight as any other private company that does business in the state. The state member will be a public corporation authorized under a statute to be adopted by the legislature similar to other state owned public corporations, such as the Alaska Energy Authority, the Alaska Industrial Development and Export Authority, the Alaska Housing Finance Corporation, the Alaska Municipal Bond Bank, the Alaska Railroad Corporation and the Alaska Student Loan Authority. It is anticipated that the statute will 1) establish the corporation as an instrumentality of the state under the Department of Revenue, 2) require that certain state commissioners serve as members of its Board of Directors, 3) impose certain reporting requirements on the public corporation aimed at providing the public with information regarding the state's investment, 4) will be subject to audit by the Legislative Budget and Audit Committee, and 5) subject to appropriation by the legislature.

**LLC\_16: (1 comment)**

**Statement of Concern:** Statements concerned about ANGDA's potential role with respect to the project.

**Response:** The Alaska member is a separate state public corporation that is independent of ANGDA. While it is anticipated that the state public corporation established specifically for this project will manage the state's ownership interest in the pipeline, the state envisions other roles that ANGDA may serve in connection with the project and the provision of gas within the state. For further details regarding ANGDA please refer to *Section 5.2.4.3 Alaska Natural Gas Development Authority* of the Preliminary FIF.

**LLC\_17: (1 comment)**

**Statement of Concern:** Statements concerned about the implications of gas pipeline management decisions on in-state gas movements, and whether the LLC agreement will give the state a major say during the planning phase of the project.

**Response:** In the state's proposed LLC agreement, the state entity will be a full participant in project planning decisions for the mainline LLC, and the state member's approval is required for certain key decisions. The proposed LLC agreement also guarantees that the mainline LLC must fund up to four in-state offtake points to supply in-state gas needs. Further details regarding the provision for in-state gas supply is set forth in *Section 3.6 In-State Markets of the Financial Interest Finding*.

### 3.10.2 DISP: Dispute Resolution between State and Partners—SOCs and Responses

This issue category covers concerns about the dispute resolution procedures between the state and partners.

#### **DISP\_01: (36 comments)**

**Statement of Concern:** Statements questioning whether the contract should include a dispute resolution/arbitration process or questioning specific arbitration procedures.

**Response:** The parties agreed to adopt arbitration as the method for resolving disputes under the contract in order to ensure an objective, expeditious and economic method for resolving disputes. The state's past experience in litigating major royalty and tax matters in state courts has resulted in costly and inefficient proceedings that history has shown can often be avoided by private arbitration. In fact, in response to lingering and expensive royalty valuation disputes, the state has entered into royalty settlement agreements with all of the major producers. These agreements provide for resolving disputes by arbitration, which the state has found to be both efficient and effective. Further, because of the state's decision to accept tax and royalty payments as a fixed percentage of gas production instead of as cash, the scope of disputes under the contract are more limited and lend themselves to determination in an arbitral forum. A more complete discussion of the rationale for adopting arbitration as a method of resolving disputes under the contract is detailed in *Section 3.7 Dispute Resolution* of the Preliminary FIF.

The dispute resolution procedures in the contract are applicable to disputes under the contract alone and do not govern disputes under the project entity agreements, which provide for separate dispute resolution procedures. There may be limited cases where a project entity may be involved in a dispute under the contract and would be subject to the contract's dispute resolution procedures; however, the state does not anticipate any significant overlap among disputes under the contract (which will primarily involve issues of fiscal certainty) and those under the project entity agreements (which will primarily involve commercial issues or issues of governance) and expect that the vast majority of disputes under project entity agreements will be resolved under separate dispute resolutions procedures or by the courts as set forth in the project entity governance documents.

Questions were raised during the public comment period regarding certain procedures adopted under the dispute resolution provisions of the contract, including questions regarding the limitations on discovery, the process for selecting a tribunal, the use of baseball arbitration and the use of the Alaska Arbitration Act. Improvements to the contract are being proposed to address clarifications or changes related to particular areas of concern. In this connection, the administration recommends that legislation be considered that would make it clear that arbitrations would be conducted using the procedures of the Alaska Arbitration Act. The administration would also support amendments to the proposed contract that give broader discretion to the tribunal to control discovery when the matter at issue exceeds \$10 million. The administration also favors narrowing the scope of disputes that are subject to "baseball" arbitration. Finally, the administration believes that the number of "strikes" available to a side for the purposes of determining the members of the arbitration panel

should be clarified in the contract to make certain that there is a fair opportunity given to each side in the dispute, rather than each party.

### 3.10.3 REGCON: Regulatory Conflict—SOCs and Responses

This issue category addresses the state regulation of the gas pipeline project.

#### REGCON\_01: (19 comments)

**Statement of Concern:** Statements expressing concern about the state's potential conflict of interest in its role as a regulator of the pipeline and manager of natural resources and its proposed role as a participant in the pipeline project and a marketer of state gas.

**Response:** During Fiscal contract and LLC negotiations, the parties discussed the potential conflict of interest issue arising from the state being both an investor in the project and a regulator (e.g., environmental matters) of the project. First, it is not unusual for a state to have dual roles. Anytime a state acts as an investor in a private project this potential conflict must be addressed. With regard to the Alaska gas pipeline, the state's regulatory arms will be walled off from the state's investor arm, that is, Alaska PipeCo.

Article 29 of the Fiscal contract is an example of how the walling off will work. Confidential information that is generated by the project must be kept confidential by the parties except under certain narrow circumstances. Hence, were the state in its investor role to receive a confidential document relevant to one of the state's regulatory functions, it could not provide that document to the state's regulatory arms nor even inform them of the document's existence.

The state's police powers are unchanged by the terms of the contract. No party even advocated changing or affecting those powers through the contract.

### 3.10.4 NATRSC: State Management of Natural Resources—SOCs and Resources

This issue category addresses the state management of natural resources and the development of Alaska's oil and gas.

#### NATRSC\_01: (34 comments)

**Statement of Concern:** Statements asserting that the state should maintain control of its oil and gas resources and should not give up its right to manage its resources.

**Response:** Since statehood, the state has engaged in the leasing of its oil and gas bearing lands as the best way of developing its resources. If the state determines that exploring and developing its own oil and gas resources itself is in the best interest of the state, it can terminate its leasing program at any time. At that point it would be free to do anything it wants with its resources itself. To revoke its outstanding leases would take years of litigation to resolve and would create an extremely hostile business environment in the state.

**NATRSC\_02: (56 comments )**

**Statement of Concern:** Statements indicating that the state, as owner of the gas resources, should manage them in a way that benefits Alaskans. Includes comments that the state should "maximize" benefits from Natural Resources.

**Response:** This is precisely what the State of Alaska has done since statehood. To this point in time it was determined that the best way to obtain maximum benefit from the resources was to lease the commodity in question and take a percentage of the value obtained from the sale of the product. If the state determines that exploring and developing its own oil and gas resources itself is in the best interest of the state, it can terminate its leasing program at any time. At that point it would be free to do anything it wants with its resources. To revoke its outstanding leases would take years of litigation to resolve and would create an extremely hostile business environment in the state.

**NATRSC\_03: (4 comments)**

**Statement of Concern:** Statements indicating that the state should buy out the producers and gain 100 percent ownership of the oil and gas resources and infrastructure.

**Response:** Any serving governor and legislature has the authority to negotiate such a deal. It would be prudent, however, to evaluate the economics of such a concept before taking action due to the cost entailed in proceeding with such a buy out and the tremendous economic risks the state would assume.

**NATRSC\_04: (6 comments)**

**Statement of Concern:** Statements indicating that the state should manage oil and gas resources solely for in-state use (both utilities, household and for future industrial uses).

**Response:** Any serving governor and legislature has the authority to negotiate such a deal. The proposed contract affords the state the opportunity to do exactly this with its share of gas. It would be prudent, however, to evaluate the economics of such a concept before taking action.

**NATRSC\_05: (2 comments)**

**Statement of Concern:** Statements indicating that the state should also focus its efforts on other gas and oil basins in the state, not just those on the ANS.

**Response:** Actions over the past four years indicate that the State of Alaska is doing just that. Many steps have been taken to provide incentives for activities such as Bristol Bay onshore leasing, exploration licensing programs, and incentives for oil and gas explorers across the state.

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

**Statement of Concern:** Statements indicating that the state should take legal action to change the split of oil and gas ownership between the state and federal governments to 90/10 instead of 50/50.

**Response:** Statehood affords a 90/10 split with the federal government except in specifically legislated areas such as NPRA. There is a conflict between these two concepts and any serving governor can choose to pursue litigation in this area.

**NATRSC\_07: (11 comments)**

**Statement of Concern:** Statements indicating that the state should build the pipeline by itself rather than partner with the oil companies.

**Response:** Based on our economic analysis, it was determined that sharing the cost and risk provided the state with the maximum benefit. It also provided the state with well capitalized partners who have constructed and managed energy mega-projects all over the world. By contrast the state has no experience in building or managing a project of this magnitude.

**NATRSC\_08: (3 comments)**

**Statement of Concern:** Statements indicating that the state does not have sufficient bargaining power with the oil companies to negotiate a contract that is in the interest of the state.

**Response:** The ability of the state to set taxing levels provides it with a significant level of bargaining authority. That authority alone provides the state with the complete ability to control the economic benefit of all oil and gas activities to the companies involved.

**NATRSC\_09: (20 comments)**

**Statement of Concern:** Statements indicating that Alaska needs to develop its Natural Resources; in particular its oil and gas resources.

**Response:** We completely agree and feel that the contract brings the maximum benefit of our resources to the people of the state by preserving the highest well-head value and avoiding potentially long and uncertain litigation.

**NATRSC\_10: (2 comments)**

**Statement of Concern:** Statements asserting that going forward with the project will enhance Alaska's reputation in terms of its husbandry of its natural resources.

**Response:** That goal is at the heart of the proposed contract.

**NATRSC\_11: (1 comment)**

**Statement of Concern:** The state should receive fair revenue for its natural gas resource. The proposed contract gives away more than \$10 billion in future gas revenue compared to the current tax rate on gas, and not enough work has been done to assess a gas tax rate that would be fair to all parties. The rate should be no lower than current law, and work should be done to see whether economic limit factor (ELF) tax exemptions in the current law shortchange the state. Legislative consultants at Econ One estimate that at average forecasted natural gas prices, the proposed contract reduces the companies' tax payments by over \$5 billion over the life of the gas pipeline. Former DNR officials have estimated the loss from various provisions, not including the tax rate reduction, to be over \$13 billion (Petroleum News, June 18, 2006).

**Response:** Representations have been made that the state is making several billion dollars of "concessions" in the contract. This is a distorted perspective which ignores many facts.

To begin with, in the SDGA, the legislature essentially directed the executive branch to negotiate (not litigate) a business deal to get a gas line. Any business negotiation consists of give-and-take as each party seeks to achieve its objectives at a reasonable cost. In Alaska's case the greatest "cost" would be failing to get a gas line. What some call "concessions" are some of the payments the state makes in the contract. This ignores the fact that the state also receives substantial revenues, well in excess of the payments. The contract is a total deal of payments and receipts. On the natural gas alone we estimate that at \$5.50 gas, which is a medium forecast over 35 years, the state would receive \$100 billion dollars net after all payments. This is the same amount we would have received under the ELF system for gas. (Actually, at all prices the net amount received under the contract is nearly identical to what would have been received under ELF.)

Moreover, some of these cited "concessions," or payments, are actually deductions on the new oil PPT. The PPT has a higher tax rate than the ELF system, but includes upstream deductions. These deductions are meant to increase investing in oil field production, and to arrest the current decline in oil flows, which if not checked will result in 50 percent less oil flow within 10 years. This net profit tax approach was highly successful in Norway. With the PPT, the state will on net, make several billion dollars more on oil after these deductions, not less. At current prices the state will make, between now and 2050, over \$50 billion more under the PPT on oil than under the ELF system. For the commenter to focus only on the deductions, but not the revenues, is disingenuous. The oil PPT was an integral part of the gas contract.

Again, one must look at the total deal. Looking just at the state payments alone presents a distorted perspective.

**NATRSC\_12: (2 comments)**

**Statement of Concern:** Statements indicating that Alaska should not pay any costs for gas production and development. The state has already contributed its land. Our leases trade 7/8 of the hydrocarbons for the promise of timely development under the leases.

**Response:** It is important to remember that the contract is negotiated in such a way as to make our gas competitive with other gas accumulations around the world. It is designed to get a gas pipeline built and for the state to control 20 percent of the gas resource. What we give for what we get is woven throughout the contract. Discussions of what we have given up assumes that the gas in the ground under current lease and tax regimes is economic and will go to market without any action on the part of the state. The facts simply do not support this view. There is no gas pipeline now and each of the previous attempts to build a gas pipeline under the status quo has failed. It is time to be realistic and understand that we must compete with the entire world to market our gas. That is precisely what the contract does.

### 3.10.5 AK\_FIN: Financing of Alaska's Portion of the Project—SOCs and Responses

This issue category deals with the state equity ownership in the gas pipeline project.

#### AK\_FIN\_01: (53 comments)

**Statement of Concern:** Statements commenting on state ownership: 1) expressing general agreement that the state should invest in the pipeline project; equity ownership in the pipeline is good for the state; 2) advocating different levels of equity ownership other than 20 percent, either higher or lower; 3) indicating that the state is picking up 35 percent of the cost of the GTP and upstream gathering lines, therefore the state should own that 35 percent; 4) indicating that the contract would cost the state an amount that approaches 50 percent of the entire cost of the project, yet the state will own only 20 percent of the project.

**Response:** Given the risks of the project, particularly the enormous up-front cost, the administration's analysis shows that in a "status-quo" world, the project rate of return is low. A low rate of return is particularly damaging to a project in which high risks are incurred and around which much uncertainty exists, because the low rate of return reveals a 'fragility' about the project such that relatively little adversity can destroy the economics of the project. By increasing the rate of return, the project becomes more 'robust'—a much more attractive investment opportunity which has a greater ability to withstand adversity and still return positive economics. As a result the likelihood increases that the project will move forward.

An alternative was examined by the administration – that of simply giving up state royalty value and taxes. It was determined that the state's royalty value and taxes would have to be given up entirely in order to have an effect on rate of return which is comparable to that accomplished by accepting state ownership and state gas in-kind.

By committing to own a share of the mainline and to bear its proportionate share of the upfront costs of constructing the mainline (which the state will bear in any event because actual costs are recaptured in the gas transportation tariff rates) the sponsor group will spend less money up-front. Because of the time value of money this increases their rate of return and makes the project more competitive with other investment alternatives members of the sponsor group may have available to them.

The state receives 20 percent of the gas in-kind and will own 20 percent of the pipeline. If the state were to own less than 20 percent, it would be required to make a firm transportation (FT) commitment to the pipeline owners equivalent to its 20 percent in-kind share. Financially this commitment is no different than ownership.

Similarly, if the state were to own more than 20 percent, it would require an FT commitment from member of the sponsor group for the balance they need for their gas. Again, this is financially equivalent to ownership. Accordingly, the most efficient arrangement is to have pipeline ownership approximately proportional to gas ownership.

**AK\_FINC\_02: (1 comment)**

**Statement of Concern:** Statements expressing concern that management of the state's investment in the pipeline would be problematic due to politics.

**Response:** To address the problem the administration has included proper terms in a proposed state act establishing the Alaska Natural Gas Pipeline Corporation to ensure the board is independent of politics. As specified in the act, only two of the Board members are commissioners, other five board members are public members appointed by the governor. These five board members may not hold any other state or federal office, position, or employment, either elective or appointive, except as a member of the armed forces of either the United States or the State of Alaska. In addition, they can only be dismissed for cause. The act also indicates that a public member of the board is appointed for a six-year term in accordance with AS 39.05.055(3). Staggered initial terms ensure that the public members of the board will have a continuing existence. In other words, no single governor can change the entire composition of the board; another way to make sure the board is apolitical.

**AK\_FINC\_03: (6 comments)**

**Statement of Concern:** Statements expressing concern that the gas pipeline project would take away or compromise state funding of education, local infrastructure, other social services, etc.

**Response:** There are several concerns addressed here. The first is that pipeline development would take away state education funding. We agree with your analysis of the effects of the Payments in Lieu of Taxes (PILT) on education funding, and it was never our intent to diminish the school funding mechanisms. In response, we requested (and both bodies of the legislature accepted) language to make sure the assets would remain in the tax base at full and true value. Secondly, we acknowledge that the sheer scope of the project will potentially result in some reallocation of state funds to account for the social impacts and infrastructure needs associated with the pipeline project. To alleviate as much of the burden as possible on the communities economically affected by the gas pipeline project, Article 18.1 of the contract provides 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 the 2004 report by Information Insights that was commissioned to determine potential impacts to the communities.

**AK\_FINC\_04: (4 comments)**

**Statement of Concern:** Statements suggesting that individual Alaskans be allowed to invest in the pipeline project or even possibly automatically invest their Permanent Fund dividends in the project.

**Response:** The administration has investigated various options that will allow Alaskans to become part owners of Alaska's 20 percent share of the pipeline. One option under consideration is to allow Alaskan's to invest their Permanent Fund dividends to pay for their ownership share. After the contract becomes effective, a joint finance plan between the state and the sponsor group will be prepared and a proposal to allow individual Alaskans to become part owners of Alaska's share of the pipeline can be evaluated. See *Section 5.3 State's Equity Contribution in Appendix F: Finance Plan Report* in the Preliminary FIF.

**AK\_FINC\_05: (1 comment)**

**Statement of Concern:** Statements requesting more information regarding the federal loan guarantee.

**Response:** In order to encourage development of the project, the U.S. Congress passed the Alaska Natural Gas Pipeline Act (ANGPA) of 2004. The ANGPA makes Department of Energy (DOE) guarantees available for up to \$18 billion or 80 percent of the cost of the project, whichever is less, and delegates administration of the federal loan guarantee program to DOE. The specifics of the program are still being developed by DOE. At this point, there have been no communications with or regulations issued by DOE on the terms and conditions of the federal loan guarantee. It is expected conversations with DOE will commence once the SGDA contract is signed and a conceptual finance plan developed by the state and three other pipeline owners. Both the state and the sponsor group see potential value in utilizing the DOE guarantees in some fashion, and intend to take full advantage of the DOE guarantees if they are available on acceptable terms and conditions.

The full text regarding the federal loan guarantee can be found in Section 116 Loan Guarantees, Division C – Alaska Natural Gas Pipeline at the following website: [www.ferc.gov/industries/gas/indus-act/angtp/act.htm#act](http://www.ferc.gov/industries/gas/indus-act/angtp/act.htm#act). More information regarding the development of this loan guarantee program can be found through the U.S. Department of Energy website at [www.fossil.energy.gov/news/techlines/2005/tl\\_pipeline\\_noi.html](http://www.fossil.energy.gov/news/techlines/2005/tl_pipeline_noi.html).

**AK\_FINC\_06: (2 comments)**

**Statement of Concern:** Statements expressing concerns about the failure of the contract to specify a capital structure (i.e., to limit the equity portion of project capitalization to no more than 20 percent of total capital) to be used for assuring that the pipeline's financing rates are as low as possible, and the failure to include commitments to maximize the available federal loan guarantees in order to keep rates low.

**Response:** The contract does not specify project financing details. The state's proposed mainline LLC agreement includes provisions regarding project financing. Specifically, *Article 11 Financing the Project* includes the detailed provisions regarding finance strategy, the finance committee, finance plan, finance committee process, further actions and other financing provisions. As specified in *Section 11.1 Finance Strategy*, "the agreed finance strategy is to endeavor to develop a financing that takes advantage of the federal guarantee instruments covering 80 percent of the sum of (x) the project cost and (y) interest during construction ..."

Regarding the capital structure, the state and its financial advisors are exploring various financing option with considerations to obtain the lowest cost of capital over the long run and to utilize the DOE guarantees to lower the cost of borrowing and increase the likelihood that the state and the sponsor group can finance 80 percent of estimated project costs. The state and the sponsor group would not make the final selection of a finance plan until the specifics of the projects components, including design engineering, procurement and construction costs, are further developed.

**AK\_FINC\_07: (4 comments)**

**Statement of Concern:** Statements indicating that the 20 percent equity contribution, proposed 35 percent tax credits in the PPT, and upstream costs to the state will cost the state billions of dollars and could actually cause the state to go negative on the project, while member of the sponsor group still make a good profit.

**Response:** The state will be a 20 percent owner of most portions of the pipeline project in Alaska consisting of the mainline and GTP. For the gas transmission pipelines, which bring the gas from the gas fields to the GTP, the state's ownership share will be in proportion to its expected share of gas in those pipelines, no more and no less. That varies by field. The state has the right to withdraw from ownership participation in any individual component of the project prior to project sanction with full recovery of its prior investment, but must commit to taking capacity in the open season for all component in proportion to its share of the gas throughput. If it continues as an owner in pipeline facilities, it will receive the commensurate reward for its investment based on the tariffs approved by FERC. Thus, the state receives the same returns as the other investors with respect to such investments.

The 35 percent commitment allowance (see Article 20) which applies only to GTP and gas transmission pipeline was included to increase the producer's internal rate of return on the overall pipeline project and to make it competitive with other petroleum investment opportunities members of the sponsor group have around the world. It is also true that portions of the pipeline project will be eligible for the 20 percent tax credit under the Profit Share Petroleum tax (PPT, passed by the legislature on August 11 and signed into law on August 19 (see HB 3001). The administration believes this incentive is necessary to address the state's declining oil production and provide the incentives for finding and developing additional gas reserves necessary to sustain operations of the proposed pipeline and encourage its expansion from about 4 bcf/d of initial capacity to 6 bcf/d.

**AK\_FINC\_08: (1 comment)**

**Statement of Concern:** Statements indicating that the FIF should do a better job of specifying how much capital is at stake in terms of both private and state funds.

**Response:** The amount of capital contributions from members of the sponsor group or the state through project entities depends on the total cost, the debt/equity ratio, and each member's equity sharing ratio of the project.

In order to complete the project and realize its economic benefits, the sponsor group and the state collectively will need to spend upwards of \$20 billion. In 2001, the sponsor group developed a detailed cost estimate of about \$18.5 billion for a project including a gas treatment plant, a pipeline from Alaska to Alberta, a NGL plant, and a pipeline from Alberta to Chicago. This estimate was subsequently rounded to \$20 billion and updated to 2003 dollars. The ultimate cost of the project may be substantially higher than \$20 billion. More detailed cost estimates will be prepared during the period between the effective date of the sponsor group contract and project sanction.

The state and the sponsor group are exploring a full range of financing structures and options at this time. The state plans to seek a debt/equity ratio of 80/20 so as to obtain the lowest cost of capital and tariff applicable to the firm transportation contracts over the long run. The state has negotiated a 20 percent ownership stake in the project, while the sponsor group will

collectively own 80 percent of the project. Therefore, the state expects to invest a minimum of \$800 million as equity capital in the state's pipeline entity (Alaska Natural Gas Pipeline Company) which will, in turn, use the funds to make equity contributions into the mainline entity. The sponsor group will collectively invest a minimum of \$3.2 billion of equity into the mainline entity.

See detailed project costs and financing structures and options in *Section 7 Financing the Pipeline* and *Appendix F Finance Plan Report* in the Preliminary FIF.

**AK\_FINC\_09: (1 comment)**

**Statement of Concern:** Statements indicating that the financial terms are not specified in the contract and therefore the findings in the Preliminary FIF are arbitrary and not based upon facts in the record.

**Response:** Financial terms, including financing provisions, capital contributions, taxes and others, will be specified in the state's proposed mainline LLC agreement.

**3.10.6 PFD: Permanent Fund Concerns—SOCs and Responses**

This issue category covers the gas pipeline project impacts on the Permanent Fund.

**PFD\_01: (7 comments)**

**Statement of Concern:** Statements indicating that the state should use the Permanent Fund to pay for the project. Other statements indicating that the Permanent Fund is large enough to invest in a higher equity ownership in the pipeline.

**Response:** *Appendix F* of the Preliminary FIF discusses three potential funding sources that alone or in combination may satisfy the state's equity contribution need to support its 20 percent ownership of the pipeline: appropriation from the General Fund by the legislature, moral obligation revenue bonds, or a Permanent Fund Corporation investment. Based upon an assumed \$20 billion cost of constructing the pipeline, the state would have to raise \$800 million of equity capital (20 percent ownership times \$20 billion construction cost or \$4 billion total state capital requirement: 20 percent equity times total state capital requirement of \$4 billion or \$800 million equity requirement). The legislature has set aside \$300 million from the General Fund to partially advance fund the state's equity requirement. The Permanent Fund may be invited to provide a portion, or all, of the remaining \$500 million equity requirement. Before the Permanent Fund invests in the pipeline, the Trustees and their investment staff, as with all investments they consider, will go through an extensive "due diligence" process to understand the project, expected return and risks. This potential investment will have to be consistent with the long term mission of maximizing "the value of the Alaska's Permanent Fund through prudent long-term investment and protection of principal to produce income to benefit all generations of Alaskans." In other words, the Permanent Fund would expect this possible investment to be eligible for investment by a prudent institutional investor by providing compensation with a risk adjusted rate of return competitive with similar holdings as well as with other opportunities in the marketplace. Even if the possible investment were to otherwise meet the prudent investor standard, the Trustees may seek express authorization from the legislature because of the amount of the investment and the importance to the state.

See details in *Section 7 Financing the Pipeline and Section 5.3.4 Equity Contribution or Loan Proceeds from the Permanent Fund* (contained in *Appendix F Finance Plan Report*) of the Preliminary FIF.

**PFD\_02: (11 comments)**

**Statement of Concern:** Statements indicating other possible Permanent Fund investments: 1) the state should use the Permanent Fund to pay for smaller pipeline projects for in-state use; 2) the state should not use the Permanent Fund to build the pipeline until a more favorable contract is negotiated; and 3) the Permanent Fund's investments should be diversified and outside of Alaska.

**Response:** The Permanent Fund Trustees, if invited, will make the judgment on whether to play a role in any projects, including smaller pipeline projects for in-state use, that satisfy its policy that any investment to be compensated with a risk adjusted rate of return competitive with similar holdings as well as with other opportunities in the marketplace mission and that it be consistent the state laws and regulations governing Permanent Fund investments. It has been the policy of the Fund to avoid investments in Alaska as other state entities such as the Alaska Industrial Development Authority and Alaska Housing Development Corporation have been assigned this mission. Because of the importance of the pipeline to the long term destiny of state, the Permanent Fund Trustees may consider waiving this policy and may choose to seek legislative guidance on this important question.

**PFD\_03: (15 comments)**

**Statement of Concern:** Statements indicating that the project could put the Permanent Fund at risk, even if the Fund is not used to pay for the pipeline. The Fund should not be used as collateral.

**Response:** The state agrees with the SOC.

**PFD\_04: (12 comments)**

**Statement of Concern:** Statements indicating that project revenues will augment the Permanent Fund, and supporting use of project revenues to augment the Permanent Fund.

**Response:** Whether the Fund's Trustees, if invited to invest, decide to directly invest in the project or not, there will be additional royalties that would flow to the Permanent Fund during the project operations. According to projections presented in Section 4 of the Preliminary FIF, by the end of the 10th year of operations, the accumulated revenues to the Permanent Fund could total about \$1.2 billion at \$3.5 per mmBtu gas price, \$2.9 billion at \$5.50 per mmBtu gas price, or \$5.3 billion at \$8.50 per mmBtu gas price. In theory, an increased size of the Fund will result in larger investment returns, larger realized earnings and increased Permanent Fund dividends.

### 3.11 Risks

Issues in this general area of concern included the risk of state equity ownership in the gas pipeline project; political risks associated with the project; risks related to taking gas in-kind; resource risks associated with the project; market risks associated with the project; environmental impacts of the project; risk of project cost overruns; and *force majeure* in the proposed contract.

#### 3.11.1 OWNRISK: State Ownership Risks—SOCs and Responses

This issue category covers the risk of state equity ownership in the gas pipeline project as well as the market risks associated with the project.

##### OWNRISK\_01: (5 comments)

**Statement of Concern:** Statements expressing concern that the state does not have the option to withdraw from the project, but the sponsor group has that option.

**Response:** Under the proposed project entity agreements, no member may withdraw from a project entity during the construction period (the period from project sanction to the date the project enters into service). At all other times, any member, including the state member, may withdraw from the project entities, but is not entitled to a return of equity contributed. Additionally, any member, including the state member, can negotiate a sale of its ownership interests in the project entities. Finally, the state member has specifically negotiated the right at project sanction to exit the project by requiring the other members to purchase its ownership interests in each project entity.

##### OWNRISK\_02: (69 comments)

**Statement of Concern:** Statements concerned about the state's investment in the project due to associated risks, and that the state will be shouldering most of them. Other statements indicating that the state's participation risks are balanced by the rewards.

**Response:** While participation in a project of this size necessarily presents a number of risks, including economic risk, cost overrun risk, resource risk, capacity management risk, political and regulatory risk and *force majeure*, the largest risk to the state is by far the fact that if the mainline is not constructed the state will have no source of revenues that can replace declining revenue streams from oil production. A detailed analysis of the long run fiscal outlook of the state both with and without the development of the mainline is set forth in *Section 1.1 Alaska's Long Run Fiscal Outlook* in the Preliminary FIF.

Project risks are addressed in the fiscal contract and the state and the other participants will take steps in the future to further mitigate these risks. In negotiating the fiscal contract and the project entity agreements, the state has strived to ensure that these risks are shared appropriately among all participants in the project and that the state will not be shouldering inappropriate amounts of the project risk.

Details regarding specific project risks and mitigation are discussed in *Section 6 Mitigating Project Risk* of the Preliminary FIF.

The administrative negotiated with the sponsor group with careful consideration on the balance of risks and rewards. The state believes that ownership of the pipeline, and sharing of the subsequent risks that occur with ownership, is necessary:

- to improve project economics to a point that the Alaska natural gas pipeline project becomes an economically competitive project and gets built,
- to provide a stable revenue stream to the state from a return on the state's investment, and
- to expedite construction of the mainline.

Benefits from the pipeline would include economic benefits, expediting construction of the project, participation in project development decision-making process, and making the project more attractive than alternative projects that the sponsor group could develop. These benefits are detailed in the Preliminary FIF, *Sections 4.1.3 Estimated Earnings from State Ownership* and *4.5 The State Should Own a Share of the Pipeline*.

In addition, the state believes it would be in its interest to negotiate an option at project sanction (the time when the participants will commit to construct the project) when the state can evaluate the risks to the state of further participation in the project.

#### **OWNRISK\_03: (4 comments)**

**Statement of Concern:** Statements expressing concern about state participation in the project without knowing how much the project will cost.

**Response:** The potential project cost is not completely unknown. In 2001, the members of the sponsor group undertook a \$125 million ANS gas pipeline feasibility study. The proposed project plan submitted by the sponsor group is the result of that study. The estimated capital cost to build a pipeline to deliver the gas to Chicago is about \$21 billion (in 2005 dollars). The state is aware that this is an estimate cost. It is not until the project sanction date that the state and the sponsor group will have completed the design engineering and permitting, and thus have a better estimate of the costs of the Alaska and Canadian portions of the project and the costs associated with FERC's certification. The state is also aware that the project is very likely to have cost overruns. If the project turns out to be too costly, the state will have the right to withdraw from participation with full recovery of its prior investment in the event the state decides not to proceed with the investment on the project sanction date.

#### **OWNRISK\_04: (3 comments)**

**Statement of Concern:** Statements concerning that there is no analysis regarding the impact on the state's credit rating in the Preliminary FIF.

**Response:** At this point there is no stand alone report on credit rating analysis. However, *Appendix F Finance Plan Report* does specify a number of financing options, along with full discussions on their implications for the state's credit rating. One of the state's finance objectives is to limit the state's liability for the funds borrowed for project construction so as to mitigate the impact the project will have on the state's borrowing capacity as well as any negative implications for the state's credit rating and cost of borrowing. Based on information currently available, the Financial Advisor's recommended Financing Plan consists of the mainline LLC pursuing a limited recourse debt financing for the majority of

project costs and the members paying their respective proportionate shares of the remaining project costs with equity contributions. The benefits of the mainline LLC undertaking a limited recourse financing include the following: (i) the state's liability to the lenders to the project would be contingent and limited to the construction period; (ii) such structure would allow for up to 80 percent of the total project costs to be financed with debt; and (iii) such financing would allow the project to benefit from the Federal Guarantee Instruments provided by the U.S. Department of Energy under the Alaska Natural Gas Pipeline Act. With such debt financing covering up to 80 percent of the total project costs, the state's required equity contribution would represent only 4 percent of total project costs, thus minimizing any impact on the state's borrowing capacity and therefore, its cost of capital and credit rating, as a result of participating in the project.

**OWNRISK\_05: (1 comment)**

**Statement of Concern:** Statements expressing concerns about state indemnification of the sponsor group.

**Response:** As is typical in projects of this nature, each member of a project entity will agree to indemnify the other members for specific losses resulting from a breach of the agreement. Additionally, the proposed project entity agreements contemplate that the members and the project entity will enter into an indemnification agreement for the indemnification of specific losses suffered by a member or certain other persons, including the operator/construction manager in connection with the construction and operation of the project in the ordinary course of business. Absent indemnification, the operator/construction manager would charge the project entity additional fees to cover its liability, which would be borne by members proportionately as a member of the project entity and which would otherwise result in a reduction of distributions payable to the state and the other members. The state member and its representatives would also benefit from indemnifications made by the other members and the project entity.

**3.11.2 POL\_RSK: Political Risks—SOCs and Responses**

This issue category covers political risks associated with the gas pipeline project.

**POL\_RSK\_01: (31 comments)**

**Statement of Concern:** Statements expressing concern about the risks/issues associated with the Canada-portion of the project such as getting through Canada, unfriendly government, and distrust of Canadians.

**Response:** We firmly believe that the Canadian federal government will act in a way that best protects its interests. In the case of the Alaska Highway gas pipeline project, Canada will greatly benefit by having Alaska gas move into the Alberta Hub. This will lower the gas transportation costs for all Canadian producers, consumers, and participating pipeline operators (such as TransCanada, Enbridge, etc.). Steps taken that add cost and delay will have negative effects for all involved (Canada, Alaska, TransCanada, Canadian gas producers, and U.S. and Canadian consumers). We are confident that the Canadian federal government is aware that protracted delays and added costs could result in no pipeline at all—and in that case everybody ends up losing.

The Preliminary FIF identified a number of potential benefits to Canada with completion of the Alaska Highway gas pipeline project including:

- Creating a larger and more efficient gas marketing hub in Alberta
- Providing greater and more efficient utilization of Canada's existing pipeline infrastructure
- Sustaining and enhancing Alberta's petrochemical industry
- Generating exploration activity for new gas resources, particularly in the Yukon Territory
- Maximizing synergies with the Mackenzie Valley Pipeline (MVP).

**POL\_RSK\_02: (2 comments)**

**Statement of Concern:** Statements requesting additional information on the Canada-portion of the project.

**Response:** The contract does not directly affect the Canadian portion of the pipeline, however since the success of the project requires Canadian cooperation the question is in order. We believe the Canadian federal government will act in a way that maximizes the benefit of the pipeline to its citizens. In the case of the Alaska Highway gas pipeline project, Canada will greatly benefit by having Alaska gas move into the Alberta Hub. This will lower the gas transportation costs for all Canadian producers, consumers, and participating pipeline operators (TransCanada). Steps taken that add cost and delay will have negative effects for all involved (Canada, Alaska, TransCanada, Canadian gas producers, and both U.S. and Canadian consumers). We are confident that the Canadian federal government is aware that protracted delays and added costs could result in no pipeline at all—and in that case everybody ends up losing.

**POL\_RSK\_03: (2 comments)**

**Statement of Concern:** Statements expressing concern that the state, as a co-owner of the pipeline, would be liable for environmental damages in Canada.

**Response:** The state's member of the consortium building and operating the pipeline in Canada would be responsible for its share of liability. That is part of the responsibility that comes with ownership.

**POL\_RSK\_04: (2 comments)**

**Statement of Concern:** Statements indicating that the Canada-portion of the project would build on good relations with the U.S.

**Response:** Canada is the United States' largest foreign trading partner. This project would add significantly to that partnership to the benefit of both nations.

**POL\_RSK\_05: (1 comment)**

**Statement of Concern:** Statements indicating that the political risks described by project proponents are exaggerated.

**Response:** We have always held the position that the political risks of a pipeline through Canada are minimal. It is in Canada's and the United States' best interest for this project to move ahead swiftly and at the lowest cost possible.

**POL\_RSK\_06: (5 comments)**

**Statement of Concern:** Statements indicating that further action on the contract should wait until a new governor is elected.

**Response:** The contract is based on rock solid economic principles that will not change no matter who the governor is. Time is not our friend and the sooner the contract is completed the better off Alaska will be. Delay will increase the chances that Alaska will not be able to cross over from an oil-based economy to a gas-based economy. The largest risk to the state is the fact that if the mainline is not constructed the state will have no source of revenues that can replace declining revenue streams from oil production. A detailed analysis of the long run fiscal outlook of the state both with and without the development of the mainline is set forth in *Section 1.1 Alaska's Long Run Fiscal Outlook* in the Preliminary FIF

### **3.11.3 INKIND: Risks Related to Gas-In-Kind—SOCs and Responses**

This issue category covers risks related to taking the state's gas in-kind.

**INKIND\_01: (54 comments)**

**Statement of Concern:** Statements expressing concern about the costs, risks, and the benefits of taking the state's gas in-kind, creating a marketing organization, giving up taking of royalty in-value and the existing production taxing structure.

**Response:** It must be remembered that the greatest risk to the state is that no Alaska gas project is built in a reasonable timeframe and at reasonable costs. This is the risk which the administration has worked diligently to eliminate, without incurring other undue or disproportionate risks to the state.

Given the risks of the project, particularly the enormous up-front cost, the administration's analysis shows that in a "status-quo" world, the project rate of return is low. A low rate of return is particularly damaging to a project in which high risks are incurred and around which much uncertainty exists, because the low rate of return reveals a 'fragility' about the project such that relatively little adversity can destroy the economics of the project. By increasing the rate of return, the project becomes more "robust"—a much more attractive investment opportunity which has a greater ability to withstand adversity and still return positive economics. As a result the likelihood increases that the project will move forward.

The rate of return is increased by the contract provisions through 1) the state taking its gas in kind, plus 2) state ownership of the pipeline. Under the status quo the state pays for its share of the pipeline slowly over time through the tariff deduction on royalties and taxes. Through the mechanism of in-kind gas and pipeline ownership, the state pays for its share up front.

The result is less money the sponsor group must lay out up-front. Because of the time value of money this increases the rate of return. An alternative was examined by the administration—that of simply giving up state royalty value and taxes. It was determined that the state share would have to be given up entirely, in order to have an effect on rate of return which is comparable to that accomplished by accepting state ownership and state gas in-kind. In addition, the state gains a seat at the table, eliminates valuation disputes, gains control over marketing strategies, and gains control over the use of state gas for in-state needs. The state can ascertain the needs of in-state use, determine the policies to be met to meet those needs, and determine the share of state gas to be committed to in-state use.

The state does assume risks with taking gas in-kind coupled with ownership: completion risk, *force majeure* risk, reserve risk, and marketing risk. The administration believes these risks are not large, and that they are very manageable by the state. For instance, we have been advised we can market our gas at top dollar for a marketing cost of only a few cents per mcf. The reward the state gets for assuming this risk is timely construction of a gas pipeline.

The most significant project risk, that of cost overruns, is actually borne proportionately by the state under any circumstances, because actual costs are recaptured in the gas transportation tariff rates paid by all shippers—and by the state in either a royalty in-value world or a royalty in-kind world.

The decision to take gas in-kind is the result of the decision to accept transportation shipping commitments, thereby relieving the sponsor group of those commitments and improving project economics without giving up the state's share of the resource.

The benefits of switching between in-value and in-kind taking of royalty gas and the benefits of switching between in-value and in-kind taking of royalty oil are different because the federal regulations governing the shipping of oil and those governing the shipping of gas are separate and very different. Because, according to federal regulations, natural gas is shipped under fixed contract arrangements, existing lease rights to switch the taking of royalty gas between in-value and in-kind are of little practical value to the state. Rather than attempting to enforce "higher-of" lease provisions for gas in a "royalty in-value" world, and incurring the legal costs and continuing contentious relationships with the very producers we are expecting to become our partners, the state has the opportunity to help ensure the pipeline is built and to market our gas to best meet the strategies and policies of the state.

The fact is that, today, the state gets no royalties or taxes from major gas sales, because access to major markets does not exist. There is no gas pipeline. State lease forms do contain a provision that the state gets the "higher-of" value obtained by various producers from oil or gas from that lease. The state and the producers have spent millions of dollars, and years in extended, expensive court battles arguing over just what this provision means and what that value is for oil. Although the state has often prevailed, the cost in litigation dollars, delays, and goodwill has been enormous. For those reasons, the state and the major producers have entered into Royalty Settlement Agreements (for oil). In each of these agreements, the state has determined that it was in the state's best interest to give up the lease "higher-of" provision in exchange for clarity in the determination of oil value.

The fiscal contract makes a similar trade for gas – but in this case the "higher-of" provision is of far less value to begin with. The benefits of switching state take of royalty gas and the benefits of switching state take of royalty oil between in-value and in-kind are very different

because of the separate and very different transportation regulatory regimes. Because, according to federal regulations natural gas is shipped under fixed contract arrangements, existing lease rights to switch the taking of royalty gas between in-value and in-kind are of little or no practical value to the state.

It is important to recognize that the state has a successful record taking royalty oil in-kind and marketing it ourselves. As with any new endeavor, the state found that oil marketing required a professional commercial staff, and now with this staff in place for many years, the state has benefited greatly from in-kind royalty oil sales. In addition, the state has a successful track record managing our own Permanent Fund and our own railroad. The state's track record in typically business endeavors is successful when that endeavor makes good public policy sense for the state, and when markets exist to ensure the success of such efforts.

Representations were made that the state is making several billion dollars of "concessions" in the contract. This is a distorted perspective. What were called "concessions" are some of the payments the state makes in the contract. The state also receives substantial revenues. The contract is a total deal of payments and receipts. At the end of the day we estimate that at \$5.50 gas, which is a medium forecast, over 25 years, the state would receive \$100 billion dollars net on the natural gas alone, after these payments.

Again, one must look at the total deal. Looking just at the state payments is a very skewed perspective; and ignores the fact established in the Preliminary FIF that total state revenues received under the contract, after all the payments and supposed 'concessions' are accounted for – match the illusory total state revenues in the 'status-quo' world. Those state revenues identified in the 'status quo' world are illusory, because that world does not exist; a project is not being moved forward toward completion in the 'status quo' world by competent sponsors in a time frame similar to that proposed for this project.

Acceptance of royalty in-kind requires that the state establish a gas marketing function, but it also frees the state to obtain value for our gas according to our own priorities and strategies. Taking state gas in-kind provides the state the best opportunity to ensure the most benefit out of our royalty gas. For instance, a producer may be willing to accept higher risks while seeking higher value for Alaska gas, whereas the state might find those incremental risks unacceptable. Conversely, a producer may be willing to accept lower gas prices, whereas the state would prefer to market more aggressively.

A variety of alternatives exist for developing a state gas marketing authority. Major third-party gas marketers exist willing to partner with the state, who are not producers of their own gas and by the very nature of their companies would be natural partners with priorities which would be consistent with those of the state. Gas marketing experts, both within the state and outside, have consistently confirmed the opportunity and potential value available to the state by taking our gas in-kind.

**INKIND\_02: (1 comment)**

**Statement of Concern:** Statements indicating that it would be appropriate for economic models to be created to project at least a range of net revenues Alaska can reasonably expect to get from its 20 percent gas in-kind taking and the potential loss of revenue compared to receiving cash payments. This provision does not significantly increase the sponsor group's projected net revenue, but it adds a risk factor that has a potentially high negative impact on the state.

**Response:** The economic models that were developed to assess the costs and benefits of the contract incorporate these concerns. In fact, 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 problems and risk the project faces.

Thus, the analysis combines different prices with capital costs and presents net revenue under various scenarios.

The models compare the net present value of state revenues under the 2005 fiscal system versus the net present value of state revenues under the proposed contract. The comparisons are shown in 2005 dollars. Unfortunately, the models as developed do not generate the outputs described in this Statement of Concern. The state recognizes that including these outputs will enhance the public's understanding of the contract and the FIF and will consider augmenting the economic models to provide these outputs after the contract is negotiated and signed.

### **3.11.4 RSC\_RSK: Resource Risks—SOCs and Responses**

This issue category deals with resource risks associated with the gas pipeline project.

**RSC\_RSK\_01: (7 comments)**

**Statement of Concern:** Statements indicating that risks of under capacity due to insufficient gas discoveries exist; that resources from areas outside of the ANS, including Yukon Flats and Nenana, have the potential of helping to keep the pipeline full over the term of the contract; and that a mutual links exists between the gas pipeline and the opening of ANWR.

**Response:** Resource risk is a component of the overall risk picture for the gas pipeline project, however 35 tcf of known reserves have been identified, which can keep the pipeline full for the first 20 years of its operating life. Over the three-decade period between now and that point in time, exploration is expected to provide the additional reserves necessary.

*Section 1.2 Alaska North Slope Natural Gas Resources* of the Preliminary FIF provides detail about both the known ANS reserves, and assessments of the resource potential in NPR-A, ANWR (1002 area), the existing ANS area, and adjacent state waters. The total ANS

resource estimate of undiscovered conventional natural gas resource is 119 tcf. Despite the focus on ANS potential, resources from other areas of the state have every opportunity to also provide deliveries to the Alaska gas pipeline project, including Arctic federal waters offshore Alaska, interior basins such as Yukon Flats and Nenana, and Cook Inlet – were another huge discovery such as Beluga or McArthur River to be made. Depending on the timing of exploration and commitments made by the explorers, such deliveries may displace some deliveries from the ANS, may result in a larger pipeline being constructed or expansions being completed, or they may indeed be delivered as ANS gas production declines.

Reserves risk is very low, particularly compared with the risks and costs to the state of deferring a gas pipeline project, or moving forward with a poorly-conceived project supported by groups lacking the financial strength and experience to complete the project on time and on budget. Reserves risk is further minimized by provision of fiscal certainty, via the upstream uniform fiscal contract, to all explorers who commit gas reserves to the gas pipeline project. In addition, ongoing programs by the state, such as DNR's area wide leasing program; the DGGs, DNR, and AOGCC electronic data programs; and various DNR and DOR exploration tax incentives further minimize reserves risk to the state.

### 3.11.5 MRKT: Market Risks—SOCs and Responses

This issue category covers market risks associated with the gas pipeline project.

#### MRKT\_01: (83 comments)

**Statement of Concern:** Statements related to market current conditions, future conditions, and their relationship to the gas pipeline. Some of these comments related to the appropriateness of the timing of the line and how that will take advantage of securing markets. Others stated that prices were not good now and that delay of the line will result in better prices. Others pointed out that the gas supplied through the line will adversely affect domestic markets or that such markets will be already adversely affected by Canadian gas or LNG imports.

**Response:** A number of people commented on the market effects of the gas pipeline, both positive and negative. Many of the positive and supportive components are covered under the section concerning the contract being a balanced deal for the state and will not be duplicated here.

We believe that the time to secure domestic gas markets is now and that delay will only result in increased competition and longer term market uncertainty and risk. While many commenters stated that the time was right to secure markets, others stated that either the timing was wrong or that the pipeline itself and competing market supplies would lead to reduced prices and therefore timing was bad. Market timing can not be forecast with any degree of certainty. Market conditions at a particular time are as much a reflection of the past as they are expectations about the future. The interdependency of the markets, supplies and prices can not be captured in a snapshot.

It is true that there will be competing supplies of natural gas to the domestic market. Some will arrive from Canada, in part through a Mackenzie Valley Pipeline into the same markets anticipated for ANS gas. Other supplies will result from increased LNG imports through

terminals in the U.S., Canada, and Mexico. By assuring consumers that ANS gas will be available and price competitive in the near future, we will forestall some competing projects thereby reducing some project uncertainty and risk.

The volume of gas proposed to arrive via the Alaska gas pipeline will be more than many of the competing projects combined. This large volume provides some market assurance of acceptance and allows ANS to compete on favorable price terms. Wood Mackenzie's January 2006 study projects North American LNG imports increasing from 1.7 bcf per day in 2005 to 18.4 bcf per day in 2020. Some of this increase in imports is via Mexico, Canada, and the Bahamas but most is from U.S. terminals in the Gulf of Mexico. As an overall indicator, the U.S. Department of Energy projected total U.S. consumption to increase from 22.4 tcf (trillion cubic feet) in 2004 to 26.9 tcf in 2030. This is an increase of 4.5 tcf per annum or 12.3 bcf per day.

Studies commissioned by the commissioner as part of this finding took into account competing sources of supply and projected world oil and gas prices. All of our studies and those of most pundits worldwide indicate that gas prices will be in a range that will provide long-term positive returns to the pipeline, the sponsor group, and the state.

See the Preliminary FIF, *Appendix C Is Alaska's Natural Gas Stranded* for greater detail.

**MRKT\_02: (17 comments)**

**Statement of Concern:** Statements indicating that the gas pipeline would compete with other projects for capital investment.

**Response:** Without a doubt the ANS gas pipeline will be competing for capital investment on a company by company and an international basis. Studies by PFC Energy showed that on a net return basis the project ranks in the lower third of available investment opportunities for all members of the sponsor group. This means that any incentives the state can provide will improve the project's ranking, advance its chances of funding, and begin planning and development now rather than a decade in the future. Investment decisions consider both risk and return for potential investments. Understanding the trade-off and adequately compensating one for the other will impact the prioritization of projects.

See the Preliminary FIF, *Appendix C Is Alaska's Natural Gas Stranded* and *Section 5.1 Analysis of Balance of Fiscal Principles* for greater detail.

**MRKT\_03: (20 comments)**

**Statement of Concern:** Statements of support for the route through Canada and the contract. This support covered a wide range of issues including markets, economic incentives for investment, timing, length of contract terms and conditions, and the necessity of such an agreement to begin moving ANS gas to market.

**Response:** We are grateful for all comments received concerning the gas pipeline contract. Many of these comments were questions that we are responding to. Other comments were not questions but instead statements of support or opposition. We have grouped many of the supportive statements to show the breadth of agreement we received on the terms and conditions of the contract.

Several people pointed out the oil industry will continue to be important to Alaska with or without the gas pipeline. We agree with that statement and emphasize that with the gas pipeline the industry will continue to be important for many more years than without the line.

Many people commented on the timing of the contract and how there is a window of opportunity to secure natural gas markets that must not be lost. There has always been agreement that the market for ANS natural gas is North America. A pipeline to the central continent solidifies that. All pundits predict that domestic consumption of natural gas will increase in the future and that ANS gas can play a large part in supplying that market. Due to the time horizon necessary to build such a massive and expensive project, beginning now is the only way to assure that ANS gas is the preferred and relied upon supply source rather than imported LNG. Alaska's gas is currently stranded and this contract will un-strand the gas. The size of the investment necessary to build such a line requires a long term contract and fiscal stability to secure financing and commitment for both the pipeline and production facilities. By partnering with the sponsor group, the state helps to reduce market risks and thereby increase the likelihood of long-term project success for the project.

Others supported the gas pipeline as the means of continuing oil production on the ANS. They agreed that assuring future gas flows, and thereby operation of the TAPS, was the most reliable means of encouraging additional exploration and development of oil as well as gas. Much of the development in the years to come is known to be associated oil and gas. This means that they must be jointly produced and disposed of. At this time members of the sponsor group are running out of means of disposing of non-marketable or stranded gas. The gas pipeline will resolve this problem and encourage more development. More development will increase oil production and extend TAPS longevity. By developing new resources and better utilizing existing resources, the oil industry will be able to generate many more years of employment and revenues to be enjoyed by Alaskan residents.

For additional detail see *Section 1.2.2 Impacts of Gas Production on Oil Production* in the Preliminary FIF.

### **3.11.6 ENVR: Environmental Risks—SOCs and Responses**

This issue category covers environmental impacts of the gas pipeline project.

#### **ENVR\_01: (2 comments)**

**Statement of Concern:** Statements advocating that the state develop the pipeline in a way that minimizes environmental damages and concerns that the state, as a co-owner of the pipeline, would be liable for environmental damages.

**Response:** The State of Alaska, as part-owner of the pipeline system, will be one of the lessees contractually obligated to comply with all the right-of-way lease conditions and stipulations for state and federal lands. In addition, as a lessee, the state is required to comply with all state, federal and local laws with respect to pipeline operations. In this capacity, the state would be required to ensure that all environmental obligations of the mainline LLC are fulfilled, and in the event of unforeseen environmental damage may be legally responsible for restoration and rehabilitation costs.

**ENVR\_02: (4 comments)**

**Statement of Concern:** Statements requesting information on the possible environmental impacts of the project, including the effects of disposal of impurities.

**Response:** The proposed gas pipeline project alignment, from Prudhoe Bay to Delta Junction, will generally reside within an existing utility corridor. A significant amount of information relative to this utility corridor, including environmental, has been collected since the planning phase of TAPS in the early 1970s. The Environmental Impact Statement and Department of Natural Resources decision document for renewal of the TAPS lease and grant in 2002 provides a comprehensive summary and update of this information. The Delta Junction to Canadian border segment of the pipeline route follows the Alaska Highway and will require a gap analysis to evaluate the information, including environmental, necessary to avoid or minimize project impacts. As the information becomes available, measures such as timing windows, seasonal restrictions, specific construction techniques etc. will be considered to reduce impacts to fish, wildlife and their habitats. Prudhoe currently has two large gas handling/processing plants, the Central Compressor Plant (CCP) and the Central Gas Facility (CGF). There are also numerous smaller plants located in other fields, as well as fuel gas conditioning facilities that treat the produced gas to standards required for use by the industrial equipment on the ANS. Therefore, a gas conditioning plant is not expected to create any new types of impurities or environmental impacts beyond what is currently being produced and regulated by government agencies. It will, however, be an increase in quantity.

The proposed gas processing plant has not been designed. However, we can make statements based upon gas processing done throughout the world. Typically, gas processing plants of the type proposed for the Prudhoe Bay for the TAPS produce three principal byproducts from the processing stream: carbon dioxide, sulfur dioxide, and longer-chain hydrocarbons, such as butane and propane. The carbon dioxide will continue to be re-injected into the reservoirs. This helps maintain reservoir pressure and improves both oil and gas recovery. It is a valuable byproduct and could even be used as part of a tertiary recovery system. The sulfur dioxide is produced in minute quantities (parts per million) will be re-injected. The longer chain hydrocarbons are also a valuable byproduct and have two separate uses. One is as a sold product, shipped down the TAPS, mixed with produced oil. The other is as a reservoir injectant, increasing the recovery of oil from the reservoir. The exact design of the natural gas processing plant will be conducted under the scrutiny of the Alaska Oil and Gas Conservation Commission, as have the other gas handling plants. They will continue to ensure the correct disposal or re-use of impurities from the product stream or operations of the plant.

**ENVR\_03: (6 comments)**

**Statement of Concern:** Statements expressing concern that environmental regulations may not be strongly enforced because of state ownership in the gas pipeline.

**Response:** The State Pipeline Coordinator's Office (SPCO) was established through the Department of Natural Resources as the state's coordinating over-sight agency for pipelines authorized under AS 38.35, the Right-of-Way Leasing Act. In July 1990, state (SPCO) and federal agencies combined to create the Joint Pipeline Office (JPO). Currently, there are 12 state and federal agencies affiliated with the JPO. The Bureau of Land Management (BLM) and DNR are the administrative managers of the office.

The JPO will likely be responsible for regulation and oversight of the gas pipeline in Alaska, once operational. The state right-of-way lease and the federal grant of right-of-way for the gas pipeline will be developed in parallel so that both documents contain, to the extent possible, the same conditions and stipulations. The intent is to allow both state and federal regulators the ability to monitor the entire right-of-way regardless of land ownership. This model has worked well for TAPS (reference website [www.jpo.doi.gov](http://www.jpo.doi.gov)). The oversight and monitoring of the gas pipeline would be performed consistent with current state and federal oversight processes for pipelines authorized under AS 38.35.

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

**Statement of Concern:** Statements that the impacts of the TAPS on wildlife have been minimal.

**Response:** The Environmental Impact Statement prepared by the Bureau of Land Management and the State of Alaska for the renewal of the TAPS right-of-way lease and grant summarized the impacts to birds and terrestrial mammals as follows: "Action Impacts: Impacts generally are anticipated to be local, affect only individual animals, and have no adverse impacts to populations. Population level impacts are considered very unlikely. They only would be anticipated from a very large spill or a spill that contaminated a crucial habitat in which a large number of animals were concentrated."

**ENVR\_05: (9 comments)**

**Statement of Concern:** Statements that the environmental impacts of the project will be minimal.

**Response:** The environmental impacts of the gas pipeline project will be minimal when compared to TAPS. The gas pipeline will be buried and chilled to temperatures at or below ambient ground temperatures. This means that the preferred alignment will avoid river and stream floodplains, which were utilized by TAPS because of thaw stable soils. The result is significantly reduced impacts to streams and rivers on a long-term basis. A buried pipeline will not impact large mammal migration or movement behavior. The environmental risks associated with spills of gas are much less than spill of crude oil. The transportation infrastructure required to construct the pipeline is largely in place and, when compared to TAPS, the gas pipeline construction activities will have less impact than experienced for TAPS. As part of the right-of-way leasing process, DNR will encourage the lessees to utilize previously disturbed areas to reduce overall project impacts.

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

**Statement of Concern:** Statements that a pipeline would be environmentally safer than a LNG tanker.

**Response:** The gas pipeline will be buried its entire length, except at compressor stations and possibly select river crossings. Once in the pipeline, little additional handling of the product is anticipated. The LNG transportation system includes complex processing facilities at tidewater and a tanker fleet for transportation to market. The transportation system associated with LNG requires more handling which increases both safety and environmental risks.

**ENVR\_07: (7 comments)**

**Statement of Concern:** Statements indicating there is a risk that gas development will adversely affect development of renewable energy resources.

**Response:** We also look forward to a future when renewables are among our primary sources of energy. However, it is important to recognize that the U.S. will continue to rely on fossil fuels as its main source of energy for decades to come. Natural gas is the cleanest fossil fuel available. When used to create electricity, gas-fired power produces up to 55 percent less carbon dioxide than traditional coal-fired power. Currently, 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. Adding Alaska's enormous supply of natural gas to the domestic market will go a long way towards ensuring a dependable supply of natural gas for U.S. consumers.

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

**Statement of Concern:** Statements suggesting that the legislature relax environmental regulations in Alaska as a measure that could offset the sponsor group's need for lower taxes.

**Response:** The Alaska State Legislature, through a public process, develops and revises statutes, including those addressing environmental protection. The monitoring and oversight of pipeline construction and operational activities will be structured to enforce state statutes as well as provisions of the right-of-way lease.

**ENVR\_09: (7 comments)**

**Statement of Concern:** Statements indicating that oil companies are good about protecting the environment.

**Response:** The TAPS provides a model to evaluate the proposed gas pipeline project. The Joint Pipeline Office interacts with Alyeska Pipeline Service Company on most aspects of their business, including environmental protection. Alyeska has been responsive to JPO recommendations with respect to protecting and mitigating impacts to the environment. For example, JPO biologists have worked with Alyeska on several stream restoration projects that emphasize long-term stability rather than short-term solutions requiring repetitive in-stream maintenance. To accomplish this, Alyeska specifically trained biologists and engineers in progressive stream restoration methods and committed the resources necessary to implement these stream restoration techniques. Because of this type of commitment, Alyeska received the 2005 American Petroleum Institute Distinguished Environmental and Safety Award.

The state notes that on occasion, management and environmental mistakes at production facilities do occur, as in the recent oil maintenance problems on the ANS. In light of these recent problems, the state has acknowledged that there's a need to have a more comprehensive oversight program for oil and gas production and transportation infrastructure and that there have been gaps in government oversight. To address the problem, Governor Murkowski recently signed an administrative order creating a Lease Monitoring and Engineering Integrity Coordinating Office (LMEICO) within the Department of Natural Resources. The LMEICO is charged with coordinating the oil infrastructure oversight efforts

of a multitude of state, federal and local agencies stretching from the ANS fields to the Alyeska marine terminal at Valdez. Specifically, it is tasked to: 1) perform risk assessments on all petroleum infrastructure on state leases; 2) review all facility designs, operations and maintenance programs and practices for technical competence and consistency with established government and industry standards; and 3) inspect pipelines and facilities on an ongoing basis to document compliance with approved procedures and plans.

**ENVR\_10: (7 comments)**

**Statement of Concern:** Statements expressing opposition to further oil development/drilling in Alaska so that the environment can be preserved.

**Response:** The State of Alaska relies on resource development to support the services provided to the citizens of the state. The state has always recognized the importance of balancing the need to develop natural resources with the protection of fish and wildlife habitat. The gas pipeline project, through FERC, will be subject to an Environmental Impact Statement with the state as a participant. In addition, the department of natural resources commissioner will perform a parallel public process prior to making a final decision on the right-of-way lease. These processes serve to identify possible impacts of the project, including environmental impacts. Mitigation of potential impacts is accomplished through existing law or through stipulations to the lease and grant of right-of-way.

**ENVR\_11: (1 comment)**

**Statement of Concern:** Statements indicating that the contract should require the sponsor group to begin paying for baseline data collection and monitoring immediately for areas that will be impacted by gas field development over the 45-year life of the contract.

**Response:** Once the contract is finalized and the mainline LLC is formed, the project proponents will enter into an agreement to conduct a gap analysis and, based on the results of the analysis, begin the design and implementation of the studies and field surveys necessary to ensure that all required information is available for the project to move forward. The State of Alaska and the sponsor group have reached conceptual agreement on a mechanism to fund this process and are prepared to move quickly once the contract is approved. Informal discussions with FERC also indicate they are preparing to conduct a gap analysis with the same purpose in mind. Collaboration between FERC and the State of Alaska is likely as the project moves forward.

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

**Statement of Concern:** Statements indicating that the contract should ensure that solid and hazardous waste issues brought about by pipeline and gas field development are addressed early in gas pipeline planning.

**Response:** Hazardous and solid waste issues will be addressed in the right-of-way leasing process. The lessee will be required to develop a solid and hazardous waste plan prior to receiving a notice-to-proceed for construction. The plan will be available for public review as part of the commissioner of natural resources's proposed decision.

**ENVR\_13: (1 comment)**

**Statement of Concern:** Statements indicating that the contract should require that the gas pipeline corridor in the North Slope Borough be closed to off-road access for the duration of the contract for security and fish and wildlife protection reasons.

**Response:** It is the policy of the Alaska Department of Natural Resources that access roads and the right-of-way, including work pads, will be open for the use and enjoyment of the public unless the commissioner approves the regulation/restriction. Upon completion of construction of the pipeline, the public will have access along the right-of-way, except at compressor stations, other permanent facility locations, areas where the pipeline is above-ground, and locations where access must be limited for security or safety purposes. Access roads leading to the right-of-way, whether currently existing or constructed by the lessees, may, with the commissioner's approval, have limited public access during construction and termination activities. At all other times, unless the lessee receives the written permission of the commissioner to restrict access for operation and maintenance or public and wildlife safety purposes, the pipeline right-of-way access roads must remain open for public access. If public access is limited on existing highways, trails and access roads, the lessee must provide alternative routes. The lessee must also provide appropriate warnings and safety measures when using access roads or when limiting public access to the access roads.

**3.11.7 OVERRUN: Cost Overruns—SOCs and Responses**

Comments expressed concern that cost overruns posed a significant risk for both the sponsor group and state. Some comments noted that overruns would be passed along to gas consumers in the form of higher prices.

**OVERRUN\_01: (9 comments)**

**Statement of Concern:** Statements asking the implications on state participation and concerns on the state's financial liability in the event of project cost overruns.

**Response:** By taking an ownership position in the pipeline project, the state could be financially responsible for a portion of cost overruns. It is anticipated that financial institutions lending funds to the mainline entity will not accept completion risk on the project, and will require completion guarantees from the state and the sponsor group. The state and its financial advisors are considering the extent to which the state should make provision for cost overruns; it may be committed to fund its pro rata share of cost overruns pursuant to its shareholder arrangements with the sponsor group and under the financing documents entered into in connection with the project financing. While project costs may exceed the 2001 \$20 billion cost estimate, the projected economic benefits to the state outweigh the projected costs and liabilities to be incurred by the state in connection with the project. The state would need to assume risks including ownership and shipping commitments and possible construction cost overruns, in order to make the pipeline investment economically attractive for the sponsor group.

Under the contract the cost overrun risks are shared proportionately between the state and the sponsor group. Cost overrun risk may be minimized by careful and complete alignment of project resources in a disciplined approach to project planning, permitting, design and approvals.

**OVERRUN\_02: (1 comment)**

**Statement of Concern:** Statements indicating that cost overruns are indeed a risk that this project faces, but the oil industry is taking a great risk and the state should make the project more appealing to industry.

**Response:** The state shares the risks with the sponsor group by taking 20 percent ownership of the project. The state's ownership interest in the project, coupled with taking its gas in-kind and a shipping commitment, increases the sponsor group's internal rate of return. By increasing the internal rate of return the project becomes more appealing to industry.

**OVERRUN\_03: (8 comments)**

**Statement of Concern:** Statements regarding overrun risks to the project, including implication of overruns on state participation, state liability for overruns, sponsor incentives, and uncertainty of steel prices.

**Response:** Cost overruns are a risk facing all participants in a project of this nature. Equity holders in the project entities will be obligated to contribute or finance their share of the project costs even if there are cost overruns unless the project is abandoned. Large cost overruns could present challenges to all participants in finishing the project. However, the fact that the project entity agreements provide for a high voting threshold for abandonment and that each participant will likely have a large amount of equity in the project when any overruns occur reduces the risk that the participants will abandon the project due to overruns. Additionally, lenders to the various project entities and/or members are expected to require creditworthy member affiliates to provide substantial completion support guaranteeing repayment of any financing in the event the project is not completed. Thus, not only would members abandoning the project prior to completion lose equity contributed, but their affiliates would also likely be liable for significant additional amounts under any completion support provided.

The risk of significant overruns adversely affecting the state's credit rating and ability to fund or finance its equity contributions is mitigated by the state's specifically negotiated right under the project entity agreements to require the other participants to purchase all or a portion of the state's ownership interests in the project entities at the project sanction date. At that time, there will be greater certainty as to the firm transportation commitments from shippers arising from the initial open season, the state's ability to finance its share of the project's costs and the expected overall cost of the project. The state's member in each project entity will also participate in project planning decisions by the project entities, including in votes to approve budgets.

Details regarding this topic are discussed in *Section 6.1 Economic Risk* of the Preliminary FIF.

**OVERRUN\_04: (1 comment)**

**Statement of Concern:** Statements asking whether end-users will end up paying for cost overruns and mistakes.

**Response:** Sellers of ANS natural gas would not be in a position to set their own price in a competitive market such as Chicago City Gate, where natural gas from various sources compete. In such markets, the ANS natural gas price is set based on the market competition.

not on its costs, and therefore, the end-users will not pay for cost overruns and mistakes. However, in the not-so-competitive market in Alaska, the end-users might pay for cost overruns since the gas price tends to be set based on wellhead net back and tariff where there is lack of competition from other sources. Pipeline cost overruns would possibly lead to higher pipeline tariff, which result in increased costs to ship ANS natural gas. By taking 20 percent of the ownership of the project, the state will be able to influence the course of the project development and the decisions on tariff.

### 3.11.8 FRCE: *Force majeure*—SOCs and Responses

This issue category deals with concerns regarding the *force majeure* provision in the contract.

#### FRCE\_01: (4 comments)

**Statement of Concern:** Statements expressing concern about the vulnerability of the gas pipeline to terrorist actions.

**Response:** The threat of terrorist actions will exist with respect to any gas pipeline project and will need to be addressed; however it is not a problem that can be addressed with modifications to the contract.

#### FRCE\_02: (3 comments)

**Statement of Concern:** Statements concerning the scope of the *force majeure* clause.

**Response:** The state agrees that the concept of *force majeure* provides that the performance of contractual obligations are suspended to the extent that the performance is prevented by actions outside of the performing party's control. It is generally accepted practice in international project contracts of this type to specify categories of events that the parties agree will be considered "*force majeure*" as is provided in the contract, however listing specific events does not act to limit the legal principle from applying to other events that impact the parties' performance of their obligations.

The determinative factor for *force majeure* is not whether the action could have been foreseen or not, but whether the *force majeure* event was reasonably outside the control of the party claiming that it cannot perform as a result of such event. Whether a particular type of event constitutes *force majeure* may also depend on the magnitude of the event as well. Events that would reasonably be anticipated to occur in similar projects, such as typical permitting or weather-related delays, would not give rise to *force majeure* relief, but unusual delays in obtaining permits or due to extraordinary natural events could trigger a suspension of obligations for the duration of that event. The party claiming *force majeure* relief cannot have caused the *force majeure*.

Section 35.2 of the contract imposes additional requirements on a party's ability to claim *force majeure* suspension of their obligations, including 1) an obligation to provide notice to the other parties of the *force majeure* that specifies the event giving rise to the *force majeure* and the expected duration of impact of the event (Section 35.2(a)), 2) an obligation to take steps to mitigate the extent and duration of any delay attributable to a *force majeure* suspensions (Section 35.2(b)(i)), and 3) an obligation to provide notice to the other parties when the *force majeure* ends (Section 35.2(b)(ii)). Further, Section 35.2(c) limits the sponsor group's ability to claim *force majeure* to suspend obligations with respect to the initial

planning process unless they have already spent \$120,000,000 toward the planning process or fifteen months have elapsed.

The occurrence of a *force majeure* event does not forgive the performance of obligations; it only suspends them for the duration of the *force majeure*. Royalty and other payments related to the production of oil and gas would resume with a resumption of gas deliveries through the pipeline. In addition to the express limitations on the ability of any party to claim *force majeure* relief under the contract, there is a strong incentive for the sponsor group to cure any *force majeure* in order to restore their revenues from the project.

### 3.12 Canadian Issues

Issues in this general area of concern included regulation and ownership of the Canada-portion of the gas pipeline project; the Mackenzie Valley Pipeline; and gas pipeline project impacts on Canada's First Nations.

#### 3.12.1 CAN\_OWN: Ownership Rights in Canada—SOCs and Responses

This issue category covers regulation and ownership of the Canada-portion of the gas pipeline project.

##### CAN\_OWN\_01: (3 comments)

**Statement of Concern:** Statements indicating that TransCanada's expressions of dissatisfaction with the contract's provisions are likely to lead to disputes in the Canadian regulatory process—disputes that are specifically cited as an exception to "Diligence" in Article 5.

**Response:** TransCanada is a well-known and well-respected pipeline company that would bring many benefits to the Alaska gas pipeline project. However, the decision on which regulatory framework will be used to permit the Alaska gas pipeline project through Canada (Northern Pipeline Act [NPA] or traditional National Energy Board [NEB] process) is a decision the Canadian federal government must make. To the extent that we can influence the decision, Alaska will petition for the process that results in the lowest tariff and quickest construction schedule. We firmly believe that both the Canadian federal government and TransCanada will act in a way that best protects their interests. In the case of the Alaska gas pipeline project, both Canada and TransCanada will greatly benefit by having Alaska gas move into the Alberta Hub. This will lower the gas transportation costs for all Canadian producers, consumers, and participating pipeline operators (such as TransCanada and Alliance etc.). Steps taken that add cost and delay will have negative effects for all involved (Canada, Alaska, TransCanada, Canadian gas producers, and both U.S. and Canadian consumers). We are confident that both the Canadian federal government and TransCanada are aware that protracted delays and added costs could result in no pipeline at all, and in that case everybody ends up losing.

**CAN\_OWN\_02: (2 comments)**

**Statement of Concern:** Statements indicating that TransCanada has agreed to convey any assets granted pursuant to a number of initiatives (i.e., application for right of way over state lands along the route of the gas pipeline project in Alaska, and SGDA application and negotiations) to a third party (such as the ANS producers or a project jointly pursued by the sponsor group and the state), if that third party would contractually agree to connect the natural gas transmission facilities within Alaska at the Alaska/Canada border with pipeline facilities to be constructed by TransCanada along the highway route in Canada.

**Response:** While this is a constructive and potentially beneficial offer, until the Canadian federal government makes its decision on which regulatory framework will be used to permit the Alaska gas pipeline project through Canada (NPA or traditional NEB process), it remains unclear who will ultimately construct the Canadian portion of the pipeline. While Alaska remains hopeful that TransCanada will play a significant role on the Canadian side of the project, our ultimate support must always be given to the project entity which can construct the pipeline with the lowest tariff in the shortest possible time.

**CAN\_OWN\_03: (2 comments)**

**Statement of Concern:** Statements indicating that the contract's ownership provisions are inconsistent with the rights conveyed by Canadian law to Foothills Pipe Lines, Ltd. (the wholly-owned subsidiary of the TransCanada Corporation that is entitled to own and construct the Canadian portion of the project).

**Response:** This statement presupposes the outcome of the Canadian federal government's decision on the regulatory framework under which they propose to permit the Canadian portion of the Alaska gas pipeline project. Until that decision is made it would be extremely difficult to determine with any degree of accuracy what course of action is the best to insure the pipeline is constructed at the lowest possible cost and in the shortest period of time. When all is said and done, we feel certain that the Canadian government will base their course of action on what is best for the project and their constituents.

**CAN\_OWN\_04: (2 comments)**

**Statement of Concern:** Statements indicating that Foothills Pipe Lines, Ltd. has already constructed what has now become known as the pre-build of the Alaska gas pipeline project, under its NPA certificates, and it has constructed five expansions to these facilities pursuant to the Northern Pipeline Act. These investments were made in reliance on the rights awarded to Foothills pursuant to the relevant NEB decision, the NPA and the Canada/US Agreement.

**Response:** While this statement clearly articulates TransCanada's views on the history of the pre-built portion of the line constructed under the NPA, the significance of those historical actions will ultimately be determined by the decisions made by the Canadian federal government as it chooses the regulatory framework under which they propose to permit the Canadian portion of the Alaska gas pipeline project and the subsequent actions taken by TransCanada.

**CAN\_OWN\_05: (2 comments)**

**Statement of Concern:** Statements indicating that the contract should not be ratified unless and until ownership of the Canadian portion of the gas pipeline project is resolved to the satisfaction of Foothills Pipe Lines, Ltd. as the holder of the existing certificates in Canada.

**Response:** The value of those certificates and the influence they will have on the Canadian federal government's decision on the regulatory framework under which they choose to permit the gas pipeline project through Canada is a matter for them to decide. They will make the decision in a timeframe of their choosing. It would be inappropriate for Alaska to wait until that decision is made before taking action. The contract is basically an upstream fiscal document designed to fix financial terms in such a way as to allow the sponsor group and the state to determine their individual risk/reward profile for the project so that they could decide if they wish to participate in the effort or not. All Canadian issues will ultimately manifest themselves in the pipeline tariff rate and as such join a long list of things yet to be determined. Tariffs that are too high and delays that are too long could very well cause the project to become uneconomic. This being the case, there is no reason to wait on final resolution of Canadian issues before contract ratification.

**3.12.2 CANREG: Canadian Regulatory Issues—SOCs and Responses**

This issue category covers regulatory issues concerning the Canada-portion of the gas pipeline project.

**CANREG\_01: (2 comments)**

**Statement of Concern:** Statements concerned about the interaction between FERC and the Canadian regulators (NEB); specifically, questions about which organization would have precedence.

**Response:** Lines of responsibility are very clear and well defined. In the United States it will be the FERC and in Canada it will be the NEB. Both of these organizations recognize the importance of coordinating their responsibilities and Memorandums of Understanding have already been signed to ensure such coordination will happen.

**CANREG\_02: (1 comment)**

**Statement of Concern:** Statements indicating that the state has no business in demanding that Canada regulate this project in a particular manner, much less agreeing to a specific regulatory body when alternatives exist under Canadian law. As such, Articles 8.1, 8.2, and 8.3 should be deleted entirely.

**Response:** Neither the United States nor Alaska can (or should) dictate to Canada how to regulate the pipeline in that jurisdiction. The contract does not have nor imply authority over the Canadian government.

**CANREG\_03: (2 comments)**

**Statement of Concern:** Statements expressing concern that Article 8.2 of the contract requires the state and sponsor group to 'seek and support the exclusivity of ... NEB's jurisdiction as described in Article 8.1 in any agency or court proceeding' relating to the Canadian portion of the project, but no mention is made anywhere in the contract of the

existing regulatory regime in Canada or of the Northern Pipeline Agency, which was created specifically and solely for this project pursuant to the Northern Pipeline Act.

**Response:** The contract has no binding effect on the Canadian government, and the state of Alaska believes that they will make their decision based on what they believe is in the best interest of all Canadian citizens. When that decision is made all contract participants will abide by the decision and act accordingly. One thing is very clear, protracted litigation is in nobody's interest, could kill the gas pipeline project, and deny both Canadian and American citizens of the massive benefits associated with the project. Whatever decision is made in Canada will take all of these possibilities into consideration.

**CANREG\_04: (2 comments)**

**Statement of Concern:** Statements noting that the two processes of the NEB and the Northern Pipeline Agency are integrally related for the gas pipeline project. Separate jurisdiction of the two regulatory regimes over different aspects of the project is recognized in the NPA framework.

**Response:** This is one point of view, but the Canadian federal government has yet to make a determination as to which regulatory regime it will use to permit the Alaska gas pipeline project through its jurisdiction. We are certain that when it does make its decision all of the information provided above will be given proper consideration.

**3.12.3 ALB: Issues Regarding the Alberta Hub—SOCs and Responses**

This issue category covers concerns regarding integrating the proposed pipeline project with the existing Canadian gas pipeline infrastructure (or the Alberta Hub).

**ALB\_01: (1 comment)**

**Statement of Concern:** Statement indicating that the contract project will integrate with existing gas infrastructure in Canada and the U.S.

**Response:** As currently proposed, the Alaskan Highway Pipeline will connect with the existing infrastructure in Canada. This Canadian gas pipeline infrastructure is often referred to as the Alberta Hub. The Alberta Hub is currently running under capacity and this under capacity situation is expected to grow over the coming years. The benefit to Alaska in this is that use of existing capacity on any pipeline is far less expensive than building new capacity. This means that the tariff will be lower on existing capacity and lower tariffs means higher wellhead values and higher wellhead values means more economic benefit to Alaskans.

**ALB\_02: (1 comment)**

**Statement of Concern:** Statements requesting for clarification on AK take/revenue (since Alaska is a participant in the mainline) in the event that gas flows from Canada to the lower 48.

**Response:** Alaska's financial take equals the market price at which the gas is sold minus the cost of transportation from the wellhead to the market (tariff costs). The tariff is controlled in the United States by FERC and in Canada by the NEB. Approved tariffs in both the U.S. and

Canada are restricted to contain only the cost to build and operate the pipeline along with an approved profit rate.

### 3.12.4 MCKZ: Mackenzie Valley Pipeline—SOCs and Responses

This issue category covers the Mackenzie Valley Pipeline (MVP) issues.

#### **MCKZ\_01: (1 comment)**

**Statement of Concern:** Statements advocating use of the project to transport gas from the Mackenzie Delta.

**Response:** In order to have a direct impact on the Mackenzie Delta gas, Alaska's pipeline would have to go "Over the Top" into Canada. Currently this route is barred in both State of Alaska and federal legislation. The long-term benefit to Alaska from its gas is to bring it south along the highway so that current and future generations of Alaskans have access to the resource.

#### **MCKZ\_02 (2 comments)**

**Statement of Concern:** Statements concerned (or advocating) that if the MVP is built first it may be more feasible to simply build a shorter line from Alaska to connect into the MVP.

**Response:** In order for that to happen Alaska's pipeline would have to go "Over the Top" into Canada. Currently this route is barred in both State of Alaska and federal legislation. The long-term benefit to Alaska from its gas is to bring it south along the highway so that current and future generations of Alaskans have access to the resource.

#### **MCKZ\_03: (1 comment)**

**Statement of Concern:** Statements expressing concern that the MVP will be completed before the Alaska gas pipeline.

**Response:** Most if not all of the Mackenzie gas is destined for the tar sands project in Alberta. Gas not used there will be available for distribution through the Alberta hub. The reserves in the Mackenzie Delta are significantly less than the ANS and will not pose a threat to the marketing of Alaska's gas.

#### **MCKZ\_04: (1 comment)**

**Statement of Concern:** Statements expressing concern that the state and oil companies are intentionally delaying the project until after the MVP is completed.

**Response:** The MVP is well along in the permitting and design process. It is reasonable to assume that this project will be built before the Alaska project. However, most if not all of the Mackenzie gas is destined for the tar sands project in Alberta. Gas not used there will be available for distribution through the Alberta Hub. The reserves in the Mackenzie Delta are significantly less than the ANS and will not pose a threat to the marketing of Alaska's gas.

### 3.12.5 INDG: Indigenous Peoples in Canada—SOCs and Responses

This issue category addresses the impacts on Canada's First Nations from the gas pipeline project.

#### INDG\_01: (3 comments)

**Statement of Concern:** Statements expressing concern about the lack of dialog between the state and the First Nations of Canada and suggesting that governments and sponsors of the project work with First Nations so they can realize economic benefits of the project.

**Response:** Once the contract has been signed, the builders of the pipeline will work extensively with the Canadian government and affected First Nations to arrange a mutually beneficial relationship. In the end, all parties will have to agree on the terms and conditions associated with the construction and operation of the pipeline as it passes over each landowners jurisdiction.

The State of Alaska has a government to government relationship with Canada's federal and provincial governments as well as with the First Nations. We have ongoing regular communications with the federal and provincial governments, and once we have a project that is moving forward through Canada it will be appropriate to have more direct and detailed communications with these groups.

#### INDG\_02: (2 comments)

**Statement of Concern:** Statements concerned that the contract does not deal with the issue of the sovereignty of First Nations in Canada.

**Response:** It is not within the scope of the contract to deal with Canadian sovereignty issues. This is an issue to be settled between Canada's First Nations and their federal government.

## 3.13 Other Transportation Alternatives

Issues in this general area of concern included evaluation of alternative gas pipeline projects, such as the Alaska Gasline Port Authority (AGPA) proposal and the Y-line gas pipeline option.

### 3.13.1 OTA: Other Transportation Alternatives—and Responses

This issue category covers the evaluation of alternative gas pipeline projects and other transportation alternatives.

#### OTA\_01: (18 comments)

**Statement of Concern:** Statements supporting various gas pipeline project alternatives, including an over-the-top route to the Mackenzie Delta, a line to Anchorage or southeast Alaska, and a railroad through Canada.

**Response:** The over-the-top route from the ANS to Mackenzie gas fields is not in the best interest of the State of Alaska and is not an alternative that this administration will consider or permit. Currently, the route is barred in both state and federal legislation. Any such route would provide the fewest overall benefits to Alaska. An over-the-top route would result in

relatively few construction jobs for Alaskans, provide no access to ANS gas for Alaskans, provide virtually no ongoing operations jobs in Alaska, and generate far less property tax for local municipalities.

A preliminary analysis by the state considers a modified AGPA route with a terminus in Anchorage or Kenai rather than Valdez. The initial analysis suggests that such a route may be less expensive overall than a route to Valdez when location, construction, and operation of LNG compression plants are considered. However, such a route has not been formally proposed to the state and therefore is not under full consideration at this time. Further, specific details regarding the size and the scope of a project along a modified AGPA route that would be necessary to conduct a full analysis of the total economic benefits to the state from such a project have yet to be developed.

The construction of a pipeline link to Southcentral is not a part of this project. The cost of such a link is used in the analysis to provide direct comparison with the AGPA project. While a link to Southcentral is anticipated, the particulars including routing and size will be decided in the future by Southcentral businesses and municipal leaders.

Alternative suggestions included routing a pipeline through southeast Alaska or construction of a railway through Canada. The southeast route has not been analyzed although a cursory examination of the construction challenges presented by local topography suggests that such a route would be impractical. Rail transport of natural gas is a more expensive method of transportation than pipelines. Therefore it would result in lower wellhead prices and lower state revenues.

See the Preliminary FIF, *Section 5.2 Other Options and Appendix G & H*.

**OTA\_02: (73 comments)**

**Statement of Concern:** Statements indicating that all gas pipeline project proposals should be considered, not just that of the sponsor group.

**Response:** All proposals have been considered and the most beneficial to the state is the one proposed by contract for Legislative approval. The review process for proposals has lasted years. In 2004, the administration called for applications under the Stranded Gas Development Act for the development of a fiscal contract for a natural gas pipeline from the ANS. Five applications were received and reviewed. In-depth discussions were begun with the applicants and ultimately three proposals were selected for further consideration. These three are the joint state and sponsor group ownership, the AGPA proposal, and one by TransCanada. The AGPA proposed an LNG related route and the other two were essentially the same route with a different ownership structure of the pipeline. Based on more focused discussion during 2005, the administration determined that a pipeline through Alaska and Canada would be of more benefit to Alaska if it was undertaken in joint ownership by the state and the sponsor group rather than by a third party. The comparative analysis of the sponsor group's project route and the AGPA route conducted by Information Insights demonstrates that the sponsor group's project route provides more benefit to the state. As is appropriate, it is this single proposal and contract that is being brought forth for Legislative approval.

For more information see the response to OTA\_03 below. Additional information can also be found in *Section 5.2 Other Options and Appendix G & H* in the Preliminary FIF.

**OTA\_03: (1 comment)**

**Statement of Concern:** Statements indicating that the administration considered other proposals but chose to negotiate with the sponsor group. Whether additional negotiations could have been pursued does not address the merits of the proposed contract.

**Response:** The state agrees with the statement. The state chose to negotiate with the sponsor group because they hold the leases for approximately 98 percent of the proven ANS gas reserves, they have the financial capability to pursue a project of this magnitude, and they have the technical expertise necessary for the project. The state therefore believes that a project with the sponsor group is in the interest of the state because it is the most cost-effective and the best arrangement to make the pipeline happen in the timeliest manner.

**3.13.2 AGPA: The AGPA Alternative—SOCs and Responses**

This issue category covers an alternative gas pipeline project based on the Alaska Gasline Port Authority proposal as well as the impacts on the Permanent Fund from the gas pipeline project.

**AGPA\_01: (120 comments)**

**Statement of Concern:** Statements supporting the AGPA proposal rather than a pipeline through Canada. This support covered a wide range of points including permitting, dual operation with TAPS, greater development within Alaska, greater benefit to Alaskans, less damage to the environment, and reduced resource risk of lower gas reserves.

**Response:** The proposed AGPA line and the TAPS follow the same general route from the ANS to Delta Junction [approximately two-thirds of the Alaska segment]. Permits for pipeline right-of-way exist for both proposed routes (except for the spur lines). Routing through Canada will be more complicated than just through Alaska due to the longer pipeline distance and more land owners and oversight agencies. However, given the time required before construction can begin, it is our opinion that either route can be fully permitted without construction delay. While the AGPA pipeline could be completed before the sponsor group's pipeline route, the LNG compression plants can not. Without operational compression plants, the gas can not be tankered from Valdez. Therefore, product flow along the sponsor group's pipeline route can occur at full capacity prior to the AGPA route, presuming construction begins at the same time.

Another commenter suggested that the AGPA proposal would allow joint security oversight with TAPS. As noted, the sponsor group's proposed route follows the TAPS route for two-thirds of its length in Alaska so joint security is possible for either alternative. Security costs are but one component of pipeline operation costs and have been factored into the analysis.

Alaskan employment over the life of the project is greater with the sponsor group's route than with the AGPA project. Employment must be considered not only during construction but also during operation and, more importantly, associated with state spending over the life of the project. The length of the pipeline to be constructed in Alaska under the sponsor group's proposal is longer than in the AGPA proposal. This is due to the combination of main line (about fifty miles shorter in the sponsor group's proposal) and the spur line to Southcentral (about twice as long in the sponsor group's proposal). In either case the trained labor pool in Alaska will not be sufficient and non-Alaskans will be required. This is

certainly the case for construction of the LNG plant which will require many specialists that do not reside in Alaska. The construction of pipelines combined with three LNG trains would employ more people in Alaska and for a longer period of time than the sponsor group's line. This was examined in greater detail by the Information Insights study. Also, the LNG project would require more long-term Alaskan employment than the sponsor group's line.

State revenues from royalty and severance tax are related to the value of gas at the wellhead. The wellhead value will be lower with an LNG project than with a pipeline through Canada because of markets, transportation costs, and fuel losses. This means that state revenues from an LNG project will be lower over the entire life of the project. Lower state revenues will lead to less state spending on roads, transportation, goods, services, employment, and welfare transfer payments (including PFD dividends, and fewer jobs. Overall, the Sponsor group's proposal will lead to greater benefits to the state, municipalities, and residents than the APGA proposal.

Several commenters suggested that the AGPA proposal would allow the TAPS line to be decommissioned or made redundant. Oil and natural gas cannot be moved down the same pipeline. Oil is a liquid moved through TAPS in a heated state and under low pressure. Natural gas will be moved chilled and under great pressure. These two manners of transport are not compatible.

Both of the proposed projects allow for take-off points within Alaska and both provide for spur lines to Southcentral. Therefore, neither project has advantage or disadvantage when it comes to related in-state use of gas for Kenai exports, new businesses, or in-state consumption. The spur-line required by the sponsor group's route would be longer and more expensive to Southcentral but no less feasible. Any additional costs would be passed on to Southcentral consumers through pipeline tariffs on the spur line. However, in either case the price of gas at the takeoff point will be significantly lower than mid-continent market prices since the transportation costs from Alaska to that market will not be included in Alaskan intra-state prices. Both projects will provide most Alaskans access to natural gas.

Some comments suggest that Alaska's gas should be for the benefit of Alaskans or, alternately, that the political risk associated with a route through Canada is significant. Both projects will carry volumes far in excess of possible Alaskan markets. In both cases royalties and severance taxes will be retained by Alaska and Alaskans will reap benefits as the employment multiplier stimulates the economy. Both projects allow for in-state takeoff and use in the interior and Southcentral parts of the state. While Canada is a foreign country, it is one of the most politically stable in the world and is expect to continue to enjoy peaceful, cooperative relationships with the U.S. Canada has national laws related to pipeline oversight so excessive tariffs or off-takes are not an issue or concern. Transit through Canada does not entail significant political risks.

One commenter pointed out that costs of LNG compression and transmission will probably decrease in the future so the economics of the alternative will improve. This is possible but we have no way to reliably predict the likelihood or magnitude of these changes. Technological change is an important consideration in investment but difficult to quantify. Often technological change makes existing facilities obsolete because they can not take advantage of the change. Costs per unit for both projects will change over time as facilities are depreciated, upgraded, and throughput varie

We do know that the costs of construction for pipelines and LNG compression plants have increased dramatically in recent years due to escalating costs for material and labor. It is probable that this level of price inflation will decrease in the future. It is also likely that the costs of operation for both pipelines and LNG will change, and perhaps both decrease, in the future. In comparing the two projects, the important aspect is whether such changes will be disproportionate or occur after construction (capital) costs are incurred. The analysis we conducted makes use of the best available information and we believe it accurately reflects conditions and costs as best they can be estimated.

Both routes will have environmental impacts. The route follows a corridor already occupied by TAPS, the Alcan Highway, and existing pipelines. It is not planned to go through pristine environments. The AGPA proposal involves a shorter pipeline along the TAPS corridor but it also entails a very large facility in Valdez, tanker traffic through Prince William Sound and along the west coast, new receiving terminals, and additional connecting pipelines. It is questionable if the infrastructure and transportation logistics network required by the AGPA route would be of less impact than the Sponsor group's route. While LNG leaks are not as environmentally polluting as oil spills, they are life threatening. LNG tankers and terminals are potentially explosive and any such explosion, while of short duration, would likely be of catastrophic proportion.

The natural gas reserves in Alaska are sufficient to supply either project with supplies to last well beyond modeled project life. One commenter suggested that the AGPA proposal was preferred because it reduces the risk of increased transportation costs if insufficient natural gas reserves are discovered. There are sufficient reserves already discovered, over 35 trillion cubic feet (tcf), to supply either pipeline for at least a couple of decades. The natural gas potential of the ANS, and of other areas of Alaska that would have access to the pipeline via supply spurs, far exceeds the resource necessary to supply the line for thirty-five years, the period considered in this analysis. The USGS estimates undiscovered ANS reserves at an additional 155 tcf.

See the Preliminary FIF, *Section 5.2 Other Options and Appendix G & H*.

**AGPA\_02: (32 comments)**

**Statement of Concern:** Statements in opposition to the AGPA proposal, including statements that (1) the AGPA proposal contains too much risk for the state, (2) the AGPA route is more expensive than the sponsor group's route, (3) the producers may not sell their gas for conversion to LNG, (4) gas transmission losses are higher with LNG, and (5) increased vessel traffic in Prince William Sound would present unacceptable risks.

**Response:** The analysis conducted for the state shows that the benefits to the state and its entities are highest with the sponsor group's proposal. It is less expensive to construct overall, less expensive to operate, and results in higher wellhead value and therefore larger royalties and severance taxes.

An important comparative factor between the sponsor group's project and the LNG proposals is the comparison of delivered gas provided under each proposal. Even if each proposal shipped the same amount of gas from the ANS, conversion to LNG results in less delivered gas. This is due to routine gas losses along transmission routes plus gas used for LNG compression and re-gasification. The LNG process results in the largest losses including the

use of gas as a fuel stock for the process. Therefore the LNG route will have significantly more gas lost in the process and less gas delivered to market than the sponsor group's project route. This means that all market revenues and all transportation costs will ultimately be accrued against a lesser market volume. This will logically result in a lower wellhead volume and lower state royalty and severance tax revenues.

One commenter stated that LNG would be in direct competition with foreign imports and therefore at a market disadvantage. Another stated that LNG was better suited for international gas markets and therefore would bring greater revenues. The analyses conducted for this determination accounted for other supplies and their expected import price to the U.S. as well as forecasted west coast market size. The Pacific Rim market overall is about one-fifth the size of the Atlantic/east coast market accessed by a mid-continent pipeline terminus. Due to market size, available supplies, and future projections of both, deliveries to the west coast are expected to bring a lower market price than deliveries to mid-continent.

One last comment stated that the APGA route should not be considered "All Alaskan" since it includes a Canadian tanker terminal and pipeline through Canada starting at Kitimat and running through British Columbia into Alberta. The state agrees with this comment.

See the Preliminary FIF, *Section 5.2 Other Options* and *Appendix G & H*.

**AGPA\_03: (3 comments)**

**Statement of Concern:** Statements indicating that the various names used to describe the proposed sponsor group's project confuse it with the AGPA proposal.

**Response:** Consistency of nomenclature has been attempted throughout the Preliminary FIF, but it contains many documents by many authors. We agree that the terms "The Alaska Line" or "The Alaska Gas Pipeline" for the proposed project may lead to confusion with the "All Alaska Project" sponsored by the Alaska Gas Pipeline Authority.

**AGPA\_04: (2 comments)**

**Statement of Concern:** Statements indicating that the Permanent Fund should be used to fund the AGPA project.

**Response:** The Permanent Fund Board has retained consultants to help them investigate the option of investing in a gas pipeline. These investigations are ongoing and can be reviewed on the Board's website. The Permanent Fund is managed by an independent body and it benefits all Alaskans to allow them to make independent investment decisions rather than encumber them with decisions by the administration or legislature.

**AGPA\_05: (11 comments)**

**Statement of Concern:** Statements advocating the LNG project because a ballot measure was approved at the 2002 General Election to establish the Alaska Natural Gas Development Authority in order to maximize revenues for Alaska and jobs and gas for Alaskans.

**Response:** The 2002 ballot measure and accompanying legislation created the Alaska Natural Gas Development Authority. When ANGDA was established it was focusing on an LNG project. Since that time, ANGDA has decided to focus its efforts on the development of a spur-line to South-central, Alaska as a complement to any mainline gasline to be built.

whether an LNG line to Valdez or a pipeline that follows the Alaska highway through Canada. The SGDA is a statutory authority that is separate from the 2002 initiative. The initiative does not supersede the authority provided by the SGDA to pursue a pipeline project to the lower 48. The spur line project and the mainline project complement each other. The administration fully supports ANGDA in their efforts to develop the spur line project.

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

**Statement of Concern:** Statements indicating AGPA's project is preferred because it does not require state concessions or incentives.

**Response:** The analysis conducted for the Preliminary FIF shows that the project proposed by the sponsor group has greater returns to the state including all incentives. The overall project economics and total life returns of the project are what need to be compared when evaluating alternatives. Comparing incentives alone gives a distorted view of long-run project worth.

**3.13.3 YLINE: The Y-Line Alternative—SOCs and Responses**

This issue category covers statements supporting a Y-line gas pipeline project alternative.

**YLINE\_01: (10 comments)**

**Statement of Concern:** Statements supporting a Y-line gas pipeline project alternative.

**Response:** A Y-line presents some advantages but is of less benefit to Alaska than the sponsor group project alone. A combination project contains many of the advantages of each project but also the costs of each. Several studies conducted for the state show that the costs of transporting gas along a Y-line system would be higher than the under the sponsor group project. This will result in a lower wellhead price and therefore lower revenues to the state with the associated government spending impacts.

Competing suggestions included building the Valdez portion of the line first to train Alaskan workers and building the Canadian portion first until LNG markets develop. Given the length of any alternative, a gas pipeline will be constructed in the same spatial manner as was TAPS—that is simultaneously with multiple construction camps and construction nodes. Any Y-line proposal that does not fully utilize the pipeline from the ANS to Delta Junction will result in higher pipeline tariffs and therefore lower wellhead prices. A Y-line would result in more pipeline in Alaska than the sponsor group project, but only one LNG compression plant so less construction employment than the AGPA proposal.

If the purpose of a Y-line is to be able to export LNG from Alaska (either to domestic or foreign markets) then the spur line to Southcentral may provide that opportunity. There is an LNG facility in Kenai that is supplied by Cook Inlet gas. ANS gas supplies arriving in Southcentral from a spur line, combined with Cook Inlet gas, will be more than enough to supply local markets. Therefore, the spur line will result in excess supply, some of which could be exported as LNG.

See the Preliminary FIF, *Section 5.2 Other Options* and *Appendix G & H*.

## 4 Analysis of Comments

In examining the comments submitted during the public process, it was clear that there were varying degrees of depth and supporting analysis in the comments. For the most part, comments from the general public were relatively short statements expressing a view on whether or not the contract should be approved, or whether they had concerns with a particular part of the contract. Other comments were much more in-depth and included detailed arguments on the pros and cons of particular issues and articles within the contract and FIF. To facilitate examination of these more in-depth comments, each submission was grouped into one of following groups.

- 1) General Public
- 2) In-depth Comments from the General Public
- 3) Communities
- 4) Entities with Direct Commercial Interests
- 5) Entities with Indirect Commercial Interests
- 6) Interest Groups
- 7) Legislators and their Consultants

It was also very clear that there were particular issues that were generating more comments than others, and that many of the comments on these "hot button" issues included recommendations for changes to the contract and FIF. These issues listed below were classified as Category 1 issues, while all other issues classified as Category 2. The following list shows the Category 1 issues.

**Table 14. Count of Submissions Discussing Category 1 Issues**

<b>Category 1 Issues</b>	<b>Number of Submissions</b>	<b>Percent of Submissions</b>
Fiscal Certainty	221	10
Alaska Hire	175	8
Work Commitments	155	7
In-State Use	100	5
Gas In-Kind	54	3
Dispute Resolution	36	2
<b>All Coded Submissions</b>	<b>2120</b>	<b>100</b>

The analysts then went through the detailed submissions from the various groups and linked the discussions to particular articles in the contract. The results were tabulated into the following matrix (Table 15) which was then used to formulate conclusions and recommendations for future negotiations.

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

**Table 15. Matrix of Comments by Group and Contract Article**

	Contract Provision	Public Comments		Count of ✓'s	Legislators					Legislative Consultants					Communities		Entities with Direct Commercial Interests						Entities with Indirect Commercial Interests			Interest Groups									
		General (n=2,020)	In-Depth (n=79)		Thermault	Wagoner	Guttenberg	Rainnie	Minority	Econ1	GT	B&C	Harper	Johnston	Eason	MAG	NSB	Shell	Chevron	Anadarko	Pioneer	Doyon	Tesoro	BG	Alaska	AGPA	ANGDA	Trans Canada	AFL-CIO	RDC	CWN	BB II	AOGA	Haines Chamber	Anchorage Chamber
<b>Category I Issues</b> (Issues most often raised)																																			
Fiscal Certainty	Article 11	9%	37%	9	✓	✓	✓	✓	✓			✓	✓	✓										✓						✓	✓				
Work Commitments	Article 5	6%	33%	10	✓			✓	✓	✓		✓											✓						✓	✓					
In-State Use	Article 9	4%	15%	7	✓				✓				✓										✓	✓											
AK Hire	Article 6	7%	19%	10		✓		✓					✓										✓			✓			✓						
only if "equal to or less than costs of non-AK"				1																									✓						
Project labor agreement				1																						✓									
strong wage protection provisions				1										✓																					
AK business preference during procurement				1																						✓									
Gas In Kind Issues	Articles 12, 13	2%	14%	8	✓			✓	✓			✓	✓										✓						✓	✓					
Dispute Resolution/ Arbitration	Part E, Article 26	1%	18%	14	✓				✓		✓												✓							✓					
Amendment for Conformance (eliminate or include prudent operator standards)	Article 41.2			2	✓						✓																								
Overlapping dispute resolution procedures between the Contract and LLC				1										✓																					

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

	Contract Provision	Public Comments		Count of ✓'s	Legislators					Legis' tive Consultants					Com- munities		Entities with Direct Commercial Interests					Entities with Indirect Commercial Interests			Interest Groups												
		General (n=2,020)	In-depth (n=79)		Theriault	Wagoner	Guttenberg	Ramras	Minority	Econ1	GT	B&C	Harper	Johnson	Eason	MAG	NSB	Shell	Chevron	Anadarko	Pioneer	Doyon	Tesoro	BG	Alaska	AGPA	ANGDA	Trans Canada	AFL-CIO	RDC	CWN	BB II	AOGA	Haines Chamber	Anchorage Chamber		
relinquishing Presumption of correctness				2						✓		✓																									
Concerns on Baseball Arbitration	Part E			1							✓																										
Need municipal rights for dispute resolution				2											✓																				✓		
<b>Category II Issues</b> (Other Issues raised by stakeholders)																																					
Expansion	Article 8			16						✓																											
Rolled-in Tariffs	Article 8.7			2												✓						✓															
Inadequate provisions (include binding commitments wrt terms and conditions)				7	✓	✓		✓								✓		✓					✓												✓		
State-initiated expansion (barriers to expansion)	Article 8.7			5	✓															✓	✓	✓						✓									
Sole risk expansions (capacity and pricing)				1	✓																																
Access	Article 8			6																																	
3rd party access (mainline)				5		✓										✓			✓																	✓	
Upstream facilities				1												✓																					
Capacity Management	Article 10			8							✓							✓				✓															
State's right to terminate capacity management if FERC, NEB, or DOJ do not approve certain provisions				1	✓																																

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

	Contract Provision	Public Comments		Count of ✓'s	Legislators					Legislative Consultants					Communitarian		Entities with Direct Commercial Interests						Entities with Indirect Commercial Interests				Interest Groups								
		General (n=2,020)	In-Depth (n=78)		Theriot	Wagner	Guttenberg	Ramras	Minority	Econ1	GT	B&C	Harper	Johnston	Eason	MAG	NSB	Shell	Chevron	Anadarko	Pioneer	Doyon	Tesoro	BG	Alaska	AGPA	ANGDA	Trans Canada	AFL-CIO	RDC	CWN	BB II	AOGA	Haines Chamber	Anchorage Chamber
	Provisions for state to release capacity below in-state off-take point after each open season			1	✓																														
	Indemnifies the sponsor group from failure to perform under capacity provisions			1																															✓
	Modify the take point to as far downstream (AECO)			2	✓								✓																						
<b>Qualified Project</b>	Article 4			12			✓				✓																								
	Specify design			1														✓																	
	Contract should not allow QPP amendments every year			2																															✓
	Changes should be approved by Commissioners of Revenue and Natural Resources (State consent)			3	✓					✓			✓																						
	No limitation on project amendment			1																															
	Over-the top should be ruled out			3				✓					✓																						✓







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

	Contract Provision	Public Comments		Count of ✓'s	Legislators					Legislative Consultants					Communities		Entities with Direct Commercial Interests						Entities with Indirect Commercial Interests			Interest Groups								
		General (n=2,020)	In-depth (n=79)		Theriault	Wagoner	Guttenberg	Ramras	Minority	Econ1	GT	B&C	Harper	Johnston	Eason	MAG	NSB	Shell	Chevron	Anadarko	Pioneer	Doyon	Tesoro	BG	Alaska	AGPA	ANGDA	Trans Canada	AFL-CIO	RDC	CWN	BB II	AOGA	Haines Chamber
Oil properties provisions undervalue TAPS (\$3.5 B vs \$4.3 B)				2										✓	✓																			
Oil unit production method—protection from large revenue fluctuations				1											✓																			
Gas unit similar to oil				1											✓																			
PILT provisions to take effect during project sanction	Article 3.1			1											✓																			
Personal property tax on vessels over 95 ft	Article 11.4			1										✓																				
Accommodate new local government formation in unorganized borough	Article 21			1											✓																			
[combine 81 & 82] oil and gas unit of production methods should address municipality concerns				1											✓																			
Effect of re-opener on local fiscal resources (fiscal certainty)				1											✓																			
Eliminate provisions that restrict/reduce municipal taxation of gas and collection of AS 43.56 prior to sanction	Article 3.1			1										✓																				

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

	Contract Provision	Public Comments		Count of ✓'s	Legislators					Legislative Consultants					Communities		Entities with Direct Commercial Interests						Entities with Indirect Commercial Interests						Interest Groups							
		General (n=2020)	In-depth (n=79)		Thermaul	Wagner	Guthrie	Ramirez	Minority	Econ1	GT	B&C	Harper	Johnson	Eason	MAG	NSB	Shell	Chvron	Anadarko	Pioneer	Doyon	Tesoro	BG	Alaska	AGPA	ANGDA	Trans Canada	AFL-CIO	RDC	CWN	BB II	AOGA	Haines Chamber	Anchorage Chamber	
Progressivity provision on price differential payment				2	✓							✓																								
Terms of Current Leases				2		✓							✓																							
List of Properties	Exhibit D			3																																
limit to properties for pipeline's initial capacity				2	✓								✓																							
address new properties through Article 10.7				1	✓								✓																							
PTU	Article 23			6	✓								✓											✓										✓	✓	
Ownership/capital structure				6		✓																													✓	
Impact on state credit rating				1																																
Equity <=20%				1										✓																						
Maximize Federal Loan Guarantees				1										✓																						
Liability	Article 37			1																																
Participation in the Project/Contract Signatory				1																																
Open Season				1																																
Definition of State (remove ANGDA)	Article 1			1																																
Tax Breaks/Concessions				9																																
Tax breaks apply to affiliates and subcontractors	Article 11.10			1																																✓



## 5 Summary and Conclusions

Section 43.82.430 of the SGDA requires the State to follow a three step process with respect to the public comments. First a summary of the public comments must be prepared. Second, after consulting with the Commissioner of Natural Resources, as appropriate, and with the pertinent municipal advisory group, the State must prepare a list of proposed amendments, if any, to the draft fiscal contract. Third, the State must make final findings as to whether the contract and any proposed amendments to it meet the "requirements and purposes" of the SGDA.

The Administration is committed to following this process. This report is a comprehensive summary of the public comments that were received. The report summarizes not only comments from the public at large but comments from legislators, civic organizations, legislative consultants, and other private interests. The comments have been carefully reviewed, tabulated, organized and responded to. This report completes the first step of the requisite public comment process.

The Administration is engaged in finishing the second and third steps.

It is in the final stages of developing a list of proposed amendments to the draft fiscal contracts. These amendments address major concerns expressed in the public comments where appropriate. The substance of many of the changes that the Administration is contemplating is described in the answers to the Statements of Concern. The Administration will release in the near future the text of the proposed amendments and an explanation of their relationship to the major issues raised in the public comment process.

To satisfy the third requirement of the SGDA for the public process, the Administration will release a revised Interim Fiscal Interest Finding. That document is being prepared and it will be released once it is completed. The public comment process has contributed to the revisions that are being drafted.



# **Attachment 1:**

## **Indices of Submissions**

**Part 1: Index of All Submissions**

**Part 2: Index of Submissions Associated with  
Organizations**

**Part 3: Index of Submissions from Legislators or  
their Consultants**

# Part 1

## Index of All Submissions

This index lists all of the submissions received during the public process. The index is sorted alphabetically, and shows the submitter's name, the submission number and the SOCs to which the submission was coded. To find the state's responses to the concerns in a particular submission, look up the submission by the submitter's name in the appropriate index, note the SOCs to which the submission was coded, then look up the state's response to the SOCs in Chapter 3 of the Summary of Public Comments.

## Submissions - Individuals and Organizations

To see the response to a comment, find the name of the commenter and note the Statement of Concern (SOC) codes assigned to it. Next, turn to the Response to Comments section to read the definition of the SOC and the response to the concern.

Response to Comments on the Alaska Natural Gas Pipeline Fiscal Contract

Submissions - Individuals and Organizations

<u>Commenter</u>	<u>Submission #</u>	<u>Codes</u>	<u>Commenter</u>	<u>Submission #</u>	<u>Codes</u>
Aberle, Bill	1974	PPT_03	Alaska Department of Revenue	1662	ACC_01
Absher, Bob	0979	AGPA_05 CNFDL_02 LEGIS_01			AK_DMD_01 AK_FINC_07 DISP_01 LLC_09
Absher, Carole	1102	AGPA_01 ENVR_07 FIF_02			OWNRISK_02 PTU_01 RCA_02
Abukasis, Ms.	2145	FIF_01			WORK_COMM_01
Aburto, Carlos	1275	FIF_01			WORK_COMM_07
Achberger, Chuck	0842	AK_FINC_01 FIF_01 FISC_02 INCNT_01			
Acosta, Marcus	0412	AGPA_02 FISC_02 MRKT_03 PPT_01			
Adams, David Michael	1155	AK_FINC_01 FIF_01 PPT_01 PPT_03			
Adams, Robert	0329	FIF_01			
Agnew, Robert	1681	POL_RSK_01			
Ahlin-Stieren, Darci	2055	GENBEN_05			
Aiken, Lee	2064	FIF_01			
Akin, Robert	1172	FIF_01			