

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

February 5, 2014

3:30 p.m.

MEMBERS PRESENT

Senator Cathy Giessel, Chair
Senator Fred Dyson, Vice Chair
Senator Peter Micciche
Senator Click Bishop
Senator Lesil McGuire
Senator Anna Fairclough
Senator Hollis French

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

PRESENTATION: HEADS OF AGREEMENT (HOA) PANEL DISCUSSION

- HEARD

SENATE BILL NO. 148

"An Act excluding certain land from the Kachemak Bay Critical Habitat Area."

- MOVED SB 148 OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

BILL: SB 148

SHORT TITLE: KACHEMAK BAY CRITICAL HABITAT AREA

SPONSOR(s): SENATOR(s) MICCICHE

01/31/14	(S)	READ THE FIRST TIME - REFERRALS
01/31/14	(S)	RES
02/03/14	(S)	RES WAIVED PUBLIC HEARING NOTICE, RULE 23
02/05/14	(S)	RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

DAVID VAN TUYL, Regional Manager
BP Exploration, Alaska, Inc.

POSITION STATEMENT: Commented on the Heads Of Agreement (HOA).

BILL MCMAHON, Sr. Commercial Advisor
Alaska Gas Development
ExxonMobil Production Company

POSITION STATEMENT: Commented on the Heads Of Agreement (HOA).

PAT FLOOD, Supervisor
North Slope Gas Development Team
ConocoPhillips Alaska
Anchorage, Alaska

POSITION STATEMENT: Commented on the Heads Of Agreement (HOA).

TONY PALMER, Vice President
Major Projects Development
TransCanada
President, TransCanada's Alaska Corporations

POSITION STATEMENT: Commented on the Heads Of Agreement (HOA) and the Memorandum of Understanding (MOU).

DAN FAUSKE, President
Alaska Gasline Development Corp. (AGDC)
Anchorage, Alaska

POSITION STATEMENT: Commented on the Heads Of Agreement (HOA).

SENATOR MICCICHE
Alaska State Legislature
Juneau, AK

POSITION STATEMENT: Sponsor of SB 148.

CYNTHIA BIRKHIMER
Kachemak Bay Conservation Society (KBCS)
Homer, Alaska

POSITION STATEMENT: Supported SB 148 with some changes.

WALT WREDE, Manager
City of Homer
Homer, Alaska

POSITION STATEMENT: Strongly supported SB 148.

RANDY BATES, Director
Division of Habitat
Alaska Department of Fish and Game (ADF&G)
Juneau, Alaska

POSITION STATEMENT: Available to answer questions on SB 148.

ACTION NARRATIVE

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CHAIR CATHY GIESSEL called the Senate Resources Standing Committee meeting to order at 3:30 p.m. Present at the call to order were Senators Dyson, Micciche, French, and Chair Giessel.

Presentation: Heads of Agreement (HOA) Panel Discussion

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CHAIR GIESSEL said today's topics would be the Heads of Agreement (HOA) panel discussion and the Memorandum of Understanding (MOU) with TransCanada. She said as a life-long Alaskan she was here long before the companies they represent were on the ground here and she appreciated what they had brought to the state. She grew up in Fairbanks and it changed significantly when oil began to be produced. Today all the amenities Alaskans enjoy today come from their companies and its employees' work.

She said they had been talking about developing gas for the last several decades and it's becoming more and more on the agenda. They often do polling about what the public thinks; she likes reliable polling and sees huge support for an instate gas pipeline. In 2012, 60 percent of the people said yes to an instate pipeline; when asked if state funds should be used, 69 percent of the respondents said yes. Why one hadn't been built yet is an interesting question, and the interesting answer is that a majority of folks, 48 percent, said that failure of leadership by state elected officials was the reason. Well, she thought possibly some other factors came into play.

In 2013 the same questions were asked: 61 percent said yes to an instate gasline; use of state funds for it, 67 percent said yes; and if the state was getting closer to making a natural gas pipeline a reality or is it still a pipedream: 43 percent said it's getting closer, 44 percent said it will never happen in our lifetime. She thought they had moved the dial with the HOA and the MOU, and that's what they were going to discuss today.

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SENATOR FAIRCLOUGH joined the committee.

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DAVID VAN TUYL, Regional Manager, BP Exploration, Alaska, Inc. said he had been working in Alaska for almost 30 years, the last 15 of which had been dedicated in various efforts to get

Alaska's gas to market including serving on the management committee for the Denali pipeline effort, the joint effort between BP and ConocoPhillips. He also serves on the management committee of the AKLNG project, working with all the parties before them today. He stated that the HOA and the project that it enables is critically important and BP was grateful for the legislature's consideration and were giving it their full time and effort.

He said that executing the HOA was a very important step for BP; BP Alaska President, Janet Weiss, was thrilled to sign it. The HOA is supported all the way to the top of the house in BP. Seven entities signed the HOA and that aligned effort, which provides the roadmap for a way forward for the legislature to consider three things that will advance the AKLNG project that they call the "3-P's:"

-participation by the state as co-investor;

-percentage: the HOA provides for the producers to pay production tax with gas and the legislature needs to determine what that gross percentage is going to be (when added to state's royalty taken in kind (RIK) that adds up to the participation level);

-process: the HOA lays out a forward process by which terms will be negotiated with the administration and ultimately brought back to the legislature for its consideration in 2015.

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He said the HOA is important to BP, because of what it says and signifies. It integrates the resources of all the parties in front of them now who are united in making the possibility of AKLNG project a reality. Along with the major North Slope producers and TransCanada, the HOA parties include the Alaska Gasline Development Corporation (AGDC) that was tasked by this legislature with bringing gas to Alaskans. It signals a tangible representation of the willingness and the ability of the state and all the parties to work through some tough issues and to find solutions to industry and the marketplace. Rolling up their collective sleeves and finding constructive solutions is going to be critical going forward together.

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Finally, he said the HOA signifies the important initial step in giving the AKLNG project the opportunity to compete in the world market. It tells the market that the key players are united behind a single project, and BP believes that the AKLNG project can successfully compete. That excites them here in Juneau, in Anchorage, and in their executive offices in Houston and London.

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SENATOR MCGUIRE joined the committee.

MR. VAN TUYL said there is a lot of work to do before they can know with certainty that the AKLNG project will compete successfully, but the HOA is a critical step in that direction. BP is pleased with the administration's policy decision to participate in the project as a co-investor, side by side with them. That creates a really important commercial alignment that will help also in solving the challenges going forward. It sends an important signal to the world that the project has the support of the host government, a critical element of success of a major project like this. He hoped the legislature will agree that the state should participate as a co-investor.

MR. VAN TUYL said that any one of them, even with their best efforts, can't make this project a success, but all of them working together cooperatively can. BP sees the HOA as that first step on that journey, and he looked forward to work with them in the coming weeks and months as they watch the future of the AKLNG project unfold.

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BILL MCMAHON, Sr. Commercial Advisor, Alaska Gas Development, ExxonMobil Production Company, said he had more than 31 years of experience with ExxonMobil. He had time to work in gas engineering and natural gas contracting; he had also worked in their international organization, but for the last 20 years he had been pursuing commercialization of Alaska natural gas. This has included efforts to consider converting it to liquids and moving it down the TAPS and pipelines to the North American markets and LNG to the Far East. He had also been involved in establishing fiscal regimes with the administration that would encourage such a development.

ExxonMobil's assets in Alaska are a key part of their international portfolio. They have been in Alaska for more than 50 years and to date have spent over \$13 billion here developing oil and natural gas resources. They are the operator of Pt. Thomson and ExxonMobil is the largest working interest owner at Prudhoe Bay, and the largest lease holder of natural gas in the state.

He said they had been involved with all the past efforts to try to commercialize natural gas and are excited about the promise that AKLNG project brings. Within ExxonMobil this project was

recently moved to their ExxonMobil Development Company, and he has moved there, too. It is the organization within the corporation that is vested with the duty of developing megaprojects: the design, the management of the risk, construction, and startup of very large projects.

ExxonMobil is encouraged by the progress that has been made and it has been a pleasure to work with folks here and the administration; it is a significant milestone.

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PAT FLOOD, Supervisor, North Slope Gas Development Team, ConocoPhillips, Anchorage, Alaska, said he had worked as an engineer in the oil and gas business for more than 30 years and his entire career has been devoted to developing gas and oil resources in Alaska.

ConocoPhillips has been trying for many years to achieve an economically viable plan to develop Alaska's vast gas resources. They believe that with the HOA and the strength of the state behind those efforts they have a path forward that could lead to a commercially viable LNG project.

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They believe there are four key areas for legislative input to continue advancing the project as envisioned in the HOA:

- the state must participate in the project;
- it needs to decide what share of the gas it will have, which sets the state participation in the project;
- the legislature needs to define the production tax, a tax share taken as gas molecules which with the existing royalty share also taken as gas molecules provides the state's overall gas share. This state gas share needs to be consistent with and support the state participation share;
- the legislature also needs to give the administration tools to confidentiality work through the arrangements and contracts required to move the project ahead.

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TONY PALMER, Vice President, Major Projects Development, TransCanada, also president, TransCanada's Alaska Corporations, said they believe it is historic to have all of these parties in front of the state with an aligned proposal. They have worked very hard over the course of the past 40 years to advance Alaska's gas to market and had never sat with all the parties collectively in front of them today with a proposal.

He had already described the fundamental elements needed for a successful project in the LNG business; they are in front of them. He noted that there had been compromises by all the parties; it is the nature of any agreement. Value must be adjusted for all parties.

If sanctioned, he thought this project could compete vigorously in the LNG market and succeed. The proposal asks the legislature to go to the next step and establishes the risk and rewards for all of the parties to do that. Beyond that there are decision points and stage gates for every party, a norm for developing major projects.

MR. PALMER said this project will provide optionality for the state. But advancing the AGDC pipeline to the next stage was also to provide optionality to the state so that Alaskans could see gas delivered to themselves from the North Slope and in this case, have the opportunity to commercialize the gas in international markets and bring real value to Alaskans. The dollars are very large if the project can succeed.

He said he took this proposal to his board of directors to get approval to sign the agreements on behalf of TransCanada and he looked forward to answering their questions and working with the legislature over the next two or three months.

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DAN FAUSKE, President, Alaska Gasline Development Corp. (AGDC), Anchorage, Alaska, thanked the people next to him and the legislature for the passage of HB 4 last year that put them at the table to begin with. It gave them the strength and power they needed to help represent the state by being an entity that could deal with confidentiality agreements in deference to DNR and DOR.

He related that it reminded him of his former life as a chief financial officer and treasurer of the North Slope Borough, the head taxman on the North Slope, and he had years of negotiating with oil companies on issues of valuation. He said you have to have your thinking cap on in these meetings, because a lot of issues are going on. This is a massive undertaking. They have a project going forward and are pleased to hear the compliments from the industry as to the success and advances they are making.

MR. FAUSKE said one of the greatest things that AGDC brings to the table is the leverage: they are at the table, they have a

project going forward (ASAP) already, and they own assets that bring meaning to the project. This project makes sense and he urged them to move quickly but use caution and employ great study. He said AGDC's mandate was to continue moving the ASAP project forward and if it could be blended into what is going on here, so much the better.

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CHAIR GIESSEL opened questions by the committee.

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SENATOR FRENCH said this is exciting and a fantastic opportunity and thanked them for meeting him in his office. He knew there were compromises and serious negotiations, and asked each of them what they gave up.

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MR. VAN TUYL answered first that at any time you get these parties together in a room there is an argument, but he wanted to emphasize that they worked through their differences by listening to one another and allowing their views to be shaped to accommodate the view of others.

One issue was the manner in which the project would be regulated and, specifically how expansions would work. They came up with a pretty good template in Article 6, Appendix A, which guides how expansions work. No one party gets to have their way without ensuring that the other parties aren't impacted. Appendix A also is biased toward making sure the project is expandable under certain conditions it sets out.

MR. MCMAHON said for BP it was how much detail went into the HOA and how much would be saved for later discussions. When pressed, they came up the 3-P's as being the three key things they wanted to achieve with the state:

- getting authority to participate in the project;
- setting the overall percentage of state gas share and state participation;
- setting up a process to put together project enabling contracts.

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MR. FLOOD said for ConocoPhillips it was more about eliciting an understanding and coming to terms. One of the things they grappled with was the state acting in its proprietary capacity and also acting in its other capacity as a regulator. It is a consideration throughout the document. The state needs a certain

amount of access to information, but they want to make sure that the state in its proprietary capacity is acting in its proper roll. It's unusual for ConocoPhillips to find themselves in that position, because they aren't typically in commercial agreements with the State of Alaska. They had to find new territory and a way how to go forward.

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MR. PALMER said some parties want to enjoy the sausage and others want to see how the sausage was made. There were compromises made by all parties and that is the nature of any good agreement. TransCanada made compromises with regards to expansions, which they are in favor of. An agreement was made between all of the parties that can work going forward. That structure was negotiated by all of the parties for an extensive period of time, but they came up with a structure that could work for the existing parties that are the initial customers on the project and work for expansions by these parties as well as new third parties that may find gas in Alaska or actually have gas today that are not part of this group.

Some of the terms in the MOU are actually more beneficial for the state than what was passed in the Alaska Gasline Inducement Act (AGIA) statute some six years ago in terms of the return on equity, he said.

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MR. FAUSKE said AGDC probably made concessions of time knowing in HB 4 getting gas to Alaska was their number one priority; that had to be balanced between arguments based on what is good for the shareholders. If the process they are working on is successful ASAP will go away, and he wanted to them to know that the state was well represented and that his staff was not being driven off of its mission financially or time wise.

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CHAIR GIESSEL noted former Senator Drue Pearce in the audience as well as the commissioners of DNR and DOR.

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CHAIR GIESSEL asked Mr. Fauske to describe more about the subsidiary that will be formed under AGDC and how that fits in with this project.

MR. FAUSKE explained that they were originally involved in the midstream, and then the discussion turned more towards having them involved in downstream or liquefaction. One of the concerns

they had was that they were not granted that authority under the enabling legislation. It was then determined that a subsidiary could be created to handle it. The bill gets into far more detail about the functions.

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SENATOR MCGUIRE said the subsidiary maintains some of AGDC's powers and yet AGDC continues on with its separate mission, and noting that there was no mixing of monies, asked if there was a conflict.

CHAIR GIESSEL apologized saying they would discuss that later, because they were on the HOA and the MOU right now.

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SENATOR FRENCH said the HOA looks to enabling legislation to make it come to fruition sets out a lot of principles, but the MOU says there are no commitments, and he wanted to hear from Mr. Fauske and Mr. Palmer about how the legal status of the MOU and how binding it is; he wasn't sure it had the same "exit ramps" as the HOA.

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MR. FAUSKE said he is not a signatory to the MOU, so he couldn't give a good answer.

MR. PALMER said he wasn't a lawyer, but had done a number of agreements and could respond. They believe the MOU is in exactly the same position: they are seeking the sanction of the legislature to make it a valid document to go forward. If the legislature does not sanction the MOU, then it, in effect, will become null and void.

SENATOR FRENCH asked the mechanism for sanction. Would SB 138 be the same enabling legislation for the MOU?

MR. PALMER answered yes; the enabling legislation will empower the administration to move forward under the MOU, and it is stages so that the MOU terms would ultimately be turned into a precedent agreement (PA) later this summer that the legislature would approve and ultimately turn into a firm transportation services agreement, which would come back to the legislature in 2015 for approval.

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SENATOR FRENCH said if they approve the HOA it still has off ramps and wanted to know how the MOU process goes forward and

what things would have to happen in order for it to come into effect.

MR. PALMER clarified that if the MOU is approved by the legislature with the HOA, they move to a PA negotiated between the administration and TransCanada; that PA will move them through the next stage of the process, ultimately to the firm transportation service agreement, which will come back to this body. He said there are specific off-ramps established for both the state and TransCanada already in the MOU through the pre-FEED process, the FEED process, and ultimately the rest of the process.

SENATOR FRENCH said he could take that answer off line, not wanting to take up too much committee time.

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SENATOR MICCICHE asked for a quick overview of Article 4, because it was important for the public to hear there are ways out of the MOU.

MR. PALMER explained that Appendix C in the MOU, a clause that has "termination events," which he said gives the state the right at any time to give 90 days' notice to TransCanada to terminate prior to the FEED. If all parties agree to move into final investment decision (FID) then there are also off-ramps specifically for the state to withdraw within 60 days from the date when one or more of the producers or the transporter withdraws from the AKLNG project, or at any time if the shipper (the state) or the ANS producers on their behalf is unable to sign agreements to sell all of its royalty or tax gas on terms acceptable to the state.

At FID, for any reason, the state has an off-ramp. At the bottom of page 8 there are some off-ramps for TransCanada and then on the top of page 9 there are additional off ramps for either party if the terms of the FEED agreements or definitive agreements are not acceptable to the state or TransCanada. Then there is an off-ramp for regulatory approvals within 90 days and at FID if all the rights-of-ways, easements, and land leases have not been secured. There are additional off-ramps post-MOU sanctioning. Another clause talks about the right for the state to acquire TransCanada's position in the project.

CHAIR GIESSEL asked if that meant buying the work TransCanada had done previously.

MR. PALMER answered yes. There is a mechanism for the state to reimburse TransCanada for its portion of the cost it had expended plus an AFUDC 7.1 percent rate, which is less than TransCanada's equity rate (and this project at the development stage is being financed with equity). Reimbursement of those dollars to TransCanada would mean the state is stepping into its shoes.

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SENATOR BISHOP joined the meeting.

CHAIR GIESSEL asked him to clarify the FID when the "big money gets spent." Is that the build it point?

MR. PALMER answered yes. If they walk through the stages contemplated in the HOA and other documents, they propose to go into the pre-FEED stage; the next stage is FEED stage; that also ramps up the dollars. The FID is that point at which all of the companies and the state (AGDC) would be making a decision to actually construct the project and spend the multiple tens of billions of dollars to put the pipeline in the ground, put the liquefaction plant in the ground and build the GTP, and ultimately go into service several years after.

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SENATOR DYSON asked if TransCanada's data that it has acquired as a result of its field work under the AGIA license will be brought to the table under this new agreement.

MR. PALMER answered yes.

SENATOR DYSON asked if that information would be available to all the participants including the state as the project goes forward without having to reimburse TransCanada for that work.

MR. PALMER answered yes, that is the proposal under the HOA and the MOU. That information will be available to the project going forward at no cost.

SENATOR DYSON said he is beginning to understand that the state's power to tax is limited to the total amount of the state's financial participation in the project.

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MR. MCMAHON replied that it's just the other way around, and explained that the legislature decides what level of taxation through the production tax; and that gets coupled with the

royalty share (which is not modified) and will set total gas share; that in turn would set the state participation in the project. State participation in the project is not a cap of taxes; it is an outcome from the tax rate.

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SENATOR DYSON asked if the legislature decided to change the production tax part of the agreement if the state would be forced to change its financial investment position in the agreement.

MR. MCMAHON replied yes; that would be the result. One of the things they will talk about in developing the project-enabling contracts is how that would be handled.

SENATOR DYSON asked if there is precedence for that on this continent.

MR. FLOOD replied that the HOA contemplates that the state's participation and the state's gas share would be the same. The state's gas share would be composed of the existing royalty share with some modification of net profit leases or sliding scale leases and the production tax. The state would not be forced to do anything; it just wouldn't be consistent with the existing HOA.

SENATOR DYSON supposed if royalty share is 12.5 percent and the state decides that their production tax portion is 12.5 percent (equaling 25 percent) then the state would get 25 percent of the gas input into the process as its share and becomes a de facto producer. But the agreement requires that the state cannot change the production tax share or if they did, that would change their ownership of gas requiring that their investment in the project would retain the alignment. So, if the state went to a total of 30 percent it would have to have 30 percent of the investment capital?

MR. VAN TUYL said that was correct; part of the reason for wanting to ensure that the state's portion is set is because they are talking about entering into an LNG project which will be underpinned by a number of things including long term sales and purchase agreements. Every party will want to know their set portion that they can actually sell. Changing that up and down through time is problematic in placing long term contracts. The HOA also envisions other elements of state take such as revenues brought in through property taxes and state corporate income tax.

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SENATOR FAIRCLOUGH asked if BP (and the companies) sees any other values in having the state as a partner aside from the ownership equity interest and the taxations so that the tax doesn't fluctuate.

MR. VAN TUYL replied that BP believes state participation is absolutely critical to the success of this project, the reason being that nothing aligns like equity. With the state actually being a co-investor in the project taking its royalty share in kind and tax as gas molecules, the state and the producers will have an unprecedented level of alignment. Issues coming down the pike will be seen in a similar light, because they will be commercially motivated in a similar way, so they are more likely to find mutually agreeable solutions. That kind of structure is seen in a lot of mega-LNG projects around the world that have host government support.

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MR. FLOOD, expanding on alignment, said that LNG projects are built on a long chain of contracts and ultimately rely on the confidence of the markets that they would be serving with the gas. Having the state as a supportive, cooperative partner is an ideal situation for that. It's hard to imagine moving this project forward in an atmosphere of conflict.

SENATOR FAIRCLOUGH asked if it might be a reduction of risk to their shareholders to have the state as a partner.

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MR. MCMAHON responded that the advantage to ExxonMobil would be that the state's investment in the project would match their economic interest in the project. So, ExxonMobil would have the advantage of only needing to raise the capital to match the gas that they take. Lower investment brings lower risk, and that would be an advantage that state investment brings.

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SENATOR FAIRCLOUGH said, as a counter to that, she would ask the administration to be prepared to describe what advantages the state sees in having the proposed partners.

She said some people may not know that TransCanada and its shareholders have actually invested under the AGIA license in the project already and asked if Mr. Palmer if he could let Alaskans know how much money they had invested.

MR. PALMER said he would leave out TransCanada's previous 30 years' investment in pursuit of this project, but today they with ExxonMobil had invested approximately \$130 million of unreimbursed dollars in the AGIA project. The state has invested some \$300 million. That is all equity investment but they have been unsuccessful in bringing that project to fruition, principally because of the shale gas revolution in North America. In the event this project proposal is sanctioned the information that was developed under that initiative would be contributed and available for this project going forward at no additional cost to the state.

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SENATOR FAIRCLOUGH asked how TransCanada makes money for its shareholders.

MR. PALMER answered it's TransCanada's business to attract customers across North America; they own some 40,000 miles of pipe in Canada, the U.S., and Mexico; that has been their business for almost 60 years. They own no natural gas or oil that moves through those pipes. So, what they see in the MOU is the first stage moving towards an ultimately affirmed transportation agreement (TA) which sets out how TransCanada's obligations to their customer (the state) and what their rights are. The way they make money is by investing equity; they don't make a profit on the debt side of the equation.

TransCanada brings their skill sets to the table and earns a return on the equity and also achieves a return on the capital over the life of the project. He said it's quite similar to a railway that doesn't own the product that it moves and to their competitors across North America and internationally. Their business is all about bringing their areas of expertise to the table to obtain permits and ultimately build, own, and operate pipelines for parties that are their customers.

MR. PALMER said the dollars for TransCanada's shareholders are based on low business risk at modest returns. The 25 percent equity proposal once this project is in service is a relatively low equity ratio compared to pipelines in in Canada that have 40 percent equity.

SENATOR FAIRCLOUGH said one of the challenges Alaskans have had in moving oil in TAPS is the notion that because the big three have ownership interests that it has been difficult for other smaller companies to gain access into that line. She said it

sounds like they would be pro-expansion, because they make more money with more gas in the line, so that would be a benefit to the state.

MR. PALMER answered yes; their business is not only to own the initial investment in a project (equivalent to the state's share in this case for the pipeline and GTP), but clearly they are aligned fundamentally with the state to want to expand, and by expanding they get to invest in a project that they are confident in; and their shareholders like that sort of investment.

He said the expansion terms allow expansions subject to not having a negative effect either physically or financially on the other parties. But those same rights lie with each of the producers; if they wish to expand for their own gas or compete for new parties' gas they can do that, as well.

4:40:30 PM

SENATOR MICCICHE said Mr. Palmer's first answer made it sound like TransCanada primarily makes its money through repayment of capital, but probably the most significant way they make revenue is by shipping gas on a per-unit, per-distance basis.

MR. PALMER replied that TransCanada makes money by transporting gas for its customers, but this project is not driven on a per unit volume of gas flowing the system; it's based on a contracted quantity. So, the state in this case would be contracting with TransCanada to move its 20 or 25 percent (several hundred million cubic feet a day); they would have the right to move that volume of gas through the pipeline every day and the TransCanada would have the obligation to provide them with that service every day.

If an additional one unit moved through that same pipeline, there is no change in TransCanada's earnings on the base system. In the event of an expansion and TransCanada can invest more dollars, that is attractive to them. That's how they would earn more money.

SENATOR MICCICHE said he was asking a question that he wanted Alaskans to hear the answers to in a way they will understand. Since there are three different prices for off take points, is there somewhat of a per-distance basis?

MR. PALMER answered yes. It's a volumetric distance structure and the administration's consultants had in state deliveries at

less than \$4: less so at Nenana, a little more as you move to Big Lake, and then the highest number for the farthest distance, which is to the LNG plant in Nikiski.

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SENATOR MICCICHE said they keep talking about this relationship in terms of a marriage, but really until they get to an FID they are sort of dating. As he struggles with why TransCanada makes sense, one of the things that is clearly on the plus side is that they have a significant investment in this project to date; the state has, too, of about \$330 million.

MR. PALMER agreed.

SENATOR MICCICHE said he would like to take advantage of that, but if the state were to end that relationship would it have to compensate TransCanada somewhat for the unreimbursed amount?

MR. PALMER replied that the definition of "development costs" on page 9 in Appendix C of the MOU says that those costs are post-January 1, 2014. So, that would mean that TransCanada is in effect conveying to the SOA, if the MOU is sanctioned, the work that has been established to date.

SENATOR MICCICHE said that was an important clarification and a significant value.

[4:46:34 PM](#)

SENATOR FRENCH said on page 2, Exhibit B, of the MOU has conditions on the state with respect to transferring its interest in a limited partnership, and the way he is reading that was the state can't sell its ownership interest to a competitor of TransCanada's. He asked if the reverse was true.

MR. PALMER said he didn't think there was such a restriction on TransCanada. The rationale for TransCanada to seek to limit the state is that they don't want to contribute assets to a project only to discover that a competitor has moved in and is being a partner without having gone through that same process. The state could bring in a buyer of its LNG through that structure; the restriction is specifically to someone that competes with TransCanada in the pipeline business in North America.

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CHAIR GIESSEL asked about Exhibit C, section 6, bullet 6, on page 2, that says TransCanada is funding basically the construction of the pipeline and the state then will buy

interest in that (reimbursing them 25 percent), and asked if bullet 6 was referring to 12 percent interest.

MR. PALMER explained that TransCanada will invest in its share of the project and his colleagues will invest in their share of the pipeline and the GTP; in the case of liquefaction, AGDC's vehicle will own the state's share with the producers (TransCanada will not be a participant). But for the pipeline and the GTP, if the state settles on the 20-25 percent in front of them, TransCanada would fund and own 20-25 percent of the pipeline and the GTP. Using \$45 billion for the cost of the project, the pipeline and GTP are something on the order of half that battle. Taking 25 percent just because the math is easy of \$22 billion, TransCanada would be investing \$5.5 billion. Of that \$5.5 billion, once in operation, 75 percent of it would be debt and 25 percent would be equity. Twenty-five percent of \$5.5 billion is just under \$1.4 billion of equity that would be invested. It's on that \$1.4 billion they would receive, as part of the tolls they charge the state, a 12 percent return, declining over time as the project depreciates.

The clause on the top of the next page for debt, for the remainder of the \$5.5 billion, the \$4.1 billion in round numbers, will have a 5 percent interest rate all adjusted for U.S. 30-year treasuries. Both the interest rate and the equity are adjusted over time for the U.S. treasuries until FID.

So, TransCanada's charges to its customer, the SOA, will be made up of a number of components, most of them capital related: depreciation to recover TransCanada's capital (\$5.5 billion over the life of the project). If that project has a 25-year contract, they will recover that \$5.5 billion over 25 years. Secondly, they will earn a return on the equity component as it diminishes and the debt which they also will fund over the life of the project.

Next they will have to pay incomes taxes on the equity; there will also be property taxes and operations and maintenance costs to operate this project that will also be charged to customers. Those will be accumulated into a "toll" or a "tariff." All of those components go forward to ultimately make up the charges they will make to the state. This is how they ultimately charge their customers for a project like this.

MR. PALMER reiterated: TransCanada invests its dollars and doesn't make a return on the operating costs or the taxes (which flow through to the customer); they don't intend on making a

return on the debt; they intend to make a return on the equity component (the \$1.4 billion); that's how their shareholders are reimbursed.

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SENATOR FAIRCLOUGH said she wanted to return to the subject that TransCanada might one day sell its interests to one or all three of the major producers and not stay in the game to protect expansion or other interests that Alaska might have. She asked in 30,000 miles of pipe in Mexico, the U.S., and Canada how they typically retain control of the pipe or what their interest looks like as that goes forward in their business model.

MR. PALMER said TransCanada likes to own 100 percent of the pipelines it invests in. It doesn't always, but if they have a smaller position in a pipeline over time, if it's an attractive investment, they generally like to be a buyer if there are other sellers of their share. But obviously, TransCanada's shareholders like this type of investment; that's why they retain parties like himself and others in the company to seek out and find opportunities.

He had told them they compete for LNG projects on the B.C. Coast; they have competed for oil pipelines and gas pipelines; that's what they do every day. Their shareholders like them to have modest business risk and a modest return and they seek to invest in a company that has opportunities just like this. In fact, watching TransCanada's position going forward, they seek out energy infrastructure investment opportunities across North America very focused on gas pipelines, oil pipelines, storage, and power generation. Those are the only four types of investment they are pursuing actively. So, if this project proceeds, they get to invest their \$1.4 billion worth of equity, and if they earn their return on that, that's an attractive investment for TransCanada and a fair and competitive proposal for the customer, as well.

SENATOR FAIRCLOUGH asked if Alaskans should have confidence that TransCanada would be more likely to seek additional ownership interests versus selling ownership interest.

MR. PALMER replied, depending on the attractiveness of the project and if it's succeeding and LNG is being successfully sold into the Asian market and there are profits for all concerned, yes; you would expect that TransCanada would be highly attracted to an opportunity to obtain a higher share. And they have invested in a number of companies where they

originally had a smaller share, and ultimately have tried to raise the percentage ownership in other pipelines across North America in the last 60 years.

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CHAIR GIESSEL said they started out talking about Alaskan's focus on instate gas and whether they believed it would happen and asked if Alaska is any closer to making a natural gas pipeline a reality or is it still a pipeline dream that will never happen; 44 percent in the 2013 survey said it would never happen. What would convince them that this project is more likely to happen?

MR. VAN TUYL answered they are all at a place they have never been before and have an agreement to prove it; it has signatures representing seven different entities and the senior management of the three producers are all behind this project. Back in 2012 the three CEOs wrote a letter to the governor talking about this project and its potential for finally getting to the dream of monetizing Alaska's gas. They are at a place they have never been before and there is a lot of work to do, but because they have this HOA they have demonstrated the ability to work through tough problems and solve them. And they are confident they can continue to do that and give Alaska gas a chance to compete; BP believes Alaska gas can compete.

MR. MCMAHON echoed Mr. Van Tuyl's comments. ExxonMobil is personally excited about having this group of players together; it's a strong team. They have never had this kind of alignment before.

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MR. FLOOD said a couple of years ago ConocoPhillips and all these companies got together and saw that the North American market was not the likely market, but saw promise in another market, and they have been working on that market for years now. Couple that with an administration in a relationship that has grown over the years. They have learned how to put a project forward that they can cooperate on and actually get done. The time is right; the relationships are good, and as long as the state is behind them, they are in very good shape with this project.

MR. PALMER said in addition to what colleagues have already stated that as a student of the LNG business (TransCanada has no LNG for sale), they have looked very carefully as a corporation

as to whether or not they should participate in this Alaska project as they do for any other investment.

Fundamentals are required to succeed in the business:

-Access to supply: With the sovereign being the state owning the gas and the corporations holding leases on the bulk of North Slope gas that is clearly available for this LNG project.

-A capable pipeline company is needed to obtain the permits and to move that gas 800 miles across those mountains in Arctic conditions. TransCanada, with these colleagues, provide that.

-Must have liquefaction capability; it should not be your first liquefaction plant. The gentlemen next to him represent corporations that have built liquefaction plants. So, they actually have done it before and can do it again here. Mr. Butt and his team clearly know how to do that.

-You have Asian markets which are quite different from the North American transparent market where there are thousands of players. In North America you can sign on to a computer screen and find out the gas price day by day and hour by hour; thousands of people buy and sell gas. That is not the case in the Asian markets. In fact, you have relatively closed markets with one or two handfuls of parties that you must deal with. These three corporations do that every day; they sell LNG into those markets every day; very few parties in the world actually to do that. Many state-owned entities do that, but there are very few counterparts to these corporations that do it. This project is holding three of those parties that sell LNG into the Asian markets every day.

- Credit worthiness is needed to support a project in the \$50-billion range. Most corporations or states do not want to bet their entire financial capacity on a single project. Most corporations want to have some diversity, but they need to be substantive enough to backstop this project as it goes forward. You clearly have that with the portfolio of the state, the four companies and AGDC.

-You must be competitive on a cost and price basis; but relative to the other worldwide LNG projects that are being proposed, this project can be competitive on a price basis. In fact, in many cases that's not the differentiating factor. The differentiating factor for successful LNG projects is if they

have resolved the outstanding issues that are within the control of the parties.

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MR. FAUSKE said they now have an opportunity to weigh this deal versus the risk profile that the state is willing to take based on the rate of return that it anticipates and how it coincides with the hurdle rates at other factories that the industry must have. He was encouraged by the work that was going on, because there is an absolute willingness to do it. This is a great step forward.

The other advantage they have is that the state owns AGDC, not as big a project, but its original outlay was to bring gas to Alaskans with some type of commercial activity on the outset. The two need to be weighed against each other to determine what is in the best interests of the state, but they beauty of it is that they have choices. He thought it was an absolute opportune time for the state.

CHAIR GIESSEL thanked everyone saying they wanted to hear "from you" their perspectives on how this came together and what can be anticipated going forward.

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At ease from 5:09 to 5:19 p.m.

SB 148-KACHEMAK BAY CRITICAL HABITAT AREA

[5:19:49 PM](#)

CHAIR GIESSEL announced SB 148 to be up for consideration.

SENATOR MICCICHE, sponsor of SB 148, explained that this bill amends AS 16.20.590 by exempting the Homer Port and Harbor and a small area that is planned for future harbor and deep water dock expansion from the Kachemak Bay Critical Habitat Area (KBCHA). It cleans up the language of the management plan that says the plan does not apply to municipal harbors within the critical boundary area. However, the statutory boundary excluded the harbor, so they listed the statutory boundary.

Amending the boundary allows normal maintenance work in the harbor without requiring expensive and potentially time-consuming permitting from Alaska Department of Fish and Game (ADF&G). He said that this permitting would not be necessary if the management plan and the statutory boundary matched, which they will through this action.

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Homer projects impacted by permitting requirements in the past have been ramp replacement, float replacement, Pioneer Dock construction, and deep water dock fender replacement.

SENATOR MICCICHE said the primary reason they are asking for this - because the Homer Harbor provides a secure environmentally responsible place to store and maintain vessels that support the oil and gas industry in Cook Inlet.

He said SB 148 is important to his district and to Homer, but also important to Southcentral Alaska and the Interior in places like Fairbanks, because it helps provide a safe harbor to support the natural gas exploration and production in north Cook Inlet. It certainly gives an increased potential to distribute natural gas to rural Alaskans outside of that area.

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CHAIR GIESSEL noted a zero fiscal note and a copy of the management plan that said drilling rig storage will not be allowed in Kachemak Bay Critical Habitat Area, possibly the section he wanted to correct.

SENATOR MICCICHE said that was correct, and he added that he had checked with the agencies and local NGO's to make sure they supported it and he heard that they recognize the harbor as a safe location for this type of activity and were not opposing the bill.

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CYNTHIA BIRKIMER, Kachemak Bay Conservation Society (KBCS), Homer, Alaska, said they understand the reason for this request, and it appears that including these areas within the critical habitat area (CHA) could have been a simple oversight. They support this action on its face, but have some concerns about details of the wording. Concerns are about the size of area requested to be removed and she asked that it specifically exclude any and all oil and gas, mineral exploration, and development activities from within the confines of the newly removed land. They ask that this area be specifically designated within the bill to allow harbor industry-specific operations such as vessel moorage, storage, and freight transfer.

She believed this could be the first action to remove designated lands from within a CHA in the state and was concerned that it will set a precedent for this type of undesignated land actions

especially with regard to resource development interests within the boundaries of a CHA.

MS. BIRKHIMER said at the present time the Parnell administration is openly working to undermine the existing management process of state CHAs, game refuges, and wildlife sanctuaries through the application of Administrative Order (AO) 266. This action looks suspect and could make the KBCHA vulnerable to future incursions. Their concerns are for the long term protection of the local area encompassed by the KBCHA, and to this end she requested specific sections of the City Homer resolution 14-005 be incorporated into the wording of SB 148 as follows:

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Lines 62-65:

Whereas, the City of Homer has deep appreciation for the Critical Habitat Designation and the adopted Management Plan because it protects the resources which provide the very foundation of the local economy, lifestyle and quality of life; and

Line 74-75: Whereas, the City stipulates it does not propose or support any other amendments to the Kachemak Bay Critical Habitat Area or Plan as part of this request.

SENATOR FAIRCLOUGH asked if she was speaking on behalf of the organization, which means they have taken a formal vote, and how many members her organization has.

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MS. BIRKHIMER said she represents KBCS has 100 members and the board has seven members.

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WALT WREDE, Manager, City of Homer, Homer, Alaska, said he strongly supported SB 148. He said they have a resolution from the City Council which was adopted unanimously. This bill is simple; it just carves the port and harbor area out of the CHA where it was never intended to be. This has caused a conflict between the CHA plan and the statutes.

Passing this has a number of benefits: it resolves a conflict with statute and the CHA plan with respect to municipal lands and the port and harbor area. It will make permitting easier are

the regulatory environment much better for ADF&G allowing them to solve some of the ambiguities they are faced with now.

He said this legislation would solve some long standing problems they have been dealing with for decades including a requirement in the plan that any vessel that anchors over 14 days needs to get a permit from the ADF&G. The port of Homer is very busy and this is a very impractical requirement.

They have also seen a lot of permitting delays and extra costs as a result of being included in the CHA; sometimes this includes even routine maintenance like replacing and repairing floats in the harbor.

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Finally, Mr. Wrede said, what really brought this to light was whether or not the department could permit oil and gas drilling rigs to be docked at the deep water dock for routine maintenance, repair. They want to allow that, because Homer is an ice-free, deep-water port that has many resources that could be of service to the industry, and oil and gas drilling is ramping up quite a bit in the Cook Inlet. From an environmental point of view this is the safest place for those vessels to be when they need to be tied up and repaired.

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RANDY BATES, Director, Division of Habitat, Alaska Department of Fish and Game (ADF&G), said he would answer questions on SB 148.

CHAIR GIESSEL asked how many permits the department processes for the vessels that are docked there for over 14 days.

MR. BATES replied that within the last five years they have processed a total of 150 permits for the KBCHA; 29 of them have been within the area described in SB 148.

CHAIR GIESSEL, finding no further discussion, closed public testimony.

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SENATOR DYSON moved to report SB 148 from committee to the next committee of referral with attached fiscal notes and individual recommendations. There were no objections and it was so ordered.

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CHAIR GIESSEL announced the next meeting's agenda and adjourned the meeting at 5:34 p.m.

