

**ALASKA STATE LEGISLATURE
JOINT MEETING
SENATE RESOURCES STANDING COMMITTEE
HOUSE RESOURCES STANDING COMMITTEE
NIKISKI, ALASKA**

June 16, 2015

3:01 p.m.

MEMBERS PRESENT

SENATE RESOURCES

Senator Cathy Giessel, Chair
Senator John Coghill
Senator Peter Micciche
Senator Bill Stoltze
Senator Bill Wielechowski

HOUSE RESOURCES

Representative Benjamin Nageak, Co-Chair
Representative David Talerico, Co-Chair
Representative Bob Herron
Representative Kurt Olson
Representative Paul Seaton
Representative Andy Josephson
Representative Geran Tarr

MEMBERS ABSENT

SENATE RESOURCES

Senator Mia Costello, Vice Chair
Senator Bert Stedman

HOUSE RESOURCES

Representative Mike Hawker, Vice Chair
Representative Craig Johnson

OTHER LEGISLATORS PRESENT

Senator Anna Mackinnon
Senator Lesil McGuire
Representative Mike Chenault

COMMITTEE CALENDAR

AKLNG Project Overview with Steve Butt

- HEARD

AKLNG Fiscal Team Update

- HEARD

AKLNG Third Party Report of DNR and DOR Involvement

- HEARD

AKLNG Impact to the Kenai Peninsula Borough with Larry Persily

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

STEVE BUTT, Project Manager
AKLNG Project

POSITION STATEMENT: Provided AKLNG update.

DAVID VAN TUYL, Regional Manager
BP Alaska
Anchorage, Alaska

POSITION STATEMENT: Provided AKLNG fiscal update.

BILL MCMAHON, Senior Commercial Advisor
ExxonMobil

POSITION STATEMENT: Provided AKLNG fiscal update.

DARREN MEZNARICH, Project Integration Manager
AKLNG Project
ConocoPhillips

POSITION STATEMENT: Provided AKLNG fiscal update.

VINCENT LEE, Director
Major Projects Development
TransCanada, LLC

POSITION STATEMENT: Testified on the AKLNG fiscal update, but due to technical difficulties it was not clear enough to summarize.

DAN FAUSKE, President
Alaska Gas Development Corporation (AGDC)
Anchorage, Alaska
POSITION STATEMENT: Provided AKLNG fiscal update.

KEN VASSAR, Council
Alaska Gasline Development Corporation (AGDC)
POSITION STATEMENT: Provided AKLNG fiscal update on constitutional issues.

AUDIE SETTERS, General Manager
State Gas Team
Department of Natural Resources (DNR)
POSITION STATEMENT: Provided State Gas Team AKLNG Project update.

RANDALL HOFFBECK, Commissioner
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: Provided State Gas Team AKLNG Project update.

DONA KEPPERS, Deputy Commissioner
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: Provided State Gas Team AKLNG Project update.

RANDALL HOFFBECK, Commissioner
Department of Revenue (DOR)
Juneau, Alaska
POSITION STATEMENT: Provided State Gas Team AKLNG Project update.

LARRY PERSILY, Oil and Gas Advisor
Kenai Peninsula Borough
Soldotna, Alaska
POSITION STATEMENT: Provided AKLNG Project update for the Kenai Peninsula Borough.

ACTION NARRATIVE

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CHAIR CATHY GIESSEL called the joint meeting of the Senate and House Resources Standing Committees to order at 3:00 p.m. Present at the call to order were Senators Stoltze, Wielechowski, Coghill, Micciche, and Chair Giessel; Representatives Herron, Josephson, Tarr, Olson, Seaton, and Co-Chairs Talerico and Nageak.

AKLNG Project Update with Steve Butt

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CHAIR GIESSEL announced that the first part of today's hearing is required as part of SB 138, which established the AKLNG framework that passed in 2014. It authorized the State of Alaska to enter into the pre-front end engineering and design (pre-FEED) stage of an integrated gas project. She invited the project manager, Steve Butt, to the table.

STEVE BUTT, Project Manager, AKLNG Project, related that a group was put together under SB 138 to formalize the joint venture agreement that includes BP, ConocoPhillips, ExxonMobil, TransCanada and the Alaska Gasline Development Corporation (AGDC) acting as the state's agent for the downstream and midstream segments (TransCanada is the midstream and AGDC is the downstream).

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He said he was there on behalf of the 135 people who work on the project and he was going to do his very best to help the committee understand what they accomplished in the last four months. He said those 135 people work with several hundred contractors and different consortiums.

MR. BUTT said the AKLNG Project is an integrated LNG project to treat, transport and liquefy natural gas that has been discovered on the North Slope, principally in the Prudhoe Bay field and the Point Thomson field that have somewhere between 32 and 35 tcf of gas. It moves about 3.3 bcf a day down to Nikiski and that leaves about 2.4 bcf gas a day for liquefaction. The balance is used for fuel and instate use. The 2.4 bcf/day is about 10 times what the state uses right now, about enough energy to fuel an economy the size of Germany. "It's an enormous number." He said the scale of the project is very large and will cost \$45-\$55 billion. The sheer complexity and scope of the project requires careful integration.

MR. BUTT showed pictures of the Point Thomson drilling rig that was finishing the third well for the IPS. The modules will start

being brought in for the compression facility over the next few weeks. The gas treatment plant (GTP) is in final design and the same optimization work is being done on building the liquefaction facility.

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The Safety, Health and Environment Report indicated that there was a minor non-toxic hydraulic fluid release of one cup that was remediated.

They spent about \$300 million, which includes \$200 million on pre-FEED work since 2014, about \$25-30 million per month. The work was primarily focused on two activities: one addressing regulatory work with the Federal Energy Regulatory Commission (FERC) and the other doing basic design.

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Since their last talk, one great milestone issue came up: the Deputy Secretary of the Department of Energy announced an export authorization for non-free trade authorization countries; that means the project can ship LNG to anywhere in the world. The request was for 20 million metric tons annually for a 30-year period with a 12-year start to initiation of the permit and construction. He pointed out that all numbers are unprecedented; the Department of Energy has never granted an export authorization of that duration, of that magnitude or with more than seven years for construction. He said there was strong support from the DOE and the federal government.

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Another big milestone is that FERC accepted their resource report that initiated the Environmental Impact Statement (EIS). This is an arduous process but it is required for getting an authorization for construction.

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Key Messages:

1. AKLNG is an integrated LNG project: plant plus pipeline that provides gas to Alaskans and can sell LNG anywhere in the world. One of the most important characteristics of the integration design is that there are four parties - ConocoPhillips, BP, ExxonMobil and the State of Alaska - that have fundamental claims to gas on the North Slope and rights to revenues generated by that resource; 98 percent of the gas is owned by project participants. Aligning the four parties is the difference between a project that will work and one that will struggle.

2. The ARC of Success is:

-Alignment: the state is a key participant with voting rights, and rights to data. Partners can talk to each other with transparency. The alignment factor is critical.

-Risk reduction: Pre-FEED identifies/mitigates risk.

-Cost reduction: cost of supply defines competitiveness.

MR. BUTT said his last message was that as the team goes through all the work, they are trying really hard to match the pre-FEED pace to all broader schedule issues. The pre-FEED work will keep the project umbrella deliverables they all agreed to in the Joint Venture Agreement (JVA) on track. But that is done as part of a broader whole. Things like commercial issues all have to come together so that when they get to different phase gates in this project management structure they come together at the same time. Otherwise pieces won't be ready at the right time.

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The design of the gas treatment plant (GTP) pad/camp has been completed. Access to required construction gravel is confirmed and water resource availability is being evaluated. A lot of geotechnical work is being done at Nikiski and with the Prudhoe Bay operator on a whole host of issues.

One real milestone was completing the winter near-shore excavation program. They had to find out if the west dock at Prudhoe Bay needed to be deeper to bring in modules in the winter. Traditionally the work is done in the summer, but they decided to use a traditional hydro-ax to cut the ice and pick up the coils when they are frozen. Doing this in the winter will free up the summer months for moving modules and logistics work. This has been tested successfully.

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Pipeline work/design is continuing to go really well, he reported. The route is complete and aligns with AGDC. Work is continuing on key areas such as Atigun Pass, Glitter Gulch and Nikiski. The western route across Cook Inlet was chosen. The hydraulic work has been done and material design is being evaluated along with weld procedures for the different sections of the pipeline.

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MR. BUTT explained that all parties had become aligned on pipeline routing across Cook Inlet. Since the focus has been on Nikiski as the best site for the LNG plant, a lot of work had

been done on how to cross the Inlet and they believe the western route is best. It's 14 miles shorter and has a lower environmental impact; it avoids the 25 miles within the Susitna Gunnery range with unexploded ordinance. Second, the mouth of the Knik Arm is where all the eight Chugach power cables are and the lay barge to put in the pipe has a 300 ft. anchor spread. So, it would have to be able to move the 300 ft. spread without hitting the power cables that would compromise power to the City of Anchorage. The other big issue is that the mouth of the Knik Arm has a lot of sediments coming in it from glaciers and it is one of the most active seabeds in south Alaska. It has moved 40 feet in six years.

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They are continuing to improve marine facility design and operational capability and actually did the civil work for the gas-to-liquids (GTL) plant location. It would cost \$3-4 billion to move 131 million cubic yards of rock into Prince William Sound (PWS) locations, but the extensive civil work impacts are unknown and probably can't be permitted. He said it would be easier to put a GTL in Seward because it has a great site for shipping, but it is not a good place to find 800 flat acres for the GTL plant.

In Cook Inlet, the challenge was getting across the Kenai River and moving gas down into a premier salmon area. This would increase costs because it makes the pipeline much longer, would increase the environmental impact by crossing important waters. Staying in an existing industrial area would limit that impact. Additionally, with the Valdez/Prince William option there is the difficulty in getting the gas back to the population centers in Anchorage; that would require a very long spur going back through Glennallen.

The Seward pipeline access point would be very difficult to construct. He repeated that their exercise focuses around the ability to be successful by keeping costs down and that is why they are focusing on Nikiski as the plant site and have had nothing but excellent welcomes from community members.

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MR. BUTT related that every year field work is done for regulatory data and this year 250 people spent about \$50 million on it. They are primarily cultural heritage specialists who found five cultural area sites, about 75 percent of them are old Alaskan settlements.

CHAIR GIESSEL recognized Speaker Chenault in attendance.

SENATOR MICCICHE said a lot of people did not understand the work behind the site choice.

MR. BUTT replied that a lot of very proprietary specialized design work went behind it, but he would talk about what he could. They had been making sure all participants are happy and having some "good conversations" with the State Gas Team about constructability challenges.

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SENATOR STOLTZE had a question, but due to technological difficulties it was indiscernible.

MR. BUTT said as part of the Environmental Impact Statement process, FERC wants to know what the community thinks about the project in terms of different routings and other options. So, last year they had a lot of stakeholder engagement holding 80 sessions; FERC had also held their own sessions. Everyone wants confidence that the community supports the project.

He had four sessions in late May with about 700 people representing about 300 Alaska businesses, because local Alaskans have knowledge on how to work in Alaska which will help drive down costs. Those are "going really well." The U.S. Coast Guard is very supportive. He related that the White House sees this project favorably because the limited carbon footprint is very efficient with all the CO₂ being put back in the ground.

They take environmental responsibility for protecting marine mammals and habitat whatever route is taken. That is why extensive pre-FEED work went into coming up with a really good design that works for all the stakeholders. It will provide "comfort" that the design really works when they got to the FEED stage decision. "We really want to get it right," he said, and "Working on the wrong line gets very expensive very fast."

He said the labor and logistics study assured understanding of how this huge project would get built. The scale is enormous and means 15,000 more jobs in Alaska.

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They had great dialogues with the different labor unions, the Department of Labor and the Native corporations on developing the craft labor skills that are needed, but there is so much

work that some of it will have to be exported. That is the only way to keep the project economic.

MR. BUTT remarked how hard it is to drive buses of 40 people safely on a highway and that 3,500 people will be working on site. How will they be moved along with the 250 thousand tons of steel that will need to be fabricated and get it landed in the right way? All ports in Alaska are being looked at, multiple ports for different materials.

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Lastly, Mr. Butt covered forward plans. The Joint Venture Agreement (JVA) is a playbook telling them how to build an AKLNG Project. As part of that, everyone agreed on what work had to get done to make sure that pre-FEED questions can be answered; that work is on track and will be complete and available for shareholder review in the fourth quarter of 2015. This will inform additional work.

MR. BUTT said they must keep their FERC and EIS work on track; the first draft of the resource report is done. The second draft is expected in early 2016. They want to keep the engineering deliverables and the FERC documents together.

With that said, they need to keep working with the state to understand some of the open issues like some of the transitions that are being discussed, potential changes in the state's Asian relationship, how the state wants to be involved in the project and how that may impact the resources available to the project and how it might impact the skills available to the project.

They can test how new risks can be mitigated and understand very clearly how to the actual offtake locations will be built. The AGDC has done a lot of work on this using everything outside of the main distribution as part of their mandate. They want to know how that would work, so the offtakes are in the right place and the hydraulic model can be validated.

He said they want to make sure the project design elements - pipeline size, route and plant site - are to everyone's satisfaction. They don't want to waste resources by having to switch routes. Alignment among the parties is needed on the fundamental design issues. In addition, they want to make sure they have complete support from the administration's 45-day review team to their satisfaction. They will be positioned for a FEED decision when the open issues are resolved.

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As Mr. Butt mentioned earlier, the project's pace and spend must be matched to all these other open issues so that when the work is ready to go across the gate it's in the right place. Does it have viable technical options, does it have government support, are permits and land uses achievable; is there potential commercial viability at a level that all of the parties are comfortable with? The parties and the citizens of Alaska will have to decide, under SB 138, if they want to continue investing 25 percent of the money required to move to the next level; that's \$1 billion to \$1.5 billion,.

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CHAIR GIESSEL asked him to talk about employment of Alaskans right now in the project.

MR. BUTT said about 200 people are working on the field work, about 30-40 doing the geo-technical work; and several hundred people are providing logistical support (ASRC). Hundreds of people are coming up to support that work.

CHAIR GIESSEL said she knew the State of Alaska was trying to do its part to have a prepared workforce. She thanked Mr. Butt for the presentation.

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At ease from 3:58 to 4:03 p.m.

AKLNG Fiscal Team Update

[4:03:12 PM](#)

CHAIR GIESSEL called the meeting back to order and announced the AKLNG fiscal team update as the next order of business.

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DAVID VAN TUYL, Regional Manager, BP Alaska, Anchorage, Alaska, said he had been working for BP for almost 31 years, the last half of that on the Alaska gas project. He is now working on the Joint Fiscal Team and Management Committee of the AKLNG Project. He is pleased to be in Nikiski, the site of the future liquefaction facility. The success of this project is critical to BP's business here in Alaska, he said, and also critical to the future of the State of Alaska, itself, and for so many Alaskans who will benefit directly and indirectly from a successful project.

He said the project recently took a very important step forward in receiving export authorization for non-trade countries from the U.S. Department of Energy. It's a big deal. The project would not be a success without that approval. The relative speed with which that approval was obtained also shows how important the project is on the U.S. federal level. That approval sends an important message to the world that the AKLNG Project is real and is coming; the project is building momentum.

MR. VAN TUYL said there is much to be done, but they continue to make progress. Since the early days of the Walker Administration all partners had worked productively with his team and they will continue doing that. They remain actively engaged on a variety of fronts to continue to progress the project and the associated commercial work members will hear about shortly.

He concluded that last year they started on this journey together; project momentum is continuing. BP looks forward to continuing this journey together in the coming months. He thanked them and turned the presentation over to Mr. McMahon.

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BILL MCMAHON, Senior Commercial Advisor, ExxonMobil, said he had been working for ExxonMobil for more than 33 years. The last 23 of those year he had been focused on Alaska gas development. He said Alaska continues to be a very important part of ExxonMobil's worldwide portfolio; they had been in Alaska for more than 50 years and had invested more than \$13 billion. ExxonMobil is committed to Alaska and continues to actively pursue investment opportunities there. As operator at Point Thomson, ExxonMobil was pleased to reach the settlement agreement back in 2012 that allowed that project to move forward for development and allowed the AKLNG Project. Since that time, they had been moving quickly to get the initial production system running. It is scheduled to start up either late this year or early next year, well before their commitment in the settlement.

As the largest working partner at Prudhoe Bay and the largest lease holder of discovered natural in Alaska, ExxonMobil has serious commitments to the AKLNG Project. ExxonMobil has been involved with all past gas commercialization efforts and is excited by the promise of AKLNG and is working diligently toward the next major milestone. Today he would review their progress and remaining key challenges.

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DARREN MEZNARICH, Project Integration Manager of AKLNG, ConocoPhillips, Anchorage, Alaska, said he had been with the company for 25 years. He said ConocoPhillips is working hard with the administration and the other parties on technical work and the necessary commercial and fiscal agreements and are ready to move to the next phase. He said ConocoPhillips testified in February that the most important commercial agreement throughout is the gas supply agreement. It is foundational for a project of this scale and size. It's the basis for determining the rate and the volume of gas between Prudhoe Bay and Point Thomson and what happens if volumes are not supplied. This agreement is key for ConocoPhillips in a special session. It is crucial to agree on them now so the project has a solid commercial foundation, which the legislature can consider additional fiscal and project enabling legislation on. He is encouraged by the state's support of the project and the governor's accessibility and engagement. The governor's team brings important LNG expertise and experience to the project.

VINCENT LEE, Director, Major Projects Development, TransCanada, testified but due to technical difficulties it wasn't clear enough to summarize.

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DAN FAUSKE, President, Alaska Gas Development Corporation (AGDC), Anchorage, Alaska, said it continues to be a pleasure working with state agencies on AKLNG team. He said they continue to do work on the Alaska Stand Alone Project (ASAP), but it's all geotechnical or environmental work that benefits the other project.

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SENATOR STOLTZE said he tries to understand the dynamics between the two groups and asked if there is a schism between their philosophies.

MR. McMAHON answered that he would show slides about how integrated they are.

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MR. McMAHON went to slide 2 that introduced the term "sponsor group" that has all seven parties that have an interest in AKLNG Project: the Department of Natural Resources (DNR), the Department of Revenue (DOR) from the governor's office; AGDC as the state's representative making the investments in the pre-FEED stage of the project, TransCanada; and ExxonMobil, BP and ConocoPhillips who hold the rights for the natural gas in

Prudhoe Bay. All are concerned with progressing the project. In addition to what Mr. Butt talked about, the project team is interested in the ongoing commercial and fiscal work.

FERC and NEPA applicants are the same group of folks; the administration is not a formal applicant but it has very heavy consultation involvement, because FERC is very interested in where the State of Alaska stands on these applications. The critical issue is the EIS that will allow the project to turn earth and start construction.

The third box on the slide indicated the five joint interest parties that signed the agreement governing pre-FEED activities. The DOE export license work was all done under the name of the AKLNG Project, LLC. The terms of that agreement allow for the addition of parties. So they anticipate that the state would put a representative into the LLC with some kind of connection with the state royalty in kind election.

MR. MCMAHON said slide 3 summarizes the 7 parties having interest in pre-FEED, and highlights activities and deliverables with a target completion by year end. He used the chart to remind people of what is inside and outside the project.

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MR. McMAHON said slide 3 showed everything Mr. Butt said on one page. It showed the seven parties that have a vested interest in moving this project forward and good progress is being made towards completing the pre-FEED deliverables. One of the key things was passing the bill that grants right-of-ways through state parks. Mr. Butt has been targeting completion of this work by year-end, so owner reviews can happen after that.

The circle on slide 4 reminds folks of what is in the project and what is outside the project. Everything in the circle is officially part of AKLNG: the two transmission lines to connect two fields into the gas treatment plant (GTP), the GTP gets gas to a quality so that it can be turned into a liquid, the pipeline that goes across the state and the LNG plant, storage and loading in Nikiski.

Prudhoe Bay and Point Thomson are outside the box but central to the project, and the owners of those two units are working closely to get natural gas flowing. Another box outside the circle represented in-state gas supply, a priority for the project. So, they will work with the administration and AGDC to find out where those offtakes will be. The sponsors have a wide

span of interests in activities beyond just the project team in: gas production, commercial, fiscal, regulatory, external affairs and government relations. Work in each of those areas will need to be completed in sync with all the other paths. The sponsors don't discuss individual efforts to monetize the gas.

For gas production the main thing to update is first in the Point Thompson Unit (PTU) area where 75-80 percent of the initial production system is going to be able to be reused for gas expansion. More reservoir data can be collected as the field gets up and running. As that moves forward, it will provide a good oil and gas expansion foundation.

The Alaska Oil and Gas Conservation Commission (AOGCC) has been having regular interactions the Point Thomson owners about the gas offtakes and hope to be in a position next month to begin the formal application for them. At the same time, the Prudhoe Bay owners are actively working on getting ready for gas sales and have had successful technical workshops with AOGCC and will be submitting a formal request soon.

He presented a gas production visual that charted upstream working interests, producer share and working interests, producer and state shares after royalty and after royalty and production tax divided up by PBU and PTU. The ultimate split of the two different fields is subject to the gas supply and the regulatory authorizations. He explained that if the State of Alaska (SOA) would take royalty in kind it would receive about 13 percent of the natural gas coming out of the project and producers/partners would take less. Under the SB 138 construct, if the state takes RIK and tax as gas (TAG) the state would then control around 25 percent of the gas and the producer shares would shrink.

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SENATOR MICCICHE asked how he assumed 13 percent of royalty in kind and 25 percent with RIK and TAG.

MR. McMAHON explained that the royalty percentages are defined in their lease agreements and the increase for tax as gas is based on SB 138 that set 13 percent as the production tax for natural gas for this project.

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CHAIR GIESSEL said they know that as a state there are things the partners are waiting for like the RIK and TAG determinations. But he is working on a gas balancing agreement

now amongst the parties and asked if the state is part of the discussion and how that is progressing.

MR. McMAHON answered that they are progressing and he has a chart coming up about it.

[4:30:33 PM](#)

REPRESENTATIVE SEATON said the Point Thomson distribution was based on the amount of investment each company has in that field and asked if the state has additional investment through any creditor being paid for work on the PTU and if that would be reflected in royalty or the production tax.

MR. McMAHON answered that the participation at Point Thomson is governed by their lease agreements. So, ExxonMobil pays about 62 percent of the costs, BP pays about 32 percent of the costs, and ConocoPhillips pays about 5 percent of the costs; there is no state participation in Point Thomson. The state participation the chart talks about focuses on the AKLNG Project.

REPRESENTATIVE SEATON asked if tax credits were taken for the development of the Point Thomson Unit if the tax credits were considered as an investment by the state.

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MR. McMAHON answered that Point Thomson has lease expenditures that do qualify for tax credits under SB 21, but he didn't have that information with him.

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He said once lease modifications under SB 138 are drafted, applications will be submitted to DNR. They address royalty-in-kind (RIK) and royalty-in-value (RIV) switching and limit it to a particular period in time. Right now the State of Alaska has the right to switch back and forth, but that would be inconsistent with this project having stability over a period of time. Also, Point Thomson has a sliding scale royalty (SSR) as well as net profit sharing (NPS) leases. SB 138 envisioned that it be Point Thomson owners unless DNR can come to terms that those variable leases can be converted into a fixed percentage to increase the state's gas share of participation in the project.

SENATOR COGHILL asked what timeframe he was talking about.

MR. McMAHON's answer was indiscernible.

MR. MCMAHON said a large amount of work was going into developing the commercial basins for the venture and the foundation agreements need to be sufficiently completed before fiscal action can be taken by the legislature over moving into FEED.

The first area they are working on is the governor's long term venture including how the facilities would be expanded. Just like a negotiated agreement governed their pre-FEED activities, they are in the process of negotiating an agreement that would govern FEED, engineering, procurement and construction as well as long term operations. They are also developing agreements on how gas will be supplied to the project, of particular importance to the state because under the construct if the state takes RIK and producers elect TAG, then the state will need to know how they will lift that 25 percent of gas out of the fields into the project. Also, since gas will be coming from two different fields, those commercial agreements will govern how those fields produce it.

A third area of importance is to understand how people can take gas off the project to supply to Alaskans as well as lifting the LNG from the loading docks onto ships. They are also working mostly with the State Gas Team on agreements around in-state gas and other agreements until they get to the point of justifying legislative action on fiscals.

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A Long Term Firm Transportation Services Agreement (FTSA) between the state and TransCanada needs to be worked out. Depending on who the parties are, some of the agreements will require legislative review.

CHAIR GIESSEL said she felt that the timeline for a special session on these issues was getting tight, around the end of October. There is also a 90 day public notice for their review. She asked how he felt about that.

MR. McMAHON responded from ExxonMobil's perspective they are making good progress. The way you get to agreements is to start with terms. It is a daunting task, but they are making progress.

MR. VAN TUYL agreed that it is daunting, but BP is encouraged that separate independent teams working are on different aspects of the project.

MR. MEZNARICH said they had hoped to be further along, but the work is challenging.

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MR. LEE said that TransCanada was not at liberty to discuss details, but could say that the administration had informally approached TransCanada about taking steps to terminate its relationship with the State of Alaska.

CHAIR GIESSEL said she appreciated his comments. The governor had indicated his desire to go it alone on the pipeline and the legislative consultants had outlined what that cash call would entail.

REPRESENTATIVE HERRON noted that earlier Mr. Lee had stated that a termination notice had not been received by TransCanada and asked if the governor had asked for any information about a termination process.

MR. LEE's said that this question was better directed to the administration, but that the choice was entirely within the purview of the State of Alaska.

REPRESENTATIVE HERRON asked if this is a good time for the governor to negotiate this.

MR. LEE's answer was indiscernible.

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CHAIR GIESSEL reminded folks that termination criteria was spelled out in Appendix C on pages 8 and 9 of the memorandum of understanding (MOU) with a deadline for entering into the FTSA of September 31, 2015. If the state decides to go it alone and not enter that FTSA, it would owe TransCanada the amount of investment they have made up to this point plus 7.1 percent interest, which the governor's office has estimated to be \$108 million.

SENATOR STOLTZE asked if the legislature was supposed to focus on fiscal terms or legislation on the right-of-ways this year.

MR. McMAHON answered that the first issue would be legislation on flow-related property tax and payments during construction; next would be a review and ratification of any fiscal contract agreed to by the partners and the state of Alaska; finally, many of the commercial agreements require legislative review and approval.

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MR. FAUSKE said the gas balancing agreement is also key, because without it there is no project.

[4:52:19 PM](#)

MR. MEZNARICH added that gas supply and the fiscal terms, things laid out in the Heads of Agreement (HOA) roadmap, are also key.

MR. VAN TUYL commented that a royalty-in-kind election was under the purview of the administration. That underpins the basic structure of the gasline and enables the alignment everyone has been talking about.

CHAIR GIESSEL remarked that the legislature will not have any review of the RIK issue; it will be under the DNR commissioner's review.

SENATOR MICCICHE asked if he thought the administration was creating obstacles to an acceptable timeline or improving relationships. Does the administration have the potential to derail this very important project or will improvements keep everyone on schedule this year?

MR. VAN TUYL replied that BP is using the roadmap in SB 138 and a key thing that underpins that is commercial alignment. The administration is absolutely interested in this project and BP's preference is to continue maturing the relationships addressed in SB 138.

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MR. MEZNARICH recognized that the administration has good constructive proposals and brings a sense of urgency to the project.

[4:57:56 PM](#)

MR. McMAHON said this is all about putting together predictable and durable fiscal terms for a project that is of unprecedented scale. It is important to LNG buyers, lenders and investors and the administration recognizes this. They are in a dialogue with the administration about the mechanism for financing and property taxes.

SENATOR STOLTZE asked if he had looked at the possibility of needing a constitutional amendment for the fiscal terms.

MR. VAN TUYL answered that he is not an attorney and that BP is sufficiently confident about fiscal stability to have spent hundreds of millions on the project.

[5:02:21 PM](#)

MR. FAUSKE said he isn't an attorney either, but a constitutional amendment would be another benchmark that requires a general election, which moves the project out another year. He wasn't sure if it would be required or not. They must keep in mind to not be too cautious because the market could just leave them "sitting in the wake."

SENATOR COGHILL's asked what was different about a standard royalty contract and the election of the state in a contract to take its royalty in gas. Had the parties thought that through?

MR. McMAHON's answer they have thought that through, and that the terms of the lease agreement, and the added protection of SB 138, there was sufficient grounds to contract that. That was also why limiting the ability of the state of Alaska to switch between royalty-in-kind (RIK) and royalty-in-value (RIV) leases is so important to the project.

SENATOR COGHILL asked if the state had ever unilaterally gone in and changed royalty agreements.

MR. McMAHON answered not to his knowledge.

SENATOR COGHILL's next question was indiscernible.

CHAIR GIESSEL said that was a good point and invited Mr. Fauske to answer the question on competition.

MR. FAUSKE said he would let AGDC council answer that.

[5:07:53 PM](#)

KEN VASSAR, Council, Alaska Gasline Development Corporation (AGDC), explained that the constitutional question is if one legislature can bind subsequent legislatures in terms of taxes. Taxes are in a different situation than royalties and he thought a constitutional amendment would be needed. The state receives royalties, but that is not considered taxes.

SENATOR MACKINNON asked how long a constitutional vote would delay the project.

[5:10:15 PM](#)

MR. McMAHON answered that would need to be talked through with the administration and the first time a vote could happen is in the next general election in 2016. A critical path for this project is continuing the work with FERC. As long as work on that continues, the startup date won't be impacted.

MR. MEZNARICH commented that the constitutional issue would not get in the way of the timeline.

[5:15:52 PM](#)

SENATOR COGHILL said he thought the original plan was for the state to take its gas to market and asked how that affects the tax.

MR. McMAHON said that is still the plan (state taking RIK and producers paying their TAG). SB 138 contained the obligation for each producer to make a proposal to the State of Alaska to either purchase or market its share of the state's gas.

[5:17:34 PM](#)

SENATOR COGHILL asked if there would still be a constitutional question if the state chose to continue on with the HOA with gas that is marketed and get the value for it when whoever buys it pays for it.

MR. McMAHON said the constitutional challenge is that there are other taxes out there like property tax and can the state provide certainty on those.

SENATOR MICCICHE said that Alaskans are averse to changing their constitution, but have also been unpredictable in changing their tax regime. Have the companies planned the two scenarios: one if the constitutional vote fails, the other if it is successful?

MR. McMAHON answered that one of the challenges of having a public vote on a constitutional amendment is if the people give a solid answer. It's difficult to imagine them saying no.

MR. VAN TUYL remarked that that was a hypothetical question and answer. Offering it in the abstract might be difficult for voters to get their mind around. The rest of his answer was [indiscernible].

MR. FAUSKE suggested not raising taxes during the time of loan payback if the length of payback is shortened, because you can't guarantee an investor a timeframe that meets with their investment parameters.

[5:24:02 PM](#)

SENATOR STOLTZE remarked that the legislature decoupled oil and gas two years earlier. Now there is talk about fiscal certainty on the topic of gas taxes. But what would happen if there was a move to revisit oil taxes?

MR. McMAHON said he touched on one of the two key parameters that will have to be agreed to in any fiscal contract. The first is to think of is how long the terms will be predictable and the other is the breadth of predictability (what taxes are cut). His answer to either one is that it depends on the entire [indiscernible]. Having protection on the gas business by having the oil business exposed would have to be factored into whatever the gas terms are.

[5:26:16 PM](#)

MR. McMAHON continued with his update. He said the DOE export authorizations have been received and good progress has been made on the NEPA pre-file. Their strategy is to submit two drafts to the FERC before doing the final submission. The first draft went in on February of this year and the second draft will go in February 2016. One of the key things that will support that is public comment. Last year they hosted about 60 public comment events and they have more than 60 planned for this fall. It is critical to maintain the FERC docket so that the export license remains valid, and it's critical to push on through the NEPA pre-file process to get the EIS permit that allows them to turn dirt.

Finally, the External Affairs and Government Relations Team is all about the public image of this project, which cannot proceed without broad public support. They are busy facilitating meaningful community engagement.

[5:29:13 PM](#)

Given the magnitude of the legislative ratification step, it's essential that participants are aligned and time be taken to complete all the deliverables needed for a FEED decision.

MR. McMAHON said the remaining challenges are: establishing the role of the state as project participant in terms of lease modifications and RIK election, timely completion of fiscal and key commercial contracts, legislation for property taxes including a flow-related property tax mechanism after startup and impact payments during construction and legislation to provide durable predictable fiscal terms.

REPRESENTATIVE TARR asked if he could comment on a letter from the governor's office saying they identified a lack of urgency in resolving some of the issues listed.

MR. VAN TUYL replied they had signed a confidentiality agreement with seven parties that requires them to keep certain information confidential.

MR. MEZMARICH said a number of different work streams are moving forward in parallel and that progress is being made on each front.

[5:35:50 PM](#)

REPRESENTATIVE JOSEPHSON went back to the tax issue and the proposed constitutional amendment. Some people would ask why the state would relinquish this sovereign authority, but others could be educated that this is a different kind of contract, a long term supply contract.

MR. McMAHON said if the constitutional amendment approach is chosen, it would be critical to have the contracts effective by a successful vote of the people. The people would need to see progress before the vote.

State Gas Team Update

[5:40:34 PM](#)

CHAIR GIESSEL announced the State Gas Team update.

AUDIE SETTERS, General Manager, State Gas Team, Department of Natural Resources (DNR), provided his background which was working for Chevron, mostly overseas. His experience was all along the value chain. He was indirectly involved in developing Chevron's LNG business when it merged with Texaco. They embarked on a strategy to build three big gas projects, two in Australia and one in Angola. It was a successful strategy.

MR. SETTERS said he was hired by the Parnell Administration in September to help on the LNG marketing. The State's Gas Team is organized under the Office of the Governor and consists of: the Department of Revenue, Department of Natural Resources, himself as general manager, the Department of Law and the AGDC.

CHAIR GIESSEL said the chart had only his name and no other names for the other headings.

[5:48:02 PM](#)

MR. SETTERS said everyone in the organization is still there, but they are going through a transition that will bring organizations together into one team.

CHAIR GIESSEL asked how many people are still there and what roles they have.

MR. SETTERS said Marty Rutherford is still there, but the Governor thought someone with more global experience would be better, and Ms. Rutherford is supportive of that. He said the State of Alaska's stakeholders are many; there are potential lenders, the legislature and Alaskans.

He said that coming to a new organization he felt it was important to define what success looks like. It's "One Team" that has clearly defined roles and responsibilities, is streamlined and empowers negotiating teams with clear authority to negotiate the suite of agreements that are needed and obtain stakeholder agreement to enter FEED in 2016. The organization will encourage the training and development of Alaskan residents for jobs related to the AKLNG Project. His role in this project is not necessarily to fish but to help teach the state how to fish. He made that clear to the Parnell Administration and to Governor Walker who supports him wholeheartedly.

[5:52:41 PM](#)

CHAIR GIESSEL said she wanted to know who the people on the Team are and asked him how much money was being spent on the State Gas Team.

MR. SETTERS agreed to get that information.

[5:54:15 PM](#)

MR. SETTERS said the immediate priorities are:

- Align stakeholders;
- Consolidate and integrate the various project stakeholders involved in negotiations and the decision process;
- Establish processes to ensure state negotiating teams are armed with a clear authority to negotiate;
- Negotiate the suite of agreements required to support a legislative special session in the fall of 2015, which will enable a FEED decision in 2016;
- Develop commercial agreements and economic analysis that will inform the RIK vs. RIV determination by the DNR commissioner; (Marty Rutherford's team is helping make the RIK vs. RIV

determination and commercial agreements need to be developed to define how risks are mitigated under the RIK decision)

-Build the LNG marketing organization required to promote market awareness around AKLNG and support its marketing requirements. Uniquely, the state has very strong partners who have a long history in the state in the LNG business and who are loyal and want to expand their relationship with the state.

5:56:17 PM

REPRESENTATIVE HERRON asked what his biggest surprise and biggest disappointment were after his first day on the job.

MR. SETTERS replied that his biggest surprise was how strong the brand was and how the market reacted to AKLNG. After meetings last year, he was amazed at how excited the market was. Initially, he was a little bit frustrated by the progress of the project.

CHAIR GIESSEL said he indicated a dilemma in the choice between RIK and RIV and remarked that the state won't need a marketing organization if it takes its royalty in kind.

MR. SETTERS replied that they are planning for success. SB 138 describes the base case as RIK, but they need to build a case for RIK and that means understanding how this project would be received in the market. One thing the state doesn't want to do is waste people's time if it doesn't have anything to sell. He wants to be able to provide the legislature some kind of assessment on how the market perceives the project in the fall special session.

6:01:06 PM

CHAIR GIESSEL talked about her reading of the statute.

SENATOR MICCICHE's asked how the state was taking advantage of the joint venture structure of the project.

MR. SETTERS said there were many opportunities for Alaskans to take advantage of marketing the gas, whether it was equity marketing or joint venture marketing. There is flexibility, but a joint venture marketing position allows the state to combine the marketability of that gas.

SENATOR MICCICHE opined that the state has an obligation to the people of the state to market its gas as best as possible.

SENATOR WIELECHOWSKI's question and Mr. Setters' follow-up: [indiscernible]. Mr. Setters mentioned that the intent of the governor's letter was well received by the producers and helped some of the alignment and the senses of urgency.

6:08:02 PM

SENATOR STOLTZE asked the role of the Permanent Fund in financing this project.

MR. SETTERS answered that it is his second week on the job, but he didn't understand how it could be used. [Discussion was indiscernible.]

6:10:18 PM

RANDALL HOFFBECK, Commissioner, Department of Revenue (DOR), Anchorage, Alaska, answered the Permanent Fund question by saying its use was being determined. State savings would have to be used as part of its investment. There have been discussions around whether this should be a good investment for a percentage of the Permanent Fund.

SENATOR STOLTZE asked if he was envisioning going through the portfolio as a trustee's presentation or through the legislative process.

MR. HOFFBECK answered that it could occur either way. Investing early would probably be a legislative decision.

SENATOR STOLTZE [indiscernible] question about funding the project.

MR. SETTERS said TransCanada's share is \$108 million for reimbursable pre-FEED costs. One thing is sure; they don't want to impact the quality of the work that is coming out of the AKLNG Team. They also want to keep up a good long-term working relationship with TransCanada, because it is an excellent company.

CHAIR GIESSEL said the \$108 million is only the immediate number, all the consultants have indicated the risks of ongoing cash calls.

MR. SETTERS answered that she was right and the state would have to carry its 25 percent working interest through FEED and ultimately through the project. Terms are associated with it; so, it's not just spending more money. It also leads to higher revenues.

[6:18:42 PM](#)

DONA KEPPERS, Deputy Commissioner, Department of Revenue (DOR), Anchorage, Alaska, said she works with Audie Setters as part of the State Gas Team; she is the bridge between the gas team from the previous administration to this one. She became deputy commissioner with the administration change. She provided more background, but it was indiscernible.

[6:20:51 PM](#)

RANDALL HOFFBECK, Commissioner, Department of Revenue (DOR), said he came up with a simplified formula for evaluating the AKLNG Project that is robust and predictable. [Some of his testimony was indiscernible, but can be found on slide 11 of his presentation.] The property tax issue was discussed.

[6:27:20 PM](#)

SENATOR STOLTZE mentioned the constitutional amendment and decoupling issues.

COMMISSIONER HOFFBECK replied that he was not involved in the writing of that and couldn't comment.

[6:28:19 PM](#)

MR. SETTERS said he has a legal background on this issue and what they are trying to do is create an incentive to build a gas project. [Discussion indiscernible.]

SENATOR MACKINNON asked if they were considering a version of the property tax agreement, maybe around November.

COMMISSIONER HOFFBECK answered yes.

[6:32:06 PM](#)

SENATOR STOLTZE asked what Rigdon Boykin's role is.

MR. SETTERS answered that he is responsible for the 45-day review, making sure that opportunities for progress are identified and creative solutions are found. He is also identifying any issues that may create a problem for the project down the road. The 45-days was supposed to start at the end of the regular session, but it was delayed a little bit and is about half way done. A full report will be made available to the legislature.

SENATOR STOLTZE asked what Mr. Boykin's background is.

MR. SETTERS replied that he had a chance to work with him for about a month and found him to be extremely creative individual who is also an attorney. He has had 20 years of direct experience with projects in Alaska and in putting very complicated deals together. He is a very positive force in terms of getting people to think outside the box and in breaking the logjams in the negotiations. He was involved in the Port Authority, for one thing.

[6:34:38 PM](#)

CHAIR GIESSEL asked about Radoslov Shipkoff's role in the project.

MR. SETTERS said he is with Greengate, LLC, based in Washington, D.C., whose specialty is in project financing. Being able to look at the project through the eyes of lenders is very helpful in helping understand the pitfalls. Mr. Shipkoff would facilitate timely review of the project.

CHAIR GIESSEL said it sounds like this is another person from out of state.

MR. SETTERS answered yes, but Radoslov has probably looked at every LNG project in the world. He brings a fresh set of eyes and an understanding of what it takes to get these projects going.

CHAIR GIESSEL said you can't argue with having someone with the state who has experience and expertise.

REPRESENTATIVE SEATON said he wanted to make sure that they look at Legislative Budget and Audit Committee's (LB&A) consultant Rick Harper's paper that analyzed the HOA and all of the fiscal proposals so that those questions could be brought forward and answered in the analysis.

REPRESENTATIVE JOSEPHSON's question and Mr. Setters' answer was indiscernible.

[6:38:07 PM](#)

REPRESENTATIVE HERRON asked if he is aware that Mr. Shipkoff had worked at the old Port Authority.

MR. SETTERS answered no.

REPRESENTATIVE HERRON asked him to pass on this question to the governor and asked if it is possible that leadership in both

houses, the co-chairs of the Finance and Resources Committees could get a preliminary review of the 45-day report before it goes final.

MR. SETTERS said he would pass that on.

AKLNG Update on Impacts to the Kenai Peninsula Borough

[6:40:18 PM](#)

CHAIR GIESSEL invited Larry Persily to give an update on the impacts of the AKLNG Project to the Kenai Peninsula Borough.

[6:40:26 PM](#)

LARRY PERSILY, Oil and Gas Advisor, Kenai Peninsula Borough, said he had worked on this project for 15 years as a state official, as a federal official, and now as a municipal official. he expected half the value of this project would be in the Kenai Peninsula Borough boundaries and would consist of a liquefaction plant, marine terminals, storage tanks, almost 30 miles of pipe on the bottom of Cook Inlet and more miles on the west and east sides of Cook Inlet.

Five main issues the Kenai Peninsula Borough is working on:

1. The FERC EIS process is the appropriate avenue for the borough or other municipalities to address the socio economic issues. FERC in issuing an order for an LNG plant can include mitigation measures.
2. The potential relocation of Kenai Spur Highway for safety and security reasons to go around the pipe site would be the most immediate change in the community
3. Fiscal uncertainty can be harmful for a project like this and they are trying their best working with AKLNG to answer questions and keeping the public them informed
4. Ensure receipt of fair value for borough land
5. Work with the state and municipalities to achieve adequate impact aid during construction and payment in lieu of property taxes after start-up.

[6:43:50 PM](#)

MR. PERSILY said the next round of draft reports for the Environmental Impact Statement will fill in more details on not just the baseline - how much traffic is on the road - but how much traffic will be on the road during and after this construction and some possible mitigation measures. This is a major concern particularly in the Nikiski/Kenai/Soldotna corridor where it's very busy or is only one road and a couple

of lanes sometimes. The Kenai airport and emergency services will have to be expanded.

He said the project is undertaking a labor supply and demand study and a logistics study - what ports and what potential points to bring in materials and workers. There is a potential site for the Kenai Spur Highway relocation as it wouldn't be good for the highway to go through a work zone.

He said local residents' concerns are what one would expect for a project of this size. But people want answers to specifics that just don't exist yet, like where the work camp will be and work hours, how many people will be there and how will they get from the work camp to the job site. More information on that will come later. Noise and traffic, property values - some people are in the area and wished they had been bought out; others are happy with being there - are all issues.

MR. PERSILY said that increased pressure on sport fishing in the Kenai is also a big concern. Employers are worried that wage inflation will make it hard to hold onto workers.

The better job the project does of getting accurate information out there and the better job municipalities and local governments do in the process will help gain public acceptance and avoid or lessen surprises and conflicts later on.

MR. PERSILY said they are reaching out to AKLNG to ensure that whatever property is needed from the borough is transferred in a timely fashion so it doesn't delay the project.

He said the borough is also looking at future growth opportunities after the project is operating, making sure there are lands available for housing or economic opportunity in the area.

MR. PERSILY explained that there are two pieces to the property tax issue: the impact aid during construction making the municipalities whole and then coming up with a formula for a payment in lieu of property taxes (PILT) during operation. They have been asked to come up with some estimates for the impact aid during construction - from airport accommodations, highways, police, fire, emergency services, social services - but it's a little hard because they don't have all the data - how many workers and work camps, non-resident, residents - yet. But they will come up with something that will probably be on the high side, because it is not precise.

He said the borough understands that impact aid is intended to make the municipalities whole; it is not a profit center or windfall. The big questions are not only how much will go into the account but how it will come back out. A grant process has been talked about in the advisory group. Who will make the decisions? What if the DCCED makes a decision the borough doesn't like? Can it be appealed? Will the money be spent and then be reimbursed or can it be requested in advance of spending?

In terms of payment in lieu of tax (PILT) during operation, Mr. Persily said that a volume-driven formula makes sense rather than battling for 30 years as happened on the Trans Alaska oil pipeline (TAPS). To come up with the value of a 40 foot section of steel pipe coated with concrete sitting at the bottom of Cook Inlet you would look for three comps but where would they come from? And a formula would give some certainty to the project developers. If .20 mills is used for the entire project, that would equate to close to \$1/per thousand cubic feet. Looking at economics, that's a pretty heavy burden. The LNG plant alone would more than triple the total assessed value in the borough. Kind of like during impact aid, you look at that and say well the borough probably doesn't need three times as much money as in the past, but what does it need and what is fair? What can the project afford in a competitive environment? Once the formula is set, how it gets shared between the different municipalities - the North Slope Borough, Fairbanks, Denali, Mat-Su, Anchorage and Kenai - will be another challenge, although it won't be the companies' problem.

How the six municipalities debate the distribution of PILT will be another issue. Will there be one PILT for the gas treatment plant that is entirely in the North Slope Borough, one PILT formula for the LNG plant which is entirely in the Kenai Borough, and a separate one for the pipeline that could be calculated by mileage?

CHAIR GIESSEL thanked Mr. Persily.

[6:56:39 PM](#)

ADJOURNMENT

CHAIR GIESSEL adjourned the Senate Resources Committee meeting at 6:57 p.m.