

SENATE FINANCE COMMITTEE
February 20, 2014
5:07 p.m.

[5:07:28 PM](#)

CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 5:07 p.m.

MEMBERS PRESENT

Senator Pete Kelly, Co-Chair
Senator Kevin Meyer, Co-Chair
Senator Anna Fairclough, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Joe Balash, Commissioner, Department of Natural Resources.

SUMMARY

STATE OF ALASKA BACKGROUND and HISTORY AS RELATED TO
CURRENT GAS TRENDS

Co-Chair Kelly stated that the discussion would be related to SB 138, which was not yet in committee.

[5:08:36 PM](#)

^STATE OF ALASKA BACKGROUND and HISTORY AS RELATED TO
CURRENT GAS TRENDS

[5:08:38 PM](#)

JOE BALASH, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, (DNR) discussed the PowerPoint presentation, "Alaska North Slope Gas Commercialization" (copy on file). He stated that

his presentation would address the history of Alaska North Slope liquid natural gas (AKLNG) commercialization. He felt that he had a unique perspective, because he was the incoming committee aide for the Legislative Budget and Audit Committee in 2004. He signed a confidentiality agreement that gave him access to the materials and documents that were being exchanged between the administration and various applicants under the Stranded Gas Development Act. He stressed that he did not have a seat at the table during those negotiations, but he had a "front row seat." In 2006, he left the legislative branch and joined the governors' office. At that time, he joined the team that put together the Alaska Gasline Inducement Act (AGIA) statute and framework that has since been instituted. In 2010, he joined DNR, so he has had a very close view of the transition during the previous 10 years. He stressed that he had his own biases, and what he witness affected his perspective. He hoped that his presentation would help contextualize the information and history.

Commissioner Balash displayed slide 2, "Alaska North Slope Gas Commercialization."

Commercializing Alaska North Slope Gas:

Where we have been

Where we are

Where we hope to be

Key principles for any project

Gas to address Alaska's in-state needs for abundant supplies of low-cost energy and economic growth

Gas that will maximize the value of the state's massive resource base through high-volume and export markets

A project that incentivizes exploration and investment in continued oil and gas development

[5:12:15 PM](#)

Commissioner Balash looked at slide 3, "North Slope Gas Commercialization: Benefits to the State."

In-State Gas: opportunity for competitively priced, reliable in-state gas supply

Commercialization of Alaska North Slope gas resources through sale of large quantities of natural gas beyond in-state needs

Additional revenues to the State

Creates jobs for Alaskans in the exploration, development, production, and transportation of natural gas

Increased opportunities for Alaskan based contractors and businesses

Infrastructure for development of additional gas resources to enhance further oil and gas exploration/production opportunities

Commissioner Balash highlighted slide 4, "North Slope Gas Commercialization: State Interests."

Alaska has world-class unconventional resources, including tens of billions of barrels of heavy oil, shale oil, and viscous oil, and hundreds of trillions of cubic feet of shale gas, tight gas, and gas hydrates.

The mean estimated onshore gas hydrate resource is 590 TCF of gas-in-place, with a mean of 85.4 TCF potentially recoverable with current technology (USGS, 2008).

Commissioner Balash spoke to slide 5, "North Slope Gas Commercialization: AGIA Background, Purpose, and Terms."

Alaska Gasline Inducement Act (AGIA) resulted from the aftermath of the failed Stranded Gas Development Act (SGDA)

Relied on private sector project sponsor

-Utilized reimbursement to de-risk development costs

-Also secured an option to purchase information/assets if project did not advance

Established terms designed to maximize state benefits

-Low tariffs - through high debt/equity capital structure

-Favorable expansion policy

Expectation was long lead time on development could proceed in parallel with commercial/fiscal negotiations

[5:17:13 PM](#)

Commissioner Balash discussed slide 6, "North Slope Gas Commercialization: History and Timelines."

2007:

AGIA process set out in statute

Applications received December 1, 2007

2008:

April: Denali announced by BP and COP

July: Enstar-ANGDA Plan announced

August: AGIA license approved by Legislature

2009:

February: In-State Project Manager is named
Built on work started by Enstar and Anadarko

June: ExxonMobil aligns with TC to form the Alaska Pipeline Project (APP)

Co-Chair Kelly handed the gavel to Co-Chair Meyer.

[5:24:00 PM](#)

Commissioner Balash looked at slide 7, "North Slope Gas Commercialization: History and Timelines."

2010:

April: Legislature passes HB 369

July: Open Season held for APP - conditioned bids received

October: Open Season held for Denali - conditioned bids received

Shift to LNG in 2011:

May: BP and Conoco abandon Denali

July: AGDC/ASAP project plan released

October: Governor Parnell calls on parties to move forward on large-diameter pipeline to tidewater in Alaska in an AGIA framework

Co-Chair Meyer handed the gavel to Co-Chair Kelly.

[5:30:56 PM](#)

Co-Chair Meyer wondered if the condition bids were confidential. Commissioner Balash replied in the affirmative.

Co-Chair Meyer asked if there were positive results during the open season. Commissioner Balash replied that both projects had announced that they had successfully achieved or attracted bids, but were conditioned.

Vice-Chair Fairclough queried the number of bids. Commissioner Balash responded that the administration did not receive the specific details of the bids, but briefings had indicated a sufficient capacity bid for the Alberta project to warrant continued development costs associated with the project. He stressed that the work on the Richardson Highway leg to Valdez was halted in order to focus exclusively on the Alberta leg.

Vice-Chair Fairclough wondered whether the administration had knowledge of other conditions beside financial certainty that were received on those conditional bids. Commissioner Balash replied that he was not able to speak of it publicly.

Vice-Chair Fairclough wondered why the discussion of financial certainty was allowed, but the discussion of other conditions could not be addressed.

Co-Chair Kelly felt that there may be a miscommunication, and asked Vice-Chair Fairclough to restate her question.

Vice-Chair Fairclough understood that conditional bids were under confidentiality agreements, but stated that Commissioner Balash had shared that one of the conditional bids was related to fiscal terms. She wondered why other conditions could not be shared, if it was known that financial terms were one of the conditions. Co-Chair Kelly felt there may be another opportunity to address those concerns. He stressed that Commissioner Balash should not be made to feel like he was breaching any confidentiality agreements.

Commissioner Balash stated that he would seek further understanding, if he were able to speak to the details publicly.

[5:35:22 PM](#)

Commissioner Balash discussed slide 8, "North Slope Gas Commercialization: 2012 State of the State and Benchmarks."

Governor's Roadmap to Gasline

1. Resolve Point Thomson
2. Align during the first quarter of 2012 under an AGIA framework on a large diameter gasline to tidewater
3. Two projects—under AGIA and AGDC—complete discussions by third quarter of 2012 determining what potential exists to consolidate projects

4. Harden numbers on an Alaska LNG project by the third quarter of 2012, and identify a pipeline project and associated work schedule

5. If milestones are met, the 2013 Legislature can take up gas tax legislation designed to move the project forward

January 2012: Three CEOs meet with the Governor

"Currently, Alaska is pursuing parallel tracks to get a gasline. The State financially supports two different projects - one under the Alaska Gasline Inducement Act, and the other under the Alaska Gasline Development Corporation. While both are making progress, neither can finish the job." -Governor Sean Parnell, 2012 State of the State

Co-Chair Kelly asked how the project would apply to the AGIA framework, because the projects were so different. Commissioner Balash responded that there were project plan amendments that were submitted by the licensee to the commissioners of DOR and DNR that were approved, which allowed TransCanada to conduct certain planning activities that would support the AKLNG project. He announced that information had been gathered for reimbursement, and then used by the parties to continue their discussions in exploring whether or not an LNG project could provide the market opportunity that an Alberta project did not provide. He stressed that all parties had not signed on to AGIA; however they were all working together with the state's licensee to continue to discuss the mission of AGIA.

[5:41:49 PM](#)

Co-Chair Kelly surmised that TransCanada was a licensee under AGIA.

Commissioner Balash highlighted slide 9, "North Slope Gas Commercialization: Point Thomson Settlement."

March 30, 2012: Point Thomson Settlement Agreement filed with the Alaska Supreme Court

Premised on requirement to perform work, start production

Working Interest Owners must earn the acreage

Sanction of Major Gas Sale pipeline project (in 2016 or 2019) secures entire unit

Senator Dunleavy asked for an explanation of the Pt. Thompson dispute. Commissioner Balash stated that, for several years the resources at Pt. Thompson were thought to include both oil and gas. The understanding was that Pt. Thompson was considered a "retrograde condensate reservoir", which meant that that gas was under such enormous pressure that the other hydrocarbons in the field were in a gaseous state. When the gas was brought to the surface, there were certain hydrocarbon liquids that fell out. It was possible to recover those liquids, and push the gas back into the reservoir, which was considered a cycle. The question in the dispute was how much of the liquid could be discovered, and did the field need to be developed with liquids recovery as the primary means of production and commercial activity, before gas recovery.

Senator Dunleavy surmised that the dispute was related to whether or not Pt. Thompson was considered an oil or gas field. Commissioner Balash agreed.

Senator Dunleavy wondered how long the dispute occurred. Commissioner Balash replied that the unit was terminated by in 2006, and the litigation carried on through 2012. The settlement occurred on March 30, 2012.

[5:46:37 PM](#)

Senator Dunleavy asked what Pt. Thompson was currently considered. Commissioner Balash replied that Pt. Thompson was considered a hydrocarbon field.

Senator Dunleavy felt that it was a circular conclusion. Commissioner Balash agreed. He stated that the purpose of the initial production system was to test the methods that were in dispute between the state and the working interest owners. The initial production system that would go into operation in 2016 was expected to yield approximately 10,000 barrels per day. He stressed that there was concern regarding yield sustainment. The result of the yield would determine expansion of the cycling program to recover all of the condensate before blowing down the gas.

Co-Chair Kelly wondered if that oil and/or gas would be taxed. Commissioner Balash replied that the ownership interest would be recovered in the form of royalties. The royalties at Pt. Thompson were slightly higher than the royalties at Prudhoe Bay, but the production tax was done through the oil and gas production tax. The produced hydrocarbon would be valued and taxed at 35 percent. Oil would qualify for the production tax credit available under 43.55. Gas would not get a production tax credit. He stressed that SB 21 allowed Pt. Thompson to qualify for the gross value reduction, because of the timing of its commercial activity.

Co-Chair Kelly asked for a definition of the term "blow down." Commissioner Balash replied that the term "blow down" referred to the release of the gas from the reservoir. Gas was trapped under the earth in a hard formation, and was typically under pressure. The pressure of the oil and gas that pushes the hydrocarbons into the well bores that were drilled into the fields, but the pressure declined as the fields was produced. When the gas pressure was relieved, there was less energy in the field. The oil did not flow as well, inhibiting oil recovery. He explained that the Alaska Oil and Gas Conservation Commission (AOGCC) paid close attention to the way in which any given field is managed and produced.

[5:51:14 PM](#)

Vice-Chair Fairclough wondered if the "ring" was around the field or at the bottom of the field. Commissioner Balash replied that in the course of the Pt. Thompson settlement discussions, DNR gained access to additional geological information that helped informed DNR of the likely state of affairs at the bottom of the field. He stressed that it was a key factor that lead DNR to pursue the settlement as outlined in the terms.

Commissioner Balash displayed slide 10, "North Slope Gas Commercialization: 2013 Milestones: Governor's State of the State."

1. By February 15, private parties involved in APP must select a concept on an all-Alaska project; they must describe and detail the project and pipeline specifications. To include:

the size of the pipe and the daily volume of gas

the location of the gas treatment plant and detailing the number of compressor stations to move the gas along

the size and scope of the liquefaction plant and LNG storage tanks

the number of off-take points to ensure that Alaskans can utilize our gas for our needs

2. Spring 2013: Companies finalize an agreement to advance to Pre-FEED (front-end engineering design)

Pre-Feed - hundreds of millions of private-sector dollars

3. Producers ensure a full summer field season (Summer 2013)

[5:56:18 PM](#)

Commissioner Balash highlighted slide 11, "North Slope Commercialization: 2013 Milestones."

April:

HB 4 and More Alaska Production Act (MAPA/SB21) passed by Legislature June:

Last milestone of 2013 not met - no special session on gas tax legislation October:

Nikiski named as preferred location for pipeline terminus

Commissioner Balash displayed slide 12, "North Slope Commercialization: Fiscal Discussions."

Early Breakthrough on Take vs. Stability

Set take terms now, provide stability later

Commensurate commitments by parties as project moves forward

Fundamental differences between SOA and Producers -
stemming from our misalignment of interests

State interests driven by lowest transportation
charges/highest netback

Lack of regulation at LNG plant/terminal
(ownership of pipeline only does not solve the
problem)

Integrated companies are not driven by the
capital structure/netback

Key to Resolution: equity participation by SOA
(project in a project)

Allows each party to structure their financing as
they see fit

Enables any party to initiate an expansion on a
sole-risk/keep-whole basis

[6:01:49 PM](#)

Co-Chair Kelly queried the definition of the phrase "rolled in." Commissioner Balash replied that there was an additional cost, when a cost was expanded. Sometimes those expansions were cheap, which meant that the expansion was efficient and the per unit cost decreased overall. Sometimes the expansions were so costly that the per unit costs increase. There was a methodology called "rolled in" rate making, which blended the per unit costs resulting in everyone's tariff to increase. Allowing expansions to occur on a sole risk keep hold basis would result if the state deciding to take equity participation in the project. The original parties on the project would have their own separate tariff, and if an expansion occurred by one party, the other three parties were not required to participate.

Senator Bishop asked what would happen if the other parties took advantage of the expansion that was paid for by another party. Commissioner Balash replied that the other parties would be required to pay for the second expansion, under the principles outlined in Appendix A of the HOA.

Vice-Chair Fairclough asked for information regarding the traditional forms of gas expansion. She remarked that there

was some concern regarding the Trans-Alaska Pipeline Service (TAPS), and the accessibility to that line by the smaller producers. She wondered how the TAPS pipeline model was different than the current proposal. She specifically queried the traditional choices in how gas moved in most pipelines in the world. Co-Chair Kelly also wondered if the word "expansion" in this context only referred to volume of gas through the pipeline. Commissioner Balash responded that a given pipeline could carry so much gas depending on the compressors that were able to push the gas through the pipeline. More compression must be added in order to move more gas through the pipeline. He stressed that more fuel is consumed, when more compression is added. He remarked that it was often cheaper to lay more pipe at a certain point, than simply move more gas.

[6:07:34 PM](#)

In response to a question from Vice-Chair Fairclough Commissioner Balash stated that many of the challenges that were faced by third-parties or independent producers with regard to TAPS was a product of problems that the state faced 15 to 20 years prior. During the mid-1980s to the early 2000s, the tariffs on TAPS were charged on the basis of a settlement. The tariffs were not at a fully adjudicated tariff, so there were parties who felt that the settlement produced tariffs that were too high. He stated that TAPS was considered a "common carrier", meaning anyone who was able to pay the tariff was able to use TAPS. The current participants would be pro-rated down to make room for the new party, if the pipe was already full. He stressed that the party must be able to afford the tariff. The high cost of the tariff during that time created some competitive disadvantages for non-TAPS owners. He remarked that there was currently a just and reasonable tariff, which was adjudicated by the Federal Energy Regulatory Commission (FERC).

Commissioner Balash announced that most pipelines in North America were regulated and their business was conducted in a unique way. Those pipelines were typically operated as contract carriers, rather than being considered common carriers. Being a contract carrier meant that space in the pipeline was reserved by those who had space in the pipe. The contract entitled them to the capacity day to day. He stated that if a party wanted to participate in the pipe, a change in the pipe must be made. The change would consist

of either the addition of compression, or looping. The new party would be required to pay for the expansion. He explained that the history of rate regulation and rate making in the U.S. was varied. He explained that there was a point in time when all pipelines in North America were governed by a rolled in methodology. As part of the deregulation and efforts to promote competition in the 1970s and 1980s, the U.S. moved to an incremental pricing methodology for the expansions. That change led to the construction of more pipelines in more parts of the country, which he felt was good for the U.S. He explained that Canada continued to rely on rolled in rate making for expansion services, and they had fewer pipeline companies.

[6:14:41 PM](#)

Vice-Chair Fairclough stressed that Alaska was paying attention to access, and whether new production could make it into a pipeline. She queried the likelihood of the state covering the cost of a possible expansion. She felt that a pipeline operator would want to participate in the expansion, because the capital investment would give a rate of return based on that expansion for thirty years or more. Commissioner Balash responded that he felt that the agreement with TransCanada was in Alaska's long term interest. He stressed that the state may not be the party involved in expansion. He remarked that there would be a contract with TransCanada for capacity to ensure that the gas gets to the liquefaction terminal and Alaskans. He stressed that a discovery of gas on federal land would not result in a royalty volume for that gas. He stressed that the contract with TransCanada needed to be structured on terms that work for the state over the life of the contract, which was stated in the MOU as 25 years. He explained that there were some past issues related strictly to pipelines, because the pipeline was going to provide the means to market. Currently, the new component of the liquefaction terminal was going to be the primary hurdle for third parties to get their gas to market.

Vice-Chair Fairclough queried the definition of "train." Commissioner Balash explained that a "train" was a unit of the processing component either on the North Slope to remove the carbon dioxide, or at the other under end of the pipeline at the liquefaction unit. He stated that a train was a piece of equipment that reduced the temperature and increases the pressure on the gas to convert it to a liquid

state. He stated that the trains were modular. There were three trains in the proposed project: three trains for GTP and three trains for liquefaction. There will mostly likely be an additional train, in order to expand the capacity of the facility to make more LNG. He remarked that without the addition of more LNG, expansion of the project was pointless.

[6:22:05 PM](#)

Commissioner Balash discussed slide 13, "North Slope Commercialization: What's Different This Time?"

Pt. Thomson resolved

All the necessary parties have aligned to make an Alaska gasline project go - three producers, a pre-eminent pipeline builder, and AGDC

Commercial issues being resolved by parties

Gas-oil ratio (GOR) reaching a tipping point in 2020s

Clear articulation of all parties' commitments

Agencies asking the Legislature to provide term sheet-level approach

Papering of Definitive Agreements only occurs after Legislature grants authority

Definitive Agreements not binding unless/until Legislature ratifies - at next stage of commitment by Producers

Commissioner Balash addressed slide 14, "Long-Term North Slope Oil and gas Revenues are Driven by AKLNG Project Success." He stated that the slide was from the presentation from the previous evening's meeting. He explained that the slide showed the state's revenue picture, which showed an oil-only world and an oil plus gas world. He stressed that the development of the gas resource was in the state's interest, in order to support the public services that were provided in state business.

[6:30:48 PM](#)

Senator Dunleavy wondered if the 2020 was the year that the GOR lines would cross, and the focus would be on gas revenue. He asked if production was declining. Commissioner Balash responded with slide 15, "Producer (Upstream + Midstream) Status Quo Annual Cash Flows." He announced that the issue was related to the production of the gas and the removing of the gas from the field caused a negative consequence on oil production. He stressed that a negative consequence on oil production would affect a business decision regarding gas production. He remarked that the DNR models predicted that sometime in the 2020s, the oil impacts at Prudhoe Bay would be negligible. That impact would then force the Prudhoe Bay companies to evaluate gas production as a revenue generator, rather than also taking into account the oil losses.

Senator Dunleavy explained that there was a similar conversation related to different kinds of Prudhoe Bay business. He wondered what Commissioner Balash was referring to in his comments. Commissioner Balash replied that he was referring to the initial production area at Prudhoe Bay in the Sadlerochit Reservoir. He was referring to the portion of Prudhoe Bay that contained both oil and gas in one horizon. There are additional horizons above and below the IPA that can produce oil and gas, because of the extraordinary complexity and richness of the Prudhoe Bay hydrocarbons. He stressed that it was possible to develop additional oil resources, once the blow down of the Prudhoe Bay gas cap begins.

Senator Dunleavy wondered if there was a still plan to arrest the degree of oil production decline. Commissioner Balash responded that there was absolutely a plan to reduce oil production decline.

Senator Dunleavy asked if the use of gas would affect the effort to increase oil production. Commissioner Balash stated that the gas should not affect that effort, but it requires approval from the AOGCC to ensure that the efforts are not affected. He remarked that cleaning up the gas from Prudhoe Bay will require pulling carbon dioxide out of the gas stream, and that carbon dioxide could then be used for enhanced oil recovery to improve recovery at Prudhoe Bay or other nearby fields.

Senator Bishop remarked that there had been previous testimony in previous years about other proposed pipelines that had also been as optimistic as this proposal.

#

ADJOURNMENT

6:37:31 PM

The meeting was adjourned at 6:37 p.m.