

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

January 27, 2014

1:04 p.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Dan Saddler, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Craig Johnson
Representative Kurt Olson
Representative Paul Seaton
Representative Scott Kawasaki
Representative Geran Tarr

MEMBERS ABSENT

Representative Mike Hawker

OTHER LEGISLATORS PRESENT

Representative Lora Reinbold
Representative Andy Josephson
Representative Shelly Hughes

COMMITTEE CALENDAR

OVERVIEW(S): ALASKA LNG PROJECT - HEADS OF AGREEMENT

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

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

POSITION STATEMENT: Assisted in providing the overview regarding the Alaska Liquefied Natural Gas (LNG) Project, Heads of Agreement.

JOE BALASH, Commissioner
Department of Natural Resources (DNR)

Anchorage, Alaska

POSITION STATEMENT: Assisted in providing the overview regarding the Alaska Liquefied Natural Gas Project, Heads of Agreement.

MICHAEL PAWLOWSKI, Deputy Commissioner
Office of the Commissioner
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: Assisted in providing the overview regarding the Alaska Liquefied Natural Gas Project, Heads of Agreement.

ACTION NARRATIVE

[1:04:10 PM](#)

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 1:04 p.m. Representatives Tarr, Johnson, Seaton, P. Wilson, Kawasaki, Saddler, and Feige were present at the call to order. Representative Olson arrived as the meeting was in progress. Also present were Representatives Reinbold, Josephson, and Hughes.

OVERVIEW(S): Alaska LNG Project - Heads of Agreement

[1:04:32 PM](#)

CO-CHAIR FEIGE announced that the only order of business is an overview of the Alaska Liquefied Natural Gas (LNG) Project, Heads of Agreement.

[1:05:21 PM](#)

ANGELA RODELL, Commissioner, Department of Revenue, explained that the Heads of Agreement is between the Department of Revenue (DOR), the Department of Natural Resources (DNR), the Alaska Gasline Development Corporation (AGDC), the three major producers [ExxonMobil Alaska Production Inc. (EMAP), ConocoPhillips Alaska, Inc. (ConocoPhillips), BP Exploration (Alaska) Inc. (BP)], and [TransCanada Alaska Development Inc. (TADI)]. It is an agreement that has not been previously seen in Alaska. Commissioner Rodell advised that the agreement creates a road map for the state, the producers, and the pipeline company to commercialize North Slope gas as an all-encompassing liquefied natural gas project. This will require the state to review the investment, the opportunities for

investment, and how to bring the investment to fruition. The project will provide jobs, revenue, and gas to Alaskans.

[1:07:22 PM](#)

JOE BALASH, Commissioner, Department of Natural Resources (DNR), began his presentation by stating that Alaskans have been dealing with pipeline issues in detail over the last few years. The department's understanding of those projects had to do with an overland project to a liquid market, which was a highly regulated piece of infrastructure from the field to a very deep, very liquid, and transparent marketplace. However, LNG projects present different challenges and considerations, which include differences in the market itself, contracts involved, regulatory jurisdiction, and, in particular, the overlay that is fundamentally very different than what the state has dealt with over the last decade. A 2013 study was commissioned that examined how the state, DNR in particular, could maximize the value of royalty interests. The study found that engagement with the contractors, the nature of the relationships, and the drivers in this sort of project are unique. Findings in the study contributed to the department's current thinking that ultimately the way for the state to maximize its royalty value is to assert ownership upfront in the components of the project. In that method the state gains greater control over the manner in which those components are financed. Commissioner Balash expressed that regardless of whether the project is overland or an LNG project, certain objectives and principles for Alaskans remain true. He requested the committee keep in mind that when it comes to getting gas to Alaskans, to refer to Article 6.3, Regulatory Framework, Access and Expansion, which is where reference is made to access for third parties and access for identified Alaskans.

[1:10:37 PM](#)

COMMISSIONER BALASH informed the committee that Article 11 refers to jobs and business opportunities. Appendix A: Pro-Expansion Principles is information important to a long-term future as it maximizes the state's value and provides access to third party explorers for expansions of the system. He described the Heads of Agreement as a document that provides, in broad terms, the principles needed to secure Alaska's future on its own terms. He related the belief that within a phased approach a certain set of steps could be taken, and authority granted within the statutes. The department expects that the

agreements would be brought to the public for review and would receive the legislature's approval in late 2015 or early 2016.

1:12:33 PM

MICHAEL PAWLOWSKI, Deputy Commissioner, Office of the Commissioner, Department of Revenue, began by saying that the intent of his presentation is an orientation of how to read the Heads of Agreement, which he defined as a roadmap and a blue print of how the Parties intend to move the project forward through the initial and subsequent Pre-Front-End Engineering and Design (Pre-FEED) stages. He directed attention to slide 2, noting that the Heads of Agreement is not a contract, but rather the first step to a legally binding set of agreements. An LNG project is not the same as previous efforts the state made for an overland pipeline. An LNG project is inherently more complicated and will be filled with multiple different contracts. The agreements will come in a phased approach and the commitments of each of the parties will become more definitive through each phase toward the commercialization of the gas.

1:14:19 PM

MR. PAWLOWSKI noted that slide 3 was created from [Exhibit I-B) of the Heads of Agreement. He said this exhibit provides the concept of what is now called the Alaska LNG Project, a very different project than had been previously contemplated. He opined that Alaskans will be familiar with the concept of a gas treatment plant (GTP) and a pipeline, which individually are monstrous components. Approximately 250,000-300,000 tons of steel will be necessary for construction of the gas treatment plant. There will be a pipeline, a world class liquefaction plant, storage and loading [facilities] and improvements at Point Thomson and Prudhoe Bay. This creates a real opportunity to commercialize gas by turning it into LNG and supplying the global marketplace.

1:15:26 PM

MR. PAWLOWSKI, turning to slide 4, explained that the Heads of Agreement is organized into 16 sections, beginning with a series of recitals describing the common understanding between the present parties and future events. Thirteen specific articles cover the guidelines and principles for development of the project. The appendix articulates the critical pro-expansion principles that will govern the project, not just through the

Pre-FEED stage, but across the life of the project. The process, he further explained, began with the governor calling for the parties to align around an LNG project which then led to a concept selection stage. He said today's presentation is a guideline of how to move from the concept selection stage to a more aggressive ramp up of Pre-FEED development.

[1:16:37 PM](#)

MR. PAWLOWSKI, moving to slides 5-6, emphasized the importance within the documents of the terms "The Administration," "The Parties or Party," "The Alaska LNG Project Parties," and "Producer Parties," as they indicate a specific role for specific people. He noted the importance of dividing up who is being referenced as there are appropriate roles for the resource agencies in the management of the state's gas and mineral interests. At the same time there are places where the Administration and the agencies do not need to be involved in the long-term commercial development; there are subsidiary corporations and partners that are involved in the day-to-day business activities. State government should not move into those operational agreements at the agency level although the state needs to be a party to them so that the Administration can manage and regulate them. The word "administration" in the context of this agreement is the Department of Natural Resources and Department of Revenue. The word "state" is used more broadly and indicates other functions of state government, such as support for infrastructure, regulatory and permitting work. Separate to that, is the parties to the agreement which includes the Administration, Alaska Gasline Development Corporation (AGDC) or its subsidiary, TransCanada Alaska Development, Inc., (TADI), ExxonMobil Alaska Production, Inc., (EMAP), ConocoPhillips Alaska, Inc., (ConocoPhillips), BP Exploration (Alaska), Inc. (BP). The word "party" or "parties" in the agreement is referring to that collective group.

[1:19:18 PM](#)

REPRESENTATIVE KAWASAKI, recalling the passage of the Alaska Gasline Inducement Act (AGIA), questioned whether other parties were included in the 2014 Heads of Agreement.

COMMISSIONER BALASH responded that the Heads of Agreement is the next step forward. Regarding TransCanada and the partnership the state has through the AGIA license, TransCanada has fulfilled the requirements it had and there was no need to pursue other parties. However, TransCanada's expertise lies

primarily in the treatment and transportation of gas through a pipeline, not in the liquefaction component. He expected that at some point going forward, a different set of partners for that project component will be looked for.

[1:21:19 PM](#)

MR. PAWLOWSKI advised that getting more digital from the Parties is in the agreement referenced to Alaska LNG Parties. This is specifically the owners of the infrastructure and the capacity within that infrastructure. Therefore, it includes the AGDC or an AGDC subsidiary, which under this construct holds the state's interests in the liquefaction plant; TADI, which has custody of the state's interests in the mid-stream and treatment; ExxonMobil; ConocoPhillips; and BP Exploration. The Administration, as the resource owner, is not directly in the Alaska LNG Parties group because state agencies do not have a role in the infrastructure; that is a different separation. There are specific agreements and work to be developed with the Producer Parties upstream of the project. The agreement references "Producer Parties" to reference specifically ExxonMobil, ConocoPhillips, and BP Exploration as the interest owners upstream at Prudhoe Bay and the Point Thomson field.

[1:22:45 PM](#)

MR. PAWLOWSKI directed attention to slide 7, which specifies the key sections, "Recitals", of the agreement. The Recitals are intended to provide a context to the reader, articulate roles and goals, provide direction for the project, and recognize the Alaska Stand Alone Pipeline (ASAP) project that is currently being advanced by the AGDC. The governor saw that circumstances had changed due to Lower 48 shale development and requested the Parties come together under an LNG project. Although funding by the state under the AGIA license has supported key activities, the Administration and TransCanada believe it is appropriate to transition from the AGIA license and focus on the Alaska LNG Project. The Alaska Gasline Development Corporation (AGDC) plays an important role in advancing the state's interests, and during the State of the State message, the governor described it as the "ace in the hole." The AGDC will provide material benefit to the ASAP moving forward particularly on access and need for in-state gas. Mr. Pawlowski put forth that the Alaska LNG Parties wish to ramp up the Pre-FEED phase of the Alaska LNG Project, which is estimated to cost more than \$400 million over the next 12-18 months. He pointed out that within the Heads of

Agreement a capitalized word is typically referring back to something that is a specifically defined term.

[1:25:17 PM](#)

MR. PAWLOWSKI, responding to Representative Seaton, explained that the Alaska Gasline Development Corporation is currently working toward an open season by assessing in-state needs for natural gas. The Heads of Agreement contemplates at least five offtake points for the access of Alaskans to gas moving through the project. It is believed that ADGC's work, in consultation with the Alaska LNG Project, will let the Alaska LNG Project know where the offtake points need to be and how much gas is demanded. A lot of work will transfer over that supports access to gas for Alaskans, whether it is the ASAP project or the Alaska LNG Project that moves forward. In further response to Representative Seaton, Mr. Pawlowski confirmed that access to state gas means supplying information to the project where Alaskans will get gas from, not a supply of gas to, the project.

[1:26:30 PM](#)

MR. PAWLOWSKI, returning to his presentation, moved to slide 8 and highlighted five key definitions in the agreement. The "Enabling Legislation" concept, he explained, is necessary to advance the project as the Heads of Agreement is not a binding agreement, although the agreement does become effective once enabling legislation is put into place. The "Memorandum of Understanding" (MOU) is between TransCanada and the Administration and is for a transition from the AGIA license to a more Alaskan commercial relationship. "Pre-FEED" is pre-front-end engineering and design work for the Alaska LNG Project that will be sufficient to support filings to the Federal Energy Regulatory Commission (FERC). "Royalty in Kind" (RIK) takes gas in kind for the state's royalty share, instead of taking the value in money. "Tax as Gas" (TAG) described in Article 8.1.1, is production tax being conceived as being paid in a similar way as RIK; it is coming as a molecule not as a residual value.

[1:27:54 PM](#)

MR. PAWLOWSKI, responding to Representative Saddler, verified that "Tax as Gas" means exactly the same as "Tax in Kind" (TIK); TAG is a convenient acronym, not a term of art.

[1:28:17 PM](#)

COMMISSIONER BALASH, responding to Representative Tarr regarding the success rate of other jurisdictions, stated that within other regimes around the world, tax and royalty systems are employed in the traditional sense. During the department's investigation it was discovered that typically the royalty rates were considerably lower than in Alaska. The department was then concerned that it may need to make an adjustment to its royalty rates. Further investigation revealed that in jurisdictions where sovereign governments participate, it is not unusual for that government to invest directly and participate in the project. In Alaska's case, utilization of the state's production tax interest in the gas combined with the state's royalty interest arrives at an overall equity interest. There are many parallels to practices that have been employed around the world.

[1:30:13 PM](#)

REPRESENTATIVE TARR surmised that the concept of owner equity interests will make the state "winners with everybody else or losers with everybody else." It would basically just increase the extent in which Alaska is a winner under a better price scenario and a loser under a low price scenario.

COMMISSIONER BALASH replied that there are risks and rewards involved which will be discussed within the actual sales contracts. To avoid downside risks in the marketing of gases, various players in the project may decide to pursue different forms of pricing. That will likely come in the form of limited upside through employment of an "S Curve."

[1:31:31 PM](#)

COMMISSIONER BALASH, responding to Representative P. Wilson regarding where in the process Alaska could decide to become a part owner of the pipeline, advised that [the departments] are currently requesting permission to participate in an agreement for Pre-FEED, which is basically a cost sharing and asset ownership agreement. The actual equity agreements regarding the infrastructure itself will be those developed over the course of the next 18 months within the Pre-FEED phase. Those agreements address the parameters under which any one of the parties, including Alaska or other investors, might bring in further partnerships and partners.

[1:33:08 PM](#)

REPRESENTATIVE JOHNSON pointed out that a key recital not mentioned earlier by Mr. Pawlowski is the state's participation in the Alaska LNG Project. He urged that this important recital not be brushed over.

MR. PAWLOWSKI replied that state participation is important and has its own article, which will be reviewed later in the presentation.

[1:34:13 PM](#)

MR. PAWLOWSKI continued his presentation, turning to slide 9 to describe the principles and benefits of state participation to the Alaska LNG Project and to Alaskans. One benefit is "gas to Alaskans" which allows opportunities for a competitively priced and reliable in-state gas supply. A second benefit is "jobs to Alaskans" for construction of the infrastructure and from exploration and development of additional reserves. Another benefit is "revenues to the state" from the development of gas interests as well as the returns from the investment in the infrastructure. A fourth benefit is "opportunities for additional gas development" from opening the North Slope basin. The existence of gas infrastructure creates opportunities for the development of additional gas reserves, and also an environment for exploring for oil and finding gas.

[1:36:03 PM](#)

REPRESENTATIVE SEATON, referring to the Heads of Agreement, asked who is looking out for the interests of the new explorers, and would the new players pay a higher transmission cost than the three major producers.

COMMISSIONER BALASH answered the construct is that each sponsor Party will own its segment for each component of the project. It will be a project within a project. Initially there will be slack in the system and room to expand the pipe with compression as opposed to looping. Appendix A specifies that any party can expand any component of the project so long as the party is prepared to do so at its sole risk. Other parties who do not want to participate in the expansion are unaffected. It will be demonstrated to the committee how this will work for a non-sponsor's gas supply in the overall agreement and how there will be a pathway for the non-sponsors to get gas to market.

[1:38:11 PM](#)

REPRESENTATIVE SEATON understood from previous discussions that there would be built-in slack initially - unless the "three major parties" decide to reserve that for themselves as an expansion. Thus, any further expansion is no longer constrained by the rolled-in rate provisions, and therefore the state is back to the problem of not having an incentive for exploring for gas. He requested information regarding how this will work.

COMMISSIONER BALASH replied there is a specific rolled-in rate statute under AGIA and there is a limit. The question is at what point do new entrants have to pay more of the cost, where is that line drawn, and functionally how much gas gets into the system before tripping over that line. There is a general sense of the capacity of the pipeline, but the specific limitations of the system are unknown until finalization of the Pre-FEED stage. The general understanding is that at 42 inches the pipeline throughput can be expanded considerably and have sufficient room in the pipeline to add an additional train at the marine terminal, and still have additional room for throughput for increased instate demand. Which of the Parties undertakes an expansion will be a function of who finds additional gas reserves and is able to sell those reserves the quickest. The difference between the Alaska LNG Project and past projects is the nature of the contracts, the Sale and Purchase Agreements (SPAs), required to move forward. A typical LNG buyer is in the business of buying LNG because it is from a country that does not have other energy resources. This buyer is very interested in energy security and making sure that what it is buying is actually there by being able to trace what it is buying to the specific resource or reserves in the ground. It will be difficult for any of the parties to expand the scope of the project without having that gas and buyer lined up ahead of time.

[1:42:05 PM](#)

REPRESENTATIVE TARR understood Commissioner Balash to be saying that at the beginning of the agreement [the state] would have certain commitments made in terms of its equity interests and the other parties involved, but at the time where one of the new explorers comes in, upstream through downstream, [the state] would have the opportunity to recalibrate that relationship. The potential exists, if [the state] is not interested in that particular expansion effort, to essentially become a lessor and to become a minority party as other parties decided to move forward.

COMMISSIONER BALASH responded that that is possible, but when thinking about expansion scenarios it will depend upon where the gas is located. The state's interests depend upon the source of the gas. If it is located on state land, the state will still have royalty and production tax. If the gas is coming from onshore non-state land, the state will have a production tax interest but not necessarily a royalty interest. Federal offshore gas has very little state interest associated with it.

[1:43:47 PM](#)

CO-CHAIR FEIGE stated this is a key provision. For example, if another party discovers a new field after the pipeline is built and wants to put gas into it, the state as an original party to this agreement is not responsible for the cost associated with that party putting gas into the pipeline which is already constructed. The state is protected from having to make future equity investments to improve the system, yet the state still derives production tax and royalty from the new quantities of gas that will fill the expansion space in the project.

COMMISSIONER BALASH answered that the committee will have the opportunity to review different scenarios and how things play out. He emphasized that Appendix A is regarding "any" party, it is not any party with at least "X percent" equity. The relative size of a party's interest does not dictate that party's ability to expand. The state's share or its partner's share might be important in the up-front wrangling over which party is the lead on a given component in the project.

[1:45:16 PM](#)

MR. PAWLOWSKI resumed his presentation. Addressing slide 10, he explained that Article 4 of the Heads of Agreement is subsequent to passage of enabling legislation. Article 4 describes work to be conducted during the Pre-FEED stage of the project. Ramp up of Pre-FEED is expected to take 18-24 months. Pre-FEED will be followed by a review of each Party and its management, and the decision to proceed to the next step is up to each individual party. Article 4 delineates what happens during the Pre-FEED period, which includes the development of sufficient information for evaluating the technical, cost, and schedule aspects of the Alaska LNG Project and the development of key project services agreement for the state's gas between the state and TransCanada and AGDC or AGDC's subsidiary. They will work within the infrastructure and work with the state to carry out its capacity and interests in a transparent manner. Mr. Pawlowski stressed

that a critical portion of Article 4 is that the parties, including the [producer parties], develop mutually agreed upon gas offtake and balancing agreements. The Department of Natural Resources will determine how the gas is produced going into the system and when the title is transferred to the state so it has gas to move through the system. This work must be accomplished as there is more than one field - Prudhoe Bay and Point Thomson - initially starting to supply gas. The state has an interest in those, and DNR as the landowner is uniquely positioned to work with the Parties. Mr. Pawlowski advised that Article 8.3.3 is a commitment from each of the producer parties, individually, to initiate individual gas sales or shipping efforts during the Pre-FEED stage. An LNG project is fundamentally driven by the market. This article is a clear statement of intent by the parties that as Pre-FEED is ramped up, the [producer parties] and the state will each test the market to determine whether Alaska gas can compete. The intent is also to determine whether there is an opportunity to move this project to the next stage. This is viewed as a fundamental difference in the efforts to commercialize Alaska gas.

[1:49:16 PM](#)

MR. PAWLOWSKI turned to slide 11 depicting Attachment 3 of Exhibit I-B in the Heads of Agreement, which highlights each stage of the project. He explained that certain work happens during the 12-18 months of the Pre-FEED phase, which will cost hundreds of millions of dollars and includes the beginning of individual LNG sales to test the market. The decision then arises whether to move to Front-End Engineering and Design (FEED), which will be in the billions of dollars and is expected to take 2-3 years. Following FEED, the project moves into the final investment decisions stage, which is when the Engineering, Procurement & Construction (EPC) contracts are executed. This stage will take 5-6 years and will cost in the tens of billions of dollars. Under the Heads of Agreement, the state will take a substantial role and will work with multiple partners with expertise in LNG through each gate of the project.

[1:50:47 PM](#)

MR. PAWLOWSKI introduced slide 12 regarding Article 5 for state participation in the Alaska LNG Project. He said state participation would yield significant benefits to the state, including maximizing the value of the state's resources, opportunity for delivery of gas to Alaskans, public transparency of the state's approval process, opportunity for additional

state revenues, realization of access and pro-expansion principles, improving the alignment of interests between the state and producer parties, and reducing valuation and other potential disputes between the state and producer parties. The state will participate in the infrastructure by entering into agreements with TransCanada and the AGDC subsidiary. The state participation section sets the range for state interest and an expectation that that interest will be somewhere between 20 percent and 25 percent. This approximate amount is regarding the state gas share with the blend of royalty gas and production tax gas.

[1:52:55 PM](#)

COMMISSIONER BALASH, responding to Representative Kawasaki about what risks the state would be taking on, advised that the manner in which the state participates is going to be important and the risks faced will be different depending upon the phase of the project. During the development phase there will be cash calls on the participating parties. If the state is participating directly and on its own it will have to be prepared to meet those cash calls as project development costs are incurred. A benefit of TransCanada being a partner in the midstream is that TransCanada will be responsible for meeting the cash calls, not the state. With regard to the execution of the project, one of the risks is cost overrun and the state will be interested in those costs staying on budget and on time. TransCanada's track record for delivering projects in an arctic environment is unparalleled in terms of coming in on time and on budget, so long as it receives regulatory approvals from the federal government. Subsequent to the construction phase and beginning operation, and depending upon how the state financed its share of the project, and whether it relied on a service provider or partner, the state will have certain substantial demands or financing charges to meet every day. These charges will be in the millions of dollars every day and how the state meets those demands will be based upon revenue coming into the state. He said the aforementioned go back to the Sale and Purchase Agreement, which includes the terms for the sale of the LNG itself. The state may have different interests or needs in the structuring of those agreements than the other parties. The state may want to have an "S" curve that protects it at the downside. Exactly how those particular risks are evaluated and what the state does to mitigate them is very important, he emphasized. The state has an opportunity within the Heads of Agreement to leverage the expertise of its partners to assist in development of mitigation strategies, and to apply those

strategies to the state's needs in its own way. For more detail on some of the risks, Commissioner Balash directed the committee to the royalty study released in November [2013].

[1:57:01 PM](#)

REPRESENTATIVE TARR recalled that the royalty study recommended an equity share in the 35 percent range as the most desirable of the three ranges that were evaluated.

COMMISSIONER BALASH replied, "That is not correct." He advised that scenarios as high as 35 percent were looked at to determine what it did to the state and to other parties. This figure was at the top end of the mutually beneficial aspect of state participation. At 35 percent there were circumstances where other sponsors would be as well off, but many circumstances where they would not. If the body chooses a tax rate that puts the state lower than 20 percent, he surmised that the state probably would not be interested in moving forward. If it results in higher than 25 percent, some of the other parties may not choose to move forward.

COMMISSIONER RODELL added that the state also must balance it with what the state can afford. The state's participation means it is going to have to find a way to come up with the cash calls in each of these stage gates as the project moves forward. In terms of long-term revenue, 35 percent may be attractive but it also requires the state putting up a considerable amount of money today. There is a need to balance the state's operating budgets and capital budgets along with whatever the state's appropriate participation is in this project.

[1:59:35 PM](#)

REPRESENTATIVE SEATON inquired whether finding purchasers willing to buy the state's gas on a long-term contract would provide financing for the state's portion.

COMMISSIONER RODELL answered that such a scenario would definitely create a mechanism the state could use to generate and raise capital to finance the state's portion of the project.

REPRESENTATIVE SEATON surmised, then, that if the state had financing from the purchasers of long-term sales, the constraint on the upper range of 25 percent would somewhat go away as far as coming up with cash calls.

COMMISSIONER RODELL replied that an important function of the Pre-FEED stage is to set something this year to start the conversations. Work will be performed over the next 18 months by both ADGC and the producer parties to assess the marketing capability. The state will determine what the demand is for the state's gas both internally and externally. This information will assist the administration and legislature in 2015 during the discussions of what adjustments need to be made to all of the agreements.

REPRESENTATIVE SEATON stated that he is trying to determine if, in the Heads of Agreement, the state is restricting itself if it finds sales for its portion of gas. Or, he asked, if the state is only proceeding forward on sales for everyone together and in that manner everyone receives a portion of the gas or if the state is proceeding with the idea that importers willing to work directly with the state puts the state in a different position than necessarily equivalent among producers.

COMMISSIONER RODELL responded that a benchmark has been set in recognizing what is known today and recognizing the need to come back and continue with these discussions. [The administration] is confident about the 20-25 percent range, meaning both in-state and export demand, and it is intended to be an ongoing conversation.

[2:02:43 PM](#)

MR. PAWLOWSKI, before continuing his presentation, informed members that presentations by the state's and legislature's experts will be provided regarding royalty, production tax, and other government take issues. He specified it is important to not lose sight of other "state take" terms which impact this project and the project's economics. Royalty and production tax are not the only factors in the fiscal system - property tax at \$45-\$65 billion is a significant factor through the life of this project. Mr. Pawlowski then turned to slide 13 of his presentation regarding the regulatory framework, access, and expansion under Article 6 of the Heads of Agreement. Article 6 recognizes that under Section 3 of the Natural Gas Act there is an opportunity for a tailored regulatory framework that meets the needs of Alaskans, provides commercial terms for access and pro-expansion, and protects Alaskans when alternatives are available in the regulatory framework. Ultimately regulations depend upon development of the commercial agreements supporting the pro-extension principles, and there is an opportunity to

protect the state by committing to advancing this project during the Pre-FEED stage under Section 3 of the Natural Gas Act.

[2:05:07 PM](#)

MR. PAWLOWSKI, responding to Co-Chair Saddler about why Section 3 of the Natural Gas Act is so important, stated that the regulatory agencies assert what the jurisdiction is to be, and it is up to a regulatory agency at the federal level to make a decision. He maintained that LNG plants are clearly the regulatory responsibility of the Federal Energy Regulatory Commission (FERC), under Section 3 of the Natural Gas Act. From the state's perspective this created concern regarding royalty and production tax evaluation. Royalty begins with the state's value equation from the wellhead, after transportation costs are deducted. Production tax uses the same mechanism through the gross value at the point of production with a slightly different treatment of deductible expenditures, and at that point the state calculates a production tax. Both are sensitive to the cost of moving through the tariffs. FERC, Section 3, for an LNG terminal is clearly not economically regulated. It is a "black box." From the state's perspective the best way to create an alignment is by "going into the black box" in order to maximize the state's royalty value, tax interests, and transparency interests. [The administration] views an amicable agreement, with parties working together to solve each other's problems, as the best way to move this project forward. The alternative would be jurisdictional disputes and litigation. The best plan is working together, clearly stating the state's interests, and moving forward together.

[2:07:10 PM](#)

MR. PAWLOWSKI, responding to Co-Chair Saddler about whether FERC has indicated any objections to the aforementioned, stated that discussions have not yet been engaged with FERC. A portion of Article 6 describes the process to start the discussion through the filing of a Petition for Declaratory Order, starting to seek clarification on jurisdiction, and a commitment that all parties will work together to solve each other's problems. An important portion of the Heads of Agreement, Page 11, is recognition that each party must be satisfied with the commercial terms and regulatory framework prior to the execution of the FEED agreement for the Alaska LNG Project. This is a place where the word "party" is used to recognize that it is just investors in the infrastructure. The investors of the infrastructure plus the agencies all must be comfortable with the agreement.

[2:08:13 PM](#)

REPRESENTATIVE SADDLER asked whether there are provisions for dispute resolution should all parties not agree to enter FEED.

MR. PAWLOWSKI replied that dispute issues are to be developed during the Pre-FEED phase, such as how the commercial relationships work, and what happens if and when. Currently the Heads of Agreement is the alignment mechanism which states that through Pre-FEED the parties will work together. This phase gets more detailed and more complicated as it moves forward.

[2:09:10 PM](#)

MR. PAWLOWSKI turned to slide 14 of his presentation and urged the members to note why the expansion principles are so important to the state. Alaska has significant gas resources on the North Slope - the currently known reserves are 35 trillion cubic feet (TCF) and the U.S. Geological Survey (USGS) estimates the technically recoverable conventional gas resources are more than 240 TCF. There is a large difference between what a reserve is and what a technically recoverable resource is, but all indications from the geological perspective is that the state has vibrant gas resources available to be explored and developed. This project is the avenue for that development as pro-expansion guarantees that Alaska land, beyond Prudhoe Bay and Point Thomson, will continue to be explored for gas and that that gas will get into the line and benefit Alaskans.

[2:10:09 PM](#)

MR. PAWLOWSKI called attention to Appendix A, Pro-Expansion Principles, displayed on slide 15. He said these principles provide high-level guidelines and principles covering the expansion of any component of the Alaska LNG Project, during both the Pre-FEED stage and development of commercial agreements during that state. From the state's perspective the key is that any party to the project has a right, but not the obligation, to expand the component it is in. Referring to the highlighted language of slide 15, he stated that expansions can proceed if they meet the criteria in Section A.1.1. [The administration] believes this will put the state on a strong footing to protect the state's interests and move the project.

[2:11:22 PM](#)

MR. PAWLOWSKI, responding to Representative Olson, clarified that the 240 trillion cubic feet of gas he previously mentioned is for conventional gas resources only and does not include any unconventional gas resources.

[2:11:41 PM](#)

MR. PAWLOWSKI moved to slide 16, stating that the Heads of Agreement contemplates the enabling legislation that has been introduced by the governor and that this committee will review. Article 7 of the Heads of Agreement describes a two stage process which includes the establishment of general take terms and mechanisms to provide clarity and predictability for the parties during the Pre-FEED stage. Article 7 defines who does what and who is responsible for what because multiple contracts between multiple parties will be necessary to move the project. The timeline presented on slide 16 assumes a success case by starting with the enactment of enabling legislation in April 2014. Then, throughout 2014 and 2015, the agencies, AGDC, AGDC's subsidiary, TransCanada, and the producer parties, both internally and externally, will work to put the project enabling contracts back together. In 2015 this package of work will come before the legislature and the public to consider whether it is appropriate to move to the next stage and each party, individually, will decide whether to advance to the next stage of the project.

[2:13:43 PM](#)

MR. PAWLOWSKI then discussed Article 8 of the Heads of Agreement (slide 17), which describes the royalty and tax terms. A key provision is that AS 38.05.182 directs DNR to take royalties in-kind on oil and gas. [The Alaska North Slope Royalty Study, November 2013, undertaken by Black & Veatch Corporation on behalf of the Department of Natural Resources, State of Alaska,] recognized risks that the state would be exposed to by going in-kind. A primary risk is that the state, in taking a step into the global LNG market, is not as well equipped as the producer parties that operate in the market on a day-in-day-out basis. He said Article 8.3.3 is an example of what happens when parties work together. The article [page 14 of the Heads of Agreement] states that individual producer parties will "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 that is made from the State's deliveries [RIK plus TAG] of natural gas to the Alaska LNG Project" This means the producer parties will work

with the state to provide an opportunity and an option, not a foregone conclusion, to market on behalf of the state a portion of the LNG. [The administration] believes that is a major step in the state's direction of dealing with the primary risks identified in the royalty study.

[2:15:45 PM](#)

MR. PAWLOWSKI moved to slide 18, noting that Articles 9 and 10 address other project enabling terms, and additional support, for the Alaska LNG Project. Property tax is one of the most significant fiscal impacts of the project and in Alaska that tax is shared between the state and local governments. The administration came to the table with the intent to engage local municipalities in a plan for property tax, both within and outside of the project corridor. The Heads of Agreement commits the state to a consultation process with local governments to develop payments in lieu of taxes and impact payments during the project, which must happen during the Pre-FEED stage. It also recognizes that the project enabling contracts negotiated between the parties must be of a sufficient duration to support financing, to permit the realization of competitive economic returns, and to support gas and LNG sales. Predictability of the terms matters as much to the state as it does to any of the parties and that work will be developed during the Pre-FEED stage. There is general support for the development of the necessary infrastructure and other local, state, and federal permitting requirements, including the continuation of a healthy long-term oil business to share the costs and development of the upstream in Alaska.

[2:17:28 PM](#)

MR. PAWLOWSKI turned to slide 19, addressing the Alaska hire and content within Article 11. He said Article 11 commits the parties to some principles, including guidance to hire Alaska residents; contract with Alaska businesses; participate with the Department of Labor & Workforce Development in updating training plans and provide training that prepares Alaskans for work on the project; and negotiate in good faith project labor agreements for the Alaska LNG Project. Based upon Exhibit I-B, the estimated total project cost is \$45-\$65 billion with between 9,000 and 15,000 jobs during peak construction. The LNG project will also provide about 1,000 jobs once in operation, including long-term, community-supporting jobs in liquefaction.

[2:18:53 PM](#)

MR. PAWLOWSKI concluded his presentation by displaying a picture of Point Thomson (slide 20) and stating that development of those reserves, and the unlocking of the settlement, forms a foundation to move this project forward. He quoted from the October 1, 2012, letter in Exhibit I-B: "While North Slope gas commercialization is challenging, working together, we can maintain the momentum toward our shared vision for Alaska." He added that the Heads of Agreement is an alignment around a vision and a road map and is people working together to solve problems for the unlocking of a resource that will be of benefit to generations of Alaskans.

[2:20:42 PM](#)

CO-CHAIR FEIGE thanked the witnesses for their efforts including the entities involved in preparing the Heads of Agreement. He recognized that the state resolved differences with other parties and that the other parties worked together amongst themselves to resolve their differences. The agreement is a huge step forward in advancing the notion of a gas pipeline to move North Slope gas to market. The pipeline would have great benefits for the state in revenue, jobs, building the economy, and lowering Alaskan's energy expenses.

[2:21:01 PM](#)

CO-CHAIR SADDLER recognized that the Heads of Agreement answers some questions but contains firm answers to very few of the hard questions that the legislature and the public are going to ask. He said his questions include what the state's specific obligations are; what the legislature's specific obligations are, step by step, moving forward; at what point can the legislature amend the conditions; and will there be any opportunity for the legislature to amend the Heads of Agreement before approving the enabling legislation.

COMMISSIONER BALASH offered his belief that the question really refers to the enabling legislation. When [the administration] reviews that legislation with the committee, members will see what [the administration] is asking for in the way of authority. [The administration] will turn to that authority to put on paper any additional details desired, which are details necessary before making a multi-hundred-million-dollar decision. He said, currently, [the administration] is requesting legislative authority to proceed on a tens of millions-dollar decision to get to that next step. Regarding particular points within the

Heads of Agreement that the legislature would like to change or amend, he guessed that "it depends." [The administration] is prepared to discuss how its decisions were made during an open dialogue with the other parties. There may be some room to maneuver on the part of everyone. However, he said, he would describe this as a term sheet that was developed with the other parties and it is now being brought to the legislature. If the legislature decides to send [the administration] a counter, "we'll see what happens," he said. There may be some things to talk about, but it is hard to be specific without understanding exactly what Co-Chair Saddler would like to see different.

CO-CHAIR SADDLER interjected that it was not his intention to second guess [the administration] or begin making changes to the Heads of Agreement. He understood that the department was able to negotiate what it could agree with, and where there was not yet agreement was left to another day.

[2:24:14 PM](#)

COMMISSIONER BALASH said Co-Chair Saddler's statement is fair, and he explained that the enabling legislation itself is where the legislature can engage. Two big decisions for the legislature are whether the state should participate and, if yes, then the issue becomes the state's percentage overall, which is arrived at by establishing the production tax rate. There are also questions regarding establishing a subsidiary for AGDC. [The administration] had to make decisions based upon the best advice it had as to what to include in the legislation on introduction, but there is discretion in what was ultimately decided upon and the legislature, as a separate branch, will want to review that and possibly make different decisions.

MR. PAWLOWSKI added that when the enabling legislation is discussed, there are other pieces where a dialogue with the committees will be valuable. Those include what the role of the legislature is during the developments of these agreements, how is the information flowing, and how is the diligence happening. The governor and the administration have no intention of completely stepping away as the intention is to be much more transparent to the public, presenting the deal up front, and working together over the next couple of years. There will be opportunities to discuss how the legislature and public will have a role in watching the project evolve.

[2:26:50 PM](#)

REPRESENTATIVE KAWASAKI referred to Appendix A regarding pro-expansion principles, and noted the legislature had always discussed, under AGIA or another pipeline, that it was to be a common carrier and to have expansions paid for. He requested an explanation for the departure from this particular principle.

COMMISSIONER BALASH explained that the provisional framework for AGIA was built around Section 7 of the Natural Gas Act, and Section 7 contemplates contract carriage, not common carriage. Article 6 of the Heads of Agreement sets out that each party will pursue the operation of its section of the pipe as it deems fit. Each of the producer parties will pursue proprietary operation. The state, in partnership with TransCanada and ADGC, will operate in a fashion more akin to open access; for example, providing service to third parties and offering intermittent service. Rather than one tariff that is charged to all the parties, there will be four tariffs. Within each portion of the project each party will set up its own financing. In the early 1970s, Governor Egan spelled out how it would be in the state's interest to own one-eighth of the TransAlaska Pipeline Service (TAPS) for a number of reasons, including the ability to see how much the costs were and to be certain the state did not overpay its tariffs, he explained. Unfortunately Governor Egan was a vote or two short in getting that ownership position, but had he been successful, the state would have had a much different past. The state then went into decades of disputes and hostilities over the rates Alaska was charged for its share of the production. It was not because the project cost more or less; it was the basis of the financing for those costs. A party could have the same costs for a given pipeline or piece of infrastructure, and if it finances with more debt or less, or it has varying rates of return, it can affect the tariff considerably. [The administration] wants to ensure that for the portion of the project the state is paying for, the state will be in a position to set up the financing. For example, if one of the companies decides to go 100 percent equity and receive a 13 percent rate of return on that equity, it will not affect the state and it will not affect the state's other interests. "In some ways, it is a live and let live approach."

[2:31:31 PM](#)

CO-CHAIR SADDLER requested an explanation regarding TransCanada and the term "hold the state's equity share".

COMMISSIONER BALASH replied that, in essence, TransCanada will operate as the state's equity agent in the [gas] treatment plant

and the pipeline. The parties have agreed on a certain set of commercial terms that begin with the recognition that this is transportation that is set up for the state's gas. At the end of the initial contract term the state has the ability call back the state's equity position in the infrastructure. Before that, the state has an opportunity to participate in the equity directly, which is an option that the state enjoys up until the point of FEED. As part of the due diligence effort, [the administration] will explore and work with AGDC and others to identify whether it makes sense for the state to call that option and remain a participant in the midstream elements. He said that during its next presentation before the committee [the administration] will discuss the cash consequences of going 100 percent TransCanada, 0 percent TransCanada, or something in between.

[2:33:42 PM](#)

CO-CHAIR SADDLER noted he is looking forward to understanding how TransCanada will act as the state's agent. He then inquired how long the initial contract period is.

COMMISSIONER BALASH answered that the Firm Transportation Services Agreement (FTSA) in the term sheet is expected to be 25 years, subject to further adjustment as the state gains an understanding of the marketing arrangements and the terms of the Sale and Purchase Agreements (SPAs). The Precedent Agreement is a two-year item, where the state has a development cost agreement up-front that leads into the FTSA.

[2:34:37 PM](#)

REPRESENTATIVE TARR, regarding cash flow, asked at what point in the project timeline is the break-even point expected to be reached and the revenue earnings to begin.

MR. PAWLOWSKI specified that economic analysis discussions from DNR's experts, the state's experts, and the legislature's experts will be forthcoming. He cautioned that models are models. The committee can look at the crossover points, returns, and cash flows for the rate that [the administration] understands today. However, the largest driver is managing the capital costs of construction, which is part of the reason [the administration] sees such a benefit in participating with partners like BP, Conoco, and Exxon, and TransCanada that have expertise at bringing projects in around the estimated capital costs. Within any analysis there must be sensitivity to the

fact that it is a model and that it must be looked at in multiple sensitivities, not just one distinct point in time.

2:36:20 PM

REPRESENTATIVE TARR brought attention to slide 18 and inquired whether consultations with local governments, payments in lieu of property tax, and impact payments is similar to what happens now with impacted communities for North Slope oil development.

COMMISSIONER BALASH responded that it is not dissimilar, but not quite the same. It is more in keeping with the agreement that Red Dog Mine has with the Northwest Arctic Borough.

MR. PAWLOWSKI interjected that the impact payment concept has much to do with levy of property tax during the construction period, how it is calculated, and what the tax might be. The municipal partners must be able to calculate how to slide cash flows and tax rates from the construction period on into the operation period. A lot of work must be performed on the property tax side to ascertain that communities are sharing benefits in a manner that supports community needs during construction as well as providing benefits long term through property taxes.

2:38:07 PM

REPRESENTATIVE SEATON noted that royalty and production tax could be taken in kind, that each party may have a different financing mechanism, and that each party would be operating independently. He asked what the effect would be of taking the production tax in kind under this type of arrangement. For example, a party with 100 percent equity could shift all the costs down the stream so that the wellhead value is much less and most of the cost is shifted to transportation of LNG. He further asked whether the purpose of that is so it does not affect the tax rate and the only thing the state would be missing out on, or that could be influenced, is the corporate income tax.

MR. PAWLOWSKI replied there is a difference between gross value and a percent of production. The difference becomes important when reviewing the question about fuel gas the state is responsible for. He assured Representative Seaton those details would be discussed with the enabling legislation, but it does provide real transparency over what the costs are that go into

the equation to determine the value in a manner that protects the state.

REPRESENTATIVE SEATON requested that a simple flow chart be prepared for the committee of how the state gets to [gross value], how that influences cost shifting, and how it would not influence the production tax, but what influence it would have depending upon those decisions made by other parties.

[2:40:32 PM](#)

CO-CHAIR SADDLER recalled there were concerns in that same general area in a previous iteration of a natural gas line deal; the lack of openness and transparency causes that previous one to not be successful. These were some of the pitfalls that caused the previous [natural gas line deal] to not be successful. He inquired about the specific ways the process outlined in the Heads of Agreement addresses those concerns and hopes to ameliorate them.

MR. PAWLOWSKI responded that Articles 5.5 and 5.6 on page 10 of the Heads of Agreement puts forward how information flows during the Pre-FEED stage and in the principle of information flow after the Pre-FEED stage. He reminded the members that in this construct the resource agencies are actually customers of [the state's] agents. [The state's] agents are either the AGDC subsidiary or TransCanada on the terms that are negotiated between the state and TransCanada by those services agreements. Article 5.5 covers the flow of information during the Pre-FEED stage and at that point the administration works with ADGC and the producer parties in a proprietary capacity to have access to that information during the Pre-FEED stage. When the project moves into operation, Article 5.6 describes the disclosure of information, subject to relevant confidentiality and applicable law, in sufficient detail to allow each Alaska LNG party to meet its reasonable business needs, including obligations to customers. An important point is what information needs to be shared from TransCanada or AGDC back to the state to allow the state clarity and comfort in the shipping. Those are negotiated in the services agreements to carry and transport state gas or provide liquefaction services. Articles 5.5 and 5.6 provide the mechanisms during Pre-FEED and after Pre-FEED of how that information flows back to the state and through the state to the people and the legislature. Within the enabling legislation are some additional pieces that [the administration] has set up for engagement with the legislature, along with other public information around the way the tax is treated.

2:43:23 PM

REPRESENTATIVE TARR queried whether [the administration] has any comments on the forthcoming RCA reauthorization legislation. During a previous conversation it was explained that there was an agreement about who had responsibility over each component of the project. She asked whether that was something the committee should be thinking about when it considers that legislation. She also noted it has been reported that FERC has an enormous backlog.

COMMISSIONER BALASH replied that jurisdiction on this project will be a function of federal law. The state's statutes regarding regulation of pipelines and associated facilities gives a wide berth to federal jurisdiction. In this case, there is no disputing that FERC has jurisdiction over the liquefaction and marine terminal. The federal statutes are unclear as to how far that jurisdiction extends with regard to a pipeline that feeds into a liquefaction terminal. He noted there is a fair debate to be had between and among FERC attorneys. It was realized that the state can put forward a theory as to what law applies and why, but ultimately it is the commission that decides. Should the commission assert jurisdiction over the pipeline, Article 6 provides a method to develop a plan for how the commercial terms will apply and how a tailored approach will be employed for this project.

2:46:02 PM

COMMISSIONER BALASH, responding to Representative Kawasaki, explained that there are multiple copies of the same signature pages of the Heads of Agreement because they had to be signed by a number of people in different parts of the country.

REPRESENTATIVE KAWASAKI observed that the date for termination of the Heads of Agreement is December 31, 2015. He asked whether there are provisions for a withdrawn partner or for a scenario in which the legislature decides not to go this way.

COMMISSIONER BALASH answered that this administration will serve through early December 2014, and in November the people will decide [if it is longer]. This particular agreement is set to expire December 31, 2015, because it will be known by then whether the state will be proceeding to the FEED gate. If there is not progress along the way, if the other needed contracts are not developed, it is fair to let this agreement expire. The

administration and the legislature will then have a much more difficult conversation regarding what to do about it.

[2:48:31 PM](#)

CO-CHAIR SADDLER, regarding the signatories on the back pages of the Heads of Agreement, asked whether there any assumptions the committee should know about the level of commitment by the Alaska subsidiaries and by the parent corporations of BP, ConocoPhillips, and ExxonMobil.

MR. PAWLOWSKI deferred to the parties signing the Heads of Agreement, saying it would be more appropriate for them to speak about their respective commitments.

CO-CHAIR SADDLER inquired at what point in the process laid out by the Heads of Agreement the state would have a better idea of what the expected rate of return would be as an equity participant in the gasline and all the associated components. He clarified he is not asking what the rate would be, but when it be expected to know the rate of return.

MR. PAWLOWSKI responded that the rate of return would not be known until the project is built and in operation. There will be estimates with increasing clarity and predictability throughout Pre-FEED, FEED, and during construction. He pointed out that there were things with the Trans-Alaska Pipeline System (TAPS) that changed the rate of return for many of the people involved in that project.

[2:50:12 PM](#)

CO-CHAIR FEIGE queried whether it was fair to say that there will be a clearer idea as the project moves closer to the FEED process and as the SPAs are negotiated.

MR. PAWLOWSKI offered his belief that at the conclusion of Pre-FEED there will be a much clearer idea of what to expect. It must be clear enough for the state, as well as everyone, to be able to take the next step to what will then be a multi-billion-dollar commitment for each party.

Co-Chair Feige commented it does not make sense to proceed if no one will buy the product.

[2:50:48 PM](#)

REPRESENTATIVE SEATON recalled that in the previous iteration of the state participation and ownership, one of the biggest problems became the state regulating itself. He requested a spreadsheet of how the state is getting around that same problem under this proposed LNG scenario so it can be seen where there are problems.

REPRESENTATIVE JOHNSON commented that since he has not heard of any of the presidents of these companies being fired, they must have been acting at the behest of their board of directors. He queried whether at any point there will be discussions about the interaction between this and the current law of the land.

COMMISSIONER BALASH answered that he will specifically address this question during a forthcoming committee meeting.

REPRESENTATIVE TARR surmised that the Tax as Gas will now be the standard that [the administration] is rolling into the proposal and is how all of it will be factored.

COMMISSIONER BALASH nodded yes.

[2:54:10 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 2:54 P.M.