

**ALASKA STATE LEGISLATURE**  
**HOUSE LABOR AND COMMERCE STANDING COMMITTEE**

February 19, 2014

3:34 p.m.

**MEMBERS PRESENT**

Representative Kurt Olson, Chair  
Representative Lora Reinbold, Vice Chair  
Representative Mike Chenault  
Representative Bob Herron  
Representative Charisse Millett  
Representative Dan Saddler  
Representative Andy Josephson

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

ALASKA LNG PROJECT - MEMORANDUM OF UNDERSTANDING - HEADS OF AGREEMENT~ DEPARTMENT OF NATURAL RESOURCES~ AND DEPARTMENT OF REVENUE

- HEARD

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

JOE BALASH, Commissioner  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** Testified and answered questions during the during the Alaska LNG Project presentation.

ANGELA RODELL, Commissioner  
Department of Revenue (DOR)  
Juneau, Alaska

**POSITION STATEMENT:** Testified and answered questions during the during the Alaska LNG Project presentation.

**ACTION NARRATIVE**

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CHAIR KURT OLSON called the House Labor and Commerce Standing Committee meeting to order at 3:34 p.m. Representatives Reinbold, Saddler, Josephson, and Olson were present at the call to order. Representatives Herron, Chenault, and Millett arrived as the meeting was in progress.

**Alaska LNG Project - Memorandum of Understanding - Heads of Agreement, Department of Natural Resources, and Department of Revenue**

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CHAIR OLSON announced that the only order of business would be a presentation: Alaska LNG Project - Memorandum of Understanding Heads of Agreement, Department of Natural Resources, and the Department of Revenue.

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JOE BALASH, COMMISSIONER, Department of Natural Resources (DNR), provided an overview of three main guidance documents for the Alaska LNG Project: the Heads of Agreement (HOA), the Memorandum of Understanding (MOU), and [HB 277] [slide 2]. He stated that the bill contains three parts: participation, percentage of participation, and the process for developing contracts for legislative approval. In order to understand the authorities in the bill, the department refers back to the HOA and the MOU, which inform the legislature and the public. In January, both he and Commissioner Rodell signed the HOA - a document that describes the "road map" project sponsors will follow and the contracts that will govern the project as a whole. These documents describe key principles and understandings between and among the parties. The MOU describes the manner in which the state will partner with TransCanada PipeLines Limited (TransCanada) on the midstream elements of the project and includes some key commercial terms that are in the state's best interest. All actions on whether to advance the LNG project are dependent upon passage of enabling legislation, he said.

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COMMISSIONER BALASH discussed the heads of agreement (HOA) for the Alaska LNG project [slide 3]. The agreement was signed by the state Department of Natural Resources (DNR) and Department of Revenue (DOR), the Alaska Gasline Development Corporation

(AGDC), TransCanada Alaska Development Inc. (TransCanada), ExxonMobil Alaska Production, Inc., ConocoPhillips Alaska, Inc., and BP Exploration (Alaska) Inc. The definition of the HOA from [www.investopedia.com](http://www.investopedia.com) read, as follows:

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 the roles and responsibilities of the parties involved in a potential partnership before any binding documents are drawn up.

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COMMISSIONER BALASH described the organization of the HOA [slide 4]. The HOA is broken into 16 sections and 13 articles. A set of recitals outline the history behind this agreement. Additionally, an index provides a series of correspondence from the producers and the governor over the past few years and the appendix describes the pro-expansion principles for the project.

COMMISSIONER BALASH turned to key recitals [slide 5]. The key recitals language [pages 2-4 of the HOA] recognizes changed circumstances in the Lower 48 natural gas market that led Governor Parnell to change direction from the Alaska Gasline Inducement Act (AGIA) framework and direct focus on an Alaska LNG project targeting Pacific markets. Second, another recital recognizes that funding from the state under AGIA has supported key activities related to the Alaska LNG project. Both the state and TransCanada believe it is appropriate to back away from the AGIA license and focus on the Alaska LNG project. Third, the state recognizes that AGDC is pursuing the Alaska Stand Alone Pipeline ("ASAP") project. Further, the Alaska LNG project and ASAP intend to cooperate with one another; however, for now the ASAP remains unfettered, unobstructed, and on schedule. Fourth, the Alaska LNG parties wish to ramp up the Pre-FEED phase of the Alaska LNG project, which is estimated to cost over \$400 million using a phased approach.

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COMMISSIONER BALASH highlighted a few key definitions. He said "enabling legislation" will provide the DNR and DOR certain authority to advance the project by negotiating contracts with the parties. The "MOU" refers to a separate agreement between

TransCanada, Commissioner Rodell, and himself. The pre-front-end engineering and design or "Pre-FEED" phase is the current phase, consisting of work that will inform the front-end engineering and design or "FEED" phase. He anticipated this process will take two to three years to complete and will cost upwards of \$1.5 to \$2 billion. This process should generate sufficient information to make a complete application at the Federal Energy Regulatory Commission (FERC), noting the FERC has exclusive jurisdiction on liquefaction terminals and plants. The "RIK" means royalty in kind and "TAG" means "Tax as Gas" which will be the DOR's share of revenues of the gas production that is a key part of this project.

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COMMISSIONER BALASH reviewed additional key provisions [slide 7]. Some key principles deserved their own article for recognition, he said. All of the parties recognize and respect the authority of this branch of government and if enabling legislation is passed the parties would negotiate contracts to proceed in the fashion contemplated. Article 3 describes broadly some of the key benefits of developing the Alaska LNG project, including providing gas to Alaskans, jobs for Alaskans, revenue to the state, and opportunities for additional development. The substantial infrastructure contemplated has the potential to facilitate an expansion of unprecedented exploration activities on the North Slope. Currently, and for the last 40 years, a discovery that included methane had been considered insignificant. When considering the success of an exploration well, companies evaluate the likelihood that producers will find oil and gas; and for the last 40 years finding gas was not part of the success case. If infrastructure is in place, companies will now have an opportunity to monetize gas so the opportunity for success will increase and give more positive decisions to put "holes in the ground" on the North Slope. For all the benefits of 3-D seismic and the latest innovations, it still all comes down to whether you put that "hole in the ground" and can test what the seismic data indicates. He said that additional drilling will lead to production.

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REPRESENTATIVE JOSEPHSON, relative to the second key recital, asked about the treble damages. He said he is not a contract lawyer; however, it seems TransCanada said it will waive the [AGIA] statute and any right and entitlement. He offered his

belief that this is called a novation, which takes a previous agreement and places a new agreement on top of it. He asked whether any argument exists that if the enabling statute passes that there is no legal repercussion.

COMMISSIONER BALASH answered that the department has worked hard not to expose the state to any further liability or treble damages under AS 43.90. He offered to have the DOL explain the rationale to the committee; however, he understood that part of the reason that the state is not in jeopardy is due to TransCanada's involvement in the project as contemplated here. The key element of the project assurances clause in AGIA is that the state would not grant benefits or inducement to a competing project. He asked how a project could be a competing project if the licensee is a part of it. He acknowledged other considerations come into play. One thing in the MOU itself is that there is a very clear delineation between the parties, and that [the state and TransCanada] are stepping away from the [AGIA] license and leaving it behind.

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REPRESENTATIVE MILLETT asked for clarification on the state "stepping away from the AGIA agreement" but the state is not terminating it.

COMMISSIONER BALASH answered no; that the state is utilizing the abandonment provisions in the Alaska Gasline Inducement Act statutes. He advised that at this point the state doesn't have the authorities granted in the enabling legislation to become part of the Alaska LNG project. He stated that the state needs the enabling legislation to pass and the agreements contemplated in the HOA to be formed. At that point TransCanada and the state will "step out of the AGIA license and leave it behind."

REPRESENTATIVE MILLETT asked whether the AGIA license would be terminated at that point.

COMMISSIONER BALASH agreed that is correct if the enabling legislation passes. He explained that the state is currently operating under a "project plan amendment (PPA)- 1 B" that allows some of the pre-planning activities to occur during the first and second quarter, but it is expected to terminate rather than finalize the last of the accounting for the reimbursements and "buttoning things up."

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REPRESENTATIVE MILLETT asked if this project doesn't go through but ASAP does occur, whether that is considered a termination of the AGIA agreement.

COMMISSIONER BALASH answered that the MOU lays out what the state will do if the enabling legislation passes, but not what will happen if it does not. He said he could not predict what will happen in May.

REPRESENTATIVE MILLETT speculated that treble damages could be assessed if the enabling legislation doesn't pass.

COMMISSIONER BALASH answered that he can't speak to AGCD, but the organization has "gone out of their way to ensure that they haven't done anything to cross that line and expose the state to damage." He did not see that happening.

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REPRESENTATIVE SADDLER asked to put on the record that this does not represent a mutual finding that AGIA project is uneconomic, but it will represent a mutual abandonment conditioned on the legislature passing the enabling legislation. He asked for clarification on the process for the uneconomic finding.

COMMISSIONER BALASH answered that the process laid out in AS 43.90.240 allows either party to deem the proposed Alaska LNG project uneconomic, followed by the choice to either agree or disagree, which would take the matter to arbitration. Essentially, the state has agreed to the mutual agreement path, that the Alberta project licensed under AGIA is uneconomic. Thus, the state and TransCanada have "agreed to agree."

REPRESENTATIVE SADDLER asked whether an objective standard defines "uneconomic."

COMMISSIONER BALASH responded that the statute has some references to what would be considered under arbitration, but it is not specified in detail; enough ambiguity exists that either party could argue over it.

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REPRESENTATIVE SADDLER reiterated that the term isn't clearly defined, but either party could make a claim.

COMMISSIONER BALASH agreed that is an option available under the statute.

CHAIR OLSON remarked that the legislature tried to clarify that more specifically.

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COMMISSIONER BALASH turned to Article 4, to the project work contemplated by the parties [slide 8]. He explained that the state is currently entering the Pre-FEED stage, which is expected to last 18 to 24 months. The information gathered will include additional environmental data, baseline data, technical information, and engineering necessary to refine the cost estimates to allow all parties to evaluate whether the proposed Alaska LNG project is viable or if sufficient possibility exists to warrant spending "the really big dollars in FEED." During this phase, key project services agreements will be developed with TransCanada and AGDC to carry the state's interest in the liquefaction plant - looking downstream. The overall contemplation is that the state would have a portion of the gas and a proportionate part of the infrastructure in terms of production tax and royalty interests. So, as the state looks downstream to the GTP, pipeline, liquefaction terminals, and the project service agreements with the two entities, it must also look upstream to the producers.

COMMISSIONER BALASH said the state will seek offtake agreements and balancing agreements with the producers, which he characterized as being a big part of the overall package. In order for the state to be comfortable in taking on the obligations associated with the midstream service agreements, it's necessary to know that "we're going to have gas and the right amount of gas." That's where the offtake and balancing agreements come in. The state will need to look to the companies that have the leases, the working interest owners, and producers to obtain the state's share of the gas. Since the state has varying royalty rates between Prudhoe Bay and Point Thomson, it doesn't know which field will come on first or the amount, it means that the state could be a little high or low. In the long run, the state will ultimately have a 75-25 split between Prudhoe Bay and Point Thomson, which is determined by the commercial balancing agreement. Balancing agreements are routinely used by industry to smooth out some of the uneven aspects of production that occur.

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REPRESENTATIVE MILLETT, referring to the MOU, said the language seems to indicate the state becomes part of the licensee, such that the license will be owned jointly by the state, the users, and TransCanada.

COMMISSIONER BALASH asked whether she was referring to paragraph 8 in the MOU, which refers to PPA-1 B referenced previously, which is a continuation until the end of first quarter. In order for the licensee to operate under the terms of the license and be qualified or entitled to reimbursement, the parties must have a work plan and budget approved by the DNR and DOR. Thus, PPA-1 B was essentially a work plan and budget that covers this period of time. In response to a question, he answered that the current licensees are TransCanada and Foothills Pipe Lines Ltd.

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COMMISSIONER BALASH emphasized key activity 4 is significant. The state and each of the producer parties would initiate preliminary marketing efforts for LNG. He stated that during Alaska's tortured history when considering North Slope gas for commercialization, a number of parties sought to sell its LNG to Pacific markets; however, the parties didn't have the gas to sell. In this case all three producers and the state would initiate the marketing efforts so critical to the success of an LNG project. He characterized the heart of an LNG project as being the sales and purchase agreements (SPA), which are long-term agreements between the producers and the buyers, since the financing and the investment rest on it. Those long-term contracts signal that this project is "real" and means to do business with the buyers of LNG in Asian markets.

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COMMISSIONER BALASH discussed the state's participation in the proposed Alaska LNG project [slide 9]. He said, with respect to the state's participation in the project, the findings and determinations that he and Commissioner Rodell have made show the project could yield significant benefits. The state will participate in the infrastructure as an equity holder of gas, but will enter into partnerships with TransCanada and AGDC or AGDC's subsidiary to carry the state's interest in the infrastructure. The DNR and DOR aren't equipped to be corporate players or infrastructure players in the traditional sense so the state must rely on an agent such as AGDC or TransCanada to do so. Finally, the state has agreed that the state's interest

should be consistent with the state's share of the gas, and when combined with the state's royalty will total 20 to 25 percent of the gas. He noted the Governor's bill "pegs things" at a little more than 22 percent. In essence, so long as the figures are not too low or too high the state will be ready to move forward. Certainly the legislature has a number of things it needs to consider, including the state's debt capacity and where "the number" puts the state relative to the other parties. In other words, the party with the biggest share in the gas will have the biggest "say" in the project, he said.

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REPRESENTATIVE HERRON referring to key provision 3 asked whether going to 22.5 or 22.7 percent would be a tipping point. He asked for further clarification.

COMMISSIONER BALASH responded that as the department examined the principles the fundamental goal was an alignment of interest between the state and the other parties, as well as aligning the state's interest in the gas with its interest in the infrastructure. He acknowledged that at some point the percentage is too big or is too small. The department has an opportunity to realize real revenues for the state in the long run relative to the risks the state might be undertaking as a participant in the project. He suggested that going to less than 20 percent is probably a big problem. He said that going over 25 percent could also create a problem for other parties and maybe for the state, too, in terms of what the state can afford.

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COMMISSIONER BALASH said Article 6 relates to the regulatory framework and key access and expansion principles. He pointed out that one thing the state wants to ensure is to provide multiple offtake points to get gas to Alaskans, but also as a means to get gas into the project. He recalled the activities underway by Doyon, Limited in the Nenana Basin. If Doyon finds significant gas it will need to get that gas to market. He characterized it as being almost as important to get gas into the pipeline as out of the pipeline. The work AGDC has been undertaking in the open season will inform the project by identifying demand points and where to locate offtake points. However, he offered his belief that the key is the overarching structure. Each party who has a share of the gas is going to hold its capacity in the infrastructure in the same basic

percentage and operate its share of the infrastructure on a proprietary basis. One of the reasons the state has had so many disputes on the Trans-Alaska Pipeline System (TAPS) has to do with the manner in which tariffs are structured. He recalled that TAPS cost was approximately \$8 billion, but the question is how was the \$8 billion financed and how does that affect the tariff ultimately.

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COMMISSIONER BALASH said that Governor Egan wanted the state to own its share of TAPS and he fell short a vote in the Senate. Thus, the state didn't own its share of TAPS and subsequently has fought with the owners over those tariffs since the tariff affects the state's royalty and production tax value. In order to move past this, the key provisions of the proposed Alaska LNG are structured so each party will operate its own share and finance its own share of the infrastructure. Therefore, it will not impact the state if one party decides on a high equity or to have a high return on that equity. In the conventional structure, those decisions would be material, but this approach would allow the state to seek a "live and let live" arrangement. The other parties will set up business as the parties see fit and the state will do likewise. He moved to key provision 4, and stated that the portion of the project that the state's agents - AGDC and TransCanada - share would be committed to provide access to third parties on terms developed with the state. He concluded that these are the key provisions of Article 6.

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COMMISSIONER BALASH turned to Appendix A [page 21 of the HOA], which lays out the principles for expansions in the project. He emphasized that A.1.1 outlines that any party may initiate the process for an expansion of any component, including the GTP, the pipeline, or the marine terminal. He acknowledged that there is a "carve out" for the liquefaction trains, which is important. He pointed out highlighted texts and assuming there are no negative impacts on other parties, the expansion can proceed. In essence, it represents a sole risk as the approach to expansions. For example, the state is interested in expansion in the pipeline, and as long as it doesn't impact the other parties, the expansion will occur and the state will benefit from additional gas production.

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REPRESENTATIVE SADDLER referred to Sections A.2 and A.3, of Appendix A and asked for the principle for any modification of the LNG liquefaction plant.

COMMISSIONER BALASH explained that the expansion principles differentiate between the liquefaction trains and everything else. Basically, the principle is that any part of the project except the liquefaction trains can be expanded on the sole risk basis; however, the trains are the most sensitive part of the infrastructure and any modification to the original trains must be agreed to by all parties. Those agreements are described in A.2. He said that A.3 allows a party to build a new train if a modification of the original train is impossible or not agreed upon. The project is being designed around the concept of three liquefaction trains, with a certain capacity available. In the event sufficient additional gas is discovered that can commit to capacity in the pipeline or the GTP and can fill a new liquefaction train, the facility can be added at the marine site. Again, this applies the same principles, that if one party wants to add a liquefaction train, the other parties can participate but don't have to do so.

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REPRESENTATIVE SADDLER understood the GTP plant is either "all on or all off." He related his understanding that if someone finds gas and wants to send gas that requires liquefaction services, the party can do so at cost or several parties can collectively do so. He also understood one party could pay to build an additional liquefaction train. He asked whether the parties can sell liquefaction capacity to others.

COMMISSIONER BALASH answered in essence; yes. He said, "He who owns the infrastructure owns the capacity." He acknowledged that the state would need to be sensitive to the other parties in terms of the operating agreements and ensure the agreements do not cause harm or problems. If the party wanted to take the risk of building an entire liquefaction train, even without enough gas for the train, and was willing to speculate and sell the capacity later on to someone else, it represents a business proposition.

REPRESENTATIVE SADDLER assumed that it could happen in several ways.

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REPRESENTATIVE JOSEPHSON related a scenario in which the state owned 25 percent for royalty and production tax of the molecules. He surmised the state could market it to third parties who were not parties of the initial agreement.

COMMISSIONER BALASH answered that is correct.

REPRESENTATIVE JOSEPHSON wondered if the state's 25 percent expands to 30 percent making 105 percent, or alternatively, does the state surrender 5 percent of its capacity to an independent.

COMMISSIONER BALASH acknowledged his questioning is a very interesting line of questions. It has to do with is how the capital cost and operating costs will be reallocated among the parties. He stressed this is something that is going to require very careful crafting of the operating agreements in the next phase of development, which is the type of detail that will need to be worked out. He agreed that the project does not become a 105 percent project, but would necessitate a reallocation or recalculation of the equity interest.

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REPRESENTATIVE JOSEPHSON said when he thinks of compression he thinks of it as putting more molecules in the same space in the pipeline.

COMMISSIONER BALASH answered that is correct.

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COMMISSIONER BALASH continued with Article 7, which is related to enabling legislation and the timeline [slide 12]. He said this describes the enabling legislation, which requires other parties to take a "leap of faith." While the language appears in the HOA itself, the other parties did not review the bill until it was introduced. However, the actual drafting and language fell on the DOR, the DNR, and the Department of Law. He hoped the legislature would pass the enabling legislation by April 2014 and that over the next 12-18 months the administration and other parties would develop all of the contracts necessary to advance the Alaska LNG project to the [front-end-engineering design] FEED phase. He also said the department will keep the legislature informed as these contracts are developed. In terms of the timeline, in 2015 the legislature will consider the project enabling contracts and if

approved, all parties will be ready to move to FEED phase late in 2015 or early in 2016.

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COMMISSIONER BALASH discussed royalties and production taxes in Article 8 [slide 13]. He indicated that the combination of those two interests represents the "state's gas share." He noted that the royalty share for Prudhoe Bay is generally set at 12.5 percent while a few leases have sliding scale royalty and net profits share royalty provisions. Point Thomson royalty has generally been a little higher. Thus, by blending the rates together the state royalty interest is slightly higher than 13 percent overall. Under the Alaska LNG project, the state is asking for a gross determination for production taxes, which in combination would total somewhere between 20-25 percent. In order to facilitate this, the state must manage the gas, take responsibility for the gas, and ultimately market the gas. Under state leases, the state can take its gas royalty in kind (RIK) or in value (RIV). He said he was surprised to learn that the statutes direct the state to take its royalty in kind unless the state determines it is in the best interests of the state to. Thus, the starting point will be to use RIK.

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COMMISSIONER BALASH pointed out that in 2013, Black & Veatch identified potential risks and opportunities related to RIK. Many of the state's risks would be ameliorated or mitigated if it has an interest in the infrastructure, but B&V identified the state marketing its gas as the biggest risk due to the state's inexperience in marketing liquefied natural gas (LNG). The state would need to establish an organization to market its gas, but would likely suffer a discount in doing so. The producer parties have committed per the HOA [8.3.3], which read, in part, as follows: "... negotiate separately with the State in good faith to enter into an agreement with the state regarding the purchase or other disposition of a portion of the LNG ...." He offered his belief that a significant number of anti-trust lawyers crafted the language since this area of law as a delicate area of law in the U.S. and in Asia. He cautioned that the state must be very careful not to collude or "trip over" the complex laws. This means that the state should be able to leverage the marketing expertise and the specific terms that the producer parties use to sell Alaska's LNG. He said the department believes this approach will protect the state in

terms of the RIK investment identified by the 2013 Black and Veatch study.

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REPRESENTATIVE HERRON asked whether the "the delicate balance" means the state is saying it won't be short changed, that the rate will be nearly identical to the partners' rates.

COMMISSIONER BALASH answered that he is correct that this is the intent going forward. He said the state held initial conversations with each of the parties to investigate this. As part of the Pre-FEED process, the state will develop more specific agreements the legislature will review in 2015.

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REPRESENTATIVE HERRON asked whether the state can negotiate separately with the three individual parties so it has the unique position of having access to specific knowledge.

COMMISSIONER BALASH answered that he will spend a significant amount of time with anti-trust counsel to ensure that the department doesn't expose the state to anti-trust jeopardy. He agreed that the state will be able to identify opportunities with each of the three companies. Additionally, the state will also have opportunities to independently market its LNG. Certainly, the state may find good reason to independently market some volume of its LNG product, he said.

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REPRESENTATIVE HERRON asked whether the opportunity is unique to the state or if it can negotiate with another partner independent of the state.

COMMISSIONER BALASH responded that the state needed this specific provision in terms of the RIK approach. He said that how parties market respective volumes of LNG is left to each of them. He related he is familiar with joint marketing, which is where all project sponsors come together and form a new marketing company to market the total output. Those organizations have to be "hived off" or separated from the parent entity. That type of approach is not universally used, but it has been used by these companies in other projects.

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REPRESENTATIVE SADDLER asked for clarification of the disposition of a portion of the LNG under Article 8.3.3.

COMMISSIONER BALASH explained an outright purchase would consist of purchase at the outlet of the LNG plant. Another disposition would be "anything else." For example, the state might sign on as a co-party in an individual sale agreement with one of the entities. In essence, the state would be marketing side by side with the other parties. He related that from conversations with each of the three companies, that the department heard three different approaches to solve the marketing issue. He stated that directionally, the solutions were similar but the differences were in the details. He offered his belief that the legislature has much to look forward to in learning about portfolios of contracts, the management of portfolios, and the differences each company takes on marketing.

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CHAIR OLSON asked whether the state will market gas on a BTU basis or a volume basis.

COMMISSIONER BALASH answered that every SPA is a unique deal. Thus the broad metric for the sale of LNG is measured in tons per annum.

CHAIR OLSON interjected a question on how the LNG would be taxed.

COMMISSIONER BALASH answered that the contract itself will likely contain heat contract requirements so the gas that is produced at North Slope and converted to LNG will have range of heat that will help market the LNG. The state will take a gross volume approach for tax purposes so the state will get a gross volume rather than something that will vary volumetrically depending on the heat.

CHAIR OLSON asked whether it will be similar to the way it has been handled out of Nikiski to Japan for the past 42 years.

COMMISSIONER BALASH answered that he is not familiar with production taxing aspects, although he is more familiar with the royalty aspects. He said the state uses a simple method and takes a percentage of the calculation on the Japan Crude Cocktail price (JCC).

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REPRESENTATIVE SADDLER understood the tax will be based on gross volume and the contracts will be based on heat value or BTU value. He asked whether the balancing agreement would be used in instances in which the tax is based on certain BTU value, but over time the BTU varies from the contract.

COMMISSIONER BALASH answered that this could potentially be an aspect of a balancing agreement; however, the state seeks to ultimately solve the volume issue through the balancing agreements by using a series of debits and credits to ensure that "everyone gets their due." Thus, no one over produces or under produces from their respective share, he said. He acknowledged that the balancing agreements can have a variety of mechanisms, features, and commercial solutions to deal with an imbalance. He offered his belief that the state will want to pay close attention to the offtake agreement specifying the heat content of the gas.

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REPRESENTATIVE JOSEPHSON said he thinks of RIK as being a tank of natural gas in the sky, in terms of the state's accounting. He related "scuttlebutt" exists regarding the constitutional prohibition provision that does not allow legislatures to impact future legislatures from changing the gross production tax rate. He understood the constitutional provision would not apply if the state take uses RIK, but it would apply if the state were to take its royalty as cash. He asked why RIK would be different. He expressed concern that if this legislature [passed HB 277] it might inadvertently "tie the hands" of subsequent legislatures.

COMMISSIONER BALASH replied that he is touching on a point that is critical to the success of this project, which is how any parties - including DOR and the DNR in their fiduciary roles - can enter into the types of contracts necessary for an Alaska LNG project to go forward. However, the state has as much an interest in the durability in the terms as the other parties, since the state will take out long-term financing, long-term capacity, and long-term sales of LNG. It will also want to count on things occurring as expected. He emphasized the importance of being able to survive the constitutional questions in a democratic form of government. He acknowledged that RIK is not the magic key, but the crossover between multiple agreements will provide an avenue of opportunities for the parties to solve the durability problem and challenge. He referred to the tank

described earlier, and visualized it being filled and delivered 5 times a day for 25 years. It's important that happens so the state can meet its obligations to the buyers. He surmised that if a future legislature were to change taxes the agreements will need to contemplate this in advance, to predict how the agreements would change. In order to get to "yes" on the initial agreements, everyone will need to be comfortable with how the specific mechanisms will work.

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COMMISSIONER BALASH related a scenario in which the state's [royalty and production] is 20 percent, but 15 years from now the rates change from 20 to 30 percent. In that scenario, the state would have 50 percent more volume on hand and consequently, the state would need to find capacity for its gas. However, the parties whose taxes are being raised have the capacity so it is likely the parties would charge the state the same as the increase. He concluded that how this all fits together will be explored over the next two years.

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REPRESENTATIVE SADDLER asked whether he was saying there is a constitutional obligation to preserve the right of future legislatures to change taxes. He understood the commissioner envisioned a network of agreements that would dampen out the effect of any future changes to end up "not nullifying" but minimizing it to the point that all the parties will ultimately still be in agreement.

COMMISSIONER BALASH responded that rather than describe it as "nullifying" he would describe it as understanding consequences. He said the state incurs consequences when it changes its taxes and in this instance the consequences will be specific and may affect other agreements the state may care about. He indicated that exactly how many places "we'll have to work with" in the overall complex network of contracts is something the state will be exploring.

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ANGELA RODELL, Commissioner, Department of Revenue (DOR), explained the contracts will be specific and targeted contracts that are in place. These provisions don't apply to all the oil and gas production across the entire state and there are opportunities for the state and future legislatures to take

various actions, just as the legislature does now, and to recognize any distinction between the oil and gas production occurring in different areas. For example, this is how it happens with respect to Cook Inlet and the North Slope production. She reminded members that while these contracts have consequences, the legislature can examine a variety of tax plans in the future as they see fit.

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COMMISSIONER BALASH referred to Articles 9 and 10 [slide 14]. He indicated some other project enabling terms are found in Articles 9 and 10. The department believes that a payment in lieu of tax (PILT) system will serve the state and municipalities very well. The department has committed to work in consultation with local governments to develop a system of PILT that will go into effect on operation of the pipeline. Preceding that, there will be impact payments provided to the affected communities as well. He said that is an undertaking that will begin if this enabling legislation passes. The department did not envision the need to engage with communities until the project is viable.

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REPRESENTATIVE SADDLER understood the statewide municipal or local property taxes are paid in cash. He asked for clarification on PILT.

COMMISSIONER RODELL answered that rather than having a mill rate that resets every year based on valuation changes and potential debates on valuations, the parties would have an agreement on the payment of property tax not based on a mil rate calculated against a valuation, but as a flat payment. The parties will come to an agreement as to how the payment will be calculated and what is taken into account. It would identify what type of impact payments would occur prior to improvements to valuation and property, but there is tremendous impact on infrastructure and communities due to the work that has happened. It's a negotiation, she said.

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REPRESENTATIVE SADDLER asked whether the department currently has this power or if it will be granted by the enabling legislation.

COMMISSIONER RODELL answered neither. The department doesn't currently have the power to negotiate that and doesn't contemplate it in the enabling legislation. Rather, the department would like to work with municipalities and other local governments and come back with a comprehensive property tax proposal in 2015.

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CHAIR OLSON asked whether the initial structure will be set for the life of the project.

COMMISSIONER RODELL answered that she was unsure since the department will want to take into account the various stages of the project, including but not limited to what the impacts are when revenues begin flowing, when the valuations will take effect, and when people can expect to receive property taxes off that project. The project will generate revenue and become a source of payment for the property taxes. At this point the department doesn't know the answers, but it wants to develop a framework. She envisioned the administration coming to the legislature every single year until gas flows, adjusting and amending the contract structure.

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COMMISSIONER BALASH, in response to a question on whether the Trans-Alaska Pipeline System is balanced every five to 10 years by the Federal Energy Regulatory Commission (FERC) and the Regulatory Commission of Alaska (RCA), suggested it might refer to the tariff setting.

CHAIR OLSON offered his belief that it is based the agreement on the valuation of the pipeline and the recalculation of the state taxes.

COMMISSIONER BALASH answered that some of those valuation determinations factor into the full and fair value that is assessed but he was unsure how those interrelate.

COMMISSIONER RODELL said she was unsure but will look into it.

COMMISSIONER BALASH, in response to a question, recalled the rate-making trial that the Federal Energy Regulatory Commission and Regulatory Commission of Alaska (RCA) jointly conducted as lasting several months.

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COMMISSIONER BALASH, in response to a comment, agreed since significant money is involved disputes arise. He remarked that the state ships its oil on the producer's pipeline. He offered his belief that one benefit of the Alaska LNG project is that the state will be shipping gas on its own share of the infrastructure. Previous types of disputes, protracted trials, and adjudications will hopefully be a thing of the past.

CHAIR OLSON remarked that he'd be really impressed if that happens. He said, "In fact, quite frankly I'm impressed that we've gone as far as we have on this one...."

REPRESENTATIVE HERRON remarked that literally this means "real" money for local projects and the product that the state will sell.

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COMMISSIONER BALASH discussed the key provisions in Articles 9 and 10 [slide 14]. He touched on the need for PILTS, that the need for the project enabling contracts which will allow each of the parties to take the kinds of investments necessary for this to come together and move forward. An expression of general support from the state will be needed in this agreement in order to develop the necessary infrastructure and permitting, as well as the need for a healthy long-term oil business in Alaska to support the proposed Alaska LNG project. With respect to the overall economics, the economics of gas relies on oil to carry the costs of operating Prudhoe Bay and Point Thomson so the oil business must be healthy or the gas revenue will need to support the costs and the state could "start to get into trouble."

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COMMISSIONER BALASH turned to the topic of Alaska hire and content [slide 15.] He said the administration has identified some important things for the men and women who will be working on this project. He said that Article 11 [page 16 of the HOA] provides guidance on the hiring of Alaska residents, contracting with Alaska businesses, and participation of the Department of Labor & Workforce Development in providing training for occupations needed to support the project, and a commitment by the project sponsors to negotiate in good faith project labor agreements for the project. He pointed out key points, including the estimated total project cost at \$45-65 billion.

He stated that at peak construction the state will enjoy 15,000 jobs in Alaska. Once the project is in operation it will result in 1,000 long term jobs, noting that the Kenai community will benefit from many jobs due to the operation of the LNG plant and associated marine terminal and vessels.

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REPRESENTATIVE JOSEPHSON commented on the bullet commit to negotiate good faith project agreements. He related his understanding that the language "commit to negotiate in good faith" is not strong enough. He recalled that an amendment made it into AGIA, signed by members of both parties in the House. He offered his belief that this language is not in HB 277. He asked whether this is correct, and if so, if there is something that can be done to enhance the language.

COMMISSIONER BALASH thought he might have a couple of pieces of the history wrong and offered to meet to discuss this more fully at a later time.

COMMISSIONER BALASH said that the effort in the original AGIA statute and HOA is to try to recognize project labor agreements could be helpful tools to avoid work stoppages. However, if the state obligated the project sponsors to sign a PLA, there wouldn't be much room to negotiate. In other words, they would have to agree to whatever terms were laid out. Thus, the concept of negotiating in good faith is to make sure the opportunity happens and is fully explored by the relevant parties. He cautioned not to "put our thumbs on the scale" to determine the outcome of the negotiations. He said that the state is trying to keep things on an even fashion. He offered his belief that when the legislature discusses the bill, many provision are not contained in the bill since the enabling legislation creates a general law. Therefore, the state hopes to avoid putting significant detail in the underlying statutes. The HOA is a guidance document the parties can rely on to negotiate, which is available to the legislature to use as a measuring stick.

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REPRESENTATIVE JOSEPHSON commented. He said, "In order to make the biggest tent you can make, there are going to be colleagues who even at this early stage are going to be looking for that. Thanks."

CHAIR OLSON remarked that he recalled the amendment being discussed but he did not recall "21 signatures" on that particular amendment.

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**ADJOURNMENT**

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 5:01 p.m.