CHAPTER 23

THE ALASKA GAS PIPELINE: BREAKING NEW GROUND

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Synopsis

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I. Introduction

As will become clear during the course of this paper, its title at this particular point in time could be either *The Alaska Gas Pipeline: Breaking New Ground* or *The Alaska Gas Pipeline: Retreading Old Ground.* A substantial amount of activity has occurred on the Alaska Gas Pipeline Project (Project) since 2000, which culminated in a broad-ranging agreement with the then Governor of the State of Alaska (State) in early 2006.[2] The Alaska legislature subsequently failed to approve the agreement during the remainder of 2006, however, and in some respects the Project is now back where it has been since the 1970's – a project in waiting.

Indeed, to at least one interested and knowledgeable observer of the situation, the Project may have taken a step backwards during the last half of 2006. When then Governor Frank Murkowski announced the agreement early in 2006, FERC Chairman Joseph Kelliher said the following:

> The announcement of an agreement between the State of Alaska and producers is a highly encouraging step toward building a pipeline to bring Alaska gas to the lower 48 states. Building this pipeline is a key part of our national effort to secure abundant and affordable supplies of this environmentally friendly fuel. The Federal Energy Regulatory

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[1] The authors wish to acknowledge and thank Deborah J. Jones of BP Exploration (Alaska) Inc. for her extensive work on this paper and presentation. It would not have been possible without her efforts. The authors also wish to make clear that the views expressed in this paper are entirely their own and do not represent the positions of either BP Exploration (Alaska) Inc., or Jones Day.

[2] The reason that the State plays such an important role in the Project is because, as the mineral interest owner, a substantial landowner and the taxing authority, the State has control over critical cost and permit components of both the upstream and midstream elements of the Project. The need to achieve certainty over "the risk of changing state and municipal taxes with respect to any proposed natural gas pipeline project" is critical to the economics of the Project. Federal Energy Regulatory Commission, *Report to Congress on Progress Made in Licensing and Constructing the Alaska Natural Gas Pipeline* (2006) at 4, http://www.ferc.gov/legal/staff-reports/alaska-report.pdf (last visited Jan. 15, 2007) [hereinafter "FERC Initial Report"]. Indeed, the need to achieve certainty over this fundamental risk is so important that the Federal Energy Regulatory Commission (FERC or Commission) has referred to it as "the first impediment to the development of an Alaska natural gas pipeline project." *Id.* at 4.

> Commission stands ready to expeditiously carry out its regulatory responsibilities once this agreement is consummated and we have proposals before us.[3]

After reflecting on the full range of events occurring during the remainder of 2006, however, the FERC's assessment is much less promising. In its *Third Report to Congress on Progress Made in Licensing and Constructing the Alaska Natural Gas Pipeline* submitted on January 31, 2007,[4] the Commission described the current status of the Project as follows:

> The federal government is ready to act. However, no pipeline application has been developed, and the prospects of an application are more remote than a year ago. Over the past year, the schedule for an Alaska gas pipeline has slipped considerably.… The main obstacle to progress on an Alaskan gas pipeline is the failure to resolve state issues necessary before a project sponsor will commit to go forward.[5]

Alaska's senior United States Senator, Senator Ted Stevens, appears to be similarly concerned.[6]

Although it would be easy in the face of such comments to become pessimistic about the Project, the authors of this paper, at this point at least, remain optimistic. As the FERC Third Report also states, "Alaska offers a reliable continental source of natural gas for the Lower 48 States that will help the U.S. economy to grow and thrive, and also contribute to the economic well being of the State of Alaska."[7] The year 2007 will be extremely critical, however, to such an effort. As a previous FERC Report to Congress stated:

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[3] Statement of Chairman Joseph Kelliher, Feb. 22, 2006, *quoted at* Federal Energy Regulatory Commission, Industries, Gas, Alaska Natural Gas Transportation Projects, http://www.ferc.gov/industries/gas/indus-act/angtp.asp (last visited Jan. 20, 2007).

[4] Federal Energy Regulatory Commission, *Third Report to Congress on Progress Made in Licensing and Constructing the Alaska Natural Gas Pipeline* 5 (2007), http://www.ferc.gov/legal/staff-reports/angta-third.pdf (last visited Feb. 1, 2007) [hereinafter "FERC Third Report"].

[5] *Id.* at 7 (emphasis supplied).

[6] Steve Quinn, *Stevens Concerned Over Pipeline Plan*, Anchorage Daily News, Feb. 6, 2007, at A1, available at http://www.adn.com/money/industries/oil/story/8618949p-8511540c.html ("Alaska's senior senator expressed reservations Monday on the heels of a federal report that says the state's schedule for a natural gas pipeline had "slipped considerably. 'I'm very concerned about it; it concerns me in that it lays out a problem that can't be solved here in Washington,' U.S. Sen. Ted Stevens, R-Alaska, said in a telephone interview."); Michele Heller, *Stevens Urges Action on Gas Pipeline*, Anchorage Daily News, Feb. 10, 2007, at B1, available at http://www.adn.com/money/industries/oil/pipeline/v-printer/story/8629545p-8521851c.html ("U.S. Sen. Ted Stevens said Friday he wants Alaska, U.S. and Canadian officials to meet to set a timeline for getting moving on a proposed natural gas pipeline from Alaska to the Midwest. Saying time is critical, the Alaska Republican called for a summit to help get the multibillion project rolling.")

[7] *FERC Third Report, supra* note 4, at 6-7.

> Government and industry in the United States are acting in various ways to obtain adequate natural gas supplies to satisfy future demand.… Alaskan North Slope gas can … be part of the solution to the nation's natural gas needs in this generation. Alaskan gas is not the only option available to the Lower 48[, however]. Twenty years ago, Alaskan gas would have been in competition only with other North American gas production. Now, Alaskan natural gas production will also face competition from low-cost production in LNG exporting countries across the globe. … Timely action on an Alaska natural gas project will allow North Slope gas to reach the Lower 48 states.… Gas buyers in the Lower 48[, however,] are more likely to enter into long-term LNG contracts if there is no substantial progress on building an Alaska pipeline. And, the longer an Alaskan pipeline is delayed, the more strength is gained by the proponents of LNG.… Any further delays may serve to make the Alaska gas pipeline uneconomic in comparison to LNG imports.… Alaska is at risk of being marginalized in the search for new natural gas supplies for U.S. consumption.… Significant progress on an Alaska natural gas pipeline is needed for North Slope gas to become part of the supply mix which will satisfy the U.S. need for natural gas in this generation.[8]

This FERC Second Report, delivered six months before the even more pessimistic FERC Third Report, stressed the importance of "significant progress." As the subsequent FERC Third Report notes, that progress did not occur during the remainder of 2006. The failure to make-up the lost ground and achieve substantial progress in 2007 may very well create the conditions implicitly predicted above in the FERC Second Report – the deferral of the Alaska natural gas pipeline for at least yet another generation. At least in the FERC's view, the level of achievement needed to regain momentum is the approval of a project by the State and up to and potentially including the filing with FERC of a pipeline application for that project.

This paper will focus first on the history of the Project since conception through today, and then identify and discuss some of the issues that were raised last year during the Alaska legislature's consideration of then Governor Murkowski's proposed agreement. Those issues remain to be resolved today before final agreement with the State can be achieved. The intent is to give the reader the necessary background to understand how the Project has gone through cycles – and why it may again – and to understand the scope of the issues as they are discussed during this coming year and beyond.

[8] Federal Energy Regulatory Commission, *Second Report to Congress on Progress Made in Licensing and Constructing the Alaska Natural Gas Pipeline* 10-11, 15 (2006), http://www.ferc.gov/legal/staff-reports/angta-second.pdf (last visited Jan. 15, 2007) [hereinafter "FERC Second Report"].

One final note is important before moving to the body of this paper. This Project is a world scale mega-project – if undertaken, it will be the largest private sector project in history – and subject to a tremendous amount of risk. As the FERC has recognized, in 2001 the cost of the Project was estimated at $21 billion dollars. Since that time, the cost of the steel required to build the pipeline has nearly doubled and it is clear that the cost of the Project ultimately will be higher.[9] The Project also faces substantial risks as a result of (1) its tremendous physical size and scope, (2) the long lead-time involved between commencement and realization, (3) the unique environmental and competitive conditions which it will encounter, and (4) the complexity resulting from its international scope.[10] As if those were not enough of a challenge, there also is substantial uncertainty surrounding the Project at the market end. As the FERC has noted, "market fluctuations over time led to the earlier suspension" of previous efforts to build a gas pipeline from Alaska to the Lower 48, and even now, the "margins of economic feasibility presented by this unique, massive undertaking" are "narrow."[11]

It is important to understand that, regardless of the final ownership structure of the pipeline, the financial consequences of these risks ultimately will be borne by the resource owners – the producers of the gas to be shipped through the Project and the State as royalty owner. Consequently, it is those parties who must be satisfied that the risks are manageable.

These risks are not mitigated by having another, "independent" party construct the pipeline. During the course of the debate in the Alaska legislature in 2006, some parties talked about the desirability of having an "independent" pipeline own and develop the Project. That does not shift risk away from the resource owners, however, and in fact significantly increases it. Before an "independent" pipeline would be able to finance the investment required to construct the line, it will need firm, long term, irrevocable transportation agreements from financially secure shippers. The resource owners are likely also to be those shippers, but even if they are not directly, they nevertheless will still bear the costs of those agreements through sales prices reduced in some fashion by transportation costs.

Once these commitments are made, the independent pipeline largely will become insulated from the financial consequences of cost overruns, delays, regulatory burdens, reduced market demand and other unanticipated factors – those will all be transferred through the firm transportation charge to the shipper. And, because the "independent" pipeline will no longer be at risk for these charges, it will not have the same incentives as the shipper to hold costs in check, increasing the risk that costs may further escalate.[12]

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9 *FERC Initial Report, supra* note 2, at 9-10.

10 *Id.*

11 *Id.*

12 From the perspective of a resource owner, the potential that a shipper may later challenge the "prudence" of these costs in a regulatory forum such as FERC does not effectively mitigate this risk. Such

The ultimate loser in that transaction will be the resource owners, the producers and the State as royalty owner, who will suffer reduced wellhead values as a result.

As the FERC has recognized, the producers have made clear that in order to bear the financial risks and costs of this Project, they must receive certain commitments from the host government in return.[13] These commitments rise to one level if the resource owners own and construct the pipeline. At least then they are in control of the costs being incurred. Because of the additional risks being imposed, the level of necessary commitments will rise to a higher level, however, if another party constructs the line.

In either event, the producers will require confidence that the State's fiscal framework will not change in the middle of project life. In order to make the economics of the Project sufficiently attractive to elicit from the producers either the investment or the commitments necessary to finance the pipeline, the State-level costs and risks will need to be tightly controlled. Put another way, as the FERC has recognized, the producers will only make the financial commitments necessary to underwrite the Project "once they have successfully negotiated for … fiscal certainty…."[14]

The producers also have said that they will require (i) neutral decision making in the event of a dispute, (ii) a robust and longstanding alignment of the economic interests of the State and the producers to avoid ongoing friction and dispute, and (iii) finally, as part of the alignment of interests, a robust, longstanding and fair agreement on revenue share for all parties.

Because of their critical importance to the progress of the Project, these trade-offs should be kept in mind – if not at the center – of the continuing debate in 2007.

II. The Historical and Current Status of the Project

Alaskans and oil and gas lessees working within the State have shared the dream of developing the huge gas resources on the Alaska North Slope (ANS) since the discovery of the giant Prudhoe Bay field in the winter of 1967-68.[15] For over 35 years,

(continued…)

proceedings are time consuming, expensive and imperfect at best. The best protection is to control costs from the outset. If anything, the need to control costs at the front end, rather than rely on after-the-fact regulatory review, is even more important in this situation because of the magnitude of the challenges faced by this Project. In such a situation, regulatory agencies may be more inclined to provide the pipeline with leeway in the judgments they make and, thus, less inclined to second guess those judgments on later review. Moreover, the magnitude of the unanticipated costs will likely be exponentially higher than in more "normal" pipeline projects in the Lower 48.

[13] *See FERC Initial Report, supra* note 2.

[14] *Id.* at 4.

[15] *Midwestern Gas Transmission Co. v. FERC,* 589 F.2d 603, 609 (D.C. Cir. 1978); President's *Decision and Report to Congress on the Alaska Natural Gas Transportation System* (Executive Office of the

that dream has envisioned numerous brainstorms, including icebreaking tankers and submarines to carry liquefied natural gas (LNG), generating electricity on the ANS, converting gas to methanol, converting gas-to-liquid (GTL), and producing petrochemicals.[16] Most visions have imagined a second pipeline alongside the Trans Alaska Pipeline System (TAPS) for some part of the journey to different destination markets. Despite spending in excess of a billion dollars, industry has been unable to find an economical project.[17] For Alaskans, the dream has proven elusive and often frustrating. Major hurdles include large construction costs, permitting and regulatory environment, fiscal uncertainty, and market risks. This section will chronicle some of those early dreams, but will primarily detail the efforts beginning in 2000 to get ANS gas to market.

A. Early Attempts to Monetize Vast ANS Gas Resources

1. ANS Gas Resources – Vast and Unique

The ANS contains huge known and undiscovered gas resources. The Alaska Department of Natural Resources (ADNR) places the recoverable known ANS gas resources at 35 tcf of gas.[18] Figure 1 shows the locations of the known resources and the

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(continued…)

President, Energy Policy and Planning, September 1977) as enacted into law by H.J. Res. 621, Pub. L. No. 95-108 (November 2, 1977) [hereinafter "Presidential Decision"]; Jack Roderick, *Crude Dreams: A Personal History of Oil & Politics in Alaska* 217-29 (1997) [hereinafter "Roderick"]; Petroleum News, *Dispelling the Alaska Fear Factor: A Guide to Alaska's Oil and Gas Basins and Business Environment,* 2005-2006, *at* 12.1-12.23 [hereinafter "Basins"]. Federal Energy Regulatory Commission, *U.S. Senate Committee on Energy and Natural Resources – Alaska Natural Gas Transportation Act: Staff Report of the Federal Energy Regulatory Commission* 16 (2001) [hereinafter "2001 FERC Report"]; National Petroleum Council, *Balancing Natural Gas Policy: Fueling the Demands of a Growing Economy* 39 (2003); Alaska Oil and Gas Association, *Jamison Credited with Prudhoe Find,* Oil & Gas Chronicle: A Timeline of Development in Alaska, Jul. 2006, at 10.

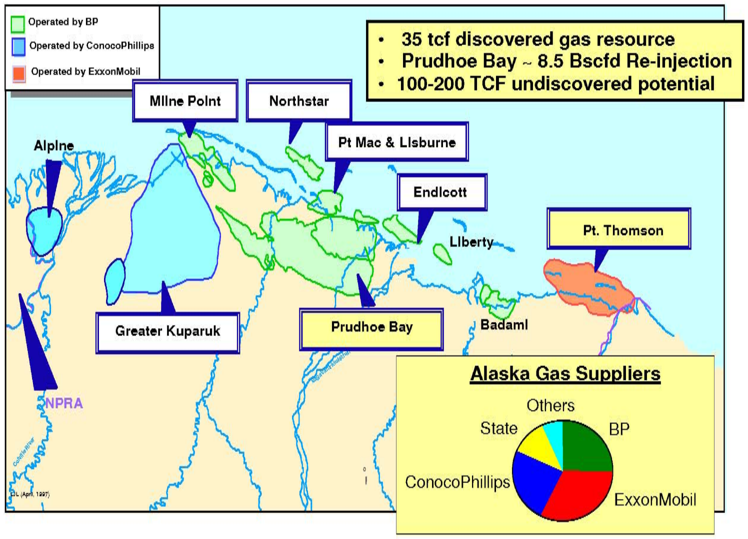
16 BP Exploration External Affairs Department, *Juneau Report: Alaska's Gas … What's the Next Move?* 12 (Spring 1998) [hereinafter "1998 Juneau Report"]; BP Exploration External Affairs Department, *Juneau Report: Alaska Natural Gas – Clean Energy for North America* 10, 12 (Winter 2000) [hereinafter "2000 Juneau Report"]; Cambridge Energy Research Associates, *White Paper: Alaska Natural Gas* 1-2 (October 1999) [hereinafter "CERA Gas"]; 2001 *FERC Report*, *supra* note 15, at 16; Alaska Department of Revenue, *State Financial Participation in an Alaska Natural Gas Pipeline* 1-1 (2002), http://www.revenue.state.ak.us/gasline/ContractDocuments/State%20Agencies/DOR%20Docs/CDP_707476.pdf (last visited Jan. 9, 2007); Energy Information Administration, *Analysis of Selected Provisions of Proposed Energy Legislation: 2003* 40 (2003), http://www.eia.doe.gov/oiaf/servicerpt/eleg/pdf/sroiaf(2003)04.pdf (last visited Jan. 18, 2007) [hereinafter "EIA 2004"].

17 *1998 Juneau Report, supra* note 16, at 12; *2000 Juneau Report, supra* note 16, at 9.

18 Alaska Department of Natural Resources Division of Oil & Gas, *Alaska Oil and Gas Report December 2004,* 4-2, Table IV.1 (2004), http://www.dog.dnr.State.ak.us/oil/products/publications/annual/2004_annual_report/Section4.pdf (last visited Jan. 9, 2007); *CERA Gas, supra* note 16, at 2; Kirk W. Sherwood and James D. Craig, U.S. Dept. of

interests in them. As shown in Table 1, most of the gas is contained in the Prudhoe Bay and the Point Thomson fields. Currently, the Prudhoe Bay gas is produced and reinjected into the reservoir for enhanced oil recovery purposes.[19]

FIGURE 1 – Known ANS Gas Resources



BP Exploration (Alaska) Inc., Alaska Gas, Presentation to the Public:
Alaska Gas Pipeline Overview, July 2006 (2006)

TABLE 1 Estimated Recoverable Known
ANS Gas Resources

Known Reserves Unit or Area	Gas Reserves (bcf)
Prudhoe Bay Field	23,000
Point Thomson	8,000
Duck Island Unit	843
Kuparuk River Unit	1,150
Northstar	450
Colville River Unit	400
Barrow-Walakpa	34
Milne Point Unit	14
Greater Point McIntyre	1,526
Total ANS	35,417

Source: ADNR, 2004.

Notes: Remaining recoverable resources are gas that are economic and technologically feasible to produce and are expected to produce revenue in the foreseeable future.

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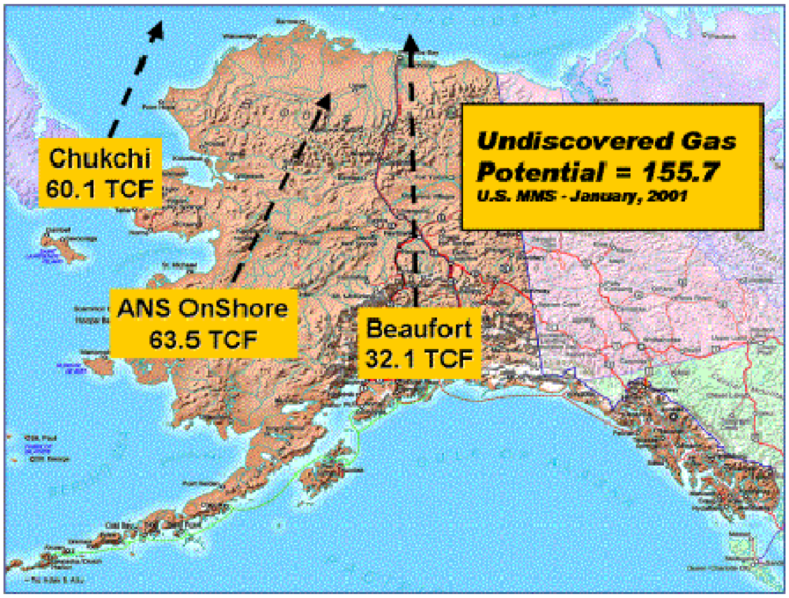
the Interior Minerals Management Service, *Prospects for Development of Alaska Natural Gas: A Review* (2001), available at http://www.mms.gov/alaska/re/natgas/akngas.htm (last visited Jan. 16, 2007) [hereinafter "Sherwood"]; *Basins, supra* note 15, at 12.9.

19 *CERA Gas, supra* note 16, at 2; *Sherwood, supra* note 18, at 36.

The U.S. Minerals Management Service (MMS) estimates that Arctic Alaska may contain as much as 156 tcf of undiscovered conventional natural gas resources broken down as follows: 64 tcf from Northern Alaska; 32 tcf from the Beaufort Shelf, and 60 tcf from the Chukchi Shelf.[20] In addition, there is oil and gas potential in other areas in Alaska along most of the proposed pipeline routes.[21]

FIGURE 2 Undiscovered Gas Potential



BP, ConocoPhillips and ExxonMobil, Amended Application for Development of a Contract Under AS 43.82 The Alaska Stranded Gas Development Act 15, January 20, 2004, http://www.revenue.state.ak.us/GaslineDocs/ConocoPhillips%20Application_Amendment_1_20_04.pdf (accessed Jan. 3, 2007).

Besides conventional gas resources, the North Slope is known to contain significant accumulations of non-conventional natural gas resources, including both coal bed

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[20] *Sherwood*, *supra* note 18, at 20, 61 (2001); *See also* David W. Houseknecht, *Conventional Natural Gas Resource Potential, Alaska North Slope (USGS Open-File Report 2004-1440)* 3 (2004), http://pubs.usgs.gov/of/2004/1440/2004-1440.pdf (last visited Jan. 9, 2007); *Basins, supra* note 15, at 12.9.

[21] *See* Richard G. Stanley *et al.*, *Oil and Gas Assessment of Yukon Flats, East-Central Alaska, 2004 (USGS Fact Sheet 2004-3121)* Table I (2004), http://pubs.usgs.gov/fs/2004/3121/ (last visited Jan. 9, 2007).

methane and gas hydrates.[22] The U.S. Geological Survey (USGS) has pegged the natural gas hydrates in place on the ANS as much as 590 tcf.[23]

If a means to transport ANS gas to markets were ever built, exploration for gas on the ANS and surrounding areas is expected to increase dramatically.[24]

2. Early Attempts to Monetize the ANS Gas Resource: 1970s - 1982

a. Three Competing Proposals

The regulatory and economic environment in the 1970s and 1980s for gas was very different from the environment that exists today. Gas pipeline companies were the only purchasers, transporters, and sellers of gas. A complex regulatory system would allow ANS gas at high prices to be "rolled in" with low prices set by the government for most gas produced in the Lower 48 States.[25] During the 1970s, the Lower 48 was confronted with gas shortages, including a lack of resources to meet gas demand.[26] The Trans-Alaska Pipeline Authorization Act of 1973[27] authorized the president to enter negotiations with Canada regarding oil and gas pipelines from the ANS through Canada. These circumstances provided incentives to bring gas from the ANS to the Lower 48 states, resulting in three competitive proposals to bring ANS gas to market.[28]

The first was a 1970 proposal by Alaskan Arctic Gas Pipeline Company (Arctic Gas) to construct a 4,800-mile pipeline to the Lower 48 states passing easterly through the Arctic National Wildlife Reserve (ANWR), then southeasterly through the Mackenzie

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[22] Timothy S. Collett, *Alaska North Slope Gas Hydrate Energy Resources Open-File Report 2004–1454* 2-3 (2004)**,** http://pubs.usgs.gov/of/2004/1454/OFR2004-1454.pdf (last visited Jan. 9, 2007) [hereinafter "Collett'] ("However, numerous technical challenges must be resolved before this potential resource can be considered an economically producible reserve."). *See also Sherwood, supra* note 18, at 21; Alan Bailey, *Bering Sea Likely Rich in Hydrates,* Petroleum News (Anchorage), Jan. 21, 2007, available at http://www.petroleumnews.com (ANS has "extensive gas hydrate deposits").

[23] *See Collett, supra* note 22, at 2; *Sherwood, supra* note 18, at 20-21.

[24] Alaska Department of Revenue, *Interim Findings and Determination Related to the Stranded Gas Development Act for a Contract Between the State of Alaska and BP Exploration (Alaska) Inc., ConocoPhillips Alaska Inc., and ExxonMobil Alaska Production Inc.* 118-19 (2006), http://www.revenue.state.ak.us/gasline/IFIF%2011-16-06.pdf (last visited Jan. 10, 2007) [hereinafter "IFD"]. Approximately 18 tcf of gas must be found and produced in addition to the 35 tcf of gas already identified to support the Alaska project. Kay Cashman, *Anadarko Plans Gas Exploration Well*, Petroleum News (Anchorage), Nov. 19, 2006, available at http://www.petroleumnews.com. For example, "Anadarko has said that when it had its partnership agreements in place and was reasonably certain a gas line would be built, it would begin gas exploration."

[25] *2000 Juneau Report, supra* note 16, at 8.

[26] *2001 FERC Report, supra* note 16, at 4-5.

[27] 43 U.S.C. 1651 (1973).

[28] *See generally IFD*, *supra* note 24, at 1.3.1.

River valley to connect with existing pipelines in southern Canada.[29] Arctic Gas was a U.S. and Canadian consortium consisting of the three major Alaska lessees, Canadian companies with discoveries in the Mackenzie Delta, large pipeline companies, and major gas utilities.[30] In March of 1974, Arctic Gas applied to the Federal Power Commission (FPC), the predecessor agency to the FERC, to build its project.[31]

El Paso Natural Gas Company put a competing proposal forward to the FPC in September of 1974.[32] Under that proposal, ANS gas would be transported via pipeline alongside the TAPS to Valdez, then liquefied through chilling, next shipped in LNG tankers to California where it would be regasified, and ultimately provided to consumers directly or through existing pipelines.[33]

On July 9, 1976, another group, called the Alcan Pipeline Company (Alcan), surfaced the Alcan project or, as it would later be called, "Alaska Natural Gas Transportation System (ANGTS)."[34] This system would have also been an overland pipeline system, about 4,800 miles long. However, it would not cross ANWR, but would follow the TAPS south of Fairbanks, and then follow the Alaska Highway route to central Alberta, Canada, and finally connect into a new build system in Canada that would carry the gas to the Lower 48 states (Overland or Southern Route).[35] Led by TransCanada, the successor to Alcan, and its subsidiary Foothills, the ANGTS proponents remain active today.[36]

b. Government Action

In the mid to late 1970s, both the U.S. and the Canadian governments and their agencies took several actions to encourage the development of Arctic gas. Beginning in 1975, both FPC and the Canadian National Energy Board (NEB) conducted hearings

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29 *1998 Juneau Report, supra* note 16, at 12; *2000 Juneau Report, supra* note 16, at 9; Foothills Pipe Lines Ltd., *Northern Backgrounder* 8 (2000) [hereinafter "Northern Backgrounder"].

30 *1998 Juneau Report, supra* note 16, at 12-13; *2000 Juneau Report, supra* note 16, at 9; *Northern Backgrounder, supra* note 29, at 8.

31 *Midwestern,* 589 F.2d at 609; *2001 FERC Report*, *supra* note 15, at 16.

32 *Midwestern*, 589 F.2d at 609; *Presidential Decision*, *supra* note 15, at 215; *1998 Juneau Report, supra* note 16, at 13; *2000 Juneau Report, supra* note 16, at 9; *2001 FERC Report, supra* note 15, at 17.

33 *Presidential Decision, supra* note 15, at 215; *1998 Juneau Report, supra* note 16, at 12-13; *2000 Juneau Report, supra* note 16, at 9.

34 *Midwestern,* 589 F.2d at 610; *Presidential Decision, supra* note 15, at 216; *1998 Juneau Report, supra* note 16, at 12-13; *2000 Juneau Report, supra* note 16, at 9; *Northern Backgrounder, supra* note 29, at 8. Alcan changed its name to Northwest Alaskan Pipeline Company (Northwest), which consisted of Northwest Energy of Utah and Foothills Pipe Line, Ltd. of Calgary (Foothills). *Midwestern,* 589 F.2d at 610 n.7. The two companies had been members of Arctic Gas, but left to submit a competing proposal. *1998 Juneau Report, supra* note 16, at 14.

35 *1998 Juneau Report, supra* note 16, at 13; *2000 Juneau Report, supra* note 16, at 9.

36 *IFD, supra* note 24, at 32.

regarding the applications. Meanwhile, building on the experiences regarding the construction of TAPS, the U.S. Congress passed the Alaska Natural Gas Transportation Act (ANGTA) in October of 1976 to speed up the construction of a gas pipeline.[37] The statute called for an expedited approval process, including a presidential decision regarding the best possible system.[38]

On February 1, 1977, the FPC administrative judge completed his hearings and issued an initial decision favoring the Arctic Gas proposal.[39] On May 1, 1977, the four sitting FPC Commissioners issued a decision favoring an Overland Route rather than a LNG system, but split 2-2 between the Arctic Gas proposal and the Northwest proposal.[40] The El Paso proposal was essentially dead although it would be resurrected in a different form in the 1980s. As required by ANGTA, U.S. government agencies submitted recommendations to the president regarding a transportation system.[41]

Then, on July 4, 1977, the NEB rejected the Arctic Gas proposal and approved the ANGTS.[42] It found that the Arctic Gas proposal was "environmentally unacceptable."[43] Many have hypothecated what was behind the NEB's approval and what might have happened if the Arctic Gas proposal had gone forward.[44]

Within weeks, the two governments began meeting to enter a treaty regarding Arctic gas development. During September of 1977, the governments also concluded a "Transit Treaty" providing generally that neither country would interfere with the transportation of petroleum regardless of its source or discriminate against such a

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37 15 U.S.C. 719, *et seq.*, Pub. L. No 94-586, 90 Stat. 2912 (1976).

38 *Presidential Decision, supra* note 15, at 216; *Northern Backgrounder, supra* note 29, at 6-7.

39 *Presidential Decision, supra* note 15, at 216.

40 *Midwestern,* 589 F.2d at 610; *Presidential Decision, supra* note 15, at 216; *FPC Recommendation to the President, Alaska Natural Gas Transportation Act,* 58 F.P.C. 810, 1121 (May 1, 1977) (the FPC rejected the El Paso proposal partially because of the other two routes' ability to transport other gas from Canada and elsewhere along the route); *2001 FERC Report*, *supra* note 15, at 4 & 19.

41 *Presidential Decision, supra* note 15, at 216.

42 *Reasons for Decision, Northern Pipelines* (NEB, July 4, 1977), https://www.neb-one.gc.ca/ll-eng/livelink.exe?func=ll&objId=239633&objAction=browse&sort=name (last visited Jan. 24, 2007); *1998 Juneau Report, supra* note 16, at 14-15; *Northern Backgrounder, supra* note 29, at 9.

43 *Presidential Decision, supra* note 15, at 217.

44 *1998 Juneau Report, supra* note 16, at 13-14.

transportation system.[45] In September, they announced that they reached an Agreement on Principles, which favored the ANGTS.[46]

Within days after reaching the Agreement on Principles, President Carter chose the ANGTS as the preferred route in 1977 (President's Decision).[47] Carter selected the ANGTS primarily because the liquefaction project consumed too much gas in comparison with the ANGTS and it could potentially transport Canadian gas earlier.[48] The Arctic Gas project had become problematic because of unresolved aboriginal claims in the Mackenzie Valley and environmental impacts of its crossing ANWR.[49] The president found the ANGTS to be "clearly superior" to El Paso's proposal.[50] He also noted that the route would foster cooperation between the U.S and Canada.[51] Finally, the president observed that the project "will be one of the largest – if not the largest – privately financed international business ventures of all time."[52]

On November 2, 1977, the U.S. Congress passed a joint resolution ratifying the President's Decision.[53] Shortly thereafter, the FERC issued an order granting certificates of public convenience and necessity to the ANGTS sponsors subject to certain conditions.[54] Early in 1978, the Canadian government passed the Northern Pipeline Act, which, among other things, granted a certificate for the Canadian portion of the ANGTS.[55]

Trouble began for the ANGTS even in 1978 and the setbacks continued through 1982 when the project was suspended.[56] In 1978, Congress passed the Natural Gas Policy Act (NGPA), which allowed Alaska gas to be "rolled in" with lower cost Lower 48 gas.[57] But, by the early 1980s, gas deregulation swept the market and little so-called

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45 The full title of the Transit Treaty is the *Agreement between the Government of the United States of America and the Government of Canada Concerning Transit Pipelines*. The treaty became effective in October of 1977, after Senate ratification. *2001 FERC Report, supra* note 15, at n.5 & 21; *1998 Juneau Report, supra* note 16, at 15; *Northern Backgrounder, supra* note 29, at 10.

46 *Midwestern*, 589 F.2d at 611; *Presidential Decision, supra* note 15, at 217; *2001 FERC Report, supra* note 15, at 21-22.

47 *Midwestern,* 589 F.2d at 611.

48 *Id.*; *Presidential Decision, supra* note 15, at 217; *1998 Juneau Report, supra* note 16, at 15.

49 *Presidential Decision, supra* note 15, at 329; *1998 Juneau Report, supra* note 16, at 15.

50 *Presidential Decision, supra* note 15, at 218 & 329.

51 *Id.* note 50 at 219.

52 *Id.*

53 H.R. J. Res. 621, Pub. L. No. 95-158, 91 Stat. 1268, 95th Cong., 1st Sess. (1977).

54 *Alaskan Northwest Natural Gas Transportation Company,* 3 F.E.R.C. ¶ 61,290 (June 30, 1978); *Alcan Pipeline Co., et al.*, 1 F.E.R.C. ¶ 61,248 (December 16, 1977).

55 Bill C-25, passed April 4, 1978 3rd Session, 30th Parliament. S.C. 1977-78, C.20.

56 *See generally IFD, supra* note 24, at 33-34.

57 *1998 Juneau Report, supra* note 16, at 15.

"old" gas[58] was available to be rolled in with Alaska gas.[59] Gas prices in the Lower 48 collapsed, creating a gas bubble.[60] Costs of the ANGTS continued to escalate.[61] Despite the many incentives for the ANGTS, the Alaska portions were never constructed and "nothing of substance has been done to move this project forward since May 1982."[62]

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58 "Old gas" or "old flowing gas" is generally gas "that was committed or dedicated to interstate commerce on the day before enactment of the [NGPA and] intrastate flowing gas subject to the price ceilings for intrastate rollover contracts …." Ceiling Prices; Old Gas Pricing Structure, 51 Fed. Reg. 22,168 (June 18, 1986) (to be codified at 18 C.F.R. Parts 154, 157, 270, 271 and 284). Under the NGPA, the interstate portion of the old gas was held largely to the below market prices at which it had been priced prior to the passage of the Act, adjusted for inflation. At the time of the passage of the NGPA, it was anticipated that this gas would continue to be available for some time after the passage of the Act to be rolled in with the higher priced Alaska and other, "new" gas developed after the enactment of the Act in order to ease their entry into the market. As other sources of "new" gas were brought on after the passage of the NGPA at high price levels, however, the pricing "cushion" provided by the "old" gas was rapidly used up to the point that, by the early 1980's, little of the anticipated "cushion" remained for Alaska – or for that matter, other later "new" – gas.

59 *1998 Juneau Report, supra* note 16, at 16.

60 *2000 Juneau Report, supra* note 16, at 9; *EIA 2004, supra* note 16, at 40; Energy Information Administration, *The Effects of the Alaska Oil and Natural Gas Provisions of H.R. 4 and S. 1766 on U.S. Energy Markets* 13, (2002), http://www.eia.doe.gov/oiaf/servicerpt/aong/pdf/sroiaf(2002)02.pdf (last visited Jan. 10, 2007); *2000 Juneau Report, supra* note 16, at 9. By 1987, gas prices were "about one-tenth of what the sponsors of the big Alaska projects assumed they would receive for their gas …."

61 *1998 Juneau Report, supra* note 16, at 16-17; *2000 Juneau Report, supra* note 16, at 9; *Sherwood, supra* note 18, at 39.

62 *2001 FERC Report*, *supra* note 15, at 7; *IFD, supra* note 24, at 33 ("the project was suspended in May 1982"); *CERA Gas, supra* note 16, at 12; *Northern Backgrounder, supra* note 29, at 4 ("As a result of market conditions in the U.S. lower 48, the completion of Phase II of the ANGTS has been deferred"); R. Ridlehoover and B. Pulliam, *Alaska Gas and NGL: Economic Analysis of Value and Royalty* iv (2002), http://www.dog.dnr.state.ak.us/oil/products/publications/otherreports/value/ngl_value_study.pdf (last visited January 2, 2007) [hereinafter "Ridlehoover"] ("price reversals put the project on hold, where it remained until 2000").

3. LNG and Other Attempts to Monetize ANS Gas Resources: 1982 – 1999

With the collapse of Lower 48 gas prices, others eyed a different market for ANS gas. In the early 1980s, a group of Alaska citizens led by two former Alaska governors formed Yukon Pacific Corporation (YPC) to try again to develop an LNG project.[63] However, instead of shipping LNG to the West Coast, this project would have shipped gas to the Far East.[64] YPC secured various permits and rights-of-way.[65] Additionally, in 1989, the U.S. Department of Energy (DOE) authorized YPC to export gas to the Far East and in 1995, FERC authorized the construction of an LNG facility for gas export to the Far East.[66] Despite many efforts, the YPC project has not been developed and reportedly YPC's various permits and authorizations have been acquired by the Alaska Gasline Port Authority (AGPA).[67]

The major ANS oil and gas producers continued to study ANS gas development in the 1980s and 1990s without identifying a commercially viable option.[68] ARCO Alaska Inc. (ARCO) conducted a joint study with YPC and a Japanese institute, but concluded the Asian market was not ready yet for Alaska LNG.[69] BP Exploration (Alaska) Inc. (BP) also studied the Asian market.[70]

In 1992, a group of North Slope producers and others began once again to study the LNG export concept to the Far East.[71] The effort looked at various routes and was continued through 2000.[72] Other options looked at by this group included a gas to liquids project.[73]

In 1998 continuing through 2001, Phillips Alaska, Inc. (Phillips), BP, Foothills, and Marubeni Corporation of Japan were part of a joint venture to study delivering ANS

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63 *See Basins, supra* note 15, at 12.10; *1998 Juneau Report, supra* note 16, at 13 & 17; *2000 Juneau Report, supra* note 16, at 9; *Sherwood, supra* note 18, at 50-54.

64 *1998 Juneau Report, supra* note 16, at 13; *2000 Juneau Report, supra* note 16, at 9.

65 *1998 Juneau Report, supra* note 16, at 17. Eventually, YPC majority ownership passed to CSX Corporation, a U.S. transportation company. *1998 Juneau Report, supra* note 16, at 17.

66 *Order Granting NGA Section 3 Authorization for the Siting, Construction and Operation of LNG Facility***,** 71 F.E.R.C. ¶ 61,197 (May 22, 1995), reh'g denied 72 F.E.R.C. ¶ 61,226 (Sept. 14, 1995).

67 *See IFD, supra* note 24, at 35.

68 *See Basins, supra* note 15, at 12.14-12.16.

69 *1998 Juneau Report, supra* note 16, at 17.

70 *Id.* note 69 at 17.

71 *Id.*; *2000 Juneau Report, supra* note 16, at 9. The group consisted of BP, ARCO and Exxon Co. U.S.A (Exxon). *1998 Juneau Report, supra* note 16, at 17.

72 *1998 Juneau Report, supra* note 16, at 17; *2000 Juneau Report, supra* note 16, at 9.

73 *Basins, supra* note 15, at 12.15-12.16; *1998 Juneau Report, supra* note 16, at 17.

gas through an LNG project to East Asia.[74] The consortium ultimately concluded that this project was not cost competitive.[75]

None of these projects for ANS gas development proved to be economic. In the mid to late 1990s, the Alaska government examined various ways to improve its fiscal system to encourage development.[76] As a result, in 1998, then Governor Knowles introduced the Alaska Stranded Gas Development Act (Stranded Gas Act) to provide for a negotiated fiscal contract between the State and a developer for an LNG project.[77] This act paved the way for the fiscal contract (Fiscal Contract)[78] that was agreed to between the Alaska administration and BP, Phillips – later ConocoPhillips Alaska, Inc. (ConocoPhillips) – and ExxonMobil Production Company (ExxonMobil) (collectively Producers).

B. Recent Restart of Attempts to Monetize the ANS Gas Resources

Beginning in 2000, Lower 48 and worldwide gas prices began to rise and interest in developing an ANS gas project began again.[79]

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74 *Northern Backgrounder, supra* note 29, at 34.

75 *See Basins, supra* note 15, at 12.15.

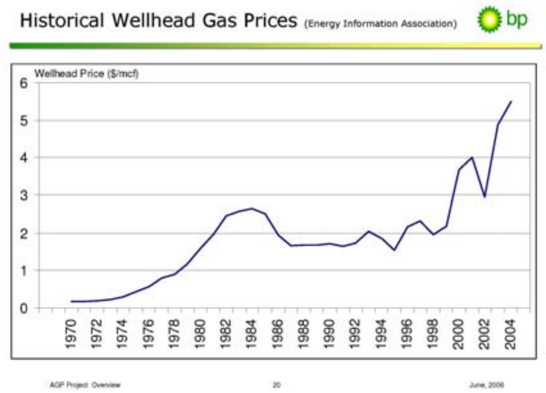
76 *1998 Juneau Report, supra* note 16, at 20-21.

77 AS 43.82.010-.990. The Stranded Gas Act was originally signed into law on July 7, 1998. *See IFD, supra* note 24, at 40.

78 *Alaska Stranded Gas Fiscal Contract Between the State of Alaska and BP Exploration (Alaska) Inc., ConocoPhillips Alaska, Inc., and ExxonMobil Alaska Production Inc.*, May 24, 2006, http://www.revenue.state.ak.us/gasline/ContractDocuments/Main%20Documents/Fiscal%20Contract/SGDA_Contract_5%2024%2006%20final.pdf (last visited January 29, 2007).

79 *See IFD, supra* note 24, at 34; *Ridlehoover, supra* note 62, at iv & 4-5; Cambridge Energy Resources Associates has also concluded that gas prices were too low to support gas development on the ANS from 1985 to 2000, and probably to Spring of 2002 when gas prices experienced a sustained increase. *See Affidavit of David Hobbs at 3, Request for Reconsideration and Stay of the Findings and Decision of the Commissioner, Department of Natural Resources, State of Alaska Regarding the Point Thomson Unit dated November 27, 2006* (Dec. 18, 2006).

FIGURE 3 Historical Wellhead Gas Prices



BP Exploration (Alaska) Inc., Alaska Gas, Presentation to the Public: Alaska Gas Pipeline Overview, July 2006 (2006)

Many other developments began to favor ANS gas commercialization, including:

- Improved technology and lower construction costs
- Improved investment climate
- Alignment of interests in the giant Prudhoe oil and gas field
- Introduction of federal legislation, which ultimately passed in 2004.[80]

As these favorable changes began to unfold, many entities began to re-examine the development of the ANS gas resources. The most comprehensive study was undertaken by the Producers. In December of 2000, the Producers formed a joint study team to complete a comprehensive conceptual study to assess the feasibility of constructing a pipeline to deliver Alaska gas to Canadian and Lower 48 markets. This study assessed the cost, technology, regulatory and environmental issues associated with the project.[81] The Producers spent in excess of $125 million on the study.[82] The study concluded in April of 2002, finding that although a pipeline was technically viable, it was not currently commercially viable.[83] The study findings noted that viable government frameworks were essential, including U.S. federal legislation, fiscal certainty with the

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[80] *See Basins, supra* note 15, at 12.8; *2000 Juneau Report, supra* note 16, at 12-13.

[81] BP, ConocoPhillips and ExxonMobil, *Amended Application for Development of a Contract Under AS 43.82 The Alaska Stranded Gas Development Act* § 5.2 (2004), http://www.revenue.state.ak.us/GaslineDocs/ConocoPhillips%20Application_Amendment_1_20_04.pdf (last visited Jan. 3, 2007) [hereinafter "Producers' Application"].

[82] *Producers' Application, supra* note 81, at § 5.2 ("$125 million was spent on this study, which involved 110 owner company representatives and over one million staff-hours (including contractors)").

[83] BP, ExxonMobil, and Phillips 66, *Alaska Producer Pipeline Update* 5 (2002) (on file with BP Exploration (Alaska) Inc.) [hereinafter "Update"]; *see Basins, supra* note 15, at 12.19.

State, and regulatory certainty with Canada.[84] The Producers agreed to continue to collaborate to look for cost savings opportunities and to work with governments to establish the necessary frameworks.[85]

1. New United States Federal Frameworks – The Alaska Natural Gas Pipeline Act (Alaska Pipeline Act)

a. The Enactment of the Alaska Pipeline Act

With the renewed interest in ANS gas development, the U.S. federal government sought ways to again timely stimulate development of a project and establish a new framework for that development.[86] A bill, first introduced in 2001 with a broader national energy package, was finally passed in late 2004 to accomplish that objective.[87] The Alaska Pipeline Act[88] sought to clarify and expedite the process for developing an ANS gas pipeline. To stimulate the project, it authorized the Secretary of Energy to issue federal loan guarantee instruments of up to $18 billion for loans and other debt obligations for an Alaska project.[89] It did not affect any decision, authorization, or presidential action relating to ANGTA.[90]

It did, however, provide a new framework for the issuance of a certificate of public convenience other than ANGTA for a project meeting the requirements of the Alaska Pipeline Act.[91] The process is an expedited one, with FERC designated the lead agency and responsible for issuing an environmental impact statement within 20 months from the submission of a complete application.[92] Although FERC has historically lacked the authority to order expansions of a gas pipeline, the Alaska Pipeline Act, in a "dramatic break from existing case law,"[93] gave that authority to FERC to order expansion of the pipeline to address concerns expressed by the State and non-pipeline owners.[94] It also established an independent office, the Office of the Federal Coordinator, to coordinate the expeditious discharge of activities of federal agencies under, and to ensure the compliance of those agencies with, the Alaska Pipeline Act.[95] Next, to further expedite any project, the Alaska Pipeline Act provided for timely judicial review by:

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84 *Update, supra* note 83, at 23.
85 *Id.* note 84, at 23; *Producers Application, supra* note 81, at § 5.2.
86 *FERC Initial Report, supra* note 2, at 2; *Basins, supra* note 15, at 12.21.
87 *IFD, supra* note 24, at Annex 1.
88 15 U.S.C. § 720-720n (2004). Pub. L. No. 108-324, div. C, § 102, 118 Stat. 1255 (October 13, 2004).
89 15 U.S.C. § 720n (2004).
90 *Id.* § 720h.
91 *Id.* § 720a.
92 *Id.* § 720b.
93 *IFD, supra* note 24, at Annex 1.
94 15 U.S.C. § 720c (2004).
95 *Id.* § 720d.

(1) setting a 60 day statute of limitations on any claim after the date of the decision or action giving rise to the claim; and (2) placing original and exclusive jurisdiction in the D.C. Circuit Court of Appeals with a request that the court give expedited consideration to any matter under the Alaska Pipeline Act.[96] Finally, it provided that if no application for a certificate were filed by April of 2006 (eighteen months after the Pipeline Act's enactment), the secretary of the DOE would be required to study alternative approaches to the construction and operation of an Alaska natural gas transportation project.[97]

The Alaska Pipeline Act was a major step forward for an Alaska project.[98] It clarified the various regulatory processes, provided for unprecedented mandatory expansions of the pipeline, and provided financing guarantees for the project.

b. Recent Federal Actions Under the Alaska Pipeline Act

(1) FERC Orders 2005 and 2005A

The Alaska Pipeline Act also required the FERC to adopt regulations regarding the conduct of the "open season" processes for the Alaska project within 120 days from the enactment of the Alaska Pipeline Act.[99] To fulfill that requirement, the FERC issued a Notice of Proposed Rulemaking on November 15, 2004 and, following a public process,

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[96] *Id.* § 720e. In addition, the Pipeline Act contained several provisions that were beneficial to the State of Alaska. First, it prohibited any so-called "Over the Top" routes through the Beaufort Sea to Canada. § 720a(d). Second, it contained special provisions relating to the in-state use of gas, including a study and access. § 720a(g)-(h). Third, it clarified the scope of FERC authority over spur lines within Alaska. § 720e(b). Fourth, although FERC is responsible for establishing rates for transportation on the system, it required the FERC to consult with the State of Alaska on rates for delivery of gas within Alaska. § 720e(c)(2). Fifth, the State was given primary responsibility for surveillance and monitoring where the system crosses State lands. § 720d(e)(2).

[97] *Id.* § 720g.

[98] *IFD, supra* note 24, at Annex 1.

[99] 15 U.S.C. § 720a(e). The "open season" is a period during which those interested in transporting gas through a new pipeline (or an expansion of an existing pipeline) may reserve capacity on the pipeline. The "open season" process may start by providing for non-binding indications of interest in order to permit the pipeline company to develop a preliminary design for the project. Even if non-binding indications of interest are accepted initially, this usually is followed by a further process in which shippers make binding indications of interest prior to the time that the project owner submits. Shippers who make binding commitments receive priority for capacity on the pipeline if it is built, but in return must commit to pay for that capacity whether or not they use it. The open season process allows the pipeline owner to: (1) design a pipeline to accommodate the capacity necessary to transport the committed gas to each particular destination without overbuilding the pipeline; and (2) obtain financing to construct the pipeline. Energy Information Administration, Dep't of Energy, *U.S. Natural Gas Pipeline and Storage Expansions in 2003* at 14 (2004), www.eia.doe.gov/pub/oil_gas/natural_gas/feature_articles/2004/Pipestor04/ngpipestor04.pdf; *see also Preliminary Determination on Non-Environmental Issues, Rockies Express Pipeline LLC*, 116 FERC ¶ 61,272 at para. 68-73 (2006) (approving open season procedures providing for various levels of rates).

issued Order No. 2005 on February 9, 2005.[100] After several parties requested rehearing or clarification, the FERC issued Order 2005-A on June 1, 2005.[101]

The new open season regulations apply whether the pipeline would be constructed under ANGTA or under the Natural Gas Act pursuant to the Alaska Pipeline Act. The regulations generally provide:

> [T]he open-season regulations specify the criteria for and timing of any open seasons, promote competition in the exploration, development, and production of Alaska natural gas, and, for any open-season for capacity exceeding the initial capacity, provide for the transportation of natural gas other than from Alaska's North Slope. In addition to providing prospective project sponsors with flexibility in the design of their open seasons, the open-season rules allow pre-subscriptions of capacity. The rules also provide rate certainty for voluntary expansions by specifying that rolled-in rate treatment will attach to voluntary expansions.[102]

The primary areas of contention were:

1. Whether FERC could require changes to the design of a project. The Producers and others contended that the requirement was beyond FERC's authority and it may not be possible to efficiently design a pipeline to accommodate the capacity of all bidders.

2. Whether the regulations provided for an unduly discriminatory set-aside of capacity for fields other than Prudhoe Bay and Point Thomson. The Producers and others contended that they did.

3. Whether there should be a rebuttable presumption in favor of "rolled-in" rates for expansions.[103] The rebuttable presumption was contrary to the general rule in the United States, but FERC distinguished the Alaska project on the basis that there is likely to be only one pipeline from the ANS to markets.

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100 *Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects,* Order No. 2005, 70 Fed. Reg. 8269 (Feb. 9, 2005) (to be codified at 18 C.F.R. pt. 157), 110 F.E.R.C. ¶ 61,095 (2005). *order on reh'g,* Order No. 2005-A, 70 Fed. Reg. 35011 (June 16, 2005) (to be codified at 18 C.F.R. pt. 157), 111 F.E.R.C. ¶ 61,332 (2005); *see Basins, supra* note 15, at 12.22.

101 *Id.*

102 *FERC Initial Report*, *supra* note 2, at 2.

103 "Rolled-in rates" refers to the ratemaking process in which the costs of an expansion are "rolled-in" with the existing facility costs of the pipeline and charged to all shippers. The other approach generally used in pipeline ratemaking is "incremental rates." In that process, the pipeline establishes a separate cost of service for the expansion and charges a separate rate for the expansion service to the expansion shippers based on that separate cost of service. *See* Statement of Policy, Certification of New Interstate Natural Gas Pipeline Facilities, 88 FERC ¶ 61,277 (1999).

4. Whether the requirement to consider late bids, which may be rejected only under limited circumstances, was reasonable. The Producers and others contended that the requirement could delay the project by creating uncertainties and delay. The FERC agreed to revise the regulation to clarify the basis on which such late bids could be rejected.

5. Whether the requirement that an applicant must file a detailed plan for conducting an open season for FERC approval 90 days before providing notice of the open season would unduly delay the process. The Producers and others objected that the requirement would delay the process and would not reduce the number of disputes. The FERC agreed to make some changes to regulations to make clear what must be contained in the plan and to eliminate certain notice requirements.

6. Whether the requirement that pre-subscription agreements for initial capacity would be permitted only if that capacity were offered to all bidders under the same terms and that if capacity is oversubscribed and the applicant does not redesign the project to accommodate all capacity requests, only the pre-subscription capacity, not capacity acquired in the open season, must be allocated on a pro rata basis negated the whole process. The Producers maintained that the requirement unduly discriminated against those who made early commitments to the project. FERC did not find this argument persuasive because the Producers and other potential shippers had a "plethora" of information regarding the project and could decide whether entering into pre-subscription agreements would be beneficial. FERC did, however, clarify the requirement to eliminate the ability to cherry pick.

The Producers appealed the final regulations to the D.C. Circuit Court on the limited issue of whether FERC could require the redesign of a pipeline.[104] The Producers asserted that the FERC's authority under the Alaska Pipeline Act did not include the authority to condition the granting of a certificate to require the applicant to build capacity that it did not propose even if that capacity had not been bid for and may never be used. Oral argument was held on the appeal on December 5, 2006, and the attorney representing the State legislature could not predict when a decision would be reached.[105]

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[104] *Exxon Mobil Corporation v. FERC*, No. 05-1299 (D.C. Cir filed July 29, 2005); *FERC Third Report, supra* note 4, at 5.

[105] Memorandum from Donald C. Shepler on Summary of D.C. Circuit Oral Argument on Appeal of FERC Order Nos. 2005 and 2005-A to Senator Gene Therriault and Representative Ralph Samuels 4-5 (Dec. 6, 2006), http://lba.legis.State.ak.us/sga/doc_log/2006-12-06_alaska_memo_summarizing_oral_argument.pdf (last visited Jan. 24, 2007).

(2) DOE Report

Because no application for a certificate to construct an Alaska project was filed by April of 2006 (eighteen months after the enactment of the Alaska Pipeline Act), the act required the secretary of the DOE to study alternative approaches to the construction and operation of a project.[106] Even though the time for study has long passed, the only note of any DOE study was by FERC in its July 10, 2006 report to Congress.[107] That report states that on April 13, 2006, DOE began "a pre-scoping study to evaluate options, risks, and resources needed for further study."[108] The most recent January 2007 report to Congress does not mention the study.[109]

(3) Federal Loan Guaranty

On May 27, 2005, the DOE published a Notice of Inquiry seeking public comment on the $18 billion loan guarantee program called for in the Alaska Pipeline Act.[110] The Notice of Inquiry stated that DOE was considering adopting regulations regarding the program and sought comments on the following matters:

- Should DOE negotiate a conditional commitment before a certificate is issued by FERC?
- Should the DOE Secretary make certain findings regarding the sponsor and its project before engaging in negotiations?
- Should special terms attach to the financing of the Alaska project?
- Does the Alaska Pipeline Act preclude any "lender risk" on project debt that receives a federal guarantee and what should be the impact of the possibility of 100% debt in the project's evaluation?
- Should DOE impose a loan guarantee?
- What type and form of assurance should the DOE require to ensure that the sponsor contribute 20% of the equity to the project?
- How should the maximum term of the loan be calculated?
- What recourse should the DOE have in the event of default?
- Can or should cost overruns be funded through authorized guaranteed debt?
- What are the appropriate reporting requirements?

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106 15 U.S.C. § 720g (2004).

107 *FERC Second Report, supra* note 8, at 7.

108 *Id. See* Tim Bradner, *DOE to Examine Alternatives for Building Gas Line,* Journal of Commerce, Feb. 26, 2006, available at http://www.alaskajournal.com/stories/ (last visited Jan. 8, 2007).

109 *FERC Third Report, supra* note 4, at 5.

110 Alaska Natural Gas Pipeline Loan Guarantee, 70 Fed. Reg. 30,707 (Dep't of Energy, May 27, 2005).

DOE continues to monitor the Alaska project's progress before publishing specific regulations.[111]

(4) Office of Federal Coordinator

The Alaska Pipeline Act created an independent office in the executive branch of the Office of the Federal Coordinator for Alaska Natural Gas Transportation Projects and created a head of that office (Federal Coordinator) to be appointed by the President and confirmed by the Senate.[112] Recently, former Alaska Senate President and assistant to the Secretary of the Interior Drue Pearce was tabbed to fill the position.[113] She is to ensure that all federal agencies expeditiously discharge their duties under the Alaska Pipeline Act and has responsibility for monitoring any project that crosses federal and private lands. She is to coordinate the activities by federal agencies for permitting and construction of a pipeline to bring North Slope gas to markets in the Lower 48.[114] To facilitate the coordination, 15 federal agencies signed a memorandum of understanding to work together to expedite the project.

2. Canadian Regulatory Frameworks – Lack of Clarity

The Producers believe that a clear regulatory framework in Canada is necessary for an Alaska project to be developed.[115] That framework is the National Energy Board Act. According to FERC, however, lack of clarity remains whether that act may be accessed.

> On the one hand, Foothills … insists it has an exclusive right to exercise its existing certificates under the Northern Pipeline Act; on the other hand, the [Producers] argue that they have the right to apply for a new certificate under the National Energy Board Act.… The Government of Canada is considering the issue and has not taken a public position. The [Producers have] long held that one of the key elements in justifying continuation of the project is Canadian agency and First Nation regulatory process clarity.[116]

In the *Fiscal Contract,* the Producers agreed to move forward with the project despite some's perceived lack of clarity in Canada and spend at least $120 million

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111 *FERC Second Report, supra* note 8, at 7.

112 15 U.S.C. § 720d(a)-(b).

113 *Inside Alaska Business*, Anchorage Daily News, Dec. 21, 2006, at F1, available at http://www.adn.com.

114 Drue Pearce, *Office of Federal Coordinator, Federal Coordinator: What is This New Job Drue Has?* (2006), http://www.akrdc.org/membership/events/breakfast/0607/pearce.pdf (last visited Jan. 16, 2007).

115 *FERC Initial Report, supra* note 2, at 7-8.

116 *Id.*

dollars.[117] The *Fiscal Contract,* however, does provide that if the State contends that the Producers have not diligently developed the project, then in a dispute the arbitration panel must consider that the parties recognized that the project's development could be adversely impacted by the Canadian regulatory processes and aboriginal issues and must be instructed that in determining whether the Producers have not acted diligently that other major pipeline projects have experienced delays in Canada.[118]

The Canadian Mackenzie gas project is also receiving consideration from the Government of Canada. This major project, costing $7 billion, includes a 750-mile pipeline from the Mackenzie River Valley, to deliver about 1.2 bcfd of gas to North American markets.[119] Recently, talks have stalled pending review of the project's cost estimate and construction schedule.[120] However, the regulatory review process before the NEB is continuing.[121] The FERC sees this project as posing risks to the Alaska project due to a lack of sufficient steel and shortage of skilled labor to build both projects simultaneously. At least one Producer has stated that the two projects are not in competition.[122] The Mackenzie project is smaller and further advanced than the Alaska project. If the Mackenzie project goes before the Alaska project, it might benefit from the experiences gained through the construction of the Mackenzie project.

3. New Alaska Frameworks - Reauthorization of Stranded Gas Act

As noted in Section II.B.4.b. the Producers remained committed to working with governments to establish the necessary frameworks for an Alaska project. The first part

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117 *Fiscal Contract*, supra art. 27.
118 *Id.* art. 5.
119 *FERC Second Report, supra* note 8, at 9-10.
120 *Id.* note 119, at 9-10.
121 *Id.*
122 William J. Tobin, *Voice of the Times,* Anchorage Daily News, June 26, 2005, at J3; Richard Macedo, *NWT, Mackenzie Pipeline Proponents Ink Socio-Economic Deal,* Nickle's Daily Oil Bulletin, Jan. 22, 2007, at 3. ("Territories' Industry Minister Brendan Bell, meanwhile, was in Alaska … to meet with Alaska's new governor Sarah Palin. '[I] brought her up to date on Mackenzie and expressed our feeling that there is some urgency around bringing Arctic gas to market,' he said, citing competition from liquefied natural gas regasification facilities on the continent and inflationary effects on major projects as some key challenges. Alaska has its own much delayed proposed mega project, the Alaska Highway Pipeline. Bell doesn't think the two projects are going to compete for resources like manpower and steel, if they get built. 'I don't think that's a legitimate concern anymore,' Bell said. 'I think they're cued up nicely to have Mackenzie go first and then Alaska to follow.' Alaska's new governor said last week she will introduce legislation to give any interested energy company or consortium the opportunity to compete openly for the right to build the natural gas pipeline from the state's North Slope region…."

of those frameworks occurred when the Stranded Gas Act was reauthorized in 2003.[123] As amended, the act extended the time to file an application until March 31, 2005.[124]

The amended Stranded Gas Act also broadened the types of projects to which the act applied from only LNG projects to a pipeline project or any other technology that commercialized natural gas.[125] The act's stated purposes are to:

- "encourage new investment to develop the State's stranded gas resources by authorizing establishment of fiscal terms related to that new investment without significantly altering tax and royalty methodologies and rates on existing oil and gas infrastructure and production";
- "allow the fiscal terms applicable … to be tailored to the particular economic conditions of the project and to establish those fiscal terms in advance with as much certainty as the Constitution of the State of Alaska allows"; and
- "maximize the benefit to the people of the state of the development of the state's stranded gas resources."[126]

The Stranded Gas Act contemplated a process under which all three branches of government, the executive, the legislative, and the judicial branch, were to participate in the development, approval, or review of contract. (We will refer to the executive branch as the "Murkowski administration" while Frank Murkowski was governor and the "Palin administration" while Sarah Palin has been governor.) The following summarizes the process for developing, reviewing, and approving a contract under the act:

- An applicant would submit an application.[127]
- The Commissioner of the Alaska Department of Revenue (DOR Commissioner) would review the application to determine whether the applicant and the application qualified under the act.[128]
- If the DOR Commissioner determined that the applicant and the project qualified, the State could then negotiate to develop a fiscal contract with the applicant.[129]
- If the negotiations successfully resulted in a fiscal contract, the DOR Commissioner would issue a preliminary finding and determination that

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[123] HB 16 was signed into law on April 4, 2003. *See* Tim Bradner, *Palin's Pipeline Vision an Appetizer for Real Deal*, Anchorage Daily News, Jan. 21, 2007, at H1; *Basins, supra* note 15, at 12.4.

[124] AS 43.82.170; *see Basins, supra* note 15, at 12.19.

[125] AS 43.82.100.

[126] AS 43.82.010.

[127] AS 43.82.120.

[128] AS 43.82.100 & .130-.140.

[129] AS 43.82.200-.270.

the contract was in the public interest and seek public and legislative comment.[130]

- After consideration of those comments and making any appropriate changes to the contract, the DOR Commissioner could then issue a final finding and determination and have the Governor submit the contract to the legislature for authority to execute the contract.[131]
- If approved by the legislature, the Governor could execute the contract on behalf of the State within 60 days of the effective date of the law approving the contract.[132]

Because the Stranded Gas Act recognized that there would be legal challenges to any fiscal contract, it required that any challenge be brought within 120 days after the final execution of the contract.[133] Such a challenge would ultimately bring certainty to the process and the terms of any fiscal contract.

4. Stranded Gas Act Applications

Following the reauthorization of the Stranded Gas Act, a number of applications were submitted to the DOR Commissioner to develop ANS gas. Those applications contained three basic proposals with variations. The next sections discuss the basic proposals, the applications, and the action taken by the State of Alaska on those applications. In the discussion, it is important to remember that the State government actually consists of three branches of government: the executive, the legislature, and the judicial. As we will see, each branch was to be given a role in the consideration of a contract.

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[130] AS 43.82.400-.410.

[131] AS 43.82.430.

[132] AS 43.82.435. A more detailed description of the process is contained in the State's *Interim Findings and Determination*. *See IFD, supra* note 24, at 43-47.

[133] AS 43.82.440.

a. The Proposals

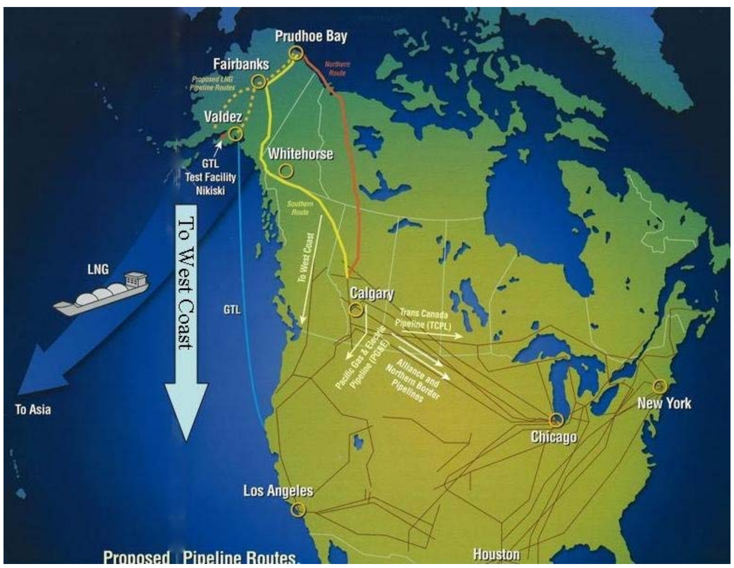
Three basic pipeline proposals were considered by the Murkowski administration. They and their variants, as well as other proposals put forward in the 2000s, are outlined in the following paragraphs.

The first basic proposal may be summarized as some variant of the Overland or Southern route, with pipeline paralleling the TAPS from the ANS to Delta Junction, then paralleling the Alaska Highway to Alberta, Canada. Variants of the Overland Route included: (1) a route that was the same as the Overland Route, but extending on to Chicago (Chicago route); (2) a route from the ANS heading offshore into the Beaufort Sea, then east along the coast to the Mackenzie River Delta in Canada, and finally into Alberta or extending to Chicago (Northern Route). Under U.S. federal law, the Northern Route is prohibited, and under Alaska law a Northern Route is not permittable until a Southern Route is constructed. The Producers have stated their intent to pursue the Southern Route.

The next basic proposal was an LNG proposal. A pipeline would parallel the TAPS transporting gas to either a location in South Central Alaska or Valdez (LNG route). There the gas would be liquefied and then shipped by LNG tanker to locations on the West Coast or the Far East.

The last basic proposal is simply a combination of the first two – a so-called "Y-line" which would split near Delta Junction, Alaska, and then consist of two main pipelines, one continuing to Canada and the other heading to an LNG liquefaction plant in southern Alaska. Figure 4 shows generic Northern, Southern, LNG and Y-line Routes.

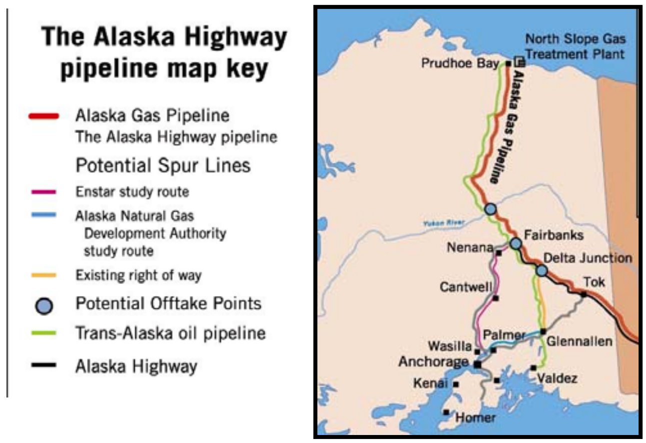
FIGURE 4 Basic Alaska Project Routes



BP Exploration External Affairs Department, *Juneau Report: Alaska Natural Gas – Clean Energy for North America* 10-11 (Winter 2000)

In addition to the basic proposals, other proposals have included various so-called "Spur Lines" that would take gas from a main pipeline and then transport that gas for use to Southcentral Alaska.[134] Figure 5 shows examples of potential Spur Lines from a main pipeline following a Southern Route.

FIGURE 5 Potential Spur Line Routes



BP Exploration (Alaska) Inc., Alaska Gas, Presentation to the Public: Alaska Gas Pipeline Overview, July 2006 (2006)

The Murkowski administration also discussed the possibility of monetizing ANS gas through use of the GTL technology.[135] BP operates a GTL test plant in Nikiski, Alaska. Other ANS producers have been involved in the use of GTL technology. The process has been around for over 50 years. Currently, no entity is advancing such a project in Alaska and the administration found it inferior to other proposed projects in numerous respects.[136] The next section will consider the various entities that have sponsored a proposed project, most of which were the subject of an application under the Stranded Gas Act.

b. Producers

On January 20, 2004, the Producers submitted a final application under the Stranded Gas Act.[137] Their plan called for the construction of a pipeline and related

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[134] Anchorage Chamber of Commerce, *Natural Gas and Alaska's Future* 17 (Anchorage Chamber of Commerce (2005), http://www.revenue.state.ak.us/gasline/ContractDocuments/Other%20Docs/AncChamber/OTR_000822.pdf (last visited Jan. 15, 2007) [hereinafter "Chamber"].

[135] *IFD, supra* note 24, at 187-89.

[136] *Id.* note 135, at 187-89.

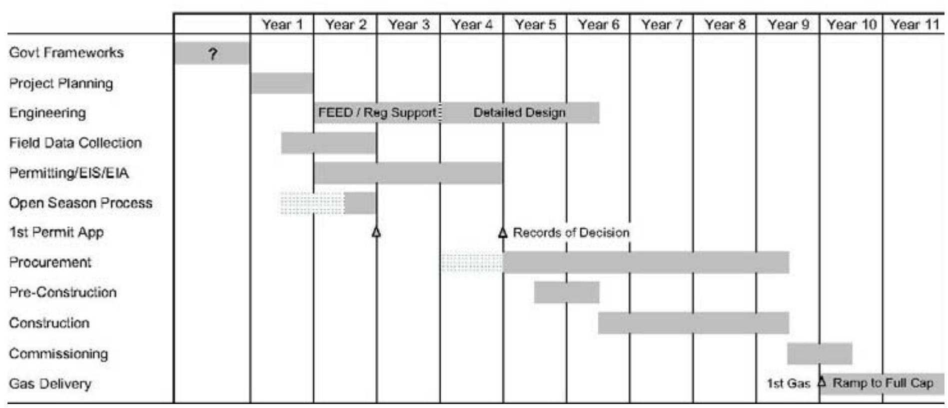
[137] *See Basins, supra* note 15, at 12.20.

facilities, with a design capacity to transport approximately 4 bcfd of gas from the ANS to North American markets, expandable by approximately 1 bcfd.[138]

The project's four major components would be a gas treatment plant (GTP), a large diameter pipeline from Alaska to Alberta, a potential natural gas liquids (NGL) plant, and possibly a pipeline from Alberta to Chicago.[139] The preliminary design basis was for a 52-inch buried pipe operating at 2500 pounds per square inch.[140] Compressor stations would be installed at regular intervals along the pipeline.[141] Where pipeline crossed permafrost, the gas would be chilled to lessen the mechanical pipeline strains and mitigate impact on frozen soils.[142]

The Producer's application included a success case timeline of ten years for completion of the project, culminating with gas deliveries to markets.[143] The timeline started after completion of a fiscal contract with the State and was contingent on the success of key events, including key government approvals. Figure 6 is the conceptual timeline in the Producer's application.

FIGURE 6 Conceptual Project Timeline



BP, ConocoPhillips and ExxonMobil, *Amended Application for Development of a Contract Under AS 43.82 The Alaska Stranded Gas Development Act 10*, January 20, 2004, http://www.revenue.state.ak.us/GaslineDocs/ConocoPhillips%20Application_Amendment_1_20_04.pdf (accessed Jan. 3, 2007).

Because the Producers are gas resource owners, their proposal to the State was unique. The Producers' proposal would establish terms governing the resource as well as the pipeline that would transport that resource to market.

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138 *Producers' Application, supra* note 81, at § 5.1.
139 *Id.* note 138, at § 5.1.
140 *Id.*
141 *Id.*
142 *Id.*
143 *Id.* note 138, at § 5.3.

The Producers considered a pipeline project a "promising option," but had previously determined that the project was not currently "commercially viable."[144] They sought fiscal certainty from the State of Alaska as provided under the Stranded Gas Act. They desired a "predictable, durable and binding fiscal contract" containing "simple and clear fiscal and royalty take terms" and contract terms that the State could not unilaterally change.[145] The Producers and the Murkowski administration successfully negotiated a contract, which will be described in Section II.C.

c. Other Applications

Several other applications under the Stranded Gas Act were considered by the Murkowski administration. Additionally, the administration considered the role of other entities that did not apply and others have suggested other possible sponsors.[146] We discuss each sponsor separately. The applicants and projects were:

(1) TransCanada

TransCanada, and its wholly owned subsidiary Alaskan Northwest Natural Gas Transportation Company (Northwest Gas), submitted their application on June 1, 2004.[147] TransCanada is the largest natural gas transmission company in Canada, operating over 24,000 miles of gas pipelines. TransCanada also holds the U.S. and Canadian permits that were originally issued for the ANGTS. The Alaska Department of Revenue (ADOR) approved their application on June 16, 2004.[148]

TransCanada's proposal was similar to the Producers' proposal except TransCanada would end its pipeline in Alberta rather than extending it to Chicago.[149] The 48-inch diameter pipeline would have an initial design of approximately 4.5 bcfd and could be expanded to 5.9 bcfd.

The Murkowski administration and TransCanada reached a consensus on most major principles regarding the application. Because TransCanada was only a pipeline

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144 *Id.* note 138, at § 5.2.

145 *Id.*

146 *See generally IFD, supra* note 24, at 169-242.

147 TransCanada, *Application of TransCanada Corporation ("TransCanada") and Alaskan Northwest Natural Gas Transportation Company ("ANNGTC") Submitted to the Alaska Department of Revenue Pursuant to AS 43.82.120 For Approvals under the Alaska Stranded Gas Development Act* 1, (2004), http://www.revenue.state.ak.us/GasLine/TransCanada%20Application.pdf (last visited Jan. 3, 2007) [hereinafter "TransCanada Application"]. Northwest Gas is a partnership consisting of two partners that are wholly-owned by TransCanada, TransCanada PipeLine USA, Ltd. (TC PipeLines) and United Alaska Fuels Corporation. Foothills Pipe Lines Ltd. (Foothills), a wholly owned subsidiary of TC PipeLines and Westcoast Energy, Inc., holds the certificates to build the pipeline in Canada for transportation of ANS gas under the Northern Pipeline Act of 1978. *Id.* at 6, 9.

148 *See IFD, supra* note 24, at 169.

149 *TransCanada Application, supra* note 147, at 3.

company, the terms of the agreement did not include terms relating to upstream gas production and development. Additionally, the Murkowski administration worked with TransCanada on an updated State right-of-way (ROW) application. In October of 2004, the administration issued a proposed decision for public comment,[150] but a final decision on the ROW application has never been issued. The administration and TransCanada did negotiate to a conceptual agreement.[151]

The administration, however, ended the negotiations. According to the Murkowski administration, it ended the discussions when it decided that it was in the State's interests to complete a contract with the Producers.[152] TransCanada ultimately appeared to support the arrangement between the State and the Producers to the extent it did not infringe on TransCanada's rights to build the Canadian portion of the pipeline.[153]

(2) AGPA

AGPA submitted an application under the Stranded Gas Act on February 27, 2004.[154] AGPA is a municipal corporation created by two Alaska boroughs and the City of Valdez under the Alaska Municipal Port Authority Act.[155] The Internal Revenue Service (IRS) has issued a ruling to AGPA that its income would be exempt from U.S. federal income taxes based on the representations made by AGPA.[156] In a study prepared for the ADOR, the accuracy of AGPA's representations to the IRS was questioned.[157]

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[150] ADNR, *Alaska Natural Gas Transportation System Right-of-Way Lease: Commissioner's Analysis and Proposed Decision and Action* (Oct. 2004).

[151] Under the confidentiality provisions of the Stranded Gas Act, TransCanada opted to keep the terms of the agreement confidential. *See IFD, supra* note 24, at 177, 179.

[152] *Id.* note 151, at 169 & 177-79.

[153] Letter from Hal Kvisle, TransCanada Chief Executive Officer, to Frank Murkowski, Alaska Governor (June 8, 2006). *See IFD, supra* note 24, at R-4-509. *See* Tim Bradner, *Pipeline Firms Will Be Back at the Table for Gas Talks in '07*, Alaska Journal of Commerce, Dec. 31, 2006, available at http://www.alaskajournal.com/stories/.

[154] Alaska Gasline Port Authority, *Application of The Alaska Gasline Port Authority to the State of Alaska, for Approval Under A.S. 43.82 The Alaska Stranded Gas Development Act* 1 (2004), http://www.revenue.State.ak.us/GaslineDocs/GaslineApplicationBW.pdf (last visited Jan. 3, 2007) [hereinafter "AGPA Application"]; *IFD, supra* note 24, at 170. In 2004, Sempra Energy entered into an agreement with AGPA regarding an LNG proposal and advanced over $6,000,000 to the AGPA before canceling the arrangement. *See Basins, supra* note 15, at 12.12-12.14; *Chamber, supra* note 134, at 27. Sempra Energy was not a party to the AGPA application.

[155] AS 29.35.600. *See IFD, supra* note 24, at 179; *AGPA Application, supra* note 154, at 2.

[156] Letter from Timothy L. Jones, Internal Revenue Service, on Alaska Gasline Port Authority tax exemption to Travis Gibbs, O'Melveny & Myers LLP, attorney (Jan. 24, 2000) (on file with BP Exploration (Alaska) Inc). *See AGPA Application, supra* note 154, at 2.

[157] Petrie Parkman & Co. and CH2M Hill, *State Financial Participation in an Alaska Natural Gas Pipeline* 5-15-16 (2002).

According to AGPA, it has also acquired YPC's right of way permits for a pipeline in Alaska.[158]

AGPA's original proposal was an 800-mile, 48-inch diameter pipeline along the TAPS to Valdez, with a 125-mile spur line from Glenallen. The spur would connect with the pipeline grid serving Southcentral Alaska owned by Enstar Natural Gas Company, an Alaskan utility.[159] Later, AGPA proposed a Y-Line project that would ship 3.5 bcfd to the Canadian border and 1.5 bcfd to Valdez.[160] In either proposal, there would be an LNG facility at Valdez and the LNG would be tankered from there to regasification facilities to be built on the West Coast or located in the Far East. LPG would also be extracted in Valdez and tankered to Asian and U.S. markets.[161]

AGPA withdrew its original application, but later resubmitted an application.[162] The DOR Commissioner conditionally approved that application, but AGPA never met the conditions. The ADOR considered the application to "never [be] approved."[163]

(3) Enbridge

Enbridge Inc. (Enbridge), a large Canadian oil and gas pipeline company, submitted an application to the State on April 30, 2004.[164] Enbridge also proposed an Overland Route. However, it proposed a smaller 36-inch diameter pipeline with an initial capacity of 2.6 bcfd, expandable to 5 bcfd through additional compression or looping.[165] Enbridge saw the key advantage of the smaller pipeline as the ability of North American mills to manufacture the pipe of that diameter and possibly allow for a faster project schedule.[166] Like the other overland proposals, the pipeline would terminate in Alberta.[167]

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158 *IFD, supra* note 24, at 180.

159 *AGPA Application, supra* note 154, at 1.

160 *IFD, supra* note 24, at 179.

161 *Id.* note 160, at 179.

162 Alaska Gasline Port Authority, *Re-Application of the Alaska Gasline Port Authority to the State of Alaska, for Approval Under A.S. 43.82 the Alaska Stranded Gas Development Act* 1 (2005), http://www.revenue.State.ak.us/GaslineDocs/AGPA%20re-application%203-30-05.htm (last visited Jan. 3, 2007).

163 *IFD, supra* note 24, at 170.

164 Enbridge, *Application of Enbridge Inc. ("Enbridge") to the Alaska Department of Revenue Pursuant to AS 43.82.120 for Approvals Under the Alaska Stranded Gas Development Act* 1-3 (2005), http://www.revenue.State.ak.us/GaslineDocs/Enbridge%20Application.pdf (last visited Jan. 3, 2007) [hereinafter "Enbridge Application"]; *IFD, supra* note 24, at 170; *see generally Basins, supra* note 15, at 12.22-23.

165 *Enbridge Application, supra* note 164, at 8.

166 *Id.* note 165, at 9.

167 *Id.* note 165, at 8.

Enbridge never negotiated with the State. Enbridge failed to enter into a reimbursable services agreement that was required by the State to initiate negotiations and the proposal never advanced.[168]

(4) MidAmerican

MidAmerican Energy Holdings Company and MEHC Alaska Gas Transmission Company, LLC (collectively, MidAmerican), two companies associated with famed investor Warren Buffet, a former president of ARCO Ken Thompson, and certain Alaska native corporations submitted an application under the Stranded Gas Act on January 22, 2004.[169] MidAmerican's proposal consisted of the construction of a 48-inch diameter pipeline from the ANS to the Alaska border where it would interconnect with a new pipeline to be built by TransCanada that would eventually interconnect with existing pipelines in Canada for delivery of gas to Canadian and U.S. markets.[170]

The ADOR accepted the application, but, like Enbridge, MidAmerican never entered the required reimbursable services agreement with the State.[171] MidAmerican desired a five-year exclusive arrangement with the State that would prevent the State from dealing with any other applicant.[172] The State refused and MidAmerican "walked away" and "abandoned its Alaska gas pipeline proposal."[173]

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168 *IFD, supra* note 24, at 170. AS 43.82.240(a) authorizes the ADOR Commissioner to condition development of a fiscal contract with an applicant on an agreement to reimburse the State for certain expenses incurred by the State in processing the application up to $1,500,000.

169 MidAmerican Energy Holdings Company and MEHC Alaska Gas Transmission Company, LLC, *Application of MidAmerican Energy Holdings Company and MEHC Alaska Gas Transmission Company, LLC to State of Alaska Department of Revenue for Approval Under the Alaska Stranded Gas Development Act* (2004), http://www.revenue.state.ak.us/GaslineDocs/MEHC-MAGTC%20Final%20App%2012204.pdf (last visited Jan. 3, 2007) [hereinafter "MidAmerican Application"]; *see generally Basins, supra* note 15, at 12.23. MidAmerican is an affiliate of Berkshire Hathaway, Inc., one of the largest diversified companies in the world. MidAmerican, through its subsidiaries, owns Kern River Gas Transmission Company and Northern Natural Gas Company, which operate over 18,000 miles of interstate natural gas transportation facilities, making it the second largest interstate natural gas transmission company in the U.S. *Id.* at 1 n.1. The native corporations involved in the project included: Cook Inlet Regional, Inc., Arctic Slope Regional Corporation, Aleut Corporation, and Bering Straits Native Corporation. *Id.* at 9 & 9 n.7.

170 *MidAmerican Application, supra* note 169, at 5.

171 *IFD, supra* note 24, at 170.

172 *Id.* note 171, at 170; *Chamber, supra* note 134, at 26.

173 *IFD, supra* note 24, at 170; *Chamber, supra* note 134, at 26; Larry Persily, *What Went Wrong? The Story Behind Failed Gas Line Talks between MidAmerican, State of Alaska,* Petroleum News (Anchorage), April 11, 2004, available at http://petroleumnews.com ("highly publicized, highly promoted effort to build Alaska's long-awaited gas line broke down … [and MidAmerican said that t]he Governor is trying to make it sound sinister"); Larry Persily, *More Money for Alaska Natural Gas Line, Legislature Likely to OK Additional $9 Million for Studies, Right of Way,* Petroleum News (Anchorage), May 9, 2004, available at http://petroleumnews.com ("company walked away from negotiations when the State refused MidAmerican's ultimatum for exclusive rights to the gas line project"); Larry Persily, *Alaska Senators Ask*

(5) ANGDA

The Alaska Natural Gas Development Authority (Authority) is a political subdivision of the State of Alaska created by voter initiative in 2002.[174] It has a separate legal existence and is governed by a board of directors appointed by the Governor. The executive director, Harold Heinze, is a former ARCO president and former DOR Commissioner.[175]

The initiative authorizes the Authority to develop the LNG route. The Authority, however, has deferred to AGPA on that project.[176] Rather, it has given its attention to a Spur Line from Glenallen, Alaska to interconnect with the Southcentral Alaska gas pipeline grid.[177] Additionally, the Authority is examining the feasibility of distributing liquid propane from the Alaska project throughout coastal Alaska for electrical power generation and domestic heating.[178] Although the Authority did not apply under the Stranded Gas Act, the ADNR did issue the Authority a conditional right-of-way lease for its proposed Spur Line in July of 2006.[179]

Recently Alaska's new Governor Sarah Palin has called on the Authority to take a greater role in ANS gas development. She suggested that the Authority exercise its authority granted by the voter initiative and work to develop an LNG Route.[180] In response, ANGDA proposed in February of 2007 that it build a 1.25 bcf/d project to take gas to Alaska markets and to other markets via a LNG facility located in Valdez.[181]

(continued…)

Who Should Build Gas Pipeline, Legislators Hear Pros and Cons of Producer- vs. Non-Producer-Owned Natural Gas Pipeline; Alaska's Best Interests At Issue, Petroleum News (Anchorage), April 18, 2004, available at http://petroleumnews.com (Senator "Ogan said he called the meeting not to debate or 'Monday morning quarterback' the Governor's decision to reject MidAmerican's demand for sole development rights to the North Slope project or the pipeline company's subsequent decision to walk away from negotiations and abandon its Alaska gas pipeline proposal.")

174 AS 41.41.010-.990.

175 *Basins, supra* note 15, at 12.16-12.17; *Chamber, supra* note 134, at 21.

176 *IFD, supra* note 24, at 190; *Basins, supra* note 15, at 12.16-12.17.

177 *IFD, supra* note 24, at 190; *Basins, supra* note 15, at 12.16-12.17.

178 P N D Incorporated, *Feasibility Study of Propane Distribution Throughout Coastal Alaska (in Conjunction with Gas Spur Line to Southcentral Alaska)* 4 (2005), http://www.allalaskalng.com/reports/propane_dist_report.pdf (last visited Jan. 16, 2007).

179 *IFD, supra* note 24, at 190.

180 Kristen Nelson, *What Role for ANGDA under Palin?,* Petroleum News (Anchorage), Dec. 24, 2006, available at http://petroleumnews.com.

181 *See* Kristen Nelson, *ANGDA Goes Local - Alaska Gas Market System Looks at 1.25 bcf Line to Southcentral, Valdez*, Petroleum News (Anchorage), Feb. 4, 2007, available at http://petroleumnews.com. ANGDA stated the project would consist of (1) a 24-inch diameter pipeline costing $4 billion, (2) a conditioning plant costing $1 billion; (3) a 7 million tons per annum LNG plant costing $3 billion; and

d. The Murkowski Administration Analyses of the Various Proposals

The Murkowski administration chose the Producers' proposal as the best project for Alaska.[182] The administration believed that the Alaska economy must transition from an oil based economy to a gas based economy soon.[183] Without a gas project, Alaska would face a fiscal crisis within the next ten years.[184]

Their reasoning for choosing the Producers' project may be summarized as follows:

- The Producers have access to most of the 35 tcf of known ANS gas resources. No other applicant has access to the gas.
- The Producers have experience constructing large oil and gas projects. TransCanada and other pipeline companies also have experience. AGPA and the Authority have none.
- The Producers' financial strength and capacity is unsurpassed and they can deal with potential large cost overruns. None of the other applicants had anywhere near this financial strength and capacity.[185]
- Lengthy litigation is the only way that the other applicants or sponsors could get access to gas with no guarantee of a successful result.[186] TransCanada recognized that "it is difficult to see how a gas pipeline could proceed expeditiously without the agreement and support of the ANS producers."[187]

(continued…)

(4) available tankers and LNG regasification facilities. *Id.* ANGDA estimates a one to two-year study would be necessary before a go/no go decision could be made. *Id.*

[182] *IFD, supra* note 24, at 173-225.

[183] *Id.* note 182, at 0-1.

[184] *Id.* at ES-3.

[185] *Id.* at 176-183. Large cost overruns are a very real danger with large projects. Shell's Sakhalin oil and gas project is expected to incur a 100 per cent overrun. Tim Bradner, *Alaska Waits as Legislature Debates Gas Line,* Alaska Journal of Commerce, May 21, 2006, available at http://www.alaskajournal.com/stories/ (last visited Jan. 8, 2007).

[186] The IFD noted that ANGPA had filed litigation to try to compel some of the Producers to sell it gas, but its case was summarily dismissed. *IFD, supra* note 24, at 173. Complaint, *The Alaska Gasline Port Authority v. ExxonMobil Corp., et al.,* Case No. 4:05-cv-0026-RRB (D. Alaska filed December 19, 2005). Then Alaska Attorney General Dave Márquez commented that the decision was a correct one and reaffirmed the Murkowski's administration belief that "the structure of the Port Authority's proposal is untenable." Press Release, State of Alaska Department of Law, *Attorney General Márquez Comments on Dismissal of Alaska Gasline Port Authority's Antitrust Lawsuit against ExxonMobil Corporation* (2006), http://www.law.state.ak.us/pdf/press/062006-agpa-release.pdf (last visited Jan. 10, 2007).

[187] *IFD, supra* note 24, at 174.

- The Southern Route produced greater monetary benefits for the State than any other proposal.

The Murkowski administration compared the estimated revenues from the three basic project proposals – a Southern Route, LNG Route, and a Y-line route. Table 2 summarizes the administration's results.

TABLE 2 Economic Indicators of Three Natural Gas Project Options

Metric	Sponsor Group Project	AGPA LNG	AGPA LNG with Y-line
Nominal (i.e., money of the day) Revenues		(Billions of $)	
State	122.8	82.6	104.5
Sponsor group	255.0	160.0	187.0
Local governments	7.1	22.4	16.7
Total	385.0	265.0	308.0
Net present value (2006 $) of Revenues			
State @ 5% discount rate to 2006	29.5	19.6	22.1
Sponsor group @ 10% discount rate to 2006	19.6	9.5	9.9
Local governments @ 5% discount rate to 2006	1.9	5.6	4.2
Total NPV	51.0	34.7	36.2
Total local, state, and project spending after construction (2006 $)	75.0	68.8	59.3
Gas revenue contributions to Alaska Permanent Fund Corporation (APFC), 2016-2051 (2006 $)[1]	32.3	20.3	17.7
Wellhead value after tariff ($ per mmBtu)	3.01	2.50	2.73

Source: Information Insights, 2006.
Notes: [1] Contributions to APFC plus cumulative earnings, net of dividends paid, based on 7.6 percent return and current dividend law. Gas price assumptions for the sponsor group project are $5.33 mmBtu in Chicago and $4.64/mmBtu in Alberta; for the LNG project gas price assumptions are $4.65/mmBtu U.S. and Canadian West Coast, average LNG $4.25/mmBtu B.C. LNG; for the Y-line project gas price assumptions are $5.33/mmBtu Chicago and $5.13/mmBtu LNG.

Alaska Department of Revenue **IFIF-191**

Alaska Department of Revenue, *Interim Findings and Determination Related to the Stranded Gas Development Act for a Contract between the State of Alaska and BP Exploration (Alaska) Inc., ConocoPhillips Alaska Inc., and ExxonMobil Alaska Production Inc.* IFIF-191 (2006)

The administration concluded that AGPA's LNG project would return more money to the participating governments, but would shortchange the rest of the State, including State government.[188]

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188 The ADOR commissioned PFC Energy to assess the AGPA project. PFC Energy, *Assessment of the Alaska Gasline Port Authority LNG Project* 3 (2006), http://www.revenue.State.ak.us/Publications/Assessment%20of%20AGPA%20Project.pdf (last visited Jan. 10, 2007) [hereinafter "PFC Energy"]. PFC Energy concluded the AGPA project "offers a significantly lower netback to North Slope gas than the Chicago pipeline project." *Id.* at 5 & 61. According to one commentator, "Alaska LNG just can't compete" and has "the lowest possibility of fruition among any of the alternatives to monetize [ANS] gas." Tristone Capital, *Monetizing Northern Frontier Gas; Is the Market Window Closing?* 46 (2005), (on file with BP Exploration (Alaska) Inc.) [hereinafter "Tristone"]. Douglas Reynolds, an economics professor at the University of Alaska (Fairbanks) has spent several years modeling the various options. He found that the Overland Route provided the best financial returns for the Producers and the State. Douglas B. Reynolds, *Alaska and North Slope Natural Gas: Development Issues*

In sum, the Murkowski administration found that the Producers' proposal and the *Fiscal Contract* they negotiated with the Producers represented the best chance that a project would actually be developed. The development of the project was in the State's best interests.[189]

C. Contract Developments

1. Negotiations with Producers

The Murkowski administration negotiated with the applicants under the Stranded Gas Act from January of 2004 to May 24, 2006, when it released the proposed *Fiscal Contract* with the Producers.[190] It began to prepare for the effort in early 2003.[191]

As described in Sections II.B.4.c.(1). and II.B.4.c.(4). above, the administration negotiated with MidAmerican and TransCanada, and met with others about their proposals to develop Alaska gas. The Murkowski administration began its lengthy negotiations with the Producers in 2004.

Almost two years later, a major breakthrough occurred on December 1, 2005, when the parties reached agreement on core gas fiscal terms and, at a "high level" a package of terms that would be acceptable.[192] Still, the contract was far from complete. During the week of February 20th, more high-level meetings took place and an agreement in principle was confirmed.[193] The Producers agreed not to oppose a new petroleum production tax (PPT) with terms outlined in Section II.C.2. in recognition of the agreement on gas terms, including fiscal stability. The Governor held a press conference with the high-level Producer officials announcing the deal.[194]

(continued…)

and U.S. and Canadian Implications 123 & 225 (2003). The Port Authority's analysis shows that it would provide more benefits to the State under some assumptions. Alaska Gasline Port Authority, *Presentation to Senate Special Committee on Natural Gas Development: Project Economics* (Aug. 3-4, 2006) (presentation on file with BP Exploration (Alaska) Inc.). The Murkowski administration and others have questioned AGPA's assumptions including:

- AGPA could get access to the gas within three years.
- AGPA could get an exemption from FERC oversight.
- AGPA could get an exemption from the requirement to use Jones Act tankers.

189 *See IFD*, *supra* note 24, at ES-3-4, 330-345.

190 *Id.* note 189, at App. T, 1.

191 *Id.*

192 *Id.* at App. T, 55.

193 *Id.* at App. T, 57.

194 *Id.* at App. T, 59. *See* Gov. Frank Murkowski, *Oil Tax Structure Must Stand on Its Own,* Alaska Journal of Commerce, Mar. 5, 2006, available at http://www.alaskajournal.com/stories/.

As discussed in Section II.D.3.a below, the Governor shortly thereafter introduced a PPT bill that raised severance taxes. The bill, however, did not pass in the form introduced. The bill that ultimately did pass with increased taxes beyond that contained in the Governor's bill. The completion of the *Fiscal Contract* and its terms are discussed in the next section.

2. Basic Contract Terms

On May 10, 2006, the Murkowski administration and the Producers finalized a contract for all issues except for the PPT and the contract was released to the public.[195] A full *Fiscal Contract,* including the PPT language and exhibits, was released on May 24th.[196]

Both the administration and the Producers believed that the *Fiscal Contract* would enable an Alaska gas line project that is economically viable to advance.[197] The administration viewed the contract as a "business deal."[198] If the project were successful, the *Fiscal Contract* would provide substantial benefits to both the State and the Producers now and in the future. The administration estimated that the State revenues could be $5 billion per year from the gas project.[199] Significantly, the contract provided for State ownership of 20 per cent of the project; the ownership reduced risk to the Producers while maintaining and smoothing State revenues.[200] The fundamental assumptions underlying the *Fiscal Contract* are:

- The State and the Producers both desired a gas pipeline.
- The Producers need fiscal stability and certainty before investing the huge amount of capital necessary to build the pipeline.
- Both wanted a fair share of the revenues from the pipeline, with the State wanting a relatively stable revenue stream and recognition of the need for State and local revenues.
- The State wanted to provide incentives for explorers to discover and produce gas.

The *Fiscal Contract* promotes these fundamental assumptions through important promises the parties made to each other in the contract. The contract specifies remedies

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195 *IFD, supra* note 24, at 61. *See* Wesley Loy, *"Completed" Gas Plan Tossed to Legislature*, Anchorage Daily News, May 25, 2006, at B1.

196 *IFD, supra* note 24, at 62.

197 *Id.* note 196, at ES-5 & 50.

198 *Id.* at ES-5.

199 Tim Bradner, *Governor: If Gas Line Were Already Built, State Would See $5B,* Alaska Journal of Commerce, Jan. 15, 2006, available at http://www.alaskajournal.com/stories/. In the 1970s, the State of Alaska had considered financing, owning, and operating the TAPS, but ultimately it was owned by the oil and gas companies. *See Roderick, supra* note 15, at 335-46.

200 *IFD, supra* note 24, at 87.

if either party breaches the contract, including the State's right to terminate the contract if the project is not diligently advanced. A termination for failure to advance the project would result in loss of the contract's fiscal stability and certainty and essentially force the Producers to abandon their Alaska businesses.[201]

The following summarizes the important promises and the State's remedies.

Producers Promises:

- Diligently advance the project, including providing timely project updates
- Make a series of monetary and gas payments to the State, estimated to exceed $100,000,000,000 for a completed project and estimated by State experts to equal what the State would have received under the old fiscal system on both a nominal and real basis,[202] by:
  - Delivering approximately 20% of all gas produced to the State and managing its pipeline capacity to transport that gas
  - Making cash payments in lieu of production taxes, property taxes, and income taxes
  - Making "impact" payments during the construction phase
- Employ qualified Alaskans and use Alaskan businesses to the extent allowed by law, including
  - Investing $5,000,000 in training and development programs for Alaskans
  - Assisting the State in recruiting qualified Alaskans for jobs on the project
- Facilitate in-state use of gas by:
  - Providing up to four in-state offtake points for delivery to Alaskan consumers
  - Completing studies of in-state gas needs and in-state NGL potential
  - Providing in-state service rates
- Facilitate access to, and expansion of, the gas line to encourage exploration and accommodate new gas discoveries
- Agree to State ownership of the gas treatment plant, Point Thomson Unit (PTU) gas transmission line, and gas line to Alberta
- Timely develop the PTU for delivery of gas to the project.

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[201] Tim Bradner, *BP: Gas Line Contract Holds Producers' Feet to the Fire,* Alaska Journal of Commerce, May 21, 2006, available at http://www.alaskajournal.com/stories/.

[202] *IFD, supra* note 24, at 90-100 & Table 7 (base case scenario); ADOR, *Preliminary Findings and Determination as Required by the Stranded Gas Development Act for a Contract between the State of Alaska and BP Alaska (Exploration), Inc., ConocoPhillips Alaska, Inc., and ExxonMobil Alaska Production, Inc.* 75 (2006), http://www.revenue.state.ak.us/gasline/ContractDocuments/Main%20Documents/Fiscal%20Interest%20Finding/FIF%20version%209%20compiled--no%20appendixes.pdf (last visited Jan. 25, 2007) [hereinafter "PFD"] ("model results indicate that gas revenues are about the same under either fiscal structure").

State Promises:

- Provide fiscal stability by not changing oil and gas fiscal terms for 45 years
- Provide regulatory certainty
- Pay for its ownership share of the gas treatment plant, PTU gas transmission line, and gas line to Alberta
- Pay for its share of gas field, processing, and transportation costs
- Refrain from terminating the PTU so long as the Producers timely develop the project and the unit

Joint Promises:

- Support the FERC's and the NEB's jurisdiction over the project
- Make timely payments to each other
    - Limit each other's common law rights in the event of a default or underpayments
    - Provide for commercially reasonable interest for late payments
- Maintain confidentiality of commercially sensitive information
- Follow fair and impartial dispute resolution procedures

State's Remedies

- Before the State bids at an open season (estimated to be 2-3 years from *Fiscal Contract* execution), the State can terminate the *Fiscal Contract*, take away fiscal stability and certainty (including raising taxes), and the Producers lose investment in the project
- After the State bids at the open season, but before project sanction, the State has all of the above remedies, plus any member of the Producers choosing to withdraw from the *Fiscal Contract* must relinquish its oil and gas leases on the ANS and any interest it holds in the project
- After project sanction, the State is entitled to any damages that it suffers resulting from the Producers' failure to build the line or other contract breaches (that is, the State must be put in as good a position as if the Producers had performed as required by the *Fiscal Contract*)

Producers' Remedies

- If the State breaches the capacity management provisions, the Producers may terminate their duties under those provisions
- In general, the producers are entitled to standard breach of contract remedies subject to the certain limitations on remedies and damages, such as a limitation on lost profits, contained in many commercial agreements.

The terms were designed to reduce disputes that had plagued relationships between the State and industry for years. Any disputes under the *Fiscal Contract* would be handled by arbitration to avoid protracted and costly litigation.[203] The parties desired

[203] *IFD, supra* note 24, at 85-86.

that the legislature would quickly approve the contract so that the project could advance. That was not to be.

3. Introduction to Constitutional Issues Regarding the Fiscal Contract

When the Stranded Gas Act was originally introduced in 1998, the act expressly provided that fiscal stability should be provided to the maximum extent allowed under the Alaska constitution.[204] Other constitutional issues were also noted by the then attorney general.[205] The original act went so far as to require that a suit to challenge the constitutionality of a contract developed under the act be brought within 120 days after its execution

The Murkowski administration and the Producers were well aware that the *Fiscal Contract* would be subject to various constitutional challenges. Indeed, the contract contains a provision dealing with the conduct of the parties during the course of that litigation.

After the *Fiscal Contract* was publicly released, the legislature and its consultants raised a number of constitutional and other legal questions concerning the contract. The major issues included:

- Whether the contract's fiscal stability terms violated Article IX, sections 1 and 4 of the Alaska Constitution's provision that the power of taxation should never be surrendered except as provided in that article.[206] The Alaska attorney general issued a comprehensive opinion regarding the first point. He concluded that "Alaska's constitution prohibits the legislature from surrendering the power of taxation, but permits the legislature to suspend or contract away the tax power" [and] "that the proposed SGDA Contract is constitutional."[207]

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[204] AS 43.82.010. *See* letter from David Márquez, Alaska attorney general, to Ben Stevens, State Senator, and John Harris, State Representative (May 23, 2006), http://www.law.state.ak.us/department/civil/gasline.html (last visited Jan. 16, 2007) ("question of whether the Alaska Constitution would permit a fiscal contract as envisioned by the SGDA has been circulating at least since the SGDA was contemplated almost 10 years ago").

[205] Memorandum from Bruce Botelho, Alaska attorney general, to Tony Knowles, Alaska Governor (May 29, 1998) (on file with BP Exploration (Alaska) Inc).

[206] Memorandum from Donald M. Bullock, Jr., legislative counsel, on contracting away the power of taxation to Les Gara, State Representative (May 18, 2006), http://www.law.state.ak.us/department/civil/gasline.html (last visited Jan. 16, 2007); letter from Hollis French, State Senator to Colleague, Alaska Representatives (June 6, 2006) (on file with BP Exploration (Alaska) Inc).

[207] Memorandum from David Márquez, Alaska attorney general, on Effect of Article IX, Sections 1 and 4 of the Alaska Constitution on Proposed Stranded Gas Development Act Contract Terms to William Corbus,

- Assuming the fiscal stability terms did not violate Article IX, section 1, would a unilateral amendment of the contract by a subsequent State legislature infringe on the impairment of contract clause, Article I, section 10 of the Alaska Constitution?[208] The legal counsel for the Alaska legislature concluded that it would so infringe the impairment clause.[209]
- Whether the Governor has authority to execute the *Fiscal Contract* without legislative approval.[210] In response, the attorney general stated "legislative approval of the contract is constitutionally required because the contract changes taxes …."[211]
- Whether the provisions of the contract requiring the State to indemnify the Producers under certain circumstances infringed on Article IX, Section 13 of the Alaska Constitution, imposing limitations on the State's ability to enter into indemnification agreements. The attorney general issued an opinion concluding "the indemnification provisions here are valid."[212]
- Whether the *Fiscal Contract* raised significant anti-trust concerns. An opinion by the law firm of Morrison & Foerster, the firm retained to represent the State in the gas line negotiations, found that the Producers' potential ownership of the Alaska project "does not raise significant competitive concerns."[213]

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ADOR Commissioner 1, 3 (May 10, 2006), http://www.law.state.ak.us/pdf/opinions/661-03-0485-SGDA.pdf (last visited Jan. 16, 2007).

208 Memorandum from Donald M. Bullock, Jr., legislative counsel, on contracting away the power of taxation to Les Gara, State Representative (May 18, 2006), http://www.law.state.ak.us/department/civil/gasline.html (last visited Jan. 16, 2007).

209 Memorandum from Donald M. Bullock, Jr., legislative counsel, on contracting away the power of taxation to Les Gara, State Representative (May 18, 2006), http://www.law.state.ak.us/pdf/press/legal-services-wo24-ls1938.pdf (last visited Jan. 17, 2007).

210 Memorandum from Tamara Brandt Cook, Director of Alaska Legal Services, on proposed natural gas pipeline contract to Les Gara, State Representative (June 22, 2006) (on file with BP Exploration (Alaska) Inc).

211 Memorandum from David Márquez, Alaska attorney general, on constitutionality of AS 43.82.435 to Lesil McGuire, State Representative (July 24, 2006), http://www.law.state.ak.us/pdf/admin/ag-as4382435-ltr-mcguire-072406.pdf (last visited Jan. 17, 2007). In fact, the Murkowski administration recognized that the likelihood of successfully defending the contract against a constitutional challenge was enhanced if the contract received legislative approval. Matt Volz, *Terms for Signing Gas Line Contract Unresolved,* Anchorage Daily News, July 25, 2006, at B1 (Murkowski Chief of Staff Jim Clark Stated that "our position before the Supreme Court is enhanced by having legislative approval.").

212 Memorandum from David Márquez, Alaska attorney general, addressing comments by Senator French and Representative Gruenberg to Ben Stevens, State Senator, and John Harris, State Representative (July 28, 2006), http://www.law.state.ak.us/pdf/admin/ag-sgda-ltr-stevens-harris-072806.pdf (last visited Jan. 17, 2007).

213 Memorandum from Bradley Lui, *et al.*, Morrison & Foerster on Alaska Natural Gas Pipeline – Producer Owned Pipeline Project to State of Alaska 1 (Oct. 20, 2006),

These concerns formed a backdrop for the *Fiscal Contract* as the legislature and the public considered the *Fiscal Contract* in 2006. We will next examine the developments regarding the contract in 2006.

D. 2006 Developments

1. Expectations for 2006

In February of 2006, the Murkowski administration and the Producers reached a broad agreement on the *Fiscal Contract* and the principles and rates that would be contained in a new oil and gas production tax, referred to as the PPT.[214] In summary, the key terms for the PPT were:

- A tax rate of 20% on "net income"
- A credit rate of 20% on investments or losses
- The credit rate would apply to investments made between 2001-05
- A $73 million standard deduction
- A credit rate of 35% for investment in the GTP (this would either be included in the new PPT or the *Fiscal Contract*)
- A July 1, 2006 effective date.[215]

On February 22, 2006, then Governor Murkowski, calling it one of the biggest days in Alaska's history, announced the agreement in principle.[216] The agreement was a significant development because: (1) for the first time, the State and an industry had agreed on a contract to develop ANS gas; and (2) the Producers, after fighting any tax increase for years, had actually agreed not to oppose an increase that would collect an additional estimated $1-2 billion per year for the State.[217] The gas line deal was contingent on the legislature's approval of the tax increase, so-called "20/20" rate based

(continued…)

http://www.revenue.state.ak.us/gasline/IFIF%20Appendix%20R%20vol%201.pdf (last visited Jan. 25, 2006).

214 *IFD, supra* note 24, at App. T, 57.

215 *Id.* note 214, at App. T, 59-60.

216 *Id.* at App. T, 59; Frank Murkowski, *Oil Tax Structure Must Stand on Its Own,* Alaska Journal of Commerce, Mar. 5, 2006, available at http://www.alaskajournal.com/stories/.

217 Tim Bradner, *Administration, Producers Reach Gas Line Deal,* Alaska Journal of Commerce, Feb. 26, 2006, available at http://www.alaskajournal.com/stories/ (at $40, the State would get $400 to $600 million more, at $20, the State would lose $150 to $200 million; the crossover point was about $25); Tim Bradner, *Oil Tax Change Mulled, Regardless of Gas Line,* Alaska Journal of Commerce, Feb. 12, 2006, available at http://www.alaskajournal.com/stories/ (at $60/barrel oil); Gov. Frank Murkowski, *Proper Oil Tax Vital to Alaska's Future*, Anchorage Daily News, June 16, 2006, at B6 (Governor says his PPT bill would provide nearly $1 billion more to the State per year under current prices).

on the tax and credit rates, negotiated with the Producers.[218] The hope was that the legislature would pass the PPT and approve the *Fiscal Contract* by the middle of 2006, and finally the development of ANS gas would move forward.

But, that did not happen. These next sections explore what did happen. An Alaska journal reported that the consensus was that "[e]veryone was at fault …."[219]

2. 2006 Political Environment

During 2006, the *Fiscal Contract* and its associated PPT dominated Alaska politics. Fifty of sixty Alaska legislative seats would be up for grabs as well as the governorship.[220] Governor Murkowski, who had the second lowest popularity rating of any U.S. governor, was running for re-election.[221] According to one reporter, Murkowski needed the contract approved to win.[222]

Former Democratic Governor Tony Knowles came out of retirement to run against Murkowski. But Murkowski finished third within his own Republican Party primary to Sarah Palin.[223] Palin would ultimately win the governorship in a race against Knowles and independent Andrew Halcro. According to the State's largest paper, "Gov. Palin won the election, campaigning, in great part, against Gov. Murkowski's gas line efforts" and lack of trust in those efforts.[224]

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[218] Tim Bradner, *Administration, Producers Reach Gas Line Deal,* Alaska Journal of Commerce, Feb. 26, 2006 available at http://www.alaskajournal.com/stories/ ("If the Legislature enacts a higher tax rate, the governor said the producers might not support it, an inference that this could cause negotiations on the gas deal to be reopened.").

[219] Melissa Campbell, *Leaders Warn Gas Line Delays Will Be Widely Felt*, Alaska Journal of Commerce, Jan. 7, 2007, at 1, 11.

[220] Anne Sutton, *Special Session Raises Questions on Timing,* Anchorage Daily News, June 27, 2006, at B1.

[221] *Ad Aims at Heart of Poor Image,* Anchorage Daily News, June 20, 2006, at B1. *See also* Paul Jenkins, *Voice of the Times*, Anchorage Daily News, Dec. 8, 2006, at B5.

[222] Tim Bradner, *Gas Line Will Figure Large in Session's Politics,* Alaska Journal of Commerce, Jan. 15, 2006, available at http://www.alaskajournal.com/stories/.

[223] *See* Anne Sutton, *Murkowski looks at Public Life with Few Regrets,* Anchorage Daily News, Dec. 3, 2006, at A9 (Murkowski finishes 3rd).

[224] *Opinion*, Anchorage Daily News, Dec. 8, 2006, at B4; Sarah Palin, *Constitution Should Guide Us to Oil Tax that Best Benefits Alaskans*, Alaska Journal of Commerce, Mar. 26, 2006, available at http://www.alaskajournal.com/stories/. *See* Matt Volz, *Pipeline Question Dominates Election,* Anchorage Daily News, Aug. 22, 2006, at B1; Don Hunter, *Partisan Politics Put Aside by Palin,* Anchorage Daily News, Jan. 27, 2006, at B1 (Palin said that "Murkowski has shaken the trust of Alaskans by keeping them in the dark about his gas pipeline negotiations with oil companies.").

3. 2006 Legislative Activity

a. PPT

On February 23, 2006, the administration presented the new PPT bill to the House and Senate Resources Committees.[225] The legislature failed to pass the PPT bill during the regular session, which ended in May.[226] The Governor called a 30-day special session to commence immediately at the end of the regular session to consider the PPT and the *Fiscal Contract.* The legislature was again divided over the many issues regarding the PPT and was unable to pass a PPT bill.[227]

According to the media, the business community was mounting pressure to pass the PPT and get on with reviewing the *Fiscal Contract.*[228] The Governor called a second special session for July and August to consider again the PPT and the *Fiscal Contract*.[229] The PPT legislation passed with a different tax rate, a progressivity factor, and other changes that substantially increased the tax on the oil and gas industry compared to the Governor's version of the bill.[230] The PPT would effectively double, or even triple, the Producers' taxes.[231] Alaska would have the highest marginal severance tax rate in the United States and one of the highest in the world. Both the new governor and some legislators have expressed the view that if the "results of the PPT, when implemented, are not satisfactory, the [PPT] issue would be revisited."[232]

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[225] *IFD, supra* note 24, at App. T, 60. The companion legislation regarding PPT was introduced at the Governor's request in both bodies. *See* HB 488, 24th Legis., 2d Sess. (2006); SB 309, 24th Legis., 2d Sess. (2006).

[226] *IFD, supra* note 24, at App. T, 63.

[227] *See* HB 2001, 24th Legis., 2d Sess. (2006); SB 2002, 24th Legis., 2d Sess. (2006).

[228] Tim Bradner, *Business Groups Blast Legislature over Tax, Gas Line,* Alaska Journal of Commerce, June 18, 2006, available at http://www.alaskajournal.com/stories/; Richard Richtmyer, *Business Leaders Fume Over Impasse,* Anchorage Daily News, June 10, 2006, at B1.

[229] *IFD, supra* note 24, at App. T, 64.

[230] *Id.* note 229, at App. T, 65.

[231] Tim Bradner, *Oil Tax Rewrite Efforts Could Cost Industry Billions More,* Alaska Journal of Commerce, June 11, 2006, available at http://www.alaskajournal.com/stories/; John Hult, *Governor Takes Gas Line Pitch to Kenai during Comment Session,* Alaska Journal of Commerce, July 23, 2006, available at http://www.alaskajournal.com/stories/072306/oil_20060723036.shtml; Gov. Frank Murkowski, *Proper Oil Tax Vital to Alaska's Future*, Anchorage Daily News, June 16, 2006, at B6 (Governor says his PPT bill would double industry tax, but some lawmakers want to triple the tax).

[232] *FERC Third Report, supra* note 4, at 3; *see* HB 89, 25th Legis. (2007)

b. Consideration of the *Fiscal Contract*

(1) Legislature

(a) Regular Session

During the regular legislative session, the *Fiscal Contract* itself was not considered by the legislature. It did, however, consider several changes to the Stranded Gas Act process. In SB 316 and HB 502, the Governor proposed to clarify whether the Preliminary Finding and Determination regarding the *Fiscal Contract* could be judicially reviewed.[233] Legislative committees substantially amended the Governor's original bill, but ultimately the bill did not pass the legislature.

Also during the regular session, Senator Hollis French, an Anchorage Democrat, sued to force the Governor to publicly release the *Fiscal Contract.*[234] After ensuring the Producers' confidentiality rights were protected, a superior court judge ordered the release of the contract and, within days, the Governor released the contract.[235]

(b) Special Sessions

On May 10, 2006, the first day of the first special session called by the Governor, his DOR Commissioner issued his "Preliminary Findings and Determination" (PFD) regarding the proposed *Fiscal Contract* for legislative and public comment as required under the Stranded Gas Act.[236] The PFD contained a comprehensive review of the contract, the Alaska project, and the reasons why the administration chose the Producers' project, and an explanation of the contract's terms. During the first special session, the administration gave the legislature an 11-day overview of the contract.[237] Otherwise, the contract itself was not considered as the legislature again focused on the PPT legislation.

During a second special session beginning on July 12, 2006, the legislature again focused on the PPT bill. The legislature, however, did hold several hearings on bills relating to: (1) the Supreme Court's original review of challenges to a fiscal contract; (2) the formation of a public corporation to own an interest in a gas line; and (3) changes to the procedure for contract approval and to deal with changes the Governor believed

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233 *See* HB 502, 24th Legis., 2d Sess. (2006); SB 316, 24th Legis., 2d Sess. (2006).

234 *French v. Murkowski et al.*, No. 1JU-06-00703 CI (Alaska Super., April 21, 2006). *See* Kristen Nelson, *Issues in Two Alaska Stranded Gas Act Suits Resolved, Says Gov. Sarah Palin*, Petroleum News (Anchorage), Dec. 24, 2006, *available at* http://www.petroleumnews.com.

235 *French v. Murkowski et al.,* No. 1JU-06-00703 CI (Alaska Super., May 10, 2006).

236 *PFD, supra* note 202.

237 *IFD, supra* note 24, at App. R, R-5 - R-6.

were necessary to support fiscal certainty on oil.[238] None of the bills ever passed the legislature and the contract never got a straight up or down vote.[239]

(c) Post special session and legislators' suit

Governor Murkowski lost the primary on August 22, 2006. Nevertheless, several times he indicated that he would call the legislature back for another session to consider the contract.[240] He eventually dropped those plans after being told by legislators that the "reality" was the voters had asked for change and the *Fiscal Contract* did not have enough legislative support to move forward at that time.[241] As one long time oil and gas observer stated, the contract was simply "bogged down in controversy in the Alaska Legislature" with no hope of passing in 2006.[242]

But, that was not the end of Governor Murkowski's dealings with the legislature over the *Fiscal Contract.* He had steadfastedly refused to promise that he would only sign the *Fiscal Contract* if it were approved by the legislature despite the advice of his attorney general that approval was required.[243] As a result, in early November of 2006, several legislators sued Governor Murkowski to enjoin him from signing the *Fiscal Contract* without legislative approval.[244] A superior court judge granted an injunction,

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238 *See* HB 2002, 24th Legis., 2d Sess. (2006) (dealing with Supreme Court jurisdiction and 60-day limit to file challenges); SB 2002, 24th Legis., 2d Sess. (2006) (also dealing with Supreme Court jurisdiction and 60-day limit to file challenges); HB 2003, 24th Legis., 2d Sess. (2006) (dealing with formation of a public pipeline corporation); SB 2003, 24th Legis., 2d Sess. (2006) (also dealing with formation of a public pipeline corporation); HB 2004, 24th Legis., 2d Sess. (2006) (dealing with more than a dozen amendments to the Stranded Gas Act); SB 2004, 24th Legis., 2d Sess. (2006) (also dealing with dealing with more than a dozen amendments to the Stranded Gas Act). *See* Frank Murkowski, *Oil Tax Structure Must Stand on Its Own*, Alaska Journal of Commerce, Mar. 5, 2006, available at http://www.alaskajournal.com/stories/; Matt Volz, *Senators Take Gas Contract Authority from Murkowski,* Anchorage Daily News, Aug. 5, 2006, at B3; *Second Special Session Opens July 12,* Anchorage Daily News, June 24, 2006, at B7.

239 *See* Matt Volz, *Chances Slim Gas Contract Will Get Vote,* Anchorage Daily News, July 28, 2006, at B1.

240 *See* Matt Volz, *Murkowski Renews Pitch for Gas Pipeline,* Anchorage Daily News, Sept 23, 2006, at B1; Jesse Zink, *Ethics Surfaced, Then Dropped from View,* Anchorage Daily News, Sept 15, 2006, at B6.

241 Kyle Hopkins, *Two Want a Fresh Start on Gas Line,* Anchorage Daily News, Sept. 8, 2006, at A1; Richard Richtmyer, *Special Session on Gas Line Appears Unlikely,* Anchorage Daily News, Sept. 2, 2006, at A10 (Representative Harris told Governor Murkowski that "there isn't enough support ...."); Matt Volz, *Murkowski Renews Pitch for Gas Pipeline,* Anchorage Daily News, Sept 23, 2006, at B1.

242 Tim Bradner, *As Time Passes, Gas Line Prospects Cloud,* Alaska Journal of Commerce, July 23, 2006, available at http://www.alaskajournal.com/stories/.

243 Memorandum from David Márquez, Alaska attorney general, on constitutionality of AS 43.82.435 to Lesil McGuire, State Representative (July 24, 2006), http://www.law.state.ak.us/pdf/admin/ag-as4382435-ltr-mcguire-072406.pdf (last visited Jan. 16, 2007). *See* Matt Volz, *Murkowski Renews Pitch for Gas Pipeline,* Anchorage Daily News, Sept 23, 2006, at B1.

244 Complaint, *The Legislature of the State of Alaska et al. v. Gov. Frank Murkowski*, Case No. 4FA-06-2722 CI, (Alaska Super., Oct. 31, 2006). *See* Kristen Nelson, *Issues in Two Stranded Gas Act Suits*

and the Alaska Supreme Court denied the Governor's petition for review on November 29, 2006.[245]

(2) Public Review and Interim Finding and Determination

After releasing the PFD on May 10, 2006, the Murkowski administration engaged in a long public review process. Although the Stranded Gas Act called for 30 days to allow for comment, the administration allowed for 75 days.[246] The administration conducted hearings throughout the State and took comment by public testimony, telephone, email, and other written submission.[247] The administration received over 2,000 submissions and analyzed and reviewed the comments.[248] The administration found that a majority of the comments generally favored the *Fiscal Contract.*[249]

Based on the legislative and public comments, the administration issued its "Interim Findings and Determination" (IFD) regarding the *Fiscal Contract* on November 16, 2006, shortly before Governor Murkowski left office. In the IFD, the Murkowski administration recommended a series of changes to the proposed *Fiscal Contract* and Limited Liability Corporation (LLC) Agreement, none of which had been approved by the Producers.[250] It recommended that the new administration: (1) quickly renegotiate the contract with the Producers to include the amendments and other necessary agreements; and (2) seek legislative approval of necessary amendments to the Stranded Gas Act to authorize the contract and legislative approval of the amended contract.[251] According to the Murkowski administration, time was of the essence because (1) "the State cannot afford delay and the greatest risk it faces is not getting a pipeline built" and (2) without a pipeline, the State may have "insufficient revenues to meet growing fiscal requirements.[252] The DOR Commissioner said that gas was still stranded under the Stranded Gas Act and with the proposed changes, the contract would be in the State's long-term fiscal interests and further the purposes of the act by encouraging new

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Resolved, Says Gov. Sarah Palin, Petroleum News (Anchorage), Dec. 24, 2006, available at http://www.petroleumnews.com.

[245] Memorandum Decision and Preliminary Injunction Order, *The Legislature of the State of Alaska et al. v. Gov. Frank Murkowski*, Case No. 4FA-06-2722CI, at 10-11 (Alaska Super., Nov. 9, 2006); *Gov. Frank Murkowski v. Legislature of the State of Alaska, et al.*, Case No. S-12490 (Alaska Sup., Nov. 29, 2006).

[246] *IFD, supra* note 24, at App. R, R-2.

[247] *Id.* note 246, at App. R, R-9; *see, e.g.,* Tim Bradner, *Anchorage Gas Hearings Bring Out Both Sides,* Alaska Journal of Commerce, June 11, 2006, available at http://www.alaskajournal.com/stories/.

[248] *IFD, supra* note 24, at App. R, R-v.

[249] *Id.* note 248, at App. R, R-23-24.

[250] *Id.* at ES-20-22, App. K & App.L .

[251] *Id.* at 0-5.

[252] *Id.* at ES-39.

investment in Alaska, providing fiscal certainty necessary to stimulate the project, and maximizing the benefits from the project for all Alaskans.[253]

4. ADNR Order Terminating the PTU

a. The Commissioner's decision

The PTU is an oil and gas unit located on the ANS with large known hydrocarbon resources, an estimated 400 million barrels of gas condensates and oil and 8 tcf of gas or about 25 per cent of the known gas resources. The unit has 28 leaseholders, but 4 own 98 per cent of the resources.[254] They are BP, ConocoPhillips, ExxonMobil, and Chevron U.S.A. Inc.[255] The unit has been in existence for about 30 years, but has never produced any hydrocarbons, despite the spending of hundreds of millions of dollars by its leaseholders to find an economic development.[256]

Now, however, its gas has become "an important factor in the economic viability of the gasline project" and "is critical to the success of the project."[257] To coordinate the PTU's development with the gasline project's development, the *Fiscal Contract* contained provisions for the development of the PTU that were to replace the requirements in other agreements with the State.[258] Those requirements provided for State approval of plans for development of the PTU. Under the plan set forth in the *Fiscal Contract*, the Producers were required to:

- Apply to the Alaska Oil and Gas Conservation Commission for appropriate pool rules within six months of the contract's effective date;
- Enter binding commitments at the initial open season for the project to provide a minimum of 500 million cubic feet of gas to the project; and
- Comply with all other work commitments in the *Fiscal Contract*.[259]

Under the agreement reached with the Murkowski administration, PTU development would be governed by the *Fiscal Contract*; only if the Producers failed to satisfy those obligations would development be governed by the old agreements and rules.[260]

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253 *Id.* at ES-330-45.
254 *PFD, supra* note 202, at 130.
255 *Id.*
256 *Id.*
257 *Id.* note 254, at ES-12. & 55.
258 *Fiscal Contract*, *supra* art. 23.
259 *Id.*
260 *Id.* PTU development would also once again be governed by the old agreements and rules once gas started to flow from PTU to the project.

But, when the legislature failed to approve the contract, Governor Murkowski's ADNR Commissioner Michael Menge decided to address the issue of PTU development.[261] On November 27, 2006, Menge issued a decision placing the PTU in default (PTU Decision).[262] The PTU Decision effectively terminates the leases within the unit no later than February 25, 2007.[263] Under the PTU Agreement, the lessees in the unit are required to file a plan of development with the ADNR. As PTU operator, ExxonMobil's plan called for the drilling of one well in the PTU during a five-year period, re-examining other production options besides a gas sales option under the new PPT, and continuing a variety of studies. Menge found this plan unacceptable. He viewed this plan as too little too late given that the unit has been in existence for over 25 years and has never produced any hydrocarbons.[264] Under the PTU Decision, over 100,000 acres of State lands will revert to the State.[265]

b. The Effect on the Pipeline

The PTU lessees have appealed the PTU Decision.[266] In the appeal, they have argued that the plan complies with the "reasonable prudent operator" standard, which obligates them to develop the unit as a reasonable prudent operator, and the ADNR Commissioner wrongfully ignored the economic test in that standard. Moreover, the lessees have argued that the PTU decision was arbitrary and capricious, ignoring 30 years of Alaska practice and precedent in the area. Under Alaska law, units with wells that have been certified as capable of production of paying quantities may not be terminated by the ADNR except through court action. Under ADNR decisions for the last 30 years a well can be certified even if it has been plugged and abandoned or remains certified even if it is later plugged and abandoned. In its PTU Decision, the ADNR reversed this policy and declared that wells that have been plugged and abandoned cannot be certified wells.

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261 *Fiscal Contract, supra* art. 23.

262 Commissioner, Department of Natural Resources, State of Alaska, *Commissioner's Decision on Appeal from the Director's October 27, 2005 Decision Denying the Proposed Plans for Development of the Point Thomson Unit*, November 27, 2006. *See* Kristen Nelson, *Point Thomson in Default*, Petroleum News (Anchorage), Dec. 3, 2006, available at http://www.petroleumnews.com.

263 11 AAC 83.140.

264 Ken Boyd, another former Division Director, said although the State's impatience was understandable, it was not fair to say the PTU lessees simply sat on the PTU for 30 years. He noted that they have spent millions trying to develop the field and gas prices have only risen since 2000. *See* Wesley Loy, *Governor Goes After Slope Field,* Anchorage Daily News, Nov. 28, 2006, at A1.

265 Commissioner, Department of Natural Resources, State of Alaska, *Commissioner's Decision on Appeal from the Director's October 27, 2005 Decision Denying the Proposed Plans for Development of the Point Thomson Unit*, November 27, 2006.

266 *BP Exploration (Alaska) Inc. v. State*, No. 3AN-06-13760 CI (Alaska Super., Dec. 22, 2006); *Exxon Mobil Corp. et al. v. State*, No. 3AN-06 13826 CI (Alaska Super., Dec. 27, 2006); *Exxon Mobil Corp. v. State*, No. 3AN-06-13751 CI (Alaska Super., Dec. 22, 2006), *Chevron U.S.A. Inc. v. State,* No. 3AN-06-13773 CI (Alaska Super., Dec. 26. 2006). *See FERC Third Report, supra* note 4, at 4.

Although the ADNR recognized that its reversal of this policy conflicted with that practice and precedent, the ADNR stated the rule was based on "bad policy."[267]

The State's assistant attorney general stated that he thought litigation would last about two to three years.[268] ExxonMobil's view was that "[a]ny litigation … to take back the Point Thomson leases is likely to be protracted."[269] The Murkowski administration repeatedly recognized that the PTU gas resource underpinned a gas line and that any litigation regarding the PTU could be very lengthy.[270] ExxonMobil called the PTU Decision "a major setback for an Alaska gas pipeline project since gas supply from Point Thomson is critical for the project."[271] ConocoPhillips expressed hope "that the State's concerns regarding the lack of development at Point Thomson can be resolved in a way that does not delay progress on a … project."[272] The State left open the possibility that the litigation over the PTU could be settled in the future. In her State of the State Address on January 17, 2007, new governor Sarah Palin called the lack of development at the PTU for 30 years "WAREHOUSING Alaska's resources, [which] is not an option anymore."[273]

5. Reality at the End of 2006

By the end of 2006, the Alaska project was stalled.[274] A new administration and new legislature was set to take over and were calling for a re-examination of all proposals and applicants for an Alaska project.

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267 Commissioner, Department of Natural Resources, State of Alaska, *Commissioner's Decision on Reconsideration of the November 27, 2006 Point Thomson Unit Termination Decision*, December 27, 2006.

268 *Meet Alaska 2007: Alaska Wants Gas Pipeline, But Industry Needs Fairness, Predictability,* Petroleum News (Anchorage), Jan. 21, 2007, available at http://www.petroleumnews.com ("litigation [could] take two, or perhaps three, years").

269 Kristen Nelson, *Point Thomson in Default,* Petroleum News (Anchorage), Dec. 3, 2006, available at http://www.petroleumnews.com.

270 *Id.*

271 *Id.*

272 *Id.*

273 Sarah Palin, Governor of the State of Alaska, *State of the State Address* (Jan. 17, 2007) transcript available at http://www.gov.state.ak.us/speeches.php?id=66).

274 *See FERC Third Report*, *supra* note 4, at 7 ("prospects [for] an [Alaska gas line] application are more remote than a year ago [and o]ver the past year, the schedule for an Alaska gas pipeline has slipped considerably"). Alan Bailey, *BP 'Ready to Go' on Slope Gas Line,* Petroleum News (Anchorage), Jan. 28, 2007, available at http://www.petroleumnews.com (BP "express[ed] regret that the project had not moved forward in 2006").

E. Outlook for 2007

1. The Palin Administration

Newly elected Governor Palin campaigned on a promise to re-examine all options for an Alaska project. Her actions so far during her short tenure indicate that she will do just that and not move any Alaska project forward too quickly.

Before she began her campaign for governor, Palin was a supporter of, and appeared in advertisements favoring, the AGPA project.[275] Questions regarding her impartiality were raised during the campaign.[276] She claimed her support was a "myth."[277] She saw many positives with the LNG proposal, but had never viewed it as an exclusive option.[278] She vowed to propose a competitive process to pick the best project to finally market North Slope gas and "meet with potential sponsors" soon after taking office.[279]

In addition, she made clear that the process that she intended to follow in developing a contract for the project would not be the process laid out under current law, the Stranded Gas Act.[280] Palin does not believe that ANS gas is "stranded," and therefore, the Stranded Gas Act should not be the basis under which a contract for an Alaska project should be developed. During her campaign, she stated that she planned to abandon that act and introduce a new bill seeking a law of general application on the first day of the Alaska Legislature's 2007 session.[281] According to her, the "bill will provide for all

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[275] *See* Kyle Hopkins, *Palin Finishes Meet-and-Greet Gas Talks*, Anchorage Daily News, Dec. 7, 2006, at B1; Matt Volz, *Palin Casts Herself as a Republican Party Iconoclast,* Anchorage Daily News, Aug. 11, 2006, at B1.

[276] Alan Bailey, *Piecing Together the Palin Puzzle,* Petroleum News (Anchorage), Nov. 19, 2006, available at http://www.petroleumnews.com.

[277] *Id.*; Wesley Loy, *Palin, Parnell intend to Get to Work Right Away on Gas Pipeline*, Anchorage Daily News, Nov. 8, 2006, at A10.

[278] *Id.*

[279] *Id.* Elizabeth Bluemink, *Palin to Welcome Gas Line Hopefuls*, Anchorage Daily News, Nov. 17, 2006, at A10.

[280] *Id.* Palin's bill would require benchmarks for: (1) access to gas for Alaskan communities; (2) jobs for Alaskans; (3) pre-construction benchmarks; (4) pipeline expansion requirements; (5) reasonable tariffs; and (6) legislative approval. She would also require a firm start date for construction. *See Where They Stand; Running for Governor 2006,* Anchorage Daily News, Oct. 22, 2006, at A12.

[281] *See FERC Third Report*, *supra* note 4, at 3; Kristen Nelson, *Issues in Two Alaska Stranded Gas Act Suits Resolved, says Gov. Sarah Palin,* Petroleum News (Anchorage), Dec. 24, 2006, available at http://www.petroleumnews.com; Kristen Nelson, *Palin to Consider All Gas Pipeline Proposals; Preliminary Meetings with 12 Firms, Agencies Held; State Negotiating Team Being Formed,* Petroleum News (Anchorage), Dec. 10, 2006, available at http://www.petroleumnews.com; Governor's Office Press Release, *Initial Gas Pipeline Meetings,* Dec. 6, 2006, http://gov.state.ak.us/archive.php?id=3&type=1 (last visited Jan. 16, 2007).

proposals to be considered in a more open, competitive manner."[282] In her January 17, 2007, State of the State Address on the first day of the session, Palin said that bill was not ready yet and "with legislation this important, it's more important 'to do it right than do it fast.'"[283] As we go to press, the bill, called the "Alaska Gasline Inducement Act," has not been released.[284]

As the new governor, Palin has begun to appoint new commissioners and department heads. But, there is no certainty yet who will be on the gas line negotiating team for the State and putting together a team will likely take some time.[285] The new administration must also sort out what funding is available to continue the process - without funding it may not be able to take appropriate action.[286] It is to be expected that a new administration has a "lot of work just setting the government up."[287]

Consistent with campaign statements, Palin met with 12 entities to discuss an Alaska project immediately after taking office. On December 5th and 6th, she and her team met with AGPA, the Authority, BP, BG Group, Chevron, ConocoPhillips, Enbridge, ExxonMobil, MidAmerican, Semco Energy Inc., Shell, and TransCanada.[288] After the meetings, Palin stated that some of the lessons learned from the past were: (1) the administration and the legislature must work together as a team; (2) more public involvement was required; (3) gas explorers must have access to any pipeline; and (4) the

282 Kristen Nelson, *Issues in Two Alaska Stranded Gas Act Suits Resolved, says Gov. Sarah Palin,* Petroleum News (Anchorage), Dec. 24, 2006, available at www.petroleumnews.com.

283 Sarah Palin, Governor of the State of Alaska, *State of the State Address* (Jan. 17, 2007) transcript available at http://www.gov.state.ak.us/speeches.php?id=66) [hereinafter "Palin State of the State Address"]. In her speech, Palin said that the bill would contain inducements for firms to build a pipeline and for leaseholders who control the gas to commit their gas to the project. *Id.* She also stated that an applicant under her bill would be required to provide gas for Alaskans, provide jobs for Alaskans, meet project benchmarks, and develop a pipeline with expansion capacity. *See FERC Third Report, supra* note 4, at 3; Kristin Nelson, *Competition Key to Palin Gas Line Bill; Alaska Legislature Waiting for Administration's Proposal,* Petroleum News (Anchorage), Jan. 28, 2007, available at http://www.petroleumnews.com.

284 *FERC Third Report*, *supra* note 4, at 3 (Alaska Gasline Inducement Act).

285 Kay Cashman, *Palin Selects Rutherford to Head DNR,* Petroleum News (Anchorage), Dec. 3, 2006, available at http://www.petroleumnews.com; *Pipeline Firms Will Be Back at the Table for Talks in '07*, Alaska Journal of Commerce, Dec. 31, 2006, available at http://www.alaskajournal.com/stories/.

286 Melissa Campbell, *Leaders Warn Gas Line Delays Will Be Widely Felt*, Alaska Journal of Commerce, Jan. 7, 2007, at 1.

287 Kyle Hopkins, *Cautious Approach on Ethics Encouraged,* Anchorage Daily News, Jan. 5, 2007, at A1.

288 Kristen Nelson, *Palin to Consider All Gas Pipeline Proposals; Preliminary Meetings with 12 Firms, Agencies Held; State Negotiating Team Being Formed*, Petroleum News (Anchorage), Dec. 10, 2006, available at http://www.petroleumnews.com; Kyle Hopkins & Richard Richtmyer, *Palin, Players Get Together*, Anchorage Daily News, Dec. 6, 2006, at B1.

process must have more transparency.[289] Many participants mentioned the need for State participation and the Governor stated that State equity was still on the table.[290]

Palin has not "laid out a timeline for her gas pipeline plan" and has said she "will take her time in starting new negotiations …."[291] The Alaska Senate President and the Chairman of the Legislative Budget and Audit Committee recently told a gathering that they did not expect to see a gas pipeline contract from Governor Palin before the regular legislative session ends in May.[292] Business leaders are worried about a delay which could be caused by Governor Palin's "assur[ance to] each [sponsor] they will have equal opportunity to propose building a coveted gas line."[293] The ConocoPhillips' president gave this view: the "[p]ast administration … worked this for a number of years to get to the point where they were…. I think the reality is it is going to take longer than we would like it to take."[294] Although the FERC has said that over the past year the Alaska pipeline's schedule has "slipped considerably" with "the main obstacle to progress" being "the failure to resolve stale issues," the Palin administration has said "it's 'not accurate' that the schedule has slipped."[295] The Producers have vowed to work with the new Governor as soon as she is ready to begin a process.[296]

2. Delay May Kill the Alaska Project

Unfortunately, delay is Alaska's own worst enemy. Alaska's oil-based economy is suffering and it needs to transition to a gas economy to create investment, job opportunities, and a long-term sustainable cash flow for the State.[297] The Murkowski administration estimated the loss to the State for continued delays in the project at about $900 million per year.[298] That assumes that the pipeline will actually be built.

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289 *Id.*

290 *Id.*

291 Wesley Loy, *Palin, Parnell Intend to Get to Work Right Away on Gas Pipeline,* Anchorage Daily News, Nov. 8, 2006, at A10; Tim Bradner, *Pipeline Firms Will Be Back at the Table for Talks in '07*, Alaska Journal of Commerce, Dec. 31, 2006, available at http://www.alaskajournal.com/stories/.

292 Melissa Campbell, *Legislative Leaders: Gas Line Deal Unlikely in the Coming Session*, Alaska Journal of Commerce, Jan. 14, 2007, available at http://www.alaskajournal.com/stories/.

293 Melissa Campbell, *Leaders Warn Gas Line Delays Will Be Widely Felt*, Alaska Journal of Commerce, Jan. 7, 2007, at 1.

294 Kristen Nelson, *State Should Move Ahead with Gas Line,* Petroleum News (Anchorage), Nov. 19, 2006, available at http://www.petroleumnews.com.

295 *FERC Third Report, supra* note 4, at 7; Wesley Loy, *Feds Grim on Gas Line*, Anchorage Daily News, Feb. 2, 2007 at A1.

296 Wesley Loy, *Palin, Parnell Intend to Get to Work Right Away on Gas Pipeline,* Anchorage Daily News, Nov. 8, 2006, at A10; Elizabeth Bluemink, *Palin to Welcome Gas Line Hopefuls,* Anchorage Daily News, Nov. 17, 2006, at A10.

297 *See IFD, supra* note 24, at ES-3 & 1-4.

298 *Id.* note 297, at 0-1.

The more ominous prediction is that delay will cause the pipeline to never be built, at least within the current generation. As noted at the outset of this paper, the possibility was highlighted by FERC in the FERC Second Report to Congress on progress regarding the Alaska project.[299] Other respected commentators have also noted that the "threat of substitution away from northern gas to LNG is real."[300]

Continuing delay may mean the loss of an Alaska gas line project. Or it may mean it "will [only] lose years."[301] Either way, it will be costly to all parties and not offer the opportunity to fulfill the long held dream of ANS gas commercialization.

III. ISSUES

During the legislative sessions, which considered the *Fiscal Contract*, a number of issues were raised about its terms. Several of these issues also found their way into Governor Palin's State of the State Address earlier this year.[302] Because these issues likely will play an important role in continued discussions this coming year about the Project, this paper provides a brief discussion of each.

The issues are: (i) fiscal framework; (ii) state participation; (iii) producer ownership of the Project; (iv) access and expansion; (v) project pace; and (vi) the status of the Point Thomson Unit.

A. Fiscal Framework

The *Fiscal Contract* generally provided for contractual certainty for a term of years for, among other things, future tax and royalty rates.[303] Ensuring through contract that a host government's fiscal framework will not change in the middle of project life is

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299 *FERC Second Report, supra* note 8, at 10-13. Alaska gas faces other competition including coal and nuclear power. *See CERA Gas, supra* note 16, at 14; Alan Bailey, *Conoco Continues Alaska Investments,* Petroleum News (Anchorage), Jan. 28, 2007, available at http://www.petroleumnews.com ("In recent years coal has started to somewhat supplant natural gas as a power generation fuel."); Paul Laird, *Meet Alaska 2007: Our Silver Linings Come with Clouds,* Petroleum News (Anchorage), Jan. 21, 2007, available at http://www.petroleumnews.com ('threat of being displaced from the market by LNG imports also is increasing").

300 *Tristone, supra* note 188, at 10. The administration fiscal team advisor Pedro Van Meurs told the Alaska legislators that, even with a fiscal contract, there was a 20-30 per cent chance that the Alaska project would not go forward. Tim Bradner, *Alaska Waits as Legislature Debates Gas Line,* Alaska Journal of Commerce, May 21, 2006, available at http://www.alaskajournal.com/stories/.

301 *See* Gregg Erickson, *State Subsidies Won't Speed Gas Line,* Anchorage Daily News, Jan. 14, 2007, at J2. ("It may be time for Alaskans to consider the possibility that there is only a slim chance that North Slope natural gas will to market anytime soon."). Kristen Nelson, *State Should Move Ahead with Gas Line,* Petroleum News (Anchorage), Nov. 19, 2006, available at http://www.petroleumnews.com (quoting former ARCO president Ken Thompson).

302 *See Palin State of the State Address, supra* note 283.

303 *See supra* p. 36 ("State Promises").

not uncommon in large scale, world class, frontier mega-projects involving substantial risk and financial commitments.[304]

For example, in the recent BTC (Baku-Tblisi-Ceyhan) oil pipeline mega-project involving the construction of a large scale, frontier, line from the Caspian Sea, offshore Azerbaijan, to the Turkish port of Ceyhan, the parties, including the governments of Azerbaijan, Georgia and Turkey, provided as follows:

> Except as otherwise specifically provided in this Agreement, no Project Participant shall be subject to any Taxes or any Tax compliance or filing obligations arising from or related, directly or indirectly, to MEP [Main Export Pipeline] Activities, the MEP System, the Facilities, the Rights to Land, Petroleum that is transported through the Facilities of the MEP System or any related assets or activities, whether before, on or after the Effective Date.[305]

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[304] S*ee Constitutional Versus Contractual Commitments by Governments,* Special Institute, International Resources Law II: A Blueprint for Mineral Development, Rocky Mtn. Min. L. Found. at 5-1 (1995). ("When governments wish to attract new mineral investments, one way they do so is by agreeing to provide fixed, long term assurances of the rights, duties and benefits that the mineral company will obtain from future mineral projects. The purpose of such assurances is to induce the mineral company to invest by reducing the risk that once the investment has been made, a commercial find has been identified and operations have commenced, the government would either cancel the rights granted or so change the fiscal terms applicable to the project as to make it uneconomic."); *see also* M. Coale, *Stabilization Clauses In International Petroleum Transactions*, 30 Denv. J. Int'l L. & Pol'y 217, 221 (2002) ("Long-term resource and energy projects such as oil and gas exploration and mining have a serious need for stability that goes beyond short-term projects. … To avoid financial uncertainty about these requirements, companies frequently ask for assurances of stability of the status quo. Sometimes these promises are made as administrative orders or regulations, however they are more frequently made through legislation or in specific contract provisions.") [hereinafter "Coale, Stabilization Clause"]; G. Verhoosel, *Foreign Direct Investment and Legal Constraints on Domestic Environmental Policies: Striking A "Reasonable" Balance between Stability and Change*, 29 Law & Pol'y Int'l Bus. 451, 453 (1998) ("Likewise, international investment agreements, such as those concerning the exploration or exploitation of natural resources, have included so-called "stabilization" or "freezing" clauses since the 1960s. More recently, a number of national investment codes have also included stability provisions. All these legal instruments have the common goal of "immunizing" [multinational enterprises] against the impact of possible changes in domestic policies, such as fiscal treatment, repatriation of assets, and other state actions…."); M. Waeldi and G. Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 Tex. Int'l L.J. 216, 226-227 (1996) ("Resource and energy projects (oil, gas, mining) have a very acute need for stability which goes beyond the normal stability requirements of other shorter-term industrial projects. … Given these massive uncertainties, which do not exist in most other cases of industrial foreign investment, it is understandable that the one thing the natural resources industry abhors is the addition of more factors of great uncertainty (such as the fiscal regime) into their decision process. Fiscal uncertainty could wreak havoc upon these models; at the very least, it means that considerable investment, already at high risk of failure, will be exposed to additional risk.").

[305] Agreement Among The Azerbaijan Republic, Georgia and The Republic of Turkey Relating to the Transportation of Petroleum Via the Territories of The Azerbaijan Republic, Georgia and The Republic of Turkey Through the Baku-Tbilisi-Ceyhan Main Export Pipeline, executed Nov. 18, 1999, at Art. V(1)

The term of certainty provided for the BTC participants is 60 years.[306]

As discussed previously in this paper, because of the risks inherent in this Project, confidence that the fiscal framework will not change in the middle of project life – what others have termed "fiscal stability" in the international context – is critical to the Project's advancement.[307] As one observer has noted,

> Lack of fiscal stability would expose investors to: --Significant possible erosion of value under average and high prices; and --Very significant exposure to downside price and cost overrun conditions. For the giant Alaska gas project, investors cannot take this risk. Fiscal stability is absolutely required.[308]

The Producers consistently have said that they will be unable to attract the capital or make the commitments necessary to support the Project if the possibility remains, after making those commitments, that the State can subsequently increase its share of the total revenue stream anticipated to be derived from ANS gas at the expense of the Producers

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available at http://subsites.bp.com/caspian/BTC/Eng/agmt4/agmt4.PDF (last visited, Jan. 25, 2007) [hereinafter "BTC Agreement"].

306 Host Government Agreement Between and Among The Government of The Azerbaijan Republic and The State Oil Company of The Azerbaijan Republic, BP Exploration (Caspian Sea) Ltd., Statoil BTC Caspian as Ramco Hazar Energy Limited, Turkiye Petrolleri A.O., Unocal BTC Pipeline, Ltd., Itochu Oil Exploration (Azerbaijan) Inc. and Delta Hess (BTC) Limited, executed Oct. 17, 2000, at Art. 3.1 [hereinafter "Host Government Agreement"], available at http://subsites.bp.com/caspian/BTC/Eng/agmt1/agmt1.PDF (last visited, Jan. 25, 2007). See also similar agreements with The Government of Georgia (http://subsites.bp.com/caspian/BTC/Eng/agmt2/agmt2.PDF) and The Government of the Republic of Turkey (http://subsites.bp.com/caspian/BTC/Eng/agmt3/agmt3.PDF). Additional examples of extended contractual periods in a largely upstream context are provided at D. Johnston, Preliminary Review and Discussion of the Proposed Gas Pipeline Contract and the 10 May, 2006, Fiscal Interest Finding at 19-20 (June 15-16, 2006), available at http://lba.legis.state.ak.us/sga/doc_log/2006-06-15_johnston_alaska_testimony.pdf (last visited Feb. 10, 2007) (stating that the average term for typical host government contracts covering exploration and production activities is 32.5 years), and P. Van Meurs, Fiscal Interest Finding, Presentation to the Alaska Legislature at 25 (May 23, 2006) [hereinafter "Van Meurs May 23rd Presentation"], available at http://www.gov.state.ak.us/gasline/pdf/May23-11am-Fiscal-Interest-Finding-v2.pdf (last visited Feb. 10, 2007) (stating that the average term for host government agreements with "major gas exporters and anticipated LNG exporters" ranges between 30 and 44 years). The Interim Fiscal Determination additionally found that "Thirty five years of fiscal stability from the effective date is not uncommon in large oil and gas related projects …." *IFD, supra* note 24, at ES-15.

307 *See supra* pp. 3-5; *see also IFD, supra* note 24, at O-2 ("The SGDA envisioned that it would be difficult, if not impossible, to find responsible commercial entities willing to invest the billions of dollars necessary to make this project a reality without some assurance of stable taxes in the future [i.e., fiscal stability]"). For the common use of the term "fiscal stability" in the international context, *see* the articles cited in *supra* note 304.

308 *Van Meurs May 23rd Presentation, supra* note 306, at 23.

through revising the State's royalty regulations, increasing tax rates or otherwise finding other ways to increase State take. Consistent with the approach taken in similar international mega-projects, the *Fiscal Contract* reflected an agreement on this issue.

As part of the need to provide fiscal stability, the Producers also have said that any disputes that might arise during the term of their commitment should be resolved through arbitration before a neutral body. In order to provide a more efficient and fairer method for resolving disputes, the use of neutral arbitration is common in industry-related host government agreements.[309] It also generally is favored by Alaska courts.[310]

During the legislative sessions, concern was expressed that, by agreeing to provide certainty for a term of years for, among other things, future tax and royalty takes and through neutral decision making, the State was limiting its sovereignty. In her State of the State, Governor Palin expressed the same reservation, stating that in her view, the *Fiscal Contract* required that the State "give up some fundamental rights as a state … because the deal removed our taxing, regulatory, and judicial authorities for DECADES. In fact, under those terms, my youngest daughter, Piper, would be older than I am right now before the state could amend those terms!"[311]

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[309] Daniel Johnston, *International Oil Company Financial Management in Nontechnical Language* at 173 (1998) ("arbitration is 'standard in the industry.'") *See also* AIPN 2002 Model Form International Operating Agreement: "<u>Arbitration</u>. Any Dispute [not finally resolved by alternative dispute resolution procedures set forth in Articles 18.2(B) and 18.2(C)] shall be exclusively and definitively resolved through final and binding arbitration, it being the intention of the Parties that this is a broad form arbitration agreement designed to encompass all possible disputes." Similarly, the AIPN 2002 International Model Well Services Contract provides: "Any dispute, controversy, or claim arising out of, relating to, or in any way connected with this Contract, including, without limitation, the existence, validity, performance, breach, or termination thereof, shall be settled by final and binding arbitration in accordance with the following arbitration Rules:" The AIPN 2004 International Model Farmout Agreement stipulates: "Except as may be otherwise agreed in the JOA, any and all claims, demands, causes of action, disputes, controversies and other matters in question arising out of or relating to this Agreement, including any question regarding its breach, existence, validity or termination, which the Parties do not resolve amicably within a period of ____ days, shall be resolved by three arbitrators in accordance with the Arbitration Rules of the ____________________. . . ."

[310] The Alaska Supreme Court has held that the "common law and statutes of Alaska evince 'a strong public policy in favor of arbitration.'" *Barnica v. Kenai Peninsula Borough School District*, 46 P.2d 974, 978 (Alaska 2002), (quoting *Department of Pub. Safety v. Public Safety Employees Ass'n*, 732 P.2d 1090, 1093 (Alaska 1987) quoting *University of Alaska v. Modern Constr, Inc.*, 522 P.2d 1132, 1138 (Alaska 1974)). This policy is reflected in Alaska's 1968 adoption of the Uniform Arbitration Act, ch. 232, §SLA 1968, and 2004 adoption of the Revised Uniform Arbitration Act, ch. 170, SLA 2004. Consistent with this approval, arbitration is now widely used in Alaska commercial agreements as a method to resolve disputes. *Gilbert v. Sperbeck*, 126 P.3d 1057, 1061 n. 17 (Alaska 2005) (quoting *Bd. of Ed., Fairbanks N. Star Borough Sch. Dist. v. Ewig*, 609 P.2d 10,13 (Alaska 1980)).

[311] *Palin State of the State, supra* note 203. Of course, the length of time for which stability is provided is critical. *See Coale, Stabilization Clauses, supra* note 304, at 219 ("Since these petroleum agreements require a large initial outlay of capital, and long-term investment in projects including exploration,

The resolution of this issue is critical to the future of the Project, but it is far from clear what that resolution will be. As noted above, confidence that the fiscal framework will not change in the middle of project life is required to justify the investments necessary to support the project. Because the Alaska Project is in competition with similar projects elsewhere in the world,[312] some form of stability ultimately will be required in Alaska as well, if the State's oil and gas lessees are to make the investments and commitments necessary to move the Project forward. The State's actions on this issue in the coming year will be critical.[313]

B. State Participation

Through its royalty and tax rates, the State has a significant, if indirect, ownership interest in the production to be transported through the Project. The *Fiscal Contract* converted that interest into gas in kind and provided that, as with the Producers and other shippers, the State would contract for firm transportation to cover its share of production and take an ownership interest in the Project, also proportionate to its interest in the underlying production.

Again, such an approach is not uncommon in large scale, world class projects involving substantial risk and financial commitments. In the BTC project, for instance, a unit of the Azerbaijan state oil company also owns a significant share of the oil being transported through the pipeline and also has taken an ownership share in the pipeline. Similar relationships also exist in the Chad Cameroon Pipeline[314] and the South Caucuses Pipeline.[315]

(continued…)

appraisal and development that must be recouped from earnings, these investments expose the international oil company to substantial risk for an extended period.").

312 S*ee* P. Van Meurs, *Gas International Comparison; IFD, supra* note 24, at App. S-2 – S-3, available at http://www.revenue.state.ak.us/gasline/GAS-INTERNATIONAL-COMPARISON-v5.pdf (last visited, Feb. 1, 2007) [hereinafter "Gas International Comparison"] ("The Alaska Gas Pipeline project is clearly a project that competes with large distance gas exporters. Therefore in order to determine whether the Alaska terms for the proposed contract are competitive we need to compare with other large distance exporters, in particular exporters to the Lower 48 market…," and finding that the "[t]he [*Fiscal Contract*] terms plus the PPT terms are competitive with other long distance exporters to the Lower 48 market.")

313 In the State of the State, Governor Palin made the following comment on this issue in the course of describing AGIA:

> [T]he Act provides inducements to those who hold the leases and control the gas. Regardless of who builds the line, we need a mechanism to "strongly encourage" the leaseholders to commit their gas to the licensed project.

Palin State of the State, *supra* note 203.

314 The World Bank Group, *Project Description, Chad Cameroon Pipeline*, available at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/EXTREGINI/EXTCHADC

As the Producers explained during the legislative session, there are reasons important to the success of the Project which support the State's take of its ownership interest in kind, its commitment to firm transportation and the State's participation in the ownership group. The State's take of its ownership interest in kind eliminates the potential for valuation disputes concerning its royalty and tax share, in addition to potentially enhancing the State's revenues.[316] Direct State ownership of an interest in the gas pipeline provides the State with a "seat at the table," involving the State directly in the Project's decision-making process. This results in improved alignment between the owners and the State on ongoing commercial issues, which reduces the potential for disagreement, dispute and litigation. This, in turn, reduces risk and cost.

Direct ownership of the resource, a commitment to firm transportation, and an interest in the Project also ensures that the State and the Producers are commercially aligned to deliver a low-cost project, which increases the netback realized at the wellhead. In the event of a cost overrun, being a direct owner in the pipeline also allows the State to

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AMPIPELINE/0,,contentMDK:20485927~menuPK:1175780~pagePK:64168445~piPK:64168309~theSitePK:843238,00.html (last visited, Feb. 10, 2007) (the governments of Chad and Cameroon own an interest in the Chad Cameroon Pipeline).

[315] European Bank for Reconstruction and Development, *Project Summary Document, SOCAR South Caucasus Gas Pipeline,* available at http://www.ebrd.co.uk/projects/psd/psd2003/27637.htm (last visited, Feb. 10, 2007).

[316] Taking its share of product in kind is not a new concept to the State. The State is doing it today with oil. A similar take-in-kind approach also is proving highly successful – and profitable – to the United States government with respect to its share of natural gas produced from Federal lands. According to the U.S. Minerals Management Service in its most recent report on its RIK program,

> FY 2005 saw the continuing positive evolution of the MMS RIK program as a fully operational component of MMS's asset management approach to managing the Nation's mineral royalty asset stream. Program performance far outpaced program goals. Administrative costs continued to decrease compared to the cash royalty alternative. *Revenues to the Treasury were increased.* Accounting periods were closed within 6 months. *Conflict with producers was virtually non-existent.* Agency knowledge of the Nation's energy infrastructure/markets was increased.

Minerals Management Service, United States Department of Interior, *Royalty in Kind Program, Fiscal 2005 Year Report* at i (2006) (emphasis supplied), available at http://www.mrm.mms.gov/RIKweb/PDFDocs/RIKPRPFY2005.pdf. More money for the government, lower administrative costs and fewer disputes is a good thing. *See also* Minerals Management Service, United States Department of Interior, *Report To Congress: Minerals Management Service Royalty In Kind Operation Energy Policy Act Of 2005 -- Section 342* at 10 (September 2006), available at http://www.mrm.mms.gov/RIKweb/PDFDocs/ReportToCongress.pdf ("In the mid-1990s, the MMS began exploring the potential for a more broadly applied RIK operation to increase efficiencies, decrease conflict and enhance revenues generated from oil and gas production royalties."). The program has been successful, not only in terms of reducing disputes but also increasing royalty revenue. *Id.* at 28 ("The significant benefits of the RIK have been demonstrated in terms of substantial additional mineral revenue to the Treasury and operational efficiencies for government and industry.").

recover any reasonable cost overruns in the tariff, effectively hedging its cost overrun risk. If the State were not an owner, any such cost overruns would be included in the tariff which would reduce the value of the State's gas, without any corresponding increase to the State in tariff income. This, in turn, could lead to dispute and risk.

Moreover, by committing to firm transportation for the State's share of throughput and committing to invest in the Project, State ownership of a portion of the pipeline also improves the overall economics of the Project to the Producers and reduces project risk.[317] One of the reasons for this is that the pipeline portion of any project typically produces a lower return on investment than the upstream portions. Because investing producers look at the overall return expected to be realized on the total investment in deciding whether to go forward with a given project, obtaining a firm transportation commitment from the State for its share of the production and reducing the investment level required in the portion of the Project producing the lowest return improves the overall return and makes the Project more economic.[318] Such an improvement in overall return is especially important in the Alaska Project, where the risks and investment levels required are substantial and the returns potentially marginal in the first instance.

During the legislative session, concern was expressed that:

- direct State ownership of an interest in production and the Project extended the State into a business segment with which it was not familiar;
- potentially required the State to raise and invest a substantial amount of money in an enterprise not typically undertaken by State government; and
- to some degree, eliminated the State's ability later to second-guess producer decisions by challenging the level of the transportation deduction from royalty and tax calculations.

Where the State may be headed on this issue in the future is murky. Governor Palin does recognize, at least, that the State must play some role in improving the economics of the Project for investors. In describing AGIA during her State of the State, Governor Palin had this to say about state participation:

> [AGIA] offers inducements to those who will build the pipeline itself. … The pipeline construction incentives will be valuable, and will encourage companies to compete for the right to build this line. We're currently

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317 *Van Meurs May 23rd Presentation, supra* note 306, at 7-12. *See also IFD*, *supra* note 24, at ES-5 ("Successful development requires … a firm transportation (FT) commitment to ship the gas on the gas pipeline because firm transportation commitment is the basis for financing the pipeline.").

318 *Id.* at 11 ("The proposed contract improves the project economics through the shipping commitment without lowering the State revenues.")

> developing such incentives as a substantial state capital contribution so bidders know that we'll have skin in the game.[319]

Of course, improving the economics of the Project through State investment addresses only part of the issue, however. As contemplated in the *Fiscal Contract*, State participation went further and, by actively involving the State as an owner of gas being shipped through the pipeline, as a firm transportation holder as well as an owner of an interest in the pipeline, also significantly aligned the commercial interests of the State and the Producers. As noted above, this alignment, in turn, is important to mitigating risk and future cost by reducing the likelihood that the State and producers will later become involved in protracted and disruptive disagreements involving the operation of the pipeline, the incurrence of pipeline costs, the calculation of royalty and taxes and other, similar matters.

As with confidence that the fiscal framework will not change in the middle of project life, State ownership of the State's share of the gas resource and a corresponding share of the Project is important to the future viability of the Project. As noted above, it is consistent with instances in which other host governments have taken responsibility for their share of the resource and become a participant in the downstream phases of the project as well. By improving project economics and reducing risk, a similar level of participation here will increase the likelihood that the Project will be viable.

C. Producer Ownership of the Project

As explained previously in this paper,[320] as a world scale mega-project in a frontier region, the Project faces a number of enormous challenges and risks. The parties who have the greatest incentive to limit these risks are the resource owners, because they are the ones who ultimately will bear the financial consequences of any resulting added costs. To put control over these risks in the hands of the parties with the greatest incentive to control them, the *Fiscal Contract* provided that the resource owners would own and operate the pipeline. In short, responsibility for Project ownership and operation was vested in those persons with the greatest incentive to control cost and burden – those who ultimately would pay the tab.

As with fiscal stability and state participation in ownership, this approach is consistent with the structure adopted in other, similar large scale, world class mega-projects. The BTC, Chad Cameroon and South Caucasus Pipelines are all recent examples of a structure in which the resource owners also own the related pipeline.[321]

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319 *Palin State of the State, supra* note 283.

320 *See supra* pp. 3-5.

321 The BTC pipeline is owned by the large resource owners delivering oil into the pipeline and is operated by BP, one of the resource owners. BP Caspian, *Baku-Tblisi-Ceyhan Pipeline, Our Partners*, http://www.bp.com/genericarticle.do?categoryId=9006669&contentId=7014365 (last visited, Feb. 10,

In projects of this type, such structures generally are looked to because, as discussed previously, it is the resource owners' money that ultimately is being put at risk. As a result, the resource owners have the greatest incentive to ensure that the projects are done in the least costly and burdensome manner possible. Because the host government inevitably also is either a resource owner or, at a minimum, has a significant financial stake in the netback value of the resource, they also benefit from such decisions as the best alternative for preserving their value.

During the legislative session, however, some fretted that Producer ownership of the Alaska Project possibly could have the effect of limiting future exploration activities elsewhere on the North Slope by later arriving, non-owner producers. Critics said that if the Producers owned the pipeline, they in some fashion would use their ownership to foreclose later producers from gaining access to the pipeline, and thus, to markets. By limiting their access to markets, the incumbent Producers would undercut the incentive for later producers to engage in exploration and development efforts and thus, preserve those opportunities to themselves.

The issues of access and expansion of the Project are addressed in the next section of this paper. For the moment, suffice it to say that the Project already is subject to extensive legislative and regulatory provisions which will prevent such conduct. In any case, access and expansion regulations are *identical* regardless of whether the producers or a third party own the pipeline.

The much more important point, however, is that constructing the Project at the lowest possible cost is *the* critical component to ensuring that new exploration continues to occur. In frontier and marginal areas, cost is the key component in driving new exploration activity. If costs, particularly including the cost of transportation to market, are held under control, the economics supporting new exploration activities remain robust. On the other hand, if costs are not controlled, exploration activities wither. Thus, the critical factor in evaluating the Project from any resource owner's perspective – affiliated or independent – should be whether the person with the greatest means and best incentive

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2007). The Chad Cameroon Pipeline similarly is owned by the large resource owners delivering oil into the pipeline and is operated by ExxonMobil, one of the resource owners. Esso Exploration and Production Chad, Inc., *Transporting Chad's Oil to Market*, http://www.essochad.com/Chad-English/PA/Files/17_ch13.pdf (last visited, Feb. 10, 2007). Finally, the South Caucasus Gas Pipeline is owned by the large resource owners delivering gas into the pipeline and is operated by SOCAR (commercial operator) and BP (technical operator), both resource owners. BP Caspian, *South Caucasus Gas Pipeline, Our Partners,* http://www.bp.com/genericarticle.do?categoryId=9006670&contentId=7014379 (last visited, Feb. 10, 2007).

to complete and operate the Project at the lowest cost and with the least burden is put in charge.[322]

As with the other issues, it is uncertain what direction this issue will take in the coming year. In her State of the State, Governor Palin simply stated that, under AGIA, the pipeline may be owned by:

> … the three major oil producers, it might be an independent pipeline company, it might be a state or quasi-state entity, or it might be a combination of entities joining forces.[323]

If the goal of encouraging continued exploration is to be achieved, the central focus of that decision should be on which entity is best equipped to bring the Project to completion at the lowest cost and subject to the least ongoing burden.

D. Access and Expansion

For the reasons explained in the preceding section, in the *Fiscal Contract* ownership of the Project was vested in the primary resource owners. Although ensuring access to the Project by third parties and expansion if additional exploration warrants are also critical issues, few additional provisions dealing with access or expansion were included in the *Fiscal Contract* itself. This was so because of the legislative and regulatory provisions already contained in Federal law controlling the Project.

These existing legislative and regulatory provisions are extensive. First, as an interstate pipeline, the Project will be operated as an open access pipeline pursuant to the FERC's Order 636 and subsequent rules.[324] Those rules require that pipelines are held open and available to transport gas on behalf of all parties, whether affiliated with the pipeline owner or not. Most pipelines in the Lower 48 have affiliates engaged in marketing activities of one form or another.[325] Taking that fact into account, the open access provisions are designed to ensure that non-affiliates are able to obtain

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322 As discussed previously, *supra* pp. 4-5, an "independent" pipeline owner does not share these incentives to the same degree as a resource owner.

323 *Palin State of the State, supra* note 283.

324 Order No. 636, 59 FERC ¶ 61.030 (1992); Order No. 636-A, 60 FERC ¶ 61,102 (1992); Order No. 636-B, 61 FERC ¶ 61,272 (1992); Order No. 636-C, 78 FERC ¶ 61,186 (1997).

325 In adopting its Order No. 2004 dealing with affiliates, the FERC concluded that "a review of data from the 85 interstate natural gas pipelines and certificated storage companies that submitted an Index of Customers for October 2003, shows that 63 of them transport or store gas for their affiliates." Order No. 2004, Standards of Conduct for Transmission Providers, 68 Fed. Reg. 69,134 (Dec. 11, 2003), III FERC Stats. & Regs. ¶ 31,155 at ¶ 10 n.14 (Nov. 25, 2003) ("Order No. 2004"), at ¶ 10 n.14. *See also* Order No. 2004-C, 109 FERC ¶ 61,325, at ¶ 49 (2004) (characterizing the fact that one major interstate pipeline operates without any energy affiliates as presenting "unique circumstances.").

non-discriminatory, equal access to pipeline facilities on the same terms as are affiliates.[326]

Second, for the Alaska gas pipeline the Alaska Pipeline Act[327] requires that the FERC issue additional, separate rules governing the open season for the Project.[328] In response, the FERC has issued implementing regulations requiring that the Project adopt the same open access principles as other interstate pipelines, but much earlier in the process than required for other, Lower 48 pipelines.[329] These regulations provide additional protections to third-party shippers by requiring that the non-discriminatory provisions applicable to interstate pipelines apply to the open season phase of the Project.[330]

Finally, the Alaska Pipeline Act itself provides statutory authority authorizing the FERC to require expansions of the Project under certain conditions if additional exploration warrants.[331] The FERC does not have similar authority over Lower 48 interstate pipelines and the unprecedented grant of such authority in the case of the Project obviously is intended to give third party Alaska shippers the right to force additional pipeline expansions in situations where the pipeline owners do not agree to do so voluntarily.[332]

Given the cumulative effect of these, in some instances, specially crafted regulations, extensive and, indeed in the case of the initial open season and required expansions, unprecedented rules already govern access to and expansions by the Project.

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326 Recently, the D.C. Circuit remanded Order No. 2004 for further consideration on the issue of whether the provisions of Order No. 2004 should be applied, among other entities, to relationships between a pipeline and its production affiliates. *National Fuel Gas Supply Corporation v. FERC*, 468 F.3d 831 (D.C. Cir. 2006). In response, the FERC has issued an interim rule which excludes, pending consideration of the D.C. Circuit's remand, a pipeline's relationship with its production affiliate from the scope of the Order No. 2004 requirements, Interim Rule, Standards of Conduct for Transmission Providers, Order No. 690, III FERC Stats. & Regs. ¶ 31,327 (Jan. 9, 2007), and a notice of proposed rulemaking to consider the issue further. Notice of Proposed Rulemaking, 118 FERC ¶ 61,031 (2007). It is uncertain what the outcome of the proposed rulemaking may be. The Commission may make a permanent change to the scope of Order No. 2004, or it may readopt the same or a broader rule with further reasoning to respond to the D.C. Circuit's direction.

327 *See supra* note 88.

328 15 U.S.C. § 720a(e) (2004).

329 These regulations were adopted in Order Nos. 2005 and 2005-A, s*ee supra* note 100, and are codified at 18 C.F.R §§ 157.30 – 157.39 (2006).

330 18 C.F.R. § 157.35 (2006); *see also* Order No. 2005, *supra* note 100 at ¶ 73-81. These regulations do so, in part, by cross referencing portions of the Commission's Order No. 2004 series of regulations. As noted above, the Order No. 2004 series of regulations recently have been remanded by the D.C. Circuit. *See supra* note 326. Because of the relationship between the two sets of regulations, it may be anticipated that if the Commission ultimately revises its Order No. 2004 regulations as a result of the remand, the Commission also will revisit the related portion of its Order No. 2005 regulations.

331 15 U.S.C. § 720c (2004).

332 *See* related discussion at *supra* notes 93-94.

Nevertheless, during the Alaska legislative sessions on the *Fiscal Contract* some parties asserted that these existing provisions were not sufficiently extensive to protect future producers and shippers and should be additionally supplemented.

The efforts by these parties are not new, however, and instead effectively attempt to revisit old battlegrounds. Detailed concerns about access and expansions were raised by third parties and considered by Congress at the time the Alaska Pipeline Act was passed and by the FERC at the time the implementing rules were adopted.[333] In response, Congress and the FERC adopted provisions dealing with these issues that they concluded struck appropriate balances among the various competing interests.[334] In a very real

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333 Indeed, at the time that the FERC was considering the issuance of its Order No. 2005, the Alaska legislature itself directly requested that the FERC adopt significant parts of the same set of rules subsequently suggested during the legislative session. III FERC Stats. & Regs. ¶ 31,175 (2005) at ¶ 67 ("Alaska Legislators suggest … [that] the pipeline should conduct periodic, non-binding open seasons"); ¶¶ 115 - 116 ("Alaska Legislators … contend that rolled-in pricing should be required for pipeline expansions. Alaska Legislators contend that incremental treatment for expansions would discriminate against expansion shippers …. Alaska Legislators argue that the prospect of incremental rates will also act to reduce competition and impede the development of Alaska natural gas.").

334 *See, e.g.,* the Commission's resolution of the issue of whether expansions should be afforded "rolled-in" or "incremental" rate treatment. After reciting the comments and concerns of the Alaska Legislators, the FERC found in Order No. 2005 that

> We conclude that there should be a rebuttable presumption in favor of rolled-in pricing for project expansions. … Incremental pricing of expansion could put expansion shippers at a significant rate disadvantage compared with initial shippers, and accordingly could discourage exploration, development and production of Alaska natural gas. … [However,] [a]s a general matter, we have historically not favored requiring existing shippers to subsidize the rates of new shippers. … In conclusion, to provide guidance to potential shippers in advance of the initial open season that is the subject of this rule, the Commission intends to harmonize both objectives (rate predictability for initial shippers and reduction of barriers to future exploration and production) in designing rates for future expansions of any Alaska natural gas transportation project. … We cannot at this point, without a specific project proposal or the facts surrounding a proposed expansion before us, define exactly what will be required to overcome the presumption."

Order No. 2005, *supra* note 100 at ¶¶ 123-125. And after reciting the comments of the Alaska Legislators on rehearing, the FERC found in Order No. 2005-A that

> In adopting the presumption for rolled-in treatment, the Commission balanced rate predictability for initial shippers with the objective of reducing barriers to future exploration, development and production of Alaska natural gas. … Nothing in the requests for rehearing causes us to question our conclusion that a rebuttable presumption of rolled-in treatment for the expansion of an Alaska Project is a reasonable approach to the difficult issues we, and prospective pipeline proponents and shippers, may face in the future. We think that the signal we are sending is a positive one that will help spur natural gas exploration and development in Alaska. At the same time, we have not prejudged how we will resolve future proceedings, and all parties will have the opportunity to convince us of appropriate rate treatment if and when expansion proposals for an Alaska project are developed."

Order No. 2005-A, *supra* note 100 at ¶¶ 48, 51.

sense, the concerns raised during the legislative sessions simply sought to achieve through additional restrictions imposed in some form at the State level what the Congress and FERC had already considered and decided were not appropriate for the Project.

As with the other issues related to the Project, the issues regarding third-party access to the Project and expansion are important. Certainly, as they engage in exploration and develop their own resources, non-owner producers and other shippers will require access to the Project and the Alaska Pipeline Act and FERC rules provide for that. To the extent that non-owner producers and other shippers request expansions of the Project and believe that they are unfairly denied them, the mandatory expansion provisions of the Alaska Pipeline Act[335] provides them with a forum in which to seek an order remedying the situation.

Preserving the existing balances struck by Congress and FERC is equally as important, however. Imposing additional obligations will impose additional costs and risks on a Project that already is facing extensive costs and risks. In the past, Lower 48 pipelines have opposed compulsory expansion provisions similar to the mandatory expansion provisions of the Alaska Pipeline Act because it takes the decision of whether and when to invest additional money out of their hands and puts it in the hands of others. While the mandatory expansion provisions of the Alaska Pipeline Act specify procedures for imposing such burdens on the Project, it was carefully crafted by Congress to balance the interests of the Project owners and potential shippers in order to avoid imposing unnecessary additional risks and costs on the Project. Efforts to second guess Congress and retrade those balances now will create additional risk and burden on the Project.

The same is true of efforts to impose additional access provisions beyond those imposed by the FERC. In the same manner as did Congress in crafting the mandatory expansion provisions, the FERC balanced the interests of all parties in crafting the open access rules that apply to the Project. Efforts to second guess the FERC and retrade those balances now create additional risk and burden on the Project.

The debate over these issues, however, will continue this coming year. In her State of the State, Governor Palin stated that the AGIA will contain, at least, some additional terms dealing with access and expansion. As she described AGIA,

> It requires terms that ensure competitive and long-term exploration and MORE development on the Slope. The pipeline must be able to expand in step with the development of new reserves …."[336]

The resolution of this issue will be critical.

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[335] 15 U.S.C. § 720c (2004).

[336] *Palin State of the State*, *supra* note 283.

E. Project Pace

The *Fiscal Contract* provided that the State and Producers would proceed with "diligence" to evaluate and, if justified, pursue the project. The "diligence" standard was chosen because, at this early stage of the Project, more definitive guideposts are inappropriate.

This is for two reasons. First, as a multi-jurisdictional project, the attempted imposition of firm timelines by one host government for the completion of activities involving or dependent on the approval also of other governments or entities is self-defeating until all governments and other entities are prepared to do the same.[337] In the BTC project, for example, firm project and completion dates were not agreed until all governments were in a position to approve all aspects of the project, and even then the completion dates were carefully conditioned to provide flexibility.[338]

In a situation in which each government acts alone, the earlier imposition of firm project and completion dates by one host government will provide the other governments or entities, which may not share the same interests as the initial host government, with significant leverage over the project. By simply delaying permits or approvals, the second host government or entity will increase its leverage to obtain whatever additional requirements or conditions it might seek to impose as the project applicants begin to approach the date on which sanctions or loss of the project may occur under the initial host government's timeline. The potential for these additional conditions, which might not be able to stand on their own merit absent the additional leverage created by the time deadlines imposed by the initial host government, certainly add risk to the project.[339]

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[337] For example, in addition to the federal and provincial Canadian governments, some aspects of the Project may also require approval by Canadian First Nations.

[338] *See Host Government Agreement, supra* note 306, at Art. 3.6 ("Except as otherwise may be expressly provided in another Project Agreement, it is expressly understood by the Parties to this Agreement that no MEP Participant or other Project Participant is committed, or is in any manner obligated to any of the State Authorities, to undertake any Project Activities or otherwise to implement or carry out the Project, or to continue any Project Activities that it may have begun, in reliance on this or any other Project Agreement, or otherwise.").

[339] This reason explains why the work commitment applied in midstream projects is sometimes different from the standard adopted in upstream projects. Because upstream projects largely are within a single jurisdiction, the single jurisdiction is in a position to approve all of the permits required at the time the agreement containing the firm dates is executed. In instances in which a midstream project extends across multiple jurisdictions, however, no one government or entity is in a position to approve all of the permits at any given time and thus, providing in any agreement with any single host government for deadlines to achieve certain objectives only serves to provide the other host governments with added leverage, and thus, increases project risk and cost. There are other instances in which upstream and midstream projects also may be treated differently. *See Gas International Comparison, supra* note 312 (discussing differences in the level of government take imposed between the upstream and midstream sectors).

The second reason that more definitive guideposts are not appropriate is because flexibility in the timing of a project of this tremendous size and scope is critical. As one observer commented during the legislative hearings:

> The approach under the contract conforms with modern project management practices. The project execution of very large projects involves careful preparation, evaluation and front end engineering. The IPA Institute ('Independent Project Analysis, Inc.') has analyzed in depth the reasons for the failure of many very large projects through cost overruns. What is essential in preventing cost overruns is to adopt project schedules that are reasonable and provide sufficient time to carry out the necessary preparation and obtain all data. The lack of proper data gathering or analysis is one of the reasons why very large projects fail in achieving cost objectives. Projects often fail in execution because the "unknown unknowns" turn out to be very damaging through delays in timing or unforeseen costs. For these reasons international government-company contracts related to large petroleum projects do not contain specific time tables, obligatory deadlines or detailed obligatory work programs. Instead contracts provide for flexible schedules and approval processes as contained in the proposed contract.[340]

Under these circumstances, the use of the term "diligence" to define the scope of the work commitment and the pace at which the Project is to proceed is especially appropriate. As the United States Supreme Court has stated in discussing the "prudent operator" standard, which is substantially similar to the diligence standard, the obligation of "diligence" leaves the determination of project pace to the specific facts and circumstances which the Project may encounter as it progresses:

> Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances. ...Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required**.**

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[340] P. Van Meurs, *Work Commitments, Presentation to the Alaska Legislature* at 18-20 (May 16, 2006) [hereinafter "Van Meurs, Work Commitments"]. *See also IFD, supra* note 24, at ES-15 ("[A] binding commitment and set date to construct the pipeline was not in the best interest of either the state or the sponsor group. [According to] Independent Project Analysis, Inc., a consulting firm with expertise in the management of large projects … schedule-driven projects invariably encounter cost overruns."), and ES-16 ("[T]here is not a single large multi-billion dollar international contract involving gas development that 'guarantees a project' because a schedule-driven project will most certainly result in significant cost overruns.").

Sauder v. Mid-Continent Petroleum Corp., 292 U.S. 272, 280, 54 S. Ct. 671, 673, 78 L.Ed. 1255 (1934).[341] As a consequence, the standard requires that the entity charged with "diligence" will continue at all times to progress the project, but without incurring the additional cost and risk which the imposition of artificial deadlines – particularly if imposed by only one of many entities – may create.[342]

Notwithstanding these benefits, during the legislative hearings some complained that this standard was not sufficiently specific to produce a project. Instead, despite the express obligation of "diligence" some parties took the view that the standard was so vague as to sanction non-action by the Project owners. This view appears to be shared, at least in part, by Governor Palin. In her State of the State, the Governor described the agreement presented to the legislature as "'no deal.' … Remember, in exchange for unnecessary concessions, the producers didn't have to commit to preparing applications, much less build a gasline."[343]

The standard applied to set the pace of the Project going forward is critical. If the pace is set too tightly, or in a manner which will provide other entities with substantial leverage, risk will increase, costs will expand and the potential for completion of a successful project will be substantially reduced. Of course, those responsible for developing the Project should not be left with indefinite obligations, but the obligations imposed need to take into account the magnitude and complexity of the Project and the need for new thinking to address issues as they arise during the course of project development.

The use of the "diligence" standard meets both of those objectives. It imposes the obligation to move forward, while allowing for the automatic recognition of the facts and circumstances that the Project will encounter. In the *Fiscal Contract*, the standard also was coupled with effective penalties. As one observer summarized:

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[341] Black's Law Dictionary defines "diligence" similarly, as "[s]uch a measure of prudence … as is properly to be expected from, and ordinarily exercised by, a reasonable prudent man, under the particular circumstances …." *Black's Law Dictionary* 314 (6th ed. 1991).

[342] The use of this standard also applies well known principles of law. The prudent operator standard or due diligence standard are the standards expressly or impliedly contained in virtually every lease in the United States. 5 Williams & Meyers, *Oil and Gas Law* § 806.3 at 42-43 (2004). Moreover, the State of Alaska has included a similar "diligence" standard in its oil and gas leases for over 45 years. For example, paragraph 20 of the State's DL-1 "Competitive Oil and Gas Lease" form, which was used as early as 1960, states under the heading "DILIGENCE; PREVENTION OF WASTE" that "Lessee shall exercise reasonable diligence in drilling, producing, and operating wells on said land." Paragraph 13(a) of the State's current "Competitive Oil and Gas Lease" form (DOG 200604) contains identical language. This standard has proved successful. Applying that standard, the State has collected over $75 billion in royalties and taxes from oil and gas leases.

[343] *Palin State of the State, supra* note 283.

> If sponsors do not proceed diligently until Project Sanction, the State can terminate the contract, subject to arbitration. Termination of the contract would result in loss of fiscal stability on oil and gas for the Sponsors.[344]

In addition, termination of the Project also would result in loss of any investment made by the owners up to the time of the termination, loss of the State's agreement to take-in-kind and to share in pipeline ownership, and, if terminated after the State has made a firm capacity commitment in an open season, the additional loss of the producers' Alaska lease position. After comparing these terms to similar commitment provisions in other host government agreements, the same observer concluded that these terms provide "strong and specific work commitment provisions compared to large international projects."[345]

Nonetheless, in her State of the State, Governor Palin appears to signal a different approach. Under AGIA,

> [T]o get a chance to compete for the inducement package, the applicant must agree to certain bedrock, "must-have" requirements of the state; such as … project benchmarks.[346]

The manner in which this issue is resolved will be critical to Project success.

F. Point Thomson Unit

As noted earlier in this paper, in December 2006 the Commissioner of the ADNR issued an order terminating the Point Thomson Unit. As also noted earlier, that termination was appealed by the Point Thomson lessees in January of this year and it is not the purpose of this paper to address those issues.[347]

Importantly, however, before the developments of late last year and early this year the *Fiscal Contract* had addressed the Point Thomson issue in a significant way. In essence, the Producers agreed to commit a certain quantity of gas to the Project in order to help make it viable and agreed promptly to apply for the issuance of pool rules to

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344 *Van Meurs, Work Commitments, supra* note 340, at 3.

345 *Id.* at 30. The international projects to which Mr. Van Meurs compared the Alaska project were Kashagan (Kazakhstan), Qatar LNG, Sakhalin (Russia) and Azerbaijan (upstream and midstream). *Id.* at 23-29 (among other things, Mr. Van Meurs noted that these other projects "[f]ail to have a specific work program on the mid stream component of the project, [f]ail to have a start date for the initial studies on the project, [and] [f]ail to have a specific provision that the agreement can be terminated in case companies are not diligent.") The PFD also concluded that the work commitments of the fiscal contract are stronger than comparable large projects. *See PFD, supra* note 202 at 128-29.

346 *Palin State of the State, supra* note 283.

347 *See supra pp.* 45 - 47.

authorize a gas offtake rate for Point Thomson unit gas. In return, the State agreed to maintain the Point Thomson Unit as the Project proceeded.

These terms recognized that the inclusion of the Point Thomson gas resource is essential to the viability of a gas pipeline project. The Point Thomson resource represents approximately 25% of the known gas volumes that would be available to feed a gas pipeline project. Without those resources, the parties recognized that the Project is not viable. As such, the *Fiscal Contract* recognized that Point Thomson is an anchor field and that no reasonable investor would commit to participate in the Project if the anchor leases critical to the success of the Project were at issue.

During the open season, investors will make firm transportation commitments to ship gas. These long term commitments require that shippers pay for transportation capacity whether or not they have gas volumes to fill that capacity and are the financial underpinnings of the project. The *Fiscal Contract* recognized that no investor would be willing to execute firm transportation commitments to ship Point Thomson gas without certainty as to their ownership of the leases. Without that certainty, the risk associated with making the firm transportation commitment is simply too great.

Now that the Commissioner of the ADNR has issued an order terminating the Point Thomson Unit, that the status of the underlying leases – and thus, 25% of the known volumes available to support the Project – is uncertain. As noted earlier in this paper, the State's assistant attorney general assigned to this case has estimated that the litigation is likely to last two to three years.[348] Until that litigation is resolved, *no* party – not the current lessees nor any potential future lessees – will be in a position to make any firm transportation commitments with respect to the Point Thomson gas. Because the developments involving Point Thomson are so recent it is not clear that any party – the State, the FERC or the Producers – has been able to think through the full implications of these recent events on the Project. Nevertheless, they at least significantly increase the risk both of the Project and of the Project ever going forward.

IV. Conclusion

The title of this paper at this particular point in time could be either *The Alaska Gas Pipeline: Breaking New Ground* or *The Alaska Gas Pipeline: Retreading Old Ground*. As noted at the outset, the authors of this paper consciously chose *Breaking New Ground* because they remain optimistic that the current efforts surrounding the Project ultimately will culminate in a successful result.

When looking back over the history of this project, however, time and time again over the last 30-plus years strong efforts have been made to bring a successful project

[348] Text at *supra* note 268.

forth, but without ultimate success.[349] At least in the FERC's view, time also is of the essence or else the market may, once again as it did in the early 1980's, pass Alaska gas by. The year 2007 is critical for this Project and the issues involved are substantial.

In this context, there are two things going for the Project – first, that the greatest beneficiary of success will be Alaska and it is Alaska that is in control of the issues that are critical to be addressed in 2007, and second, that there is broad recognition that "building this pipeline is a key part of our national effort to secure abundant and affordable supplies of this environmentally friendly fuel,"[350] and, thus, there is strong Federal support for success.[351] Certainly, the desire is there to resolve the issues. The open question is whether the parties will be able to find the means to do so.

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349 In some respects the deferral of the project to future years has yielded benefits. For example, by maintaining field pressure the continued availability of high volumes of gas has improved oil recovery. Moreover, given the price lows realized in the mid-1980s and 1990s in the United States natural gas market, there is significant question if the initial project had been completed in the early 1980s whether it would have remained economic or produced the best long-term value for Alaska's gas resource.

350 *See supra* note 2.

351 Indeed, some notice should be made in this regard of Section 109 of the Alaska Pipeline Act, which requires the DOE Secretary to study "establishing a Federal government corporation to construct an Alaskan natural gas transportation project." 15 U.S.C. § 720g.