(H) FINANCE STANDING COMMITTEE * April 15, Tuesday, 1:30 PM HOUSE FINANCE 519

Notable Questions From Committee and Responses from Testifiers:

3:03pm-Rep. Neuman: When we're going through these values back to the state, when you show a value back to the state, on page 2, $7 a million btu, when we're going through these costs and the value to the state, when you're showing on page 2 a value back to the state of $7 a million btu, what I don't see here are the costs for the lease expenditures for standard allowable deductions, which costs the state. In Pt. Thomson unit that was a $5 billion investment. That would be $1.75 billion dollars that has to get paid back in, in how many years?

Comm. Balash: The deductions are realized in the year in which the expenditure is made. So, it would depend on how much of that $5 billion was spent over which years.

Rep. Neuman: So what we don't see here is what it costs the state for the lease expenditures which are standard allowable deductions from the value. That's quite a bit of money if you look at the value chain, the cubic feet that are being produced at a certain btu value, a million btu's, a thousand cubic feet, I think we're using here. So I go back to just the basics, when you look at the evaluation of your time value of money, and if we were to do these numbers, working those numbers, that would be interesting to see that because what is the netback on the state? Because, again, we've seen that this is just a gross number, a gross value back without any deductions, is that correct?

Dep. Comm. Pawlowski: We're happy to pull some work Black and Veatch has done on this for you. The intent here was to illustrate the value chain. As you take a step into the larger project, you're right, there are other costs associated upstream that are deducted. There's also additional oil production that counts as an additional value. When we've run those equations, the internal rate of the return for the state, that investment metric, exceeded 20% because there is an additional tens of thousands of barrels of oil that come with the build out of Pt. Thomson and there is naturally the gas production that comes with it. We've done some work on that that we're happy to circulate around the committee. I just, for the record so people are clear, that work was performed by Black and Veatch based on Black and Veatch's analysis, not with information from the Department of Revenue because I typically try and stay out of the conversation on Pt. Thomson too deeply.

3:07pm- Rep. Austerman: What you're showing us is the cost factors at the GTP and then the pipeline and the LNG and is there a million btu price from Pt. Thomson to the GTP that the state's going to take up?

Dep. Comm. Pawlowski: That I believe is rolled into the GTP tariff, there is a small cost for the pipe that is moving the gas from Pt. Thomson to the gas treatment plant, just as there is a cost for the pipe moving from Prudhoe Bay to the gas treatment plant which is actually in the Prudhoe Bay unit geographically. So those are rolled in here, and, again, these are rounded numbers. We didn't want to come to the table for the public with pennies here and pennies there to distort the math. It's just for illustration.

3:08pm-Rep. Gara: I would like you to come back at some point, this is not crucial to me because it is what it is, but you said that in addition to this we've got a corporate tax at 9%, but when the oil industry sued us many years ago, it's not 9% of their profits in Alaska, it's 9% of their world-wide accounted profits which in some years has been 5% from what I understand. I don't need the answer to that right now unless you have it, I'd like to get to something else.

Dep. Comm. Pawlowski: I was just going to point out in the March 10 presentation to the Senate Finance committee available on BASIS, we have the 10 year schedule of cash flow based on these assumptions. You can see the corporate income tax and the property tax broken out. You're right, it is not, and we do not model, a 9.4%. We model a lower number, though the statutory number is 9.4%.

Rep. Gara: As I read the bill as it was introduced, we've talked about a small change that was made in Resources, but as it was introduced, the law read that its royalty in-kind or royalty in-value and you have to make a best interest finding, and if it's the best interest of the state, after your finding that we get it in-value, then we take it in-value. If it's the best interest after you consider all the factors and everything out there, we take it in-kind, but everything we're being presented seems to mean that you've already made your best interest finding that it's in-kind? Or have you not made that finding?

Comm. Balash: The assumptions that have been used in a lot of our materials have made the assumption that we are getting the same price as the producers. So that is short hand for, either, we've reached a satisfactory arrangement with them to dispose of our gas on the same terms they're getting, or we're in-value, in which case we're getting the terms they're getting. For purposes of doing the analysis we've been able to rely on those as a reasonable set of assumptions regardless of the case. As far as our agreement with the other parties goes, the Heads of Agreement, provided that we reach satisfactory resolution on the sale or disposition of our gas, our LNG, then yes we are prepared to take in-kind. But, there's a pretty high hurdle here to satisfy us in that regard. That was the whole point and purpose of publishing the royalty study last November, was to let everyone know, the public, the companies, the legislature, that there are real risks associated with the state going in-kind and the parties that are best positioned to help mitigate those risks are the other producers. I think the notion that we're going to have to bargain hard for this, I think is misplaced. This is something, in essence, we've already agreed to. What is going to be difficult is fashioning the necessary agreements with each company individually while keeping everything in-bounds and fair relative to the Federal and International anti-trust statutes. Making sure that we protect ourselves, we protect the interests of Alaskans, but that we also protect the information of competitors from competitors.

3:12pm- Rep. Gara: Ms. Poduval from Black and Veatch has testified on the concern that I've raised that we're paying for full-capacity, but what if we don't get full capacity. Her response, as I recall, is that normally more than 90% of capacity is met, that you get more than 90% of your capacity in these deals filled. But I don't know what more than 90% means. So does this model take into account that we don't owe Trans Canada payments for any unused capacity? If we get taxes we don't have to worry about that, we actually get all the money, we don't have to pay for any unused capacity, we get no penalty for that. But in-kind, if we're only filling, what I guess has been termed, more than 90% of our capacity commitment, but I don't know what that number is, does this reflect that it's going to be something less than 100% or are you assuming that we are going to get 100% of our gas all the time and we won't owe any money to Trans-Canada for gas that's not shipped?

Comm. Balash: One thing I would like to point out for the committee is there are some risks that accrue and hit the state regardless of whether we're talking about in-value or in-kind. Underutilization of capacity, be it the state's or the producer's, is going to impact our revenues, period. The project is going to cost what it costs. The revenues that are generated will be generated based on the throughput of the project and so if the project at-large is not at 100% every single day, then that extra capacity, that under-utilized capacity, still had to be paid for up front and will be reflected in the deductions through the value chain and impacting the total revenue at some point. That's something that doesn't change whether we're in-kind or in-value.

Dep. Comm. Pawlowski: Let me reach out to Ms. Poduval-

Rep. Gara: I was just asking about your model, whether it reflected 100% capacity or less.

Dep. Comm. Pawlowski: That's what I'll talk to her about and get back to you because there are seasonal swings.

Vice-Chair Neuman then mentioned that at some imminent point in the future they'd like answers to these questions, but that their time is compressed and when asking questions they need to get straight to their points.

3:17pm-Rep. Gara: Let's say we're shipping at 95% capacity. I understand there's a cost to us under both systems, but the cost is much bigger if we're taking in-kind because we owe Trans-Canada- not only don't we get the gas, but we also owe Trans-Canada the shipping charge, which we don't ever owe in-value. In-value, if less gas is shipped than we expect, the tariff of the companies goes up a little bit, we get less taxes, but you're making it sound like it's the same exact amount of money. Am I not correct, that if we take it in-value the cost of paying for empty shipping charges is higher to the state than if we only fill it 95% and we're taking it in-value? They're not the exact same amounts of money right?

Comm. Balash: I want to be careful to not get caught up in semantics. What I am intending to illustrate or explain is that there are certain risks and throughput utilization is one of those risks that is present whether you are in-value or in-kind. I think what you are concerned about is a situation where the state either receives less gas than it was planning to receive or chooses to drop off gas in state and not take it all the way to the liquefaction plant and ultimately to market. In those cases, then yes, there is a greater risk associated with the state, but that's going to be something that we must mitigate and the number on issue there, making sure that we get the amount of gas we need to fill out capacity will come in the off-take and balancing agreements. I personally am unwilling to take out capacity on any infrastructure without knowing that we will receive gas to put into that capacity and you don't have to worry whether I think it's a good idea or not. The lending institutions that will be setting up the financing for all of this won't let us do it either unless we have sufficient security to ensure that gas will flow through the infrastructure. On the second point, if for some reason we choose to divert our gas somewhere along the way and not completely utilize the pipeline and the liquefaction plant because suddenly there's a million people living in Fairbanks and they all need natural gas to heat their homes, then that's a choice we're going to be faced with, but we will have. That's a choice we will make as a state down the road. I think that's a rather unlikely scenario. But there is something that I think is also important to realize is, in the terms of the MOU with Trans-Canada, we have four rate-making or tariff making purposes with Trans-Canada, assumed 100% utilization of the capacity. Even though we know that there will be days that there's maintenance turn-around or something and we know we won't be at 100% all day every day, but we're making that assumption. An in the event that Trans-Canada is able to find a customer who is willing to take interruptible service, not firm service, but interruptible service, and what that means is they're going to be able to take advantage of those opportunities in the pipe to move a little more gas every day, we're going to get a revenue credit. In other words, if they sell that capacity on an intermittent basis to some third party, we're going to see a very large piece of that revenue come back to us, because, frankly, we paid for it. And if we paid for it and we don't use it, and somebody else does, then we want our money back. Those are the kinds of things we've been thinking about and planned for and know that we have to mitigate in all of our agreements and there will be additional steps to mitigate against those risks if we're going to protect the state's interests.

3:22pm-Rep. Wilson: So who do we right now have a contract with royalty in-kind for oil?

Comm. Balash: We have two contracts right now. One is with Flint Hills Resources and one is with Tesoro. The Flint Hills Resources contract is one that we expect will soon expire. They have begun nominating zero barrels per month under that particular contract and there's a 90 day lead cycle here where we have the ability to nominate 90 days in advance. So by the end of this year, I expect we won't have a contract with Flint Hills. But we will have a contract with Tesoro through that continues through the remainder of the year.

Rep. Wilson: Those aren't in-value, those are in-kind?

Comm. Balash: Those are in-kind contracts

Rep. Wilson: So we don't have any in-value contracts at this time?

Comm. Balash: We have settlement agreements with all three of the major North Slope producers to value our oil produced under the DL1 lease form.

Rep. Wilson: If the Asian market changes from the time that- let's say the producers sell theirs at a certain price and it's taxed based on what they sold it at, but we get gas in turn, not the amount of money that goes to it. If when we get the gas and we get it to the Asian market it's under the amount that we gave them credit for, how do rectify that.

Dep. Comm. Pawlowski: I think the important thing to remember, and if I'm misunderstanding your question I apologize, is that the state is getting our royalty in-tax gas, not after we go through the market and back. The state is actually getting it as the gas is produced at the top. So that gas is then moving through being sold on the same price, at the same day, in the same way. It's not a calculation that comes back and then creates a volume of gas. It's just 13%-14% of the gas produced will be the state's through royalty and then after that comes out another 13% of the gas produced will be the state's tax share. So we get 25% of whatever is coming out of the unit going into the state as the state's share.

3:25-Rep. Wilson: If I understand what you're saying right now, that's what you're talking about is how we calculate what the state's getting. I'm talking about instead of the producers paying a tax they can pay it in gas. So is that done in the same fashion where we just get 13% of that gas that comes there no matter what the value is at the time, and then the transparency that you're talking about is just what happens to be the price of the day at the wellhead?

Dep. Comm. Pawlowski: Yes, we get the 13% in gas for tax the same way the state gets royalty in-kind. It's just delivered to the state, the state will take custody of it, in this case DNR will get custody of it. What it's sold for depends on the contract so you'll have a daily price. The transparency I'm talking about is that the state will be deducting or paying the state or an agent like Trans-Canada that we've approved. In the in-value situation it's the producer who elects how and where and when and that's the misalignment that we talked a lot about in the royalty study. So if I look at this situation, the producer has an incentive because their tax, in the traditional sense, would be based on the $7 at the top to instead earn money in the liquefaction plant and drop the dollar they're paying taxes and royalties off of to $3. So now we'd be getting 25% of $3 rather than 25% of $7.

3:27-Rep. Wilson: So this just isn't about transparency though, this really is about the companies knowing that the state is not going to keep changing the tax regime every time they turn around and this is their way of being able to get certainty because it's going to be a certain percentage. They know what it is, no matter what the price of gas is, now we're basing it on a percentage of what we get in the gas…..The bottom line I do get is that if we do want this to happen, the certainty part right now is what this does for the other three companies that want to go in as partners.

Dep. Comm. Pawlowski: That's correct. I think the only thing I'd add to it is that it's about certainty for the other parties but it's also about putting the state in the position to control the state's destiny and protect the state's interests. It's about taking care of Alaska and I think we saw that as a very key interest in investing and going in-kind. You're right, Trans-Canada is sort-of a separate question. This question is about how to we stand in a way that is best going to protect the state.

3:29-Rep. Austerman: I want to go back to part of the original question from this morning in reference to the take-off points and the amount of gas that will be available in state to be used and want to hear what thought patterns you have had or thoughts you've had in how to determine the demand and future demand and I suspect that will have some play within compression and whatever else for the size of the pipe and what we will be able to provide it at a later date as well. So if you can just kind of talk us through the process there so that at least Alaskans know the potential of having gas be used.

Dep. Comm. Pawlowski: The place I'd start is really on page 3 of the Heads of Agreement and its sub I. This is in the recital section where the Heads of Agreement tells the progression of thought that the parties to the Heads of Agreement went through in laying the project out. In this one in particular it gets back to the synergy that the Governor and the Administration saw between what this body started last year with the in-state project under the Alaska Gasline Development Corporation and the larger project which, and many of the members around the table described to me separately, is important for the size and scale of it and for the potential revenues it will bring to the state. They are a bit separate, but the work that the Alaska Gasline Development Corporation is doing moving towards an open season over this year and into the first quarter of 2015 is they're out in the field looking for gas and demand for gas from Alaska along the right-of-way. That's part of what their open season work is. So what sub I recognizes is that the Administration is going to work with and AGDC will participate in and cooperate with the Alaska LNG project, the big project… Then we go to page 12 of the HOA in 6.5. When we looked at the Alaska Gasline Development Corporation, it was in the context that they're not just tasked with the small in-state line, but more broadly with getting gas to Alaskans. That's one of their core missions and the bill before you actually refines some of those missions. In the near-term to assist the state in addressing in-state gas demand, the project is going to include at least 5 take-off points along this pipeline route between the North Slope and Nikiski. Those points and where they are going to be are done in consultation with the Alaska Gasline Development Corporation who, over this pre-FEED time period, is figuring out who needs gas within the state of Alaska along that right-of-way. How much gas? That allows us to design the capacity appropriately working with the other parties. There's additional language in the statutes about how DNR assesses in-state gas demand in looking at disposition of gas. So that's all part of what goes in the pre-FEED period. But we thought leveraging AGDC's work to Alaskans was the right way to not duplicate work between the two since they're out there doing it today.

3:33pm-Rep. Austerman: So AGDC will do the work that will come up with the determination of what the potential in-state use would be?

Dep. Comm. Pawlowski: AGDC is doing the work right now as part of their work of advancing the smaller project. Their doing that work today, that's part of what they will need to build their project should the legislature determine that, we get to late 2015 and it doesn't look like the large AKLNG project is the path the state wants to go down, looking at the smaller project, they need to have that work in place to be able to advance that project. By building the cooperation between the projects, they're sharing information back and forth. The state will transfer the work that it gets from AGDC's work to inform the larger project on where to go.

Rep. Austerman: There's going to be a takeoff for in-state would be less value and would bring in less revenue to the state whoever sells it, whether it's the state of the producers. Is that correct?

Dep. Comm. Pawlowski: That is absolutely correct. Especially the terms of the MOU with Trans-Canada say, not just that the gas entering the LNG plant up going north is less because the transportation costs are less, but that there's a mileage-sensitive tariff. So when you get to Fairbanks and you think about the interior, it's closer to the North Slope. The tariff to get to Fairbanks in the Nenana zone will be lower than the tariff that it takes to get all the way down to South Central.

3:35pm-Rep. Austerman: The value to the state if they use their 25% of the gas and sold it in-state, that should be priced basically the same in-value as you would get in the Asian market because you didn't run it through the LNG and had that expense.

Comm. Balash: I think what you're hitting on is the phenomenon I would describe as a point of indifference. At what point, in terms of the value of gas sold here in Alaska, are we indifferent, whether it's sold to Alaskans or overseas. It's an interesting economic analysis because you have to then consider whatever cost you will, associated with the risks of the liquefaction plant and your counter-party risk with your buyers and that sort of thing. But, if you look at the example here, and consider the $3 netback on the screen, that is the value of the gas at the slope, after you have deducted all the costs. The first two figures, $2 and $2 are for the GTP and the pipeline. So that would suggest that those $2 and $2 is $4 plus the $3 value at the Slope would add up to $7. So, arguably, a sale of the gas for $7 in-state would bring just as much revenue to Alaska as would a sale of LNG overseas. Those are the kinds of things that we'll have to consider as we go forward, but again, exactly whose gas is going to satisfy in-state demand has not been determined.

Dep. Comm. Pawlowski: If I can add one more thing, this goes to a term in the MOU that Commissioner Designee Balash spoke about yesterday, is you can look at the gas in Fairbanks as in coming from the North Slope and coming south or looking at the backhaul provision in the MOU, look at a Cook Inlet price going north for free. That was put into the MOU to provide that sort of benefit to the interior and being able to look at which is the better price compared to what's going on in the Cook Inlet region.

Rep. Austerman: Once the gas leaves the LNG and heads to the Asian market and is sold, what is the anticipated length of contract?

Dep. Comm. Pawlowski: Those contracts are going to be, as we understand it, at least the initial ones, very long duration contracts. They're going to have to be of the length and commitment that the state can use to finance and the other parties can use to finance and make the investment decision in this project. And we assume 20+ year contracts for the initial ones. There will be other interim agreements that will provide opportunity and additional capacity, but you're going to look for the long-term agreement to be able to, with any confidence, make a final investment decision.

3:39-Rep. Austerman: My point there is that if we're not very careful on getting the in-state demand correctly up front and we sell everything for 20 years we could have some in-state problems as well.

Comm. Balash: That is exactly why we believe it is important to have a midstream partner like Trans-Canada who knows how to make money moving additional gas. The ability to expand the pipeline to meet those in-state demands is something we don't have the expertise here in your state agencies. And the incentive of making an extra buck by moving an extra metric of gas is something that we think is going to be in their interest and ultimately serve the people of Alaska very well.

3:40- Rep. Neuman: One thing I've been thinking about is reducing the state's risk and when I look at the LNG facility and shipping gas to the Asian market, depending on foreign flag vessels to do that can be a huge risk. Recently there was an article in Alaska Business Monthly magazine, it talked about that. There's currently 375 LNG tankers, worldwide. In 2008 there were 300. There's 5700 oil tankers for comparison. At $150-$250 million each, the most expensive one ever built was about $300 million. When we're looking at a $45 billion dollar project, have you looked at the opportunity for the state to possibly enter into agreements to purchase one or two tankers to make sure that those flows are not interrupted and reduce risk to the state, and also to be able to make a share in that profit, particularly since there's no other American flagged LNG vessels. So, if we had an American flagged vessel, we could also be shipping our gas to other places in America, or moving their gas. To me, how do you reduce risk, make the most value for what you've got? I like to think out of the box, you have to do that with this kind of stuff.

Comm. Balash: We have not looked at that particular question specifically. What we have considered is the relationship of ownership of the vessels to the nature of the sales contract itself. There are two big categories of contracts: those that you sell destination ex vessel and those that you sell free on board. And I never can remember which is which, but one means title is changing hands at the outlet of the LNG plant and one is changing title at the dockside destination over in Asia. The way we've examined the question, we understand that the shipping cost is going to be around $1, but whether the sales price is a dollar higher or lower depends on if we own the vessel or whether we're responsible for chartering the vessel or whether the buyer has taken responsibility for that.

3:43pm-Rep. Wilson: Just one question from when we talked about going from south to north, why are we building an LNG plant on the North Slope if we already know we can get it from Cook Inlet, we're going to build an LNG plant there anyway, why are building two?

Dep. Comm. Pawlowski: One of my other responsibilities is I'm the designee for the Department of Revenue on the AIDA board, so I spend a lot of time, I joke, working from my favorite immediate LNG project to the other big LNG project that is going to take a while longer. And it really has to do a lot with the timing. The LNG plant is small, the plant that we're talking about building on the North Slope right now for the interior energy project, is a near term project that will provide the ability to build our the infrastructure to take advantage of this project when its able to come through. This project is not likely to be online prior to the early 2020's because of just the scale of permitting and the amount of work that needs to be done. The interior energy project we're looking at, a very near term startup, I believe they're already authorizing loans for build out in the region right now, so that's the difference between the two.

3:45- Rep. Wilson: Since money is getting tight, not that I'm trying to give any away, I know there's another LNG plan, a smaller one, that's not necessarily capacity that is taking Cook Inlet gas as well, although I was pointing to that one to start with. But, if we're talking about sooner than later, and we're talking for a shorter period of time than we were beforehand, and we're talking about building out, that's completely different, but I think at the beginning when we were talking about doing the North Slope, we'd thought we'd be there longer. Now these two plants have kind of come together, it seems like it's going to be more temporary than it was before. So looking at the best economics for the state, and having longer contracts now supposedly in Cook Inlet, would it not be smarter for the state so we'd have more money to put in this plant to do a little bit reshaping of the one that is currently taking in Cook Inlet gas so we could get gas to Fairbanks quicker and not with as much money being invested.

Dep. Comm. Pawlowski: The direction to advance the Interior Energy Project was the legislative direction. Actually, a lot of the confidence in the work that's going on there, especially of late as we've MWH as the actual preferred party, they're bringing people together, and the opportunity to use that facility long-term is there. I think the thing that I've been bringing to the board and trying to stress is that we do, as a board, need to think a lot about what level of state resource gets stranded in that project if this project goes through and how we're going to handle that. At this point it's undefined, but the opportunity to bring gas to Fairbanks, not just for residence at this point, but we're also seeing interest from Golden Valley, whose dealing with the shutdown of Flint Hills and the availability of fuel to move through the turbines. There's a lot of benefit being discussed in the LNG trucking project. The go decision on that has not been made yet, but it's moving very rapidly forward, I still think it's important to keep that project advancing, to get gas to the interior as soon as possible to help lay the ground for the demand for this project when it comes through.

3:47pm-Rep. Guttenberg: I want to go back to a question I had at the tail-end of this morning. Talking about Trans-Canada, the state being able to guide and be a definitive direction for Trans-Canada sitting in the board room where they're making the decisions on this project, they're only a 25% interest at that. We have possibly a conflicting interest with there's in that we want capacity. We want to be able to expand. I think a lot of us think about the construction of this line to be able to expand whatever capacity we can at the beginning and not fill it up with compression, which the other three participants might want to minimize the cost up front because they have a different interest and develop a design strategy that has it at capacity with compression. And we're sending Trans-Canada to the table because we want the capacity to be able to expand with compression because that's a whole lot more reasonable for us and our pipelines and independent developers and others that we want to see come in. I know we have mixing agreements and things like that, but we're only 25% at the table. How do we direct the other 75% of the interest when we're in conflict?

Comm. Balash: One of the unique challenges we face here is that pretty much all of the gas at Pt. Thomson and Prudhoe Bay is necessary to support a project of this size, financed for this long. What that means is pretty much every party at the table has a veto. The likelihood that this is going to succeed or that this is going to more forward without every party's interest being satisfied is pretty small. So that is something that is going to work for us in many instances and one that I think we need to be very thoughtful about as the agreements come together and come back for your review and approval. Inside the equity arrangements and the governance structure for that infrastructure, the final design of this project is going to be very, very important. The expansion principles that you'll find in Appendix A of the

Heads of Agreement lay out the circumstances under which an expansion cannot move forward. The circumstances under which one of the other parties might be harmed. So as we go through the pre-FEED phase and we get to a final design basis, to take to FERC, to file for EPA purposes, and really go to town on the final project design, we're going to need to be satisfied that the design is of the type we need. Namely, that there is going to be a sufficient increment of capacity available through compression. We will be seeking certifications from our counterparties and making sure that we're not walking into a scenario where we think we're going to have a billion cubic feet a day of compression available and then, oops, down the road find there's a problem caused. We're going to be seeking the assurances, the certifications, the warrants, that in fact the design should and will be able to expand to meet those design parameters that we think we're banking on at this particular stage and phase. One of the things that we've eve n discussed with the companies is the potential for building the pipe a little bit larger. They think 42 is the right number, and we think it might be the right number, we're not quite ready to let go of that rope and there are scenarios where it might make sense for the state to pre-pay for a little bit larger pipe. We've looked at scenarios like that, we've looked at the difference in cost between a 48 inch pipe and a 42 inch pipe. Now the pipe stock is going to cost more, but the compression and the associated facilities will cost less and the back-of-the-envelope number's we've gotten would indicate that difference is about $6 million. So much like Rep. Neuman's idea to potentially put another ship in the water, the idea that we might pre-pay for additional pipe capacity up front, because you're probably only going to dig one ditch, especially in Addigan, is something that we've contemplated. And I would observe as well, that in Appendix A, when there is a reallocation of capital among the parties, that if we were to pre-pay for a bigger pipe, that an expansion might occur in the future that we don't participate in. So we would have paid for that opportunity, we want to make sure we get some of that capital back. Some of those provisions are already baked in to Appendix A in those expansion principles.

3:54pm-Rep. Guttenberg: So we put $600 million to increase capacity through the size of the pipe, what is the liability to the state for not using all of that?

Dep. Comm. Pawlowski: You'd be recovering that extra cost in the tariffs and that would be how you would have paid for it, which is why, as Commissioner Designee Balash said, the reallocation of capital, should somebody come in and use that capacity, your rates should go down and you should be repaid potentially, not repaid but reallocated, for that initial outlay.

Rep. Guttenberg: But I'm not talking about when it reaches capacity for the expansion that we have prepaid for. I'm talking about when it's just larger in the pipe and the gas is initially flowing and there's additional capacity that nobody is using. Do we have to compensate Trans-Canada for that, or is it just the pipe flowing at less capacity for all the parties?

Dep. Comm. Pawlowski: As I understand it that would be, since Trans-Canada, in theory, would be our agent in that circumstance, that extra incremental cost would just be rolled into the capital cost that then is just spread across the tariffs. If you're just moving less gas through a larger pipe that extra cost would be borne by the state because they would be buying the opportunity for that expansion to occur.

3:57pm- Rep. Thompson: We're talking about expanding capacity, maybe making it a 48 inch pipe, and in the HOA there's provisions to provide at least 5 outtake points. Let's say Middle Earth finds a huge amount of gas. Is there any considerations been made for an intake point?

Comm. Balash: That's something that I would, if I had to choose right now today where those five off-take points were going to be, at least two of them would be placed in places where I think gas is going to be found to come into the pipe, one of those being Nenana.

3:59pm- Rep. Wilson: I think this still brings back the question we asked this morning as far as Trans-Canada goes is it really an option for us to go alone because of the time it would take for us to get out of AGIA. We had Mr. Marks come here and tell us we could get out of it easily, quickly, because it's not economic anymore to go down to the Lower 48, it's not a big deal. So, I think what we've been trying to figure out here, if it's inevitable that we're going with Trans-Canada, then we just need to get the going alone out of the way, then it just becomes between the other two portions of that… If we're going to do this, that we need to have it done to be able to capitalize on that, or are we going to be like the lower 48 market where we're too late.

Comm. Balash: Getting out of AGIA isn't the hard part and that's not the jeopardy that we are, frankly, concerned about. What we are worried about is maintaining project momentum and doing so with all of the partners we've been working with for the last three years. Trans-Canada, of course, we've been working with longer than that and right now we have partnerships that have been planning on Trans-Canada's involvement. There is summer fieldwork that is going to take place this year and the rest of the pre-FEED activity that will take place over the next 18 to 24 months, and there is an organization that's being stood up that is going to be populated with Trans-Canada employees who have certain skill sets and expertise that will join the venture. If, for whatever reason, Trans-Canada were to suddenly not be involved in that, there would be a scramble to fill that void, and one that the other three would probably fight over, and I can't tell you how long that would probably take for the to fight it out, but they would fight it out, and we're concerned that it really would cause a delay. Maybe it's just one year, might be two, but I guarantee you that the other three companies don't get along every day and they would leave each other a little bruised, perhaps even a little bloodied, and we think that would not be in our interest.

4:02pm- Rep. Wilson: So with that kind of sounds like we only have the other two decisions. But since this bill has been changed so many times, and we don't even know what it looked like the first time…are there other things… it would be nice to have an outline that says these things must be in there, others might be nice, but these are the things that have to be there so if we go through all this at the end of the day it doesn't get thrown out because we don't match the HOA any longer.

Dep. Comm. Pawlowski: An observation I'd make on some things that I really believe have added value through the process is you have not often seen much actual maneuvering within the substance of the bill itself, which you've actually seen as the legislature helping the Administration by telling the Administration we want to know when you come back with these next agreements that we're going to have to be making decisions on. I'd encourage members to really look at the sections 60 and beyond which are the directions to come back with financing information, range of options, to look at the type of expansion policies we've been describing. To think of what information your predecessors or you will need for those next big decisions. I think that's where we've seen the best value in the bill.

4:04pm- Rep. Stoltze: Is the 13% tax rate, is that locked in on this portion, the production tax?

Comm. Balash: The answer to that is no. SB 138 is setting a production tax, but there is nothing here that SB 138 does that allows the Administration to execute long-term agreements. It does give us the authority to negotiate and execute agreements of a duration of less than two years. But I think if an agreement is longer than two years, it must be approved by the Legislature before it can be executed,

Rep. Stoltze: So, as we work through this process, and right not there's a 12% royalty, and a 135 production tax, if for whatever reason we looked at the economics, somewhere down in the future, when you come back for a final investment decision possibly, then if the state legislature for some reason feels there should be another 2%, 3%, name the number, that option is still open after 138 gets signed?

Dep. Comm. Pawlowski: The power to set taxes is the legislature's power. And when the Administration brings back agreements, developed under the authorities provided by this legislation, the legislature will have another chance to take a look at things and decide what the legislature decides to do. The administration is confident in the tax rate that is being established here, I don't want to imply that we would be supporting a change to that, but you're right, the legislature's prerogative to establish tax rates and set tax rates provides an opportunity in the future.

4:07pm- Rep. Edgmon: The point I'm hearing is that…within that two year period, we just heard about the sense of urgency and the need to maintain momentum. The pressure on us as legislators to continue the project going forward will be pretty great… But as I work through all the different permutations here, I need to better understand exactly to what degree we're making that implied agreement because the decisions we make today could very well add to the momentum that we're going to feel as legislators that we need to sort of conform with to keep the project going. That to me should not be understated at this point.

Dep. Comm. Pawlowski: I appreciate the comment, and I think it takes me to another part of the bill that I think is really important. People have joked about the future, the amount of time that I going to be involved on the Executive Branch side, but there's also a lot of time going forward and we're lucky to have members who have spent a lot of time working on these issues over the years, because if you look at the power we've really asked for in here, it's to engage the legislature, you individually, either in committees, executive sessions, under confidentiality as these agreements are developed. We're going to be looking at a lot of input and guidance from the legislature over the next two years. That is why this will be successful. And I think that's really important, that it's not just the Administration that's looking at maintaining momentum, getting involved, working these issues out. There's high lights for public briefings, but we're going to have to work together on when we need guidance and the administration needs input from the legislature, how we're going to interact with each other so that you're not being surprised and put in a place where you haven't followed through the logic of why you're getting to that decision. There's no way that this can be rushed to those bigger decisions in the late 2015 time period. We don't see that as a recipe for success.

4:10pm- Rep. Edgmon: I'd like to see, even an informal analysis, of what the debt service might be for an off-take point, whether the 20% of affordable energy, the royalty amount, if that can service one off-take point, two off-take points, how this might affect the cash calls leading up to 2020.