

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 25, 2014

4:38 p.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Dan Saddler, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Mike Hawker
Representative Kurt Olson
Representative Paul Seaton
Representative Scott Kawasaki

MEMBERS ABSENT

Representative Craig Johnson
Representative Geran Tarr

COMMITTEE CALENDAR

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 138(FIN) AM

"An Act relating to the purposes, powers, and duties of the Alaska Gasline Development Corporation; relating to an in-state natural gas pipeline, an Alaska liquefied natural gas project, and associated funds; requiring state agencies and other entities to expedite reviews and actions related to natural gas pipelines and projects; relating to the authorities and duties of the commissioner of natural resources relating to a North Slope natural gas project, oil and gas and gas only leases, and royalty gas and other gas received by the state including gas received as payment for the production tax on gas; relating to the tax on oil and gas production, on oil production, and on gas production; relating to the duties of the commissioner of revenue relating to a North Slope natural gas project and gas received as payment for tax; relating to confidential information and public record status of information provided to or in the custody of the Department of Natural Resources and the Department of Revenue; relating to apportionment factors of the Alaska Net Income Tax Act; amending the definition of gross value at the 'point of production' for gas for purposes of the oil and gas production tax; clarifying that the exploration incentive credit, the oil or gas producer education credit, and the film production tax credit may not be taken against the gas production tax paid in gas; relating to the oil or gas producer education credit; requesting the governor to establish an

interim advisory board to advise the governor on municipal involvement in a North Slope natural gas project; relating to the development of a plan by the Alaska Energy Authority for developing infrastructure to deliver affordable energy to areas of the state that will not have direct access to a North Slope natural gas pipeline and a recommendation of a funding source for energy infrastructure development; establishing the Alaska affordable energy fund; requiring the commissioner of revenue to develop a plan and suggest legislation for municipalities, regional corporations, and residents of the state to acquire ownership interests in a North Slope natural gas pipeline project; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 138

SHORT TITLE: GAS PIPELINE; AGDC; OIL & GAS PROD. TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/24/14	(S)	READ THE FIRST TIME - REFERRALS
01/24/14	(S)	RES, FIN
02/07/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/07/14	(S)	Heard & Held
02/07/14	(S)	MINUTE(RES)
02/10/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/10/14	(S)	Heard & Held
02/10/14	(S)	MINUTE(RES)
02/12/14	(S)	RES WAIVED PUBLIC HEARING NOTICE, RULE 23
02/12/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/12/14	(S)	Heard & Held
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02/13/14	(S)	RES AT 8:00 AM BUTROVICH 205
02/13/14	(S)	Heard & Held
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02/24/14 (S) RES RPT CS 2DP 4NR 1AM NEW TITLE
02/24/14 (S) DP: GIESSEL, MCGUIRE
02/24/14 (S) NR: FRENCH, MICCICHE, BISHOP,
FAIRCLOUGH
02/24/14 (S) AM: DYSON
02/24/14 (S) RES AT 8:00 AM BUTROVICH 205
02/24/14 (S) -- MEETING CANCELED --
02/24/14 (S) RES AT 3:30 PM BUTROVICH 205
02/24/14 (S) Moved CSSB 138(RES) Out of Committee
02/24/14 (S) MINUTE(RES)
02/25/14 (S) FIN AT 9:00 AM SENATE FINANCE 532
02/25/14 (S) Heard & Held
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 03/12/14 (H) RES AT 1:00 PM BARNES 124
 03/12/14 (H) -- MEETING CANCELED --
 03/14/14 (S) FIN RPT CS 6DP 1AM NEW TITLE
 03/14/14 (S) LETTER OF INTENT WITH FINANCE REPORT
 03/14/14 (S) DP: KELLY, MEYER, DUNLEAVY, FAIRCLOUGH,
 BISHOP, HOFFMAN
 03/14/14 (S) AM: OLSON
 03/14/14 (S) FIN AT 9:00 AM SENATE FINANCE 532
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 03/19/14 (H) RES, L&C, FIN
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 03/25/14 (H) RES AT 4:30 PM BARNES 124

WITNESS REGISTER

DEEPA PODUVAL, Principal
 Management Consulting Division
 Black & Veatch Corporation;
 Consultant, Department of Natural Resources (DNR)
 Houston, Texas

POSITION STATEMENT: In relation to CSSB 138(FIN) am, provided a PowerPoint presentation entitled, "Observations on Heads of Agreement."

PETER ABT, Management Director
Management Consulting Division
Black & Veatch Corporation;
Consultant, Department of Natural Resources (DNR)
Houston, Texas

POSITION STATEMENT: In relation to CSSB 138(FIN) am, assisted in providing a PowerPoint presentation entitled, "Observations on Heads of Agreement."

JASON DE STIGTER, Senior Consultant
Management Consulting Division
Black & Veatch Corporation;
Consultant, Department of Natural Resources
Kansas City, Missouri

POSITION STATEMENT: In relation to CSSB 138(FIN) am, answered a question related to the PowerPoint presentation entitled, "Observations on Heads of Agreement."

ACTION NARRATIVE

[4:38:22 PM](#)

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 4:38 p.m. Representatives Olson, Seaton, P. Wilson, Kawasaki, Hawker, Saddler, and Feige were present at the call to order.

SB 138-GAS PIPELINE; AGDC; OIL & GAS PROD. TAX

[4:38:47 PM](#)

CO-CHAIR FEIGE announced that the only order of business would be CS FOR SENATE BILL NO. 138(FIN) am, "An Act relating to the purposes, powers, and duties of the Alaska Gasline Development Corporation; relating to an in-state natural gas pipeline, an Alaska liquefied natural gas project, and associated funds; requiring state agencies and other entities to expedite reviews and actions related to natural gas pipelines and projects; relating to the authorities and duties of the commissioner of natural resources relating to a North Slope natural gas project, oil and gas and gas only leases, and royalty gas and other gas received by the state including gas received as payment for the

production tax on gas; relating to the tax on oil and gas production, on oil production, and on gas production; relating to the duties of the commissioner of revenue relating to a North Slope natural gas project and gas received as payment for tax; relating to confidential information and public record status of information provided to or in the custody of the Department of Natural Resources and the Department of Revenue; relating to apportionment factors of the Alaska Net Income Tax Act; amending the definition of gross value at the 'point of production' for gas for purposes of the oil and gas production tax; clarifying that the exploration incentive credit, the oil or gas producer education credit, and the film production tax credit may not be taken against the gas production tax paid in gas; relating to the oil or gas producer education credit; requesting the governor to establish an interim advisory board to advise the governor on municipal involvement in a North Slope natural gas project; relating to the development of a plan by the Alaska Energy Authority for developing infrastructure to deliver affordable energy to areas of the state that will not have direct access to a North Slope natural gas pipeline and a recommendation of a funding source for energy infrastructure development; establishing the Alaska affordable energy fund; requiring the commissioner of revenue to develop a plan and suggest legislation for municipalities, regional corporations, and residents of the state to acquire ownership interests in a North Slope natural gas pipeline project; making conforming amendments; and providing for an effective date."

[4:39:07 PM](#)

DEEPA PODUVAL, Principal, Management Consulting Division, Black & Veatch Corporation; Consultant, Department of Natural Resources (DNR): We are consultants to the Department of Natural Resources, helping with economic analysis as well as commercial support. I work the state, with DNR specifically, for the past seven or eight years starting ... toward the end of [State Gasline Development Act] SGDA, through [Alaska Gasline Inducement Act] AGIA and for the last couple of years on the Alaska [Liquefied Natural Gas] LNG Project.

[4:40:12 PM](#)

PETER ABT, Management Director, Management Consulting Division, Black & Veatch Corporation; Consultant, Department of Natural Resources (DNR): I've been working with the State of Alaska since the royalty study was commissioned this past summer and my

primary area of expertise with it [is] LNG markets and commercial structure.

MS. PODUVAL: And on the phone we have Jason De Stigter he is manager with Black & Veatch and he has lead much of the analysis that we've used to support the state. And he's available for questions, Mr. Chair.

[4:40:58 PM](#)

MS. PODUVAL: So, what we have are two different sessions that we're hoping to walk this committee through. We've broken out our discussion of the transaction that is in front of you and the enabling legislation into two different pieces. The first is our observations on the Heads of Agreement, one of the two major agreements that the state has entered into. And the second, we'll be focusing on TransCanada's participation specifically. Today what we're hoping to walk through is our observations on the Heads of Agreement. And tomorrow, when we're back here, we will be focusing on TransCanada and its participation in the project.

CHAIR FEIGE: Okay and we've been joined by Representative Isaacson in the gallery. If you'd like Rep. Johnson is not here. So, if you want to sit at the table, go ahead.

MS. PODUVAL: Before we start walking through the specifics of the Heads of Agreement (HOA), I wanted to show this chart [slide 3] and just sort of put into perspective what is at stake here with the AK LNG Project. And what we're essentially showing here is projected revenues for the state in two different worlds: one without the Alaska LNG Project, an oil only world; and the other with the Alaska LNG Project where there is oil as well as gas production from the North Slope. And what we start seeing here is that ... in the oil only world, the forecast - at least as it is today - would be for declining revenues for the state, and fairly aggressive at that. The Alaska LNG Project is essentially forecast to potentially bring up to \$4-\$4.5 billion per year of additional revenues to the state.

REPRESENTATIVE FEIGE: And those revenues are gross or net?

MS. PODUVAL: Those are net revenues to the state. One other fact that I want to highlight while we're on this slide [slide 3] is that all of our analysis models these two worlds each time we look at the project. And so, we model an oil only world and use that as our base line and we layer on top of that a world

that has gas production from the North Slope and revenues associated with that; and recognizing that there are some interdependencies between those two here in Alaska. Whenever we speak of revenues from the AK LNG Project what we're referring to are incremental revenues that would be attributed to the Alaska LNG Project and so it would be net of any impacts that would occur to the state's revenues on the oil side, whether positive or negative. If we go on to slide 4; just putting the HOA within the context of the AK LNG Project's development timeline. Where we are today in 2014 is ahead of the first of these development stages, which is Pre-FEED and FEED, essentially stands for Front-End Engineering and Design, and it's the first step to starting to understand the project's cost and scope better. As it's anticipated today, this will hopefully kick off mid-2014 and go through the next 18 months and would be expected to be completed at the end of 2015. The next stage in the project's development would be the front-end engineering and design. And this is where the detailed scoping of the project will occur. And so, from a technical perspective, the scope will be well described and defined, the cost estimates associated with this project will become much narrower than the \$45-\$65 billion or the \$39-\$54 billion that we hear today. But there are also some other very important project development steps that get achieved during the FEED process. In addition to the technical specifications being worked out, the second aspect that will get finalized during the FEED process are the commercial arrangements associated with the project. And that will include ... both the project's commercial structure itself and how the different pieces ... will be shared between all of the different stakeholders, but also very importantly, this is a stage where discussions with the market start to occur and the sales and purchase agreements associated with the LNG will be negotiated and finalized during this stage as well. The third aspect that we'll ... work through FEED are the financing arrangements that will accompany this project. And so, for each of the different stakeholders in the project - the producers as well as notionally the state with an equity share, and potentially TransCanada - this is the stage during which discussions and negotiations are entered into in the financial market as well and the debt that will be secured to finance the project will all be worked out. And so, all of that information -- having good information on the project's scope and cost, having information on the price as well as the volume ... that will be associated with the LNG that's coming out of this project, and having the financing agreements in place, essentially gives the different project participants sufficient information to trigger a key point in the project's

development, which is denoted here as FID or final investment decision. And that's really when the majority of the project's construction activity and the project's costs related to that will start being incurred. And so, if you look at the boxes at the bottom, they associate costs with each of these project development stages. The first state though Pre-FEED would have, for the state, somewhere between \$40 and a \$100 million being invested. Then you get to the FEED stage and the state's investment goes to between \$180 and about \$450 million, or about 2 to 3 percent of the total investment. Then, it is after FID when more information about the project is available that the \$7 to \$13 billion, or up to 95 to 97 percent of the project's costs, will start being spent. If you get to FID and all of the information in front of you does not point toward an economically viable project -- in other words the market is not there or the market is not willing to give the prices that would be needed to support the cost structure of this project, or the financing arrangements are simply not attractive enough to where the different stakeholders can make money, at that point each of the producers as well as the state, TransCanada, they would all be taking that decision not to go ahead with the project and not to put billions of dollars into a project that doesn't have all of the pieces lined up. The flip side of that, or the ... success path associated with that, is if you go through the FEED process and have all of those elements lined up, at that point there is sufficient comfort in the deals that have been struck that this project will be economic to where you can actually take the step where the state as well as all of the different parties now start investing billions of dollars. So, what the HOA really takes us through is Pre-FEED; its decisions associated with for the state investing the \$40 to \$100 million and to enter into commercial agreements with the other stakeholders here that hone in on ... all of the details that will support entering into FEED after Pre-FEED, if that is the decision that the project developers take in essentially moving the process forward.

[4:50:15 PM](#)

CO-CHAIR FEIGE: Question, Representative Hawker, then Kawasaki.

REPRESENTATIVE HAWKER: Thank you Mr. Chair. Good to see you back again. I'd like to just - I've got your presentation here - and I'd just like to establish a real foundational understanding for myself. I think last fall, the last time you were in front of House Resources here talking about the royalty study, which of course plays into a lot of these economics that

we are going to be looking at here. There was a fairly lengthy discussion about how that royalty study at the time was necessarily based really on the estimated project costs of the original AK LNG Project which was TransCanada's open season and then their original plan to go to Valdez. There's certainly been announcements of changes subsequent to that time. I'm just wondering ... is this document still based on that original TransCanada concept or have you been able to have access to and are working with numbers that - recognizing that FEED is all about tying things down a whole lot tighter - but is this really about the current project and have you had the chance to incorporate an update of the project from what it was last time we were talking to you into the documents in front of us.

[4:51:37 PM](#)

MS. PODUVAL: Representative Hawker, through the Chair, thank you. It's very nice to see you again too. The short answer is yes. The cost estimates here incorporate the assessment that we made Sorry, let me back up. The pipeline cost estimates and the [gross domestic product] GDP cost estimates, I believe are what you're referring to when you say we started with the royalty study from AGIA cost estimates. And so, what we did as part of the royalty study is to evaluate those cost estimates in light of the changes in the market and update those cost estimates to what would they, would be today, and we worked with both Black & Veatch technical experts as well as the state's technical experts in order to update that. And so, the cost estimates that you're seeing here are essentially today's view of what the project's cost would be. And again, they have a wide range ... as you refer to. We fully expect that as the project goes through the FEED stage that that range will get narrowed down a lot more, but this is reflecting ... the best available information today on what the project's cost estimates are.

[4:53:07 PM](#)

REPRESENTATIVE HAWKER: Follow up ...

CO-CHAIR FEIGE: Follow up, Representative Hawker.

REPRESENTATIVE HAWKER: These are Black & Veatch's estimates, though, they really have not been triangulated with the project sponsors.

MS. PODUVAL: Representative Hawker, through the Chair, I believe they are lined up with the range within which the project sponsors have provided their cost estimate. And so, their cost estimate goes from \$45 billion to \$65 billion and our's falls somewhere in the middle of that range. And so, we're at about \$54 billion as our base case and we've done sensitivities ... across both ends of that. And so to that extent it has been triangulated against what the project sponsors have provided as cost estimates as well.

[4:53:51 PM](#)

REPRESENTATIVE HAWKER: I guess then, my take away is -- Mr. Chair. What you're telling me is no, you don't have access to project cost information from the people that are actually the project sponsors. But you see yourself landing with your estimates, derived from the original TransCanada plan, ... within the ranges provided by those project sponsors, which gives you a sense they're being reasonable here.

MS. PODUVAL: Representative Hawker, through the Chair. Yes, to the extent that the project has ... detailed cost estimates, whatever that level of detail is at that point. That's not something we have incorporated here, but the fact that our cost estimates fall within that range give us comfort that we're in the right ballpark.

[4:54:31 PM](#)

REPRESENTATIVE HAWKER: Thank you.

CO-CHAIR FEIGE: Representative Kawasaki, did you have a question?

[4:54:35 PM](#)

REPRESENTATIVE KAWASAKI: Yea, thank you, Mr. Chairman. Thanks for being here Deepa. And just to tag along to that last question, ... several of us took a mega project seminar discussing sort of the biggest issue when it comes to failure of projects being the schedule-driven process that doom mega projects more than any other single factor. Have you guys taken that into account in the proposal that's before you? ... Do you have a risk analysis? Or, ... you just picked a straight line in the middle of the road, this is what we've heard from the industry versus this is the low from the industry.

[4:55:18 PM](#)

MS. PODUVAL: Representative Kawasaki, through the Chair. We have looked at the risk to the project from there being a delay in the project schedule. And we will certainly list that as one of the risks that this project carries, given the complexity of this project as well as the scale of this project. So, ... in combination with market prices, capital costs, schedule; those would all be significant risk factors for this project. A lot of the analysis that we show here ... picks sort of a base-case view just to allow us to discuss the different aspects that we are. But we have looked at risk analysis, ... testing the bounds of that.

[4:56:07 PM](#)

CO-CHAIR FEIGE: Follow up, Representative Kawasaki?

REPRESENTATIVE KAWASAKI: Similarly to Enalytica yesterday, do you have stress case ... scenario that we can see before we go too much further here.

MS. PODUVAL: Representative Kawasaki, through the Chair. We may have taken a slightly different approach, I don't know that we have a stress scenario. We stressed it for different variables and try to understand ... what some of the biggest drivers are that can move the needle and which ones don't bubble up to that level. But that's certainly something that we can do; create one stress scenario and provide that to you.

[4:56:47 PM](#)

CO-CHAIR FEIGE: Follow up, Representative Kawasaki?

REPRESENTATIVE KAWASAKI: Thank you, Mr. Chairman, to follow up then. ... The stress case scenarios that were presented yesterday, but from the [Legislative Budget & Audit Committee] LB&A consultants, were cost overruns at 25 percent, market changing between \$7 and \$15 or something like that ... and un-utilization. Can we figure what your stress case would be using those similar numbers? And maybe, if you're using a different analysis, that's completely fine too. I just would like to see that. I have a different question, though, on the timeline.

CO-CHAIR FEIGE: Okay, go ahead.

REPRESENTATIVE KAWASAKI: Thank you, Mr. Chairman. On the timeline, we had the Administration come in earlier and talk about the estimated timeline and ... I think the concern from committee members is that once we set this thing in motion, it's really hard to stop or really hard to come back to us. Between the Pre-FEED and the FEED stage, ... how much of a dedicated time do we have? It seems like there's potentially a month or two before we have to make a quick decision with available data and then saying similarly placed in 2018. And then another follow-up question would be if the legislature can't come to some sort of resolution at that point, how impactful it is to the timeline.

MS. PODUVAL: Representative Kawasaki, through the Chair. I would probably defer those questions to the Administration because they are closer to the negotiations with the producers and ... will have much more information to you on how the ... intersection of those different project development stages and what sort of timeline ... would be available as a buffer between those.

[4:58:39 PM](#)

CO-CHAIR FEIGE: Representative Hawker.

REPRESENTATIVE HAWKER: Thank you, Mr. Chair. Two foundational questions again here. As you are presenting cost information here ... are these only the direct costs of the state in pursuing the project, that is the things that we are going to have to cash up to pay for? Or do these costs include what I'll call the indirect costs of the foregone revenue, the pre-operations revenue that is foregone as a result of allowing some of these development costs to be deducted in determination of oil revenues, which ... really shows up nicely on your previous chart? So, first question is: When you show numbers here as what it is going to cost us, are they just the direct numbers or do they include the indirect?

[4:59:29 PM](#)

MS. PODUVAL: Representative Hawker through the Chair, the numbers that are shown here are just the direct costs of the project. The analysis that we show you in terms of the state's revenues, NPVs, all of that incorporates direct as well as indirect, as you are referring to it, of ... any production credits that would impact oil taxes and all of that.

[4:59:54 PM](#)

REPRESENTATIVE HAWKER: And my last question is you're showing on this chart ... your range of estimates recognizing everything we've said so far in this meeting on the state's obligation, the direct obligation. ... What is your estimate right now for the modeling work here you're doing of total project cost?

[5:00:22 PM](#)

MS. PODUVAL: Our estimate for the project's cost is \$45 billion.

REPRESENTATIVE HAWKER: Forty-five?

MS. PODUVAL: Yes, in today's dollars, so that's 2014 dollars.

[5:00:37 PM](#)

REPRESENTATIVE HAWKER: So ... that begs one more question. I just want to make sure. When you are saying in 2014 dollars you are discounting the future expenditures in those future years back to 2014 dollars?

MS. PODUVAL: Correct. We actually work in the reverse. We start with the cost estimate today and we escalate it for what they will be in the dollars of the day. And so we start with the \$45 billion and escalate it forward and that gets us closer to \$54 or so billion in nominal terms.

REPRESENTATIVE HAWKER: Nominal and could you repeat that number?

MS. PODUVAL: \$54 billion in nominal terms, 54 or 55, yep.

REPRESENTATIVE HAWKER: Forty-five for

MS. PODUVAL: Dollars of the day, 2014 dollars, and 54, yes.

REPRESENTATIVE HAWKER: On nominal. Thank you.

MS. PODUVAL: Fifty-four or fifty-five, I'll have to check, but in that range, if that helps.

REPRESENTATIVE HAWKER: For this conversation that is certainly ... more than adequate.

REPRESENTATIVE HAWKER: Thank you, Mr. Chair.

CO-CHAIR FEIGE: You're welcome. Okay.

[5:01:45 PM](#)

MS. PODUVAL: Slide 5 here. Again, just ... condensing into one slide what we walked through in a couple of hearings on the royalty study and trying to connect where we are to what the study's findings and recommendations were. We just wanted to take a few minutes here to touch again upon what the study's key findings were, how they drove our recommendations, and how that pointed towards a state equity participation in the project as a viable alternative for the state to consider. The study looked at four different aspects. The first was looking at the LNG markets to understand ... is that an attractive market for us to pursue. The second aspect of it was looking at the supply chain and trying to cost the project and trying to understand what the commercial structure associated with the project would be. The third aspect was looking at a fiscal perspective and understanding where the project would stack up compared to other projects globally. And then the fourth one was trying to understand the risks associated with project and commercial strategies and options for the state. The key findings, basically, said that the global LNG market is growing. It's forecast to double between now and 2030, the demand for LNG, but that it is also competitive, the supply is growing as well. That this is an attractive growing market is being recognized not just here in Alaska but a number of other projects worldwide and that are all going to compete for this market. The government take as well as the cost structure for the Alaska LNG Project are high. And so, put together, what those factors pointed us to is that there is room here to improve the commercial attractiveness of the project for Alaska to be able to compete effectively for this growing LNG demand with the other projects that are all trying to meet it as well. And the concept of is it possible to create or improve commercial attractiveness of the Alaska LNG Project while still preserving value to the state -- sort of the search for the elusive win-win. The Alaska LNG Project is expected to be a large, complex, and a high-cost project. ... each component of the project by itself would be considered a world class complex project - just the [gas treatment plant] GTP, just the pipeline, just the LNG plant. Put them all together and ... it's a challenging undertaking. Given that, one of the findings of the study was that the project structure for AK LNG is likely to be some form of an integrated project. And why that is the case is driven by

the complexity as well as the scale of the project. An integrated structure where the producers own the infrastructure associated with the AK LNG Project as well creates the opportunity for more project control and that becomes critical for success with a project like this. What you don't want to have happen is the GTP is ready but the LNG plant is not or the pipeline is ready and the other components are not. Having an integrated project control essentially allows all of those different development timelines to be lined up so the entire project is ready at the earliest date it can be. If you put those two together, what it points to is that we might have a project that looks a lot like [Trans-Alaska Pipeline System] TAPS, that's completely producer owned and integrated. And along with that comes certain risks to the state and to the extent that in creating value of and improving the commercial attractiveness of the AK LNG Project the state stays cognizant of those risks and is able to mitigate them, then that would be valuable to the state. So, this concept of creating alignment between the producers and the state starts becoming important. And it was really the combination of those factors - how can we improve the commercial attractiveness of the LNG project to the producers and to where it can compete effectively for that demand, how can we preserve value to the state in doing so and how can we line ourselves up with the producers anticipating this integrated project - that all led to the concept of the state's equity participation in the project.

[5:06:43 PM](#)

MS. PODUVAL: One way of improving commercial attractiveness for the state, and a somewhat ... more passive way, would be simply to transfer value by reducing royalty or production tax. So, stay in the structure that exists today and say we are modifying our production tax structure so that we improve the attractiveness of this project for the producers. And that would entail... a transfer of value across the table from the state to the producers. So, from that perspective you check the improved commercial attractiveness, but not necessarily the retaining value to the state and aligning with the producers for transparency and all of these other objectives that the state has. By being an equity participant in the project, it helps the state to use those billions of dollars that it might have ... given the producers as reduction in taxes or a change in the fiscal terms and use that as an investment to procure an ownership share in the project. And along with that ownership share, especially if it is set up where each of the different parties has an equivalent part of the gas as well as an

equivalent share of the ownership of the project, helps to create that path for the gas all the way to market and create alignment where you are not having to negotiate with each other on what the tariffs have to be for your gas to move on their part of the project or vice versa. Now, ... that is sort of in a quick few minutes nutshell the thought process getting to the equity share. But we also recognized that there are significant risks associated ... with participation in this project. I mean if this project goes ahead, with or without participation, there are risks that the state should recognize and manage. And we highlighted a number of them in the royalty study and I'll touch again in our discussion here on some of those.

CO-CHAIR FEIGE: Question?

REPRESENTATIVE HAWKER: End of the slide.

CO-CHAIR FEIGE: Okay.

[5:09:06 PM](#)

REPRESENTATIVE HAWKER: Thank you, Mr. Chair.

CO-CHAIR FEIGE: Sure.

REPRESENTATIVE HAWKER: The whole process that you've outlined here makes a lot of sense of course. It follows right on the dialogue you've led the legislature through with the royalty study, issues, recommendations, and conclusion. I think we've all come to see the desired attributes of alignment and integration, as you called it here. And then, as you've got it labeled, state equity participation seems to be the thing that brings all that together - the alignment and the integration. I guess my question is: Is it state equity participation if the state transfers its ownership and control to the outside commercial interest, which would be TransCanada of course? Is that going to be viewed in your view ... that whether it is actually state ownership and control for another third party that we have assigned our actual ownership and sovereign interest in these assets to and in fact we do not have the ownership and control, ... that option where state has no ownership, state has no control versus the state maintaining ownership or control to some degree. Does that make a difference in your perspective on the viability of state equity participation to meet those objectives of alignment and integration?

[5:10:55 PM](#)

MS. PODUVAL: Representative Hawker, through the Chair. In my mind I've separated these two into two different decisions. The first being ... does it make sense for the state to have an equity participation in the project as opposed to any other structure or staying in the current fiscal structure? And then the second decision associated with that is if we've reached the conclusion that state equity participation is beneficial to the state, and there are merits associated with that, then how do we optimize that equity participation? And bringing on a partner or otherwise ... I think falls in that second decision on ... Is this the best way to optimize the state's equity participation? Having said that, I think your question on are we yielding control or transparency by bringing on a third party such as TransCanada into the mix, a lot of that will depend on the actual terms that get negotiated in these agreements with TransCanada. And we don't view that as creating any sort of misalignment between the state and the producers and in some ways that's almost the more important area to find alignment. Like I said, the state bringing in TransCanada as a way to optimize its equity participation is a discussion between the state and TransCanada and those negotiations will hopefully - and the agreements that will follow - will hopefully create access to information for the state and help the state achieve some of the same objectives as it would from an ownership perspective as it would without TransCanada.

CO-CHAIR FEIGE: Follow up, Representative Hawker?

[5:12:50 PM](#)

REPRESENTATIVE HAWKER: Your words here, you said you, Black & Veatch, don't see whether it is TransCanada or the state ownership or control, whatever our matrix is, you don't see it creating a misalignment with the producer entities. Do you have any idea how they see it? And I know they're sitting in the room here, but ... I don't know either, haven't asked them, haven't talked to them. But I'm just curious do you know that it doesn't or do you just think it doesn't?

[5:13:18 PM](#)

MS. PODUVAL: Representative Hawker, through the Chair, I wouldn't presume to answer for them, I do not know. I would point to the fact that they're actively in these negotiations with TransCanada as well as in the room to indicate that it

works for them, but that's really all I would have to base it on.

REPRESENTATIVE HAWKER: Thank you.

CO-CHAIR FEIGE: Any other questions? Do you have one?

[5:13:46 PM](#)

REPRESENTATIVE ISAACSON: I'm not sure how to phrase it, Mr. Chair, but thank you. Following up with Representative Hawker's question, Deepa, was the idea that ... the alignment depends on the terms that we come to and we have to determine that. Now, maybe that is what the rest of your presentation is about, I take it, but what confused me a little bit - maybe you could me even phrase the terms of my confusion - is if we assign our ownership participation to a third party, any third party, and depending on the terms ... what are the terms that we should look for to make sure that ... we still have an active voice? And is that common with sovereigns assigning a third party their participation rights like we're doing?

[5:14:42 PM](#)

MR. ABT: Through the Chair, I'm sorry I haven't met you yet, I'm Peter Abt with Black & Veatch. It's important as you get into these discussions with TransCanada, or whomever that third party is, that you walk into those discussions knowing clearly what you want out of them. So, what's important to the state is to maintain transparency, like to have a real appreciation for the costs that will be incurred in the development of the project. And that is a critical component to include in the negotiations and the discussions with TransCanada. The element of control is going to be very interesting discussion to have. I think the state's participation and the level of control that the state will have in the GTP and the pipeline will be driven by whether or not they choose to exercise the buyback option. But it is always a lever that they have in the process up to the point that those decisions are made. And in terms of the sovereign assigning its rights in other projects, there are instances where that does happen indeed. There's a couple of examples that may come to mind and it was in the early stages of development of some of these projects. The Trinidadian government assigned a lot of the rights to the development of the project to the producers in that instance, primarily Amoco and BP, so it's a situation that has occurred in the past, yes.

CO-CHAIR FEIGE: Representative Kawasaki.

5:17:02 PM

REPRESENTATIVE KAWASAKI: Thank you, Mr. Chairman. We're talking a little bit about transparency and the ability for us as a partner with a private entity to understand what things are going on. The two reports that we have from LB&A's contractors seem to talk about the ownership issue and privacy and confidentiality and I'll just paraphrase. It just says it's possible that a partnership with these private parties who generally operate with greater confidentiality than public entities could limit that transparency. Can you kind of address that and then in terms of state standing versus reducing the risk against our other partners that are available?

5:17:39 PM

MS. PODUVAL: Representative Kawasaki through the Chair, I think we will probably touch on some of that later in the presentation. But I will say that I'm not quite sure I follow the view on transparency when we talk about how private entities in some ways would have less transparency than public entities. I think if we look at that from the state's perspective and the options are to have an equity participation in the project or not ... so, I may be misstating your premise, but if ... we're thinking that having an equity participation would make us akin to private entities being in business together, then that will definitely be a framework where the state would have access to more information than it would being on the outside as just a sovereign. So, for example, ... the state would not have information on where the producers are in their development process; what the costs are that are being estimated for the project; or any of that, being outside on the sovereign you'd be waiting for press releases essentially to tell you that. Being an equity participation and having a seat at the table, you're at least part of the discussion and you know what they're up to ... with relation to this project.

CO-CHAIR FEIGE: Please continue.

5:19:24 PM

MS. PODUVAL: [slide 6] So, turning back to some of what the royalty study pointed out and what led to this recommendation of state equity participation, we want to use those criteria as ... the benchmark against which we look at the Heads of Agreement

that the state has entered into. And so, the first being ... create alignment through equity participation. The second was improve commercial attractiveness of the Alaska LNG Project. Preserve value to the state. And manage the risks that would come ... with this structure as the state goes ahead with this project. And so, what I want to do here is walk through each of those four elements within the context of the HOA and say ... have we gotten there, have we not gotten there, which areas are the work in progress.

5:20:27 PM

MS. PODUVAL: [slide 7] So, looking at the first aspect which is creating alignment through equity participation. Just touching on the highlights of the Heads of Agreement and the concept that it tries to capture, the central one here is that royalty taken as gas and tax taken as gas together create a state gas share. And then that state gas share is equivalent to the state's equity share in the project. And the state's equity share in turn impacts the investment that the state will make in the project as well as the revenues that the state will earn in the future. The structure as it's envisioned now would have the state holding equity along the entire supply chain. And again, this is breaking out the second decision which is once we have this equity what are we going to do with it, is there a partner involved or not. The Heads of Agreement gets us to the point where the state has an equity share through the entire supply chain and has a path to market. And then the concept that commitments are made in a stage-gated manner. And sitting today before Pre-FEED has been done, the state is not committing itself to spending billions of dollars and seeing this project through all the way through construction and what's really being contemplated here is decisions that enable Pre-FEED and move the ball forward. So, these key elements help to create that alignment that we were talking about and maybe the pieces that are important in facilitating that alignment is this concept of having a state gas share and having an equity in the project that matches that state gas share and for each of the producers to also have a share in the project that's proportional to their gas. That structure and having the path through the entire project helps create ... this concept of a project within a project where each party has their own gas and their way of getting that gas to market, and it in some ways reduces the number of things you have to agree on. So, I think from the perspective of alignment, the structure that's been laid out is probably well thought out from that perspective. [slide 8] Then looking at the attractiveness of the ... AK LNG Project and

whether what's being envisioned here improves the commercial attractiveness of the project. We looked at what the producers' returns from the project would be and the state's equity investment in the project essentially improves the producers' returns by between 3 and 4 percent in the project and that's meaningful, given the scale of this project. And it is largely achieved by the state contributing between 20 and 25 percent of the upfront capital costs associated with this project. The upfront capital costs are so significant that ... the state taking on ... a meaningful portion of that essentially increases the producers' returns on the project. And ... risk is being shared with the state too, ... from the producers' perspective the state has skin in the game. The other aspect ... that would be seen as being attractive from the producers' perspective is this concept of the state taking its share as gas. It allows them to reduce the potential for valuation disputes out in the future and to know at least from the experience with TAPS we've seen that those can be expensive, long drawn out, and ... resource intensive on both sides.

CO-CHAIR FEIGE: Representative Hawker, question?

REPRESENTATIVE HAWKER: Again, I wanted to get to the end of the slide.

CO-CHAIR FEIGE: Okay, keep going.

MS. PODUVAL: Go ahead.

[5:24:31 PM](#)

REPRESENTATIVE HAWKER: Mr. Chair. Could you explain the footnote on modified status quo.

[5:24:43 PM](#)

MS. PODUVAL: Representative Hawker through the Chair, thank you for that question and I should have pointed that out when I discussed this. We've culled out specifically here status quo as modified status quo and the reason we've done that is we've assumed that the production credits that are applicable on the oil side with SB 21 would be extended to gas as sort of the least that the state would have to do to have potentially an AK LNG Project in a world where it did nothing else. And so, we're trying to create a baseline for the world without state equity participation saying what would the state have to do at the very least ... to have an AK LNG project proceed. And we picked here

that this \$5 per barrel production credit that's been offered on the oil side would potentially be expended on the gas side as a \$5 per barrel of oil equivalent for gas recognizing that when SB 21 was structured that gas was not really addressed ... because the focus was really on oil at that point. And so, that's the benchmark we use here, and you will see it in a few other places as well, to measure against the world where the state has an equity participation to understand is it better, it is worse.

CO-CHAIR FEIGE: Follow up, Rep. Hawker?

[5:26:14 PM](#)

REPRESENTATIVE HAWKER: Thank you, Mr. Chair. I did see that you've in several places here ... this is the first chart we've got the footnote on.

MS. PODUVAL: Yes, and thank you for the question.

REPRESENTATIVE HAWKER: Raises the question: ... why here and is this appropriate and relevant to the dialogue we should be undertaking to make this modified status quo at this point in time because when we ... passed [SB] 21 last year, the whole idea ... was, frankly, to end these barrel of oil equivalency conversions as it relates to gas. It was very, clearly, we knew that we were dealing with the oil tax at a flat rate ... it was a net tax basically, but a flat rate. Now, today as we are looking forward at the enabling legislation, it completely abandons net tax on gas, moves us into a gross tax, and again we're now talking - not even only a gross dollar value tax - but a tax that is paid in this project in molecules, not in dollars. So, I'm just really truly asking how and why can a ... barrel of oil equivalent \$5 being factored into these calculations really be relevant to us here.

MS. PODUVAL: Representative Hawker, through the Chair. I think one of the things we recognized when we looked at ... just status quo, SB 21 as it is, and the economics for the Alaska LNG Project is that that's not a project that will likely go ahead, not with that cost structure, not with that fiscal structure. And so, with the recognition that that something would have to be given on the fiscal side, ... whether or not this production credit as we've assumed it here will get there, ... I would again say likely not, if I had to guess. But it was for the purpose of establishing a benchmark, it was nothing more than an assumption to say that something would have to be done and maybe this one is sort of the lowest hanging fruit from that

perspective as opposed to maybe changing the tax rate itself or ... any other combination that we could have picked.

CO-CHAIR FEIGE: Representative Hawker.

[5:28:54 PM](#)

REPRESENTATIVE HAWKER: Again, from my decision making. First off, we, the legislature, have not extended this \$5 a barrel of oil equivalent adjustment to gas; ... we may, we may not. However, what we do have in front of us -- and that's based on a net tax -- so somewhere in here ... you have to be pricing gas sales in this. And the whole point is we're getting away from having to ... base that on an oil price. Somewhere there has to be an oil price in that calculation, which complicates this. The whole idea of going to gross molecules was to get away from these vagaries to something that we have not given. If we really were going to use a modified status quo, would it not be much more meaningful to us to look at the decisions we are making. And that is either starting with exactly what the status quo is. Or, if we want to modify the status quo, should we not be modifying it and looking at the \$13 MCF gross tax adjustment that is, in fact, the question that is before us in the legislation. Like I said, this \$5 is ... other than being a footnote to this page, I don't think it's ever going to enter into any calculation we ever see. And I understand modeling, I understand the rationale you gave us, but I don't know that this just doesn't create an artificial data point, an artificial modified status quo that has very little reason. Again, I think we should be using, if anything, that 13 percent gross tax reduction or the 13 percent gross tax in molecules, rather than this calculated number that's never going to see the light of day.

[5:30:56 PM](#)

MS. PODUVAL: Representative Hawker, through the Chair. So, we do use the 13 percent ... gross tax when we're looking at the equity participation; so just for clarification that's the ... after picture. ... and I would agree with what you just stated that ... this is not real in that production credits have not been extended to gas and we don't know what that would be on the gas side, like I said We made a low hanging fruit assumption on something would have to give on the gas side and that's what we picked.

[5:31:35 PM](#)

REPRESENTATIVE HAWKER: Always a danger to assume the legislature does anything, but thank you. I mean I understand your rationale.

MS. PODUVAL: Thank you.

CO-CHAIR FEIGE: Representative Seaton, then [Representative] Isaacson.

[5:31:44 PM](#)

REPRESENTATIVE SEATON: Thank you. For the producer [internal rate of return] IRR, do we have to assume the base case or are you ... calculating the 18 to 23 percent internal rate of return -the green box - is that a calculation or are you having to calculate this base price based on what something might be and then inflating that by 3 to 4 percent. I mean, if we don't need the base case that's ... all these assumptions and what would be if there was a net tax on gas. And if you can just calculate the IRR and let us know whether that IRR is sufficient in the project to make it attractive or not, or is it really the discrimination between these two taxing mechanisms.

[5:32:38 PM](#)

MS. PODUVAL: Representative Seaton, through the Chair. One does not influence the other. They're just two different calculations of what the producers' returns from the project would be and so the stand alone calculation of what the producers' returns from the project would be with state equity participation is that 18 to ... 22 percent that you're seeing here.

REPRESENTATIVE SEATON: Okay.

[5:33:00 PM](#)

CO-CHAIR FEIGE: Representative Isaacson.

REPRESENTATIVE ISAACSON: Thank you, Mr. Chair. So, if I understand right from a couple slides back - the study findings - you were saying we needed to reduce high government take and you suggested that we would do this by modified production tax or the royalty share. So, in this assumption the modified status quo is that we modified the production tax. If we don't

modify the production tax using this modified status quo, what does that do to the 3 to 4 percent which you said was meaningful? Does it drop into a different category of meaning?

[5:33:41 PM](#)

MS. PODUVAL: We can get you the numbers. I don't have the numbers off the top of my head what the comparison to the ... unmodified status quo would be. But ... notionally the producers' returns would be even lower in a status quo world because with a modified status quo we're assuming ... they get a fiscal break with the production credit extended to gas.

[5:34:07 PM](#)

REPRESENTATIVE ISAACSON: So, follow up?

CO-CHAIR FEIGE: Follow up.

REPRESENTATIVE ISAACSON: So, is that going to modify the rest of the model that you present to us if we assume other than the modified. How will we read the rest of this if the base assumption is that we have a modified status quo.

MS. PODUVAL: ... The baseline for the producers would be even lower revenues than what the modified status quo would show and so ... from the perspective of the producers' returns with state equity participation, we would improve that by more than 3 to 4 percent.

CO-CHAIR FEIGE: Follow up?

REPRESENTATIVE ISAACSON: So if I understand what you're saying, if we go to the status quo the green box will drop down a little bit, but ... this is before we talk about our equity, it'll bounce back up even with the status quo [slide 8].

MS. PODUVAL: The blue box would drop down. The green box would stay where it is.

REPRESENTATIVE ISAACSON: Ok. Alright. Thank you. And if you would point that out throughout here - the presentation - that would be helpful. Thank you.

CO-CHAIR FEIGE: Okay.

[5:35:37 PM](#)

MS. PODUVAL: Again, I would highlight that ... the numbers are the numbers. We're standing here at a point in time looking forward on a project that's going to be large on which we have ... fairly limited information. And so, really all the numbers point to here are trends and directions that ... the project moves with the state having an equity participation in the project. Is the revenue going to be \$4 billion from this project? I mean, I'm not sure I would bet anything on that. There's lots of uncertainties that are yet to be resolved about this project and whether it's capital costs or price, or ... any of the key assumptions that we're making here. All we can do - all we're doing here - is ... make assumptions based on the best information that you have today and ... try and study sensitivities around those assumptions to understand how much it moves your answer but really what we're focused on is ... is the answer still valid? Does this conceptually make sense to do and does it make sense to go through the next stage of this process and go through Pre-FEED; get more information. At that point we have to stop and think does it make sense to go through FEED and get more information? Does it make sense to exercise a final investment decision and go forward. And so, as more and more information becomes available, the numbers will start being better, will start making more sense. There will be more people that will ... be able to defend those numbers and ... those numbers will have greater validity. We just have to recognize that this is so early in the process that ... whether it's the [Legislative Budget & Audit Committee] LB&A consultants or us or anybody else that's trying to run these numbers, we're making use of the best information we have to make decisions.

[5:37:46 PM](#)

REPRESENTATIVE ISAACSON: Understood. Thank you.

CO-CHAIR FEIGE: Representative Kawasaki, question? And then [Representative] Seaton.

REPRESENTATIVE KAWASAKI: I think part of that was answered. Deepa, this is ... more of a directional analysis to showing an improvement from a modified status quo to some sort of equity partnership. I ... just have ... a couple questions; ... the first one dealing with what an estimated internal rate of return looks attractive in the first place. These numbers seem to be fairly high for a major large-scale project.

[5:38:17 PM](#)

MS. PODUVAL: I think ... some of that information is proprietary and hard to get And I would make the distinction between an upstream expected return [on] investment versus a midstream return on investment. Generally, for the upstream ... from the producers' perspective, and they're comparing this project to other opportunities they have for exploration and development of resources worldwide, they will be looking at it from the perspective of an upstream return on investment and those tend to be high The numbers that I see here are not too high within that context at all.

[5:39:04 PM](#)

REPRESENTATIVE KAWASAKI: Different question.

MS. PODUVAL: And again, something that you could follow up with the producers when they're here, too.

CO-CHAIR FEIGE: Follow up?

REPRESENTATIVE KAWASAKI: No, it's actually a different question. It's dealing with the third bullet point on the reducing valuation disputes [slide 8]. Can you ... elaborate a little bit on that. I think you started to speak about TAPS and just some sort of an alignment there.

[5:39:25 PM](#)

MS. PODUVAL: Sure. Representative Kawasaki, through the Chair. Having ... an equity participation in the project and the state owning its half through the midstream and the downstream and taking its gas as kind ... both tax as well as royalty on the Slope - essentially takes away the entire discussion on what shall the wellhead price be; what is an allowable deduction for passage through the GTP, the pipeline, and the LNG plant. All of that ... from a valuation perspective goes away. One of the ... sticking points when ... you're in a royalty-in-value world is there's always constant ... misalignment between the producers and the state from that regard. Where from their perspective the wellhead value needs to be the lowest it can possibly be because it influences ... the royalty and taxes that they pay. And from the state's perspective, that needs to be exactly the opposite. What happens here with equity participation is: we don't have to argue with them about what the wellhead price needs to be or what the tariff has to be going through the GTP, LNG, and the pipeline because they can set tariff on their side of the project however they want to

move their part of the gas. We will be moving - the state will be moving - its share of the gas through the portion of the project that the state owns. ... Like I said before, you don't have to agree on more things than you have to agree on, from that perspective.

REPRESENTATIVE KAWASAKI: Follow up?

CO-CHAIR FEIGE: Follow up, Representative Kawasaki?

[5:40:58 PM](#)

REPRESENTATIVE KAWASAKI: So, ... the state might elect to take all of its gas in-kind but we sometimes take it in-value. I guess, doesn't that set the State of Alaska arguing for the lowest value for the entire project. And then how does that ... impact ... the rest of the chain.

MS. PODUVAL: The structure that's being contemplated here would have the state receiving its royalty in-kind, essentially, as gas on the North Slope at the wellhead. And so, there's not notionally a scenario where you would be in-value in this world and want to have ... a low transportation cost through the project.

REPRESENTATIVE KAWASAKI: Okay.

MS. PODUVAL: Because you've already in some ways prepaid for that transportation cost through the project by making that investment upfront.

[5:42:11 PM](#)

CO-CHAIR FEIGE: Okay. On to the next slide.

MR. PODUVAL: In moving to the concept of ... if we've created more commercial attractiveness for this project from the producers' perspective and coming to the state's perspective in trying to understand have we also preserved value to the state, or as much value as we can for the state, by making ... an investment in the Alaska LNG Project? And that's ... the next sort of criteria or sort of principle from the royalty study that ... we're examining here. And again, ... we're trying to understand that relative to an [royalty-in-value] RIV world where the state does not make an equity investment in the project. So, what the next two slides show are projected cash flows to the state. And this one is standing in an RIV world

and you'll see that the mix of the state's revenues - it's about \$4 billion a year - the mix of the state's revenues are weighted towards royalty and production tax and then property taxes is the next big item, with some state corporate income tax [slide 10]. And that ... is the pocket of revenue that accrues to the state in an RIV world. The other thing you'll notice here, too, is that the upfront investment - so to speak - from the state's perspective - or the negative cash flows that we show here are ... fairly small in the context of this project. And again that's just reflecting the production tax credits that will accrue as a result of the investment that's in dispute at Point Thomson. ... and in the total cash flows ... adding all of this up through 2041 is about \$70 billion - let's say \$68 billion. Moving to

[5:44:08 PM](#)

CO-CHAIR FEIGE: Question? Representative Saddler.

CO-CHAIR SADDLER: Quick question. Deepa, there's two little dips here after the first ... two-three years, and then also 2039. Are those ... assuming expansions?

MS. PODUVAL: Representative Saddler, through the Chair. That's additional investment that gets made in the project both at Point Thomson as well as if there's yet to find gas that has to come in to keep the project full. There's upstream investment associated with that and that causes the dip.

CO-CHAIR SADDLER: So you're assuming additional investment at Point Thomson at about 2026, ... specifically?

MS. PODUVAL: ... the 2026 is a good question. I'll have to go back and look at that but I was referring more to the 2036-2038 time period there. That's the dip where there's additional investment in Point Thomson - just additional drilling, boost of compression, etcetera to keep the production up.

CO-CHAIR SADDLER: Okay.

[5:45:07 PM](#)

CO-CHAIR FEIGE: Representative Wilson.

REPRESENTATIVE P. WILSON: Everybody in here probably knows this, but what's the gray it's SCIT.

MS. PODUVAL: State Corporate Income Tax.

REPRESENTATIVE P. WILSON: Thank you.

[5:45:17 PM](#)

MS. PODUVAL: Then the next slide, on slide 11, looks at the revenues to the state in a world with equity participation. And so, a couple of things to focus on here is that -- again, the total dollars ... it's a little over \$4 billion in this scenario with 25 percent equity that we're looking at -- the mix starts looking a little different. There's still royalty, but production tax is a component that's a little lower. Property tax still stays significant, but we're also capturing some revenues from project ownership. And that's ... simply a return on the state's equity on the project. And so, the buckets under which the state's capturing this revenue gets lightly modified. And then the other pertinent fact is the total cash flow; again, through this 2041 timeframe and it's about \$70 billion, again - a little over. And ... then there's the third fact here is that ... the state is investing more as can be seen by the negative dip upfront in the project. And that's ... essentially the state's 25 percent investment in the AK LNG Project. So, the takeaway from ... this is that with state equity participation there is a higher upfront investment in the project. The revenues that accrue from the project keep the state whole relative to what the state would have received in an royalty-in-value world. And so, if you put that together with the fact that the structure improves the commercial attractiveness of the project from the producers' perspective and then say ... from state's perspective it looks like the state has preserved its value as well, then those two facts come together. And ... like I said before, it's a search for that elusive win-win; but you can see how the components of that could line up.

[5:47:28 PM](#)

CO-CHAIR FEIGE: Representative Kawasaki.

REPRESENTATIVE KAWASAKI: Thank you, Mr. Chairman. I'm looking just between slide 10 and 11 and I know that the state ... we're always trying to look for a win-win. ... I think that's good. But ... in this case, we're saying that if the producers were just to go it alone and build their own pipeline at some point in time, I mean the same ... time ... we'd have projected cash flow of \$68 billion versus \$72 [billion] if we somehow have some equity partnership in this game. The problem that I've got is -

looking between graphs, page 11 and page 10 - is that there's this huge negative where we're starting to pay a lot And there's a value to that risk and I'm wondering if the value's worth the risk ... and if you can elaborate on what your thoughts are.

MS. PODUVAL: Representative Kawasaki, through the Chair. Yes, that's definitely what's on the table here. With state equity participation comes an investment upfront in the project - that's sort of the ... cornerstone of that option. And what ... this is showing is that the state gets paid back that investment upfront in the project once the revenue stream starts to come.

[5:48:52 PM](#)

CO-CHAIR FEIGE: Follow up?

REPRESENTATIVE KAWASAKI: I mean, that's ... making a lot of assumptions, but ... the difference between us doing nothing and them going it alone. I don't know if they would or not, but if they've got a commercial gasline they would; versus us being some sort of partner taking an enormous amount of risk for a project that lasts 20 years is \$4 billion. That's the difference; ... am I seeing that right, then?

MS. PODUVAL: Representative Kawasaki, through the Chair. That assumes that your baseline is not zero; that the producers would do a project without the state's participation in it; ... frankly, that might be a fairly big assumption.

CO-CHAIR FEIGE: Representative Hawker, then [Representative] Seaton.

[5:49:44 PM](#)

REPRESENTATIVE HAWKER: Thank you Mr. Chair; ... would you go to page 11 please? Thank you ... both of these graphs ... there's a lot of information embedded in these My first question is when I'm looking over here at the vertical bar showing ... 12 percent of our value back to the state comes from what you're calling "project ownership," is that 12 percent calculated from simply when project goes into operation or is it net of project costs?

MS. PODUVAL: Representative Hawker, through the Chair. Good question. I want to say it is net of the investment upfront, but let me confirm that with Jason, who's on the line. Jason,

can you confirm that for us? The percentages that we're showing on the bar on the right ... they're net of the investment up front, is that right?

[5:50:57 PM](#)

JASON DE STIGTER, Senior Consultant, Management Consulting Division, Black & Veatch Corporation; Consultant, Department of Natural Resources: Deepa, that is correct. All those bars, including slide[s] 10 and 11 show net cash flow percentages.

MS. PODUVAL: Thank you, Jason.

[5:51:16 PM](#)

REPRESENTATIVE HAWKER: May I continue briefly here, sir?

CO-CHAIR FEIGE: You may

REPRESENTATIVE HAWKER: Thank you, 'cause that makes sense to me now. If I compare the chart on page 10 to the chart on page 11. Again ... and here you're saying, "Yes, there is a \$4 billion difference in total return to the state between ... obviously, a ownership or total cash flow - \$68 and \$72 [billion] at the bottom of this page that \$4 billion. Are those numbers also net of project costs? Is that a positive cash flow from day one to the end of 2041 of those numbers?

[5:52:00 PM](#)

MS. PODUVAL: Representative Hawker, through the Chair. Yes, those are net numbers. But I would caution away from taking - from a takeaway from these slides - that there's \$4 billion incremental value to the state because of state equity participation. And the reason I would say that is because ... we're making so many assumptions related to these that that can move around quite easily. And actually, when we get to the next slide you'll see really ... how some of those variables that we assume move that. The takeaway for me ... was that the state hasn't lost value in improving the attractiveness of the project for the producers. And ... that really was what was meaningful in looking at this.

[5:52:46 PM](#)

REPRESENTATIVE HAWKER: And Mr. Chair, I think that's the point I was about to try to make next with these two slides because it

appears ... it's showing - for the uninformed eye looking at this - is, "Wow, look how much more we're getting?" But if that's only if you look to the right hand of the graph and you can see ... we look at the annual return is up there most of the time ... between \$4 and \$5 nominal billions; but that doesn't include that great big amount of money we've gotta spend going in to that. And I guess my point being is, if we adjusted those nominal billions coming in over those future years for the - just call it a ratable share of that big deficit up front - we get a line that looks an awful lot like the line on the top of the other graph without any state investment in this. So, it just seemed that really these two graphs are showing that - to me, at least - that looking only at this metric of total cash flow over the life of the project - and as you said yourself - that \$4 billion's a pretty vague number in there. There's really not a lot - and this is a point that came ... to my attention last night looking at our own consultants. There does not seem to be an awful lot of value difference to the State of Alaska between having TransCanada involved - ah strike that - that's not the word I'm looking for. I'm thinking of equity ownership through them. But there doesn't seem to be a lot of value differential between a pure status quo, especially if I don't factor in that \$5 barrel of oil equivalency (BOE) into your production taxes that we are not offering.

MS. PODUVAL: Right.

REPRESENTATIVE HAWKER: There doesn't seem to be a great deal of value differential to the state between these two scenarios. ... And I guess then my question is, am I really wrong there? And what I would imagine the real value is that we bring to the table with this venture partner concept is that intangible -- that you've already beaten me to the punch on -- is the fact that we could actually get a pipeline that's attractive to the producers and we actually get a pipeline. But whether we got TransCanada - I keep saying that - it's 'cause I keep thinking of them as the equity holder here. Whether we take an equity position or not, our economics really don't change a lot, but we might actually get a project out of it is I think is where I see these graphs going.

[5:55:09 PM](#)

MS. PODUVAL: Representative Hawker, through the Chair. I think you basically summarized what the story is. It's that having an equity participation in the project makes it more attractive for the producers. ... we're not losing value, which is valuable in

itself. The state preserves its value from participating in the project and there might actually be a project.

[5:55:37 PM](#)

REPRESENTATIVE HAWKER: And I'm - speculative question - it may be wrong question, wrong time When we do make an investment in the project, we undertake a great deal of risk, as well, that increases our state risk. Is that risk worth taking in these scenarios?

[5:55:58 PM](#)

MS. PODUVAL: Representative Hawker, through the Chair. In some ways, directly or indirectly, I think the state bears this project's risks and part of the way to think about it - at least the way I've thought about it - is that the biggest risk to the state is not having a project We started this presentation just looking at a world with oil only, without an LNG project. That in my mind is the biggest risk that the state has and so if this is an option that brings all of the different stakeholders to the table, preserves the value to the state, makes it attractive enough for the producers to be putting the other 75 percent of the investment that's needed in the project, then ... it seems like a viable path where you want to see how far this can go and whether ... we can participate and make a project happen.

[5:56:52 PM](#)

REPRESENTATIVE HAWKER: This ... rings well on my own ears. I see the world the same way as you do that -- in the gives and the gets -- you distill it all down, we might actually just get a project out of this.

MS. PODUVAL: Right. That's exactly right.

[5:57:05 PM](#)

REPRESENTATIVE HAWKER: Thank you. Appreciate the ... latitude, Mr. Chair.

CO-CHAIR FEIGE: Representative Seaton.

REPRESENTATIVE SEATON: Thank you, Mr. Chairman. Looking at these graphs, of course the biggest risk to the state is the upfront construction portion. If we're, by having the equity

position, allowing a midstream 18 to 22 percent IRR and we said that's not really high compared to upstream investments, but a good portion of our risk in the first five years of construction here is upstream credits we're giving ... against oil taxes. So, if the upstream investment - Point Thomson; there isn't that much in Prudhoe Bay 'cause it's already there - ... if those have much higher IRRs, do we really need to be offsetting those investments by taking state credits and having state participation in the upstream? As we were talking the other night, ... our investment in facilities that are totally owned by the oil companies there ... if we've got an 18 to 22 percent midstream IRR and assuming that what you were talking about is a much higher IRR in the upstream

[5:58:42 PM](#)

MS. PODUVAL: Representative Seaton, through the Chair. So, when we look at the producers' return from the project, we look at it as a combined project from their perspective. And so, the returns that we ... pointed to, the 18 to 22 percent, are their midstream and upstream combined so it's ... a little different perspective from the state in that when we ... look at the producers' cash flows from this project - both the investment that they make upfront as well as their revenues once the project is operational - their investment upfront includes not just their midstream investment - the other 75 to 80 percent of this project that they would be funding - but also the investment that they have to make in the upstream ... more specifically at Point Thomson because that's really where the upstream dollars have to be spent for this project. And then we look at their revenues associated with that and so the ... return numbers that we show is a combined return on their entire investment in the project. And so, their upstream return is not higher than what we're showing here. It's part of it.

[5:59:48 PM](#)

CO-CHAIR FEIGE: Okay. Follow up?

REPRESENTATIVE SEATON: As we go forward and do some analysis, I'd like to see some idea of tweaking what that tax credit of gas infrastructure in the upstream against oil taxes is and what that does to the economics or perceived economics of the project. Could you

MS. PODUVAL: Yes, I think we can provide that. And just as an interesting statistic, we looked at this -- it's not here but --

... if you look at just the upstream side of it in Point Thomson and the investment that the state is making notionally with production credits for the Point Thomson investment and then the revenues the state would collect just from Point Thomson from this project; the state gets a return of ... more than 25 percent on the state's ... investment through production credits in Point Thomson. So, that ... was just interesting to look at, but yes; we can provide you with more information that looks at the producers' economics with and without the production credit.

REPRESENTATIVE SEATON: And thank you. And it doesn't have to be all one or all the other. I mean, a couple of ranges; because Mr. Chairman, I think that what I'm looking at is our big risk is those upfront years of having to have that investment without income from it, especially if we are reducing ... further our budgetary scope there. So, I think that that might be something that would be very interesting to look at and see whether it does really affect the project economics.

CO-CHAIR FEIGE: Representative Hawker.

[6:01:39 PM](#)

REPRESENTATIVE HAWKER: And thank you again, Mr. Chair, ... still ... focusing on the project ownership issue; could you explain the footnote? And I guess it really gets into what we really are talking about in project ownership in the way this graph is prepared What are the metrics? What do you mean - can you explain the footnote - and particularly in the context when you talk about it being the return on equity that the state invests. This is all about a State of Alaska 25 percent equity alternative Would that return on equity have to be shared with TransCanada if we don't hold the 25 percent in its entirety ourselves? And how exactly does that work when we're basically shipping our own gas on a pipe we built for ourselves?

[6:02:32 PM](#)

MS. PODUVAL: Representative Hawker, through the Chair. What we're showing here is the different splits of the state's revenues it's almost an after the fact calculation because property tax is what it is, state corporate income tax is what it is, and ... we know how that works. But the other three buckets together - royalty, production tax, and project ownership -- what that all boils down to is that we have 25 percent of the LNG that's going to come out of this project to sell. We sell that; we get a certain bucket of dollars. And

then we have that bucket of dollars and we need to split it out between royalty, production tax, and project ownership. And the way we've done that is we've assumed ... 13 percent of it is royalty. And we've assumed that I'm sorry, the first step to that is creating a tariff for the state to pay itself, okay. And that's what we're capturing and we're assuming a 12 percent return on equity that [the Department of Natural Resources/Department of Revenue] DNR/DOR would pay to the [Alaska Gasline Development Corporation] AGDC subsidiary potentially, okay. And again, it's not creating money, it's taking the money that we have and trying to put it into buckets.

REPRESENTATIVE HAWKER: Yes.

MS. PODUVAL: And so, the fourth bucket we split it into is this project ownership and that's paying the 12 percent return and it's basically going from one pocket to the other.

REPRESENTATIVE HAWKER: Yes. Thank you.

MS. PODUVAL: And then the rest of it ... you're splitting it in that ratio of 13 percent as royalty and the rest is production tax.

REPRESENTATIVE HAWKER: Perfect. Thank you.

CO-CHAIR FEIGE: Representative Saddler.

[6:04:03 PM](#)

CO-CHAIR SADDLER: I'm afraid that Deepa I did not hear the answer whether the state would have to split that gray bar with TransCanada or not. It may have been buried inside your answer, but I didn't hear it so is this Alaska's in the pocket share or is this something we must split with TransCanada.

[6:04:31 PM](#)

MS. PODUVAL: Representative Saddler through the Chair. If you will bear with me and wait until we talk about TransCanada tomorrow, I will give you more on that. I think the short answer is to the extent that TransCanada comes into the picture and has ownership of components of the project, then the project ownership as we're showing here would be shared with TransCanada. And I'll share with you tomorrow... what value is transferred to TransCanada.

CO-CHAIR FEIGE: Okay.

6:04:49 PM

MS. PODUVAL: Moving on to slide 12, this is a really interesting, and an important one, and we should probably take a couple of minutes just to wrap our heads around what it's trying to show. You've heard, and you've seen the enabling legislation ... that the state is contemplating a 20 to 25 percent share of the project, and if you assume 13 percent is royalty, then that leaves the remaining to be a, the gross tax number, that we're looking at. And, what we're trying to explain here ... is the set of assumptions and the framework that got to those magic numbers. How did we know it was 20 to 25 percent that would keep the state whole, relative to an RIV only world, and not 30 percent or not 10 percent, okay? So, the analysis we walked through is that first of all, the first challenge is knowing what your benchmark is, that you're trying to meet, right? Because if you knew for certain what the number is, in a royalty-in-value world, without state equity participation, then you know what you're trying to beat, or match. But that is the moving target that's going to be driven by the prices in the market, as well as the capital cost for this project. Those are the two big uncertainties that make that a moving target. And so, we looked across ... a number of scenarios and we're highlighting nine scenarios here that are combinations of different price environments as well as different capital cost environments. And we're taking the combination of those three, and looking over these nine scenarios and trying to solve for how much the gross tax rate, or how much the state's equity participation percentage would have to be to be equal to what the state would have received in a royalty only world, in a royalty-in-value world, without equity participation. Okay? And so, what you see here is that in a low price environment, which is the line to the very left, the bar is low, because the state would be receiving less royalty and less net production tax in a world where prices are low. And so, the level of equity participation that the state would need, or the amount of gas - share of gas - that the state would need from the project, to meet that benchmark is also correspondingly low. So, depending on what your capital cost for the project is, somewhere between, you know, 5 to 15 percent, 4 to 13 percent as it's shown here, is the level of state equity participation that would preserve value to the state. Then, we moved to the high price environment and ... our bar is going to be high because the state's royalty and production tax in a high price environment, in a royalty-in-value only world, would be high.

And so, if need to match that level of revenues with an equity participation, then the state would need a much higher share of the gas to be able to match that. And that range is somewhere between 30, 35 percent, as we're showing here. And then we said, "Okay let's look at the middle." You know, what's between these two cases, and across the base price for different capital cost assumptions, again, we solve for how much equity does the state need in the project? What is the share of gas that the state needs, to preserve the value that it could have received in an RIV only world? And that brought us to between 20 and 30 percent, and that was the recommendation that came out of the royalty study: that the state should consider an equity participation between 20 and 30 percent.

[6:08:49 PM](#)

REPRESENTATIVE HAWKER: Thank you. This really is a neat graph, I've got to tell you, where the lines intersect at 24, 25, that's the answer. But can you tell me what you used, dollar-wise, and ... is it market destination, or ... what is low price, base price, and high price to you in this model?

[6:09:07 PM](#)

MS. PODUVAL: Representative Hawker, through the Chair. They are all with your LNG market prices, and so the netback element would be shipping and then, whatever the project cost is.

REPRESENTATIVE HAWKER: How about dollars?

MS. PODUVAL: What the actual dollar numbers are associated with this? We do it a little differently, ... we're thinking about it more from nominal terms, but the base price assumption essentially in today's terms would be: we start with the price for oil, and so it's a \$90 per barrel price of oil, and a 13.5 percent multiplier on the oil price, plus a dollar. And so, what that gets you to is about a \$13 price for LNG, in today's dollars, and that's the base price environment. We go to the high price environment, and that assumes \$120 oil price, a 15 percent multiplier, and we have that dollar added to it as well, give me a second here, I'll do the math. So, that's about a \$19 price; that'd be high. And at the low price world, we're assuming this is pegged off of Henry Hub, and so it would be about \$10, assuming a Henry Hub price of about \$4 and then a \$6 adder to account for the liquefaction

REPRESENTATIVE HAWKER: Thank you very kindly.

[6:10:41 PM](#)

CO-CHAIR FEIGE: Okay, Representative Saddler, then [Representative] Olson.

CO-CHAIR SADDLER: So, I'll give feedback to you, so again, this chart shows what level of state equity is required at different price bands to make the same amount of money to the state as would be earned under the modified status quo, right, okay. And low price, \$10, ... I kind of missed those, can you list those prices again for what you described as low price, base price.

[6:11:11 PM](#)

MS. PODUVAL: Sure, 10, 13, 19.

CO-CHAIR SADDLER: And the low price of 10 was Henry Hub linked, but the others were?

MS. PODUVAL: Oil linked.

CO-CHAIR SADDLER: Oil linked, okay.

MS. PODUVAL: And so, we assumed a \$90 oil world in the ... base price scenario, and a \$120 oil world in the high price scenario.

CO-CHAIR SADDLER: Right, thank you.

[6:11:23 PM](#)

CO-CHAIR FEIGE: Representative Olson.

REPRESENTATIVE OLSON: Oh, thank you. I like this chart too, but can you tell me which gas you were assuming comes on first for this chart?

MS. PODUVAL: Representative Olson, through the Chair. ... where the production comes from?

REPRESENTATIVE OLSON: Yeah, that would have an impact on the chart, I believe.

MS. PODUVAL: We're assuming through the project that both Point Thomson as well as Prudhoe Bay gas would be available 10 years from now when the project would be operational. So, it would be gas from Prudhoe as well as Point Thomson.

REPRESENTATIVE OLSON: No, I'm sorry. Which one did you assume was coming on first?

MS. PODUVAL: They're both coming on at the same time in our assumption, by 2024.

REPRESENTATIVE OLSON: Equal amounts, or ...

MS. PODUVAL: More Prudhoe than Point Thomson, and I can get you the actual numbers.

REPRESENTATIVE OLSON: Thank you.

CO-CHAIR FEIGE: Okay, please continue.

[6:12:15 PM](#)

MS. PODUVAL: So on slide 13, what we really wanted to highlight here is that the gross tax percentage is important. It sets what the state's total share of the gas will be, what the total state participation will be, investment as well as revenues. And so, if you assume that royalty is about 13 percent, then when we're talking about a 20 percent state equity participation that corresponds to your 8 percent gross tax level. And when you assume a 25 percent state equity participation that corresponds to the 14 percent gross tax level, recognizing that production tax is net of royalty. And so, you know, the state maximizes its value the greater the share of the gas is that the state has allocated to it and the greater the state's equity participation; and just something for this legislature to be mindful of as those decisions are in front of you.

CO-CHAIR FEIGE: Representative [P.] Wilson.

[6:13:33 PM](#)

REPRESENTATIVE P. WILSON: Would you just state that again, the greater the equity?

MS. PODUVAL: The greater the state's equity participation is, the greater the share of the gas that is assigned to the state. And that creates a lot of value for the state; the value really is in the gas. And so, the higher that percentage is the better the state will be. So, moving to the next ...

[6:13:56 PM](#)

CO-CHAIR FEIGE: Representative ...

CO-CHAIR SADDLER: In the Chair's absence, so just, in the last column there - State Investment - that's over, over what timeline, time horizon?

MS. PODUVAL: That's through construction, essentially.

CO-CHAIR SADDLER: Through, up to construction. Okay.

MS. PODUVAL: Through the end of construction.

CO-CHAIR FEIGE: Representative Seaton.

[6:14:13 PM](#)

REPRESENTATIVE SEATON: Mr. Chair.

CO-CHAIR FEIGE: Representative Seaton.

REPRESENTATIVE SEATON: Thank you. You know the statement that the value is in the gas; we had a chart earlier that showed that a lot of the value in the project was in the midstream. Was ... I misinterpreting that chart that we had from, I'm trying to remember who presented that one, where the largest portion of the value came in the midstream.

MS. PODUVAL: Representative Seaton through the Chair. I think the largest costs for this project are in the midstream. You can think about that as being value, if you are looking at the return that you receive on that midstream. From the state's perspective, the point here is that even though the state's investment will increase with ... the greater the state's equity participation will be, the state's revenues associated with those greater volumes that come with higher equity participation are more than sufficient to offset the investment upfront. And so, if you're choosing between a 20 percent participation and a 25 percent participation, recognizing that there are different investment levels associated with each of those, choosing the one that has a higher state equity participation yields more than sufficient value to offset that difference in cost and that's really the point I was trying to make.

[6:15:57 PM](#)

MS. PODUVAL: [slide 14] So, moving on to the next aspect which is This study pointed out a number of risks to the State of Alaska and cautioned that the state should be managing these risks as effectively as it can. ... I like ... what this analysis shows, but it's essentially looking at the price exposure that the state has and comparing how the state is exposed to that in a royalty-in-value world without equity participation, with the exposure that the state would have with an equity participation. Okay. If you look at the middle set of bars, the blue bars all show ... a status quo world without equity participation. The green bars are a world with state equity participation. If you look at the middle set of bars that compare those two, again, we're looking at that combination of ... prices can be high or low, capital costs can be high or low, and so there's nine different scenarios being modeled here. But the take-away from the middle set is that across the base price scenario, regardless of the capital costs, the state's value from the project is more or less equal, with equity participation, as it would have been without the equity participation. Okay? And it should be that way, by design, because, again, we're trying to ... we tried to solve for what's the level of state equity participation that would keep that ... roughly equal. Now when you move to the low price scenarios, what you will see is that the revenues that the state receives with equity participation are, across all three of those scenarios, higher than what the state would have received without the equity participation. Okay? And so, what that shows is from a low price environment perspective, having an equity ownership in the project hedges the state's price risk in that world. And then you move to the high price world and what you see is that equity participation yields lower revenues than the state would have received without the equity participation, and staying in an RIV only world. Now, this is a happy world, this is a happy world where we're making a lot of money anyway, we're just not making as much money as we would have made in an RIV only world. And so, what you see happening, is that having equity participation in the project sort of flattens the state's revenue profile and it flattens the state's exposure to price risk. It increases the state's revenues in a low price world, it decreases the state's revenues in a high price world relative to RIV only and ... to that extent ... the state is giving up some upside - if you want to look at it that way - for that price protection in a low price environment, ... which would be the scenario you want to protect against.

CO-CHAIR FEIGE: Okay, ... Representative Hawker.

[6:19:29 PM](#)

REPRESENTATIVE HAWKER: And thank you again, Mr. Chair. So, in the green bar - 25 percent equity alternative - which is state takes equity, it's the RIK scenario; is the presumptive rate in this ... the production tax rate in this RIK scenario, the 13 percent of gross?

MS. PODUVAL: That's correct.

[6:19:58 PM](#)

REPRESENTATIVE HAWKER: If I might follow up? I guess, how did you establish market price, basically, at the end of the day, what comes back to the state 'cause there's been some arguments about, or arguments - discussions about the state being The whole point of this pipeline and the whole concept behind RIK is the state is -- it's exactly what you're showing here. We're able to ultimately get a higher return on an RIK sale, a sale of our gas, than we would by taking it in-value back here in the state. There's some argument that we're disadvantaged because we're the small player in the world. Have you discounted the market prices, or taken into consideration our potential disadvantage in selling gas, or is it simply presuming that there's some kind of worldwide market price that we're all able to get equally?

MS. PODUVAL: Representative Hawker, through the Chair. You're a little ahead of me, 'cause I'm coming to the marketing.

REPRESENTATIVE HAWKER: I'd be happy to withdraw the question.

MS. PODUVAL: I'm coming to the marketing arrangement that's included in the HOA, which I believe will address that concern. But as far as the assumptions go here, we're not assuming that the state receives a discount relative to what ... the producers receive.

REPRESENTATIVE HAWKER: Thank you.

[6:21:25 PM](#)

CO-CHAIR FEIGE: Representative Isaacson.

REPRESENTATIVE ISAACSON: Thank you, Mr. Chair. So, if I'm reading this right, from your earlier description: we could actually be singing "Oh happy day" even at the high price; if

this is the modified and we actually return back to the status quo, the blue line goes down to some degree and that levels it off even at the ... higher scenarios.

MS. PODUVAL: Through the Chair, yes, that is correct.

REPRESENTATIVE ISAACSON: Is there a, sorry.

CO-CHAIR FEIGE: Go ahead.

REPRESENTATIVE ISAACSON: Is there a significance, if, to that at the higher price, or just a verification that we're on the right track? If they're both level, balancing.

[6:22:06 PM](#)

MS. PODUVAL: Through the Chair, it would drop all of these blue bars down, not just the high price world. And so ... I don't think that actually changes what we're trying to do here or where we're going. I think the validity of the equity participation providing us sort of a hedge in our price exposure would still hold true.

REPRESENTATIVE ISAACSON: Yeah. Thank you.

[6:22:28 PM](#)

CO-CHAIR FEIGE: Representative Saddler.

CO-CHAIR SADDLER: Thank you Mr. Chair. You made the statement that having the equity position, or ownership, flattens the state's risk, but that seems to be only in the base price band ... admittedly the low, medium, and high ranges of the base price. But it seems to me that the other, left-hand tranche, the low price, we are definitely advantaged and at the high price we're disadvantaged, so can you help me understand your statement a little bit more?

[6:22:58 PM](#)

MS. PODUVAL: Representative Saddler, through the Chair. And that's exactly why I said it levels the state's exposure to prices What we essentially see, what you would expect to see, is ... in a low price world you receive the lowest revenues, in a medium price world you receive ... a medium level of revenues, a high price world - you receive ... high revenues.

CO-CHAIR SADDLER: Under equity?

MS. PODUVAL: Without the equity participation, right, in general, that's how it would work. And you see that here, in how the blue bars are structured. What I mean when I say that equity participation sort of flattens the state's exposure is that the green bars in the low price scenario are not as low as the blue bars are. And so, the state earns more in the low price world with equity participation, and conversely, as you pointed out, in the high price, you don't earn as much with the green bars as you would have with the blue bars. And so ... it doesn't give you as much high side, it doesn't give you as much low side, and it sort of flattens your price.

CO-CHAIR SADDLER: This is the

[6:24:03 PM](#)

MR. ABT: If I may, through the Chair, Representative Saddler. What ... it helps to do is reduce the volatility that the state would receive in terms of revenues into the state.

CO-CHAIR SADDLER: Okay.

CO-CHAIR FEIGE: We've got a little over seven minutes left, so please continue.

[6:24:26 PM](#)

MS. PODUVAL: The second aspect of risk for the state ... we said was capital cost. And touching upon it briefly here - recognizing we're going to come back and talk about TransCanada in more detail - ... essentially the capital cost risk exposure to the state is highest before the project starts because there aren't project revenues yet to support the cash calls ... that would be demanded from the state. And to the extent that the state thinks in TransCanada as a partner in this, to share in those upfront capital costs, that is one mechanism for the state to reduce its exposure to those cash calls early in the project's development before you have revenues to offset any cash calls with. In terms of the numbers, having TransCanada participate allows the state to retain between 20 and 25 percent of the gas share, while only being responsible for between 13 and 18 percent of the upfront capital costs. And that's because they will be paying the remaining portion of the capital costs associated with the [GTP and the pipeline. And this becomes especially important if there are cost overruns associated with

this project. And that ... as we discussed before, ... is a very real risk for this project ..., given how large it is and how complex it is. ... we should all expect that costs will go up with a much higher probability than they will go down for this project. And so, ... having a partner to share ... that investment requirement upfront - to the extent that that moves - becomes even more valuable because there is some uncertainty in what the cost for the project will be. And that's what we're highlighting here, putting some numbers to it on slide 16. The left panel essentially shows the state's investment with and without TransCanada in the mix. And what it shows is under the base level of capital costs for this project - the \$45 billion level - having TransCanada as a partner reduces the state's upfront cash calls by about \$3 billion or so.

CO-CHAIR FEIGE: Representative Saddler.

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CO-CHAIR SADDLER: And could you ... expand a little bit when you say with TransCanada, with the specific conditions, is that with buyback, without, parts of those numbers a little bit more finely than what you're presenting here?

MS. PODUVAL: Representative Saddler, through the Chair, thank you for that question. We're assuming here that this is with the buyback, and so without the buyback, it will reduce the state's capital investment even further. And ...

[6:27:29 PM](#)

CO-CHAIR FEIGE: Representative [P.] Wilson, then Seaton.

REPRESENTATIVE P. WILSON: Okay. Thank you Mr. Chairman. TransCanada really has to, ... they want to maintain their ability to have a profit in this. And so, if I remember right, TransCanada says that they want to get the greater of either 60 percent of the 25 percent, or 14 percent ... of the pipeline, correct?

MS. PODUVAL: Representative Wilson, through the Chair, yes.

REPRESENTATIVE P. WILSON: Okay.

MS. PODUVAL: That's correct.

REPRESENTATIVE P. WILSON: So, and then this, this is with ... the buyback?

MS. PODUVAL: Yes, what we're showing here is with the buyback.

REPRESENTATIVE P. WILSON: Okay, thank you.

[6:28:16 PM](#)

MS. PODUVAL: And the panel on the right essentially shows here that if there are cost overruns associated with this project, and this is now a \$54 billion project instead of a \$45 billion project, then again, having TransCanada as a partner can reduce the ... investment that would be required from the state by about \$4 billion. And like I said, you know, ... we'll talk about TransCanada in much more detail tomorrow, but just from the prospective of ... is the state, managing its different risks associated with equity participation, and looking at capital cost exposure, having TransCanada is one way of reducing that upfront capital cost exposure that the state would have before there are project revenues.

[6:29:06 PM](#)

CO-CHAIR FEIGE: Representative Seaton.

REPRESENTATIVE SEATON: Thanks. On this, back one, on this slide [slide 16] are we looking at the total project? TransCanada isn't participating in the liquefaction, ... LNG plant, and where does, what part is this?

MS. PODUVAL: Representative Seaton, through the Chair. We're only assuming, as it's laid out in the [memorandum of understanding] MOU, that TransCanada would be participating in the GTP and the pipeline component of the project, and that the state would be participating in the LNG plant as well as the portion of the GTP and the pipeline through the buyback.

[6:29:44 PM](#)

REPRESENTATIVE SEATON: Okay. And the, but the LNG plant is incorporated in.

MS. PODUVAL: Yes.

REPRESENTATIVE SEATON: Okay.

[6:29:56 PM](#)

MS. PODUVAL: [slide 17] Then looking at a third major aspect of risk for the state, which is the potential loss of value through RIK - and Representative Hawker, this is what you were asking about earlier. To the extent that the state elects to take its gas in-kind - associated with this project - ... there's a few different alternatives in front of the state on how it chooses to market this, this LNG. The first option is that the state can market its own share, this one we would think of at least with current capabilities, as possibly being the least attractive one. ... there's a number of reasons why, that we laid out in the royalty study, but one, the state would be competing with the producers who have done this and are very good at it. And that's not ... that's not an exciting place for the state to be. The state does not have ... a marketing organization set up ... or the experience to be able ... to market ... this LNG successfully, from that perspective. The second alternative would be for a third party to market the state's share. So, the state could potentially negotiate with ... some LNG players, out in the market, that would purchase the state's LNG at the terminal of the LNG plant and then remarket it. This ... could be an alternative for the state to consider, but it has some constraints that the state would have to be very mindful of. One is that ... whoever this is that is going to purchase, be this third party, purchase the state's LNG at the end of the LNG plant and then remarket it, they're going to have margin built in, and profit for themselves built into it, and so by definition, the state may get ... a discount on, on its LNG, that it sold. There could be some potential for upside if the state's able to negotiate ... some sharing of the upside with this third party, but ... that's generally not how these things get structured. And there's examples of ... different sovereigns that have gone down this path and ... not liked how the world's turned out in terms of what they ended up selling it to this marketer, and what they were able to then achieve in the market, and there being a disconnect between those two. The third option is that the producers market the state's share. And this would be an option where the state could benefit from the producers' marketing expertise. And so, they would essentially clump the state's share of the LNG along with their own when they're approaching the market and procure similar terms to what they're getting for their own gas, for the state. And this ... could recreate essentially a key advantage that the state has in an RIV world, which is rather than competing with the producers, ... we're achieving the same benefit that they do

because of their experience and expertise, and because they've done this ... for a long time.

[6:33:28 PM](#)

UNKNOWN SPEAKER: Quick question?

CO-CHAIR FEIGE: You had a question first, I think, Representative Seaton, then Kawasaki.

REPRESENTATIVE SEATON: Thanks. We've talked a number of times about potential partners and looking at whether it's Mitsubishi [Gas Chemical Company] or Korea Gas [Corporation] or whoever, the, we've been told that when they buy a long-term portion of a project they want, all the way up. So, is there anything in your presentations, or have you looked at that kind of scenario, as far as economics go and what we could get out of the revenue stream versus the lowered risk by having either a partial or a full buy-out. And is there anything ... that you see in these contracts that would prevent us from exercising that option?

MR. ABT: Through the Chair, Representative Seaton, this is a marketing alternative that we have discussed ... and evaluated. And ... yes, there are plenty of buyers in the marketplace that are interested in such a structure. There's nothing contemplated within the current structure, that we're talking about here, that prohibits the state from pursuing that option if it is an alternative that it deems to be attractive.

REPRESENTATIVE SEATON: Okay. Thank you, Mr. Chair.

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CO-CHAIR FEIGE: And, let's see, Representative Kawasaki.

REPRESENTATIVE KAWASAKI: I think he was actually, he was next.

CO-CHAIR FEIGE: Or Representative Isaacson.

REPRESENTATIVE ISAACSON: All right, thank you, thank you. So, I appreciate that this is a snapshot in time. But, we have 10 years to develop, perhaps if we wanted, expand AGDC's authority, let's say, like Norway did with Statoil, to learn how to market our gas. And I guess that would have to be a provision in the HOA, if we ever wanted to contemplate. What would be your experience ... and insight into ... how might that benefit

Alaska, even if it took us a little bit to ramp up, even after a decade?

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MS. PODUVAL: Representative Isaacson, through the Chair. That's ... that's certainly an option for the state to consider. I don't, there's nothing ... in the HOA or any of the agreements being contemplated right now that would preclude the state from going that direction; and so, ... in the world of optionality that is an option that is still open to the state to pursue. Just something to think about is, we may have ... some of the best marketing organizations already available to us through the producers, and whether that will be a lower cost way of getting there; ... again, that should be part of the state's evaluation.

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MR. ABT: If I may, through the Chair, Representative Isaacson. One other thing to consider is we probably don't have 10 years, right? These decisions and the [sales and purchase agreements] SPAs that would support ... this project are necessary for project financing. So, you probably need to have them negotiated pretty much by 2017, so you might have three years and executed by 2018. So, that really accelerates the development of that expertise that would be necessary for the state to acquire.

REPRESENTATIVE ISAACSON: Thank you, good point.

[6:37:15 PM](#)

CO-CHAIR FEIGE: Representative Kawasaki.

REPRESENTATIVE KAWASAKI: Thank you. And looking at this graph, I think that is a concern amongst members ... that Alaska won't be able to figure out its market, and then we'll have this gas that is essentially not worth anything. ... is there a benefit to ... putting that somewhere in the current enabling legislation to protect the state from that risk, that sales be done ... as a unit.

[6:37:44 PM](#)

MS. PODUVAL: Representative Kawasaki, through the Chair, if you'll bear with me 'til we get to the next slide, I'll point you to where there is language in the Heads of Agreement ...

that starts taking the state toward that direction. So, ... on slide 18 here ... what we wanted to point it out, is that the Heads of Agreement includes the producers' intent to negotiate with the state to market the state's share of the gas. So, each of them would proportionately market ... what they're contributing to the state's share of the gas. And the state is only obligated to take royalty-in-kind if the producers make satisfactory arrangements for the disposition of the state's share of LNG. And so, the agreements are moving in the right direction to where the state can benefit from the producers' marketing expertise. It's too early for those details to be worked out, but directionally, ... that's where this could be heading.

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CO-CHAIR FEIGE: Okay. Right, on to the next slide.

MS. PODUVAL: And again, trying to help us understand how that alternative can work, essentially each of the different producers would market what it's contributing to the state's gas share. This is a very simple world that we're assuming here, where the state takes a 25 percent equity participation, each of the producers are producing a hundred units. But, to the extent that they are each contributing 25 units, and that makes up the state's gas share, then they would each be including those 25 units in the LNG that they're offering to the market and trying to sell. And that's how the entire state gas share ... would be marketed. You know, another thing is as part of these negotiations, one of these producers may be willing to market a greater share of the state's gas, and the state, potentially, ... if that is the case, with three different producers and three different negotiations, the state could have some upside in being able to pick ... which the best deal might be to market the state's gas share, as well. And then, moving to the risks associated with the structure itself of the state's participation [slide 19]. Wanted to highlight some of the elements that are incorporated within the Heads of Agreement and how they might impact some of the things that are important to the state. One key concept here is the concept of a project within a project. To the extent that we've equalized the upstream gas ... to the equity share ... through the AK LNG project, that allows each of the stakeholders, the producers as well as the state, to exercise ... almost complete ... commercially the terms that it wants through its own part of the project. The state does not need to ... agree with how the producers would structure their part of the project

commercially, or what tariffs they might use or not use. And similarly, the producers won't have a say in the way that the state commercially sets up its part of the project. An important aspect that that has ramifications for is the access and pro-expansion principles that are included in the Heads of Agreement. And what that points to is that each party has the ability to initiate an expansion and that is really important, because if you think about being ... a minority interest holder in the project and if that's a decision that all of the parties get to vote on and will only proceed with a majority decision or a unanimous decision, then the state could get out-voted each time it wants to initiate an expansion and have another producer that finds gas on the Slope into the project. But to the extent that the agreement will allow the state to initiate its own expansion in the project and the producers will not be able to veto that, ... with the caveat that it doesn't negatively impact their current operations which is a fairly standard caveat that's used with a lot of pipeline projects, ... that's valuable to the state because it creates access within the project for other producers that want to explore and produce in the North Slope. It allows the state to create that expansion, offer attractive terms, for those producers to be able to monetize their gas. The stage-gated commitments aspect is another important one, and we touched upon this a little earlier in our discussion today. But at this point, the state's not committing, you know, \$13 billion as its share in this project. What it's committing is to get through Pre-FEED and contribute its proportionate share of that. At every stage-gate in this project's development, the state, just like the producers, will have a decision to make on whether to move to the next stage or not and to bear the cost associated with that. And so, as more and more information becomes available to the state, just like it would to the different producers, the state will be able to make more informed decisions about spending more money toward this project. The fourth aspect we're highlighting here is access to information. To the extent that the state has a seat at the table, that creates access to information; ... like we said before, you're not waiting on a press release to find out what the producers are doing late into this project. You're understanding, ... the engineering, what the cost estimates that are being developed for the project, what is being done and what is not being done related to this project. And that can be a positive thing as well. All of these things, within the dotted line here, [slide 20] ... are principles as they're laid out right now. And they all need to be qualified in commercial agreements ... that are being negotiated and ... are yet to be finalized and signed. And this is definitely an area ... that

we should characterize as being a work in progress. Some of the principles that are laid out are pointing in the right direction, but there's a lot more detail and a lot more certainty around these elements that have to be obtained ... in the negotiations that are yet to come and to commercial agreements that are yet to be signed.

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CO-CHAIR FEIGE: Representative Seaton.

REPRESENTATIVE SEATON: Thank you. Yesterday ... our consultants raised the point about whether it was reasonable for parties that were not investing in an expansion, they don't have to pay anything, but if the unit cost was lower, they shared in the benefit; and the question was, "Is that really reasonable?" Or ... if they're guaranteed it won't cost them anything, then the benefit should flow to the people that are doing the expansion, if that occurs. So, do you have a take on that?

MS. PODUVAL: Representative Seaton, through the Chair. What the expansion principles say, essentially, are that if there's an expansion on the project and ... the expansion ends up reducing the per unit cost of the project, then everyone gets to share in that. If there's an expansion in the project, and it results in the per unit cost going up, then the party that's expanding bears that cost. The rationale for that, essentially, is that if an expansion lowers the per unit cost, the original project owners, essentially, built the infrastructure with the chief expandability that the new party is benefitting from. And so, one way to think about this is if we were not the party that's expanding ... and it's Exxon that finds new gas and wants to expand the project, and ... in order to expand the project they're using the chief compression capacity that our pipeline has.... Their next unit is not going to be as expensive because they don't have to put steel in the ground like we did to build the project. They only have to add relatively cheap compressors to be able to move more gas through the project. Okay, that's one way to think about it.

REPRESENTATIVE SEATON: Mr. Chair? I guess the question is if all parties have the opportunity to proportionately invest in the expansion ... and if they choose not to invest in the expansion, then ... my question is, and what our ... consultants raised was the question, "Does that make sense, if they're not investing in the expansion, if they choose not to invest in the expansion?" So, can something be negotiated in so that if

there's an expansion, everybody has the right to expand; but if people want to participate in the expansion, then they would share in the benefit?

MS. PODUVAL: Representative Seaton, through the Chair. The short answer to that is yes, ... that's one way of doing it where every party has the option to participate in the expansion. And when we say participate in the expansion I guess ... they would be putting the money to facilitate the expansion, they may not have more gas to put in the project and everyone ... can share in the benefit, but ... the structure that's being contemplated here is not irrational either. And ... it's not necessarily uncommon either ... where if there's a lowering of the per unit cost in a project ... with an expansion, that the original shippers benefit from that, whether or not they're part of that expansion. You'll see this rolled-in rate philosophy applied ... in the Lower 48 pipelines, for example, where all of the initial shippers would benefit if an expansion lowers the cost of the project, even though they're not investing more.

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REPRESENTATIVE SEATON: Well, and Mr. Chairman, and we had that ... in AGIA project as well, but there was ... a limit on the cost at 115 percent, so there was some participation in the expense as well, so they could go up to 115. Here we're saying it's zero, you have ... no liability for any additional cost for a rolled-in rate and yet you share in the benefits without any further investment. So, I guess it's something that maybe we can ask you guys to think about and see if there's ways of structuring that so that we can answer our consultant's questions as well, maybe from a different standpoint.

MS. PODUVAL: Representative Seaton, ... certainly, there's different ways to look at it. One way to look at it is maybe this is the trade-off for having the unilateral right to expand the project. And ... the trade-off here is that the original shippers all get to share in the costs as they go down, but they don't share in the cost if they go up. And that's what they want in return for allowing you to expand the project at will. But yes, we will think about ... if there are other ways that this can be cut.

REPRESENTATIVE SEATON: Thanks, Mr. Chairman. I just want to make sure that as we go forward with legislation, where the legislature is considering this part, ... if we can incorporate

something in there that addresses the issue that was brought to us by our consultants. So, thanks.

CO-CHAIR FEIGE: Okay. And, let's see, we're almost to the slide we've all been waiting for, Representative Isaacson.

[6:50:42 PM](#)

REPRESENTATIVE ISAACSON: Thank you, I'll make it really quick. Just to clarify the access to information. From what you've been saying then, it's your understanding that this HOA would have the access to information survive post-construction, or is it just through construction and the initial commercial agreements?

MS. PODUVAL: So the HOA ... is essentially just agreeing on principles, at this point. It's the commercial agreements that will be signed through Pre-FEED, FEED ... getting to FID that will codify and lock in these principles and legal agreements between these parties. And ... the HOA lays out the right principles that move the state and the producers in the direction towards ... all of these different objectives that the state has. But, this is a work in progress, and the actual agreements will reflect whether or not the state has ... access to information, transparency, and all of these different things that we want to see there.

REPRESENTATIVE ISAACSON: So, if I may, a short follow up. Do we need to specify intent language then to satisfy what you showed here in an earlier slide, number 8 I believe it is, in order to keep disputes down; ... we need to have access to information, that's been one of the sticky points for a long time. ... is that already intentional in the language of this HOA or do we need to specify that more particularly?

MS. PODUVAL: I believe the intent is included.

REPRESENTATIVE ISAACSON: Okay.

MS. PODUVAL: Like I said, the actual agreements ... will need to convert those into legally binding terms.

REPRESENTATIVE ISAACSON: Thank you. Okay.

[6:52:30 PM](#)

CO-CHAIR FEIGE: Okay, on to the slide we've all been waiting for.

MS. PODUVAL: The rest of them were not scintillating? Well, slide 21 is where ... we're sort of looking at that scorecard all together and saying ... we set out trying to see whether the Heads of Agreement laid out principles ... and a structure that created alignment through equity, improved the commercial attractiveness, preserved value to the state, and helped us manage the risks that we know we'll start getting exposed to. From creating an alignment through equity participation through equity, we said that the equity participation along the entire supply chain as it's being contemplated now, creating the share of state gas which is royalty and tax equivalent to what the state's investment would be in the project, those are all elements ... that help to create that alignment between the producers and the state. The state's upfront capital investment in the project through equity participation improves the producers' return on the project, and ... it helps the state to share the producers' risk ... and improve the commercial attractiveness of the project from that perspective, for the producers. We looked at the state's cash flows in a number of different worlds - in the world without an equity participation, in a world with equity participation - and saw where ... that magical 20 to 25 percent number was at and what the rationale behind that is. And within that range, the state essentially is not losing value ... by incentivizing this project and that's ... a valuable combination we think; it looks better for the producers, but the state is not bleeding value in order to do that. From the perspective of managing risk, again, just the structure of the equity participation reduces the volatility of the state's revenues to prices and hedges in a low price environment while taking away some of the upside and it helps to manage the state's price exposure, it's one of the ways that that's addressed. Having TransCanada participate in the project is ... an alternative for the state to reduce its upfront capital cost exposure before there are revenues available to offset it. With respect to marketing the state's gas itself, as well as the structure of the participation, those are elements that are in flux. Again, the Heads of Agreement includes principles and intent to solve those problems for the state and to create a structure that would help the state meet its objectives of ... access, expansion, transparency, access to information, all of those, but that's definitely the area where ... this is very much a work in progress and there will be more agreements and more details in the years ahead, where the state has work to do ... in creating legally binding language that

facilitates the state to achieve all of those. Mr. Chair, ... that's what we had in terms of a presentation, and I'm happy to take any other questions we have.

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CO-CHAIR FEIGE: Representative Saddler.

CO-CHAIR SADDLER: So, just for easy of interpretation. So, the far right bar, here, should we interpret dark green as A, light green as B, and yellow as C, or is there a different ...?

MS. PODUVAL: Representative Saddler, through the Chair. Yes, I think ... that's a fair representation.

CO-CHAIR FEIGE: No further questions from committee? That concludes part one of your presentation, I think we look forward to part two tomorrow. We will meet again at 1:00 p.m., right here in Room 124. We're adjourned.

[CSSB 138(FIN)am was held over.]

[6:56:17 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 6:56 p.m.