

SENATE FINANCE COMMITTEE

March 3, 2014

9:10 a.m.

9:10:28 AM

CALL TO ORDER

Co-Chair Meyer called the Senate Finance Committee meeting to order at 9:10 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

Senator Pete Kelly, Co-Chair
Senator Donny Olson

ALSO PRESENT

Bruce Campbell, Staff, Senator Pete Kelly; Michael Pawlowski, Deputy Commissioner, Strategic Finance, Department of Revenue; Joe Balash, Commissioner, Department of Natural Resources.

SUMMARY

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

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

#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."

[9:12:13 AM](#)

Vice-Chair Fairclough looked at slide 3 from the Black and Veatch presentation from February 19, 2014, "Long Term North Slope and Gas Revenues are Driven by AK LNG Project Success" (copy on file). She noted that there was a flat line that was related to oil only, and she wondered if there were other oil revenues above that line.

BRUCE CAMPBELL, STAFF, SENATOR PETE KELLY, agreed to provide that information.

Co-Chair Meyer referred to a presentation from analytica, which showed gas prices starting at \$10. He requested scenarios about gas prices below \$10. Mr. Campbell asked if the analysis should be as low as Henry Hub.

Co-Chair Meyer asked for scenarios with gas prices in the range of \$7 to \$10. He referred to slide 6 of a presentation from analytica on February 27, 2014. Mr. Campbell agreed to provide that information.

Vice-Chair Fairclough requested a report from the Alaska Oil and Gas Conservation Commission (AOGCC). She queried that process that would be used to determine when gas would be available. She knew that the natural gas would be reinjected into the Prudhoe Bay field to drive increased production in oil, which was of highest value to the state. Mr. Campbell agreed to provide that information.

Co-Chair Meyer asked if a member of AOGCC would be testifying in front of the committee. Vice-Chair Fairclough explained that the request was directly from one of her constituents. She explained that AOGCC announced that there was no gas available for the pipeline.

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Mr. Campbell explained that the field operators would approach AGDC and explain how the gas would get online.

Co-Chair Meyer stressed that he would like to hear from AOGCC. Mr. Campbell replied that AOGCC was regulatory

structured to say that there was no gas available. He stated that there must be proof that gas and oil could be pulled from the North Slope. The petroleum engineers were the only people that could provide that proof.

Vice-Chair Fairclough understood that there may be an outlined process. She knew that AOGCC could not compromise its regulatory structure. She would like to hear from someone that the gas would be available, and ready for market. She stressed that the industry partners had a vested interest in ensuring that the gas was available for the project.

Co-Chair Meyer agreed with Vice-Chair Fairclough, and remarked that there were constant declarations that gas would not be available, because it was more valuable to reinject it for more oil. He felt that there were different scenarios that the gas could be best used. He felt that AOGCC should comment on the availability, usefulness, and profitability of the natural gas.

Senator Hoffman requested a timeframe of when the bill would possibly move out of committee. He referred to a slide titled, "When the state is out of money", which was presented in the Senate Resources Committee. He stressed that gas should be at the burner tip as soon as possible.

Co-Chair Meyer asked for a schedule of the week on the legislation. Mr. Campbell explained that there were some requests for participation from various municipalities. There were efforts to schedule some invited testimony, and stated that the schedule was at the pleasure of the committee.

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Co-Chair Meyer surmised that the municipalities would present their perspectives from a taxation standpoint, and the public testimony would be held the following day.

Vice-Chair Fairclough requested an analysis of cash flow and impacts of that to the state.

MICHAEL PAWLOWSKI, DEPUTY COMMISSIONER, STRATEGIC FINANCE, DEPARTMENT OF REVENUE, (DOR) explained that there were some drafts that were currently under review, that would eventually be posted online.

Co-Chair Meyer wondered how the project would provide gas to Alaskans. He stressed that, if gas prices were to skyrocket, his constituents would still desire gas at the burner tip.

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JOE BALASH, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, (DNR) explained that the Heads of Agreement (HOA) outlined the opportunity to deliver gas to at least offtake points in Alaska. He stated that there would be an initial state share. He stressed that there would be a continual work with industry partners. He pointed out that there would be long term contracts that will be drafted, in order to enhance a guarantee for Liquid Natural Gas (LNG).

Co-Chair Meyer surmised that Alaskans would not get a discounted rate. Commissioner Balash replied how gas would be disposed would be a collective decision between state and industry partners.

Mr. Pawlowski explained that there is possibly a misperception. He referred to Exhibit C, Page 5, Point 17 of the Memorandum of Understanding (MOU).

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Vice-Chair Fairclough wondered if the rate would equal the tariff for the producers. She wondered if it was presumed that the 25 percent of the state share would mean that the state would sell the gas to Alaskans. Mr. Pawlowski referred to page 14 of the HOA. He stressed that there was a statement that was consistent with language from the anti-trust council. He stressed that it was not a resolved issue.

Vice-Chair Fairclough hoped that there was a preservation of the revenue stream, because keeping the product in state would forgo revenue for the state. If the molecules were owned by a different entity, it may be regulated under different laws.

Co-Chair Meyer wondered why the tax rate was so low. Mr. Pawlowski responded that there was an outline in the HOA that explained how the breakdown of revenue was

distributed, and furthered that the DNR website showed the specifics of the state's revenue share.

9:38:19 AM

Vice-Chair Fairclough requested an analysis from enalytica that showed how Alaska lined up against other tax regimes. She felt that the tax rate should be increased, because Alaska had oil that was the foundation in the credits. She wanted to see the limit on the credits, because oil was still underpinning the frontend of the project for cost recoveries. She suggested an analysis of where Alaska compared was compared to others who were attempting to bring gas to market. She would also like to the income tax with the overall government take.

Co-Chair Meyer wondered how much say the state had in the operations of the project, with only a 25 percent interest. He wondered if all involvement would only be 25 percent. Commissioner Balash responded that the percent of the equity is typically the same as the vote on the projects. He stressed that there were some circumstances that would require different forms of voting.

9:42:29 AM

Senator Hoffman understood that the administration was focused on building the gas line. He wondered if the administration felt that there were legislators that wanted more than the proposed take off plans, and wanted an AGDC plan. He stressed that Alaska was an energy state, and many people felt that Alaska should have some of the lowest energy costs in the nation. He specifically wondered if the administration felt that this proposal was enough and satisfactory for affordable energy for Alaskans. Commissioner Balash stressed that the proposal was not the last of the work that would occur. He stressed that the legislation was an "opportunity." He remarked that there was still work on finding every opportunity to bring gas to Alaskans.

Senator Hoffman felt that at every phase the state should be taking positive and additional steps to reduce tariffs. He wondered if there would be specific directions to make Alaskans feel like they can get affordable energy. He pointed out that some people feel like the project is the state's last change to obtain affordable energy. He

believed that there should be some direction beyond the five take-off points. He stressed that there should be a mandate to expand the project. Mr. Pawlowski responded that he was hesitant to provide specific estimates, because the project had a range of \$45 to \$65 billion, which was a great deal of uncertainty. He felt that all of the partners needed to embark on Pre FEED to refine the estimates, so that the anchor of the project can move forward.

[9:50:00 AM](#)

Senator Hoffman remarked that he will work on what he feels should be the enhancements and eventual expansions to the projects. He urged the administration to go beyond the proposed take-off points of the project. Commissioner Balash welcomed the opportunity to fashion something that would fit into the phased approach within the proposal.

Senator Bishop echoed Senator Hoffman's comments. He felt that the agreement should include some certainty that would not hinder the rural Alaskans. He pointed out that diesel fuel was less expensive in Juneau than it was in Fairbanks.

Vice-Chair Fairclough stated that the legislature often is very transparent with the estimates, budgets, and revenues. She felt that it may be a disadvantage to the state. She suggested that there should be collaboration with AEA to form a more confidential approach to sharing its financial reports.

[9:55:28 AM](#)

Vice-Chair Fairclough looked at page 5, Article 1.6 of the HOA. She wondered what contracts were subject to legislative ratification. She looked at page 9, section 4.4, and stated that there needed to be fiscal and commercial terms; those must have approval; and the size needed to be determined. She expressed concern regarding the value of instate energy, because it could show up in many forms. Commissioner Balash replied that the interplay between the development of the agreements and the various parties, there were agreements that would go upstream which would be discussed in the legislature. He furthered that there would be negotiated on downstream providing transportation and liquefaction agreements that would be discussed in the legislature. The sale of the state gas share would also be approved by the legislature.

Vice-Chair Fairclough looked at page 5, Article 1.6 (b) of the HOA, and wondered what would be considered "periodic." Commissioner Balash replied that the probable pace was approximately quarterly.

Vice-Chair Fairclough looked at page 5, Article 1.7 (a) of the HOA, and wondered if the intent of that section was to keep the project cost under control. Commissioner Balash replied that the issue was related to the limited number of EPC firms available to do the proposed work. He stressed that the focus was on the lowest reasonable bids to execute the project in a cost-efficient manner.

Senator Bishop wondered if he would have the ability to defend his legislative vote, because there may be an issue of confidentiality. Commissioner Balash replied that he could defend his vote, because the access to information would be confidential. Once the agreements were made public, the legislature would vote on the agreements.

[10:02:57 AM](#)

Senator Bishop surmised that the state would be able to argue for or against the agreement in the confidential meetings. Commissioner Balash explained that page 13, lines 20 through 30 of the bill outlined that issue.

Vice-Chair Fairclough looked at page 7, Article 1.17, and wondered if the state would partake in equity investments including terminal facilities and auxiliary marine vessels. Mr. Pawlowski responded that the vessels were just necessary at the actual terminals, which were specifically determined to the operations of the terminal. They were only support vessels.

Vice-Chair Fairclough stated that those vessels may be considered a guaranteed source of revenue. Commissioner Balash explained that the responsibility of the ships would be negotiated in outlining the agreements.

[10:07:05 AM](#)

Vice-Chair Fairclough looked at page 9, Article 4.5. She wondered if TransCanada would function as a marketing arm for the state during Pre FEED. Mr. Pawlowski responded that

there was no intent to have TransCanada to be the state's marketing entity.

Vice-Chair Fairclough wanted to see the agreement, because she wanted the highest value for Alaskans, and it should be resolved in Pre FEED. Commissioner Balash replied that the process for selling LNG was very similar to the phased approach for development of the infrastructure. The contacts with buyers would agree during Pre FEED, but the execution of the sales agreement would not occur until close to the final investment decision.

Mr. Pawlowski looked at page 9, Article 4.5. He stated that, during the development of the HOA, the interest of the producer parties was an indication of a difference from previous efforts.

Senator Bishop commented that instate use may be of better value to Alaskans. Commissioner Balash imagined a scenario where the state may not want to take on the risk of liquefaction and its services. He stressed that there was a trade-off, if a price mechanism could be determined to deliver the same net-back value to the treasury. He stressed, however, that it would limit the state's options.

[10:15:22 AM](#)

Vice-Chair Fairclough looked at article 4.2 of the HOA. She noted that the second line addressed other support references in article 10 in maintaining progress of the project. Article 10 addresses the Alaska Right of Way Leasing Act, and the use of imminent domain. She wondered what kind of amendments should be made to the Alaska Right of Way Leasing Act. Commissioner Balash replied that he was not aware of any changes that should be made. He stated that there were provisions which were outlined in the common carrier section of the Act, and the contract carriage amendments that were enacted the year prior in HB 4.

Vice-Chair Fairclough requested an answer in writing, to ensure that what is said is what is actually anticipated. She looked at page 16, which addressed a possibility of an amendment of the Alaska Right of Way Leasing Act.

[10:18:29 AM](#)

Vice-Chair Fairclough stressed that Alaskans had been waiting for a natural gas pipeline. She wondered if AGDC's efforts and focus should be amended to focus on the larger pipeline and bring gas to Alaskans. She remarked that there was already an appropriation for the Alaska Stand Alone Pipeline (ASAP). She felt that there may be a duplication of services. Commissioner Balash replied that this issue was difficult, and DNR did not want to interfere with the intention of AGDC. He stated that the legislature had directed AGDC to continue with ASAP through HB 4.

Vice-Chair Fairclough stressed that there was not an option of a commercial partnership when the mission of AGDC was outlined. She felt that there should be an expedited project. Mr. Pawlowski replied that the administration's position was outlined on page 3 of the HOA.

[10:27:06 AM](#)

Commissioner Balash encouraged that committee to seek out the council of AGDC regarding the cost of delay for the efforts that AGDC has undertaken. He stressed that AGDC has moved forward on ASAP, and did not feel that any of their efforts should be stalled.

Senator Bishop looked at the expansion principles, and requested an explanation of the possibility of future expansion. Commissioner Balash shared that the opportunity for expansion was very important for a state that had a mineral interest in the gas beyond Prudhoe Bay and Pt. Thompson. He shared that there was a challenge when considering the shift from a North American focus to and LNG focus. The realization for DNR was about access to the liquefaction plant to the marketplace. He stated that the pipeline provisions had been shifted in the current proposal, which would marry the liquefaction terminal and the liquefaction trains.

Mr. Pawlowski stated that an LNG project was different, because it was sold under long-term contract, and the terms of the sales were complete when the project went online. The rolled-in concept showed scenarios where the state would lose, when all of the terms were committed.

[10:33:51 AM](#)

Co-Chair Meyer looked at page 19 of a presentation from Black and Veatch. He remarked that there were some numbers on the slide that outlined the cost at each state. He wondered how it would work within the fiscal notes.

Vice-Chair Fairclough looked at page 16, Article 10.1 (c) of the HOA, and requested information about the partners' financial contribution to constructing infrastructure.

Senator Hoffman looked at page 3, item (i) delineated how the different projects under AGDC would interact. He wondered if there would be a fiscal note that would address that statement. Commissioner Balash responded that the point was to ensure that the funds already committed by the legislature that were sufficient to carry AGDC through their open season would be unaffected. The current project would be considered a separate commitment.

Senator Hoffman wondered if it was the full intent of the language within the fiscal note was intended only for the one fiscal note. Mr. Pawlowski replied that the language was specific to the fiscal note.

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

ADJOURNMENT
10:38:58 AM

The meeting was adjourned at 10:38 a.m.