

HOUSE FINANCE COMMITTEE
April 10, 2014
1:08 p.m.

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CALL TO ORDER

Co-Chair Austerman called the House Finance Committee meeting to order at 1:08 p.m.

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

MEMBERS ABSENT

None

ALSO PRESENT

Rick Harper, Energy of Business Consulting Associates;
Janak Mayer, Partner, analytica; Nikos Tsafos, Partner,
analytica; Deepa Poduval, Principal Consultant, Black and
Veatch.

SUMMARY

^RICK HARPER, BLACK & VEACH and ENALYTICA - DISCUSSION OF
NATURAL GAS ISSUES

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Co-Chair Stoltze discussed the meeting agenda.

RICK HARPER, ENERGY OF BUSINESS CONSULTING ASSOCIATES, discussed his professional background related to oil and gas, consulting, and work with the State of Alaska. He highlighted his work on liquid natural gas (LNG) projects in the U.S., Canada, and Oregon. He had been involved in consulting for 22 years; his firm was located in Houston. His firm specialized in everything transactional in the oil and gas business (e.g. lease writing, joint operating agreements, asset management agreements, and other). He provided a list of various clients including [but not limited to] Shell, Chevron, Anadarko, Intel, and other. He had significant experience in royalty taxation issues. He had been retained by the Legislative Budget and Audit Committee; his current work for the state was qualitative and not quantitative. He had been asked to look at studies and economic modeling that had been done; his role was not to duplicate or evaluate the studies. Given his past involvement in the Stranded Gas Development Act contract, the Alaska Gasline Inducement Act (AGIA), and other tax measures he had been asked to compare and contrast the items with current considerations. His report utilized his past background.

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Mr. Harper shared that his primary concern for the state revolved around royalty-in-kind (RIK) versus royalty-in-value (RIV) issues. He was in support of development, pipeline, LNG, export, and instate development. He was in full support of the project and its timing; he thought it was well thought out. Aside from his concerns about the project's internal workings he believed that in terms of the market, time was of the essence. He did not disagree with information provided by Black and Veatch or analytica related to the market. He was concerned about the structure involvement from the state's perspective. He stressed that the window of opportunity for marketing in Asia and the Pacific Rim was not open-ended. He believed there was a real sense of urgency on the producers' part; he noted that he had not had the same view on some prior projects. His approach was to ask committee members numerous questions he thought they should consider. He referred to his testimony as a "gut check" for members. He advised that a flawed project premise would lead to a flawed outcome. He asked members to consider the project objectives (e.g. expedite infrastructure, lower capital costs and financial

thresholds, and other). He commented on the different backgrounds of committee members.

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Mr. Harper began at a "20,000 foot level." He asked why a fiscally conservative individual who believed in small government would opt to design the project in a way that would expand government. He opined that if RIK occurred it would probably be the biggest intrusion into the free market on the part of a sovereign state in U.S. history. He stated that the situation would not be like bailing out General Motors or Chrysler. The real discussion was about entering into the business in a competitive way should the state decide to take its own product to market. The project would be a long-term business enterprise that would expand longer than a generation. If members believed the structure of the arrangement would lead to higher state revenues, he asked them to consider whether the state could really compete for the sale of LNG with ExxonMobil, BP, ConocoPhillips, Shell, and other major oil and gas companies. He reminded the committee that the project involved gas from a single source; whereas, competitors had multiple sources. For example, the state may have a single tanker contract against competitors with access to a multitude of facilities. He spoke to the complexity of the transaction proposal and understood that additional negotiations would be going forward. He offered that the complexity of the present structure would be significantly increased in one to two years when the legislature was asked to approve the agreements in finality. He provided the following quote from Albert Einstein:

Any fool can make things more complex. It takes a touch of genius and a lot of courage to move in the opposite direction.

Mr. Harper advised members to think about how much more complex the transaction was likely to be. He also advised members to consider the potential that it may be the lone group standing in the way of an economic advancement for Alaska and the nation if it did not accept the proposal. He queried whether the state had an opportunity to affect the transaction at present or in the future in a substantive way.

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Mr. Harper understood from prior experience that the legislature's role related to advice and consent. He communicated that his role was limited to advice. He provided the presentation: "Observations on the Memorandum of Understanding, the Heads of Agreement and the Alignment of the State's Interest" (copy on file). He had no concerns about the design of the project including the building of the pipeline, the LNG facility, the markets, or other. He opined that the proposal was a significant step forward from the past Stranded Gas Development Act contract days; however, the proposal was built on the same "chassis." He detailed that the state would adopt a dramatically different role than in the past in its role as lessor, royalty owner, and regulator. The proposal contemplated moving from RIV to RIK. He believed that the fundamental premise that RIK was a net benefit to the state was flawed. He asserted it was a concession to producers and introduced substantial risk to the state. He relayed that when faced with a multitude of documents pertaining to a large, complex project, the natural inclination was to focus on the internals and debate whether economic drivers were given sufficient weight.

Co-Chair Stoltze handed the gavel to Vice-Chair Neuman.

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Mr. Harper continued that frequently people made the mistake of failing to view a project on a macro level. He believed his role was to encourage the committee to think about the project in a macro context. He asserted that the state would abandon its implied and explicit covenants that benefited the state under the leases when moving to RIK if the proposal was adopted as is. He highlighted that there was over 100 years of history in dealing with RIV issues. He remarked that the topic was never free of conflict; there were always questions to consider about the appropriate deduction, cost, price, and other. He relayed that the history had given rise through the courts and common law to include explicit and implied covenants in leases. He underscored that all of covenants would be gone if the system changed to RIK. He stated that every lease he had ever seen in the oil and gas industry included the right for a party to take its share in-kind; however, he had not ever seen the right exercised. He relayed that the right had been exercised typically under special and

limited circumstances. He shared that the state could choose to use RIK, but it would be breaking new ground.

Mr. Harper highlighted that moving to RIK would make the state a direct competitor [with producers] with a sole source of production. He was aware that producers would likely offer an option for marketing assistance, but it would be for a fee and substantial cost. Under current lease proposals the producers had an implied duty to market gas for the state at no cost and to only take reasonable and actual deductions. He discussed that the state would have a minority stake in terms of the North Slope and globally.

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Mr. Harper disputed the notion that the state's interest may be better aligned with RIK rather than RIV. He believed it would work in the opposite direction. He explained that with RIV, notionally the producer received seven-eighths (or other lease percentage) of the value of proceeds received after the deduction of appropriate costs. The assumption was made that interests were aligned because both parties made money. Additionally, the state benefitted by economies of scale under RIV. Under RIK the producers' scale would remain substantial whereas the state's scale on a relative basis would not be. He communicated that the state would not be on equal footing with producers; it would not be a working interest owner and would not be privy to working interest owner meetings, decisions, information, and other. There was also a question about where the state would take its gas in-kind. He believed the decision to go with RIK was workable, but he encouraged the state to take its interest in-kind as far downstream in the process as possible. He asked the state to consider separating in its mind why it would own an interest in the pipeline and the LNG facility from the decision to take its gas, own capacity, or have a party own and manage on the state's behalf. He believed that under the circumstance it was easy to see why the state would take an ownership interest in the pipeline, LNG, or any other facility in order to lower the cost of capital and accelerate the project development.

Mr. Harper believed it was impossible to anticipate all of the complexities that entering in the commercial business as a state would offer.

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Mr. Harper shared that it was unusual for producers to own a pipeline and the capacity. He communicated that the concept introduced a new set of dynamics. He relayed that unlike the oil industry, the natural gas industry was not vertically integrated; typically producers often subscribed for capacity in order to meet objectives, but they did not own, build, and control the capacity of a pipeline on a pro rata basis. He added that there was nothing wrong with the concept, but he wanted the state to understand that it was unusual. He found the state's potential participation under the scenario to be concerning (specifically related to the state engaging itself commercially).

Mr. Harper discussed that vertical integration raised the issue of control over current and future basins. He relayed that the topic most closely manifested with the determination of the rate design; if pricing was rolled in and a large producer stepped in with major volumes they were encouraged because all parties would have a pro rata share. He compared it to an interstate highway system where everyone paid equal tolls. He noted that there was a middle ground. He had seen amendments that were discussed in the Senate and in the House Resources Committee about going with incremental pricing, but as additional volumes came on, tariffs could be lowered initially until the looping stage; rolled in rates could be allowed and capped. He reiterated that he would be concerned about basin control and the larger producers.

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Mr. Harper believed the economic modeling conducted by Black and Veatch was excellent, but he did not believe it took in the full effect of the downside risk of the state's participation in the commercial marketplace. An old analysis suggested that a decrement to state's net present value (NPV) could be as much as 10 percent as a result of taking its share in-kind. The question of jurisdiction of the facilities would impact how they were managed and the degree of open access the pipeline would be. He believed it was generally presumed that the project would be regulated by the Federal Energy Regulatory Commission (FERC), but it did not have to be the case. He advised the committee to consider what fundamental tenets would govern capacity and

tariffs if the project was overseen by the state and was not FERC regulated.

Mr. Harper shifted the discussion to fiscal issues. He was more concerned about the state's fiscal stability than that of the producers. He relayed that from the producers' perspective fiscal stability was typically a code word for reducing taxes and royalties. He conceded that producers should look after their interest as vigorously as possible, which they did well. He stated under the given context there was really no such thing as fiscal stability. He referred to constitutional prohibitions about one legislature binding the hands of future legislatures. He advised the committee to use caution about bearing the pressure of fiscal stability in a large-scale project. He opined that based upon economics, the project would stand on its own without fiscal concessions towards the producers. He suspected the project would be done with or without the state's participation albeit not as quickly. He surmised that under those circumstances the state would probably not have an opportunity to impact design. He believed the Black and Veatch economics showed the project to be robust under a number of scenarios. He reiterated that his testimony acted as a gut check for members related to legislation and the legislature's interaction with the process going forward. He had a high regard for members of the administration. He urged the committee to think about the importance of continuity in government positions in relation to long-term projects.

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Representative Guttenberg referred to Mr. Harper's testimony that producers had a duty to market for the state at no cost. He asked Mr. Harper to elaborate. Mr. Harper replied that producers were not entitled to deduct a marketing fee in the calculation of royalties they paid the state for its share of production under the RIV system. He relayed that the requirement would vanish under RIK.

Representative Guttenberg wondered if the requirement was included in the lease agreements between producers and the state. Mr. Harper replied that the requirement was based on two things. He relayed that the producers' duty to market was an obligation under the lease. There was an implied duty that as a reasonably prudent operator that they receive the highest price reasonably attainable for the

state's share of production. Additionally, the producers were generally precluded from assessing any marketing fees to the state. The duty was part of a benefit of the bargain. He mentioned joint testimony that he and former colleague Spencer Hosey had discussed the producers' affirmative duties and obligations. He suggested locating the old testimony to give the committee a background to compare what the proposal may mean if it abandoned RIV.

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Representative Guttenberg asked when the testimony had been given to the legislature. Mr. Harper guessed it had been 2007 or 2008.

Representative Gara referred to basin control. He wondered what the state could do to ensure that independent parties could get as much explored gas into the pipeline as possible in order to increase employment, revenue, and oil and gas production.

Mr. Harper answered that the issue revolved around what diameter line to install initially and how compression worked against the design and maximum allowable operating pressures in the pipeline. He stated that there was a game to be played. A system should be designed in order to be expanded as much as possible with compression. He stated that those were the cheapest capacity increments on the line. There were also similar considerations related to LNG facilities design and expansion. The issue needed to be dealt with first and foremost before tariffing and rate treatment because its impact could be just as significant.

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Vice-Chair Neuman wondered if the state could use its portion of capacity in the pipeline to allow for expansion. Mr. Harper replied that he had heard the option discussed; however, he had never seen a scenario where the pipeline was "basically a condominium." He detailed that throughput control and ownership of the pipeline were separate in all agreements he had seen. He surmised it could be done, but it would take careful craftsmanship by the administration. He thought it would be difficult for a minority owner to achieve.

Vice-Chair Neuman believed there was related language in the Heads of Agreement (HOA) for the Trans Alaska belt and the incorporation of minority and majority partners. Mr. Harper agreed that the issue had been addressed, but deserved further thought.

Representative Gara highlighted that under the contract the state had the ability to initiate expansion; however, if the pipeline reached expansion capacity the state would be responsible for paying the full looping cost. He believed it was a problem if there was not a rolled-in rate sharing mechanism. He had been told that expansion by compression was cheap enough that a new party could come in and pay the full cost. He believed that for the size of the pipeline under discussion there was room for up to a possible billion cubic feet (bcf) expansion. He surmised that if expansion involved the construction of a new pipeline and costs were not shared, a new company would not have the opportunity to be involved. He remarked that the state could be a zero to 10 percent owner of the pipeline and a 25 percent owner of the gas.

Mr. Harper agreed. He elaborated that the construction of a new pipeline would be a very serious investment, which normally discouraged expansion unless a new and large scale resource was discovered. For more conventional exploration and production in addition to state reserves the parties would not be able to afford the cost of looping on their own.

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Representative Gara wondered whether under the current contract gas would get to the pipeline if expansion required the construction of a new pipe and the state had the ability to bring on another partner in its share.

Mr. Harper replied that he was unsure. He believed the concern was serious. He detailed that incremental pricing was generally favored in the Lower 48, but FERC had identified Alaska as different in the past. He elaborated that Alaska was different because projects involved greenfield pipelines and unknown reserves to support the pipeline outside of Prudhoe Bay, Point Thomson, and satellite fields. He expressed concern about anything but rolled-in pricing or a lid on incremental pricing. He stated that the issues did not necessarily apply to

offtakes and other. The idea of bearing the full financial responsibility for the addition of new pipeline could be discouraging and inhibiting. He added that natural gas in Alaska was a special situation; the issues were not present in Texas, Louisiana, Wyoming, and other.

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Representative Costello pointed to the HOA and the Memorandum of Understanding (MOU). She remarked on the importance of momentum when dealing with the MOU. Additionally, it would cost the state financially if it put on the brakes. She wondered if the state would gain something by slowing down and researching the issue further.

Mr. Harper did not believe the state needed to slow down because the issues had been identified. The question was whether the legislature wanted to force the issue. He detailed that current pressures associated with the project were minor compared to pressures the legislature would face in future years. He equated the HOA and MOU to "agreements to agree" and noted that they were not binding contracts. He did not put confidence in any potential assurances from the industry to trust that the issues would be dealt with during negotiations. He stated that the producers were some of the finest in the world and were looking out for their own interests. He feared that the legislature's ability to provide advice would be very limited in one to two years without resolving what the state really wanted in terms of level of complexity and whether it wanted expansion of government and government involvement in free enterprise for years to come.

Representative Costello understood there would be future points when the legislature would address the project including at the pre-FEED [Front End Engineering and Design] and FEED [Front End Engineering and Design] stages. She asked about the different options the state had with TransCanada. She wondered when the deal would be finalized.

Mr. Harper answered that he was not the best source on steps associated with the project. He spoke to strengthening the state's involvement and ability to provide real input at meaningful points in time.

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Vice-Chair Neuman wondered if there was sufficient engineering data to prepare an economic feasibility study. He noted that there had been substantial work done with instate gaslines (e.g. the Stranded Gas Act, AGIA, and other). He remarked that substantial money had been invested by multiple parties. He was interested in the timeline.

Mr. Harper replied that it was difficult to answer the question without more specific information. He imagined that based on extensive former studies it would not take much more to put design parameters in place. He added that there was no new technology involved. He was certain that issues related to right-of-way and the location of environmentally sensitive areas were known because of prior work by the state, producers, and contractors.

Vice-Chair Neuman pointed to the testimony related to a concern about basin control. He noted the HOA included a timeline commitment from TransCanada Alaska Development Corporation on the signing of the bill. He wondered if the state should have other commitments. He asked if the contract language was standard.

Mr. Harper replied that he did not have comments or concerns to offer in relation to the instate offshoot of the larger project.

Vice-Chair Neuman believed it had been a concern. He spoke to a time value of money. He addressed the concern about the substantial money the state would put in and when producers would actually produce the product.

Mr. Harper agreed with the concern. He believed it was associated with RIV versus RIK. He shared that the producers would control ownership in the pipeline and the majority of its capacity, but they would also control decisions about when and how much gas to produce, which impacted the basin control issue and the state's share of gas. The state needed to recognize the items as a risk factor.

Vice-Chair Neuman pointed to Mr. Harper's concerns related to rolled-in rates or future expansion. He believed it would be a great thing if the volume of gas for sale required a new pipeline. Mr. Harper referred to the

scenario as a "high class problem." Vice-Chair Neuman believed it would be a good problem to have. Mr. Harper believed the state would have it.

Representative Guttenberg surmised that generally a pipeline was built at the minimum level so capacity could be extended up. He wondered if the facilities on either end were built to the same capacity. He wondered when the construction of new LNG or gas treatment plants became economical.

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Mr. Harper referred to prior discussion on the importance of design parameters. He stated that it was not unusual to oversize a pipeline in a greenfield situation; examples given included the Rockies Express Pipeline, Kern River, and other. There was a limit to how much could be done economically and under FERC rules, but it was highly desirable to create as much capacity as possible at the start.

Representative Guttenberg wondered how the state would influence the outcome without FERC in the equation. Mr. Harper answered that the state would influence the outcome through negotiations.

Representative Guttenberg asked for confirmation that the state could influence the outcome as a 25 percent partner via negotiations. Mr. Harper responded affirmatively. He spoke to the state's desired outcome and noted that its interests would diverge from other parties.

Representative Gara pointed to page 5 of the report related to risks associated with the state paying for the shipment and sale of its gas. He referenced a study mentioned by Mr. Harper citing that the arrangement could reduce the state's NPV in excess of 10 percent. He wanted to be able to vote for the plan, but wanted there to be a better balance of risk and reward. As a taxing authority with the oil pipeline the state did not have to worry about owing great liability because it received taxes based on the amount of oil shipped. However, if the state had to sell the gas and it had no control of gas coming down the pipeline, it still had to pay TransCanada for shipping capacity. He wondered whether it was feasible to develop an agreement that

producers would be liable to pay the shipping capacity fee if there was not sufficient gas in the pipeline.

Mr. Harper agreed that the risk should be addressed upfront. He classified it as a real risk.

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Vice-Chair Neuman discussed RIK versus RIV and the associated risks. Under RIK the state faced risk associated with the cost of product at the wellhead, transportation, and preparation for market; however, the chance to make more on the market helped offset those risks. He spoke to the legislature's work to determine where to set the rate timelines. He observed that if risks were not taken there would be no reward. Under RIV the state would receive value at the wellhead alone.

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Mr. Harper agreed. He disputed the premise offered to the legislature that RIK was a benefit to the state. He believed the move to RIK represented a concession on behalf of the state. He believed it was conceivable that the state could be better off with RIK, but it created a downside risk that it did not currently have. He did not believe the risk/reward balance was symmetrical. He remarked that there were other elements to include in the balance as well.

Vice-Chair Neuman asked if risks under RIK would be diminished due to the large gas volume and pipeline.

Mr. Harper replied that the volume was large, but in terms of competing in the marketplace, the volume was small. He stated that sole sourcing and the commitments required for the state to ship gas to the Pacific Rim on its own meant that deliveries had to be guaranteed. Buyers would not accept a contract that did not guarantee delivery. He relayed that ExxonMobil and BP had their own LNG in addition to established trading operations. The producers' risk profile was much different than that of the state. He pointed to potential delays due to a lost tanker or a field shutdown. He was concerned about the idea of the state sole sourcing a relatively small volume into a very sophisticated large market. However, there were people who believed the risk could be managed.

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Representative Wilson asked about risks the state would face if the project was not initiated. She spoke to the lack of affordable energy in Fairbanks and rural areas. She pointed to the refineries' current dependence on diesel. Mr. Harper replied that he supported her concern, but going with RIV or RIK did not change the metrics; the same volume of gas would move. He believed the project was robust and compelling as designed. His concerns related to the internal workings of the ownership structure. He opined that the project would be done and that instate service would be a part of it.

Vice-Chair Neuman asked whether RIK versus RIV was currently Mr. Harper's primary concern. Mr. Harper replied in the affirmative. He added that he would have concerns if the state was doing business with second or third-tier subsidiaries of one of the big producers. He cautioned the state to be careful who it agreed with and whether or not the parent company of the entity was backstopping the obligations. He stated that there were no guarantees in business, there were guarantors.

Vice-Chair Neuman remarked that ensuring that the state had good contracts would address the concerns. He commented that ExxonMobil had to amortize its investment of the billions of dollars it had put into Point Thomson. He stated that the only way for the company to amortize its investment was with a pipeline. He suspected a pipeline would be built with or without the state's involvement.

Mr. Harper believed the metrics were radically different than they had been ten years earlier. Producers had urgencies that resulted from Point Thomson development as well as the change in the gas/oil ratio. Producers also had the need to book and monetize the asset. He stated that the world was moving to natural gas, which he believed was a major part of the corporate initiative for a company like ExxonMobil. He had not thought the same thing ten years earlier. He believed the companies had reasons to be and were serious now.

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Representative Gara referred to the requirement that the state would pay TransCanada for shipping capacity even if

there was no gas in the pipeline. He wondered if the potential was a real risk to the state. Mr. Harper replied that it was a serious concern. For example, he had worked as an advisor to Sunrise Energy Corporation, a company that had gone bankrupt over a single firm transportation agreement. He referred to the argument that there were trillions of cubic feet of gas at Point Thomson and Prudhoe Bay. He stated that it was fine if the state could get comfortable that the producers would be motivated to produce gas at the maximum rate allowable and would not use the fields as storage or as a buffer to other producing fields. However, it had and could happen catastrophically.

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Vice-Chair Neuman pointed to concern on RIK versus RIV. He asked for the opinion of the consultants. He discussed measuring risk for RIK beginning at the wellhead through to market; however, there was the availability to get a profit on the end. He compared it to RIV that offered value at the wellhead.

JANAK MAYER, PARTNER, ENALYTICA, began by differentiating between questions of transactional risk around when and where an entity took custody or title of gas, how ownership was transferred, and transportation obligations. He disputed the idea that under RIK an entity was more exposed to things like price and cost risk, but the risks were taken in the hopes of a higher reward. He stated that the idea was appealing and intuitive; it had been his immediate intuition. He had questioned whether the state wanted to take on risks associated with price, cost, and construction that went along with RIK and equity. He determined his intuition had been wrong after developing models and looking at changes caused by price fluctuation and different construction costs and timing. He provided a disclaimer that he separated questions of price and cost risk from the specific workings of transaction details. He believed one of the strongest reasons for taking RIK and project equity was that risk was actually mitigated. He noted that enalytica had used different models, but had come up with very similar results to Black and Veatch. He detailed that there was less upside and less downside with

RIK. He referred to his past testimony on where value resided in dollar per barrel equivalent terms. He discussed scenario that included \$100 per barrel of oil, which translated into \$80 per barrel for LNG in Asia and transportation costs of \$60 to \$70 per barrel. He referred to the small amount of value once the fixed amount was taken out. The fundamental difference between RIV versus RIK with equity participation was that RIV guaranteed the \$60 to \$70 transportation cost. Unless there was no value left at the wellhead RIV served to guarantee the shipping amount so that when prices rose and fell the return was always steady; what varied was what the state would receive. One of the biggest reasons to consider RIK and equity was that everyone would rise and fall together; when prices were high returns were not as high they would be under RIV, but returns were better when prices were low. He referred to a model that illustrated his point quantitatively.

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NIKOS TSAFOS, PARTNER, ENALYTICA, believed the big question was whether there was a project could be accomplished with RIV and if the state's role was limited to a taxing and regulating authority. He spoke to the importance of the question. Under RIV the state would deduct costs from the final sales price to come up with a taxable barrel of LNG. He discussed the history of oil and the litigation associated with a Trans-Alaska Pipeline System (TAPS) tariff of \$5 to \$6. He questioned how much disagreement would occur with a tariff of \$60. He presumed that the disagreement could occur enough that in anticipation of such disputes, the state did not want to make the investment until it had reassurance that it was not starting another 30 to 40 year legal battle between it and producers. The crucial question was to completely understand what was being compared. For purposes of illustration enalytica had run RIK and RIV projects to demonstrate the different economics. The broader question went back to whether there was an RIV project.

Vice-Chair Neuman asked the presenters to avoid using acronyms.

Mr. Tsafos agreed. He continued to address RIK versus RIV. He questioned whether producers would be willing to make an investment under RIV based on items he had outlined. Under

an RIV scenario, he put the probability of producers making an investment in the project at a fairly low number.

DEEPA PODUVAL, PRINCIPAL CONSULTANT, BLACK AND VEATCH, agreed with Mr. Mayer and Mr. Tsafos. She added that in a Black and Veatch royalty study one of the significant risks was RIK. The study had concluded that there would be a risk of eroding significant value for the state with RIK. She detailed that the largest component of the risk related to the state's ability to compete with producers in the global LNG market. She believed the current HOA helped to reduce the risk; it included the offer of the producers to negotiate and market the state's share of LNG. She opined that for the state to have the option of writing the producers' contract brought the advantage of RIV into the RIK world. Therefore, the state would not lose value by taking a lower price contract than what the producers were able to achieve in the market.

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Mr. Mayer added that when thinking about tariff disputes it was important to consider that the liquefaction terminal would likely be regulated under FERC Section 3 (regulation of permitting, but not of the tariff). He reasoned that there was a possibility that the pipeline would also be regulated under the section, which meant the project could become a \$50 billion project with no direct regulatory oversight over the tariff or debt to equity ratio. He elaborated that there was an enormous possibility of shifting costs to create the highest tariff possible (on the liquefaction end and potentially the entire project). There was enormous incentive to do it. One of the most appealing aspects of the RIK with equity was that it took all of those potential issues off the table.

Representative Wilson wondered about the weaknesses and strengths in partnering with TransCanada versus a company that was used to shipping and other issues. She was concerned about the state's 25 percent [equity ownership] and whether TransCanada would be the strongest player at the table. She understood that TransCanada was not going to sell the state's gas. She shared that she would feel differently if the state was partnered with a company like BP that knew how to get the most return for its LNG sales. She acknowledged the benefit of the state's partnership with a company that knew how to build a pipeline, but she

was concerned about being in a position to trust competitors to sell the state's gas at their price or better.

Mr. Tsafos replied that it was important to understand that TransCanada was irrelevant in terms of how the state would sell its gas. He detailed that under the current structure TransCanada would be an owner in some of the infrastructure and would be paid a tariff for providing a service for processing and shipping gas. The typical structure was that the pipeline company would not own the gas; the state would own the gas. He pointed out that the concern about how the state would market its gas had been identified by Black and Veatch as well. He made several observations related to the issue. First, he appreciated that trying to sell the state's gas in the global market may seem daunting. He shared that he had worked with a number of companies that started from the same position; the companies had decided to learn how to sell the gas. He had observed that it did not take much to develop the expertise to sell LNG in the global market. He spoke about marketing teams of former clients that had consisted of seven to ten people. He believed learning how to market gas was different than learning how to build a liquefaction facility or a pipeline. He relayed that marketing LNG was not as complicated as it seemed upfront. He believed the cost of developing a sophisticated marketing operation was not that high. His opinion was based on experience with a number of players that had no former marketing experience. There were two ways to market the gas; one way was to sell it to someone, another way was to pay someone to sell it on the state's behalf. The HOA contemplated both of the options; it had not been determined what the state would choose. He detailed that the state could choose both options for its gas.

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Mr. Tsafos continued to answer. He expounded that paying someone to sell gas on another party's behalf was not a typical model because there was not significant upside. The large producers made money by selling gas, but not by selling another party's gas. However, the option helped the state to understand what the costs were. The state's other option was to sell its gas. He detailed that selling gas would involve the state issuing a request for proposal to Asian buyers to determine how much they were willing to pay

for the LNG. He observed that if the state directly worked with Asian markets for six to nine months on selling its LNG it would gain a good idea about what it could sell gas for. He relayed that the state's challenge was not associated with competing against its partners, but with other locations with much higher volumes of gas. He reiterated his expectation that it would not take the state long to determine what constituted a fair deal for its gas; the number of people the state would need to hire to make the determination was low. He stipulated that it was no guarantee that the state would not regret the deal it signed later; it was always possible to get the market wrong. For example, parties that signed deals in the Lower 48 with the expectation that gas would be imported regretted the decision; however, they had signed deals that were at the market at the time. He understood that the task may seem daunting, but the challenge may not be as large or insurmountable as it may seem at present.

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Representative Gara remarked that analytica was consulting for the governor's office. He expressed concern that the bill presumed the state would be able to tax the gas and that RIV would be the methodology used unless the commissioner found it was in the state's best interest to go with RIK. He believed that based on testimony in the meeting it sounded like the decision to go with RIK had been made.

Mr. Mayer clarified that analytica worked for the Legislative Budget and Audit Committee and not the administration. He stated that the HOA posited a vision, future, and project structure that would use royalty and tax in kind, but only if it was in the state's best interest. The focus on RIK with an equity share was an endpoint that was envisioned, but not predetermined. Additionally, much of the debate had been about whether RIK could or would be desirable for the state. Ultimately, if the state could not come to an agreement on RIK it would need to change direction, which would probably require much of the project structure to be reconsidered. He stressed that the state was not committed to RIK, its commitment was to pursue the route to determine if it was possible to overcome the issues.

Ms. Poduval added that the HOA specified that the election to take RIK would be subject to arriving at satisfactory arrangements for the disposition of the state's LNG. She explained that the language did not contemplate that RIK was a done deal. She did not believe the best interest findings had been presupposed in any way. Discussions related to the state taking equity participation in the project were separate from the decision to take RIK or RIV.

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Representative Gara apologized for his misstatement about the testifiers' representation. He referred to enalytica's testimony that under RIV the downside risk was not as great. He spoke to risks the state would take on if it sold the gas itself. First, the state had no control over production on the North Slope and how much gas it would receive. Second, the state would owe TransCanada for shipping gas even when gas was not shipped. He thought the risks were substantial. He observed that under RIV the risks did not exist. He wondered why he should take the risks so lightly.

Mr. Tsafos relayed that the conditions and possible compensations of the failure to deliver gas would be negotiated in the agreements in the next couple of years. He stated that technically speaking only the operator had control over production, which could affect all parties involved. He could not think of a scenario where producing gas would go against any of the parties' interest. He stated that the producers could compensate and meet the obligation to deliver gas to Japan with other supply sources, but it would be a poor economic decision. He elaborated that each party would invest significant capital and revenues would be made by selling gas. He added there would be a commitment to sell the gas for 15 or 20 years prior to the start of the project. It was possible that accidents or outages may occur resulting in less or no production; the state would not be the only one that would have a claim or complaint against the operator. He stated that the issues would be settled contractually. He believed the idea that there was any economic incentive to not produce gas ignored the fundamental goal of LNG investments.

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Vice-Chair Neuman surmised that if an entity had \$45 billion in debt it would have incentive to sell as much gas as quickly as possible. Mr. Tsafos agreed.

Representative Gara believed the assumption was missing a component. He noted that the state did not know about the goals of producers. He surmised that producers may find that during a given period they could make more money by using their gas to produce oil instead of shipping it. He discussed a scenario where TransCanada agreed to produce less gas because the price of oil had spiked. He wondered if the risk was valid.

Ms. Poduval replied that it was not a coincidence that LNG projects worldwide operated at over 90 percent utilization. She stressed that the economics did not make sense once billions had been spent to not run a project at full capacity. She noted there was always the possibility for unplanned outages. She reasoned that using Prudhoe Bay as a storage field would be an extremely expensive storage field at \$45 billion to \$50 billion. She summarized that every party would have incentives lined up to maximize natural gas production from the slope and to run the project at its highest utilization.

Mr. Mayer added that parties would also have 15 to 20 year take-or-pay commitments to customers in Asia; if the commitments could not be met through the project, the parties would be required to locate the gas elsewhere, which would involve a significant financial penalty in many cases. Additionally, in most instances parties would have significant debt obligations that were guaranteed directly from the project's cash flows or by the parent entity. Parties would also have to justify the reason for letting a \$50 billion project sit idle without earning the return promised to their boards. He could not imagine any incentive to not maximize gas production. He acknowledged that there could be situations where production could be interrupted that created a range of risks the state would need to manage. He agreed that the difficulty, onus, and complexity of managing the risks was higher in an RIK world than in a pure taxing regulating authority world. The risks were the reason for the host of agreements to be negotiated in upcoming year including the balance of offtake from the fields and how the agreements compared with obligations on the sale of the state's LNG. He noted that there were many pieces to understand and stated that the "devil was in the

details." For instance, under what circumstances the state would be obligated to sell LNG to counterparties in Asia and what its obligation would be if it could not provide the gas. He spoke to understanding what constituted "force majeure" events, when the obligation to provide LNG was no longer in place, and how it matched against the state's contractual assurances with producers that it would have the gas. He stated that the ability to balance and manage the items was not unprecedented; there were any number of global projects where the project owner did not directly control or own the upstream, but the projects had to be carefully negotiated and thought through. He agreed that Representative Gara was right to be concerned.

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Mr. Tsafos expounded that if there was an outage, the producers would not earn money on their capacity, but the state would have a tariff that it could be required to pay even without production. He pointed to the difference between a TransCanada versus a no-TransCanada scenario for the state. He stated that it was no different economically than taking on debt. He compared the situation to an owner's requirement to pay the mortgage on a building whether or not it was rented. The economic downside risk to the state of being on the hook for a commitment even when gas was not flowing through the pipeline. He explained that with no TransCanada the state would owe debt to the bank. He pointed out that the scenarios were not too dissimilar.

Representative Munoz referred to testimony by Mr. Harper that moving to RIK would be a concession to producers. She asked for a comment.

Ms. Poduval did not agree that going to RIK was a concession to producers. She referred to advantages to RIK including price protection during low price circumstances where the state actually fared better with RIK. She noted that going to RIK with equity participation was the package that increased the commercial attractiveness of the project for the producers. From the perspective of commercial attractiveness the question was not necessarily between RIK and RIV, but between the possibility of having or not having a project for the state to participate in. She discussed preservation of value to the state and incentives the state could offer to producers in a way that would transfer value back to the state as opposed to a fiscal

concession that reduced the royalty or tax percentage. Additionally, she addressed at what point the value of the state's equity participation and gas share would equal the value it would have received from a theoretical project under RIV without equity participation.

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Representative Munoz expressed concern about the idea that going with RIK could be a risk to the state and the project NPV. Ms. Poduval answered that if anything, the risk to the state would come from making upfront investments alongside the producers. She agreed that the state could risk losing up to \$400 million of investment if the project did not reach an affirmative final investment decision (FID). In a success-case scenario at FID the state would have sold the LNG, locked in the project debt, determined cash flows, and the NPV would be significantly positive. She believed the real risk to the state would be prior to the FID to the extent that the state was a partner in the project through the pre-FEED and FEED stages.

Vice-Chair Neuman asked for comment on the capitalization structure. He wondered about the costs for gas treatment, pipelines, transportation. He referred to the 70 percent/30 percent (70/30) debt equity structure during the development and construction stages. He asked why structure would be changed to 75/25 two years after the initial startup date through the term of the transportation agreements. He wondered why the numbers optimal.

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Ms. Poduval relayed that during AGIA, TransCanada had proposed and accepted a 70/30 debt equity structure. She detailed that higher debt was better for the project shipper because debt was less expensive than equity, which meant the state's rate was lower.

Vice-Chair Neuman asked Ms. Poduval to elaborate.

Ms. Poduval explained that under the state's deal with TransCanada the cost of debt was 5 percent whereas the return on equity was 12 percent; therefore, the state was paying more for the equity portion of TransCanada's capitalization structure than for the debt. She summarized that the higher the debt in the structure, the cheaper the

cost of the transportation capacity would be for the state. She elaborated that moving to a 75/25 debt to equity structure two years after the project begins was a concession the state had achieved during negotiations. She relayed that a 70/30 capitalization structure was not unusual for LNG projects. She noted that the topic was covered in the royalty study that benchmarked a number of global LNG projects. She explained that 70/30 was the most aggressive debt heavy structure. Several of the other projects the study included had 60/40 or 50/50 structures, which made projects more expensive. She added that a couple of projects had been financed completely with equity off of the sponsors' balance sheets. She provided the Gorgon LNG project as an example. She summarized that a 70/30 structure was in the "fairway" of what a prudent or attractive capitalization structure would be for LNG projects.

Mr. Mayer referred to previous debt-to-equity information they had presented that included an analysis of FERC data for U.S. pipeline companies. He relayed that there tended to be a ceiling around the 60/40 ratio, which was typically a common ratio for pipelines. He stated that a 70/30 ratio was aggressive and 75/35 was even more aggressive. The consultants believed that the overall rate structure with TransCanada was attractive. He added the stipulation that certain items could change (e.g. a potential change in rate tracker and the actual debt and equity costs) before FID. He concluded that the 75/25 debt-to-equity structure was attractive.

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Vice-Chair Neuman remarked that TransCanada had committed approximately \$6 billion at 5 percent debt with risers. He asked if the 70 percent debt benefited the state.

Ms. Poduval requested clarification.

Vice-Chair Neuman noted that there was 70 percent debt during the development/construction phase. He referenced that TransCanada would construct the pipeline and gas treatment facility for about \$6 billion at 5 percent debt with risers. He wondered if the benefit to the state would increase if the debt was 75 percent.

Ms. Poduval replied that 75 percent debt was optimal; the more debt the better, from the state's perspective. She stated that the 75/25 ratio throughout the life of the project was even more attractive than the 70/30 ratio during the construction phase.

Vice-Chair Neuman assumed that the reason lay behind TransCanada's commitment to a 5 percent interest rate on \$6 billion. Ms. Poduval responded in the affirmative, but noted it was subject to trackers.

Representative Guttenberg discussed the RIK and RIV. He recalled that the modeling displayed that RIV was a better deal for the state but that the commissioner would make the final decision. He wondered what would tip the scale the other direction.

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Mr. Mayer replied that the scale would be tipped to RIK if existing hurdles could be overcome. He detailed that it was necessary to know the LNG sale terms, understanding the nature of offtake and balancing agreements, the state's gas share and how it may change over time, and what potential events of production interruption meant. He elaborated that it would be necessary to take a look at the change to understand the different obligations and how they were connected.

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Representative Guttenberg surmised that more would be known about RIK versus RIV in one to two years when terms, conditions, and contracts had been put in place.

Mr. Tsafos replied that the key variable to the attractiveness of RIK related to how well the gas had been sold. He noted that in the next 1.5 years there may be a range of finality on terms; the state may have preliminary agreements to sell gas and other more final agreements. He did not think the state would have nailed the whole issue down in the next 1.5 years; the process began with an MOU and HOA and turned into final contracts. He added a comment on the broader discussion of RIK versus RIV. He stated that whether RIK or RIV was more favorable to the state depended on the cost and price. He underscored that there was not a scenario where RIK or RIV was always better. He pointed to

the importance of understanding that there were tradeoffs with both RIK and RIV; depending on the market, one or the other could yield more money for the state.

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Representative Guttenberg stated that at some point the state would need to balance the risk. He surmised that in 15 months when parties came back to the legislature there would continue to be tradeoffs under each scenario. He hoped the range would be narrowed with a better understanding of the world market and interest. He noted that the state would not have the ability to make changes after that point. He wondered about the chances that the project would do what the state wanted it to do.

Ms. Poduval looked at RIK and RIV separately from equity participation. She theorized that if in 1.5 years the state had negotiated an agreement that producers would sell the state's share of LNG at the same price as their own, it would give the state comfort that using RIK would not be worse than RIV.

Representative Guttenberg wondered when the state should have concern that an agreement did not look as favorable for the state as possible. He wondered what warning signs to look out for.

Ms. Poduval replied that an agreement for the producers to sell the state's gas with significant costs would be a red flag that the state may receive less under an RIK scenario. Additionally, it would be unclear whether RIK or RIV was better for the state if the producers purchased the state's LNG outright rather than selling it along with their own LNG to the market; the state would not have visibility on the price the producers received for their own oil. Offtake and in-balance agreements could go either way and involved volume related risks the state would take with RIK that it may or may not manage directly with RIV. She advised that risk of volume imbalances or interrupted gas flow was shared equitably with producers or that producers had mitigated the state's risks associated with the items.

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Mr. Tsafos recommended paying close attention to who agreements were with if the state was marketing its own

gas. He stated that it was always possible to find someone to sell gas to, but it did not mean it would be in the state's best interest. He explained that the state would make decisions based on the credit-worthiness of its counter parties. He advised that there were a range of customers from good to bad. He would be concerned that the market was not being receptive to Alaskan gas if all willing buyers were inexperienced without strong balance sheets.

Vice-Chair Neuman wondered what the consultants' studies showed as the minimum gas market price that would cover the state's costs.

Mr. Mayer answered that enalytica had conducted a number of stress case analyses. He emphasized that all figures were preliminary. One scenario combined a substantial increase in the project's capital cost, an 80 percent pipeline utilization rate, and a price of gas of \$7 per mmbtu. Under the "almost perfect storm" of negative outcomes it did not reach a point where the state was actually losing money on an annual basis although the project would generate a fairly poor return. Once FID had been reached, the fundamental risk was that the project may or may not achieve returns the state had hoped for. He stated that a key part of considering RIK versus RIV was looking to see whether the economics looked more attractive to the state than to producers. He explained that the producers lost money in a low price scenario much faster than the state because the state was a commercial participant in the project in addition to a sovereign that took corporate income and property tax from the companies (companies were also subject to federal income tax whereas the state was not). He detailed that the relative fall in value was a much shallower slope for the state than for producers. He drew comfort from the state entering into the project with three experienced and capable companies who went into the project with eyes wide open and facing greater risks associated with price downside than the state.

Vice-Chair Neuman wondered about the breakeven price that would make a \$50 billion pipeline project economically viable.

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Mr. Mayer deferred the question to Black and Veatch.

Vice-Chair Neuman referred to charts showing \$4 billion profit on \$17 per mmbtu gas. Ms. Poduval shared that Black and Veatch had run a stress case for the House Resources Committee. She deferred to her colleague for the numbers. She stated that under the worst case scenario as outlined by Mr. Mayer, the state's cash flows and NPV remained positive given the state's receipt of property tax and other non-price sensitive sources of revenue from the project. Prices would need to be less than \$7 per mmbtu in order for the state's cash flow reach zero or below.

Vice-Chair Neuman asked for verification that Ms. Poduval was referring to \$7 [per mmbtu] to the Asian market. Ms. Poduval replied in the affirmative.

Co-Chair Austerman referred to earlier discussion about facility expansion and the cost of service. He asked for detail on the difference between roll-in versus incremental rates.

Mr. Mayer answered that future expansions and their economics would hinge on the initial design capacity of the system, the diameter of the pipeline, and how easy or difficult it was to expand it through additional compression. He believed the issue was the most important item the state should be concerned about pertaining to potential bottlenecked facilities or additional use for instate gas. He believed the issue made direct state involvement in the project important because it was not necessarily clear that the state interest was perfectly aligned with the producers by themselves. He detailed that the producers had a fairly well known and defined asset and some took on additional exploration more than others, which could lead to the discovery of additional gas. He could envision a case where the primary incentive for producers would be to have a well-defined capacity for the initial project, to keep the costs at a minimum, and to know it would make the desired return. Alternately, he could envision a scenario where the state's interest was broader than the previous case. Where it was in the state's best interest to spend extra money on a larger diameter pipeline with lower initial pressure and greater future expansion capability. He stated that how the costs and benefits would play out was not currently known. He believed there were costs and benefits to using TransCanada as a partner, but in the present case he believed its involvement would offer

a significant benefit. He elaborated that the benefit would come from having a pro-expansion minded party at the table when court decisions were made around engineering, pipeline size, and the costs of future expansions. He stated that the items would have a much bigger impact on the expandability of the pipeline than the question between rolled-in versus incremental rates. He relayed that under a rolled-in rates scenario if the total per unit capital cost of the pipeline was increased through an expansion the additional cost was borne by everyone, whereas on an incremental basis the additional cost was borne by the expansion participants only. He discussed the importance of understanding that for the initial participants, gas would be sold under 15 to 20-year contracts to parties in Asia with very little ability to change the terms once they were set. He reasoned that the prospect of a substantial increase in a tariff when the increase could not be passed on to an end-consumer, would be a substantial risk. He elaborated that there would be numerous circumstances where it would be against the best interest of the state and producers to have additional pipe laid in response to a small discovery of gas.

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Mr. Mayer relayed that when it came to expansions beyond compression there would be overwhelming hurdles unless they were for a large new discovery with export potential regardless of rolled-in versus incremental rates. He believed it was fundamental to establish that the state's interest was well represented in the initial design capacity decisions on the pipe size and other design considerations related to expandability.

Co-Chair Austerman surmised that it may benefit the state and TransCanada in the long-term if the expansion was done early on rather than doing it afterwards. He assumed there would be a cost savings in the strategy.

Mr. Mayer replied that there were a multitude of variables to consider when contemplating future expansion. He relayed that it could be in the state's interest to spend more on the pipe to ensure the possibility of solid expandability through compression before adding additional pipe.

Ms. Poduval expounded that it was important to have all of the facilities designed in a way that would facilitate expansion.

Vice-Chair Neuman opined that \$7 gas used in the consultants' stress case seemed phenomenally low. He believed there was a specific type of gas used in Asian markets, which was the reason for a 2,500-plus psi line. He asked what the value of gas had to be to ship, go through liquefaction, and other.

Ms. Poduval answered that for the state's portion of the project the total was just under \$8.

Vice-Chair Neuman asked if the figure included wellhead to market.

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Ms. Poduval replied that the figure did not account for shipping; with shipping it would be \$9.

Vice-Chair Neuman asked whether the figure was based on \$2 or \$3 gas. Ms. Poduval replied in the negative. She detailed that the cost did not assume a gas cost; the figure included the cost to move the gas through the infrastructure.

Vice-Chair Neuman referred to a question by Co-Chair Austerman related to expansion. He wondered about the design of the pipeline related to size. He wondered what the design decisions were based on. He remarked on the relative inaccessibility of 48-inch pipe compared to 42-inch pipe.

Mr. Mayer replied that they could not speak to the issue in detailed terms. He relayed that a smaller pipeline with high compression could have a lower initial capital cost in some circumstances. At some point with larger pipe it became difficult to source the material. He discussed his understanding that the proposed project envisioned a 42 inch line. One of the benefits of state involvement ensured that a broader range of options were evaluated in addition to how the state's interest in future expansion may compare to the producers' interest.

Ms. Poduval noted that the details had not been worked out. The initial concept selection had designated a range for the pipeline's diameter. She believed the size would be resolved through pre-FEED.

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Representative Guttenberg surmised that there were different ownership components between the gas treatment plant, the pipeline, and the LNG plant. He believed every time there was a seam it presented vulnerability to exposure on additional cost. He wondered how normal it was for a project to have the various ownership structures.

Ms. Poduval answered that she did not believe the project was sliced up in the way mentioned. She explained that it was envisioned to be an integrated project; therefore the same project team would work its way through the gas treatment plant, the pipeline, and the LNG plant. She discussed that it made sense from a management perspective for a large project to have an integrated structure in order to keep the various project components in sync. She addressed that TransCanada would hold a portion of the state's share in the gas treatment plant and the pipeline; any uncertainty related to the issue would be resolved in the enabling contracts between TransCanada and the state. She elaborated that the transportation services agreement would guarantee the state passage through the pipeline and gas treatment plant. Under the current proposal the LNG plant would be held by AGDC; the state would have a liquefaction services agreement for the LNG plant. She did not believe the structure created seams; it created commercial agreements that would define how the state's share of the gas would move through the project.

Mr. Tsafos added that the structure was highly integrated with the exception of the TransCanada portion. He elaborated that worldwide, LNG projects had many different models. He detailed that some resource owners had no ownership of the infrastructure, in other circumstances all of the pipelines were owned by the state and export facilities were owned by private companies. Additionally, there were projects where the components were integrated. Usually the resource drove how the project was structured; it was easier to use integration when there was a large-scale resource with a fairly similar player ownership. He explained that if the gas was owned across 15 different

fields with 10 owners, an integrated structure would probably not be used.

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Vice-Chair Neuman pointed to the various presentations. He advised members to take advantage of the consultants. He asked Mr. Harper to provide any closing comments. He referred to discussions on RIK, RIV, and the cost of deliverable gas to the Asian market.

Mr. Harper agreed with some of what was said by the consultants. He agreed that the initial design parameters (i.e. pipeline diameter) would have a significant impact on future access to other players and initial costs. He believed there may be incentive for producers to downsize the project as negotiations moved forward because it would result in a lower initial cost. He had heard some conflicting statements about RIK. He disputed earlier remarks that learning to market LNG was not a difficult task. He stated that it was not just a matter of finding a buyer. He detailed that under RIV the state would not take on the purchaser's credit or shipping contract risks. Additionally, the state would not take the risk that its source of production may decline. He pointed to a recent trial that had resulted in a judgment in excess of \$400 million as a result of Prudhoe Bay going down for an extended period of time. He believed there had been a remark that RIK could be potentially viewed as a concession. He believed that if the state received other counterbalances a concession would be fine. He relayed that RIK rights were present in virtually every lease in North America. He stressed that it had never been availed to any degree by a lessor. He pointed to the federal Minerals Management Services that had come close to using RIK, but after taking a close look it decided against it. He stated that RIK was typically not used. He agreed that it could be done and could be used as a concession or tradeoff to advance the project. He agreed completely with the discussion on rolled-in versus incremental rates and variances associated with capital structure.

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Representative Gara asked for verification that Mr. Harper had been citing a state consultant's data when he testified that taking RIK could result in a 10 percent loss to NPV.

Mr. Harper agreed. He relayed that the study had been conducted by the Lukens Energy Group (Black and Veatch had acquired Lukens). He suggested contacting Ken Alper [legislative aide] for a copy of the study.

Representative Gara addressed issues that had been discussed during the meeting including who would sell the state's gas, would the state get a good deal for its gas, what would happen if the state did not get the gas but was liable for shipping cost to TransCanada, and issues on expansion. He remarked that the response had been that each item would be determined in negotiations. He wondered if the state should address as many of the items as possible in the legislation. He believed that when negotiations were complete the state would be told to take the deal or leave it.

Mr. Harper replied that it would be better to address the items sooner rather than later. He believed that in 18 months or so the state would be dealing with a "fait accompli." He did not believe the process was ill intentioned, but that the negotiations would have been down a long road with many tradeoffs. He stressed that all decisions were made on incremental costs in the oil and gas business.

ADJOURNMENT

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The meeting was adjourned at 3:46 p.m.