

To: Senate Resources Committee Members
From: Lisa Weissler, Attorney
Date: February 19, 2014
Re: Senate Bill 138, Public Comment

As a signatory to the Heads of Agreement (HOA) for the Alaska LNG Project, the Administration has committed to incorporating the HOA principles into contracts if acceptable “Enabling Legislation” is passed by the Legislature. The enabling legislation is SB 138.

The HOA does not meet with the constitutional principle that Alaska’s resources be developed consistent with the public interest.

For any pipeline project, the state’s public interests remain the same. These are:

- Revenue for state public services and infrastructure
 - Revenue for communities along the pipeline route
- Gas for use in-state
- Pipeline access and expansion to encourage independent exploration and development
- Transparency
- Work commitments
- Alaska hire

If the HOA principles are incorporated into a signed contract, the state will bear the costs and responsibility for meeting the state’s public interests, while the producers will have little obligation to Alaska other than giving the state a fixed percentage of produced gas.

As demonstrated by the attached matrix, many of the HOA principles match the terms of the Stranded Gas Fiscal Contract submitted to the legislature for approval in 2006. The legislature declined to approve the contract because its terms were not in the state’s best interests.

Like the stranded gas fiscal contract, the HOA principles impose far too many obligations on the state, including paying billions to help advance and build the pipeline, assuming the risk of losing its investment if the project is not completed, paying the costs of treating, transporting and marketing state royalty and tax gas, providing gas for in-state use, being the sole provider of capacity for independent producers, and paying expansion costs. These are huge commitments by the state, made in exchange for nothing more than a continuation of pre- front-end engineering and design work. When a pipeline is finally built, the state will be locked into terms where no matter what the value of our natural gas, the state’s share and obligations remain the same – meaning that, at high prices the producers reap a windfall, and at low prices the state’s obligations could exceed its return.

Where the Stranded Gas Development Act had at least some limits and criteria to protect the state’s interests in contract negotiations, SB 138 is a blank check, providing no limits to the terms the Department of Natural Resources commissioner can develop for inclusion in a contract. The HOA identifies positions the Administration has essentially already agreed to – passage of SB 138 as written would signal legislative support for these positions. The result can only be a contract that fails to serve Alaska.

Heads of Agreement Guiding Principles Compared to Stranded Gas Fiscal Contract Terms

Alaska Interests	Heads Of Agreement - 2014	Stranded Gas Fiscal Contract - 2006
<p>REVENUE</p> <p>State Ownership Past ownership studies advised the state to consider (1) that the state does not have the financial strength to absorb large losses; (2) the need to have readily available funds for calls for capital expenses; (3) that minority participation would likely result in limited management rights; (4) that the state shares the risks of cost overruns; and (5) potential conflicts between the state's sovereign duties and fiduciary obligations as a partner.</p>	<p>Article 5. Subject to passage of enabling legislation and execution of project-enabling contracts, the State's participating interest share in each component would be approximately 20% to 25%.</p>	<p>Sec. 7.2. The State shall own, directly or indirectly through State-owned entities, a 20% interest in a Gas Treatment Plant, the Mainline, and the Alaska to Alberta Project; and in Gas Transmission Pipelines.</p>
<p>Royalty Under current law, the State has the option of taking its royalty oil or gas in kind (RIK) or in value as cash (RIV). The state's decision to switch between in kind or in value can take place on fairly short notice. For a project like the gas pipeline, longer notice is needed.</p>	<p>Section 8.1. The State will take its royalty gas in kind during the duration of the contract. Sliding scale and net profit leases will be modified to a fixed percentage royalty to be taken in-kind. The State could switch to RIV but only after the initial contract term.</p>	<p>Article 12. The State would take its royalty gas in-kind throughout the life of the contract subject to specified payment methods and calculations. Sliding scale leases could be converted to a fixed royalty percentage.</p>
<p>Gas production tax Currently, the state's oil and gas production tax is paid in cash.</p>	<p>Section 8.2. The Producers have the right to elect to make gas production tax payments in gas rather than cash.</p>	<p>Article 13. The State committed to taking tax as gas rather than cash.</p>
<p>In-kind Costs Under current law, for most leases, the producer pays the costs of treating state royalty gas, including removing and disposing of impurities.</p>	<p>Section 8.3. Based on where the HOA describes delivery of the royalty and tax gas to the State, it appears the State will assume the costs associated with treating and transporting royalty and tax gas.</p>	<p>Articles 12 & 13. The State would assume the costs associated with treating and transporting royalty and tax gas, including assuming the cost for disposal of impurities.</p>
<p>Property Taxes and Impact Payments The state levies a property tax on the value of oil and gas property in the state. Oil and gas property within local government boundaries may also be taxed at the local level.</p> <p>Communities along the pipeline route are impacted during construction by increased population pressures, housing shortages, loss of local workers to pipeline jobs, and increased public safety and health care needs.</p>	<p>Section 9.3. Subject to consultation by the Administration with local governments, payments in lieu of property taxes would be on a unit rate per throughput basis and could be level or escalating dollar payments for the Alaska LNG Project components.</p> <p>The Alaska LNG Project will pay impact payments.</p>	<p>Articles 17. Payments in lieu of oil pipeline property taxes property taxes would be based on energy throughput rather than property values,</p> <p>Article 18. The Mainline Entity would pay impact payments totaling \$125 million over five years.</p>
<p>IN-STATE MARKETS An anticipated benefit to the state in having a natural gas pipeline is getting gas to meet local power needs.</p>	<p>Section 6.5. Five in-state offtake points would be included as part of the project; third-parties will have to pay for any facilities taking gas from an offtake point. Any Party may deliver gas to an offtake point. Third-party gas must meet certain criteria.</p>	<p>Article 9. Four in-state offtake points were part of the project; third-parties would have to pay for any facilities taking gas from an offtake point. Any Party may sell gas to an Alaska purchaser; no Party is required to sell gas to an Alaska purchaser.</p>

Heads of Agreement Guiding Principles Compared to Stranded Gas Fiscal Contract Terms

Alaska Interests	Heads Of Agreement - 2014	Stranded Gas Fiscal Contract - 2006
<p>ACCESS & EXPANSION Robust exploration and development of state oil and gas resources requires that all gas producers, large and small, have capacity to ship gas in the pipeline and that transportation rates are not a barrier to new explorers and developers.</p> <p>When a pipeline is filled to capacity, it can be expanded. Expansion for an LNG project is complicated and expensive because different shipping contracts require different gas weights, and so expansions could require the addition of a new LNG processing facility (liquefaction train).</p>	<p>Section 6.3 and Appendix A. Access and expansion will be developed consistent with the regulatory framework under the Natural Gas Act, Section 3. The State portion of the project will be responsible for providing capacity access to the pipeline for independent producers, for both in-state and export gas; the Producer capacity will be private; and expansion costs will be borne by whoever requests the expansion.</p>	<p>Article 8. Regulation of and access to the project (including expansion) will be governed and controlled exclusively by the Natural Gas Act, Alaska Natural Gas Pipeline Act of 2004 [applicable to an overland pipeline], other applicable federal law and the contract. The State could initiate expansions, but only after meeting multiple hurdles, including that the State must not require existing shippers to pay a higher rate than without an expansion; and expansion would be available only every 5 years.</p>
<p>Transparency State participation in the pipeline can create a conflict between the public’s right to know the basis for its government’s decisions and the state’s fiduciary responsibility as a pipeline partner to keep project information confidential.</p>	<p>Section 7.2. The Administration will submit proposed general legislation to provide for a confidential process to develop terms for project-enabling contracts.</p> <p>- SB 138 would authorize the DNR commissioner to enter confidentiality agreements to maintain the confidentiality of information related to contract negotiations and contract implementation.</p>	<p>Article 29. Established how confidential information and material could be used and disclosed.</p> <p>- The Stranded Gas Development Act provided specific terms and conditions for confidentiality and disclosure of information during the course of contract negotiations; and established public disclosure requirements upon issuance of a preliminary findings and determination.</p>
<p>Work Commitments It is important to the state that a pipeline advances through to completion, particularly if the state makes a substantial investment in progressing the pipeline.</p>	<p>Article 4. The Alaska LNG Parties will continue Pre-FEED work through to completion with the passage of “Enabling Legislation,” execution of a new commercial agreement, and progress on other support referenced in Sec. 10. Decisions to advance to the FEED phase are subject to enabling legislation and other laws, including necessary fiscal and commercial terms.</p>	<p>Section 5.2. Participants would advance the Project planning activities by Diligence and conclude these activities with a decision on whether to begin preparation of regulatory applications for an Open Season. “Diligence” means advancing the Project as diligently as is prudent under the circumstances.</p>
<p>Alaska Hire A benefit to Alaska of a pipeline project is jobs for Alaskans. The federal constitution precludes an absolute requirement that Alaskans be hired first.</p>	<p>Article 11. Within the constraints of law, the LNG Parties will employ Alaska residents and contract with Alaska business to the extent they are qualified, available, ready, willing, and cost competitive. Prior to construction, the Parties commit to negotiate in good faith project labor agreements for the LNG Project.</p>	<p>Section 6.2. Within the constraints of law, the Midstream entity would employ Alaska residents or contract with Alaska businesses to the extent they are available, ready, willing and qualified, and competitively priced in that they offer goods or services at a total cost equal to or less than the total cost of equivalent goods or services offered by a non-Alaska resident or business.</p>