

SENATE FINANCE COMMITTEE

March 5, 2014

9:11 a.m.

9:11:18 AM

CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 9:11 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 Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Joe Balash, Commissioner, Department of Natural Resources; Michael Pawlowski, Deputy Commissioner, Strategic Finance, Department of Revenue; Deepa Poduval, Principal Consultant, Natural Gas and Power Fuels Group, Black and Veatch Management Consulting.

PRESENT VIA TELECONFERENCE

Daniel Fauske, President, Alaska Gasline Development Corporation; Miles Baker, Director, Government Relations and External Affairs, Alaska Gasline Development Corporation.

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."

9:12:08 AM

Vice-Chair Fairclough wondered if the forthcoming amendments should be drafted for the CS version O. Co-Chair Kelly replied in the affirmative.

JOE BALASH, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, (DNR) discussed the fiscal notes attached to the legislation. He explained that FN3: DNR, showed funds for both FY 15 and FY 16 needed for expenses associated with supporting the development of contracts. He stated that DNR was unable to determine ongoing costs associated with the legislation, because the contracts must be developed and see if they met with favor from the public and legislature. He felt that the explanation of the agreements had been clearly outlined: some upstream with the producers related to the offtake and balancing agreements; and some downstream that were targeted toward those midstream service providers, which included TransCanada in the GTP and pipeline, and Alaska Gasline Development Corporation (AGDC) for liquefaction. In addition, DNR would begin the sales and disposition process for the liquid natural gas (LNG). He stated that there was some analysis attached to the fiscal note. He directed attention to the last page of the analysis, and stressed that some in-house expertise must be established at DNR, specifically related to the upstream questions and agreements with the producers.

9:16:36 AM

Vice-Chair Fairclough wondered if the discussion was related to the fiscal note dated 1/20/2014. Commissioner Balash stated that he was looking at FN3: DNR, dated 1/24/2014. He did not believe that a new fiscal note had

been generated for the CS that passed from the Senate Resources Committee.

Co-Chair Kelly asked for a quote from the document that was referenced. Commissioner Balash replied that the top read, "SB 138."

Co-Chair Kelly asked for a detail of the page that was referenced. Commissioner Balash looked at page 3 of the fiscal note, which was a detail of how the requested funds would be used and utilized.

Co-Chair Kelly wondered if the first word was "allocation." Commissioner Balash responded in the affirmative.

Commissioner Balash stated that the total request was slightly less than \$9 million for DNR to support the development of the contracts. Some of the funds would be aid to the Department of Law (DOL) to support the contracts for outside council. There was a present budget of approximately \$3 million. The above items, with regard to the marketing expertise, was a total of six positions: one lead, four supporting, and one administration project assistant. He stated that there had been discussions related to where the positions would be housed and who would do the hiring. He shared that there was an option to work with AGDC, which was equipped with certain tools that could be useful in attracting the kind of talent needed for this effort. He felt that AGDC could provide some marketing services, in addition to transportation and liquefaction services. He stressed that the decisions about royalty sales would be for DNR and the legislature. He announced that there was a significant travel expense, because the team of marketing experts should travel to Asia and the various marketplaces often. He observed that the fiscal note from Department of Revenue (DOR) was quite low, relative to the DNR fiscal note, because there was an effort to focus all of the work in a single agency to avoid duplication.

[9:21:07 AM](#)

Vice-Chair Fairclough looked at the \$340 million, and wondered how the salaries were determined a reasonable amount in the market. Commissioner Balash replied that the specific number was a result of a starting salary of approximately \$250,000, which came from a conversation with

prospective employees that DNR was seeking to hire in the year prior. He felt that the salary should attract the kind of talent necessary for the task, but understood that it was not a normal salary for a state agency.

Senator Bishop wondered if the proposal was an adequate amount of money. He stressed that he wanted the best possible people working in these positions. Commissioner Balash replied that he felt the budget could work to support the efforts of the state. He understood that there could be a possibility for more money.

Commissioner Balash stated that the likelihood of the expenditures carrying through year to year depended entirely on the negotiations and actions of the legislature. He felt that the funding should be maintained, but the development of contracts and terms would be completed at a certain point. The largest expenditures moving forward would be based on monitoring and carrying out the contract terms. He hoped to see a reduction of the budget amount over time.

MICHAEL PAWLOWSKI, DEPUTY COMMISSIONER, STRATEGIC FINANCE, DEPARTMENT OF REVENUE, (DOR) looked at the fiscal note dated 1/20/2014, which was fiscal note number 4 with a number in the FY 15 column of \$750,000. He stated that it was a one-time request for FY 15, and the analysis was on page 2 of the fiscal note. He noted that there was the establishment of the mechanism as tax as gas, so the state could take a larger share of the molecules than a traditional tax. The second request was for a reimbursable services agreement with DOL to develop the regulations called for by the implementation of the tax provision. The total request from DOR was \$750,000. The intent was to work consultatively with DNR and AGDC to conduct the majority of the contract development support.

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Mr. Pawlowski explained the new fiscal note dated 2/24/2014. The FY 15 column had a request for \$500,000, and an additional request in FY 16 for \$160,000. The analysis was on page 2, and was a response to the direction from Senate Resource that DOR prepare a plan to allow individual Alaskans to invest in the project. The analysis outlined the contractual costs for DOR to prepare the plan and conduct the due diligence and structure the opportunity to

provide a recommendation for the legislature to allow Alaskans to engage in the project.

DANIEL FAUSKE, PRESIDENT, ALASKA GASLINE DEVELOPMENT CORPORATION (via teleconference), (AGDC) introduced himself.

MILES BAKER, DIRECTOR, GOVERNMENT RELATIONS AND EXTERNAL AFFAIRS, ALASKA GASLINE DEVELOPMENT CORPORATION (via teleconference), spoke to two fiscal notes prepared by AGDC. He began with FN: 2 (CED), dated 1/20/2014. He looked at the FY 15 column with a total amount of \$3.802 million, with one full-time position. The FY 16 column also had a request for \$3.802 million, and the FY 17 column had a request for \$410,000 for personal services. He remarked that there was an FY 14 supplemental request of \$700,000. The total request for the fiscal note was \$8.714 million, and represented the operating costs that would be incurred by AGDC to participate in the pre-FEED through the end of FY 16. It was anticipated that there would be additional costs in the out years, but it was too early to anticipate the exact cost to the state. The second page of the note was a high-level description of the AGDC involvement, and it was anticipated that the subsidiary would be a true subsidiary of AGDC with the utilization of existing staff. He explained that an executive would be hired to oversee the new subsidiary, and contract council would conduct the majority of the negotiations for the major documents. He noted that there would be significant travel costs associated with participation with other signatories of the HOA.

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Senator Hoffman looked at the first page of FN: 2, and asked for further explanation of the capital request for FY 15. Mr. Baker responded that the \$83.7 million was the amount that needed to be capitalized. He stated that there was a cross-reference to FN: 1.

Co-Chair Meyer asked for assurance that there was not a duplication of effort. He wondered if the state was paying for the same service twice. Mr. Fauske replied that AGDC was not going to duplicate efforts. He explained that the work was on the liquefaction side of AKLNG.

Co-Chair Meyer wondered if the expertise could be used for the standalone line, if the large line did not come to fruition. Mr. Fauske responded that the expertise could be used, as long as the state had access or had possession of the data that was developed. He felt that there could be a fairly seamless transition.

Co-Chair Meyer asked if the \$83 million request could be reappropriated to the standalone pipeline. Mr. Fauske felt that it was at the will of the legislature.

Co-Chair Meyer recalled that the legislature had appropriated \$335 million to AGDC the year prior. Mr. Baker clarified that the appropriation was for \$355 million.

Vice-Chair Fairclough wondered if there were confidentiality agreements with the subsidiary within the subsidiary, and asked if AGDC was allowed access to that data. Mr. Fauske responded that it was a possibility that the subsidiary would be under a confidentiality agreement. He stressed that the legislation outlined a separate division that was created which would be separate from AGDC. The new subsidiary would be completely separate. He stressed that the language was currently slightly confusing. He explained that there were confidentiality agreements regarding the sharing of data. He understood the concerns about managing the money.

[9:40:50 AM](#)

Vice-Chair Fairclough surmised that there would be cost savings, if the enterprise entity within AGDC was the repository of all of the data. Mr. Fauske agreed, and announced that there were cost savings and some efficiencies that should be made before moving forward.

Co-Chair Meyer stressed that the finance committee was focused on savings. He looked at the \$355 million appropriation from the year prior, and wondered if the \$83.7 million could be reappropriated from that amount to apply to the project. He surmised that it would not be possible, because this was a separate project. Mr. Fauske responded that the reappropriation was possible, but it would affect the ability of the standalone project to move forward at its current pace.

Senator Hoffman looked at page 3, item I of the HOA, which explained the current situation. He noted that the third sentence said that the administration and AGDC intended that AGDC would participate in the project. He noted that AGDC would continue to pursue the standalone pipeline project. He queried the priority of AGDC. He wondered how AGDC was prioritizing the projects. Mr. Fauske responded that there would be a point in time where prioritization must occur. There would be an eventual shift of project development.

[9:48:28 AM](#)

Senator Hoffman remarked that the ASAP would have open season in 2016, which was also the first year of FEED for the proposed project within the legislation. He wondered how that would affect each other. He also noted that the board membership was critical, but stressed that there should be specifications and guidelines of the board memberships. He felt that there should be a focus on delivering gas to all Alaskans. Mr. Fauske responded there could be one board to focus its energy and efforts toward the change. The current board had a strong and experienced membership, and brought expertise to a wide array of discussion topics.

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DEEPA PODUVAL, PRINCIPAL CONSULTANT, NATURAL GAS AND POWER FUELS GROUP, BLACK AND VEATCH MANAGEMENT CONSULTING, displayed the PowerPoint presentation, "Senate Finance Committee, Clarifications on Previous Presentations" (copy on file).

Ms. Poduval discussed slide 2, "Long-term North Slope Oil and Gas Revenues are Driven by AKLNG Project Success." She announced that the question on this slide, which showed the projected revenue forecast for the state. There was a remarkable difference of approximately \$4 billion between revenue from oil only versus oil and gas combined, from 2024 to 2040.

[10:03:18 AM](#)

Vice-Chair Fairclough wondered if oil was included in the green line, and to what extent it was included in the graph analysis. Ms. Poduval replied that the green line included oil and gas, and the green line should be considered the blue line, plus the revenues from the AKLNG project.

Ms. Poduval highlighted slide 3, "Preserve Value to State from Royalty and Taxes." She stated that the revenues were only attributed to the AKLNG project. The graph showed the distribution between royalty production tax, state corporate income tax, and property tax. She stressed that there were some oil revenues that were included, which came from two different sources. It was assumed that Pt. Thompson would produce more oil with the investment that would be made to produce gas out of Pt. Thompson, than it would without the incremental capital investment. The revenue at its peak was approximately 30,000 to 40,000 barrels per day, with the additional oil production assumed from Pt. Thompson. The production had a fairly aggressive decline to approximately 15,000 barrels per day. The value at Pt. Thompson came from the gas. The second source of oil related revenues were from "yet to find" fields, later in the project's life. It was assumed that production at Prudhoe Bay and Pt. Thompson would begin to decline by 2040, but new fields would be discovered on the North Slope to keep the project intact.

[10:07:51 AM](#)

Vice-Chair Fairclough wondered if the graph represented terminology that would be considered "blow down."

Co-Chair Kelly asked Vice-Chair Fairclough to restate her question. Vice-Chair Fairclough clarified that there had been discussions regarding where the gas would be available. She stressed that there was a challenge to define the actual reservoir of gas, in order to understand what could be recovered. She wondered if the 6 percent on the chart would be considered "blow down."

Commissioner Balash stated that the oil impacts were accounted for, but were not a part of the 6 percent that was displayed on the graph.

Vice-Chair Fairclough queried what the 6 percent represented. Ms. Poduval replied that the 6 percent referred to how much of the revenues displayed on the chart came from the oil assumptions.

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

[10:10:34 AM](#)

Senator Hoffman looked at 2018 through 2023, and noted that the green line was below the blue line on slide 2. He felt that the green line would always be above the blue line. Ms. Poduval replied with slide 3, "Preserve Value to State from Royalty and Taxes." She stressed that there would be a negative impact to the state before the project was operational.

Senator Hoffman noted that enalytica showed the same dips in value, but total for the years would be in the billions of dollars. He queried the assumptions on graph 2. Ms. Poduval replied that graph 2 was used in an earlier presentation to level set, and display the picture of the North Slope project without any state equity investment.

Senator Hoffman felt that there was not a reconciliation of the numbers that were presented by enalytica.

Co-Chair Meyer remarked that the state would continue to heavily invest in the project in the downstream, but wondered if it was too risky to have no say or investment in the upstream portion of the project. Ms. Poduval stressed that the project was extremely expensive, and the only way the producers made money was through investment with the return of production from the North Slope.

Co-Chair Meyer stressed that the producers had many more global opportunities than the State of Alaska.

[10:16:45 AM](#)

Vice-Chair Fairclough asked if AOGCC would define the highest benefit for the particular reservoir. Commissioner Balash responded that the off-tick was what mattered the most for DOR and DNR.

Ms. Poduval looked at slide 4, "Preserve Value to State From Royalty and Taxes."

IMPLICATIONS:

AKLNG is currently out of the money:

Alaska break-even price is US\$12.3/MMBtu

Projects more economic than Alaska can provide ~340 MTPA new supply, more than required to meet global LNG demand (~250 - 300 MTPA) AKLNG faces significant competition

There are several projects to the right in supply stack which will compete with AKLNG However, the risk levels of competing LNG projects also needs to be considered

Due to political, resource and other risks, some in the money projects may be delayed/cancelled, leading to range of needed capacity

Ms. Poduval displayed slide 5, "On the Global Supply Curve, AKLNG Appears to Currently be Out of the Money, Modifications Required for Competitiveness."

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delayed/cancelled, leading to range of needed capacity

Ms. Poduval explained that the slide showed the Alaska project within the context of the other global LNG programs.

[10:25:12 AM](#)

Co-Chair Kelly stated that Mr. Persily had delivered a detailed presentation of the projects.

Ms. Poduval stressed that the graph displayed a moving picture. It was one point in time which was analyzed. She remarked that every project would undergo the same kind of analysis and scrutiny. The position of the project inside the queue was dynamic, but she stressed that other projects would be more expensive and attempt to lower their cost structures to satisfy market demand.

Senator Hoffman looked at the AKLNG project, and remarked that it was the largest bump of the second tier of projects. Under the assumptions of the range of the projects, he queried the production costs in the graph. Ms. Poduval explained that the assumption was the midpoint of the range.

Senator Hoffman wondered if the assumption was \$35 billion. Ms. Poduval explained that the \$45 to \$65 billion project cost was for upstream and midstream costs. The midstream component was only the GDP pipeline and LNG plant, and was approximately \$37 and \$54 billion. The rest of the costs would be spent at Pt. Thompson. The capital cost that was assumed for the GDP pipeline and LNG plant on the graph was \$45 billion.

Senator Hoffman assumed that the construction costs would be \$55 billion, and the breakeven for Alaska would be \$12.30/MMBtu. Ms. Poduval agreed, and furthered that the lower side of the range after the FEED work was complete, it would move further left.

Senator Hoffman queried where the state would be at \$45 billion and \$65 billion. Ms. Poduval agreed to provide that information.

[10:30:05 AM](#)

Commissioner Balash stressed that the slide showed that Alaska needed to participate in the project soon.

Senator Hoffman looked at slide 4, and wondered if Commissioner Balash could speak to the state's cash flow and the displayed potential drawdowns. He would like the numbers from 2017 to 2024, and the cash demands of and impacts to the states. He understood that the decisions would be made at the end of 2017, but would like see a comparison. Commissioner Balash agreed to provide that information.

10:34:00 AM

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RECONVENED

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

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ADJOURNMENT

11:00:21 AM

The meeting was adjourned at 11:00 a.m.