

DEPARTMENT OF LAW

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GOVERNOR**

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June 5, 2007

The Honorable Sarah Palin
Governor
State of Alaska
P.O. Box 110001
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Re: SCS CSHB 177 (FIN) -- relating to the Alaska Gasline Inducement Act; providing inducements for the construction of a natural gas pipeline and shippers that commit to use that pipeline; establishing the Alaska Gasline Inducement Act reimbursement fund; providing for an Alaska Gasline Inducement Act coordinator; and making conforming amendments
Our file: 883-07-0065

Dear Governor Palin:

At the request of your legislative director, we have reviewed SCS CSHB 177(FIN), the Alaska Gasline Inducement Act (AGIA or the Act), which establishes a competitive process to facilitate construction of a natural gas pipeline to transport Alaska's natural gas from the North Slope to markets, to promote exploration and development of North Slope oil and gas resources, and to encourage oil and gas lessees and other persons to commit to ship natural gas on a project licensed under the Act. For

organizational purposes, this review is arranged by topic rather than by section number.¹

I. Competitive process for awarding a natural gas pipeline project license under AGIA

Section 1 of this bill establishes an Alaska Gasline Inducement Act license to be awarded on a competitive basis to an applicant that proposes a pipeline project that offers the maximum benefit to the people of Alaska. The licensee is entitled to state matching funds of up to \$500 million toward construction of a natural gas pipeline project. To provide financial stability early in the project, this section also provides royalty and tax inducements to encourage oil and gas leaseholders and others to enter into firm commitments during the first binding open season of the project to acquire capacity for shipping gas in the proposed pipeline.

The state matching contribution will be paid to the licensee over seven years through reimbursement of qualified expenditures toward obtaining a certificate from the appropriate state or federal regulatory agency to construct a natural gas pipeline. The matching contribution does not include the costs of overhead, litigation, lobbying,

¹ The bill has nine sections, with the core provisions in Section 1. Section 1 sets out the Alaska Gasline Inducement Act. Sections 2 through 5 are conforming amendments: Section 2 amends AS 36.30.850(b) to exempt from the State Procurement Code contracts for an arbitration panel, development of application provisions, and evaluation of applications; Section 3 amends AS 38.05.020(b) to authorize the commissioner of natural resources to carry out the provisions of this Act; Section 4 amends AS 39.25.110 to include the Alaska Gasline Inducement coordinator; and Section 5 amends AS 40.25.120(a) to exempt from the Alaska public records laws proprietary, privileged, or trade secret information under AS 43.90.150 and AS 43.90.220(e), and AGIA license applications until public notice is provided under AS 43.90.160. Several sections amend the uncodified law: Section 6 expresses legislative intent that the first request for applications be issued within 90 days after the effective date of this Act; Section 7 expresses legislative intent that the courts expedite the resolution of cases brought under this Act; Section 8 provides for severability if any provision or application of this Act is held invalid; and Section 9 provides for an immediate effective date.

existing assets, or fines and penalties, among others.² State matching contributions will be disbursed from a fund established under AS 43.90.400 for legislative appropriations.³

AS 43.90.440 grants the licensee assurances of exclusivity before commencement of commercial operations of the licensed project. If the state extends to another person preferential tax or royalty treatment or a monetary grant for the purpose of facilitating construction of a competing natural gas pipeline project in this state from the time a license is awarded under this Act until commencement of commercial operations of the licensed project, the state must pay damages equal to three times the licensee's qualified expenditures.

AS 43.90.120 establishes an open competitive qualified public process for awarding a license. The commissioners of revenue and natural resources, acting jointly, are directed to develop and publish a request for applications for a license that entitles the licensee to receive state matching contributions.⁴ AS 43.90.130 establishes requirements that applications must meet before they will be considered. In general, they include:

- a detailed description of a gas pipeline project or projects including the route, economic feasibility, management of cost overruns, budget and completion timeline, gas receipt and delivery points, including at least five offtake points in Alaska, and distance sensitive rates to the offtake points;

² AS 43.90.220 requires the licensee to maintain complete and accurate records all of expenditures and commitments of state matching contributions for seven years.

³ State matching contributions are subject to legislative appropriation to the Alaska Gasline Inducement Act reimbursement fund, AS 43.90.400. As established this provision does not violate the prohibition against dedicated funds in art. IX, sec. 7 of the Constitution of the State of Alaska. *See e.g. Myers v. Alaska Housing Finance Corporation*, 68 P.3d 386 (Alaska 2003).

⁴ The application process is exempt from the State Procurement Code, AS 36.30. (SCS CSHB 177(FIN), sec. 2).

- a date certain to hold a binding open season and apply to the regulatory agency for certificated authorization to construct the pipeline project;⁵
- to the extent permitted by law, commit to provide jobs for Alaskans, negotiate a project labor agreement for pipeline construction, establish hiring facilities in the state, use state job centers and services, and commit to negotiate a project labor agreement, which is defined as a comprehensive collective bargaining agreement;
- manage pipeline tariffs by offering rates based on a capital structure that includes at least 70 percent debt;
- commit to reasonable pipeline expansion terms to accommodate new gas discoveries; and
- demonstrate the licensee's readiness, financial resources, and technical ability to perform the commitments.

AS 43.90.140 provides for initial review of all applications for completeness, and requests for additional information before an application is rejected as incomplete. After the commissioners determine the applications are complete, they will be made available for a 60-day public notice review and comment period under AS 43.90.160.

AS 43.90.170 establishes competitive evaluation criteria for evaluating and ranking each application. In general, the criteria evaluate the monetary value of the proposal to the state in terms of time, cost, and management of cost overruns, design capacity, and expansion provisions, likelihood of success of the proposed project considering the reasonableness and feasibility of the work plan, timeline, budget, and the applicant's financial capability and track record.

AS 43.90.180 provides that if the commissioners determine that an application merits award of a license, they must issue a determination and written finding to that effect, publish notice and provide the legislature with notice of intent to issue a license. The commissioners' determination to award a license becomes effective on the effective date of a bill approving the issuance of a license under AS 43.90.190. If the

⁵ "Open season" is defined as the process that complies with 18 C.F.R. Part 157, Subpart B (Open Seasons for Alaska Natural Gas Transportation Projects) or a similar process for soliciting commitments for pipeline capacity under the regulations, policies, rules, or precedent of the Regulatory Commission of Alaska. AS 43.90.900(17).

commissioners determine that no application merits award of a license, they must issue a written finding, which is a final agency action when issued.

II. Legislative approval and commissioners' issuance of a license

AS 43.90.180 requires the commissioners to provide the legislature with notice of intent to issue a license. If the legislature passes a bill approving issuance of the license within 60 days after receiving the notice, the commissioners shall issue the license as soon as practicable.

The AGIA does not authorize the commissioners to actually issue a license until the legislature passes a bill approving issuance. Insofar as this provision may raise separation of powers questions under the Constitution of the State of Alaska,⁶ the Department of Law previously recognized on review of a similar legislative enactment that "the executive is free as a matter of comity to acquiesce in what amounts to the legislature's request for more active oversight."⁷ We noted that executive comity is particularly appropriate in circumstances that involve the state's fiscal regime – a subject substantially under the purview of the legislative branch. In the AGIA, the \$500 million state matching contribution is clearly under the purview of the legislative branch's appropriation powers, and the gas production tax exemption falls under the legislature's constitutional taxing powers.

Because the governor may acquiesce to the legislature's oversight under the AGIA, we believe this section could be viewed as evidencing the governor's freedom to acquiesce as a matter of comity. As with the previous legislation, it is "far from clear" that the legislature's approach would, in fact, violate the separation of powers doctrine.⁸ The legislature arguably has not usurped an executive function, but has divided its delegation of authority into two steps, rather than the traditional one.⁹ Keeping in mind

⁶ See *Bradner v. Hammond*, 553 P.2d 1, 5 (1976) (citing *Myers v. United States*, 272 U.S. 52 (1926) (the threshold question under the separation of powers doctrine is whether the power that will be exercised by a branch of state government is a proper function of that branch)).

⁷ 1998 Alaska Op. Atty. Gen. 122, Page 2, 1999 WL 638618 (Alaska A.G.), on review of SCS CSHB 393(FIN).

⁸ *Id.*

⁹ *Id.*

that, if possible, legislation should be construed to avoid the possibility of unconstitutionality, we believe this provision reasonably can be construed as not violative of the separation of powers.

III. Confidential information and public review of applications

The bill recognizes that the state may need to review company confidential information in order to determine whether a proposal is in the state's best interest. AS 43.90.150 provides that information "the applicant identifies and demonstrates is proprietary or is a trade secret is confidential and not subject to public information disclosure under AS 40.25." Under AS 43.90.160, however, an applicant's confidential information may be provided to the legislative auditor, the fiscal analyst who serves as head of the legislative finance division, members of the legislature, and their respective agents and contractors under confidentiality conditions. In addition, AS 43.90.160 provides that the applications are exempt from the public records laws and not subject to public disclosure until the commissioners publish notice.¹⁰

Recognizing also that the people of the state have a right to know the basis for administrative decisions affecting their welfare, the bill requires applicants to provide a summary of all confidential information. When the commissioners publish notice under AS 43.90.160, all non-confidential information and the confidential information summaries submitted by the applicants summaries will be made public.

By limiting confidential treatment to information that the applicant has shown to be proprietary or a trade secret, and requiring that summaries of confidential information be made public, the bill strikes a balance between the state's interest in encouraging applicants to submit information that will enable a fair evaluation of all proposals while maintaining the right of companies to keep proprietary and trade secret information out of the hands of their competitors.

IV. Jobs and training for Alaskans

An important goal of this legislation is to facilitate the training and hiring of Alaskans and promote a stable workforce in all phases of the construction and operation of a licensed gas pipeline project.

¹⁰ SCS CSHB 177(FIN), sec. 5.

AS 43.90.130(15) requires, "to the maximum extent permitted by law," that applicants commit to hire qualified residents from throughout the state for a range of positions on the proposed project; contract with businesses located in the state; establish hiring facilities or use existing hiring facilities in the state; and use, as far as is practicable, the job centers and services operated by the Department of Labor and Workforce Development and an Internet-based labor-exchange system operated by the state. The "Alaska hire" provisions are expressly constrained to "the maximum extent permitted by law." This requirement does not prohibit other methods of hiring, nor does it limit potential employment to persons residing in the state. We see no constitutional problems with this aspect of the bill.

To ensure stability of the workforce and timeliness of the project, AS 43.90.130(17) requires applicants to commit "to negotiate, before construction, a project labor agreement to the maximum extent permitted by law." Project labor agreement is defined as "a comprehensive collective bargaining agreement between the licensee or its agent and the appropriate labor representatives to ensure expedited construction with labor stability for the project by qualified residents of the state." On large projects such as the gas pipeline contemplated under this bill, such agreements are commonplace. Mandating a project labor agreement supports the state's legitimate interests in facilitating construction of the gas line as soon as possible to ensure that the state will receive royalty income at the earliest possible time. Timely completion of the gas line will also reduce the overall cost of the project, again reducing the impact on the tariffs charged to those shipping gas through the line, thereby maximizing the state's return.

AS 43.90.470 directs the commissioner of labor and workforce development to develop a job training program that will provide training for Alaskans in a range of gas pipeline project positions. While the term "Alaskans" may raise questions under the federal commerce clause, it is certainly possible to implement this provision without improperly restricting interstate commerce. We recommend that the commissioner of labor and workforce development take into consideration interstate commerce and equal protection concerns when developing the training program to avoid any legal impediments.

V. Judicial review

The provisions of this bill that place limitations on judicial review are within the scope of the legislature's authority under art. II, sec. 21, of the Constitution of the State of Alaska, which grants to the legislature the sole power as sovereign to pass laws establishing procedures for suits against the state.¹¹

AS 43.90.420 establishes a limitations period for legal actions challenging the constitutionality of the Act or a license issued under the Act to be filed within 90 days after the date the license is issued. In order for an application to be considered under AS 43.90.130(16), applicants are required to waive their right to appeal the rejection of their application as incomplete, issuance of a license to another applicant, or the determination that no application merits issuance of a license. Finally, to claim the inducements under AS 43.90.310(c), 43.90.320(c), and by voucher under 43.90.330(d), the person must agree not to protest or appeal a filing by the licensee to roll-in mainline expansion costs up to a level required in AS 43.90.130(7).

Based upon the doctrines of sovereign immunity and the Constitution of the State of Alaska, the legislature had authority to restrict the right of prospective licensees and other persons to seek judicial review of the state's decisions regarding the license award process and constitutional claims against the Act.

VI. Project amendments or modifications, license violations, and arbitration

AS 43.90.210 permits amendment of or modification to the project plan subject to the approval of the commissioners if the amendments or modifications improve the net present value of the project to the state, are necessary to comply with a regulatory order or requirements, or necessary because of changed circumstances outside the licensee's control and not reasonably foreseeable before the license was issued. An amendment or modification of the license must be consistent with the requirements of AS 43.90.130 and

¹¹ See e.g., *State v. Haley*, 687 P.2d 305 (Alaska 1984). This constitutional provision grants to the legislature the sole and exclusive power to enact laws establishing the terms and conditions upon which the state may be sued, consent to sue must be expressly granted by legislative authority. *Alaska v. The O/S Lynn Kendall*, 310 F. Supp. 433 (D. Alaska 1970). When authorized, the right to sue may also be made condition upon compliance with provisions governing administrative remedies. See *State v. Zia, Inc.*, 556 P.2d 1257 (Alaska 1976).

may not substantially diminish the value of the project to the state or the project's likelihood of success.

AS 43.90.230 describes the circumstances that would constitute violation of the license and allows the state to issue notice of violation, cease disbursing matching contributions and recover matching funds distributed to date. It provides for notice of the violation to the licensee and opportunity to cure. If the commissioners and the licensee are unable to resolve the violation, the commissioners shall, after providing the licensee with notice and opportunity to be heard, issue a written determination. The written determination is a final agency action for purposes of appeal to the superior court in the state.

AS 43.90.240 provides for abandonment of the project if the commissioners and licensee agree that the project is uneconomic. If the commissioners and licensee cannot agree, this section provides for arbitration under the laws of Alaska. The party claiming that the project is uneconomic bears the burden of proof by a preponderance of the evidence. If the arbitration panel determines, based on certain enumerated conditions that the project is uneconomic, the state's and licensee's obligations cease under the license and the Act. If the arbitration panel determines it is not uneconomic, the obligations continue.

VII. Alaska Gasline Inducement Act coordinator

AS 43.90.250 creates an Alaska Gasline Inducement Act coordinator position in the Office of the Governor. The position continues until one year after commencement of commercial operations of the project. The person is appointed by, and serves at the pleasure of, the governor. AS 43.90.260 requires all state agencies to conduct their reviews expeditiously and prevents the agencies from imposing any unessential requirements that will result in delay. The Alaska Gasline Inducement Act coordinator may act to preclude agency terms and conditions that are not required by law if they would significantly prevent or impair expeditious construction, operation, or expansion of the project. However, the coordinator does not have authority to amend or exempt the applicant from statutory, regulatory, or other legal requirements.

VIII. Inducements to encourage oil and gas lessees and other persons to commit to ship natural gas on a project licensed under the Act

AS 43.90.300 provides that any person that has committed to acquire firm transportation capacity during the first binding open season of the project is qualified to receive the royalty and tax inducements on gas shipped in the acquired capacity. It also provides for transfer of the resource inducements by a voucher issued under AS 43.90.330.¹²

AS 43.90.310 entitles qualified persons to royalty inducements that contractually amend the oil and gas leases from which gas is shipped on the natural gas pipeline to incorporate more favorable regulatory terms for calculating the value of the state's royalty and to limit the ability of the state to switch between taking its royalty in kind or in value. The state will adopt regulations defining the method of valuing its royalty share at a fair value that is based on reliable industry sources and minimizes retroactive adjustments. The regulations must set a methodology the state will use to exercise its right to alternate between taking its royalty in kind and in value in a way that will not cause the lessee to bear disproportionate transportation costs or interfere with the lessee's long term marketing plans. A person that commits gas in the first binding open season may elect to calculate the royalty on gas transported in the project under the person's existing lease and unit agreements or under the regulations.


AS 43.90.320 entitles persons who made firm transportation commitments during the first binding open season of the pipeline project to an exemption from the state's production tax on gas shipped in the project equal to difference in the production tax rate at the time the gas is committed for firm transportation in the first binding open season and at the time the tax is due on gas shipped in the pipeline. The tax exemption may be applied against gas production taxes within 10 years immediately following commencement of commercial operations. Earlier versions of the bill referred to this exemption as a "contract" and raised an issue under art. IX, sec. 1 of the Constitution of the State of Alaska of whether it constituted an unenforceable contracting away of the State's power of taxation. That reference is not in the final bill, however.

¹² AS 43.90.450 allows transfer of the license after approval by the commissioners, and after 30 days public notice and notice to the legislature, but only if the transfer does not increase or diminish the obligations under the license or diminish the likelihood of success of the project or the net present value of the license to the state. Royalty and tax inducements may be transferred only in connection with a sale or merger resulting in transfer of all the person's North Slope assets and firm transportation capacity contracts in the project.

IX. Conclusion

This bill is the legislature's substitute for your initial proposal. While there are changes from the document you introduced, the bill substantially implements the policies of your original proposal. We believe that the bill will withstand any significant statutory or constitutional challenge.

Sincerely,



Talis J. Colberg
Attorney General

TJC/BEH/aae