

HOUSE FINANCE COMMITTEE
March 19, 2014
8:33 a.m.

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CALL TO ORDER

Co-Chair Austerman called the meeting to order.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Mark Neuman, Vice-Chair
Representative Mia Costello
Representative Bryce Edgmon
Representative Les Gara
Representative David Guttenberg
Representative Lindsey Holmes
Representative Cathy Munoz
Representative Steve Thompson
Representative Tammie Wilson

ALSO PRESENT

Joe Balash, Commissioner, Department of Natural Resources;
Angela Rodell, Commissioner, Department of Revenue.

PRESENT VIA TELECONFERENCE

Dan Riley, Tesoro, Sacramento

SUMMARY

HB 287 APPROVE TESORO ROYALTY OIL SALE

HB 287 was HEARD and HELD in committee for
further consideration.

OVERVIEW OF THE GUIDANCE DOCUMENTS (HEADS OF AGREEMENT AND
MEMORANDUM OF UNDERSTANDING)

#hb287

HOUSE BILL NO. 287

"An Act approving and ratifying the sale of royalty oil by the State of Alaska to Tesoro Corporation and Tesoro Refining and Marketing Company LLC; and providing for an effective date."

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Co-Chair Austerman provided an introduction to HB 287.

JOE BALASH, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, provided an introduction of the bill. He stated that Alaska, as owner of oil and gas resources in the state, was entitled to a royalty share. The amount or percent of the share depended upon the specific lease term in question. Generally, the state's royalty share at Prudhoe Bay and on the Alaska North Slope (ANS) was 12.5 percent and higher. He informed the committee that the state would be able to take its royalty in-value (RIV) or in-kind (RIK) selling the hydrocarbon produced to somebody else. He reported that the Department of Natural Resources (DNR) negotiated a contract with Tesoro for one year. HB 287 would allow the state to enter into a contract lasting longer than a year with legislative approval. He relayed that Tesoro expressed its need for additional deliveries in recent discussions with DNR, hence, HB 287. He recounted that the volume of oil discussed was relatively small; between 5 thousand to 15 thousand barrels of oil per day.

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Commissioner Balash asserted that part of the reason for the limitation on volume was due to the previous negotiations with Flint Hills for 18 thousand to 24 thousand barrels of oil per day. The amount of royalty that the state had available to sell was limited by production on the North Slope. The state did not want to oversell its oil. Relative to the contract sales seen with Flint Hills there was a marine differential of \$2.15 in the formula to ensure the state collected the full value for its royalty.

Commissioner Balash continued that in the contract between the state and Tesoro the differential was \$1.95, a \$0.20 difference from its contract with Flint Hills. He explained that other special commitments were included in the agreement with Flint Hills relating to the price of gasoline in the interior relative to Anchorage pricing. The state was charging Tesoro a slightly higher price without

the same or similar provisions. He noted that Tesoro employed approximately 200 Alaskans. The Tesoro plant was the oldest, largest, and most sophisticated in Alaska. He cited that it began operations in the late 1960s and manufactured low-sulfur diesel, jet fuel, gasoline, heating fuel, and asphalt. Tesoro expressed interest in additional barrels of ANS royalty. He pointed out that the state was not ready to commit to a long-term contract.

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Co-Chair Austerman asked about the terms of the contract. Commissioner Balash replied that the contract extended through January 31, 2016.

Co-Chair Austerman asked whether the timeline was normal. Commissioner Balash replied that HB 287 extended the contract by an additional year. He elaborated that sales contracts with refineries were typically one year in length.

Co-Chair Austerman asked about the term length of the Flint Hills contract. Commissioner Balash responded that the term of the Flint Hills contract was five years. The length of the prior agreement was ten years.

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Vice-Chair Neuman noted the ability for the Tesoro refinery to produce jet fuel. He wondered if that would affect jet fuel supplies at Anchorage's international airport and at Fairbanks' airport.

Commissioner Balash replied that jet fuel was currently one of Tesoro's products and confirmed that the jet fuel supply in Alaska benefited its people. He stated that Ted Stevens International Airport in Anchorage was one of the largest air cargo hubs in the continent and had a large demand for jet fuel. He believed that all of the refineries currently operating served Anchorage's market. However, he signified that market fundamentals created a challenge for refineries in Alaska because ANS pricing was higher than feed stock available to refineries on the west coast and the Pacific Rim.

Vice-Chair Neuman noted the need for additional holding tanks for fuel in the Mat-Su region and referenced Port

Mackenzie. He directed his attention to Alaska's railroad and mentioned the loss of revenue from no longer transporting jet fuel from Fairbanks to Anchorage. He asked about the possibility of producing enough jet fuel and transporting it to Fairbanks to keep its airport full and the railroad busy.

Commissioner Balash replied that Petro Star, the remaining refinery in Interior Alaska, would continue operating for another year. However, it did not produce enough product, such as jet fuel, gasoline, and home heating oil, to meet all of the needs of the Interior. He detailed that Flint Hills would become a receiving terminal for tanker cars of product coming from Anchorage to the Fairbanks area. He elaborated that the volume of product carried to North Pole would be much smaller than what was carried to Anchorage. He furthered that although there would be additional business for the railroad, it would not equate to the amount of today's rail traffic out of the Fairbanks region.

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Vice-Chair Neuman commented that it was important the state supported the railroad and airports because of the crucial role they played in Alaska's commerce.

Representative Gara asked about RIK and whether 25 percent of the value went into the Permanent Fund. Commissioner Balash confirmed that RIK was considered royalty revenue.

Representative Gara asked for clarity regarding the formula used to determine how much money the state received. He understood the ANS spot price but inquired if it varied from day-to-day. Commissioner Balash responded positively.

Representative Gara asked if a tariff was subtracted from the total. Commissioner Balash answered yes.

Representative Gara asked how the tariff was subtracted. Commissioner Balash referred to slide 5 of the presentation: "Royalty In-Kind Sale to Tesoro Refining and Marketing LLC"(copy on file). He explained that the RIK differential of \$1.95, which accounted for marine costs to transport crude oil from Valdez to different markets on the West Coast, was subtracted from the ANS spot price. The tariff allowance was then subtracted for pipeline tariffs to move the oil from the North Slope to Valdez. Adjustments

were also included for Quality Bank purposes and for line losses. The \$1.95 figure was negotiable. The actual deductions made by the lessee under the terms of the royalty settlement agreement was a number that was currently higher than \$1.95. The commissioner reported that a smaller figure would bring additional revenue.

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Representative Gara asked for clarification about the \$1.95 marine differential and inquired why the state has to pay for it. Commissioner Balash responded that the state was entitled to its royalty share under the terms of its leases. The lessee was entitled to a reasonable cost of transportation to move the oil from the field to market. The \$1.95 accounted for marine transport which included the tanker cost and market location differential. The lessee was also entitled to a Quality Bank adjustment which accounted for the differences in crude quality. He furthered that varying qualities of oil go into the Trans-Alaska Pipeline System (TAPS) where they blend together. A quality bank adjustment was a mechanism to ensure that the producers that brought a higher quality crude oil received a higher price for their product.

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Representative Gara asked why the state would have to pay a portion of the tariff for oil traveling to Washington when it took delivery of its oil in Nikiski. He referenced the \$1.95 figure.

Commissioner Balash explained that if the amount was left in-value and the state relied on the lessees to take the oil to market, the state would have a netback at the Prudhoe Bay or North Slope fields at pump station one. As long as the state was able to get the netback price or better, then the state improved qualitative aspects of its economy; increasing employment, adding to property tax values, etc. He stated that the \$1.95 was representative of a cost less than what the state would otherwise pay to the lessees for transporting its oil to market.

Commissioner Balash stressed that RIK applied to the sale of oil. The transfer of title to the oil took place at the field. He commented that the state was not responsible for obtaining or maintaining capacity in any of the

infrastructure. The responsibility fell on the purchaser, such as Tesoro, as outlined in all of the state's existing RIK contracts.

Co-Chair Austerman commented that the bill would be heard again and that there would be time to ask follow-up questions later.

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Representative Guttenberg asked Commissioner Balash for a copy of "Exhibit A" to the best interest findings. Commissioner Balash affirmed he would provide copies to the committee.

Representative Wilson asked if there was a royalty contract with Tesoro for Cook Inlet production. If so, she wanted to know if there was a price difference between contracts.

Commissioner Balash informed the committee that the state did not have any existing royalty contracts for Cook Inlet oil sales. He stated that Cook Inlet oil production was relatively low; 20 thousand to 24 thousand barrels-a-day range. He relayed that Tesoro was the largest buyer of Cook Inlet production at present.

Representative Wilson asked if the state received any royalty from Cook Inlet production.

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Commissioner Balash affirmed that the state received royalty from Cook Inlet production but emphasized the volume of royalty was substantially smaller.

Representative Costello asked about the process and decision criteria. She wondered if the process was based on previous decisions.

Commissioner Balash replied that all sales of royalty were guided by the statutes affecting DNR, specifically AS 38.05.183. The department was required to follow the statutes and regulations and stated that the criteria were the same for short-term and long-term contracts. Generally, the state favored competitive sales but occasionally made allowances for noncompetitive sales. In the current instance the state solicited multiple buyers. However, only

two parties expressed interest: Flint Hills and Tesoro. He furthered that the statutory criteria had to be considered by the royalty board for a contract longer than one year. The board was required to give notice, hold a public hearing, and make a recommendation to the legislature about the approval of a contract. Once in the hands of the legislature, it had to be approved.

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DAN RILEY, TESORO, SACRAMENTO (via teleconference), pointed out that Tesoro was an independent refiner and marketer of petroleum products. He communicated that the company started its Alaska operations when it purchased the Kenai refinery in 1969. The capacity of Tesoro's Kenai refinery was 72 barrels per day. He relayed that the Kenai refinery focused on jet and diesel production. The refinery also produced gasoline and heating oil. He furthered that Tesoro operated the 68-mile pipeline that linked Tesoro's refinery to the Port of Anchorage. He testified in support of the legislation. He asserted that the price for RIK oil was fair and provided the company with a sufficient supply of crude. The availability of the contract would have a positive impact on the Kenai refinery operations. He noted the inclusion of a letter in committee members' packets mentioning further points about Tesoro.

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Co-Chair Stoltze mentioned that he talked with folks from the Kenai area who questioned why the price of fuel was as high as it was with the Tesoro Refinery in Kenai. He asked for Tesoro's wholesale prices and the prices prior to the per-dollar sales tax added on by the municipalities.

Mr. Riley responded by stating that he was not privy to the information Co-Chair Stoltze was looking for but remarked that the market was competitive. He referred to a presentation that was provided to the legislature in the previous year which detailed the factors of transportation fuel in Alaska. All aspects were considered in determining the price paid at the pump.

Co-Chair Stoltze asked Mr. Riley to have the appropriate people provide a written answer about pricing.

HB 287 was HEARD and HELD in committee for further consideration.

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[9:04:00 AM](#)

RECONVENED

^OVERVIEW OF THE GUIDANCE DOCUMENTS (HEADS OF AGREEMENT AND MEMORANDUM OF UNDERSTANDING)

Commissioner Balash discussed "Overview Of The Guidance Documents (Heads Of Agreement + Memorandum Of Understanding)"(copy on file). He stated that the overview was intended to provide committee members the opportunity to ask questions of the Department of Natural Resources (DNR) regarding the Heads of Agreement (HOA) with Trans Canada (TC) and Alaska's Liquid Natural Gas (AKLNG) Memorandum of Understanding (MOU). The HOA and MOA helped to support Governor Parnell's efforts to commercialize Alaska's North Slope (ANS) gas with a variety of other parties.

Commissioner Balash referred to slide 2: "Guidance Documents and HB 277." He identified the HOA and MOA as support documents. He specified that the HOA was a roadmap for the overall activities and authorities of each of the parties involved in the project: The State of Alaska, the three North Slope producers [BP, ConocoPhillips, and ExxonMobil], TC, and Alaska Gasline Development Corporation (AGDC). He reported that there was also a MOU with TC that described an agreement to transition from the Alaska Gasline Inducement Act (AGIA) into a more traditional commercial relationship where the state acted as the shipper and TC as the transporter. It also spelled out some specific key commercial terms that would be agreed to that would be beneficial to the state's long-term interest. He pointed out that both documents supported legislation, HB 277 and SB 138, that he anticipated would be heard before the House Finance Committee in the following two weeks.

Commissioner Balash explained that HB 277 outlined participation, percentage, and process, the three "P's." He indicated that the intent of the state was to align the interests of the state and the other parties allowing the AKLNG project to move forward. He opined that rather than

struggling over some of the key terms that mattered to the state, it developed an approach where the state participated as an equity partner through the state's share of the natural gas product. The state did not intend for its agencies to take on corporate day-to-day responsibilities. Instead, it would enter into contracts with the producers and with TC and AGDC to facilitate the commercialization of Alaska's gas as well as maximize the value of the gas. He continued that the legislature and the public would decide whether to advance the project further. The department used a phased approach to allow for decision making to occur as commitments were made by all parties. The state saw a lot of potential and had a deliberate process to move the project forward alongside the other project sponsors.

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Commissioner Balash discussed slide 3: "What is a Heads of Agreement?" He indicated that HOA was a common term used in the LNG world. He referred to the definition from www.investopedia.com:

A non-binding document outlining the main issues relevant to a tentative partnership agreement. Heads of agreement represents the first step on the path to a full legally binding agreement or contract, and serves as a guideline for roles and responsibilities of the parties involved in a potential partnership before any binding documents are drawn up.

Commissioner Balash commented that the definition called attention to key items and commented that DNR would be bringing a full legally binding contract back to the legislature as soon as next fall.

Commissioner Balash identified all of the parties participating in the HOA:

HEADS OF AGREEMENT

By and Among

The Administration of the State of Alaska
Alaska Gasline Development Corporation
TransCanada Alaska Development Inc.
ExxonMobil Alaska Production Inc.
ConocoPhillips Alaska Inc.

BP Exploration (Alaska) Inc.

FOR THE ALASKA LNG PROJECT

Commissioner Balash confirmed that all of the parties signed the HOA.

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Commissioner Balash discussed slide 4: "Organization of the Heads of Agreement":

The Heads of Agreement (HOA) is broken into 16 sections that include:

- Recitals of recent events and understandings between the parties.
- 13 Articles covering guidelines for the development of the project and the roles and responsibilities of the Parties to the agreement.
- And appendix articulating access and expansion principles for the project.
- An exhibit that provides copies of the 3 letters to Governor Parnell from the Producer Parties and TransCanada.

Commissioner Balash explained that recitals provided a context for the reader and a history of how the parties came to an agreement. He commented that the 13 articles listed were very specific about topics within the HOA. He spoke of the appendix which outlined the pro-expansion principles to be employed on the project. He emphasized that there were a number of things that were different about an LNG project from an overland project. The state examined some of its policies and considerations of the past that helped shape the HOA. He reported that in the back of the document there were three letters of correspondence between the governor and parties. In 2011, the governor called on the parties to align on an LNG project as opposed to the overland project that had been licensed under AGIA. The correspondence showed a history.

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Commissioner Balash turned to slide 5: "Key Recitals." He reported that the State of Alaska set out in law [AGIA] a specific set of policies and a path forward between years 2007 and 2008. However, the project was targeted at the

North American gas markets. The drastic changes that the state had seen as a result of shale gas development caused the market to become a lost opportunity for Alaska's gas. The Pacific Rim and LNG appeared to be the key opportunity currently available to the state. He supposed that the work done and the license under AGIA had value and would be able to be added to the Alaska LNG efforts. He recounted that the legislature adopted HB 4 [Legislation that passed in 2013 pertaining to the Alaska Gasline Development Corporation and the Regulatory Commission of Alaska] indicating its intention to pursue in-state gas. The HOA that was signed in January 2014 outlined Alaska Gasline Development Corporation's (AGDC) mission and acknowledged the state's intent to keep the Alaska Stand Alone Pipeline (ASAP) and AKLNG projects cooperating. He claimed that AGDC would be able to carry the states interest in the project and that when the agreement was signed the state was not trying to obviate AGDC's mission. The agreement outlined ramping up the preliminary front-end engineering design (Pre-FEED) phase of the Alaska LNG project, which was estimated to cost \$400 million. The state's share of the \$400 million would be 20 to 25 percent. The other parties' shares would be based on their prospective interest on the North Slope.

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Commissioner Balash advanced to slide 6: "Key Definitions:" He stated that the slide was included as a point of reference when reading through the HOA. He mentioned that item five, "TAG" which stood for "Tax as Gas", was an important element of the agreement and would be discussed in further detail in the future.

Commissioner Balash discussed slide 7: "Principles and Benefits":

Article 2: Principles

1. Recognizes that if Enabling Legislation is passed that the parties would negotiate contracts that would incorporate the principles in the agreement.

Commissioner Balash elaborated that commercial contracts the state enters into required legislative approval. He expressed the importance of the public being able to weigh in on long-term contracts affiliated with the project. He

compared it to buying a house. The process included agreeing to terms, practicing due diligence, and signing closing documents.

Commissioner Balash reviewed the benefits of the AKLNG project which included energy for homes and communities, jobs for Alaskans, additional revenue for the state, and opportunities for additional gas development. He stated that there was 33 trillion cubic feet of proven resource at Prudhoe Bay and Point Thompson. Federal, state, and private geologists expected tremendous additional natural gas resources on the North Slope. He asserted that once the resource was discovered the state would need to preserve an opportunity for development and delivery to market.

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Commissioner Balash discussed slide 8: "Alaska LNG Project Work." He referenced Article 4 of the HOA stating that if enabling legislation passed, work would need to be conducted by and between parties. Service agreements for transportation and liquefaction between AGDC and TransCanada would need to be drafted. Offtake and balancing agreements would also be necessary in the upstream. The state would need to ensure that it would be receiving all of the gas it needed in order to enter into other contracts related to the project. He commented that LNG projects were a daisy chain of contracts. He acknowledged that the most important contract was the sales and purchase agreement; the details of selling the LNG to the buyer. The buyer would want to see the liquefaction plant, the pipeline, the field, and the specific gas they were buying. From the state's perspective its share of the gas would come at the field. The state would enter into contracts downstream with service providers as well as upstream to ensure getting its share.

Commissioner Balash expressed the importance of the last point on slide 8. The state and each of the producer parties would initiate LNG marketing for Alaska gas, something that was new and key to the present opportunity. In the past two decades certain organizations or individuals from Alaska had traveled to markets in Asia trying to sell product they did not have. He opined that the conversation would take another shape with available product.

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Commissioner Balash discussed slide 9: "State Participation in the Project." The state's participation would potentially help to maximize the value of its resource. He noted an in-depth study about the differences in an LNG project versus an overland project. The differences started with the way in which the gas was sold. He reported that LNG sales contracts between buyers and sellers were unique and proprietary. He furthered that although broad characteristics carried from one contract to another, there was not a transparent market clearing price mechanism for LNG. He opined that another difference between an LNG and an overland project was in the nature and regulation of infrastructure. In the overland context the market was transparent and highly liquid in a regulated infrastructure. In an LNG project the pipeline may or may not be regulated, but the liquefaction plant was not regulated for access or rates, presenting a black box to the State of Alaska from a value perspective.

Commissioner Balash relayed that the state was seeking a way to participate for its share of gas. Under the terms of the state's leases it was entitled to its royalty share. However, the lessee was entitled to reasonable transportation costs. He indicated that the state paid for its share of the infrastructure either upfront or through deductions over time. He explained that the state would experience a better outcome by being involved on the front end of the project, structuring the financing of the state's share.

Commissioner Balash noted that the alignment of interest achieved was an improvement in serving the state in the long-run.

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Commissioner Balash discussed slide 10: "Regulatory Framework, Access and Expansion":

Key Provisions

1. At least five Alaskan offtake points for Alaskans to get their gas.
2. Locations of offtake points will be developed in consultation with AGDC. AGDC's work on ASAP will

greatly benefit the State and Alaska LNG Project in developing these locations.

3. Each Party's shares in capacity would be managed on a proprietary basis; essentially creating "*projects within a project.*"
4. AGDC and TransCanada's shares of capacity in the project are committed to provide access to third parties on terms developed with the State.

Commissioner Balash stated that the regulatory framework was a key point which he alluded to earlier in describing some of the differences between an overland versus an LNG project. Another critical factor was the state's access into and out of the pipeline. He also mentioned that opportunities for expansion were essential. He expounded that if a party owned 32 percent of the project it would be obligated to finance 32 percent of the project overall. The state, as a 25 percent owner, would be responsible for raising the capital or finding the partners to raise the capital for its 25 percent. It would not matter how any of the parties structured their financing. He reported that there would not be a single tariff for the pipe. Each party would have its own set of terms. Although physically there would only be one pipe, metaphorically there would be four, one for each sponsor. He believed that managing the parties' shares on a proprietary basis would help to solve some of the commercial problems that have plagued efforts in the past. He continued by stating that the state's interest was in low tariffs. They were good for the state's bottom line and helped to make unexplored lands more attractive. Meanwhile, those sponsors who did not necessarily have the same interest as the state would be able to set up their finances and their tariffs higher than the state's. The state would not be affected by any prices set by other investment parties because of how the agreement is structured.

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Commissioner Balash moved to Appendix A on slide 11 "Appendix A: Pro-Expansion Principles." He indicated that expansion issues were so fundamentally important to the State of Alaska and its long-term future that it wanted the terms detailed in the agreement with the other parties. The key principle was that parties would be able to expand the project without being vetoed by the other parties. For

example, if two of four partners wanted to expand, they could do so as long as the expansion did not compromise the ability to meet long-term obligations or negatively impact the other parties. However, the cost and the risks of the expansion were borne by the expansion parties. He mentioned liquefaction trains.

Co-Chair Austerman asked for a definition of trains.

Commissioner Balash replied that trains were equipment units that allowed for a given process to take place. There would be trains located at the North Slope to be used for a gas processing plant (GPP) and trains located in Nikiski used for the gas liquefaction process. He continued that they were units of infrastructure that would be able to be plugged together similar to modules. The capacity of the trains would be significant.

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Commissioner Balash elaborated that the liquefaction equipment was fundamental to the ability to deliver to buyers and would only be affected if all of the parties agreed. If one of the parties had more gas to take to market it would be able to propose adding a train and the other parties would have the choice to participate. The ability to expand the liquefaction terminal with additional trains was essential especially since the state did not have regulatory protection from the Federal Energy Regulatory Commission (FERC) or the Regulatory Commission of Alaska (RCA).

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Commissioner Balash moved to slide 12: "Enabling Legislation: The Timeline":

- April 2014: Legislature passes enabling legislation.
- 2014-2015: Administration and Alaska LNG Project Parties develop project enabling contracts, including, but not limited to, agreements with TransCanada and AGDC for project services for the State Gas Share, gas offtake and balancing agreements with the Producer Parties, and preliminary LNG or gas sales contracts.
- 2015: Legislature considers project enabling contracts.
- 2015-2016: Parties decide whether to advance to FEED.

Commissioner Balash stated during the intervening period the state would be keeping the legislature informed of progress. The department did not want to come out of the process in FY 15 with legislation that would not pass. The department believed the cost of the front-end engineering and design (FEED) phase would be approximately \$2 billion. The state would be looking at its portion of the cost, not the full \$2 billion.

Commissioner Balash pointed to slide 13: "Royalties and Production Taxes: Key Provisions." He informed the committee that royalty and production taxes needed to be examined in order to establish the state's share. The state would receive cash revenues from corporate income tax payments and property tax payments. However, royalty and production tax revenues would be handled such that the state's royalty interest, 12.5 percent at Prudhoe Bay and 14 to 16 percent at Point Thomson, would be combined with the state's production tax interest to equal the state's gas share. He reported that the production tax would fall within a range from 7 to 13 percent as outlined in the HOA. The state's share would fall within 20 to 25 percent overall.

Commissioner Balash addressed that taking the state's gas in-kind would not be a problem except that because the LNG business required a look through to the specific reserves and resource, all of the gas at Prudhoe Bay and Point Thomson would be required to support the particular project. If the state switched back and forth from RIK to RIV, it would create some significant commercial hardships and obstacles for the lessees. The result would likely be a decline in the state's value. He reported that the state was considering the in-kind approach. The statutes directed the state to take its oil and gas revenue in-kind unless taking it in-value would be in the state's best interest.

Commissioner Balash recounted that DNR conducted an in-depth study examining the state's options of taking its gas royalties in-kind or in-value. The department found that being paid in-kind presented challenges that would potentially result in the state receiving a lower price than producers. A provision was included in the HOA in Article 8.8.3 that required a stringent attorney review to avoid any violations of anti-competitive rules in the United States or in other countries. He noted that each of

the producers were willing to negotiate separately with the state on the sale or disposition of its share of gas. The state would have an opportunity to leverage the producers' marketing expertise which led DNR to think differently about the option of being paid in-kind. Agreements were currently not negotiated. He pointed out that the HOA was premised on the state receiving its royalties in-kind. However, the state had not committed itself to receiving its share of royalties in-kind. The state would have to feel satisfied with the marketing aspects prior to any commitments.

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Commissioner Balash discussed slide 14: "Other Project Enabling Terms and Additional State Support for the Alaska LNG Project: Key Provisions." He addressed the first item on the slide regarding property taxes. He indicated that there would be a large benefit to structuring a payment in lieu of tax, which would provide certainty to local governments and project sponsors. He furthered that the payment in lieu of tax could be structured in a variety of ways and chosen by local governments. He referred to Article 9 of the HOA which stated that the administration, in consultation with local governments, would develop payments in lieu of taxes. The state would also examine the impacts of related construction on communities throughout the Railbelt region. The state would have to account for the impacts and help local governments address any additional burdens and costs associated with the project.

Co-Chair Stoltze asked for detail on project benefits.

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Commissioner Balash noted that benefits would come with some impact. He continued that the state did not want to repeat some of the same experiences that occurred in Fairbanks in the 1970s when the Trans-Alaska Pipeline System (TAPS) was being constructed. He referenced the domestic violence and sexual assault that occurred during the construction of TAPS.

Commissioner Balash mentioned that the development and installment of infrastructure and a healthy long-term oil business would be fundamental to the overall economics of the project. He discussed that the revenues from gas would

be used to account for the cost of infrastructure. The upstream costs of maintaining Prudhoe Bay and other producing fields were borne by oil. He asserted that if the oil business was not healthy enough to bear the costs, the gas business would have to which would be problematic for the state.

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Commissioner Balash detailed slide 15: "Alaska Hire and Content." He pointed out that the estimated total cost of the project was \$45 billion to \$65 billion. He noted that there would be as many as 15 thousand jobs associated with the project during construction. He reported that roughly 1 thousand long-term operating and maintenance jobs would be generated and would command high salaries. He noted that Article 11 was found on page 16 of the HOA and provided key direction for the Alaska LNG parties in developing the project.

ANGELA RODELL, COMMISSIONER, DEPARTMENT OF REVENUE, recounted three points relating to the HOA and MOU; participation, percentage, and process. She stated that as the state developed the HOA with the other parties, it had to consider its participation not only from a percentage standpoint but also from human capital and devotion of resources perspectives on the part of DNR and the Department of Revenue (DOR). In its review, DOR recognized the opportunity to continue the state's relationship with TransCanada moving forward. The state chose to enter into an MOU with TransCanada.

Commissioner Rodell transitioned to slide 16: "What is a MOU- Memorandum of Understanding":

The MOU outlines the terms of the State of Alaska's relationship with TransCanada in the Midstream component of the Alaska LNG Project; however, the MOU will not be binding until the Legislature enacts "Enabling Legislation."

Commissioner Rodell elaborated that the MOU only applied to the pipeline and the gas treatment facilities. The MOU did not apply to the liquefaction facilities, an additional part of the project.

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Commissioner Rodell directed the committee's attention to slide 17: "Key Terms of the MOU: Key Terms of Exhibit C":

1. Favorable Debt to Equity Ratio
 - 75/25 ratio for rate-making purposes reduces the State's tariff.
 - Lower tariffs improve the State's overall cash flows.
2. Cash Contributions by TransCanada
 - TransCanada as project developer reduces the State's exposure to cash calls and obligations until the pipeline is in service.
3. Improved Value to the Treasury
 - When you consider the opportunity cost of utilizing the State's capital (which earns 6% in the treasury), our NPV is improved overall.
4. Expansions
 - TransCanada committed to 70/30 capital structure for expansions.
5. Gas to Alaskans
 - At least 5 offtake points
 - Distance sensitive rates with three zones for delivery

Commissioner Rodell emphasized the value of TransCanada committing to some of the key terms important to the State of Alaska. She commented that during Pre-FEED the state would gather additional information and be in a better financial position to commit its limited financial resources to the project. The state would also be able to take advantage of TransCanada's expertise. The MOU allowed the state to maintain reserves and to earn an attractive interest rate. She assured the group that TransCanada's 75/25 ratio for rate-making purposes and its 70/30 capital structure commitment would not dictate what TransCanada would ultimately finance.

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Commissioner Rodell advanced to slide 18: "Where We Are Today?" She noted the Point Thomson settlement and the joint work agreements. She furthered that TransCanada and ExxonMobil had been working together under the AGIA license. She reported that the state had invested \$330 million and TransCanada and that ExxonMobil had contributed

an additional \$130 million into AGIA. There was also work done in Denali by British Petroleum (BP) and ConocoPhillips equal to \$200 million. The investment by the parties led to the concept selection of the AKLNG project; creating a gas treatment facility, an 800-mile pipeline, and a liquefaction facility to be located at Nikiski.

Commissioner Rodell pointed next to HB 277, legislation that would be brought before the committee, to enact the MOU between the State of Alaska and TransCanada. She reported that the HOA had been signed. She specified that currently the legislature had to decide whether to go forward with the Pre-FEED phase, as the administration had envisioned, and contribute all of the AGIA and Denali work to the Alaska LNG project. The other option was for the state to refrain from going forward, agreeing to purchase the \$130 million worth of work from TransCanada that was spent on AGIA. In the meantime, AGDC planned to advance to a 2015 open season with ASAP (sharing with AKLNG).

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Commissioner Rodell discussed slide 19, "What Happens if HB 277 Passes?" She relayed that if the legislation passed the state would enter the pre-FEED stage that would last 12 to 18 months. The estimated cost would be \$435 million. The producers would contribute about \$327 million to \$348 million of the costs. The state's share would be \$35 million to 43 million and TransCanada would contribute \$53 million to \$67 million. At the end of the pre-FEED stage the administration would return to the legislature with information and contracts to continue into the next phase. Also, the administration would seek legislative approval to exercise the option to increase its investment to 40 percent. The state's cost would equal \$21 million to \$27 million for previous costs. The state would also have the option to stop the project entirely at which point the state would be liable to pay TransCanada for its development costs incurred on behalf of the state. Lastly, the state would have the option to continue with the project at its current level of investment.

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Commissioner Rodell discussed slide 20: "What Happens after FEED?" She stated that in two to three years the administration would return to the legislature to make a

final investment decision. The FEED costs were currently estimated at \$1.8 billion. The producer share would be approximately \$1.4 billion. The state would cover approximately \$145 million to \$180 million of the costs. She interjected that the range in dollar amounts reflected the state's percentage of investment to be between 20 to 25 percent. TransCanada would be investing between \$215 million to 270 million for the liquefaction facility. If all parties approved going forward with a final investment decision the next phase would be construction. The state would be obligated to make a final investment of about \$10 billion. The state would again have the option of ending the project prior to construction but would have to reimburse TransCanada its investment of \$183 million to \$337 million incurred on behalf of the state.

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Commissioner Rodell discussed slide 21: "Summary":

- The Heads of Agreement (HOA) and Memorandum of Understanding (MOU) provide guidance on how the powers provided in HB 277 will be used.
- At each stage in the project there are "off-ramps" and decision points for Legislative and public review.
- Commitments by the State will be made commensurate with progress by the project.

Commissioner Rodell added that commitments by the state would also be commensurate with the investments being made by the other three sponsors of the project; ExxonMobil, BP, and ConocoPhillips.

Co-Chair Austerman asked about the 20 to 25 percent ownership in-kind and gas in lieu of taxes. He asked how the money already invested in AGDC and the work that it had done played into the 20 to 25 percent ownership. He wondered about a percentage of value that the state was assuming within the 20 to 25 percent.

[10:00:28 AM](#)

Commissioner Balash responded that the work AGDC did was focused on environmental and engineering work tied to an instate standard as compared to a FERC standard. He opined that some things would fit well with AKLNG such as AGDC

sharing the state right-of-way. Each party's share of the costs would be accounted for as the project moved forward in development. The legislation specified that AGDC carried the state's interest in the liquefaction for AKLNG but would simultaneously continue to pursue ASAP. He indicated that there would be a need to continue to separate the projects until it was clear that AKLNG was going forward, at which time the state would be able to focus on just one project.

Co-Chair Stoltze indicated that HB 277 was currently in the House Resources Committee and would be heard by the House Labor and Commerce Committee before being heard in House Finance Committee. However, he wanted to take advantage of getting the questions answered early and while some of the consultants were in Juneau for other hearings. The overview was to help everyone formulate questions in preparation of receiving the bill later on in session.

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Representative Gara noted that with oil the bulk of the state's revenue was production tax and royalties. He understood the concept of taking the tax and royalties in the form of in-kind gas and indicated that royalty was approximately 13 percent. He asserted that production tax had always been greater than 13 percent but in the case of the project it would be half or equal to the royalty. He wanted to know how the commissioner had come up with his figure.

Commissioner Balash contended that tax was not always larger than royalty. He claimed the opposite was true for the vast majority of the history of North Slope production. He explained that it was important to note the difference between gross and net tax in reference to gas. He furthered that the numbers would look different even though the outputs from a cash flow perspective would potentially be unequalled. He remarked that the state was not asking to negotiate tax rates. He informed the committee that according to the constitution only the legislature was able to set tax rates. The department was asking that a tax rate be established as part of the legislative package.

Commissioner Balash reported that in identifying the range that is seen in the HOA, the state conducted a royalty study with Black and Veatch in 2013 reviewing a number of

options and opportunities. The study revealed that under the status quo, without the state making any changes or participating at all, the project would have a difficult time competing for market and capital. The state had some work to do if it wanted to bring its financial take down so that it was more competitive and to achieve an environment where the project was more likely to move forward. He recommended that the state model its royalty after the royalty rates of other projects. As the commissioner of DNR, he did not think it was a good idea, nor did he believe most Alaskans would want the state to reduce its interest in the royalty.

Commissioner Balash opined that alternatives included participation and the process of back calculating the percentage expected from production tax and royalty. He wanted to make sure the state was not needlessly reducing its overall interest. He emphasized that value and cash mattered and that the cost and charges of liquefaction without participation would potentially yield higher rates. He alleged that if all of the value was being drained because of the charges for liquefaction, then a high percentage of a thin margin would not be beneficial to the state. He continued that the legislature's consultants had done a good job of illustrating the risk to the state from a wellhead perspective.

[10:09:12 AM](#)

Co-Chair Austerman clarified that the project was not viable without state participation.

Commissioner Balash replied that if the project was to move forward now, the state needed to take reasonable steps to maximize its value. He stressed that the state's value should not be consumed by transportation and liquefaction costs.

Representative Gara agreed that at low prices royalties could be higher than production taxes and at higher prices the production tax was higher. He asked if the state was bound to a tax rate in the agreement and inferred that an expectation had been created with the oil companies that the state would not adopt a tax rate higher than the royalty. He asked for clarification.

Commissioner Balash replied that the legislation contained provisions on production taxes for natural gas. He explained that the HOA represented the circumstances under which all of the parties were prepared to move forward together. The parties would have to decide how to proceed if the legislature decided to set a number that was higher or lower. He reported that as long as the number fell within a specific range all parties were ready to move forward under the current terms set forth in the HOA. He did not recommend moving forward with the project if the legislature set a number that fell below 20 percent total for the state gas share. He anticipated that other parties would object to the state receiving higher than a 25 percent share, something that would need to be confirmed with the other signatories.

[10:13:01 AM](#)

Co-Chair Austerman noted that multiple discussions would occur when the bill came before the committee.

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ADJOURNMENT

[10:13:49 AM](#)

The meeting was adjourned at 10:13 a.m.