

**ALASKA STATE LEGISLATURE
LEGISLATIVE BUDGET AND AUDIT COMMITTEE**

May 11, 2005

1:12 p.m.

MEMBERS PRESENT

Senator Gene Therriault, Chair
Representative Ralph Samuels, Vice Chair
Senator Ben Stevens
Senator Bert Stedman
Senator Lyda Green
Senator Lyman Hoffman
Representative Mike Hawker
Representative Beth Kerttula
Senator Gary Wilken
Representative Reggie Joule

MEMBERS ABSENT

Representative Mike Chenault
Representative Pete Kott
Representative Kevin Meyer

COMMITTEE CALENDAR

OVERVIEW: NATURAL GAS PIPELINE PANEL DISCUSSION

- HEARD

APPROVAL OF MINUTES
EXECUTIVE SESSION
CONSIDERATION OF AUDITS
OTHER COMMITTEE BUSINESS

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

MARK MADDOX, Principal Deputy Assistant Secretary
Office of Fossil Energy
Department of Energy
Washington, D.C.

POSITION STATEMENT: Discussed Alaska's natural gas pipeline as one of the Bush Administration's highest priorities.

ROBERT CUPINA, Deputy Director
Office of Energy Projects
Federal Energy Regulatory Commission (FERC)
Washington, D.C.

POSITION STATEMENT: Discussed the role of FERC in regard to Alaska's natural gas pipeline.

DRUE PEARCE, Senior Advisor
to the Secretary for Alaska Affairs
Office of the Secretary
United States Department of the Interior (DOI)
Anchorage, Alaska

POSITION STATEMENT: Discussed the position of DOI in the gas pipeline.

PAT DAVIDSON, Legislative Auditor
Division of Legislative Audit
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Answered questions.

ACTION NARRATIVE

CHAIR GENE THERRIAULT called the Legislative Budget and Audit Committee meeting to order at [1:12:26 PM](#). Senators Ben Stevens, Stedman, Green, Wilken, Therriault, and Representatives Samuels and Hawker were present at the call to order. Senator Hoffman and Representatives Kerttula and Joule arrived as the meeting was in progress.

OVERVIEW: NATURAL GAS PIPELINE PANEL DISCUSSION

CHAIR THERRIAULT announced that the first order of business would be the Natural Gas Pipeline Panel Discussion.

Due to technical difficulties the committee took an at-ease from 1:14 p.m. to 1:19 p.m.

[1:19:31 PM](#)

MARK MADDOX, Principal Deputy Assistant Secretary, Office of Fossil Energy, Department of Energy (DOE), informed the committee that currently he is the designated coordinator for federal activities in moving [Alaska's natural gas pipeline] project forward. Mr. Maddox provided the following testimony:

Beginning construction of the Alaska natural gas pipeline as soon as possible is one of the Bush Administration's highest priorities. The President himself touched on it in his energy policy speech last month. The best way to put the priority in context is to quote him directly. President Bush said, "Natural gas is an important source of energy. We'll do more to develop this (indisc.) resource and that's why I signed into law a tax credit to encourage a new pipeline to bring Alaska natural gas to the rest of the United States." Interest in Alaska natural gas pipeline is as high in Washington as it is in Alaska. Alaskans are eager to benefit from its economic potential: the tens of thousands of jobs to be generated by \$20 billion in capital investment and the substantial revenue stream delivered by the production and sale of natural gas. In the Lower 48 we need the pipeline and Alaska's natural gas to uphold the balance and security of our energy portfolio, which in turn upholds our nation's economic growth and our place in the global economy.

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MR. MADDOX continued:

Without Alaska's gas and supply mix, all projections change and they do not change for the better. Alaska has 35-100 trillion cubic feet (tcf) of proven to probably proven ... recoverable reserves. When this natural gas starts moving south through a pipeline, with an initial rate of 2 trillion cubic feet a year, it will impart substantial balance to the energy in the economy; balance to the present and expectations of the future. In the Department of Energy we ... have initiated federal and agency preparations of pipeline matters soon after the President signed and enacted legislation last October. We intend to be ready to respond to a project proposal as soon as the basic arrangements are completed here in Alaska. We look forward to proceeding in cooperation with state authorities. Over the last six months our initial activity has produced an interagency working group of federal entities with the purpose of discussing coordination where responsibilities touch on the pipeline. A draft memorandum of understanding on coordination to clarify roles, responsibilities, and

jurisdictions among these agencies, which is in legal review, and it's part of the energy business plan.

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MR. MADDUX said:

This month, through executive action provided for by the pipeline act, Secretary Bodman created a new office of Alaska Natural Gas Projects within the Office of Fossil Energy. (Indisc.) the assistant secretary of fossil energy to be temporary federal coordinator of all pipeline activities. The new Office of Alaska Natural Gas Projects has two purposes: to house the activities of a permanent federal coordinator with authority to both expedite and enforce the execution of federal responsibilities relating to pipeline construction and to begin preparation for ultimate issuance of up to \$18 billion in federal guarantees to underwrite construction. We are reprogramming from other activities to the sum of \$900,000 to help the new Alaska Natural Gas projects in this fiscal year (FY). And last week the appropriate congressional notifications were made. We are in the process of seeking a budget amendment for appropriation for stepping up activities in FY 2006. Soon, we will replace required notice in the federal registrar for actions that will lay the foundation to bring a loan guarantee program to life. The present designation of the Assistant Secretary of Fossil Energy, as the temporary federal coordinator, will hold until April 13, 2006, or until the President nominates a permanent coordinator, whichever comes later. The permanent federal coordinator will serve through the duration of the project and the position is subject to confirmation in the [U.S.] Senate. If no project is proposed in the next 11 months, the duty of the temporary federal coordinator is to initiate a study of alternatives, including federal ownership with operation of a pipeline. And no one involved wants federal ownership, including the current temporary coordinator, myself.

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MR. MADDUX continued:

As the President said, natural gas is a very important source of energy for our nation. Natural gas serves six of every ten households, about 16 million total and fills many industrial uses across the economy. In addition, natural gas is indispensable as a feed stock, fertilizers and chemical manufacturers and is the fuel for about 16 percent of America's electric power. The current situation in the Lower 48's natural gas market has left thousands of megawatts of natural gas generating capacity stranded due to fuel costs; lead to higher power costs where gas-based generation is substantial; caused widespread layoffs and plant closings in the industries it most directly effects; and squeezed the budget of millions of households with much higher heating costs. The Energy Information Administration's (EIA) most recent projections for the next 20 years note that natural gas production in the Lower 48 will actually decline by almost 1 trillion cubic feet. Alaskan production will rise by almost 2.2 trillion cubic feet. And our nation's only way to increase natural gas supplies is a combination of LNG [liquefied natural gas] imports and pipeline gas from Alaska. That is why beginning construction of the Alaska pipeline as soon as possible is one of the Bush Administration's highest priorities. The EIA projects that natural gas could be moving southward by the middle of the next decade. Our intent at the U.S. Department of Energy is to do everything possible within our jurisdiction to help it before then and to help have it as soon as possible.

[1:25:57 PM](#)

ROBERT CUPINA, Deputy Director, Office of Energy Projects, Federal Energy Regulatory Commission (FERC), provided the following testimony:

I will give you an overview of FERC's role and responsibilities for processing any proposal for an Alaska natural gas pipeline, be it a new project under Section 103 of the Alaska Natural Gas Pipeline Act of 2004 or an amended project under the Alaska Natural Gas Transportation Act of 1976 (ANGTA). Either type of project would require FERC to issue a certificate of public convenience and necessity for the construction and operation of the pipeline. And the leading time component of the certificate process is

the analysis required by the National Environmental Policy Act of 1969, NEPA. For a project under the 2004 Act, FERC is clearly the lead agency for purposes of the environmental impact statement, EIS. We estimate that the entire certificate process will take approximately 38 months, including 18 months of pre-filing activity during which field data would be obtained and studies prepared plus 20 months following the filing of the complete application, as required by the 2004 Act.

For a project under the 1976 Act, FERC would still have a certificate application before it. But the lead agency would be determined by the Secretary of Energy. FERC was the lead agency for the original ANGTS [Alaska Natural Gas Transportation System] certificate, but the secretary's decision may be [influenced] by whether [the Department of] Interior (DOI) has an environmental document on their way in connection with an extension of the federal right-of-way permit. Regardless of who is the lead agency, no timeline is specified under the 2004 Act for a renewed ANGDA [Alaska Natural Gas Development Authority] project. But we would estimate that it would take the same 38 months. Meanwhile, FERC is in the rehearing stage of its open season rulemaking proceeding, which ... under the 2004 Act, applies to either type of project. FERC issued a rule in February to provide nondiscriminatory access to capacity on any Alaska natural gas transportation project, and at the same time allow sufficient stimulus for exploration, development, and production of Alaska natural gas.

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MR. CUPINA continued:

The State of Alaska, North Slope producers, Enbridge, and Chevron Texaco have filed for rehearing. And the Alaska [State Legislature] ... and Anadarko have filed answers. One issue nearly all commenters and filers have in common is the perceived open-endedness of the open season. Other issues are the allocation of capacity if the initial capacity is insufficient to accommodate all the requests; rolled in rates (indisc.) for any expansions; in-state needs study and delivery points; and rate calculations for in-state

service; and the commission's authority to require any changes to the pipeline design following an open season. Rehearing of significant orders at FERC is not unusual. In fact, it's a prerequisite before any party could take a commission order to court. In April the commission issued what's called a tolling order, and it expressed an intent to act on the merits of the rehearing petitions soon. The rule becomes effective on May 19th and project sponsors could then file open season plans. That process would take approximately six months to complete. Then sponsors could file requests to initiate the pre-filing process followed by the 38 months that I mentioned earlier. To prepare ... to complete the certificate process as expeditiously as possible, the federal agencies involved are working on an MOU ... with FERC, DOE and DOI, as the drafting committee. A federal coordinator will be instrumental in ensuring that agencies meet the schedules. At FERC we are also meeting frequently with potential project sponsors. In addition, we have entered into MOUs with both the Canadian National Energy Board and the [Regulatory Commission of Alaska (RCA)] and our environmental staff has visited Alaska, flown the route, and met with other stakeholders. As I said in my testimony before you last September, we encourage project sponsors to make a single filing to avoid time-consuming, duplicative processing, and inefficient use of resources. But whatever form a proposal to us takes, we are positioned to review such a project comprehensively and expeditiously so that Alaska gas can reach the market in a timely fashion.

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DRUE PEARCE, Senior Advisor, Secretary for Alaska Affairs, Office of the Secretary, Department of the Interior (DOI), informed the committee that in the audience is the Special Assistant to the Secretary for Alaska, Cam Toohey, and Laurie Adams, Regional Solicitor, and Colleen McCarthy, Deputy State Director, Energy & Minerals, Bureau of Land Management (BLM). Ms. Pearce provided the following testimony:

As both Mr. Maddox and Mr. Cupina said, building a gas pipeline and commercializing Alaska's North Slope gas is a priority of the President; it is a priority of our two secretaries and of Chairman Wood as well. It is part of the national energy plan, but we see it as

important to the continued economic stability of the country. Our department, DOI, has two distinct positions in the discussions about a gas pipeline. The first is, as the right-of-way permitter, BLM will be the lead agency on right-of-way depending upon which of the laws the application comes in under. But no matter which law it comes under, a year after construction the oversight will come to BLM, just as we have of TAPS [Trans-Alaska Pipeline System]. We would envision a joint pipeline office sort of management and structure that will be used for the years after a pipeline is constructed for that continued oversight, and BLM would be the lead agency. But second, and perhaps in some ways even more important but also something that most people don't think about, we, as the Department of Interior, are a huge land owner and it's our responsibility to try to maximize the value of the resources on our lands. While it is true that the 35 tcf of gas that is presently known in producible reserves on the North Slope is all coming off of state leases, the expectation for the additional 15 tcf that make this project work - because you need the 50 for the 30 years of the project - the expectation is that gas will come for the most part ... from federal leases and from federal discoveries either offshore in MMS [Minerals Management Service] as OCS [outer continental shelf], either in the National Petroleum Reserve, which is BLM's, or perhaps in ANWR [Arctic National Wildlife Refuge]. So, we have a position as a landowner. And we actually testified before FERC as part of the open season rulemaking and have been very pleased with the ... draft rule as it ... came out because it provides for the opportunity for the gas that we know is yet to be discovered ... the value to be maximized. So, we do look at this project from both directions.

MS. PEARCE continued:

It's been the experience of the Department of Interior, through work on major pipeline systems in the Lower 48 that we were permitting through rights-of-way but also through the TAPS right-of-way renewal that we just completed, that adoption of a project management approach within our agencies for permitting will facilitate the achievement and maintenance of

regulatory alignment. To that end, we are currently engaged in the development of a business plan which will outline the roles and responsibilities of individual agencies in the project management format. The Bureau of Land Management and Colleen's shop has taken the lead for the department and has been engaged in outreach efforts with all jurisdictional DOI agencies, both locally in Alaska and also in Washington, D.C. as well as the State of Alaska, the Army Corp of Engineers, and the Canadian National Energy Board. The State of Alaska, DNR, has indicated an interest in participating with [the Department of] Interior in development of a joint business plan. So, you already have the beginnings of a joint activity between the state and our agencies. Current outreach efforts include introductory briefings both in Anchorage and in Fairbanks, May 13th and 16th, respectively. Those will involve federal, state and local entities, including the North Slope Borough. In addition, while in Fairbanks, the BLM will meet with the Tanana Chiefs Council and Doyon[, Limited] to discuss how the project may effect Native resources. The focus of these outreach efforts is to initiate early coordination to facilitate the project management approach. BLM is drawing upon our national resources to assist in training and staff development.

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MS. PEARCE said:

The bureau's right-of-way management specialist will be conducting a site visit and an informal training session in June to review the right-of-way alignment and visit past construction camps to gain an understanding of the scope and magnitude of this project. The bureau has tentatively arranged for a FERC pre-filing training session to be held also in June in Anchorage. That training would be open to all effected agency personnel. At this point in time, there are several different pipeline projects in play sponsored by different entities. It is our intention, at this point and time, to prepare to meet the needs of all those potential pipeline project scenarios as we develop our business plans.

[1:37:50 PM](#)

CHAIR THERRIAULT asked Ms. Pearce to discuss where the state and the federal government stand with present obligations to the rights-of-way.

MS. PEARCE specified that there are two federal right-of-way grants. Yukon Pacific has rights-of-way for its LNG project, and the old Foothills right-of-way is now held by TransCanada. Although those rights-of-way exist, no project has been built for either.

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CHAIR THERRIAULT related that recently it has been asserted to him that the right-of-way to tidewater has some gaps in the federal land that it would cross.

MS. PEARCE surmised that Chair Therriault meant "actual gaps where we haven't completed the right-of-way process for all of the federal lands along that route." In response, she said it has not been her understanding that there are gaps. However, she offered to look into that.

SENATOR BEN STEVENS, drawing from the testimony, surmised that the new Alaska Gas Port Authority project isn't one of the projects being considered now by DOI.

MS. PEARCE specified that [DOI] is making sure, through its business plan, that the department would be prepared to deal with the right-of-way for that project as well as the others.

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MR. CUPINA, in response to Senator Ben Stevens, said that it's fair to say that the Foothills project is the 1976 ANGST project. One of the purposes of the 2004 legislation, he opined, was to clarify that it's not an exclusive proposal or potential pipeline project. Therefore, another project could be filed by entities other than Foothills and thus [FERC] suspects that a filing under the 2004 Act would most likely result in a different applicant than Foothills.

SENATOR BEN STEVENS asked whether a project that qualifies under the '04 provisions of a loan guarantee would be tied in under the '76 Act as well. "So does the loan guarantee portion of the '04 Act transcend certain elements of the '76 Act as well," he asked.

MR. MADDUX answered that any project that qualified under the '76 Act would also qualify for the loan guarantee under the 2004 Act.

SENATOR BEN STEVENS surmised then that the Foothill [project] under the '76 Act [would qualify].

[1:42:10 PM](#)

MR. MADDUX said, "That would be my reading at this point." He noted that the qualified project has a route designated, which he believes is compatible with the 1976 Act. Therefore, there wouldn't be any conflict in terms of the route and what would qualify, and thus he predicted that there wouldn't be any conflict.

SENATOR THERRIAULT requested that [Mr. Maddox] review the qualifying language for access to the federal loan guarantee.

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REPRESENTATIVE SAMUELS asked, in regard to the federal loan guarantee, whether it takes an appropriation from Congress. He also asked whether under the federal loan guarantee one would draw it down like a line of credit. He further inquired as to who is eligible.

MR. MADDUX specified that the definition of a qualified infrastructure project in the statute reads: "The term qualified infrastructure project means an Alaskan natural gas transportation project consisting of design, engineering, finance, construction, and completion of pipelines and related transportation and production systems, including gas treatment plants and ... used to transport natural gas from the Alaska North Slope to the continental United States." He further specified that an additional appropriation from Congress would be required to implement it. Although the exact amount is somewhat up in the air at this point, it would be a percentage of the total \$18 billion loan. He emphasized that the loan originator will not be the United States government. Therefore, whoever does this project, builds this project, will have to find commercial financing or private sector financing. The [federal government] will be in a role of guaranteeing that loan they negotiate in the commercial market. However, the total amount of that appropriation will depend on a number of factors, with probably the largest being the credit worthiness of whoever

is the borrowing party. Although the traditional scoring points has been about 10 percent of the total loan, a strong borrower could potentially reduce that risk significantly, to perhaps 2 percent being appropriated for reserve fund (indisc.). Mr. Maddox highlighted that there can be a fairly wide latitude under both appropriations. Moreover, that credit worthiness will impact the interest rate. Commercial banks generally base their loans on what they perceive as risk, and therefore the preference [of commercial banks] is to have the loan repaid and they don't necessarily give a flat interest rate because it's guaranteed. Furthermore, the government will be looking to make certain that if there's a business plan, that it will help execute the loan and get it repaid.

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SENATOR BEN STEVENS related his understanding that the Alaska Port Authority project, the original Yukon Pacific proposal, was exempt from FERC jurisdiction because it was an intrastate project and the gas was destined for exportation. Based on that assumption, would the new project, as proposed, be under [FERC's] jurisdiction now because the proposal includes coming to domestic markets.

MR. CUPINA clarified that when FERC issued the Yukon Pacific decision, it exempted the pipeline from FERC jurisdiction. However, it asserted jurisdiction and authorized the export terminal. In other words, that was a Section 3 foreign commerce facility under the Natural Gas Act. Therefore, while the pipeline wasn't FERC jurisdictional, the terminal was as an export terminal.

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MR. CUPINA deferred to Mr. Maddox regarding whether or not it qualifies. Mr. Cupina said although he isn't as familiar with the current proposal, it sounds as if Senator Ben Stevens is discussing the gas going to the Lower 48 as opposed to being exported. "Is that the premise," he asked.

SENATOR BEN STEVENS asked, "Is the loan back guarantee requirement is delivery to US markets? Is that ... an accurate statement?"

MR. CUPINA replied yes.

SENATOR BEN STEVENS asked if the liquefaction plant that was approved under a prior FERC approval, under Section 3, was an export facility.

MR. CUPINA answered yes.

SENATOR BEN STEVENS questioned how it's an accurate proposal for [the state] to consider when the project specifies there is permitting in place for delivery to U.S. markets based on a liquefaction facility that was granted under the exportation section of ANGDA and when there are loan back guarantees based on a loan back with delivery to U.S. markets.

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MR. CUPINA replied, "I don't know."

SENATOR BEN STEVENS asked whether that would fall under FERC's jurisdiction if it was [in the] U.S.

MR. CUPINA opined that if the gas is destined for another state outside of Alaska, the question of whether that's interstate commerce as opposed to foreign commerce would have to be revisited. "It could very well include the pipeline becoming an interstate pipeline, if in fact that's interstate commerce," he suggested.

SENATOR BEN STEVENS posed a situation in which there is a project with exportation under Section 3 in Valdez and a receiver terminal in a foreign country [from where the gas] is then piped into the U.S. market. He then asked whether that would still fall under FERC's jurisdiction.

MR. CUPINA said, "I think that would be a case of first impression, as the lawyers say, I don't know any precedent for that." If the gas goes to a foreign country, then one could argue that it's an export facility. However, the remainder of the journey of the gas in which it goes back into the U.S. isn't something that [FERC] has seen before.

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SENATOR BEN STEVENS asked, then, whether gas exported from a export facility received in a foreign country and piped back into the U.S. market would qualify under the loan back guarantee?"

MR. MADDUX opined that if FERC labeled the facility as an export facility, then DOE would have trouble recognizing it as a domestic facility.

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CHAIR THERRIAULT asked if DOI has entered into the rehearing process and asked for any clarification on the terms of the FERC rulings, as they currently stand.

MS. PEARCE replied no. The DOI hasn't filed comments, although DOI has publicly expressed its happiness with the rulemaking, as proposed.

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REPRESENTATIVE SAMUELS inquired as to the length of the earlier-mentioned study.

MR. MADDUX said that it would depend upon the scope of the study, which would have to be determined first. He related his view that the [study] would be relatively detailed and "not cheap." He predicted that it would take in excess of a year to complete such a study.

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REPRESENTATIVE HAWKER recalled Ms. Pearce's testimony regarding the volumes necessary to make the project viable. If the duty to produce could be proven on state lands, would DOI then believe such might be applicable to leases on federal lands as well.

MS. PEARCE pointed out that the terms of [DOI's] leases are different. Furthermore, the terms of BLM's leases onshore are somewhat different from the "FCS" leases. Ms. Pearce informed the committee that the NPR-A federal leases have a primary term of 10 years. The Naval Petroleum Reserves Production Act, which is the old Act, remains and those are the productions rules under which [DOI] continues to operate. Those rules mandate the leases will not be expended [a specified amount of time] after oil and gas is produced from the lease in paying quantities. Therefore, if, at the end of that primary term, there has been no production, the lease expires. Ms. Pearce informed the committee that DOI has not yet investigated the limits of its authority in situations in which oil but not gas is being produced. Attorneys for DOI are reviewing that now.

Ms. Pearce further informed the committee that DOI does not have any production from NPR-A, although there are some discoveries. Furthermore, ConocoPhillips Alaska, Inc. has moved forward on an EIS that will hopefully lead to the first NPR-A production. She pointed out that MMS Alaska and the federal OCS have similar rules and laws. She highlighted that in MMS regulations DOI doesn't distinguish gas from other resources, and therefore development is based on recoverable hydrocarbons. If both oil and gas are found to be economic, DOI requires a development plan showing how each will be recovered.

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REPRESENTATIVE HAWKER surmised that from DOI's perspective the line is drawn between the older leases and language and the new language that seems to be more encompassing.

MS. PEARCE opined that DOI's language is a bit tighter on that question. She highlighted that MMS and the state are effectively co-managing Northstar because that field overlays federal and state leases and is a joint federal-state unit. Such co-management would be expected in other areas in which the federal and state [leases] overlay. She informed the committee that in the outer OCS, where there are federal leases, development plans will be required. Furthermore, when there is a way to market the gas [DOI] would expect gas to be marketed. Ms. Pearce added that the recent lease sale in the Beaufort [Sea] resulted in Shell, for the first time in years, returning to Alaska and purchasing tens of millions of dollars in leases. Furthermore, Shell has publicly stated that it's looking for gas in the Alaska OCS. Therefore, the expectation is that Shell is present in Alaska to find and market the gas, which is one of the reasons it's so important to get the gas pipeline built.

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REPRESENTATIVE SAMUELS asked if it would be legal to tell the applicant that it must accept the FERC rules as part of the package of terms set out in the Stranded Gas Act.

MR. CUPINA said that whatever private agreements between the state and other parties are forged would not necessarily control what FERC does. However, if a party withdraws its appeal as a result of that agreement, it would conceivably obviate whatever issue was the subject of that appeal. Mr. Cupina said that the state would be free to enter into these agreements, but FERC wouldn't be bound by them.

1:59:11 PM

CHAIR THERRIault turned to the FERC allowed rate of return. He related that when he and Representative Samuels were in Washington, D.C., they were lead to believe that some of the litigated rate cases have resulted in a slightly lower range of the allowable rate of return. With regard to [Alaska's gas] pipeline [that some characterize as] a risky venture for which the risk is perhaps lowered due to the underpinnings of the federal loan guarantee, he inquired as to how that all comes together. He also inquired as to the rate of return that is probable. He further inquired as to whether one could differentiate between debt and equity.

MR. CUPINA specified that since there are no specific facts before him, he would only discuss the matter in the abstract. For Greenfield projects of a large diameter and hundreds of miles offshore, FERC has viewed those as having at least initial construction risk. In some cases, the projects weren't fully subscribed. He recalled that [FERC] has authorized rates of return on equity in the 13-14 percent range. He highlighted that the aforementioned is a return on equity as opposed to the overall rate of return. Mr. Cupina explained that the capital structure of those pipelines is a combination of debt and equity in various proportions. Typically, the proportion would be 60/40 or 70/30. He noted that equity capital is more expensive than debt capital because the stakeholders are more at risk and thus demand a higher rate of return. In general, a project with the higher ratio of debt would have a lower rate of return and vice versa.

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MR. CUPINA turned to the situation in which companies with pipe already in the ground that are operating ask for rate increases. He explained that those are typically set for hearings during which the parties often come to a settlement, which are sometimes referred to as black box settlements because one doesn't always know what the settlement includes. However, whatever comes out of these proceedings is a lower return on equity than an initial pipeline that's just starting out. He explained that the aforementioned is attributable to having operating experience, knowledge with regard to load factors, and contract timeframes. Mr. Cupina concluded that a newer pipeline is going to have a higher rate of return than an existing, ongoing pipeline.

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CHAIR THERRIAULT focused on the access to the loan guarantee, and related his understanding that access to the loan is triggered by certification or sanctioning of the project. If there was a stand-alone pipeline project that was certified/sanctioned, would the gas treatment plant be left out of the running for the loan guarantee, he asked.

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MR. MADDUX said that area is murky and he isn't prepared to answer that today. The Act allows more than one guarantee. He informed the committee that [DOE] is attempting to keep the loan guarantee process flexible to accommodate needs going forward.

CHAIR THERRIAULT returned to the earlier-mentioned situation in which the export from the state goes to a foreign country, although it's destined to come back into the county. He asked if that's an issue that [DOE] would address only if an application is made and it must determine how to interpret the language.

MR. MADDUX said that he didn't want to get too far into hypothetical situations.

2:05:16 PM

REPRESENTATIVE JOULE pointed out that the Alaska Eskimo Whaling Commission, those on the North Slope, and others in the Native community are very concerned about offshore [operations]. He inquired as to how the issues surrounding that will be addressed, as things move forward in that direction.

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MS. PEARCE acknowledged that the North Slope borough, the surrounding communities, and the Alaska Eskimo Whaling Commission oppose offshore oil and gas exploration and development. However, the federal government has established the OCS program in the face of the aforementioned opposition. Furthermore, there has been some successful exploration from the OCS with Northstar. Furthermore, she opined that exploration, particularly in the last four or so years, has been performed in a more sensitive manner. She highlighted how EnCana worked with locals to ensure its exploration didn't have any impact on

whaling nor any of the other subsistence resources. Ms. Pearce related that [DOI] will continue to work through the stipulations that require mitigation and through the open communication channels with the North Slope borough, the local communities, and the Alaska Eskimo Whaling Commission in order to discuss how to properly deal with the issues. She highlighted that at the moment there are deferrals in the areas where most of the whales have been taken from both Barrow and Kaktovik. She acknowledged concern after Shell's purchase of leases in areas that were unexpected. She noted that MMS has been invited by the community of Kaktovik to have meetings with the tribe and the community as a whole. She explained that the federal government chose to start an OCS program because there are federal resources, not just [resources] for those who live and subsist on the North Slope. The desire, she opined, is to have the best consultation and process to consider concerns and mitigate them when possible.

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REPRESENTATIVE JOULE commented that those on the North Slope have been good partners in the development of onshore [resources] considering this oil and gas development is occurring in probably the most fragile environment in the world. The offshore environment, he opined, is even more fragile. Furthermore, he didn't believe it has been demonstrated that there is the ability to react in the event that things don't work in the way "we'd" like it.

MS. PEARCE agreed that offshore [development] throughout the OCS are sensitive, each with different but serious concerns. The [North Slope] community has been brought into the discussion through Mayor George Ahmaogak, Sr., becoming a member of the OCS policy council. She opined that [DOI's] record on the Northstar [Unit] and Liberty has been excellent in terms of working with the community while trying to mitigate as many impacts as possible. Although it's not perfect, the MMS Alaska people care about what they do and will work to ensure the best system possible for that fragile location.

2:11:00 PM

SENATOR BEN STEVENS recalled Mr. Cupina's testimony specifying that the May 19th decision will have an impact 6 months later, and then 18 months later there will be a NEPA review and then a 20-month period after that. He inquired as to the point at which the project is FERC sanctioned, which he understood to be

the point at which the financial markets can provide the applicant the financial backing to move to the next level.

[2:12:05 PM](#)

MR. CUPINA characterized the open season rule as unnecessary and not a sufficient first step but rather something that has to happen before other things. The things that would follow would be some result from the Alaska Stranded Gas Act proceedings. After that is resolved, he expected that project sponsor to come into FERC and file its open season plan. Under the rule, FERC has a certain amount of time to turn around that application, after which the sponsor would engage in the open season. He estimated that from the time the plan is filed to the open season would be about six months. The real question is with regard to when that six months begins. The expectation is that the aforementioned will follow the Stranded Gas Act proceedings. He explained that just when the open season is coming to a close, the sponsor obtains the knowledge with regard to the interest in and the capacity of the pipe. Assuming there is sufficient interest, FERC would expect the sponsor to come to it to initiate the pre-filing period, which FERC estimates will take about 18 months. He explained that the 18 months is based on two field seasons/summers from which FERC and contractors can obtain the necessary environmental data. Under the 2004 statute, there is a 20-month deadline after an application is filed. Therefore, the 38 months at FERC follows the conclusion of the open season, the beginning of which is up to the sponsor.

[2:14:49 PM](#)

REPRESENTATIVE SAMUELS posed a situation in which FERC receives multiple applications, and asked if it would slow down the timeline before the six-month clock starts.

MR. CUPINA said that FERC encourages parties to emerge with one application. However, if FERC receives multiple applications, all applicants will be processed. The aforementioned situation is occurring with LNG terminals, he noted. He indicated that FERC does the environmental engineering analysis and sifts through the proposals, and at some point the market decides exactly which proposals are built. From a resource standpoint, that's a challenge, he said.

[2:16:21 PM](#)

SENATOR BEN STEVENS highlighted that there are multiple proposals: two stranded gas applicants with proposals over the highway and a third stranded gas applicant that's proposing using an LNG liquefaction plant and terminal at Valdez. He explained that the terminal in Valdez was sanctioned under Section 3 of the Natural Gas Act for export and the proposal is to reimport [the gas] via a foreign country terminal back to a pipe. He related his understanding that the timeline provided [by FERC] is essentially 42 months from action on a stranded gas act in the legislature. Therefore, he asked if the third applicant would fall into the same time category.

MR. CUPINA said yes, noting that there might be some benefit from the environmental work from the past. However, he also noted that there may be some legal and policy issues of first impression based on this import versus interstate commerce. Furthermore, if the pipeline is determined to be interstate commerce and under FERC jurisdiction, the question becomes whether the environmental analysis would have to be redone.

[2:18:37 PM](#)

CHAIR THERRIAULT surmised then that if FERC receives competing applications, it has no process by which to differentiate projects and move one forward and not another. He related his understanding that FERC's preference is to move them both forward and let the private sector sort them out when it comes to financing.

MR. CUPINA said that FERC's more recent policy has been to let the market decide. However, as FERC indicated in its open season rule, there are unique aspects of Alaska that are unpredictable. The aforementioned is why he didn't want any of his testimony to be Alaska specific and why he wanted to specify what FERC has done in the past without predicting what it will do with an Alaska project.

[2:19:47 PM](#)

CHAIR THERRIAULT returned to the allowable rate of return. He asked whether state ownership or participation would impact the allowable rate of return.

MR. CUPINA said that there is an income tax component to the return on equity. As recently as two weeks ago, FERC issued a policy statement clarifying that tax treatment and the recovery of taxes is only appropriate where taxes are paid. Therefore,

if the state or any other owner was not paying taxes, the tax component might not be part of the cost.

[2:20:56 PM](#)

CHAIR THERRIAULT noted that there has been interest in regard to how possible antitrust issues would be addressed. Although the FERC rulings to date address many of the antitrust issues, he wasn't sure that it would fully satisfy the concerns of other federal agencies, such as the Federal Trade Commission and the Department of Justice.

MR. CUPINA recalled FERC Chairman Wood's response to Representative Berkowitz in which he said [antitrust] issues will be addressed. Mr. Cupina added that much of what FERC does to prevent discrimination is consistent with antitrust objectives. "For instance, ... we have this open season ... we have the tariff that every pipeline has under which that's the only way it can do its services, the transparency of that tariff and affiliate rules that put more of a burden on pipelines that have producing affiliates and affiliates that are shippers on the system," he explained.

[2:22:34 PM](#)

REPRESENTATIVE SAMUELS turned to the relationship between FERC and the NEB, and then asked whether there would be any complications with the open season requirements if the pipeline went down a highway line.

MR. CUPINA replied no, and reminded the committee that FERC has an MOU with NEB, which is the basis for communication. He informed the committee that FERC meets three times a year with the NEB and the Mexican Sea (Indisc.) in order to stay informed with regard to North American regulatory activities. When the time comes [in Alaska] to get to specifics, FERC will use those communication channels to talk and coordinate with the NEB.

[2:23:33 PM](#)

CHAIR THERRIAULT posed a situation in which a project with producer ownership and potential antitrust issues comes before [FERC]. He then asked whether the aforementioned situation would fit within the overall length of the review process.

MR. CUPINA specified that usually FERC is able to address nonenvironmental issues within the environmental review

timeframe. The environmental analysis is the leading time component.

[2:24:32 PM](#)

SENATOR WILKEN recalled Mr. Maddox's testimony regarding a section within DOE that had been funded with some \$900,000 in allocation of assets in order to begin business. He asked if the aforementioned is unique or are there other sections within DOE that would concentrate on projects similar to the Alaska gas lines.

MR. MADDOX answered that the [section] to which Senator Wilken is referring is specific to this project and was created by statute in the fall of 2004 as part of the Act providing all the loan guarantees and supporting mechanisms for the pipeline. The sole purpose of this section will be to help expedite this project. In further response to Senator Wilken, Mr. Maddox only recalled such a situation on the oil and gas side with the ANGDA Act of 1976 when an Office of the Inspector was established. This new section is a more robust version of the Office of the Inspector that was created in the late 1970s.

[2:25:48 PM](#)

CHAIR THERRIAULT inquired as to how DOI would deal with multiple right-of-way applications.

MS. PEARCE explained that DOI has to process all right-of-way applications that it receives. She echoed earlier testimony regarding the hope that there will be some convergence because of the large amount of resources necessary to go through the process of granting a right-of-way. She noted that even though [DOI] would be under reimbursable agreements with the applicants, it would be very costly for the applicants as well as DOI. Ms. Pearce pointed out that DOI would not prioritize one applicant over another.

The committee took an at-ease from [2:27:20 PM](#) to [2:34:12 PM](#).

APPROVAL OF MINUTES

REPRESENTATIVE SAMUELS moved that the committee approve the minutes from the March 30, 2005, meeting. There being no objection, the minutes were approved.

EXECUTIVE SESSION

REPRESENTATIVE SAMUELS made a motion to move to executive session for the purpose of discussing confidential audit reports under AS 24.20.301. There being no objection, the committee went into executive session at [2:34:40 PM](#).

CONSIDERATION OF AUDITS

CHAIR THERRIAULT called the meeting back to order at [2:41 PM](#).

REPRESENTATIVE SAMUELS made a motion for the preliminary audit entitled State of Alaska Single Audit for Fiscal Year Ended June 30,2004, be released to the appropriate agencies for response. There being no objection, it was so ordered.

REPRESENTATIVE SAMUELS made a motion for the final audit entitled Department of Transportation & Public Facilities Force Account Projects be released to the public for response. There being no objection, it was so ordered.

OTHER BUSINESS

CHAIR THERRIAULT requested that Ms. Davidson review where the situation stands with the audits and when another meeting may be necessary.

[2:42:40 PM](#)

PAT DAVIDSON, Legislative Auditor, Division of Legislative Audit Alaska State Legislature, answered that the responses to the Statewide Single Audit as well as two to three additional audits would be ready for a meeting at the end of June or beginning of July.

SENATOR WILKEN thanked Chair Therriault for following up on the lack of quality and validity of the benchmark tests administered in April. He acknowledged that Chair Therriault met with the department as late as yesterday. He said he has received another summary from his district, an analysis from the University of Alaska with regard to its cursory review of the test. Senator Wilken said that thus far he has seen nothing that would lead him to base any achievement scores on that poorly put together and poorly administered test. He acknowledged that Chair Therriault has taken under advisement the request to slow this down so that the invalid scores aren't put in place in the next couple of months. Senator Wilken said

he would continue to work with Chair Therriault to ensure the matter receives the attention that it deserves.

[2:44:29 PM](#)

CHAIR THERRIAULT pointed out that this falls under a fairly tight timeline. Therefore, he expressed hope that the districts weigh in during the State Board of Education process.

[2:45:18 PM](#)

SENATOR WILKEN suggested that when members hear from their districts it could be routed to his office, but most certainly to the State Board of Education. He related his opinion that the State Board of Education has been more of a rubberstamp than a board that analyzes things. Therefore, Senator Wilken expressed concern that the board may gloss over this matter, and therefore he will track it. He said that he hopes there will be enough concern to retest.

[2:45:49 PM](#)

CHAIR THERRIAULT informed the committee that Mr. Toohey, Special Assistant to the Secretary for Alaska, DOI, indicated that another recordable disclaimer to the state had been signed over for the Porcupine, which is part of the effort with RS2477s and recordable disclaimers.

ADJOURNMENT

There being no further business before the committee, the Legislative Budget and Audit Committee meeting was adjourned at [2:46:40 PM](#).