

SENATE FINANCE COMMITTEE  
February 28, 2014  
9:09 a.m.

[9:09:44 AM](#)

CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 9:09 a.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 Donny Olson

MEMBERS ABSENT

Senator Lyman Hoffman

ALSO PRESENT

Joe Balash, Commissioner, Department of Natural Resources;  
Michael Pawlowski, Deputy Commissioner, Strategic Finance,  
Department of Revenue.

SUMMARY

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

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

[9:10:02 AM](#)

Co-Chair Kelly discussed the meeting's agenda.

#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."

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Vice-Chair Fairclough noted that the chairman had requested the committee to prepare questions. She inquired at what point did the Alaska Gasline Inducement Act (AGIA) become uneconomical, as well as what the process and timeline would be regarding completing that process. She noted that there had been conversations about TransCanada's value to the project and what things would look like if AGIA was uneconomical.

JOE BALASH, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, replied that the AGIA statute laid out a process by which the state or the licensee could say that the project was no longer economic and that they wanted it terminated; he thought that the statute was in AS 240 or 440, but that the specific number was eluding him. He explained that the other party could then either agree, in which case the license was terminated and the contractual relations would be dissolved; if, however, the second party did not agree, the statute laid out a process whereby an arbitration panel was convened and evidence was submitted. He related that the definition of "economic" was spoken to in the statute, but was not crystal clear. He related that each side would prepare their respective economic case and argument and that the arbitration panel would ultimately decide. If the arbitration panel decided in the initiating party's favor, the project was done; if the arbitration panel decided in favor of the defending party, the activities and obligations under the AGIA license remained in place. He stated that the timing for the arbitration was not spelled out explicitly, but thought that it would take months rather than years; furthermore, either party had the opportunity to try to terminate the project for some time. He opined that the reason the state and TransCanada had not tried to terminate the project because the partnership between the two entities was good; the problem for the last

several years, was there was not a good project for the basis of that partnership.

Commissioner Balash continued to address Vice-Chair Fairclough's question. He related that since the governor had called on the parties to work under an AGIA framework to explore the opportunity for liquefied natural gas (LNG) in 2011, the partnership between TransCanada and the state had been maintained. He observed that the state had maintained a lot of the beneficial provisions that were contained in the original arrangement.

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MICHAEL PAWLOWSKI, DEPUTY COMMISSIONER, STRATEGIC FINANCE, DEPARTMENT OF REVENUE, directed the committee's attention to page 3 of the memorandum of understanding (MOU) (copy on file) and noted that it housed the process to abandon the AGIA license. He pointed to page 3, number 11 and related that it described that the commissioners have committed, after enabling legislation became effective, they would initiate the process under AS 43.92.40 by finding that the project was uneconomic. He stated that number 12 was where the licensee has committed that upon an occurrence of the trigger event, that they would agree that the project's license under AGIA was uneconomic. He stated that it was the two provisions that committed both parties to initiating and agreeing on a process. He stated that the trigger events were defined on page 5 of the MOU as the effective date of the legislation. He explained that wrapping up the AGIA license would be a process; however, number 11 was a process that the commissioners would start and the licensee would agree in number 12.

Vice-Chair Fairclough stated that the follow-up for Alaskans was that they wanted to see the money and time penciled out. She clarified that she wanted the administration to produce a slide deck that could be posted on a website and moved with the bill that showed why the new route was chosen over the old one. She noted that she was convinced of the professionalism and value that TransCanada brought to the table, but that Alaskans had questions regarding why the state was not going with another partner. She observed that the state had a positive working relationship with a professional entity that could take on a mega-project and had the resources to assist Alaska in that endeavor. She noted that with the nature of

starting and stopping meetings, as well as meeting at night, it was difficult for some people to be aware of everything. She concluded that there should be a link online that people could access that would walk them through the process to talk about why the clause of the project being uneconomical was not being triggered.

Vice-Chair Fairclough noted that Alaskans also wanted to see what it would cost the state to sever the AGIA contract and the opportunity cost lost, so that they could see why the administration was choosing to point the project in the direction that it was. She believed that TransCanada was the right choice for Alaska, but that people wanted to see the numbers and why TransCanada was the better alternative to something else.

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Senator Dunleavy inquired how much it would cost the state to buy its way out of the AGIA obligations. Commissioner Balash replied that upon termination or abandonment, the license itself provided the state with an option to buy out all of the data, information, and assets that had been generated under the license; that figure was somewhere in the neighborhood of \$130 million.

Vice-Chair Fairclough repeated that she would like the administration to produce a hard document that people could access that supported the decision of sticking with TransCanada. She noted that supporting the relationships between the state and TransCanada was woven in to the Heads of Agreement (HOA), was the body of the MOU, and was built into the legislation; however, those were three very dense documents.

Co-Chair Meyer recalled mentioning that TransCanada had not built a similar pipeline to the one that was being discussed with an Alaska LNG project; however, he corrected himself and noted that the \$6 billion Keystone Pipeline was similar to what would be built in the LNG project. He thought that Alaska's LNG pipeline had an estimated cost of \$8 billion to \$10 billion. Mr. Pawlowski replied that the figure was in the range of the current estimates for the line, but that the current estimate for the overall project was somewhere between \$45 billion and \$65 billion. He noted that liquefaction represented about 50 percent of the project and the other portions were split between the

treatment plant and the pipeline. He noted that these types of projects were massive.

Co-Chair Meyer inquired who the administration envisioned would build the LNG facilities and the pipeline. Mr. Pawlowski responded that building would be conducted by contractors that were hired by the project. He pointed out that there had been discussion of TransCanada being a valuable partner to the state, but asserted that the same thing could be said of the three major producers; the ability of these companies to manage mega projects on scale and on budget was what they brought. He thought that the question was not who would build, but who would be the lead in scheduling how the projects integrated together.

Mr. Pawlowski pointed to page 30 of the HOA and noted that attachments had been inserted in this section that were project schematics for how the integrated team looked currently.

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Co-Chair Meyer requested a walkthrough of process by which a Brooks Range Petroleum or a Repsol could sell their gas in the pipeline even though they had not contributed to the building of the line; he thought that maybe Alaska, TransCanada, and the three producers might work out lease arrangement in this case. Mr. Pawlowski pointed to appendix A, which was found on page 21 of the HOA.

Commissioner Balash interjected and referenced article 6.3 (b). He noted that it was contemplated that the project would be jointly owned by the parties and that the three producer parties would operate their portion of the project on a proprietary basis.

Vice-Chair Fairclough inquired if the reference was being made to page 11, 6.3 (b) of the HOA. Commissioner Balash responded in the affirmative.

Commissioner Balash continued to address page 11, 6.3 (b) and stated that the producer parties would operate their 3/4 of the project on a proprietary basis, meaning that they would serve themselves as customers. He stated that the combination of the Alaska Gasline Development Corporation (AGDC) and TransCanada would serve as the transporter for not only the state, but also for third

parties, including the types of companies that Co-Chair Meyer had just referenced; furthermore, it was from this lens that Mr. Pawlowski would speak through regarding the provisions in appendix A. He added that the provisions that Mr. Pawlowski was about to speak to would govern the process of allowing new entrants into the pipeline.

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Mr. Pawlowski continued to discuss appendix A on page 21 of the HOA. He stated that it was important for the public and members of the committee to recognize that at the current stage, just like the rest of the HOA, appendix A contained principals that all the parties had agreed to; the section did not contain the detailed commercial agreements that would implement the principals. He related that the detailed commercial agreements would be developed during the pre-FEED and FEED stages, which were prior to the final investment decision (FID); the concepts would get written into commercial operation terms as the project moved forward. He stated that broadly speaking, the core principles that the project had agreed to could be found on beginning on A 1.1.

Mr. Pawlowski related that as the HOA envisioned, the Alaska LNG parties were British Petroleum (BP), ExxonMobil, ConocoPhillips, and TransCanada and that anyone of those parties could initiate a process for an expansion of any component of the Alaska LNG project in which they had an interest; there were a few exceptions to that expansion going forward. He noted that the exceptions included if the expansion materially or adversely affected the project itself, caused the project to be in violation of any applicable environmental or safety laws, or caused the project to be violation of a right-of-way or contractual obligation. He stated that in the paragraph following A 1.1, subsection (d), it was specified that all Alaska LNG parties with an interest in that project component would have an opportunity to participate in an expansion. He stated that the key was that any expansion party may request additional volumes, thereby increasing the capacity of the proposed expansion; he thought that this made sense to make expansions all at once for efficiency. He related that the next section covered if the boundary of an efficient expansion was crossed by making it bigger. He explained that if all parties could mutually agree to

reduce the expansion and make it efficient, it could be done.

Co-Chair Meyer inquired what would happen if all the parties did not agree to allow another company to use the line and if an arbitrator, the Regulatory Commission of Alaska, or the courts would get involved. Mr. Pawlowski replied in the negative at the current state and explained that it would be a commercial arrangement. He directed the committee's attention to the final sentence in A 1.1 (d):

Expansions can proceed if they meet the criteria in A 1.1 above.

Mr. Pawlowski explained that the parties did not get a veto, but could join the expansion by making it bigger. He stated that parties had a right to participate in an expansion, but if they chose not to, it could still proceed as long as it did not violate A 1.1's (a), (b), (c), or (d).

Co-Chair Meyer did not want to pursue the issue much further, but noted that some of subsections' conditions were fairly subjective. He directed the committee's attention to A 1.1 (a):

Materially or adversely affect or alter the Alaska LNG project facilities or operations, including technical aspects, or scheduling or quality of deliveries from the Alaska LNG project facilities.

Co-Chair Meyer thought that there could certainly be a difference of opinion regarding the above conditions. He noted that A 1.1 (b) was also fairly subjective and wanted to be sure that people could access the line. He observed that other companies besides the three majors were able to use the Trans-Alaska Pipeline System and that the system did seem to work.

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Co-Chair Kelly interjected and inquired if "that" was further reason why the state was sticking with TransCanada. Mr. Pawlowski stated that the development of "these" principles was one of the areas that the state saw a material benefit of having TransCanada at the table. He explained that the conditions were normal for expansions

and that some of them were also there to protect the state. He noted that interrupting the state's deliveries would cause damage to the state. He furthered that TransCanada had worked closely on the development of the expansion principals and pointed out that the its business model was to achieve the highest volumes of gas through the line. He stated that having a technical pipeline company working on an agreement that it would have to live with, as well as having the state's consultants and the Federal Energy Regulatory Commission's legal teams all present in the same room was helpful.

Senator Bishop noted that both parties had to agree to an expansion. He wondered, however, if there was not agreement, if an interested party could gain access if it could pay for the whole expansion. Commissioner Balash replied that A 1.2 of the HOA addressed that issue and replied in the affirmative. Senator Bishop verified that without the consent of the other parties, an interested shipper could still form an expansion if it could pay for it. Commissioner Balash responded in the affirmative.

Co-Chair Kelly noted that there were a few things that had been discussed over the last week that needed clarification. He pointed out that the administration was in discussions with members of the House and Senate regarding creating a subsidiary out of AGDC. He noted that the subsidiary issue seemed to be the most controversial issue and wondered when a resolution could be expected. Mr. Pawlowski replied that the dialogue in the Senate Finance Committee had helped with addressing the issue and discussed worked that had been done on the topic; he thought that the administration would have a suggested course of action within the next 24 to 48 hours.

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Co-Chair Kelly noted that everyone had a different idea with how to proceed, but felt that the question of the subsidiary corporation needed to be answered.

Co-Chair Kelly requested a walk-through of what it would mean for the state to find a new partner at this point in the process. He recalled that Ms. Poduval had testified that every year the project was delayed would cost the state about \$800 million and requested information regarding how long and where delays could be expected in

the project. Commissioner Balash thought there were several ways to consider the likely causes of delays that could occur; part of this could be due to the organizational structure. He explained that if you pulled one of the parties out of the equation, the question was what happened next. He mused whether the other three parties would work to fill that void or if the state would return with a new partner; this by itself could potentially cause a delay. He explained that there were questions regarding what kind of process the state would employ when finding another partner; if the process was something that the legislature would prescribe, there would probably be delays associated with the agreement of the process and criteria. He recalled that the administration's experience with the AGIA process was that there was about 17 to 18 months from when the legislation was introduced until the effective date of the act; this was another way to look at the potential for delay.

Commissioner Balash continued to address possible delays in the project. He stated that if the state wanted to keep things going, it could ask the producer parties to continue work while it identified a new partner. He explained that there would be certain agreements that would be developed during that 18-month period during pre-FEED that would be central to project enabling contracts and that the administration hoped to bring back to the legislature in 2015; he felt that the state would really be "hobbling" itself if it was engaged in that process without an experienced partner. He added that the state had a great team of not only its own employees, but also contractors and counsel that could help get to the right answer. He thought that the right answer would be arrived at faster and might potentially be better if the state had a qualified partner at its side.

Commissioner Balash addressed the potential costs of delay on the project and pointed out that the analysis that Ms. Poduval had presented was a "present value" analysis that examined the cost of delaying the project a year; he recalled that \$800 million was about the right number. He observed that there were costs to the state that could be identified, but thought that there may potentially be a cost to all of the project sponsors with regard to momentum and opportunity in the marketplace. He stated that a number of other projects and places that could source gas and LNG would be talking to same people that Alaska hoped to sell

its gas to; he did not want to see a delay in that conversation.

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Co-Chair Kelly interjected that in that context, a delay was actually a missed opportunity and not a delay at all. Commissioner Balash thought that the characterization was fair.

Co-Chair Kelly inquired if the timeframe for a potential delay was roughly two years. Mr. Pawlowski replied that he was hesitant to identify a specific time in a delay. He thought that the committee's consultants had done a good job of putting delays in the context of the unknown; the level of uncertainty, who would show up, and how long it would take was very difficult to narrow to a specific time frame like three months, six months, or a year. He concluded that he was uncomfortable identifying exactly how long a delay could be on the record at the current stage.

Co-Chair Kelly observed that three months, six months, or a year would be the time involved with identifying the next partner; a relationship then needed to be formed between the state and its new partner. He thought that it was not unreasonable to assume a two year delay if the state switched partners in the project and inquired if that was correct. Mr. Pawlowski agreed with the assertion.

Co-Chair Kelly noted that according to Ms. Poduval, two years in delay would represent a cost of \$1.6 billion and observed that there would also be potential missed opportunities.

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Vice-Chair Fairclough was unsure if doubling the \$800 million would be exact because there was a different cost to the time-value of money that depended on different assumptions; however, the sum was "huge." She thought that if the administration was modifying its position on a subsidiary of AGDC, there should be a slide deck on why it was continuing to support that line of thinking; if this assumption was being modified, she wanted the attorneys back before the committee to explain how the subsidiary inside a subsidiary would work and why it was the best choice for Alaskans commercially. She furthered that she

wanted an explanation of how the state could break down those barriers to change the mission of AGDC to add an additional component while still securing the separate funding that was put forward under the Alaska Stand Alone Project versus the Alaska LNG project. Mr. Pawlowski replied that the comments gave the administration a clear idea of what the committee wanted it to come back with and explained that the tension that the administration had been struggling with was that the "bright line" was very clear for the protection of both missions. He observed that the prior year, the legislature had equipped AGDC with driving forward the smaller diameter line and that in the current year, the administration was asking the legislature for an expanded authority for AGDC. He explained that it was a challenge and that the administration wanted to protect the divided missions of the smaller and larger diameter projects. He noted that the dialogue at the committee table had helped the administration understand what level of efficiency would be lost with a complete separation of the two missions; as a result, the administration had gone back to the drawing board to ascertain to what degree the missions could be brought close, while still maintaining the appropriate separations and firewalls. He concluded that Vice-Chair Fairclough had provided clear direction on what the administration should bring back to the committee.

[9:48:03 AM](#)

Senator Bishop discussed cash calls and noted that he did not want to be on the wrong side of history by writing IOUs for the length of the project. He requested an explanation of what a cash call was and how long the state would be on the hook for them. He wondered if the state would only be on the hook for cash calls during the construction part of the project or if it would be liable until 2040 or 2050. He stated that the idea of the state writing checks that it could not cash bothered him. Commissioner Balash replied that the line of questioning was very important in understanding the nature of the risks that the state took on as an equity participant, as well as the benefits of having partners. He stated that in any project, the need to meet cash calls as a direct participant was something that continued for the life of whatever agreement was entered into. He explained that for the state's purposes currently, the administration was seeking was an authority for short-term agreements that would cover the pre-FEED period; the longer-term agreements that would

cover FEED and beyond would come later. He explained that the state's potential exposure was being bounded in the next several years. He reported that the big questions and largest variability from the initial budget would come from construction after the FID. He stated that during construction, any partner that failed to meet a cash call would likely suffer some commercial damage within the construct of the agreement; this was something the state needed to be "extremely" cognizant of because it could potentially lose certain provisions, benefits, or advantages in agreements as a result of being unable to meet a cash call. He thought that it might be worth describing what those cash calls looked like and how often they came up; he thought that the committee could have a conversation about this, but that it was dependent on the agreement in question and whether the cash call was quarterly or annual. He noted that terms like how long a period of time the parties had to provide a requested cash call and how long in particular the state had to provide it, given its appropriations process. He thought that future legislatures might be faced with a conundrum of whether it would over-appropriate to its entity(s) in order to ensure that the reserves to meet cash calls were present or if would trim the funding really close to provide for other public services and simply meet quickly to appropriate further funds; this, in turn, would produce many questions, that while appropriate, might not be answered in a timely way. He noted that the legislature was a deliberative body and, appropriately so, took its time. He thought that the above kinds of questions drove at the root of the question of whether the state can or should be in this kind of role and position; this was where partners could play a meaningful role and step in to meet the immediate need of providing capital in a real-time commercial way.

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Co-Chair Kelly inquired if the calls would be issued from debt or out of the treasury; furthermore, if they were issued from debt, what timing was involved. Mr. Pawlowski replied that the initial stages of the project would be cash financed and that concepts around those cash levels were on page 5 of presentation that Black and Veatch had presented in committee on February 21 (copy on file). He reported that in the initial stage, the cost was looking at somewhere between \$43 million \$108 million. He reported

that the administration had a reasonable idea of the FEED costs, but that they would evolve.

Co-Chair Kelly interjected and inquired if the mechanics would use debt or cash. Mr. Pawlowski replied that the mechanics used cash until the project was ready to go; at this point, it would consist of a mix of debt and other instruments.

Senator Dunleavy inquired if the administration would be back before the committee to answer additional questions. Co-Chair Kelly noted that it would be and requested the administration to return on the following Monday for discussions.

[9:55:50 AM](#)

Senator Olson noted most of the questions that he had heard from constituents were how the project interacted with or was related to the Permanent Fund, but that he would ask them in the following meeting.

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

Co-Chair Kelly discussed the following meeting's agenda and requested the administration to provide an answer on the AGDC subsidiary issue at that time.

#

ADJOURNMENT

[9:56:58 AM](#)

The meeting was adjourned at 9:57 a.m.