



STATE OF ALASKA

SARAH PALIN, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES & DEPARTMENT OF REVENUE

ALASKA GASLINE INDUCEMENT ACT

The Honorable Fred Dyson
Senate Special Committee on Energy
State Capitol, Room 121
Juneau, Alaska 99801

July 30, 2008

Re: Response to July 29 letter from Richard Fineberg

Dear Senator Dyson:

I am writing in response to a July 28, 2008 letter to you from Mr. Richard Fineberg. The letter expresses a number of concerns Mr. Fineberg holds regarding the transportation rates (tariffs) associated with producer-owned gas pipelines, and specifically the state's ability to protect its interests in lower tariffs. Overall, Mr. Fineberg's concerns are shared by the AGIA team, and we have not overlooked them in designing and implementing AGIA. These are issues that will remain priorities as we continue to move through the project development process on a gasline. It is important to note that Mr. Fineberg does not identify anything in AGIA that increases the state's vulnerability to higher tariffs or compromises our ability to protect the state's interests.

As discussed below, Mr. Fineberg's stated concerns ignore the fact that under AGIA the State is provided with a wealth of information on the AGIA-Licensed project's cost and rates. Nor does he appreciate the fact that the State has unrestricted ability to gain further access to data via FERC proceedings and under FERC rules. Thus, contrary to what Mr. Fineberg asserts, the State has all of the tools necessary to ensure that rates for the Licensed project are as low as possible.

ACCESS TO INFORMATION NOT AN ISSUE

At the outset I agree with Mr. Fineberg's basic proposition that the State must be pro-active in ensuring that it fully appreciates all elements that go into establishing the rates (tariffs) of the AGIA Licensee. Further, his concerns about a producer-owned pipeline—outside of AGIA—are certainly legitimate. However, there is no reason to reject the AGIA license or amend AGIA to address any of the issues raised by Mr. Fineberg.

It is significant that Mr. Fineberg's experience, by his own admission, is focused on oil pipeline issues, particularly with TAPS. He does not appear to be experienced in FERC's regulation of gas pipelines or familiar with the extensive amount of information that FERC requires that gas pipelines file in conjunction with rate proceedings before that agency.

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Our FERC counsel have informed me that in addition to providing the material required by the FERC regulations, it is standard practice for the FERC Staff to conduct an on-site audit of a pipeline in conjunction with each rate case. Further, the FERC rules provide for discovery by all participants in pipeline rate cases. The discovery process is typically very extensive and reaches even to confidential data that are routinely made available to parties subject to confidentiality agreements.

It should also be noted that the State has the right under AGIA to have a representative involved as a de-facto member of the governing body (essentially the Board of Directors) of the Licensee from the time that the License is awarded until the project goes into service, and the right to obtain extensive information from the Licensee during that time. (See AS 43.90.220). Notably, though, this right only exists with respect to the AGIA licensed project and no such right exists with respect to the Denali project or for any possible future LNG project.

Mr. Fineberg (letter at 3) questions why this unique right expires once the project goes into service. This is certainly a fair question. However, it must be noted that the period leading up to the commencement of service is the period when all of the costs for the initial project will be incurred. Thus, this is certainly the most critical period in terms of ensuring that the State is fully informed as to all critical decisions that are made and as to all costs that are incurred.

THE ALLIANCE EXAMPLE

Mr. Fineberg refers to "The Alliance Example" in his letter (at 4). Alliance is a major pipeline that was originally owned by a group of about 17 mostly Canadian gas producers. It is an undisputed fact that Alliance experienced about a 37% cost overrun (comparing initial estimates to final costs). Alliance offers negotiated rates and as shown in Appendix J to the Findings the negotiated rates were lower than the recourse rates.

To the degree Mr. Fineberg is concerned about perverse incentives that a producer-owned pipeline may have to impose high tariffs in order to avoid state royalty and production taxes, we share his concerns. There is a grave danger that any producer-owned pipeline (such as Denali) will seek to manipulate the rates on the project in order to reduce netbacks (and thereby reduce taxes and royalties) while they are simply "paying themselves" the higher rates. In addition, high shipping rates will discourage the producer-owners' competitors in the upstream (production) business.

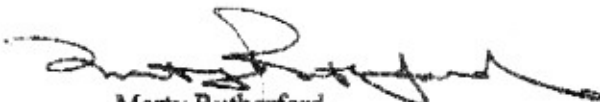
Mr. Fineberg does not appear to understand, however, that AGIA addresses this issue. For example, AGIA requires that rates be designed based on at least 70% debt financing which helps to ensure low tariffs. AGIA also requires that the Licensee expand the pipeline and utilize rolled-in rates for expansion capacity. These conditions were written into AGIA in anticipation that the Licensee could ultimately be a producer-owned company (such as Denali). These conditions will continue to apply to the TransCanada project even if the producers obtain a controlling interest in the project or even if TransCanada itself is acquired by one or more of the producers. Without AGIA, Mr. Fineberg's concerns are very appropriate, but given AGIA, his concerns about tariff manipulation by the Licensee are simply misplaced.

CONCLUSION

The State of Alaska will diligently exercise its authority to oversee the costs TransCanada, or subsequent owners of the AGLA Licensee, incurs on this project through the State's participation on the "board of directors" for the project. Thereafter the State will actively participate in the FERC processes, to defend the state's interests.

Please feel free to call me if you wish to discuss this matter further.

Sincerely,



Marty Rutherford
Deputy Commissioner
Alaska Department of Natural Resources