

DNR Update on Alaska LNG Project

Senate Resources Committee

Presented by:

Commissioner Andrew Mack

Alaska Department of Natural Resources

March 21, 2018



DNR PRESENTATION OUTLINE

- Royalty-in-Kind vs Royalty-in-Value
- Process of Royalty Gas Disposition
- Lease Management Considerations
- DNR Engagement with AGDC
- Related DNR Contracts & Agreements

DNR's LNG RIK/RIV DECISION

- AS 38.05.182 stipulates that DNR will elect to receive Alaska LNG royalty gas in-kind (RIK), unless DNR Commissioner finds that taking gas in-value (RIV) would be in the best interest of State
- Before entering an RIK contract, DNR issues a preliminary best interest finding (BIF) for public and Royalty Board comment, obtains legislative approval and issues final BIF
- BIF will include an analysis of impacts on Alaska consumers, Alaska economy and state revenues (AS 38.05.183(e), 38.06.070(a))

ROYALTY GAS DISPOSITION - RIK

- Under current AGDC-led project structure, if DNR elects RIK, State could sell royalty gas and tax as gas to AGDC
- Custody transfer of State's RIK and TAG gas share from PBU and PTU would take place on the North Slope, at the wellhead or the inlet to the gas treatment plant
- DNR is actively engaged with AGDC on discussions regarding Gas Sales Agreement
- Contract for sale of State's royalty and TAG gas by DNR will require royalty board recommendation and legislative approval

ROYALTY GAS DISPOSITION - RIV

- If DNR elects RIV, Producers would remit royalties in value to the State based on terms of lease agreements and royalty settlement agreements
- State would receive a share of the revenues achieved by the Producers through their sale of PBU & PTU gas to AGDC or to as yet unspecified buyers, net of allowable deductions
- SB138 has provisions for lease amendments to address royalty valuation

SB 138 ALLOWS LEASE AMENDMENTS

- Current lease terms provide DNR with the right to switch from RIK to RIV or vice versa on six months' notice for oil and gas
- Under AS 38.05.180 (hh) and (ii), the State and lessees may agree to amend leases committed to a North Slope natural gas project
- However, lease amendments are limited to (1) elimination of switching between RIV and RIK, (2) value methodologies for royalty calculations and (3) fixed royalty rates for net profit share and sliding scale leases
- Such lease amendments would be effective for the Initial Project Term, anticipated to be 20-25 years

DNR COMMISSIONER'S RIK FINDING

- There is no other competitive North Slope major gas sales project to monetize the gas at PBU and PTU, so a non-competitive sale is most likely
- DNR must find that selling the gas to AGDC in a non-competitive contract is in the state's best interest. The contract will need to be ratified by the legislature.
- Before entering RIK contract to export gas, DNR must issue finding that in-state demand will be met
 - AGDC anticipates setting aside ~500 mmcf/d (more than twice the state's current gas consumption) for current and future in-state gas needs

DNR COMMISSIONER'S RIK FINDING

- AGDC contemplates purchasing PBU and PTU gas
 1. At a fixed price or
 2. At a netback price with a fixed floor
- Key provisions of the Gas Supply Agreement will include terms for byproduct (CO₂) handling and disposal

RIK AND RIV BENEFITS AND RISKS

Royalty in Kind

Benefits:

- AGDC's purchase of royalty and TAG gas would support its Alaska LNG marketing relationships
- State would avoid necessity of auditing Producers' gas sales

Risks:

- Cost allocation for by-product (CO₂) handling and disposal
- Locking in RIK for Initial Project Term eliminates opportunity to switch from RIK to RIV if problems arise
- Field Cost Allowance related to gas processing

Royalty in Value

Benefits:

- State has no exposure to negative netback risk
- State receives value based on Producers' price realization

Risks:

- Future uncertainties that impact State's RIV value may include commodity prices and transportation deductions

ENGAGEMENTS WITH AGDC

- DNR Commissioner's Office is engaged with AGDC to advance a number of parallel Alaska LNG project work tracts, including negotiation of royalty and TAG gas sales
 - OPMP providing agency coordination to, and support of, Alaska LNG project permitting process
 - DNR supporting engagement with potential LNG markets and buyers
 - Integration of Alaska LNG Project's ongoing commercial analyses

DNR'S ROLE IN CONTRACTS

- DNR has authority to participate in project-enabling contracts under AS 38.05.020(b)(11), and has not yet executed any contracts under this authority
- Significantly fewer DNR contracts or agreements may be needed under current AGDC-led project structure than under previous Producer-led structure
- Gas Sales Agreement with AGDC will be key document if State elects RIK