

SENATE FINANCE COMMITTEE
February 25, 2014
5:06 p.m.

5:06:30 PM

CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 5:06 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

Bill McMahon, Senior Commercial Advisor, ExxonMobil; Dave Van Tuyl, Regional Manager, BP Exploration Alaska; Pat Flood, Supervisor, North Slope Gas Development, ConocoPhillips; Dan Fauske, President Alaska Gasline Development Corporation; Tony Palmer, Vice-President, TransCanada Alaska Interests.

SUMMARY

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

SB 138 was HEARD and HELD in committee for further consideration.

[Note: The meeting was recessed until 9:00 a.m. on February 26, 2014 and SB 138 was HEARD and HELD in committee for further consideration at that time. See February 26, 2014 minutes for detail.]

PRESENTATION: THE BUSINESS CASE BEFORE THE LEGISLATURE

[Note: The presentation continued and concluded on February 26, 2014. See February 26, 2014 minutes for detail.]

#sb138

SENATE BILL NO. 138

"An Act relating to the purposes of the Alaska Gasline Development Corporation to advance to develop a large-diameter natural gas pipeline project, including treatment and liquefaction facilities; establishing the large-diameter natural gas pipeline project fund; creating a subsidiary related to a large-diameter natural gas pipeline project, including treatment and liquefaction facilities; relating to the authority of the commissioner of natural resources to negotiate contracts related to North Slope natural gas projects, to enter into confidentiality agreements in support of contract negotiations and implementation, and to take custody of gas delivered to the state under an election to pay the oil and gas production tax in kind; relating to the sale, exchange, or disposal of gas delivered to the state under an election to pay the oil and gas production tax in kind; relating to the duties of the commissioner of revenue to direct the disposition of revenues received from gas delivered to the state in kind and to consult with the commissioner of natural resources on the custody and disposition of gas delivered to the state in kind; relating to the authority of the commissioner of natural resources to propose modifications to existing state oil and gas leases; making certain information provided to the Department of Natural Resources and the Department of Revenue exempt from inspection as a public record; making certain tax information related to an election to pay the oil and gas production tax in kind exempt from tax confidentiality provisions; relating to establishing under the oil and gas production tax a gross tax rate for gas after 2021; making the alternate minimum tax on oil and gas produced north of 68 degrees North latitude after 2021 apply only to oil; relating to apportionment factors of the Alaska Net Income Tax Act; authorizing a producer's election to pay the oil and gas production tax in kind for certain gas and relating to the

authorization; relating to monthly installment payments of the oil and gas production tax; relating to interest payments on monthly installment payments of the oil and gas production tax; relating to settlements between producers and royalty owners for oil and gas production tax; relating to annual statements by producers and explorers; relating to annual production tax values; relating to lease expenditures; amending the definition of gross value at the 'point of production' for gas for purposes of the oil and gas production tax; adding definitions related to natural gas terms; clarifying that credit may not be taken against the in-kind levy of the oil and gas production tax for gas for purposes of the exploration incentive credit, the oil or gas producer education credit, and the film production tax credit; making conforming amendments; and providing for an effective date."

[5:07:36 PM](#)

^PRESENTATION: THE BUSINESS CASE BEFORE THE LEGISLATURE

[5:07:43 PM](#)

BILL MCMAHON, SENIOR COMMERCIAL ADVISOR, EXXONMOBIL, announced some history of liquid natural gas (LNG) as produced by ExxonMobil.

Co-Chair Kelly announced that the testifiers represented the signatories of the AK LNG agreement.

Mr. McMahon continued to discuss the history of LNG in ExxonMobil. In the early 1990s there were conversations regarding an LNG project in the Far East. He stressed that the cost of transporting the LNG to the Far East was high compared to its competitors, so they moved onto a different effort. In the late 1990s, ExxonMobil was involved in a gas to liquids project, where the North Slope natural gas would be put in a chemical process with the hopes of moving down the Trans-Alaska Pipeline System (TAPS). That project would be very expensive, and the value of natural gas began to rise by the end of that decade, which closed some of the spread between liquids and natural gas. By 2000, the attention turned to building a pipeline to Alberta to access the North American markets. In 2009, ExxonMobil partnered with TransCanada to form the Alaska Pipeline

Project (APP), to build a pipeline to Alberta under the Alaska Gasline Inducement Act (AGIA) framework. He stated that changes in the North American market made that project impractical, as its competitors were successful at exploiting unconventional gas. He stated that Governor Parnell invited the three producers and TransCanada to come together to consider an LNG project to the Far East, and ExxonMobil willingly participated in that discussion. He stated that there was good progress with AK LNG, and had reached a consensus on selecting a concept. They had selected a preferred location for the LNG plant in Nikiski, and had advanced fieldwork.

[5:11:48 PM](#)

Mr. McMahon stated that he had worked for six months on the Heads of Agreement (HOA) (copy on file). The HOA laid out the principles and the roadmap under which all of the parties represented believed that the project could be successful. He stressed that SB 138 was based on the accomplishments of the HOA. He announced that ExxonMobil supports SB 138. ExxonMobil was committed to pursuing commercialization of AK LNG, and were committed to be a part of the AK LNG project. He stated that SB 138 would allow the three producers, Alaska Gasline Development Corporation (AGDC), and TransCanada to work together to progress the project; and to develop a fiscal and project framework that was essential for advancing the project to completion. He announced that SB 138 authorized three things that were critical to the success of the project: participation, percentage, and project. He felt that SB 138 would authorize the state to participate in the project, which would increase the alignment of the actors in the project to improve success. He explained that the legislation would outline the Alaska's percentage take on the natural gas, which would be in royalty gas and gross production tax. He believed that the legislation provided a robust process that would allow development for project enabling contracts. If consensus were made on the contracts, they would be presented to the legislature for approval. If SB 138 were enacted, ExxonMobil was staged for the Preliminary Frontend Engineering and Design (Pre FEED). He explained that Pre FEED was a phase of project development that would take the project from the concept and move it forward. The concept that was agreed upon was to build a gas treatment plant on the North Slope to remove impurities from the gas; to build a pipeline across the

state to Nikiski; and build an LNG plant in Nikiski to liquefy gaseous natural gas. In Pre FEED the concept would be considered while conducting additional engineering and design to have the information necessary to file for permits to construct the project. He stressed that the Pre FEED was essential, because the environmental impacts must be studied in order to complete the necessary federal permit applications. He shared some various examples of Pre FEED work.

[5:17:42 PM](#)

Senator Dunleavy understood that profitability was based on the spread between the oil price and gas. He wondered why a gas to liquids (GTL) plant was not built on the North Slope, and the existing pipeline was not used in the proposal. Mr. McMahon responded that a GTL plant necessary to convert the gas would be massive and be a logistical challenge to build on the North Slope. He stressed that the process for converting gas to liquid consumed about one-third of the gas. The resulting product was very high quality, and could be used to sulfur-free diesel, blending stocks for motor oil, and other products. Furthermore, TAPS must be modified to keep the gas separate from the crude oil. He stated that ExxonMobil had reassessed gas to liquid in 2011, and they felt that an LNG was a superior value to the gas.

[5:20:31 PM](#)

DAVE VAN TUYL, REGIONAL MANAGER, BP EXPLORATION ALASKA, read from a prepared statement:

I've been working in Alaska for BP for almost 30 years. For more than half that time I have been working to get Alaska's gas to market, first in a previous LNG effort in the late '90's, then as part of the Alaska Gas Producers Pipeline Team in 2000-2002, next with the Stranded Gas Act effort and AGIA, then as a member of the Management Committee of the Denali pipeline effort, and now today in my current role on the Fiscal Team who worked on the Heads of Agreement and the Management Committee of the Alaska LNG project Working with all the parties here.

Executing the HOA was an important step for BP. My boss, Janet Weiss, President of BP Alaska was very

pleased to be able to sign it because of what this HOA means - an aligned way forward to get Alaska's gas to market.

Importantly, there are signatures for six other parties on the HOA along with Janet's, one for each of the entities represented here on the panel, along with the commissioners of DNR and DOR.

We are all aligned on the roadmap outlined on the HOA which provides the way forward for the legislature to consider and enact enabling legislation to advance the Alaska LNG Project. And that's one of the things that's really pretty exciting.

As you know, these parties in front of you haven't always been aligned. BP was involved from 2000-2006 working with the other major producers to get a pipeline built. TransCanada pursued their own effort independently. Some of you will remember that in 2007 and 2008 BP testified robustly about AGIA. We wanted to be involved with building the gas pipeline, but had some real concerns with AGIA. After the license was awarded to TransCanada, we still wanted to commercialize our North Slope gas, so we partnered with ConocoPhillips on the Denali project in 2008. When the Denali open season in late 2010 failed to garner enough interest to warrant continuing with the project, we shut it down the following year. But we didn't stop looking for ways to commercialize Alaska gas.

Following the Point Thomson settlement, we internally came to the conclusion that the best way forward was to combine efforts with all the relevant parties, just as the Governor had suggested in late 2011.

We agreed that it was time to stop fighting yesterday's battle. It was time to find a way to work together on a new project.

That's what the HOA represents to BP. That's why we're excited about it.

BP believes the HOA is critical to successfully advancing the Alaska LNG project.

Therefore, the key question for examining SB 138 is simple. "Is SB 138 faithful to the HOA?"

For BP the answer is "YES." Sb 138 moves all parties forward, together, as envisioned in the HOA.

SB 138 enables unprecedented commercial alignment among the parties by providing for State participation thru AGDC, and authorizes the State to negotiate contracts.

The bill establishes a percentage for tax as gas that, when added to the State's royalty-in-kind share puts the State at the table with a participation of 20-25 percent as referenced in the HOA.

Finally, the bill lays out a process for negotiations to occur, providing transparency through access by the Legislature which BP believes is the winning way.

While we're generally pleased with SB 138, there are a couple of areas of particular interest to BP in the way the bill has been drafted, areas that might be improved a bit.

One area of interest is ensuring that the newly formed subsidiary of AGDC is established in an efficient manner. BP has formed subsidiaries in the past and we know about the due diligence required by tax, legal and finance professionals. It's effort well spent, but we also want to ensure the new subsidiary is established in a timely manner so pre-FEED can start ramping one the bill is enacted. This included clearly defining authorities and empowering the new subsidiary to efficiently carry out its role, as well as allowing for appropriate sharing of staff between the new subsidiary and the AGDC parent. Looking at successful LNG projects around the world confirms the importance of having a well-resourced, independent host government commercial entity - and AGDC can provide that.

[5:29:53 PM](#)

PAT FLOOD, SUPERVISOR, NORTH SLOPE GAS DEVELOPMENT, CONOCOPHILLIPS, stated that his entire career in the oil and gas industry was devoted to economic development of Alaska's oil and gas resources. He had been a resident of Alaska for over thirty years. He testified in support of SB 138. ConocoPhillips believed that there were several key areas that must be addressed in order to advance the project, and were outlined in the HOA: 1) the state must decide to participate in the project; 2) the legislature must define a production share that would be taken as gas molecules, which, along with the existing state royalty also taken as gas molecules defines the state overall gas share; and 3) the legislature must give the administration the tools to work through the arrangements and contracts required to move the project ahead with the consultation and ultimate ratification by the legislature. He recognized that state participation and the state's share was a significant policy decision, and ConocoPhillips welcomed the legislative input as a necessary step to continue advancing the project.

[5:32:22 PM](#)

Mr. Flood shared some history as to how ConocoPhillips had embarked to their current situation. One of the ConocoPhillips heritage companies pioneered the LNG business in Cook Inlet and to Asia, both in terms of the technology in the markets during the 1960s. He stressed that ConocoPhillips had been involved in the LNG business in Alaska since the 1960s. He stated that at that time, ConocoPhillips and other ConocoPhillips heritage companies were beginning steps to develop the North Slope. He pointed out that, since the beginning of production from Prudhoe Bay, the producers had looked at options to bring the North Slope to market including LNG, pipelines to North America, and GTL. During the consideration of the Denali Project, it was determined that the supply situation in those markets no longer supported the project. The international LNG market had remained stronger than the North American gas market, so at the urging of the governor, the industry partners and the state were working to taking the next steps to the large scale LNG project. This would build on more than \$500 million of work since 2000 in efforts to commercialize Alaska North Slope (ANS). The working relationship between the ConocoPhillips, BP, ExxonMobil, TransCanada, the state, and AGDC was historic, in that the parties were more aligned than ever in history. With that

alignment, the HOA provided the road map to moving the project forward. One of the key steps in the HOA was enabling legislation that addressed the three key points previously mentioned. He stated that SB 138 effectively addressed the three key areas of the HOA, and was the first step in following the HOA road map. In order for the state to effectively participate in the project, it needed a vehicle to represent and manage the state's interest, and the bill gave AGDC that role in participation. He stated that ConocoPhillips supported the provision that gave AGDC management authority. He stated that the bill gave the DNR commissioner flexibility with respect to negotiating royalty in oil and gas leases, to provide gas that could be committed to a North Slope gas project as well as other required agreements. The commissioners of both DNR and DOR must confidentially negotiate the details of many agreements that would not compromise commercial positions of either the state or the private parties. The commissioners must have that authority in order for the state to effectively participate in the project. The bill also dealt with the tax statutes in Title 43, which set the production tax at 10.5 percent, with the ability for the state to take its tax as gas molecules. Effectively, the tax rate combined with the existing royalty percentage would set the state's gas share for participation in the project. He stated that ConocoPhillips supported the bill's provisions, because they allowed for a fixed gross production tax payable in gas. The 10.5 percent rate that the administration proposed yielded a combined royalty plus production in the range of 20 to 25 percent that was agreed in the HOA.

[5:38:44 PM](#)

DAN FAUSKE, PRESIDENT ALASKA GASLINE DEVELOPMENT CORPORATION, (AGDC) expressed pleasure in working with the other participants in the HOA. He stressed that AGDC was very limited in the bill, but remarked that most of the language was statutory. He stressed that AGDC was compelled to deliver LNG to Alaskans at an affordable rate.

[5:43:43 PM](#)

TONY PALMER, VICE-PRESIDENT, TRANSCANADA ALASKA INTERESTS, testified in support of SB 138. He stated that there had been 40 years of effort by TransCanada to commercialize Alaskan LNG. He stressed that it was very significant that

there were companies that were convinced that LNG could be commercialized. He remarked that any project at this scale needed permission and customers. He stated that there were companies that had the marketing skills and experience that were able to bring LNG to market.

[5:48:11 PM](#)

Mr. Palmer remarked that there was no guaranty for success, but felt that once the components were in place, the project had a high quality initiative to succeed in the marketplace.

Senator Dunleavy surmised that once the Pre-FEED element was complete and the project was deemed profitable, they would proceed with the project. Mr. Van Tuyl agreed. He stated that the mega-projects were typically conducted through a phased-gate decision making project.

Senator Dunleavy wondered what would occur if one of the partners decided at a certain point to not continue in the project. He assumed that the millions of state investment would not be recovered. Mr. Van Tuyl replied that the determination would rely on the facts that exist at the time. He remarked that the other parties were free to advance the project.

Senator Dunleavy wondered if there were "off-ramps" for each of the industry partners. Mr. Van Tuyl responded in the affirmative.

[5:52:05 PM](#)

Senator Dunleavy queried the nature of AGDC's role, because he felt that AGDC was already perusing an instate gas line concept. Mr. Fauske replied that the role was beneficial, because the work aligned with future work of AGDC. He understood that the concept would seem confusing. He stated that the sharing of data, alignment, and environmental work coincided with other projects. He stressed that the focus was on not duplicating work or wasting money. He announced that the standalone cost would be \$7.5 to \$8 billion. He stated that the proposed project would be the largest project in the world. He felt comfortable with the partnership, and was confident that the project would move forward. He stated that AGDC would keep with the mandate of HB 4, as directed by the legislature, to supply gas to

Alaskans and help facilitate the development of a larger diameter pipe. He stated that it was most probable that AGDC's smaller pipe plan ideas would merge into the development of a larger pipe project. He stressed that a larger line, with a huge commercial application by selling a product from Alaska overseas was an ideal situation. The smaller line was always intended, and would be commercially appealing. Most people agreed that a larger pipeline was better than a small line. He pointed out that it was important for AGDC to continue with their smaller line plans, but it could merge with a larger project in the future.

Senator Bishop wondered if the focus was for Alaskans to receive the most inexpensive gas. Mr. Fauske replied in the affirmative.

Vice-Chair Fairclough remarked that the administration had proposed that Alaska could take its gas in value or in kind. She wondered if the intent was to only take the gas in molecules. She pointed out that the HOA outlined in AS 38.05.182(a) provided that royalties on oil and gas shall be taken in kind, unless the commissioner determines that taking in money would be in the best interest of the state. Mr. Flood responded that the HOA outlined that the state participation was an integral part of the project. In order to facilitate the state participation and cause the equity and gas share to align, the state would take its royalty in kind, and tax as gas was an important element of the proposal.

[5:59:28 PM](#)

Vice-Chair Fairclough surmised that the taking the royalty in kind, which could be fixed at different numbers, depending on the lease. She wondered if the tax would be in value, or was it yet to be determined. Mr. Flood responded that the tax would also be in molecules.

Vice-Chair Fairclough recommended that future models should be tax in molecules. She relayed that there was conversation regarding the pressurization in the pipe, which was not yet determined. She stated that they looked at the five off-takes for Alaskan's energy security. Depending on the pressure in the pipe, there would be a cost for straddle plans. She queried the cost of taking the pipe offline. Mr. Van Tuyl replied that a straddle plant

was a complex kit, designed to take a range of liquids to convert into other substances. He understood that the gas offtakes for moving gas in-state would be a substantially simpler process for conditioning downstream of the offtake point to make it suitable for a burner-tip specification. He remarked that there could be some conditioning, because the heat content may be slightly higher than the typical burner tip spec. He stressed that the facilities were fairly routine items.

6:02:20 PM

Vice-Chair Fairclough stressed that her topic was a current discussion point. She asked two more questions that she would hear responses at a later date: 1) she wondered at what point an export permit will allow or hold up the project; and 2) she noted that Congress established dollars that financed a pipeline, so she wondered the interplay between access of the federal funds, and whether it advantages or disadvantages the project.

Co-Chair Meyer suggested that the testifiers return for additional questions.

6:06:43 PM

RECESSED UNTIL 9:00 A.M. FEBRUARY 26, 2014

SB 138 was HEARD and HELD in committee for further consideration.

[Note: The meeting was recessed until 9:00 a.m. on February 26, 2014 and SB 138 was HEARD and HELD in committee for further consideration at that time. See February 26, 2014 minutes for detail.] You could also include a note after the presentation title as follows [Note: The presentation continued and concluded on February 26, 2014. See February 26, 2014 minutes for detail.]