

HOUSE FINANCE COMMITTEE
February 23, 2016
1:34 p.m.

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CALL TO ORDER

Co-Chair Neuman called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair
Representative Steve Thompson, Co-Chair
Representative Dan Saddler, Vice-Chair
Representative Bryce Edgmon
Representative Les Gara
Representative Lynn Gattis
Representative David Guttenberg
Representative Scott Kawasaki
Representative Cathy Munoz
Representative Lance Pruitt
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Marty Rutherford, Deputy Commissioner, Department of Natural Resources; James Cantor, Deputy Attorney General, Civil Division, Department of Law; Representative Mike Chenault; Representative Dan Ortiz; Representative Chris Tuck; Representative Jonathan Kreiss-Tompkins; Representative Louise Stutes.

PRESENT VIA TELECONFERENCE

Martin Schultz, Attorney VI, Civil Division, Oil, Gas, and Mining Section, Department of Law.

SUMMARY

AKLNG UPDATE: FUNDS EXPENDED and FY 17 FUNDING REQUESTS

Co-Chair Neuman discussed the meeting agenda.

^AKLNG UPDATE: FUNDS EXPENDED and FY 17 FUNDING REQUESTS

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MARTY RUTHERFORD, DEPUTY COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, provided a PowerPoint presentation titled "DNR AKLNG Budget Overview FY2015 - FY2017" dated February 23, 2016 (copy on file). She scrolled to the state gas team organizational chart on slide 2 titled "State Gas Team." She turned to Slide 3 that listed the roles of the various agencies in AKLNG.

Co-Chair Neuman asked Ms. Rutherford to provide a brief description of the agency roles in the project.

Ms. Rutherford provided the information on slide 3:

Agency Roles in AKLNG

Department of Natural Resources (DNR) - North Slope Gas Commercialization Office (NSG)

- Upstream [AS 38.05.180(hh), (ii)], in consult with DOR [AS 38.05.020(b)(10),(11),(12)]
- Royalty In-Kind/Royalty In-Value decision (AS 38.05.182)
- Marketing, in consult with DOR [AS 38.05.020(b)(10),(11),(12)]
- In-state Gas coordination, in consult with AGDC (SB 138, Section 73)
- Midstream Agreements, in consult with AGDC [AS 38.05.020(b)(13)]

Department of Revenue (DOR)

- Identify and recommend financing options (SB 138, Section 76)
- Recommend statutory changes to property taxes under AS 43.56 and AS 29.45.080 (SB 138, Section 74)
- Develop Impact Fees and Flow Rated Property Tax Proposals (SB 138, Section 74, AO 269 MAGPR Board)

- Allows producers to pay tax as gas (TAG) (AS 43.55.014)
- Consult with DNR on contracts negotiation [AS 43.05.010(16)]

Department of Law (DOL)

- Legal support to agencies and AGDC

Alaska Gasline Development Corporation (AGDC)

- State's ownership of project infrastructure (AS 31.25.080)
- Assist DNR/DOR in maximizing the value of the State's gas [AS 31.25.005(3)]
- Provide project services to the State at cost (i.e. without profit) [AS 31.25.005(5)]
- Deliver domestic gas to in-state customers at commercially reasonable rates [31.25.005(6)]

Ms. Rutherford elaborated on the slide. She related that DNR was primarily involved with the commercial negotiations and established a structure for interaction between the project's entities. The department was negotiating the upstream issues such as the field cost allowance, gas balancing and supply, the terms of gas availability for the domestic market, the mid-stream agreements, the expandability of the project, and the terms for third party involvement. She added that the department developed the gas marketing structure when the project was operational. She spoke to DOR's role in determining the value of the "royalty-in-kind" option that would offer the producers the opportunity to pay its production taxes to the state as gas. She detailed that in-kind payments would account for the royalties and production tax for the 25 percent equity ownership with the equivalent throughput of gas. The department would determine the project's financing structure; i.e., how the state would pay for its 25 percent equity ownership. In addition, the municipalities' impact fees and flow rated property tax proposals that would be paid by the projects would be established by DOR. She continued that the Department of Law (DOL) provided legal support to agencies and the Alaska Gasline Development Corporation (AGDC). She described the project's infrastructure that included two pipelines from Prudhoe Bay and Point Thompson units, which connected into the gas

treatment plant, the pipeline to Nikiski, the LNG (liquefied natural gas) plant and the marine terminal. She noted that AGDC was responsible for delivering gas to domestic markets and would work with utility companies and municipalities on gas delivery systems. She shared that AGDC recently formed a subsidiary to help aggregate supply and act as an intermediary on pricing between the domestic purchasers and producers.

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Co-Chair Neuman referred to Ms. Rutherford's testimony that part of AGDC's job was to deliver domestic gas to in-state customers and the possible changes to the structure of AKLNG development team. He asked whether the work to provide gas to local communities would continue. Ms. Rutherford replied in the affirmative. She expounded that AGDC regarded the task as one of its highest priority. The corporation worked with the project, municipalities and utilities to determine demand, the types of delivery systems necessary, and to present a plan to the legislature to help assist with domestic gas delivery. She moved to slide 4, titled, "North Slope Gas Commercialization (NSGC) AKLNG Team" that contained the team's organizational chart. She noted that the DNR commissioner, Mark Meyers and herself in the role of deputy commissioner were leading the team and providing oversight. She related that the next level depicted the core team that worked with consultants, experts, DOL, outside counsel, and other state agencies to negotiate the commercial agreements for the project. The agreements provided the structure for engagement in the project.

Representative Gara remarked that everyone wanted an in-state line to deliver gas locally; it was not a negotiable point for most legislators. He asked about cost savings. He spoke to the need for a buyer of the gas. He wondered whether "it made sense" to wait to develop offtake portions of the pipe until the project was certain and save \$5 million. He wondered whether waiting would adversely impact delivering gas domestically. Ms. Rutherford could not speak "definitively" to the \$5 million. However, she believed some degree of work that identified offtakes and potential volumes needed to proceed commensurate with the wrap up of the pre-FEED [Front End Engineering and Design] stage. She shared that the FEED decisions were currently "at risk" due to the low price environment. She ultimately thought that

the design work embedded in the pre-FEED stage included the delivery of the domestic gas supply. Representative Gara requested further information regarding the amount of in-state work that could be delayed without adversely impacting the ability to deliver the gas domestically. Ms. Rutherford replied that she would follow up with the information.

Co-Chair Neuman believed that the in-state offtake information was necessary to determine the costs to proceed to the FEED stage. He understood that the development team comprised of all four partners scrutinized every dollar that was spent because the costs were equally shared.

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Ms. Rutherford responded that the project was working very hard to keep cost down during pre-FEED and lower the costs of the project. She had heard the project representative speak to the need for the data associated with domestic demand in order to build it into the project design and for the resource reports required by the Federal Energy Regulatory Commission (FERC). She furthered that domestic gas supply and the degree the region's populace benefitted from the project was a critical aspect of FERC's evaluation of the project.

Representative Wilson asked how many of the individuals named on the chart were DNR employees before the project began (slide 4). Ms. Rutherford answered that most of the positions were in place when she returned to work for DNR in December, 2014. She mentioned that the North Slope Gas Commercial Lead, Anthony Scott was recently rehired by the department. Representative Wilson wondered why contractors were not being used instead of hiring employees within the department. Ms. Rutherford replied that the chart included a combination of the two. For example, Steve Wright, North Slope Gas Upstream Lead, was a contractor and was denoted on the chart in blue. She was not part of the decision regarding personnel status. She voiced that most of the team could operate under contract because the positions were not necessary beyond the final investment decision (FID). Representative Wilson asked whether the two vacant positions remaining on the team would be filled via contract. Ms. Rutherford replied that the positions were not currently necessary and she had no intention of filling them. She located a contractor to assist the department in

negotiations over the marketing structure and was considering contracting for the service.

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Ms. Rutherford turned to slide 5 titled "FY2015 NSGC Budget." She noted the chart depicted the FY 2015 budget for gas commercialization. She cited the \$10 million authorized by the legislature and reported that \$8 million was spent primarily on contractual services and that \$2 million was lapsed. Co-Chair Neuman asked what work was accomplished listed as services. Ms. Rutherford highlighted slide 6 titled, "FY 2015 Expenditure Details Personal Services & Travel" for the answer. She indicated that the chart identified the seven positions plus the deputy commissioner, and the two long-term non-permanent positions that were funded since the 2015 authorization. She listed the long-term non-permanent (LTNP) Gasline Liaison and the LTNP Permitting Liaison positions. She noted that the permitting liaison preceded the current structure that separated the permitting liaison specifically for AKLNG and was funded through the project. In addition, the previous deputy commissioner Bob Swenson, Deputy Commissioner, Department of Natural Resources billed a portion of his time to the AKLNG project. She reported that \$57.1 million [thousand] was spent in travel mostly to project meetings in Calgary and Houston.

Representative Gattis asked whether the amount was \$57 million or \$57 thousand. Ms. Rutherford corrected that the amount was \$57 thousand for travel. She elaborated that slide 7 titled "FY 2015 Expenditure Details Contractual Services & Commodities" addressed the contractual services implemented in FY 15 and that many of the contracts currently remained in operation. She relayed the following on the slide:

Services:

Black & Veatch for support, advice, analysis, and expertise in commercial negotiations, strategy, modeling, FERC and resource report drafting and review, and marketing. \$1,505.3

Pingo International, Pat Anderson for expertise in arctic pipeline engineering and design to support midstream activities. \$ 156.2

RyderScott for resource evaluation and reservoir engineering support for the upstream team. \$ 96.1

Steve Wright for expertise in project management and support in upstream activities. \$ 299.0

Audie Setters for expertise in marketing and lead marketing negotiations and activities. \$ 374.0

Breaux Leadership for risk management facilitation and risk analysis work. \$ 32.5

Petrotechnical Resources of Alaska (PRA), Ben Ball support for the upstream team with facilities engineering expertise. \$ 29.8

Steve Swaffield for commercial and governance support and expertise. \$ 229.4

RSA to UAF - Antony Scott for commercial support in commercial agreement negotiations. \$ 79.7

I/A RSA to DOL for Legal Support. \$ 3,500.0

Core Services (IT, HR, leases, software, telecommunications, etc.) \$ 60.8

Other services \$ 863.1

Training and conferences -two day workshops relating to risk management and risk analysis for the state gas team with Breaux Leadership prior to determining the need for a contract. \$9.8

Total: \$ 7,235.7

Commodities:

Office equipment, furniture \$ 28.7

IT Equipment (computers, conference room equipment, phones, etc.) \$ 19.2

Office supplies, oil and gas regulations, statute books, subscriptions \$6.8

Ms. Rutherford noted that commodities totaled \$54.7 thousand.

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Ms. Rutherford addressed slide 8 titled "FY2016 NSGC Budget All Funds." She reported that the slide contained two charts: one depicted the regular session budget and the other contained the Special Session funding. The regular session budget authorization in FY 16 was \$8.9 million of which \$8.7 was spent or obligated leaving and estimated lapsing balance of \$256 thousand. The department was appropriated an additional \$1.8 million during special session and was currently at a projected expenditure level of \$1.5 million and expected to lapse approximately \$200 thousand.

Representative Pruitt relayed that DNR originally requested \$13 million for FY 16. He wondered what had been done differently by the department to make the lesser authorization of approximately \$9 million work. Ms. Rutherford replied that the \$13 million was based primarily on how DNR had dealt with some of the marketing contracts. She delineated that the contracts had not progressed as quickly as expected and she ended up not filling via contract or department employee any of the marketing positions. Representative Pruitt surmised that the contracts had not moved forward due to lack of progression to an expected level and not due to decisions relating to how to move marketing forward. Ms. Rutherford replied in the affirmative. She commented that "the analysis associated with marketing was difficult" and made it a complicated issue. In addition, the positions of the various partners "morphed" overtime. She indicated that the department continued to determine how the issue of marketing and upstream gas supply was best integrated.

Vice-Chair Saddler asked whether the contract work provided by Audie Setters retained value. Ms. Rutherford replied that the project had not progressed enough to definitively know what work to date contained future value. However, Mr. Setters brought knowledge that produced great value in understanding certain issues but no tangible product resulted.

Vice-Chair Saddler asked whether the contract cost was worth the \$374 thousand spent. Ms. Rutherford replied that

the contract had preceded her. She was not convinced that the type of expertise was applicable at the time, which dealt with government handling of upstream issues and was not related to working interest owners. She reported that DNR was attempting to ensure that future contractors held "first chair" and understood the role of government without the upstream interest of a working interest owner and how marketing structures would assist or undermine its position. Vice-Chair Saddler asked what "first chair" meant. Ms. Rutherford replied that first chair was the primary negotiator.

Representative Gara voiced that given the current oil and gas prices the "gasline was in trouble." He stated that if there was an "insatiable demand for natural gas" the state might slow the project down and wait for prices to rise and without demand the state "risked having the last good contract" taken by a competitor and get "locked out of the market." He wondered how the issue he described was analyzed.

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Ms. Rutherford answered that all of the forecasts on the Asian market predicted that between 2023 and 2026 many of the existing contracts were up for renewal and in some cases the supply was exhausted. She remarked that the growth in LNG demand was "fairly flat" over the next ten years. She voiced that attempting to respond to the market window was a critical issue for the state and the partners. The low price environment was difficult and capital was harder to commit to projects. She emphasized that the partners were discussing ways to move the project forward and maintain the progress towards FEED. She thought that a delay in FEED would not necessarily delay the investment decision.

Representative Kawasaki asked whether she believed it was important to retain the budget request for marketers in FY 17. Ms. Rutherford replied that the department had already cut back on the marketing request for FY 17. She reiterated that the commercial negotiations had not moved as expeditiously as the administration had wished. She explained that initially the department had proposed a "worst case scenario market structure" where the state had to maintain three joint venture markets. Lead Marketers were very costly. She indicated she cut back from three to

one lead marketing positions. She deduced that given the rate of negotiations the lead marketer was not necessary until late FY 17. She offered that the marketing expense could be included in a supplemental budget. She pointed out that it was necessary to have the marketing structure in place by FEED. Representative Kawasaki asked whether other partners had marketing structures in place or were scaling back due to the current situation with gas prices. Ms. Rutherford replied that each of the partners were already active in the LNG market and had marketing in place. She acknowledged that each company was reducing its operating costs and eliminating positions but not necessarily marketing structures. The partner's marketing expertise was "brought to the table" when discussing the various marketing options for the state.

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Representative Pruitt referred to the "other services" line on slide 7 expending \$864.1 thousand in FY 15. He wondered what the costs were for. Ms. Rutherford answered that the funds were most likely for RSAs (Reimbursable Services Agreement) within the department for additional contracts. The department was working on identifying the expenditures and would provide it to the committee as soon as possible. Representative Pruitt remarked that eventually the project's costs would continue to increase.

Ms. Rutherford addressed slide 9 titled "FY 2016 NSGC Budget One Time Item" and slide 10 "FY 2016 Expenditure Details One Time Item Funding." She noted that there were several vacant positions. The marketing lead was vacant and would not be filled until necessary. She discussed slide 11 titled, "FY 2016 Expenditure Details One Time Item Funding" that listed expenditure details and one-time funding. She offered that the total appropriation was over \$7.6 million and would lapse \$200 thousand. She remarked that the "average spend for DOL" was fairly high and would be addressed by the department. She named the outside legal firms as Greenberg Traurig and Milbank, Tweed, Hadley & McCloy. She relayed the information on Slide 11 as follows:

Services:

- RSA to Law for legal support in negotiation and drafting of commercial agreements \$3,000.0

- RSA to Revenue for services provided by commercial analyst in support of upstream activities \$187.5
- Black & Veatch for support, advice, analysis, and expertise in commercial negotiations, strategy, modeling, FERC and resource report drafting and review, and marketing, estimated spend rate of \$150.0/month \$1,636.7
- Audie Setters Contract - expired Dec 2015, supported the state gas team on marketing negotiations and activities \$214.8
- Petrotechnical Resources of Alaska Contract - expired Dec 2015, supported the upstream team with facilities engineering expertise \$2.8
- Nan Thompson for support in drafting RIK/RIV decision, estimated spend rate of \$20.0/month \$200.0
- Rick Harper for midstream pipeline project support and technical review support, estimated spend rate of \$40.0/month \$331.8
- Greengate LLC, for advice, expertise, analysis and support on financing options and sources of financing, financing structures, finance considerations of commercial negotiations, and property tax support; financing and financial modeling support and analysis, estimated spend rate of [left blank] \$778.0
- Pingo International, Pat Anderson for expertise in arctic pipeline engineering and design to support midstream activities, estimated spend rate of \$57.0/month* \$696.1
- Lummus was subcontracted by Pingo to take a third party look at the current ASAP data from AGDC. Contract is for \$310.0, with 192.5 spent to date.
- Steve Wright for expertise in project management and support in upstream activities, estimated spend rate of \$35.0/month \$334.8
- Gaffney Cline contract \$5.3

- Core Services (IT, HR, leases, software, telecommunications, etc.) \$ 47.7

Total: \$ 7,435.5

Commodities:

Office supplies, IT equipment, etc. \$ 8.5

[Figures included were the projected total spend for FY 2016. The allocated amount and spending to date was also included on the chart.]

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Ms. Rutherford addressed the third special session funding on slide 12 titled "FY 2016 NSGC Budget Third Special Session Funding" and on slide 13 titled "FY 2016 Expenditure Details Third Special Session Funding." She reported that over \$1.8 million was authorized and would lapse approximately \$200 million. She moved to slide 13 and explained that the funding was allocated for two new positions; a marketing lead and a marketing analyst. The department created the PCN's (Position Control Number) but both positions remained vacant until necessary. She mentioned that the contractual services were reiterated from previous slides. The department retained the contracted expertise as much as possible. She reported that the expected unexpended balance was \$70 thousand. She turned to slide 14 titled "FY 2017 NSGC Budget Request" and commented that the amount was roughly \$7 million less than the original request due to the reduction of the two lead marketers and a reduction of positions to 11 from the anticipated need of 21 positions. Included in the 11 positions were: the 7 unfilled positions from FY 15, one position appropriated from special session, and the three new positions included in the FY 17 request.

Co-Chair Neuman referred to a conversation with Ms. Rutherford about ensuring departments had enough funds to advance to FEED. He believed it was critical to demonstrate to the investors and the world that the state was invested in the project. He expected that more information regarding funding required subsequent to FEED would be addressed "further down the road."

Representative Wilson pointed to slide 13. She referred to the expenditures in FY 16 related to marketing contractors and wondered why the items were included based on her testimony regarding the slow progress on marketing contracts. Ms. Rutherford answered that the \$1.6 million total expenditure was associated with the costs of existing contracts. She reminded the committee that DNR did not have a current marketing contractor and had not filled the other marketing positions. Representative Wilson looked at the allocation of \$350 thousand on the fourth line for a marketing contractor and recounted the testimony that DNR had not filled the position. Ms. Rutherford affirmed that DNR did not retain a marketing contractor. She added that DNR would only hire a marketing contractor unless the department was heavily engaged in a marketing structure, however she still expected that would happen during FY 16.

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Representative Wilson surmised that all of the items allocated for marketing may not all be needed and would lapse at the end of FY 16. Ms. Rutherford replied in the affirmative and ensured the department would not spend money unless absolutely necessary. Representative Wilson deduced that the money would lapse and become new money in FY 17. Ms. Rutherford affirmed the statement.

Co-Chair Neuman pointed to slide 11. He looked at an RSA for DOL in support of commercial agreements. He asked whether they were working under her direction or other entities. Ms. Rutherford answered that the outside counsel she previously named and several assistant attorney generals that worked exclusively on AKLNG together worked as part of the "matrix structure in place" as part of the legal team. She provided the example that AGDC led the "governance commercial agreement team" but included members from the legal team, DNR, and DOR. She stated that the legal team's ultimate boss was the attorney general but also worked on a daily basis at the direction of the teams. Co-Chair Neuman relayed that the legislature had concerns regarding the issue and ensured that DNR had the funds to contract for its own outside legal counsel and "work at its own discretion." He interpreted her answer to mean that "99 percent" of the legal work was performed under her direction. Ms. Rutherford replied in the affirmative and offered that "the team effort was well identified and effective under the negotiations." She reported that

directives to outside legal counsel was given in coordination with the assistant attorney generals and that she characterized the matrix as a "cohesive group."

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Representative Pruitt asked what work the state gained from Rick Harper for midstream pipeline project support for \$40 thousand per month. Ms. Rutherford responded that Mr. Harper had much experience with midstream work and gas projects. He held Chief Executive Officer (CEO) positions on various organizations related to natural gas projects and provided support for midstream technical reviews. She offered to provide his resume to the committee. Representative Pruitt asked whether he had worked in Alaska before. Ms. Rutherford replied in the affirmative. She relayed that he had previously been hired by the state for his midstream expertise. Representative Pruitt referred to the Pingo International and Lummus expenditures. He expressed particular concerns with Lummus's granted access to ASAP (Alaska Stand Alone Pipeline) data from AGDC. He asked for an explanation of what Lummus had done and what would be the end result of its work. Ms. Rutherford answered that the administration had hired Lummus subcontracted through Pingo to take a third party look at the current ASAP data from AGDC and determine its value to the state. She reported that the administration added \$310 thousand to Pingo's contract for the Lummus effort and spend \$192 thousand to date.

Ms. Rutherford continued that Lummus reviewed the publically available data. She relayed that Dan Fauske, former president, AGDC, Dave Haugan, Project Manager, AGDC, Marcia Davis, Deputy Chief of Staff, Office of the Governor, and Rigdon Boykin, former gasline consultant, worked with Lummus to provide access to confidential data. The Lummus employees signed confidentiality agreements. She indicated that the contractor would soon release a public report that analyzed the usefulness of the ASAP data for the state.

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Representative Pruitt asked about the other data being publically available. He wondered if the confidential information would eventually be shared. Ms. Rutherford responded that any confidential data contained in the

report was purged from the public report. She directed Lummus to send the confidential data back to AGDC.

Co-Chair Neuman reminded members that there was a one page document in their packet titled, "Questions & Answers Concerning the Lummus/Pingo Contracts" (copy on file) provided by DOR in their backup packets.

Ms. Rutherford added that the committee also had a letter [dated February 10, 2016] to Representative Mike Hawker distributed by AGDC regarding the issue (copy on file) included in their back up packets.

Representative Pruitt asked whether "anything" was analyzed outside the scope of AKLNG or ASAP or "data that could be utilized by the state in any future decisions outside of the two parameters." Ms. Rutherford explained that Lummus was asked to look at the data to determine how useful the information was under four separate scenarios. She mentioned the four versions; ASAP as configured, a buildup of ASAP, a project similar to AKLNG, and a forth version "in-between" the two projects.

Representative Pruitt wondered and why the state would need to look at 4 different scenarios wondered whether it created uncertainty with the state's AKLNG partners. He stated that the action gave the impression that the state was "preparing for a potential failure of the AKLNG project" by analyzing other avenues. Ms. Rutherford did not believe so. The analysis was intended to be a "cold third party review of a state asset." She remarked that "obviously the project the state was committed to" was the larger AKLNG line. She asserted that "the larger the gas project, the lower the tariff structure, the better the economics." The analysis was merely a "data point." She revealed that the report demonstrated that the other scenarios were economically "problematic."

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Co-Chair Neuman asked whether it was the state's intent to remain a 25 percent partner in AKLNG. Ms. Rutherford responded affirmatively.

Representative Wilson asked when in March that the analysis would be ready. Ms. Rutherford explained that she had asked Lummus how quickly the report would be available. She

expected to disseminate the report in the first week of March [2016]. She commented that the delay was caused by a delay in Lummuses access to the confidential materials.

Representative Wilson asked whether the legislature would have to sign confidentiality agreements to access the report or where it could be found publically. Ms. Rutherford answered that she would make the report available on DNR's website and send copies to every legislature.

Ms. Rutherford turned to slide 15 titled, "FY 2017 Budget Request Details Personal Services & Travel." She explained that the chart showed the detail of the FY 17 budget requests. She restated that the two marketing positions would likely be eliminated and would include some requests for contractual services with DOL. She informed the committee that the information regarding personal services on the slide reflected the 11 unfilled positions. She advanced to slide 16 titled, "FY 2017 Budget Request Details Services & Commodities." She relayed the following from the chart on the slide:

- RSA to Law for continued legal support for commercial agreements negotiation and drafting - estimated spend rate of \$1,000.0/month \$ 12,000.0
- RSA to Law for legal support for marketing negotiation and drafting of joint venture marketing agreements with Producers - estimated spend rate of \$400.0/month \$ 5,000.0
- Continued commercial expertise and support for the participation in commercial negotiations such as contracts with Steve Wright and Steve Swaffield \$ 600.0
- Engineering expertise for marine, facilities, etc. As commercial agreements form, the need for expertise in specific aspects of facilities or transportation may be required to assess potential disconnects between the commercial agreements and operations \$ 480.0
- Continued analysis and modeling support, specifically continued contract with Black & Veatch \$ 2,100.0

- Other professional services for expertise and support as required, such as support for midstream through Pingo, support for upstream through Ryder Scott, and support for marketing activities \$ 2,470.0
- Expansion of the AKLNG office including Core Services (IT, HR, leases, software, telecommunications, etc.). \$ 350.0

Total: \$ 23,000.0

Commodities:

- Office supplies, books, subscriptions and educational materials \$10.1
- IT Equipment \$15.0

Total: \$ 25.1

Ms. Rutherford acknowledged that the first two items related to outside counsel totaling \$17 million was very expensive. She stressed that the commercial negotiations were complex and the success of the negotiations depended on the support of outside counsel. She qualified that "the timing on the marketing remained a serious issue."

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Vice-Chair Saddler asked about the \$5 million RSA to law and wondered whether the request "presumed" the marketing lead contract would be filled and was necessary for the entire fiscal year. Ms. Rutherford answered that the negotiations applied to various areas of development and marketing and provided context for the requests. She discussed the commercial agreements negotiations that would determine the state's marketing structure. She elaborated that the state had "a couple of different significant options one of which was provided for in SB 138 (Gas Pipeline; AGDC; Oil & Gas Prod. Tax) [Chapter 14 SLA 14 - Enacted 05/08/2014]. The first option was as an equity marketer, where the state set up its own organization with its own portion of the gas and competed head to head with other co-venturers and other producers in the world. The other option found in SB 138 required that each of the other three partners provide DNR offers to either purchase the state's gas or sell the gas for the state under the

same terms they sell their gas. Yet another option was a joint venture structure where the state and partners would all coalesce the gas to the market and each partner would have a representative in the market organization. She ascertained that the last scenario would be the best structure for the state and eased many of the upstream complexities produced through having three-quarters of the gas supplied through Prudhoe Bay and one-quarter supplied by Point Thompson and the varying ownership structures. The coordinated structure would optimize costs. She continued that other options could include subsets of the joint venture market. She pointed out that while the negotiation stage was in progress the negotiations were trying to determine what works for all parties, which required outside experts on marketing organizations and LNG structures and how best to sell the gas under the structures. She relayed that DNR initially thought that having an in-house employee involved in developing the marketing organization and initial negotiations that was eventually transferred to the actual marketing organization due to the historical knowledge and experience the employee would offer the structure was in the state's best interest. She concluded that the position was "expensive and hard to find" therefore, delayed filling the position until the structure was developed.

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Representative Kawasaki asked whether the low price environment for gas made experienced gas marketers more available. Ms. Rutherford replied in the affirmative. However, the position was very well compensated and she learned that the individuals received \$600 thousand to \$800 thousand in salary per year with a 30 percent bonus. She detailed that the state prohibited the 30 percent bonus and built the bonus into the base salary with a COLA (Cost Of Living Allowance) provided as well. Representative Kawasaki reviewed the old fiscal notes from 2014 for SB 138 and discovered that the marketing position was delayed an extra year. He believed that the need for marketing efforts remained in FY 17 and was not anticipated when the bill was adopted in 2014. He noted that the RSA to DOL had changed substantially and was originally expected to cost \$3 million and currently "ballooned." He asked why the RSA was so large in comparison. Ms. Rutherford reiterated the complexity of the negotiations in drafting the commercial agreements. She shared that the outside counsels offered

different areas of expertise. She elucidated that Greenberg Tuareg understood the specifics concerning the state of Alaska's upstream capacity, royalties, leases, the FERC process, and how expansion and third party access was involved. Milbank Tweed offered profuse knowledge regarding actual LNG projects and financing and how the commercial agreements supported the financing structure. She reported that the negotiation "ratcheted up" in FY 16 increasing the costs and the complexities. She relayed that the average spend was between \$800 thousand and \$1 million per month for the two outside counsels only for the general commercial negotiations. She added that the additional \$5 million was necessary for negotiation on the marketing structure.

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Representative Pruitt surmised that the state's attorneys "needed a lot of attorneys." He asked whether DOL was in alignment with DNR. Ms. Rutherford replied in the affirmative. She detailed that rigorous discussions between the agencies were undertaken on how the state should proceed with issues that arise through the negotiations. She felt that good decisions usually emerged from that type of process.

Representative Pruitt asked why DNR needed a "middleman" represented by DOL. Ms. Rutherford believed that statute mandated the agencies were to go through DOL to hire outside counsel. She restated that DOL worked with the team on a daily basis. Representative Pruitt asked if the law needed to be changed to allow DNR to work directly with outside counsel. Ms. Rutherford answered that the department always worked with outside counsel as much as possible but the billings were always undertaken by DOL and offered very good comparative billing analysis. She felt the system was "a reasonable separation of duties."

Representative Gara did not like agencies billing each other. He thought that DOL should be involved in the legal work and remain up to date which allowed for determining whether some of the work could be done in-house at a much lower cost. He wondered whether the two elements were happening with DOL's involvement. Ms. Rutherford answered in the affirmative and added that the DOL attorneys "opined" on the applicability and interpretation of state

law. She concluded that the outside counsel brought expertise the state lacked.

Ms. Rutherford concluded the presentation on slide 16 titled, "FY 2017 Budget Request Details Services and Commodities." She relayed that the slide contained a chart outlining the services and commodities requested in FY 17 but did not provide details.

Co-Chair Neuman clarified that he was working with all of the departments involved in AKLNG on "tightening" up their AKLNG figures.

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AT EASE

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RECONVENED

JAMES CANTOR, DEPUTY ATTORNEY GENERAL, CIVIL DIVISION, DEPARTMENT OF LAW, provided a PowerPoint presentation titled "Department of Law AKLNG Project Budget" dated February 23, 2016 (copy on file).

Mr. Cantor addressed slide 2:

FY 2017 AKLNG BUDGETREQUEST

- DNR/DOR Reimbursable Services Agreements for outside counsel and experts -\$17.5 million
 - DNR Commercial Agreements -\$12.0 million
 - DNR Marketing Negotiations -\$5.0 million
 - DOR Financing & Bankability -\$500,000
- DOL annual internal funding for gasline work - \$700,000

Representative Kawasaki spoke to the 2014 fiscal notes related to a \$3 million RSA for DOL. He wondered why the legal costs escalated.

Mr. Cantor replied that the negotiations had gotten to the heart of a very complex transaction. He reported that the outside counsel of Milbank, Tweed had global expertise in LNG and that only 6 other law firms worldwide had similar experience

Mr. Cantor continued on slide 3:

DOL BUDGET NEEDED

- Negotiation & drafting of AKLNG Project commercial agreements
 - Upstream Agreements
 - Midstream Agreements
 - Marketing Agreements
 - Governance Agreements
 - Fiscal Agreements
 - Finance & Tax

- Annual internal funding for assistant attorneys general

Mr. Cantor indicated that the slide listed the types of commercial agreements the department was negotiating.

Co-Chair Neuman noted that the presentation did not include any numbers. He wondered about the specific costs associated with the various negotiations on slide 3. Mr. Cantor replied that a gross accounting was \$12 million for the commercial agreements and \$5 million for the marketing agreements which had not started. Co-Chair Neuman asked whether the marketing negotiations would begin before the FEED stage. Mr. Cantor replied in the affirmative. Co-Chair Neuman requested more detailed information regarding costs and negotiations.

Representative Munoz asked whether the funds were sufficient to complete the project. Mr. Cantor responded that the funding was dependent on how the project would proceed in FY 18.

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MARTIN SCHULTZ, ATTORNEY VI, CIVIL DIVISION, OIL, GAS, AND MINING SECTION, DEPARTMENT OF LAW (via teleconference), answered that it was a difficult question and depended on the pace of negotiations with the other AKLNG partners. He guessed that if the negotiations proceeded more aggressively the funding would meet the bulk of the expenses. Representative Munoz asked whether DOL had expended money towards the commercial agreement to date and if so, how much. Mr. Schultz answered that DOL expended money in FY 16

for the commercial agreements. He noted that through the first 6 months of FY 16 approximately \$5.1 million was spent on outside counsel and the work was in progress. He estimated the costs at \$850,000 per month. Representative Munoz asked whether the \$5.1 million was in addition to the \$12 million request for FY 17. Mr. Schultz replied that the \$5.1 million was the expenditure to date in FY 16. Representative Munoz asked what the \$5.1 million had achieved for the state. Mr. Schultz answered that agreements with the project partners were negotiated, commercial and regulatory work was accomplished including FERC efforts, and some agreements had been drafted and others were in progress.

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Co-Chair Neuman believed that another presentation was necessary to include specific budget numbers containing much more detail regarding negotiations and projections on future work and budgetary needs. He emphasized that the committee needed more information. Mr. Cantor agreed to comply with the request.

Vice-Chair Saddler referred to slide 2. He wondered about the \$700 thousand expenditure and what work was accomplished. Mr. Cantor turned to slide 4 titled, "DOL - AKLNG Team" to assist in answering the question. He explained that the department had a small team of assistant attorney generals [depicted on the slide] who worked exclusively on AKLNG and had many years' experience working on previous gasline projects. The funding requests for the gasline projects were done on a yearly basis. He noted that requests were as high as \$3 million and as low as \$700 thousand. He listed the names of the assistant attorney generals (AAG) who were primary members of the team; Jerry Juday, Martin Schultz, and Elena Romerdahl and clarified that the \$700 thousand expenditure pertained to their work. Vice-Chair Saddler asked whether the \$700 thousand paid for their entire costs. Mr. Cantor clarified that the department employed an hourly rate system as opposed to a salary per position and the hourly rate was billed to the project and included the entire costs which included support staff, utilities, etc.

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Vice-Chair Saddler thought that the process was unusual. Mr. Cantor replied that the billing structure was in place for the past 25 years. He detailed that every civil lawyer billed per hour and the amount was built into the budget. Vice-Chair Saddler questioned the stated costs and the billing system. Mr. Canto deferred to Mr. Schultz.

Mr. Schultz elaborated that the funding for gasline work typically included larger direct appropriations to DOL or via a RSA between DNR. He reported that in November, 2015 the legislature directly appropriated \$10.1 million to DOL, a \$3 million RSA between DOL and DNR, and a \$700 thousand direct appropriation during the regular session for gasline work. He revealed that the bulk of the 13.8 million in FY 16 was through direct appropriation from special session. The vast majority was of the FY 17 request was for outside counsel except the \$700 thousand appropriation for the attorneys on the gasline team. The \$17 million requested in FY 17 was an appropriation to DNR that DOL received through RSA's. He noted that an additional RSA from DOR to DOL in the amount of \$500 thousand was requested in the budget.

Co-Chair Neuman asked how much money was transferred between DOL from DNR through RSA's. Mr. Schultz answered that during the regular session in FY 16 the amount was \$3 million. He recounted the direct appropriation to DOL of \$10 million during the special session in 2015.

Vice-Chair Saddler requested the amount the department spent internally on gasline work over the years. Mr. Schultz replied that he did not have the information available. He responded that whether DOL received funding via a direct appropriation or through an RSA, the money was utilized for outside counsel to provide expertise to DNR, DOR, and AGDC to advance gasline work. The exception was the internal DOL appropriation of \$700 thousand. In previous years larger appropriations funded a mix of internal expenses and outside counsel.

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Vice-Chair Saddler was frustrated with the answer. He request the cumulative amount of internal expenses prior to FY 15. Mr. Cantor offered to provide further information.

Co-Chair Neuman interjected that the presentation was the problem and that a detailed budget was necessary for a budget presentation before the House Finance Committee.

Vice-Chair Saddler requested more clarity on past expenditures to understand the current DOL budget.

Representative Gara asked whether the department would save money if it did more work in-house or whether the expertise to perform the work internally lacking. Mr. Schultz answered that assistant attorney generals (AAG) were much cheaper than outside counsel and the department utilized AAGs as much as possible. He shared that he was one of the more experienced oil and gas attorneys in the state but his expertise was in royalties and tax disputes which was not similar to negotiating world class LNG projects and the work associated with the endeavor. He stressed that outside counsel was critical to protect the state's interest and was worth the cost of their invaluable expertise. He informed the committee that AAGs worked on the AKLNG project and were present at all of the meetings, reviewed and edited the agreements, dealt with outside counsel on state statute issues, and participated actively in the project. He believed that ideally the state would have a blend between AAGs and outside counsel. Representative Gara clarified his question. He asked whether DOL had the ability to perform more of the work in-house with additional staff and would that result in savings or was the department utilizing the internal staff as much as possible. Mr. Schultz agreed with the later statement and believed the department was using internal staff where appropriate and outside counsel where appropriate.

Representative Pruitt referred to the \$10 million direct request. He wondered why the FY 17 funding was appropriated through DNR. Mr. Schultz replied that he was not a budget expert and did not know the reason why the difference existed. He reiterated that regardless of the appropriation method the purpose of the money was used for outside counsel. Representative Pruitt stated that the RSA system was not transparent. He knew that the project was not advancing in the "same capacity." He wondered what type of agreements DOL would be engaged in with the \$12 million budget request and whether the amount was truly necessary. Mr. Schultz answered that the expenditure depended on the progression of the negotiations. He offered that if the negotiations slowed the full amount was not necessary.

Representative Pruitt asserted that he wanted a definitive amount regarding the funding request for FY 17.

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Mr. Schultz replied that he could not predict the pace of the negotiations. He assured Representative Pruitt that if the money was not necessary it would not be expended.

Mr. Cantor added that for the FY 16 budget DOL was lapsing approximately \$2 million to \$4 million due to the slower pace of negotiations.

Co-Chair Neuman spoke to the current fiscal crisis and budget cuts for services. He repeated his request for more comprehensive budget information divided into pre-FEED, FEED, and post-FEED stages of the project for the next meeting before the committee.

Representative Gattis wondered about alternative options if the project were to go into a "stall mode." She asked what would happen and how much money could be held back.

Co-Chair Neuman felt Representative Gattis's point was valid for all of the agencies involved in AKLNG.

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Representative Munoz requested information regarding how the project's partners were progressing on the agreements and whether the partners were moving forward at the same pace. Mr. Cantor agreed to supply the information.

Co-Chair Thompson reviewed the agenda for the following day noting the time change to 2:00 p.m.

#

ADJOURNMENT

[3:32:42 PM](#)

The meeting was adjourned at 3:32 p.m.