Fiscal Note

State of Alaska
2014 Legislative Session

Bill Version:	CSSB 138(FIN)
Fiscal Note Number:	12
(S) Publish Date:	3/17/14

Identifier: SB138CS(FIN)-DNR-NSG-3-16-14
Title: GAS PIPELINE; AGDC; OIL & GAS PROD. TAX
Sponsor: RLS BY REQUEST OF THE GOVERNOR
Requester: SFIN

Department: Department of Natural Resources
Appropriation: Administration & Support Services
Allocation: North Slope Gas Commercialization
OMB Component Number:

Expenditures/Revenues
Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2015 Appropriation Requested	Included in Governor's FY2015 Request	Out-Year Cost Estimates				
OPERATING EXPENDITURES	**FY 2015**	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**
Personal Services	1,769.7		1,769.7	***	***	***	***
Travel	102.0		102.0				
Services	7,090.0		7,090.0				
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	**8,961.7**	**0.0**	**8,961.7**	*****	*****	*****	*****

Fund Source (Operating Only)

1004 Gen Fund	8,961.7		8,961.7				
Total	**8,961.7**	**0.0**	**8,961.7**	*****	*****	*****	*****

Positions

Full-time	6.0		6.0				
Part-time							
Temporary							

Change in Revenues							

Estimated SUPPLEMENTAL (FY2014) cost: 0.0 *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2015) cost: 0.0 *(separate capital appropriation required)*
(discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS
Does the bill direct, or will the bill result in, regulation changes adopted by your agency? Yes
If yes, by what date are the regulations to be adopted, amended or repealed? 03/31/15

Why this fiscal note differs from previous version:

This fiscal note has been updated to reflect the committee substitute adopted by the Senate Finance Committee, which amended the Commissioner's ability to modify royalty rates under certain leases. No changes were made in the committee substitute that would affect the fiscal impact on the Department.

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Division:	Commissioner's Office	Date:	03/16/2014 02:00 PM
Approved By:	Joe Balash, Commissioner	Date:	03/16/14
Agency:	Department of Natural Resources		

STATE OF ALASKA **BILL NO.** CSSB 138(FIN)
2014 LEGISLATIVE SESSION

Analysis

This bill establishes the framework for state participation in a large natural gas project by giving the Commissioner of the Department of Natural Resources (DNR) the authority to enter into upstream and downstream commercial agreements related to a North Slope natural gas project. It also gives the DNR Commissioner, in consultation with the Commissioner of Revenue, the authority to manage the project services and disposition and sale of tax-as-gas (TAG) gas from the Department of Revenue (DOR).

With passage of this bill, the DNR Commissioner, in consultation with the DOR commissioner, will enter into contractual agreements related to the state's equity position in the project. DNR's role is to make sure that the state's equity participation complements and facilitates the state's royalty and TAG gas marketing efforts. The contracts, equity arrangements, and gas sales agreements will be subject to legislative approval and will define the state's relationship with the parties and potential gas customers during the life of a North Slope natural gas project. Each contract, arrangement, and agreement will be conditioned on continued progress of a North Slope gas project and will establish how value will be shared among the parties and manage the state's exposure to commercial risks.

Most of these agreements will be negotiated during the 12–18 months following passage of this legislation so that the state and the other parties in the project can be in a position to commit to the Front-End Engineering Design (FEED) phase. This pre-FEED work will provide the state with the information necessary to make the investment decision to enter into FEED. Equity partners will spend more than a billion dollars during FEED.

With the rights and obligations defined in the agreements, DNR will be able to structure its royalty and TAG gas marketing efforts. The marketing organization may include the potential utilization of a marketing subsidiary of AGDC or may leverage the Producers' marketing organizations and expertise, per Article 8.3 of the Heads of Agreement (HOA), resulting in a smaller state organization than might otherwise be required.

The DNR commissioner will need the support, expertise, and involvement of a variety of experts to inform the state's decisions, including:

- When the state takes its royalty and TAG gas, it will become more aligned with the North Slope gas producers than has ever been the case historically. DNR will enter into production offtake agreements and gas balancing agreements. The DNR Commissioner may modify the state's oil and gas lease terms, including modification of the lease royalty rates not less than the value the state would have received before a modification, treatment of lease net profit share provisions, field costs, and the state's rights to take royalty gas in-value.

- The DNR commissioner will enter agreements to define gas treatment costs, transportation tolls/tariffs, and liquefaction services. These agreements will also be designed to manage capacity and arrange for expansion of the project, if needed, and must accommodate changes in equity ownership. DNR will forge contractual arrangements with the producers and other industry parties participating in the project as well as state entities who may be part of the project initially or who may take over ownership later.

- The marketing of the state's gas will depend on the rights and obligations that will be defined in the agreements. As time progresses, DNR must make decisions about how it will supply royalty and TAG gas to the domestic and international markets. Gas supply agreements are likely to be long-term and may include mechanisms to attract additional investment capital into the project. Planning and design of the marketing organization will occur during the pre-FEED phase.

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Analysis Continued

Allocation: DNR will create a separate allocation code for expenditures related to the commercial production of North Slope natural gas for ease of tracking appropriations.

Expenditures: DNR will create in-house capacity to provide the administration with consistent and well-informed advice throughout the initial negotiations and to manage experts as needed through this process. This team will provide consistent support throughout the pre-FEED phase and will be in place to manage the marketing role. Establishing this capacity now and preserving it as the project develops is essential to facilitate the state's effective participation in the project.

The team will be involved in negotiating, crafting agreements, managing expert consultants at each of the project phases, monitoring the agreements as the project progresses and conditions are met or changed, and preserving and protecting confidential information provided by the state's counterparties.

This team will include a lead expert analyst; four subject matter experts specializing in commercial aspects of upstream, gas treatment and pipeline transportation, liquefaction, and international marketing; and a project assistant responsible for contract management, recordkeeping and administrative support, as follows:
- 1 Lead Expert Analyst (exempt)- $349.8 annual salary and benefits
- 4 Subject Matter Expert Analysts (exempt) - $323.7 annual salary and benefits each (total of $1,294.8)
- 1 Project Assistant (range 20) - $125.1 annual salary and benefits

Total Personal Services: $1,769.7

It is anticipated that the lead expert analyst and four subject matter expert analysts will need to make trips to Asia to conduct market research and outreach. DNR estimates that each will make quarterly trips at an estimated cost of $5.1 per trip. **Total Travel Expenses: $102.0**

Contract services include:
- $4,000.0 for substantial subject matter expertise to support the DNR commissioner and team including deal origination, deal analysis, market monitoring, infrastructure analysis, commercial contracting, financial and credit analysis, risk control and analysis, and imbalance reconciliation
- Reimbursable Service Agreements to the Department of Law: $3,000.0 for legal advice from outside counsel on commercial and financial agreements, transactional negotiations and agreements, federal jurisdictional, statutory and regulatory issues and in-house attorney services ($250.0 per month)
- DOA core service charges, lease space, and office supplies: $15.0 per position ($90.0 for 6 positions)

Total Contract Services: $7,090.0

It is anticipated that the decision to proceed into FEED will take place by the end of FY16. Impacts in FY17 and beyond are indeterminate at this time; however, pre-FEED will help determine the potential costs leading up to the FEED phase.

Revenues: No new revenues from a large gas project would be expected during the timeframe (through FY20) of this fiscal note. Revenues from a North Slope gas project could be realized as soon as FY22.

Regulations: DNR expects it will need to amend its regulations as they pertain to the disposition of royalty oil and gas to include TAG gas.