

**ALASKA STATE LEGISLATURE**  
**SENATE RESOURCES STANDING COMMITTEE**

February 14, 2014

3:32 p.m.

**MEMBERS PRESENT**

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

**MEMBERS ABSENT**

Senator Fred Dyson, Vice Chair  
Senator Anna Fairclough

**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

SENATE JOINT RESOLUTION NO. 5

Urging the United States Congress to provide a means for consistently sharing with all coastal energy-producing states, on an ongoing basis, revenue generated from oil and gas development on the outer continental shelf to ensure that those states develop, support, and maintain necessary infrastructure and preserve environmental integrity.

- 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  
 02/13/14 (S) Heard & Held  
 02/13/14 (S) MINUTE(RES)  
 02/14/14 (S) RES AT 3:30 PM BUTROVICH 205

BILL: SJR 5  
 SHORT TITLE: OFFSHORE OIL & GAS REVENUE  
 SPONSOR(s): WIELECHOWSKI

01/25/13 (S) READ THE FIRST TIME - REFERRALS  
 01/25/13 (S) RES, JUD  
 02/14/14 (S) RES AT 3:30 PM BUTROVICH 205

**WITNESS REGISTER**

JANAK MAYER, Partner  
 Enalytica  
 Anchorage, Alaska

**POSITION STATEMENT:** Presented information on the "Gas Pipeline:  
 AGDC; Oil & Gas; Production Tax.

NIKOS TSAFOS, Partner  
 Enalytica  
 Anchorage, Alaska

**POSITION STATEMENT:** Presented information on the "Gas Pipeline:  
 AGDC; Oil & Gas; Production Tax.

MICHELLE SYDEMAN, Staff  
 Senator Bill Wielechowski  
 Alaska State Legislature  
 Juneau, Alaska

**POSITION STATEMENT:** Presented information on SJR 5 on behalf of  
 the sponsor.

ADRIAN HERRERA, Coordinator  
 Arctic Power  
 Washington, D.C.

**POSITION STATEMENT:** Testified in support of SJR 5.

**ACTION NARRATIVE**

[3:32:19 PM](#)

**CHAIR CATHY GIESSEL** called the Senate Resources Standing Committee meeting to order at 3:32 p.m. Present at the call to order were Senators French, Micciche, McGuire, Bishop, and Chair Giessel.

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

[3:32:56 PM](#)

CHAIR GIESSEL announced that the first order of business would be SB 138.

JANAK MAYER, Partner, Enalytica, Anchorage, Alaska, presented information on the "Gas Pipeline: AGDC; Oil & Gas; Production Tax." He shared his work history working on oil and gas issues, oil tax reform, and transition to gas issues. He lead the Enalytica's team at PFC Energy focused on upstream economic and financial evaluation, constructing economic and financial models of projects, assets, transactions, portfolios for large international companies to small independent players to private equity firms.

NIKOS TSAFOS, Partner, Enalytica, said his chief responsibility was heading the global gas consulting practice of the firm and that he had worked with some of the world's largest oil and gas companies on a number of themes: helping companies that have gas figure out how to sell it, helping companies that want gas figure out how to buy it, and helping companies try to make sense of what is happening in the market and thinking through possibilities and scenarios. His core expertise is natural gas, natural gas markets, and commercialization strategies.

[3:35:17 PM](#)

MR. TSAFOS began with a focus on the need for alignment in making the decisions embodied in SB 138. He said it was complicated, but he would try to explain LNG in terms of oil. The Department of Revenue's (DOR) fall 2013 Revenue Sources Book forecasted the value of oil for FY2015 to be about \$105/barrel, minus \$20 for the mid-stream and \$46 for the deductible lease expenditures; that ends up being worth \$49 at the well head on the North Slope (slide 4).

[3:38:41 PM](#)

MR. TSAFOS said the price of gas isn't quite as clear as the price of oil; it's less transparent, because you can't really pick up the Wall Street Journal to see what the LNG price is. It's not consistent and it is variable by destination and

contract. He explained the same project could be selling gas to five different people at five very different prices. The price of gas is likely to be linked to oil and likely to be linked to the Japan Customs Cleared price (JCC) or what is known as the Japanese Crude Cocktail. It's effectively the price that Japan pays for its oil and that trades at a 22 cent discount to ANS. So, for all intents and purposes, if the state sells LNG that is linked to the price of JCC, it is linked to the price of ANS.

Lastly, Mr. Tsafos said, in general, gas trades at a thermal discount to oil. So, a \$100-barrel of oil does not lead one to a \$100-BOE. There are a number of reasons for that, the chief one being, especially in targeting the Asian market, there are still consumers that would switch to oil if LNG were higher (by declining to buy a cargo of LNG because oil is cheaper). So, in some ways, oil places a little bit of a cap on the price of gas.

SENATOR MICCICHE asked for an explanation of BOE.

[3:41:59 PM](#)

MR. TSAFOS explained that BOE means barrel of oil equivalent and it tries to get to the question of how much energy different fuel agents - oil, gas, coal - have. This conversion process tries to turn gas into having the same energy as oil, so in theory a barrel of oil and a BOE should contain the same amount of energy.

He explained that there are two main differences between oil and gas in the midstream, however; gas is more expensive to transport than oil and the tariff is not going to be regulated by FERC. Its price will be very much driven by not just the cost but also how the expected return on the investment is structured.

Slide 7 assumed a FY15 forecast of almost 500,000 barrels of oil (bbl) and about 400,000 BOE at \$100 bbl/\$81 BOE; the midstream is \$10 bbl/\$66 BOE.

[3:45:07 PM](#)

Upstream oil is about \$6 and about \$9 BOE at the wellhead. So, if you're trying to tax at the wellhead, you're kind of ignoring the largest part of the BOE, which is midstream. Slide 8 indicated how a drop in ANS at \$90 can wipe out that \$9 BOE, and at that point you basically have no value up on the North Slope to tax. In a different way, slide 9 hiked the costs or tariffs, not an extreme assumption, but that still ends up as zero.

Slide 10 brought it all together and allowed conclusions to be formulated. The big picture is you want to get a fair value for your gas, but how the midstream is structured is a huge driver: envision the litigation surrounding \$10/barrel midstream and then what it would be for \$66/BOE midstream! Upstream is important but in the grand scheme of things it really pales compared to the midstream; 35 percent of 384,000 annual production at \$81/BOE would result in a state take of \$370 million, not a very big number.

3:49:03 PM

MR. MAYER showed an analysis of \$80 BOE with \$10 (roughly what one might expect as a sale price into Asia in a \$100 ANS West Coast world) attempting to illustrate that returns to the upstream, royalty, and production tax vary wildly if those are the principle sources of revenue for Alaska. He said one can see the potential benefits from equity participation and taking RIK, but that gives a lot of exposure to local gas prices. Basically, whatever the state does, it is exposed to risk from quantity prices and royalty, and taking RIV actually poses the greatest price risk to the state, because of its amplifying mechanism. The reason being the construct of the fixed tariff, which in the oil world is a very small portion of the overall BOE, but it is such a large portion in the LNG world that it's like the state guaranteeing a particular rate of return and taking a share of what is left over. If that fixed portion takes up the vast majority of the BOE, what is left varies wildly with very small changes in prices. So, a 10 percent drop in price can mean the difference between still substantial revenue and tax take versus none at all.

3:52:53 PM

SENATOR FRENCH said the RIV should be fixed at the state's royalty rate of 12.5 percent, so he was assuming the blue box would be steady all the way down, but instead it was shrinking.

MR. MAYER said the point is that it's not 12 percent of \$100 or \$110 in value; it's 12 percent of \$110 minus the tariff. That is the reason in talking about alignment that the tariff becomes critical. Small changes in capital structure and rates of return that set that tariff can suddenly take away the vast amounts of the share of value for the state. Price movements can also erode the value to the state entirely. The counterintuitive point is that in lots of ways gas, both RIK and tax in kind, with a corresponding equity share offers more rather than less downside protection for the state, and the state in this environment actually takes a little less on the upside. There is potential

upside to the state in a high price environment from the RIV but more downside as well.

He said his analysis, unlike the previous analysis, was of actual results from Enalytica's model of an AKLNG project over a 30-year timeframe, but using general terms like low, mid, and high prices rather than specific price points. It shows a world in which the state takes (and the HOA sets out) a range of 20 to 25 percent share of gas and a corresponding equity stake throughout the value chain. While some of the assumptions need to be refined, the questions are the same: at relative price movements where value to the state is at high and low prices. The analysis showed that the return to the state was greatest for taking RIK when prices are low but that in return the state gave up a little when the prices were high.

[3:57:39 PM](#)

SENATOR FRENCH asked why the crossover point was at a different price for the producers than it was for the state. He thought it would be a mirror image.

MR. MAYER said there are more variables at play than just what the state and producers receive: the other stakeholders - like the federal government and the debt holders in the project.

SENATOR FRENCH asked if TransCanada performs identically to the state in this scenario.

MR. MAYER answered not necessarily, but this analysis didn't detail TransCanada's participation; further, he said that involving a separate third-party midstream player for any of the state's share inherently brings some fixed tariff component back into the equation - not the full \$66, just the tariff on the liquefaction and the pipeline, and if the state were to exercise its 40 percent option the level under which it would be subject to that fixed obligation would be reduced further.

MR. TSAFOS added another reason it is not identical is because the state's share includes parts of the chain that TransCanada is not a partner in: the LNG facility and the upstream. The whole idea in slide 11 was that RIV makes the upstream the sole price absorber and the fixed nature of tariff in "in value" amplifies the impact of price movement on state returns.

[4:00:39 PM](#)

MR. MAYER said for this analysis he had both parties sell their LNG for the same price, to help people understand what a change

in either direction would do for either party - all other things being equal and RIK participation versus RIV. The state is more insulated from price movements taking less of the downside with less upside exposure and the producers, counter to that, have greater price exposure through RIK than RIV. The federal government also has more exposure to price changes in the RIV world. By participating in the project the State of Alaska becomes a non-taxpaying entity, as long as everything is structured properly (if it owes any state taxes it owes them to itself and can discount them) with the exclusion of property tax which they had factored in as a state obligation.

So the project has two components: a producer component and a state component. The producer component with revenues from the sale of LNG, costs associated with building the upstream and different midstream components, tax obligations, and then netting all those out, an after-tax cash flow. The other component, Alaska, has the revenues, the same cost components or at least a 25 percent share of them (except for the upstream cost), and no tax obligations. That means the state is better off in low price environments and as the non-taxpaying entity that means the federal government is worse off.

[4:03:38 PM](#)

MR. MAYER pointed out that just because the state has a 25 percent share in a project doesn't mean that it gets 25 percent of the overall value (slide 13). In most circumstances the state is actually taking substantially more than 25 percent and there are a couple of reasons for that, which come back to federal government take: while the state foots 25 percent of the bill for the midstream components it doesn't foot any of the bills for the upstream and it's also a tax exempt player in this project. So the portion of value it gets out of its 25 percent share is very different than the portion of the value that the other 75 percent get from their taxed portion.

Finally, there is an even bigger difference with a substantially different cost of capital for the state than what the producers have. He ran his analysis using the same amount for cost of capital for both just to show the difference federal take makes to state value. Property tax is a fixed amount based not on revenues but on the capital value of the physical infrastructure that producers have built up and that takes up an ever larger portion of the total pie that the state is not paying. So, the state takes more and more of the net present value of the cash flows at low price environments and at times that share is quite

substantial, sometimes a majority of the value the project creates.

[4:08:18 PM](#)

SENATOR BISHOP asked because of the state's tax exempt status from the feds if its' 25 percent participation was more valuable.

MR. MAYER answered being tax exempt was the primary driver, but not sharing the upstream costs was another big factor.

SENATOR BISHOP asked if another company had to be formed under AGDC to get that advantage.

MR. MAYER said that was his understanding of the administration's rationale.

[4:09:23 PM](#)

MR. MAYER summarized that the state gets a greater share relatively speaking in lower price environments (because less is going to the federal government) and more that 25 percent at almost any price range.

[4:10:28 PM](#)

MR. TSAFOS turned to slide 14 and said the path laid out by the HOA fosters the state and oil companies caring about two similar things: the price of the commodity and making sure it gets produced at the lowest possible cost.

He underscored that just because gas is indexed to oil doesn't mean it's the same price. That indexation to oil merely defines a relationship between two commodities, but the price can be very different in different contracts. Evidence for this was on slide 15 that graphed Taiwan's three long term suppliers: Indonesia, Malaysia, and Qatar - all three with prices linked to oil. Taiwan has two contracts with Indonesia, one signed in the late 1980s and the other signed in the mid-1990s. The high slope of the two contracts ran in tandem and indicated that a \$10-20 increase in the price of oil generates a pretty significant increase in the price of gas.

The Qatar contract was signed in 2005 at a time when the buyers had the bargaining power. That relationship, even though it was still linked to oil, was very different. So, even though the LNG prices were linked to oil, the contracts were signed at different times in different markets. So the price of LNG to Taiwan, for Indonesia was about \$20, for Qatar \$7 or \$8, and for

Malaysia \$6 or \$7. But in 2008 when oil was at \$100 and they were paying the Indonesians \$19 and \$20, Qatar got its deal revised.

MR. TSAFOS said the lessons to learn are: first, don't obsess over the link to oil and, second, that new contracts don't impact existing deals. The reality is that most long-term deals will probably be wrong and all contracts have provisions to revisit things; the state's lawyers should have a strong review clause in any contracts they write. The standard practice is to have a price review every 4 or 5 years and once outside of that cycle if things get out of hand. A contract with too much flexibility won't be worth anything and a contract that is too rigid is likely to be taken over by events, he advised.

[4:17:04 PM](#)

SENATOR MICCICHE asked what could trigger a review clause and mentioned a scenario where LNG goes from \$7.50 to \$16 and shipping goes up as well and asked if the trigger could be caused by the price alone or the cost across the supply chain.

MR. TSAFOS responded that a price review is usually exercised for two reasons: the first is volatility protection and the second is the distribution of value between different participants. He turned to slide 15 to explain volatility protection: the idea being a shaky project can find commercial ways to protect itself. The most typical is an S-curve. If you don't have an S-curve you're like Indonesia: the price of oil goes up and the price of gas goes up. The S-curve says I am concerned that the price of oil may go down and I might not make a good return on my investment, so I would like to slow down how that relationship plays out as prices go down. I want some insurance; and I want to make sure I earn \$12 no matter what. You can probably sign a contract like that as long as you are willing to give up on the upside.

He said these contracts were not written to survive for the long term and assume that at times the world will no longer fundamentally represent what is in them and allow for making fundamental price reviews. For instance, if you were to sign a contract today and oil went up to \$110 you couldn't raise your hand and call for a price review, because that would be unreasonable. However if it went up to \$250, you could. A big part of price review is triggered by these clauses.

MR. TSAFOS said a second cause for price review is triggered by the distribution of value between different participants (slide

16). For instance, Equatorial Guinea when it was developing its project thought its LNG was shipping from its port to the United States, so it wanted a netback relative to the U.S. And just like everyone else who got the U.S., wrong they did. So, when the U.S. price tanked their sales prices tanked, too. That LNG was then taken by someone else at the port, put on their ships, and sold to Japan for \$17. So, it leaves the port at \$2 and ends up at \$17. When that happens the company can say the world has changed because they thought it was going to the U.S. When the company, BG, did that, the sovereign was very unhappy, because they were taxing the LNG at 2 percent. And now the company, BG, is making voluntary payments to the government of Equatorial Guinea; the point being you can upset governments only so much.

He said this had also happened in Trinidad: they had a deal where they thought they weren't sharing the upside so they fought to change the terms. Yemen just recently concluded deals to basically strike out S-curves, because they signed contracts in 2006/7 that assumed a much lower oil price world.

More often it's the sovereigns who try to restructure, because if you are an oil company, you actually buy the gas from Yemen at \$5 and sell it to Korea for \$20: they care about the \$20 but only get taxed on the \$5, and that's what creates tension. So it does not matter to the oil company where along the chain that value is distributed. The bottom line for what the state should really care about when there is a gas deal in front of it is its exposure to risk and if there are ways to protect the downside, and usually that can be done by foregoing some of the upside.

The other thing critical to price is that timing matters. If the buyers have the power, you won't get as good of a deal as when the sellers have the power. And while this is pretty self-evident, the reason he underscored was because you get tied to that relationship. So, Qatar is still living in the bargaining power of 2005 not the bargaining power of 2014.

[4:25:12 PM](#)

MR. TSAFOS said investors care about the price and the costs, and the costs are what are essentially affected by what could go wrong. In the current scenario the state is on the hook for 25 percent of the liquefaction and for a share of the 25 percent of the midstream, potentially, depending on how the TransCanada deal works through the GTP and the pipeline.

He showed some large complicated projects showing what kind of cost escalation had happened to other projects (slide 16).

Sometimes they come on line on time and under budget, but they usually don't. Some of the costs are global: the price of steel going up and not much can be done about that: some are country specific: in Australia a good living can be made working on these projects, so when the competition for labor is so intense because there is a once-in-a-generation commodity boom there, the only way to secure labor is to pay up. The last category that could cause costs to go up is very specific project issues: an accident, a fire, strikes, the pipeline route, and other things that can just go wrong. It's not a shock to have a 10 to 20 percent cost overrun, he said, and the slide showed a range of projects with cost overruns ranging from 0 percent to 120 percent.

[4:29:23 PM](#)

SENATOR MICCICHE asked if a project delay can be beneficial in terms of commodity price and value.

MR. TSAFOS answered that he could think of project delays where the damage was less than expected but not what could be called beneficial. Tying up capital does not make sense. During the economic depression of 2008/9 demand cratered and at that time there were projects going at 100 percent but they slowed down, because there was no reason to pay people overtime to complete a project to sell a commodity that no one was dying to get. Things like that on the margin can make a difference, but, again, so much capital is tied up in spending \$40 billion you really want the money to start coming in.

MR. MAYER answered that question this way: there is a big difference between the delays they are talking about here in the FEED process, and the ones that really count, which are those that happen post-FID. Many projects have delays for one reason or another in terms of the process, but at the point of FID the deals have been done and that is when the real money is getting spent. Delays after that point add up every year in terms of tens of billions of dollars in NPV lost along with no revenue coming in.

[4:32:50 PM](#)

SENATOR MICCICHE asked if he was saying that after the contracts have been executed after FID that every moment not selling gas is a delay and a hit to the bottom line, essentially.

MR. MAYER responded that maybe the contracts have been executed and include a requirement to have gas to sell, in which case that hurts; but if market conditions improve post-FID, there is

no benefit, because the state will not be signing new contracts at a better oil price slope, and it would get the downside of another year's delay and another year's interest on tens of billions of dollars with no revenue coming in.

MR. TSAFOS said the revenue might even become negative, because the state might be obligated to find something to sell if the project is not on line. For example, Indonesia had a low S-curve structure and, in fact, one of the operators was shipping gas from Egypt that was previously fetching \$17-18 for \$3-4 because they had to meet some commitments. Things like that could drive the value of the delay; it generally tends to be bad in different degrees of seriousness.

[4:34:36 PM](#)

SENATOR BISHOP observed that there were four projects in the billion-dollar range came in on budget and with no cost overruns, but then four other projects in the \$37-60 billion range had overruns of 15.6 percent to 45 percent. That underscored that value equals getting the highest price possible along with the lowest cost of construction possible, because they want to get gas back to Alaskans at the cheapest molecule price at the burner tip.

SENATOR FRENCH asked MR. Tsafos to talk about the risk to the state of having only one project to sell at one time. How can Alaska best protect itself against the fact that it is just going - in one 12-month window - to the market to establish long term contracts for all of the gas going through the pipeline for a 20-year period.

[4:36:26 PM](#)

MR. TSAFOS said first - big picture - everyone will know what kind of deal it is getting at the FID and if they are fairly similar between the players, but if the market is timed wrongly, the project won't get built. Less than 10 percent of the total cost is spent before the FID in terms of the administration's time table.

However, he said, there are other things to consider. One is that selling the gas from a project of this type is a multi-year affair (2-3 years). More important to appreciate is that Alaska has one asset but it is targeting a marketing window that no one else is targeting - no one is cutting LNG deals for 2022 or longer. Because it is taking so long for this project to get going, the window is different and the state might benefit from the fact that it is tapping into a need for some companies that

are thinking strategically long-term that other players aren't necessarily responding to. Before coming to Juneau he had conversations with some of his Japanese colleagues who are getting very excited about Alaska, because they are thinking it is the next tranche after the Lower 48, after east Africa and western Canada, and that could be quite beneficial.

Lastly, he said there is a possibility for Alaska to sign up the gas in several blocks rather than one big one. There are three trains and they usually come on line maybe six months between one another and Alaska may still have some gas to play around with. The bottom line is if the state is marketing gas and the responses from the buyers are not good, don't worry; the project just won't go forward and the sizeable money won't be spent. That's typically what happens in LNG projects.

4:41:28 PM

SENATOR MICCICHE said his understanding was that you don't necessarily have less risk because you have more projects. It's not like Australia averages its risks and the huge cost overruns were largely because of the amount of projects in a short time and their associated labor cost overruns.

MR. TSAFOS answered he was right; but some of the risk also had to do with the exchange rate between the Australian and the U.S. dollar. Because of the commodity boom, international companies earn U.S. dollars, but they buy Australian dollars to pay labor. Alaska may not have the same types of cost overruns. The AKLNG project is estimated to cost \$45-65 billion and the \$65 billion is the overrun. That is how companies are presenting their projects now: as a range.

SENATOR MICCICHE asked if the AKLNG project's royalty production tax model was more advantageous than Australia's individual contractual model.

MR. MAYER answered that there are a number of ways to set up appropriate fiscal arrangements and Australia's is similar in some ways to Alaska's. The Australian system is a profit based tax as is Alaska's: for offshore projects there's no royalty; for onshore projects there is a royalty but it is credited back by the federal government. Contractual arrangements apply to LNG projects in places like Qatar and Indonesia. But one thing really stands about Alaska that is not present in a lot of other projects, which is the sheer size of the midstream compared to the upstream component. They talked about Gorgon being similar - with a very big difficult costly upstream deep water development

being a big portion of the value, along with the pipeline and a liquefaction project, whereas he couldn't think of any other LNG projects in the \$45-60 billion ranger where almost all of that is in the midstream. In that sense, a tax regime that is focused entirely on the upstream with value netted back to the upstream is less likely to be of benefit to the state than something, however it's structured, that focuses on getting value throughout the chain.

SENATOR MCGUIRE said having alignment in the equity share is the best way to go forward. She also appreciated Senator French's question as to what happens if no one shows up and the fact that the market takes care of those things. For her the last area of risk for the state was in the midstream and not wanting to lock into something like it did in AGIA (paying forward by \$300 million) that seemed out of alignment with basic economics. She wanted to be able to extricate in a place that isn't in alignment with fair business and market principles. She said she likes this bill, because it does make sense, and she likes TransCanada as a partner, but they need to scrutinize the midstream.

SENATOR GIESSEL said she had asked the administration to clarify where those off ramps are and what they will cost.

CHAIR GIESSEL thanked the presenters and asked the committee members to submit amendments by Tuesday at 9 a.m.

SENATOR FRENCH said they hadn't even heard the entire bill yet and wanted another day.

CHAIR GIESSEL said she would take that under consideration. [SB 138 was held in committee.]

#### **SJR 5-OFFSHORE OIL & GAS REVENUE**

[4:49:59 PM](#)

CHAIR GIESSEL announced that the next order of business would be SJR 5.

[4:50:40 PM](#)

MICHELLE SYDEMAN, staff to Senator Bill Wielechowski, sponsor of SJR 5, presented it on behalf of the sponsor. She said everyone is aware of the vast oil and gas potential in the federal waters off our coasts (OCS) - more than a billion acres on more than 6,000 miles of coastline. This area is believed to contain the largest undiscovered energy resources in the United States,

estimated to be 25 billion barrels of oil and 132 tcf/natural gas; more than the current estimates for the Atlantic and Pacific regions of the OCS combined. The potential for development is obviously enormous as is the potential benefit to the U.S. Treasury.

A University of Alaska study found that energy production off Alaska could generate 35,000 jobs on average annually over a 50 year period; the total payroll an estimated \$80 billion. Since statehood, the federal government has held numerous lease sales off our coasts and collected more than \$8 billion for them. Unfortunately, Alaska has received little revenue in contrast to what happens when the federal government leases within the state's boundaries, in which case the host state receives 50 percent of the revenue - to compensate for any impacts they may bear as a result of that development. This is an automatic process that occurs off-budget at the federal level. The same should hold true for offshore development where costs and risks are often much greater.

MS. SYDEMAN said in 2006, the federal government recognized the inequity and gave four states a 37.5 percent share of revenues generated from offshore development; that did not include Alaska. It did include Mississippi, Louisiana, Texas, and Alabama, and it makes to no sense for us to be left out of that sort of arrangement.

She said fortunately the stars are coming closer in alignment in Washington, D.C. The Senate Energy and Natural Resources Committee is being by Senator Mary Landrieu, who has been a huge advocate of OCS revenue sharing. She has joined forces with Senator Lisa Murkowski and introduced a bill called Fixing America's Inequities with Review Act (FAIR). The White House is opposing this act and the primary reason is the cost and concern over the federal deficit. Senator Murkowski said this was short sighted because revenue sharing will enable the states to support offshore development by investing in roads, ports, and other necessary facilities, and to invest in the infrastructure that will enable that development to be safe and environmentally responsible. More off shore development will lead to greater revenues for the federal government.

[4:55:22 PM](#)

MS. SYDEMAN said they had developed a committee substitute (CS) after consulting with Mr. Adrian Herrera oh Arctic Power who walked them through the White House's main concerns and those were addressed in the CS. He advised that action very soon would

be helpful because Senator Landrieu would be pushing this in the near term; and having a resolution sponsored by a Democratic member of the state legislature would be helpful, because they were trying to convince a Democratic administration.

SENATOR GIESSEL opened public testimony.

4:57:03 PM

ADRIAN HERRERA, Coordinator, Arctic Power, Anchorage, Alaska, testified in support of SJR 5. He said their sole purpose is to argue for the environmentally responsible development of the federal lands in the Alaska Arctic, both on and offshore. He cautioned that the resolution must address the White House's specific concerns as laid out by the Congressional Budget Office Secretary during the hearings for the FAIR Act last year. Senior members of the committee support the bill and he expects it to move this year. It is also supported by Senator Begich who has a similar bill on revenue sharing but it is region specific.

He said the FAIR Act had one hearing last year in July and will need another one. They have not come up with \$6 billion, which the Congressional Budget Office warns the bill asks to pay, but it is spread over ten years. The White House's argument has to do with the reduction of funds going to the national Treasury. The President wants to use offshore revenues to fund the Land Water Conservation Fund (LWCF) nationwide and other environmental projects. But there is no intent to take a penny away from LWCF; so for SCR 5 to succeed, it has to address this concern.

5:00:30 PM

He opined that both sides can be aligned, but it's a case of the state providing a rebuttal to the White House's arguments against this to say we understand your concerns, but you can fund LWCF and arrange the funding to states so that environmental projects are mitigated. He explained that the 37.5 percent is made up of two sectors: 27.5 percent goes to the state and then the state would have to apply to the Treasury for an additional 10 percent, which could only be spent on alternative energy development or environmental mitigation. Until the Treasury was satisfied of the projects submitted for money, it wouldn't award that 10 percent. He said this 10 percent is going for projects that are exactly the same as those in the LWCF and the President's other environmental projects. The new chairwoman has stated that these projects will be much better mitigated on a state level than by the Treasury of Department of Interior on a national level, since states are

much more efficient at environmental mitigation and spending money appropriately with regard to OCS development.

[5:02:30 PM](#)

SENATOR GIESSEL, finding no questions, thanked him for his testimony and closed public testimony.

SENATOR GIESSEL thanked Ms. Sydeman for updating them on this legislation and said she was considering some amendments; therefore, SJR 5 would be held in committee.

SENATOR MCGUIRE expressed her frustration about how Alaska is viewed by the federal government and she would love to see a few more whereases about what has been done in the state already to relocating villages to prevent coastal erosion, funding the Arctic University in Fairbanks, helping look at affordable housing in villages, and looking at funding for deep water ports. It's important to educate the federal government about what the state is doing with these funds and what it is already doing. For 20 years they had been asking for a Polar-class ice breaker and haven't gotten one and they had been asking for help developing the Arctic. Alaska has dug into its own coffers to do this and it would be nice to have some additional revenue sharing the way other Gulf Coast states have.

She said \$250 billion in infrastructure needs had been identified for the people of Alaska; it comes down to the potential for oil spills occurring in the Bering Sea that has fed the earth almost a billion tons of Pollock.

SENATOR GIESSEL said those were excellent comments. [SJR 5 was held in committee.]

[5:06:20 PM](#)

There being no further business to come before the committee, Chair Giessel adjourned the Senate Resources Standing Committee at 5:06 p.m.