

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

February 13, 2014

8:07 a.m.

MEMBERS PRESENT

Senator Cathy Giessel, Chair
Senator Peter Micciche
Senator Click Bishop
Senator Hollis French
Senator Lesil McGuire

MEMBERS ABSENT

Senator Fred Dyson, Vice Chair
Senator Anna Fairclough

OTHER LEGISLATORS PRESENT

Senator Charlie Huggins

COMMITTEE CALENDAR

SENATE BILL NO. 138

"An Act relating to the purposes of the Alaska Gasline Development Corporation to commissioner of natural resources on the custody and disposition of gas delivered to the advance to develop a large-diameter natural gas pipeline project, including treatment state in kind; relating to the authority of the commissioner of natural resources to and liquefaction facilities; establishing the large-diameter natural gas pipeline project propose modifications to existing state oil and gas leases; making certain information fund; creating a subsidiary related to a large-diameter natural gas pipeline project, provided to the Department of Natural Resources and the Department of Revenue including treatment and liquefaction facilities; relating to the authority of the exempt from inspection as a public record; making certain tax information related to an commissioner of natural resources to negotiate contracts related to North Slope natural election to pay the oil and gas production tax in kind exempt from tax confidentiality gas projects, to enter into confidentiality agreements in support of contract negotiations provisions; relating to establishing under the oil and gas production tax a gross tax rate and implementation, and to take custody of gas delivered to the state under an election for gas after 2021; making the

alternate minimum tax on oil and gas produced north of to pay the oil and gas production tax in kind; relating to the sale, exchange, or disposal 68 degrees North latitude after 2021 apply only to oil; relating to apportionment factors of gas delivered to the state under an election to pay the oil and gas production tax in of the Alaska Net Income Tax Act; authorizing a producer's election to pay the oil and kind; relating to the duties of the commissioner of revenue to direct the disposition of gas production tax in kind for certain gas and relating to the authorization; relating to revenues received from gas delivered to the state in kind and to consult with the 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."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 138

SHORT TITLE: GAS PIPELINE; AGDC; OIL & GAS PROD. TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/24/14	(S)	READ THE FIRST TIME - REFERRALS
01/24/14	(S)	RES, FIN
02/07/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/07/14	(S)	Heard & Held
02/07/14	(S)	MINUTE(RES)
02/10/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/10/14	(S)	Heard & Held
02/10/14	(S)	MINUTE(RES)
02/12/14	(S)	RES WAIVED PUBLIC HEARING NOTICE, RULE 23
02/12/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/12/14	(S)	Heard & Held
02/12/14	(S)	MINUTE(RES)

02/13/14

(S)

RES AT 8:00 AM BUTROVICH 205

WITNESS REGISTER

DEEPA PODUVAL, Principal

Black & Veatch, Management Consulting Division

POSITION STATEMENT: Continued presenting B&V North Slope Royalty Study.

JASON DE STIGTER, Senior Consultant

Black & Veatch, Management Consulting Division

POSITION STATEMENT: Described some of the analyses in the North Slope Royalty Study.

MIKE PAWLOWSKI, Deputy Commissioner

Department of Revenue (DOR)

Juneau, Alaska

POSITION STATEMENT: Available for comments on the North Slope Royalty Study.

ACTION NARRATIVE

[8:07:23 AM](#)

CHAIR CATHY GIESSEL called the Senate Resources Standing Committee meeting to order at 8:07 a.m. Present at the call to order were Senators French, Micciche, Bishop and Chair Giessel.

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

[8:08:06 AM](#)

CHAIR GIESSEL announced SB 138 to be up for consideration and that Black & Veatch would finish presenting its North Slope Royalty Study starting on slide 43.

DEEPA PODUVAL, Principal, Black & Veatch, Management Consulting Division, said after reviewing the fiscal framework and comparing it to other successful LNG projects they concluded that Alaska's government take is high. She said there is room for reducing that take or providing some incentive to the project and they looked at some traditional ways of doing that by reducing royalty or production tax, but concluded the neither one moved the needle as much as they had expected. A lot of that has to do with the big capital expense at the front end of the project.

[8:09:10 AM](#)

So, she started looking at equity participation as a potential alternative for the state, especially if it reduced leakage to the federal government. She said there are significant risks associated with this project whether or not the state is an equity participant, prices being a significant risk factor, and it's hard to say what they will be 40 years out. Capital costs and scheduling have been demonstrated as being significant risks for large LNG projects currently under way worldwide and this project is no different. The cost for financing this project for all the parties involved, as well as the cost escalations over time, all add to its risk profile.

[8:10:44 AM](#)

She looked at the impacts of these risk factors from both the producers' perspective and the state's perspective, Ms. Poduval said, and the biggest factors impacting net present value (NPV) either to the state or the producers were prices and costs. Depending on how prices move, the state's NPV could be 50 percent less or 80 percent more and the producers are exposed equivalently to these factors.

[8:12:04 AM](#)

These risks could be managed by concentrating project control through an integrated structure, meaning single-ownership through the entire value chain. Market risk could be mitigated by securing Pre-FID commitments through sales contracts (which are typical) and by having the buyers participate in the project with 5 percent or less (typically). Risk for this large project could also be managed with state participation.

[8:15:46 AM](#)

The tangible benefits for the state with equity participation are:

- To the extent that the State transfers value to the Producers through a modification of fiscal terms as an incentive for the AKLNG project, obtaining an equity interest in the project in exchange for that transfer of value is more beneficial to the State than a simple reduction in fiscal take
- Greater alignment of economic interests between the State and Producers
- State ownership lowers the upfront capital cost to Producers creating potential economic uplift
- Allows for TCPL equity participation and operation of the pipeline and GTP
- Equity in all phases could facilitate greater transparency in the AKLNG Project

- Allows State to influence access for third parties in the most critical potential bottlenecks of the project, the pipeline and marine terminal
- Equity investment in the supply chain, while allowing SOA a seat at the table, does not necessarily provide for a vote in the decision making process
- Joint Venture Agreement structuring is critical

These are very attractive reasons for the state to have an equity position, she said, but it is very involved with the devil being in the details.

8:18:30 AM

JASON DE STIGTER, Senior Consultant, Black & Veatch, Management Consulting Division, described three alternatives for state equity participation as a way to make the project more viable for all.

1. State taking a position in the project that matches its RIK and what its tax as gas would be
2. State owning 100 percent of the pipe and passing the tariff through to producers
3. State matching 12.5 percent ownership with its corresponding 12.5 percent royalty share

He graphed the implications of those three cases for the state/federal/producers stakeholders on slide 49. He looked for cases in which the state's participation and the producers' participation stayed about the same or in which the state stayed the same and was able to induce the producers with a larger share of the project. Of the six cases he ran, only two cases - the 35 percent state gas share and the state owning the pipeline with 100 percent debt - show the state maintaining its value and the producers increasing their share.

8:22:30 AM

The Royalty Study came up with a reference case (15-35 percent range) for state participation but it could have significant deviations, so he looked for a more accurate range for the equity alternative and came up with 22 percent [slide 51]. While there are significant benefits with an equity alternative, there still are some risks and one was the capital costs going higher in the midstream component. There is also upstream risk in that the state doesn't have control over the volumes that will enter the project. And there is market risk downstream.

[8:25:31 AM](#)

MS. PODUVAL said there are risks to the Alaska project regardless of whether the state is an equity participant or not. Equity participation can benefit all the parties, but it needs to be designed right to protect the state's interests, to achieve transparency and access objectives, and to truly have a seat at the table.

[8:26:48 AM](#)

The Study found that equity participation along the value chain equalizing the share of gas with equity would be an attractive way for the state to incentivize the project, to get some value for the incentive it is providing to the producers, and to achieve the chief objective of opening up the North Slope for future explorers.

MS. PODUVAL said the decision for the state to involve TransCanada as a way of optimizing that equity participation was a separate decision and she looked at how that could impact the state and found:

1. It shifts initial project capital burden to TransCanada by transferring the state's equity share in the GTP and pipeline to TransCanada with what looks like a very favorable debt/equity ratio for transportation services. The state also has the option of buying back 40 percent of the equity stake in the GTP and pipeline at the FEED stage.
2. It secures favorable debt/equity ratio for transportation services.
3. It makes expansions more likely given the structure contemplated in the HOA.

[8:28:13 AM](#)

MS. PODUVAL stated that this analysis is ongoing and some of their high level assumptions were:

- State participating at a 20 and 25 percent level,
- State owned all of it and did not transfer a portion to TransCanada,
- TransCanada held on to the GTP and pipeline and the state does not exercise its 40 percent buy back option,
- state transfers a portion of the GTP and pipeline to TransCanada and exercises a portion of its 40 percent buy back.

[8:30:14 AM](#)

MR. DE STIGTER said slide 58 showed the state's investment under several different scenarios. The LNG plant is approximately half

the cost of the whole project and exercising the option to have TransCanada own the GTP and pipeline saves the state half of the necessary capital. Slide 59 looked at the cash calls (blue sections on slide 58). His analysis also incorporated an opportunity cost for the funds the state would have to use for the cash calls and, therefore, funds it could not use in other endeavors.

MIKE PAWLOWSKI, Deputy Commissioner, Department of Revenue (DOR), clarified that this analysis was limited to the TransCanada case and did not include other sources of revenue coming to the state from the project.

MR. DE STIGTER said it was correct that the cash flows such as property tax and state corporate income tax on the upstream were not in this analysis. Slides 60-67 graphed NPV and different cash flow scenarios.

[8:36:23 AM](#)

SENATOR MCGUIRE joined the committee.

[8:37:18 AM](#)

Slide 68 analyzed what sort of additional benefit the state would receive from expansion of the project and slide 69 outlined the key assumptions for that analysis:

- 1 LNG train expansion after five years of operation (the original project has 3 LNG trains)
- a corresponding expansion of the GTP (modular)
- adding compression to the pipe

MR. DE STIGTER said there are significant cost efficiencies with an expansion of a pipe project, because it already has a diameter; all that's needed is to add compression and that would cost \$10 billion (compared to \$45 billion for the original project), which would result in a 30 percent additional cash flow for the state (slide 70). Slide 71 showed the specific cash flow forecasts. Slide 72 bar charts represented the sums of each of the years in slide 71.

Slide 73 looked at things from a 10 percent discounted cash flow perspective and that resulted in a \$2 billion increase for the state (20 percent over the original project). So, he said, there are significant advantages with an expansion, along with significant increase in volumes.

[8:40:57 AM](#)

MR. PAWLOWSKI said the majority of what the committee heard was foundational to the work the state did and not necessarily conclusions. The risk identification by Black and Veatch informed how they worked on the HOA, in particular, and some of the work the TransCanada MOU.

[8:41:54 AM](#)

CHAIR GIESSEL opened committee questions.

SENATOR FRENCH asked how he got the same return for wildly different cash outlays on slide 62. He got part of the answer from Commissioner Rodell earlier who explained that this graph envisions not just making an investment in each scenario, but taking the other cash and investing it somewhere else and combining the returns - as if the state "had a bottomless well of money with which to work" - but really the state would be running out of cash in 2020-21. So, he asked to see that chart performed as if the state didn't have the other money to invest.

MR. PAWLOWSKI said he would work on it.

[8:43:45 AM](#)

SENATOR BISHOP asked what 20-25 percent participation in the project would do to the state's credit rating.

MR. PAWLOWSKI answered that was a key part of the analysis that the department's debt manager would testify on in the Senate Finance Committee, but he added that what drove some of the analysis was the debt capacity of the state in terms of the cash calls.

[8:45:08 AM](#)

SENATOR MICCICHE said his biggest interest was in understanding the risk associated with the project and he hadn't heard them talk about efficiencies lost on costs, resources, scheduling, and permitting by splitting the gas-to-liquids and pipeline from the liquefaction plant and asked how efficiencies could be improved.

MS. PODUVAL answered that a 5-6 year construction period was built into the project schedule and 4-5 years is more typical for a project of this size. But that is one way to allow for unanticipated delays. Also, participants like ExxonMobil, BP and ConocoPhillips bring a lot of expertise in efficiencies with them and their project management plan would work through those issues.

SENATOR MICCICHE clarified that what is unusual is having the gas-to-liquids pipeline being separated from the liquefaction facility.

MR. PAWLOWSKI said he would be happy to work with the committee to talk about the importance of having an integrated project and integrated project management. A delay in one piece will affect the others.

8:48:29 AM

SENATOR MICCICHE said he wanted to see the net present values on slide 49 overlaid against a risk profile (price and capital costs) for each selection.

MR. DE STIGTER responded that slide 51 looked at that in relation to the 15 and 35 percent cases, and whenever one has lower Capex with assumed prices, specifically if you look at the base prices, as the Capex increases the necessary participation in an equity alternative position is less than if one were to stay in a status quo position. The reason for that is as the costs of the midstream component increase under the status quo methodology the net back price at the North Slope is decreased. That's why it decreases the value of returns from an upstream perspective; whereas in an equity alternative world some of that risk is shielded because the state would be directly selling the gas (RIK) and therefore not needing to have those higher costs incurred on the upstream (because there is no direct royalty-in-value or production tax). Therefore the state's risk is more aligned with the price side.

SENATOR MICCICHE said his interest was in demonstrating the value of the TransCanada partnership.

8:51:31 AM

SENATOR FRENCH went back to the escalation factor on slide 45 to make that same point; it seemed to indicate making more money as price, Opex, and Capex went up and losing money when they went down, but she was saying it was the opposite and he asked why that was.

MS. PODUVAL answered here they were seeing the combined effect of cost and price escalation recognizing that the markets generally move together for those factors. The analysis shows that the increase in price is more beneficial than the detrimental effect of the increase in costs to this project.

SENATOR FRENCH asked if by price she meant oil or LNG price and by cost, the cost of the steel and other material elements.

MS. PODUVAL answered yes.

[8:53:19 AM](#)

SENATOR MICCICHE said it would be interesting to see expansion gas coming from an OCS project plotted on slide 73, as opposed to state ownership.

MS. PODUVAL answered that they had done those analyses and would get those to him.

[SB 138 was held in committee.]

[8:54:25 AM](#)

CHAIR GIESSEL thanked all the testifiers and adjourned the Senate Resources Committee meeting at 8:54 a.m.