LEGISLATIVE BUDGET & AUDIT COMMITTEE

Representative Ralph Samuels, Chairman

DATE: March 25, 2008

TO: Representative Paul Seaton

FROM: Steven B. Porter
Consultant to LB&A Committee

RE: Response to DNR Letter of March 13, 2008

Recently I received a copy of a letter dated March 13, 2008 sent to you by Commissioner Irwin of the Department of Natural Resources (DNR) responding to a request you made of them. The issue they addressed related to testimony I gave before the House Open Caucus on February 26, 2008. In that testimony I stated that TransCanada's application was in violation of the 70/30 debt/equity ratio requirement in AS 43.90.130(10). The Commissioner disagreed with my analysis. This letter is in response to the Commissioner's letter. My response is that the definition of "project" includes expansions; AGIA requires a minimum of 70/30 debt equity ratio be proposed for the project; TransCanada proposed less than a 70/30 debt equity ratio for expansions; therefore, TransCanada's proposal is in violation of AGIA.

Definition of Project

The statute is clear regarding the definition of project. The definition of project is found in AS 43.90.900(19).

> **Sec. 43.90.900. Definitions.** In this chapter, unless context otherwise requires, …
>
> (19) "project" means a natural gas pipeline project authorized under a license issued under this chapter;

The canons of basic statutory construction state that when a statute contains a definition section, the definition establishes the meaning wherever the term

appears in the act unless otherwise stipulated;[1] and when the meaning of the word is clear, the courts are not at liberty to look beyond the statutory definition.[2]

Definition of Licensed Project

A licensed project covers the timeframe and terms upon which the license will be granted. In AS 43.90.130 it is clear that the terms upon which the license is granted include the application phase, pre-construction, construction, operations, and expansions. In AS 43.90.260 specific reference is made to construction and operation or expansion of the project. In fact many of the terms of the license are specifically intended to apply to expansions. Since the definition of licensed project includes expansions, the definition of project also includes expansions.

Debt/Equity Ratio Requirement

The statute clearly defines the debt/equity ratio requirement in the statute.

> **AS 43.90.130. Application requirements.** An application for a license must be consistent with the terms of the request for applications under AS 43.90.120 and must …
>
> (10) commit to propose and support rates for the proposed project and for any North Slope gas treatment plant that the applicant may own, in whole or in part, that are based on a capital structure for rate-making that consists of not less than 70 percent debt.

The statute states that the applicant must propose and support rates for the project of not less than 70 percent debt. Without a clear distinction in the statute, this provision would apply to first binding open season and all subsequent open seasons, including expansions.

Legislative Intent

The DNR suggests that there is a distinction between AGIA terms that apply to the "initial proposed project" and AGIA terms that apply subsequent to that. I could not find a legal justification for holding such a position. The term "project" is used over 100 times in the AGIA statute; and when the legislature wanted to limit the scope of the application of the term "project" to a specific timeframe, it is clear they knew how to do so, e.g., "project

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[1] Barstow ex rel. Markair, Inc. v. I.R.S., 272 B.R. 710, affirmed In re Bankruptcy Estate of Markair, Inc., 308 F3d 1038, certiorari denied 123 S.Ct. 2575, 539 U.S. 926, 156 L.Ed.2d 603

[2] Seattle-First Nat. Bank v. Conaway, 98 F.3d 1195.

construction inducement," "construction and operation of the proposed project," "commit to expand the proposed project," "marine segment of the project," "first binding open season of the project,""expansion of the project". Whenever the legislature wanted to limit the scope of the term "project" they did so by the use of the terms surrounding the word, not by changing the definition of the term.

DNR Implied Definition of the Term "Project"

DNR seems to make a distinction that there is an implied intent that distinguishes between an initial project and expansions of the project. There is nothing in the statute that can be construed to imply that intent, and the court could not successfully apply it to the statute. If the term "project" is used as defined in AS 43.90.900(19), it can rationally be applied every time it is used in the statute without modifying the meaning of the statute. If the court is required to apply the DNR intent of the word, it would have to imply that some of the over 100 references to the term project meant "initial project" and other references meant the definition found in AS 43.90.900. There is nothing in the statute to assist the court in making that distinction. Without clear justification in the statute for doing so, the court will not imply intent contrary to specific definition in the statute.[3] Neither is the Administration allowed to create a distinction where none exists.

TransCanada's Dilemma

The TransCanada dilemma is that they complied with the requirements of the RFA apparently thinking they were also complying with the statute. The RFA clearly states they have the right to propose a debt/equity ratio for expansion that is less than 70/30.

> **2.2.3.5. Rate Structure and Supporting Information**[4]
> ...Applicant may commit to propose and support a capital structure for expansion facilities that consist of less than 70 percent debt.

The statutory requirement is also clear that the applicant must comply with the terms of the RFA and the statute.

> **AS 43.90.130. Application requirements.** An application for a license must be consistent with the terms of the request for applications under AS 43.90.120 and must...
>
> (10) commit to propose and support rates for the proposed project and for any North Slope gas treatment plant that the applicant

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[3] Barstow ex rel. Markair, Inc. v. I.R.S., 272 B.R. 710, affirmed In re Bankruptcy Estate of Markair, Inc., 308 F3d 1038, certiorari denied 123 S.Ct. 2575, 539 U.S. 926, 156 L.Ed.2d 603

[4] Request for Applications at p. 19

may own, in whole or in part, that are based on a capital structure for rate-making that consists of not less than 70 percent debt.

TransCanada assumed that if they complied with the RFA, they would also be complying with the statute. But DNR does not have the legal authority to require a term in the RFA that is contrary to statute. The result is that TransCanada, while depending on DNR's guidance in the RFA, submitted an application that is not in compliance with AGIA.

Potential Resolutions of Dilemma

There are at least two possible resolutions to the proposed dilemma. There is also a third resolution, but I do not think it would be fair to TransCanada. First, an equitable solution would be to allow TransCanada to modify their application to be in compliance with AGIA. This seems like the most equitable course of action. TransCanada did not intentionally violate the statute. They merely followed the terms stated in the State's RFA. Once the mistake has been identified, TransCanada should be allowed to amend their application to be in compliance with AGIA. Second, the legislature could specifically amend the statute to allow for a capital structure for expansion facilities that consist of less than 70 percent debt. If the legislature believes that less than a 70/30 debt/equity ratio for expansions is fair, then this is the avenue to take. The third alternative would be to find that TransCanada's application is not complete because it did not meet the requirements of AS 43.90.130(10). This is not an equitable solution and would be unfair to TransCanada, and I do not recommend it.

If you want additional Administration analysis of this issue, I recommend you ask the Attorney General's office for their opinion. If you have further questions regarding this memo, please feel free to contact me.

Cc: Tom Irwin, Commissioner Department of Natural Resources
Talis J. Colberg, Attorney General
Representative Ralph Samuels,Chairman LB&A Committee

Attachments:

Letter dated March 13, 2008 from Thomas E. Irwin, Commissioner, Department of Natural Resources to Representative Paul Seaton.

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

SARAH PALIN, GOVERNOR

P.O. BOX 111000
JUNEAU, ALASKA 99811-1000
PHONE: (907) 465-2400
FAX: (907) 465-3886

550 WEST 7TH AVENUE, SUITE 1400
ANCHORAGE, ALASKA 99501-3650
PHONE: (907) 269-8431
FAX: (907) 269-8918

March 13, 2008

Representative Paul Seaton
Alaska State Legislature
State Capitol, Room 102
Juneau, AK 99801-1182

Dear Representative Seaton:

You requested our response to a statement made to the legislature to the effect that the application filed by TransCanada Alaska Company and Foothills Pipe Lines Ltd. was not consistent with the Alaska Gasline Inducement Act (AGIA), because while it met the requirement to propose a 70/30 percent debt-to-equity ratio for the initial pipeline project, it contemplated a 60/40 percent debt-to-equity ratio for later capacity expansions to the project.[1] In short, the statement that the application is inconsistent with AGIA is incorrect. AGIA does not require a 70/30 percent debt-to-equity ratio for pipeline expansions; the requirement only applies to the rates for the initial project. Thus, TransCanada's proposed debt-to-equity ratio for pipeline expansions is consistent with the requirements of AGIA.

Under AGIA, the rates for the "project" are treated differently than the rates for later expansions to the project. AGIA requires, for ratemaking purposes, the use of a 70/30 debt-to-equity structure for the project proposed in the application: "An application for a license . . . must commit to propose and support rates for the proposed project . . . that are based on a capital structure for rate-making that consists of not less than 70 percent debt; . . ." (AS 43.90.130(10)). However, for the required commitment to expand the pipeline, AGIA requires the applicant to commit to "roll-in" the expansion costs to existing rates, but does not require any particular debt-to-equity ratio for the expansions. (AS 43.90.130(7)).

TransCanada's application is also consistent with the Request for Applications (RFA). The RFA provides: "Applicant may commit to propose and support a capital structure for expansion facilities that consist of less than 70 percent debt." (Section 2.2.3.5). Thus, TransCanada's plan to use a 60/40 debt-to-equity ratio for expansions was permitted by the RFA.

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[1] Comment by Steve Porter, a consultant to the Legislative Budget and Audit Committee ("LB&A"), in a presentation to the House Open Caucus on February 26, 2008.

TransCanada's application therefore complies with both the AGIA and RFA requirements by proposing a 70/30 debt-to-equity ratio for its initial proposed project, and, as permitted, proposing a different ratio for expansions.

If you have further questions, please do not hesitate to contact me.

Sincerely,

Thomas E. Irwin
Commissioner