

SENATE FINANCE COMMITTEE
THIRD SPECIAL SESSION
October 27, 2015
3:05 p.m.

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CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 3:05 p.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair
Senator Pete Kelly, Co-Chair
Senator Peter Micciche, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Pat Pitney, Director, Office of Management and Budget, Office of the Governor; Mark Myers, Commissioner, Department of Natural Resources; Senator Charlie Huggins; Senator John Coghill; Senator Gary Stevens; Senator Mia Costello; Senator Cathy Giessel; Representative Liz Vasquez.

PRESENT VIA TELECONFERENCE

Martin Schultz, Chief Assistant Attorney General, Oil, Gas, and Mining Section, Department of Law; Dona Keppers, Deputy Commissioner, Department of Revenue.

SUMMARY

SB 3001 APPROP: LNG PROJECT & FUND/AGDC/SUPP.

SB 3001 was HEARD and HELD in committee for further consideration.

APPROPRIATION DETAILS: DEPARTMENT OF LABOR AND WORKFORCE DEVELOPMENT, DEPARTMENT OF NATURAL RESOURCES, AND DEPARTMENT OF REVENUE

#sb3001

SENATE BILL NO. 3001

"An Act making supplemental appropriations; making appropriations to capitalize funds; making appropriations to the general fund from the budget reserve fund (art. IX, sec. 17, Constitution of the State of Alaska) in accordance with sec. 12(c), ch. 1, SSSLA 2015; and providing for an effective date."

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^APPROPRIATION DETAILS: DEPARTMENT OF LABOR AND WORKFORCE DEVELOPMENT, DEPARTMENT OF NATURAL RESOURCES, AND DEPARTMENT OF REVENUE

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PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET (OMB), OFFICE OF THE GOVERNOR, relayed that additional detail had been requested from the committee in response to a an October 25, 2015 PowerPoint presentation titled "TransCanada and Pre-FEED Supplemental Appropriations Summary" (copy on file). She moved to slide 7 and turned the presentation over to the Department of Natural Resources (DNR).

MARK MYERS, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, looked at slide 7, "Department of Natural Resources State Gas Team." He discussed that the supplemental budget was derived out of a recognition that the department had requested a budget of approximately \$13 million for FY 16 and had been given \$9 million with direction from the legislature to make a supplemental request if needed. He relayed that DNR needed the additional money. He detailed that one of the primary reasons for the need was due to the major negotiations involving the state gas team. He pointed to the slide and noted that a significant amount of money was needed for contractual services [\$1.480 million] to obtain individuals with the most expertise and experience. He stressed that the state was taking on a commercial enterprise and wanted to ensure that it had highly

qualified individuals with the appropriate industry backgrounds and experience. He noted that the individuals were expensive. He offered to detail qualifications needed for specific positions at the request of committee members. He added that the department had benchmarked the costs of the positions elsewhere in the industry.

Commissioner Myers communicated that when he had worked as the director of the Division of Oil and Gas in 2001, with the help of the legislature, the exempt employee structure had enabled the department to hire individuals with 20 to 30 years of industry experience (e.g. geologists, geophysicists, and commercial analysts). He acknowledged that the cost for these types of positions was high, but it was not possible to do the work without individuals with the prerequisite experience. He explained that the slide addressed the department's additional funding request associated with personal and contractual services. He relayed that the structural meat of the negotiations was currently being addressed. Negotiations included the overall governance structure and oil and gas balancing. He detailed that with oil and gas balancing it could not be guaranteed that the pipeline capacity was full or that the gas was available to buyers. Additional items were related to the security of supply and matching out supply. He noted that because the state was not a producer it required some special conditions to guarantee its supply.

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Commissioner Myers stated that the gas balancing agreement and governance structures were fundamental components of the deal, which were still in negotiation; the items provided a structural framework for negotiating other terms such as the lease modifications. He relayed that to create a predictable state gas volume it was necessary to convert its net profit and sliding scale leases to a flat royalty. He specifically referred to lease terms at Point Thomson; negotiations were currently under way, with ExxonMobil taking the lead. The state had agreed to a volumetric structure for the leases. He noted that with the net profit share lease it was necessary to make an assumption about costs associated with the lease. He explained that with a sliding scale royalty it was necessary to understand the appropriate allocation of cost associated with the lease. He remarked that it was a complicated negotiation that was somewhat dependent on the oil price prediction. He

reiterated that the negotiations were currently underway, which required experienced geologists, engineers, geophysicists, and commercial analysts. He noted that the department was utilizing the expertise of employees under the Division of Oil and Gas, who had been taken away from their other commercial work. He explained that two of the department's three commercial analysts were fully engaged in the AKLNG work and were not able to perform their work associated with other oil and gas issues.

Commissioner Myers addressed other positions specific to liquid natural gas (LNG) and relayed that one of the biggest increases was the need to start developing the gas marketing organization. He explained that the reason to begin the work was due to the fact that the state had to build some type of gas marketing organization. He elaborated that the type of organization was dependent on how the state chose to market under a royalty in kind (RIK) situation. Generally the state's default position was a joint venture marketing structure where it would share the marketing with the producers. He furthered that the state's perfect world would be for all three producers and the state to lump their gas together for marketing as a group. He explained that the structure would mean less internal competition, cargo could be maximized, balancing would be less of an issue, and it would enable the optimization of the project to the market. Additionally, security of supply would be better for the market. The advantage of the structure to the state was that it would benefit from the expertise of the companies; the state would embed people with expertise within the companies' structure. However, it was unlikely that all four companies would agree to joint venture marketing; some liked equity marketing better and others could be concerned about antitrust issues with the large amount of gas coming to market.

Commissioner Myers continued that there were many conditions and the state could not guarantee that it would get to the joint venture marketing solution. He relayed that the state may end up with several joint marketing deals with producers, which would require the state to have a marketer in each of the deals. Additionally, buyers wanted to be assured of supply; long-term customers would bring expertise to look at the reservoir to understand the deliverability. Therefore, DNR needed an upstream geoscientist and engineer in order to warranty supply to the people. He explained that the companies would also

second expertise into their structure or would provide access to the upstream component. He relayed that it was important to bring the first leader into the structure at present because once the project entered the FEED [Front End Engineering and Design] structure, negotiations with the market would begin and the structure with producers would be established. He furthered that the lead person would go to buyers in the eastern markets to show them the state had a confident supply; the process would occur in cooperation with other companies if there was a joint venture marketing agreement. He stated that because the project made the state one of the largest gas marketers in the world, the lead person would need to be very credible to the market; therefore, the individual's salary would be significant. He added that the salary had been benchmarked through a company called Human Capital (a leading provider of recruitment for the oil and gas business in Houston, Texas and internationally) using the standards for someone with 10 to 15 years of LNG experience. The structure included slightly higher pay for Alaska due to the state's higher cost of living. He noted that the salary may not reach the highest amount specified, but the state did not know; the salary was based on what consultants had specified as realistic for a lead marketer and analyst.

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Commissioner Myers discussed the different contractors within the organizational chart of the gas team. He referenced Greengate LLC as an example, which had presented on financial components of the project earlier that day. Other contractors were LNG experts with 15 to 20 years of experience. Additionally, the state had a contractor with specialty in LNG transport. He cited Black and Veatch as another contractor for the state. He stressed that the state heavily relied on the individuals in negotiations.

Senator Dunleavy referred to the "State of Alaska AKLNG Integrated State Gas Team" organizational chart dated October 26, 2015 (copy on file). He noted that there were five boxes (including the governor) in the "decision makers" category at the top of the chart. He asked for verification that it was accurate.

Commissioner Myers replied in the affirmative.

Senator Dunleavy asked if the Alaska Gasline Development Corporation (AGDC) board was a decision maker through Daniel Fauske (AGDC president) or if Mr. Fauske acted independently. He noted that AGDC also appeared occasionally in other locations in the organizational chart. He asked for a description of AGDC's role in the decision making process.

Commissioner Myers preferred that AGDC answer the question, but relayed that he would explain AGDC's role from his perspective. He discussed that the design under SB 138 [legislation passed in 2014 related to a gas pipeline, AGDC, and oil and gas production tax] was that the liquefaction plant and potentially the pipeline and GTP [gas treatment plant] components (i.e. the transportation system) would be managed through AGDC. He looked at negotiations with the producers who were involved in the operational component of the project on the management committee. He noted that DNR did not have a seat on the management committee, but AGDC did; therefore, the information would flow through AGDC with respect to the issues he had outlined. Essentially, AGDC was the infrastructure owner; whereas, DNR's responsibility was for many of the upstream issues and the marketing components. He elaborated that DNR would be the upstream management and the transportation corporation, which was a very separate entity from AGDC's role.

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Senator Dunleavy asked if Mr. Fauske was speaking on behalf of AGDC or independently as the head of the corporation. Commissioner Myers asked for verification that Senator Dunleavy was asking about the role of the AGDC board versus the role of the AGDC president.

Senator Dunleavy replied in the affirmative. Commissioner Myers answered that he could not answer the question because he was not personally on the AGDC board and did not interface with the board. His correspondence with AGDC was limited to communication with Mr. Fauske, Joe Dubler (vice president and chief financial officer), and Frank Richards (vice president of engineering and program management).

Senator Dunleavy wondered if some of the positions, especially in the lower portion of the chart, represented contractors. He asked how much funding was attributed to

each of the positions and if each of the blocks represented a full-time position, contractor, or state employee. He observed that there were many company titles included.

Commissioner Myers stated that the blue blocks represented contractors and the green were state employees. On a long-term basis, the state envisioned that some of the blue blocks would turn to green. He explained that some of the positions included under project areas would go away once there was a project. He shared that the producer and state integrated teams including EAGR [External Affairs and Government Relations], expansion, finance, fiscals, governance, and in-state gas, typically had individuals engaged from DNR, the Department of Revenue, the Department of Law, consultants, and sometimes combined with AGDC. However, most frequently the negotiating teams for the upstream, commercial, and marketing issues did not involve AGDC. He expounded that because TransCanada was currently representing the pipe, expansion discussion was done out of the DNR, DOR, and DOL team and consultants with TransCanada related to pipeline size, compressor stations, and geotechnical issues. He reasoned that once the pipeline was constructed there would be no reason for DNR to have a pipeline contractor; if the TransCanada buyout occurred, the individual would be the responsibility of AGDC. He reiterated that some of the roles were temporary through the negotiations and would switch over once pipeline construction began. He explained that the issues would be negotiated for the upstream piece, but then under the buyout AGDC would gain additional responsibilities to manage it.

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Senator Dunleavy discussed that the past session the Senate had made significant reductions and had been told that it had gone too far to some extent. He elaborated that the legislature was currently addressing the proposal to add funding for needed individuals with expertise. He surmised that the administration would probably get questions about how the state would pay for the increase. He wondered if the funds would come out of the existing budgets. He believed that as the cost grew there would come a point where the state had to consider other things it could put aside in order to pay for the project. He was interested in getting more information on salaries for the positions shown in the organizational chart.

Co-Chair MacKinnon appreciated that Marty Rutherford, Deputy Commissioner, Department of Natural Resources had provided the organizational chart the previous day. She discussed that the information was a start towards helping the legislature understand the inner workings of the department's work on standing up a commercially ready project and the technical expertise to work on the state's behalf. She noted that the organizational chart was available online for the public. She asked for verification that some of the state employee positions (represented in green) had been filled and others were vacant.

Commissioner Myers replied in the affirmative.

Co-Chair MacKinnon asked for verification that most of the contractor positions had already been filled (shown in blue). Commissioner Myers answered in the affirmative.

Co-Chair MacKinnon asked for confirmation that the orange blocks on the chart represented AGDC employees. Commissioner Myers replied that he did not know if some of the orange blocks were contracted employees.

Co-Chair MacKinnon remarked that the chart included several groups of lines to indicate decision makers. She noted that the governor was at the top of the chart with the following decision makers: Craig Richards, Attorney General, Department of Law; Randall Hoffbeck, Commissioner, Department of Revenue; Mark Myers, Commissioner, Department of Natural Resources; and Daniel Fauske, President, Alaska Gasline Development Corporation.

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Co-Chair MacKinnon addressed SB 3001, Section 1, subsection b. She explained that the administration was proposing an additional appropriation of \$13,607,000. She noted that subsection c specified that DNR would receive \$2,126,000 of the funds. She asked if the funding would be considered a one-time or recurring appropriation.

Commissioner Myers replied that the funds would be recurring at least into the FY 17 budget related to negotiator positions. He elaborated that the permanent positions (e.g. the gas marketer) would be recurring long-term as the structure was built out. The contractual

component would recur until the negotiation support was no longer needed.

Co-Chair MacKinnon queried the benefit of a marketing position filled by a state employee versus a contractor. She noted that the state would not have a pension obligation for an employee if they worked for ten years, but it would have a health obligation to the employee. She reasoned that the project was about ten years out. She wondered what a person making \$860,000 (as suggested in a recent newspaper) would do to the state's healthcare system. She asked for additional information on the decision to hire someone as an employee versus a contractor.

Commissioner Myers replied that with respect to health insurance, the salary would not really affect an employee's health benefits because they were not under the Defined Benefit program or Tier IV. He noted that the state did pay 22 percent for Tier IV, but it covered other employees under Tiers I through III. He strongly believed in having employees [involved] due to accountability to the state. He detailed that the chief marketer would be negotiating deals in the billions of dollars in the long-term on behalf of the state. He stated that sometimes contractors came and went and even the best ones may not be retained longer than six months to one year. He stressed the importance of continuity. He noted that it was possible to build an organization that included contractors, but the core leader needed to be an exceptional person. He noted that it was possible to have technical employees who were very good, but were lousy managers or team builders. He furthered that the state was looking for unique attributes in the key leader: someone who could build a team, was held accountable to the people of Alaska, and would be on the project long-term. He remarked that the state wanted a sense of "golden handcuffs" around the key leadership positions. He did not believe all of the individuals in the organization had to be employees. However, in the past two negotiations the state had hired world-class consultants, but had then lost the expertise and had to start over on the cycle. He reiterated the importance of continuity of effort, leadership capacity, and technical expertise for the lead position. He added the individual should live in Alaska while doing the job.

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Co-Chair MacKinnon queried the approximate number of employees DNR was proposing to bring on for the marketing team. She asked what the finance subcommittees could expect to see as an underlying recurring cost to support the project (associated with DNR only). Commissioner Myers answered that the marketing organization would depend on how the state chose to market. He detailed that many more personnel would be needed if the state chose to equity market. He explained that under equity marketing the team would need to be independent and autonomous with respect to building a core capacity. He furthered that under equity marketing the state would be doing billion dollar-type deals in the marketplace, which would require individuals to work on a multitude of contracts. He added that the state would be doing the marketing by itself. Under joint venture marketing, the state would need far fewer individuals because its individuals would be seconded into a team. Under the scenario, the team would consist of a leader, a lower paid analyst, geoscientist and engineer (for upstream assurance of deliverability), and an assistant. He elaborated that if there were two joint venture marketing deals the state would need a couple of additional individuals (for a total of 6 or 7 positions). He relayed that the state did not foresee a very large organization built for marketing under the joint venture marketing profile it hoped to achieve.

Co-Chair MacKinnon asked for verification that the term "seconded" pertained using employees from another organization for their expertise for a limited amount of time on a project. She asked Commissioner Myers to expand on the definition.

Commissioner Myers replied with an example about the Prudhoe Bay oil field managed by BP. He explained that the working interest owners included ConocoPhillips and ExxonMobil. He furthered that under management when decisions were made most of the individuals in the structure were BP employees, but there were engineers and geologists from the other companies as well who were assigned and worked as part of the team. He explained that seconded meant that the employees were paid by their parent organization to move into the joint venture organization. He referenced the Alyeska Pipeline Service Company as another example; there were employees working in the company from other companies. He furthered that the state

would take a state-paid employee and put them into the structure of the overall marketing infrastructure. Under joint venture marketing the state and producers could nominate parties for contracts and the group would then decide the best optimization of the contracts. The advantage of having a state employee seconded into the organization was total transparency in the data. He explained that because it was a joint organization there would be limited duplication. He noted that the state would need at least one senior person who was seconded or living in the joint venture marketing organization.

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Vice-Chair Micciche shared that one of his fears was about not taking full advantage of the partnership. He noted that three of the involved companies had decades of oil and gas experience. He was hopeful there would not be any redundant positions, where the need for the state could be met by seconded individuals into AKLNG. He queried the exercise did DNR undertake to determine which positions the state would need under its umbrella versus being seconded from the other organizations.

Commissioner Myers replied that the department asked outside consultants to look at LNG experts. Additionally, the department used its internal LNG expert Audie Setters to help design the minimum system. He elaborated that the department had assumed the fewest number of employees possible, under the most efficient structure - the single joint venture marketing structure. He stressed that the state had to have someone working inside the joint venture structure. He noted that the department felt that it was a smaller structure, which was its baseline assumption. The department also needed employees ready to go in case the structure did not happen. He noted that DNR did not believe it needed a geologist or engineer right away, but the positions would ultimately be needed. The key had been to hire the lead position to build up the appropriate structure in the beginning of the FEED structure (once the marketing structure had been negotiated). He reminded the committee that a joint venture marketing structure would require only a few additional employees; however, under an equity marketing structure it would require a much larger, self-sustaining organization. He noted that an equity marketing structure was not DNR's preference; however, he noted that there were other people who believed an equity

structure would be more beneficial to the state. He elaborated that it would be possible to do a combination of the structures. Additionally, DNR was aware that how the state chose to market may impact how the project financing worked. He explained that there had been discussion about some equity going to other parties. He concluded that from the perspective of the team and consultants, joint venture marketing would be the lowest cost with the least number of employees. He spoke to the importance of a lead position to construct the necessary components and to help the state negotiate with the producers. He noted that the state also needed a marketing professional to start going to the market to warranty the gas. He added that the marketing professional should be someone well known in the market and not himself or someone else on the state's team.

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Vice-Chair Micciche asked if a new position would be created [on the organizational chart] for a team with responsibilities associated with construction due diligence. Commissioner Myers replied that the department had assumed the specific work would be done through the AGDC structure. He emphasized the importance of ensuring transparency between AGDC and the DNR, DOR, DOL team. The state's assumption was that AGDC would have people in the project on the pipeline and GTP side. He explained that DNR felt it was critical to have experts on the commercial areas of in-state gas expansion while the negotiations were underway. Additionally, the state wanted the technical expertise (such as Pat Anderson) during the review of a 48-inch versus a 42-inch pipe to represent the broader state interests. He detailed that a pipeline interest would not necessarily represent all of the state's upstream interests. The producers were particularly interested in the production from the two fields. The state also had that interest, but it wanted to be assured there was capacity for the other gas on the North Slope. He referred to a discussion earlier in the day with the Alaska Oil and Gas Conservation Commission (AOGCC) on the resources. He relayed that there was about 50 trillion cubic feet (tcf) of proven resource on the North Slope and potentially up to 200 tcf more in undiscovered resource. He stated that the numbers were very large and the state wanted to ensure there was capacity. He noted that no determination had been made, but the state wanted to understand the ability to expand. The ability to expand depended on whether the

infrastructure was built correctly to make expandability reasonable in economic sizes and whether the commercial arrangement allowed for it.

Vice-Chair Micciche remarked that there were several state employees that would probably not be necessary even in the later stages of FEED, expansion, governance, and perhaps regulatory. He reasoned that state bureaucracies were resistant to eliminate positions, but its head count was expensive. He wondered what would happen with the positions as stages of the project were phased out.

Commissioner Myers believed the organization should be fit for the purpose at the time the capacity was needed. As constructed, the AKLNG office would cease to exist if the project was successful at the operational stage. As various negotiations were finished certain associated work would no longer be needed. For example, when PILT was fully decided, DNR's current work on the subject would become unnecessary. The organization would be adjusted appropriately at the right phase. He noted that the operational marketing organization had yet to be built (currently the state had a negotiating organization). He expected the structure to look very different when the project reached the next phases.

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Vice-Chair Micciche surmised that each box on the organizational chart represented a decrease in the ultimate value from AKLNG. He remarked that one of the fears discussed around potential new revenue was the decrease in value caused by a bloated bureaucracy. He noted that the structure may not be bloated in the organizational chart before the committee; he had significant faith in Commissioner Myers' abilities. He hoped the department would do its best to keep the organizational structure lean.

Senator Bishop commented that in relation to the gasline the current cost would probably be the cheapest check the legislature would write until the state made a gas sale. He asked if his statement was accurate.

Commissioner Myers replied that because the state would be a partner with only 25 percent of the infrastructure that's where the costs would shift. He detailed that the

transition from pre-FEED to FEED would greatly increase the engineering and development costs. He stated that when the full stage was reached, even though the state was financing, it would still be writing a very large check. He stressed that the project entailed a huge level of capital investment. He stated that when it came to the employee costs the focus should be on AGDC's budget because it would house the majority of the employees. Under a TransCanada buyout scenario the state's 25 percent interest in the capital costs would reside with AGDC. He stated that the value was in the upstream gas. He furthered that the state would be in good shape if it negotiated well, a well-functioning marketing organization had been created, and the right kind of commercial arrangements had been established.

Commissioner Myers discussed the importance of having the state's commercial negotiations lead to verifiable and straight forward outcomes. He stressed that he did not want to skimp on the lawyers and external experts at present because the state wanted to build durable agreements that would not take extra auditing or confusion. He relayed that one of the reasons for RIK was to eliminate some of the problems the state had with checking valuation. However, the state needed to be competent at marketing gas or it could have a catastrophic failure. He reiterated the importance of building a durable framework in the joint venture marketing structure. He stated that a durable, fair, transparent organization was critical, which took significant work given the number of involved parties. Once the framework had been established, the state's operational team could really shrink. He noted that building the right management agreements based on what the state had historically learned was incredibly important. He stated that the structure would be easier to manage from an upstream royalty accountability and tax accountability because of the gas conversion. He stressed that the state had to be very competent as an oil and gas company in terms of running the infrastructure. Additionally, the state's marketing had to be very good.

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Senator Bishop agreed. He wondered if Mr. Myers would personally double check resumes before a final decision was made when hiring for positions pertaining to DNR. Commissioner Myers replied in the affirmative. He stated

that the department would look hard at applicants' technical qualifications.

Senator Bishop appreciated Commissioner Myers' comments. He stressed that the organizational chart was just a piece of paper unless the state had good people in the positions.

Co-Chair MacKinnon asked for verification that the \$2,126,000 for DNR (in SB 3001) was to create a marketing team and that the analysis supported the request.

Commissioner Myers replied that there were multiple components related to the appropriation. He detailed that the document provided to the committee went through the specifics [four-page document provided to the committee from the Office of Management and Budget on October 25, 2015 titled "FY2016 Supplemental Request for State Agencies - \$13.6 Million." (copy on file)]. He communicated that \$646,000 would go to marketing and \$900,000 would go to contractual services. He addressed existing contracts and listed the following: Audie Setters worked on marketing and had taken a leadership role within DNR historically; Deepa Poduval with Black and Veatch; Radislov Shipkoff with Greengate LLC provided financial advising; Nan Thompson (former oil and gas attorney and current Enstar vice president) had been hired to as the lead to write a finding to help achieve a decision on RIK; Pat Anderson (former TransCanada vice president on Arctic pipelines) with Pingo resources; Simon Lisiecki (former vice president of shipping for an LNG company) was working on LNG shipping and financing marketing; and Steve Swaffield (former BG Canada Group president) was working on commercial financing; Steve Wright (former Chevron Alaska manager and petroleum geologist) was DNR's overall coordinator. In order to save money and keep the head count down, DNR had been pulling significant expertise out of its Division of Oil and Gas. He detailed that two of the division's three commercial analysts were spending 80 to 90 percent of their time on AKLNG project related work (meaning the individuals were not available on the oil side when needed). He elaborated that the individuals conducted the economic analysis on lease sales and royalty reopeners. He stressed that it was necessary to find a way to fund the work that needed to be done in the Division of Oil and Gas in addition to its work.

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Co-Chair MacKinnon remarked that there had been a footnote showing a \$4 million credit from TransCanada. She asked how the administration would audit the bills from TransCanada in order to ensure double payment was not made and that complete payments were made. She thought she had heard that the \$4 million had been paid and that it was being carried forward as a credit. She attributed the question to Senator Bert Stedman.

Ms. Pitney replied that there was a \$4 million credit and a \$3 million cost (there had been an offset as a result). She deferred to Commissioner Myers regarding the audit portion of the question.

Commissioner Myers answered that the department was working to obtain the final numbers in order to answer the question. He had learned that there had been a six month period under AGIA where work on AKLNG had started; therefore, there was some credit for the work on the state's side and some credit to TransCanada for work that had not been paid under the AGIA license. He explained that the items subtracted out. He had been asked if there was any overhead. As far as he knew, the 7.1 percent interest did not apply to those dollars. However, there had been an overhead associated with AGIA that did apply. He explained that it was transitional period money and the exact details would be obtained as the state worked through it.

Co-Chair MacKinnon queried the process used by DNR to ensure there was not a bill paying duplication. Commissioner Myers replied that DOR was conducting the audits and would better suited to answer the question. He relayed that had spoken with TransCanada and the state had commercial experts working on the team who were looking at a payout to TransCanada followed by an audit and reopener with the audit. He elaborated that the state would pay out TransCanada and it would then have a certain amount of time to conduct the full audit with a true up at the end of the audit. He communicated that TransCanada was amenable to the process and he believed the state would be as well, but the process had not been formalized. He communicated that the state wanted to time the payments to allow the work plan and budgets to be voted on and so AGDC had the money for the work plan and budget. TransCanada wanted to be paid before it voted on the work plan and budget for the state or turned the right over to AGDC.

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Co-Chair MacKinnon asked if the vote [on the work plan and budget] was scheduled for December 4, 2015. Commissioner Myers answered in the affirmative.

Co-Chair MacKinnon explained that the items outlined in the document provided by OMB typically came in the form of a fiscal note. She wondered if the committee would see a fiscal note.

Ms. Pitney responded that she was uncertain a fiscal note was the appropriate format; however, there was a change of record backup document showing the detail.

Co-Chair MacKinnon replied that the committee would work with the Legislative Finance Division on the appropriate documentation. She thanked Commissioner Myers for his presentation. She relayed that the committee was still working to understand the organizational chart related to the specific hierarchy. She explained that on other projects there may be each of the components broken out in an individual organizational chart showing who positions reported to and how the voting rights were assigned. For example, Senator Bishop had asked if Joe Dubler [Vice President and Chief Financial Officer, AGDC] consulted with AGDC staff, the decision makers (shown on the organizational chart), or from the AGDC board before casting a vote on behalf of the state.

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Senator Dunleavy wondered if the organizational chart represented the ideal staffing or the bare minimum for DNR to do the job.

Commissioner Myers replied that he did not know a lot about how AGDC was constructed and could not address that portion of the chart. He stated that the DNR positions on the chart represented the team that was needed. He stressed the immense nature of the negotiations. He stated that until one looked "under the hood" it was not possible to realize just how complex and difficult the negotiations were. He stated that there were four parties that did not agree on much, which were trying to reach alignment on huge issues with major uncertainty surrounding the issues. He guaranteed that the producers' teams made the

organizational chart before the committee look miniscule. He communicated that DNR was relying heavily on consultants and would not have the ability to undertake the work with only a state team; the state did not have the availability of expertise to hire the right people and to get them in place as long-term employees. He stated that it was the "coalition approach" where it was necessary to bring in the best expertise possible to push as hard as possible. He stated that it was one big push that would last months; therefore, it was necessary to lock-in the high end consultants, which meant the contract money was critical.

Commissioner Myers addressed efficiency in negotiations and acknowledged that negotiations had been scattered. He stated that everyone was still learning how to "crack the nut" in terms of critical issues such as governance and gas balancing. He used a Super Cub airplane as an analogy. He explained that the Super Cub's strength was in its frame, but it would not fly without fabric on its wings; however, the fabric could not be installed before the frame was created. He explained that there were certain structural framework agreements that needed to fall into place and there were other commercial agreements that were needed prior to doing the finding. He explained that it was not possible to speculate on some of the huge values and a conditional finding would not be satisfactory to many people. He stated that he ready to get the skin on the plane as soon as possible, but first the frame had to be assembled. He reiterated that a team of the size shown on the organizational chart was needed to build the framework. He stressed the need for outside consultants and remarked that people were working an extraordinary number of hours. He relayed that many of the state's employees were working a significant amount of unpaid overtime.

Commissioner Myers continued that it was necessary for the state to keep checking itself to ensure accuracy. He stressed the complexity of the negotiations. He believed the positions shown on the organizational chart represented the right balance for the state (not an over balance).

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Senator Dunleavy encouraged the inclusion of a fiscal note. He wondered where the administration believed the money would come from to pay for the bill. Ms. Pitney replied that the funding would come from the Constitutional Budget

Reserve (CBR) savings. She explained that the funds would require a majority vote because there was a buffer of \$500 million from previous legislation and FY 16; however, it would result in an additional draw from savings.

Senator Dunleavy remarked that in the coming year the Senate Finance Committee would be asked to look at alternative revenue sources (primarily the Permanent Fund and taxes). He wondered if there were any additional efficiencies that could be garnered in the administration that could render some money to pay for some of the project costs. He did not believe many people believed it was the last time money would be requested for potential expansion in various areas needed to support the pipeline.

Ms. Pitney replied that there had been significant work on efficiencies to date. The budget reduction between FY 15 and FY 16 for agency operations exceeded \$340 million including an unallocated \$30 million reduction. She stressed that the administration was looking for all possible savings and intended to submit additional reductions going into the FY 17 budget. She emphasized that the administration was looking for every opportunity to reduce the cost of government. She furthered that the tradeoff of funding the project and its potential for long-term revenue to the state was immense. She continued that the project was an area that required investment; at the same time the administration was taking significant reductions in the current fiscal year and was proposing additional agency reductions in the coming year.

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Co-Chair MacKinnon addressed the state's preferred joint marketing agreement structure. She asked if there would be a possibility of downsizing the expensive marketing position once the agreements were reached. Alternatively, she wondered if the position would be long-term with less expense going towards the positions if the state was able to establish joint marketing terms.

Commissioner Myers believed one critical person at the senior level was important. He was uncertain of the salary and the department would do the best it could. He explained that the included salary was closer to the upper end of the range that had come from the consultants' reports. He relayed that the petroleum geologists who had been hired

were not paid anywhere near industry wage; however, they were paid significantly more than the other employees. He communicated that senior petroleum geologists and engineers were paid between \$200,000 and \$300,000 per year in Alaska (the salaries in Houston, Texas were very similar). The state was also looking for the leadership piece on top of the other positions. He relayed that consultants like Ms. Setters would exceed the salaries if consultants were maintained (the hourly cost was very high). The other challenge with LNG marketing was that marketers were paid a significant bonus, which could easily equal close to the person's total salary depending on the year. He did not believe it was a good model for the state to be offering those types of bonuses; therefore, it was necessary to up the base salary to offset.

Co-Chair MacKinnon addressed the technical expertise that would remain in the system after TransCanada's departure. She relayed that Deputy Commissioner Rutherford had testified that 15 TransCanada executives were working on the project. She wondered if the department anticipated holding the individuals in the project. She wondered about continuity over the coming 6 to 9-month period.

Commissioner Myers answered that if TransCanada was terminated it would allow its seconded employees to stay until May [2016], which would get the project through the initial pre-FEED deliverables (not the extended deliverables) and the analysis between a 48-inch pipe versus a 42-inch pipe. He expounded that beyond that time, the core competency would be needed under AGDC or fewer secondees from the state. He believed the 15 secondees would come from the other project companies once the TransCanada left the project. He noted that the state may have a few secondees in the structure.

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Co-Chair MacKinnon stressed the importance of project stability and continuity. She believed it had been Senator Bishop and Vice-Chair Micciche had spoken about continuity and not politicizing the process. She wondered if the department's fiscal note (if provided) include exempt employees versus non-exempt employees to indicate which positions could move in and out of the project at a higher level.

Commissioner Myers replied that the department could identify which positions were exempt versus non-exempt. He relayed that almost all of the positions were exempt and he did not believe any of the anticipated positions would be non-exempt.

Vice-Chair Micciche remarked that his only concern about the TransCanada buyout was over the lack of evidence that the decision making processes would be institutionalized. He did not believe there would be an answer before the bill was processed, but he believed it needed to be considered in the future. He opined that the team could look very different in the post-operational phase and could be significantly reduced. However, there would be an added burden on the tax employees who were currently processing heavier hydrocarbon and primarily North Slope issues. He wondered if the department would assume it would need an additional headcount to account for the other process once AKLNG became operational.

Commissioner Myers believed that based on the activity the state had seen with Armstrong and Repsol related to new unitization, provided that the fields went forward, and with reserves of 500 million P1 [proven] and P3 [possible] of almost 4 billion barrels, things were moving forward. He stated that the new units and territory would be very complicated. He referred to conventional plays related to drilling and stated that with the expansions of the Torok formation at Nuna, new players were coming in and new drilling was occurring. He detailed that the drilling was leading to production and was no longer only exploratory. He discussed that the environmental permitting components would be huge; he pointed to the Colville River delta was an environmentally sensitive area. He continued that the state would have to work with partners on the Arctic Slope and the North Slope Borough. He stressed that bringing the new units to fruition would take substantial work. He continued that the state would have to do participating areas for production and tracked allocation and equity decision making. He emphasized that it was very good news, but it meant there would be much more work. He stated that when the industry transitioned from a few large fields to smaller fields or expansion of less conventional oil sands with horizontally frack wells there was significant work to do. He noted that the evolution to smaller, more spread out fields (and the large Colville field) would keep DNR's staff very busy.

Commissioner Myers discussed that the state still had active exploration licensing if it chose to continue that and was successful. He explained that the state wanted to have the capacity to do the things correctly and to accelerate them. He relayed that given his current staff was stretched thin, he had seriously considered slowing down the oil and gas lease sales in his current year budget. He elaborated that the environmental permitting pieces were becoming much more difficult for the department; much more public notice was required and there was increased acrimony particularly with respect to recent legal cases such as REDOIL [Resisting Environmental Destruction on Indigenous Lands]. Additionally, there were new water reservation issues for the department to address. In relation to development, he saw a significant increase in work would be necessary to do things right. He addressed that two recent timber sales had been appealed and were currently at his level. He stressed the complexity of the issues and stated that it was not possible to take shortcuts. Simultaneously, the federal permitting was becoming much more difficult. He addressed maintaining the state's control in areas such as SMCRA [Surface Mining Control and Reclamation Act].

Commissioner Myers could not see shrinking the size of DNR staff because the work load was increasing. He stressed that the consequences of doing things poorly meant the state would be in court indefinitely. He referred to the department's relationship with the federal government and noted that DNR was adjudicating going to court on water rights. He reiterated that resource management was becoming more difficult for the department for a multitude of reasons. He stressed the importance of having the capacity to do things right. He noted that some of the staff may switch roles from less geotechnical roles to more environmental geotechnical roles - working on wetlands mitigation banks for example. He addressed the effort of coordinating permitting that was done through the department's Office of Project Management and Permitting (OPMP); however, the office had almost no general fund left. He stated that coordination was not available if there were no funds to pay for it. He could see the [AKLNG project] organization becoming dramatically smaller, but other parts of DNR would have to be maintained in order to address resource development.

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Vice-Chair Micciche remarked that although DOR enjoyed collecting the checks, the revenue was a result of DNR's labor. He hoped the legislature would remain focused on the fact that DNR was the only true profit center in the state.

Senator Hoffman queried the proven and potential volume of natural gas. He also wondered what involvement DNR had between a 42-inch and 48-inch pipe.

Commissioner Myers replied that the resource numbers were roughly 6 tcf proven [P1] at Point Thomson and about 24 tcf proven at Prudhoe Bay. He noted that the Point Thomson number could be larger. Additionally, there was approximately 20 tcf proven scattered in a multitude of other fields. He relayed that all of the oil fields also had solution gas (as oil was produced some of the gas came out). Some of the proven gas was well outside of the production area and would require additional pipeline infrastructure, which may not be economic. On the undiscovered resource side, a number of people had put out approximately 200 tcf of conventional (some offshore and some onshore). He stated that the foothills had a very high probability and most of the wells hit gas. He explained that there was a strong indication of a basin center gas system that may be huge (well above 10 tcf). He stated that the gas was not confined to a single structure, but held in a broad area; as long as there was sand, gas would be hit. He continued that the National Petroleum Reserve-Alaska (NPRA) contained significant gas. He offered to have the Division of Oil and Gas provide a complete outlay of the resources.

Commissioner Myers spoke to unconventional resources including natural gas hydrates, which was currently estimated at 85 tcf; a significant portion of the amount was at the Prudhoe Bay, Milne Point infrastructure. He communicated that the department was moving toward a 2017 DOE [U.S. Department of Energy] and Japanese funded well in Prudhoe Bay. He relayed that the operators had been very cooperative working with DOE, the state, USGS [United States Geological Survey], and others. He relayed that if a sustained technical flow could be sustained out of the hydrate accumulations it would be a big step forward. He noted that it was gas that was probably decades away from being commercial. He communicated that the state was hoping

to see success oil success on the Chukchi Sea, but the gas was estimated at 14 tcf.

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Co-Chair MacKinnon asked about the pipe size. Commissioner Myers replied that currently the state was part of working with AKLNG to evaluate a 42-inch versus a 48-inch pipeline. The state would bring in 48-inch pipe for testing. He relayed that a 48-inch pipe was easily expandable to a much larger level, with fewer compressor stations (its base design required 4 versus 8 compressor stations, which used much less fuel gas). He continued that a single-wall thickness (X-80 pipe) was probably good for the entire route and was expandable to a much larger size. He discussed that the cost figures for expansion were relatively modest. He reasoned that if it was not done when the pipeline was built, it would never be done. The disadvantage of the larger pipe was that if the project was optimizing for Prudhoe Bay and Point Thomson only, it would not be done; a 42-inch pipe was optimized in terms of fuel use, which would require 8 compressor stations. He detailed that expansion to another 800 billion cubic feet (bcf) would require another 10 stations. He stated that a combination of X-80 and X-70 steel may need required. He relayed that steel was much lighter weight and easier to transport, the width of the gravel was less and the development work on the smaller pipe was further advanced.

Senator Hoffman wondered what the three major producers may see as an advantage and disadvantage of the different pipe sizes.

Commissioner Myers replied that that from the perspective of a producer the 42-inch pipe would be optimized if the primary goal was production from Prudhoe Bay and Point Thomson and if a producer was willing to wait until there was space available in the pipeline (approximately 2040) to put additional gas into the line. Additionally, a 42-inch pipe was less expensive and the design was further along. He explained that it depended on what someone was optimizing for. He furthered that from the state's perspective a 48-inch pipe made more sense when looking at opening up the basin and providing additional opportunities. He noted that the issue was not only about the pipe size, but the terms for expansion. He explained that if good terms for expansion were achieved, the 42-inch

pipe could be better or acceptable; however, if poor terms for expansion were achieved, the larger pipe would be optimal. He noted that some of the items could be mitigated commercially, but ultimately DNR was appreciative that the project was doing a full geotechnical analysis of the two options. He believed it was premature to make the decision on the pipe size until the review was completed in May [2016].

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Senator Dunleavy referred to talk about exhausting the field over a certain period of time. He detailed that under HB 4 [legislation passed in 2013 related to AGDC and the Regulatory Commission of Alaska] the idea had been gas for Alaskans first and exporting gas to drive the cost down for Alaskans. He wondered how the concern related to the size of the pipe and the life of the field. He wondered about the life of a field under a 36-inch and 42-inch pipeline scenario.

Commissioner Myers replied that net present value (NPV) drove companies to make the investments; whether the investment was the best based on upfront cost and potential revenue. The larger the pipeline, the quicker gas flowed, and the more cash flow early on, usually meant a higher NPV. He added that companies liked large projects that provided gas early because it made their shareholders more money. He discussed that there was a minimum size pipe needed for a pipeline system with an expense structure like AKLNG's to pay back with a regular return to the producers as well. The larger the pipeline, the cheaper the transportation costs. He furthered that a project should be as large as it could, based on the available gas for a reasonable period of time. He detailed that the payoff was typically about 25 years for a project like AKLNG; beyond 25 years, the additional gas that a project may see was so far out it had little economic value in relation to the investment. He furthered that companies looked for a "sweet spot" of volume and time frame with gas supplies to back it up. Companies were also doing long-term contracts and wanted to ensure they had enough gas to meet the contract needs. He relayed that AGDC had conducted an evaluation of a 36-inch line and had determined that it was not commercially competitive with other projects in the world. He explained that the throughput volume had to be larger. He continued if a Prudhoe Bay only project that would

produce at a lower rate through a 36-inch or 40-inch pipeline, it did not make an economic cut compared to other projects because the cost of delivery was higher. He furthered that to backstop a 42-inch line with flows of 3.6 [bcf] per day "you might look out of the system to deliver," but to deliver enough for the full trains of LNG, reserves about the size of those at Prudhoe Bay and Point Thomson were needed. He continued that at about year 16 Point Thomson would decline and a gap in capacity would begin, which was the reason having a basin with other potential was important. He explained that the project would be built based on warranting the current supply from both fields, which would maximize economics and assure suppliers the gas would be delivered. He stated that a smaller pipeline did not really fit the economic criteria to build a competitive project.

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Senator Dunleavy asked about the horizon on the fields in terms of years with a 48-inch pipe versus a 42-inch pipe if Alaskans were looking for a long-term, stable gas supply.

Commissioner Myers answered that there would be maximum production from the two fields for about 16 years with declining production to about 25 years and possibly longer. He added that new gas would be flowing in from other fields given what was known. He relayed that there were certainly other proven resources that would go into the pipeline including solution gas on the other fields, gas caps, and gas from NPRA. He elaborated that other gas would come in from the immediate infrastructure. He noted that gas from NPRA was likely to come in. He added that the Point Thomson area had upside as well. Another 20 tcf could come in from other known gas resources in Alaska depending on price, economics and time. The farther away from the GTP the more gas the project would need to bring in (unless the gas was low in carbon dioxide) because a feeder pipeline would need to be constructed. He explained that there was a minimum size of additions that depended on the distance from the infrastructure.

Co-Chair MacKinnon thanked Commissioner Myers for his presentation. She relayed that the committee was excited about a project for Alaska.

Vice-Chair Micciche asked what had been plugged in for an evaluation of excess liquefaction capacity. He noted that with a 42-inch design the project would have more supply than liquefaction. He wondered what was under consideration for a 48-inch pipeline. He noted that if in-state use would not even meet one of the millimeter marks on a yard stick. He asked about the thought process and if DNR was hopeful someone was interested.

Commissioner Myers replied that his understanding was that the design was being optimized for offtake. He elaborated that all three facilities were being designed to maximize winter production and keep production through the existing trains. He relayed that there was room for another train on the facility design; another large train would be needed. He believed there was the space and design capacity for an incrementally valid expansion. He was not aware of any commercial discussions about how it would be triggered. Secondly, there had been many discussions about spur lines, offtake points, and the possibility of a smaller LNG project in the Cook Inlet region closer to the Mat-Su port. He noted that there were certainly people interested in building smaller scale facilities. He discussed how it would fit into a design and noted that it would not necessarily take a large incremental expansion. He stated that compression would likely have to be increased because of the optimization for the existing plant. He added that the same was true related to large amounts of in-state gas beyond what was being contemplated. He relayed that the state's view to date had been that it was a very cheap option to put the pipe in the ground (once it was in the ground it was there); however, a liquefaction plant was much more challenging, given the cost structure a large expansion would be needed. He stated that one of the challenging components of the 42-inch pipe was the need for 10 compressor stations to make it an economic tranche. He relayed that it was much easier to do an expansion with the 48-inch pipeline. He stated that it was possible to move 700 [million cubic feet per day], but it would take a 42-inch pipe to its maximum.

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Vice-Chair Micciche noted that Commissioner Myers had given the same horizon with the 42-inch and 48-inch pipe. He reasoned that it was likely not accurate unless there was new gas. He stated if an additional 700 [million cubic feet

per day] was flowing, it would be more like 18 years versus 25.

Commissioner Myers agreed. He explained that his presumption was new gas. The only thing large enough would be the foothills in a single tranche or the Chukchi, which was much less likely. He opined that it was a play on having the basis under gas and having it developed. He stated that it was a risk play and he could not say that it would happen. From the producers' perspective it was an extra cost to the project, but to the state it was a cheap option for expansion.

Co-Chair MacKinnon asked DOL attorney Martin Schultz if he would be available to present on Friday given time constraints associated with the current meeting.

MARTIN SCHULTZ, CHIEF ASSISTANT ATTORNEY GENERAL, OIL, GAS, AND MINING SECTION, DEPARTMENT OF LAW (via teleconference), agreed to present on Friday.

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Co-Chair MacKinnon surmised that the appropriation in SB 3001 was placing all of the money into AGDC. She believed there had been some RSA [Reimbursable Services Agreement] transfer of funds issues in the past with DNR and AGDC. She asked if the department was content with the construction of the appropriation or could the money go directly to DNR.

Ms. Pitney replied that under the construct of the legislation direct LNG funds would go to each department; the intent was to have all of the funds show up in the LNG fund. She noted that in conversations with David Teal [director of the Legislative Finance Division] there was a difference in perspective on how it would work. The administration preferred that direct funding would go to each of the agencies; however, it believed that the RSA approach would work as well.

Co-Chair MacKinnon communicated that direct funding to the departments was her preference as well. She relayed that with the support of the committee she would work to construct a committee substitute to directly fund the departments. She understood that Ms. Pitney had expressed an interest to ensure all of the funding for the project could be tracked in order to provide transparency. She

noted that based on her observation RSA transfers could take a considerable amount of time. She elaborated that the issue had been flagged in the committee's review of the bill.

Co-Chair MacKinnon looked forward to Commissioner Myers' next update and appreciated his presentation. She moved on to a presentation by DOR. She relayed that the department was requesting \$1,381,000 under the legislation. She asked the department to address how the appropriation would be used.

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DONA KEPPERS, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE (via teleconference), began by addressing the organizational chart [State of Alaska AKLNG Integrated State Gas Team]. She relayed that she coordinated the work product and led several teams. She pointed to the finance, fiscals, and property tax columns. She explained that there were two major work streams dealing with the finance effort and the property tax effort that was part of a public process. From a reporting standpoint, the department was requesting \$794,000 for personal services as part of the supplemental request. She discussed that it was necessary to look at deliverables to learn how DOR had used its internal resources. She addressed how the department used its high level resource employees in the most effective way. The department employed two audit masters from its Tax Division, one commercial analyst, and the deputy commissioner, who supported a major piece of the work effort. She relayed that DOR did an enormous amount of coordination and collaboration dealing with its consultants (blue boxes on the organizational chart) in the work streams. The department also had an integrated workplace with its counterparts at AGDC. She elaborated that there was significant weekly communication with AGDC; the agencies used the same accounting across the areas in order to have the continuity of knowledge to move information forward.

Ms. Keppers referred to the audit masters and commercial analyst positions and shared the need for a cohesive knowledge in order to move the work products up to Commissioner Randall Hoffbeck. She noted that using the Tax Division employees for the AKLNG project had been difficult on the division because it had taken them away from their

usual work. She explained that funds were included in the supplemental request because when DNR's FY 16 budget request had been cut DOR had not received its piece of an RSA.

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Ms. Keppers pointed to slide 9 of Ms. Pitney's presentation titled "TransCanada and Pre-FEED Supplemental Appropriations Summary" dated October 2015 (copy on file) and relayed that DOR's personal services were in a collaborative, consulting, and advisory support role to DNR related to the AKLNG project. She relayed that DOR worked closely with its consultants and DNR. She reiterated that the work on AKLNG had constrained the Tax Division and the department's overall workload was increasing. She referred to the department's scope of work requirements under SB 138 on slide 8. The slide included a list of items the department had done and was continuing to work on in FY 16. She relayed that going forward a major component for the department was related to property tax, the impact and benefit of the AKLNG project, making recommendations to property tax statute, impact payment processes, revenue distribution, and coordinating with the Municipal Advisory Gas Project Review Board (MAGPR). She stated that coordinating with the MAGPR was a huge piece of stakeholder work for the department, which would continue through the spring [2016]. Another part of the department's involvement was related to the financing work. She relayed that the state's consultants Lazard and Greengate LLC were dealing with reports and financing options; however, the work effort was collaborative with DOR. She stressed that DOR was involved in a critical part of project negotiations. She communicated that the department needed to retain its current resources in order to achieve commercial agreements going forward.

Ms. Keppers addressed the department's work related to the audit of TransCanada development costs. She explained that there was a travel and audit services component DOR was responsible for, which was included in the appropriation request. Another portion of the DOR request was \$500,000 for a bankability review. She explained that the capital funds would go towards conducting an independent review of the project commercial structure and the financing plan for the state. She elaborated that the work represented the state's due diligence to determine prior to final

investment decision (FID) whether the commercial structure and financing plan for the project was bankable. She noted that the component had been added subsequent to the FY 16 budget.

Ms. Keppers referred to questions related to how the TransCanada audit worked. She referred to an earlier question about TransCanada final billings and whether the state was current on the invoices. She relayed that it was necessary to take a step back. The department had gone through the AGIA audit process. She discussed a \$330 million figure and relayed that there had been an annual audit; the final audit had been completed and extra due diligence had been conducted to ensure that the invoices billed by TransCanada were split correctly in regard to AGIA work versus AKLNG work. She reminded the committee that there had been a transition period between the two. Subsequently, special reports had been run as the AGIA systems had been closed.

Ms. Keppers continued that two audits would be conducted, the first dealt with TransCanada's development costs. She elaborated that the audit provisions were stipulated in the Precedent Agreement (PA) with TransCanada. The state was about to procure services for the audit and was currently working with TransCanada on determining the total costs. She relayed that from an accounting process standpoint there was no provision in the PA for the state to audit any TransCanada development or transporter costs until a notice of termination was received. She elaborated that once the notice was given the state would initiate the audit process according to the provisions established in the PA. She noted that the audit guidelines in the PA were contractual, not statutory. She referred to a question about the audit payment process and whether any delays would be triggered. She relayed that the PA did set out the auditing process and the payment timing requirements. The department was currently creating two or three diagrams to walk the committee through the timeline, dates, decisions, estimated amounts, and interest costs based on timing of decisions.

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Ms. Keppers referred to a question about how the state would challenge TransCanada's numbers as part of the audit process. She explained that TransCanada's costs were challenged as part of the audit process; anything that was

disputed by the state was placed into an escrow account established by the parties. The disputed amounts were determined through an executive level dispute resolution process and paid out within 30 days. She explained that anything left unresolved would be tried in Alaska court. She relayed that there was also a joint venture audit done through AGDC. She deferred any questions related to the specific audit to AGDC. She concluded that there were three audits: 1) historical, 2) current, and 3) through the joint venture agreement.

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Ms. Keppers urged support of the appropriation that would enable DOR to work through AKLNG commercial agreements. She stressed the importance of maintaining the continuity of its employees and consultants in order to bring successful agreements forward. She relayed that the department was working diligently and had very dedicated employees. She addressed an earlier question about what would happen going forward. She detailed that the commercial agreements needed to be established in FY 17. The department hoped to see a taper in FY 17; there was staff currently working on commercial agreements, which would transition to people implementing the agreements. Additionally, there would be regulatory work. For example, the department would set up impact payments, processes, and distribution systems related to property tax. The department was constantly doing a reassessment based on where the state was in the negotiations and the deliverables as specified in the agreements. Some work on the marketing plan was beginning in FY 16 with DNR; some collaborative work had been done with Audie Setters and her group, but the work would increase.

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Co-Chair MacKinnon stated that she was interested in an update from DOR on the different items in SB 138. Specifically, the committee was wondering about the progress of evaluating the possibility for individual Alaskans to take part in funding the pipeline. She asked if the department had started work on the issue.

Ms. Keppers replied in the affirmative. She furthered that with FirstSouthwest and others the department had held conference calls and meetings with corporations and several

municipalities. The department had spoken with the entities to gauge their interest on investing in the project. Lazard had compiled collected information, which would be included in its final report. She did not have details on how much the entities would want to invest and types and ranges of portfolios. She relayed that the conversation with multiple parties had been very engaging. She noted that the Lazard report would also include a plan on how to move the effort forward. She offered to follow up with Lazard to provide further information to the committee.

Co-Chair MacKinnon queried the progress on the framework of how the information may be compiled. She discussed that before the passage of SB 138 the involved committees had discussed the idea of a check box for individuals on their Permanent Fund Dividend. The discussion had considered whether it would be possible to create the dynamic to allow individual Alaskans could purchase shares in a project going forward while remaining inside the federal government's commerce laws. She furthered that the money would be held for the construction with the hope that the pipeline would provide a guaranteed rate of return for Alaskans, municipalities, Native corporations, and other businesses.

Ms. Keppers agreed to request the detail from the Lazard team and FirstSouthwest.

Co-Chair MacKinnon relayed that the committee was interested to know about the legality of the idea.

Senator Dunleavy wondered if there had been discussion about the idea of establishing investment corporation vehicles by the state where shares would be sold or individuals could invest their money and the corporation would hold an interest in the project. Alternatively, he wondered if the department was only looking at the idea of selling bonds to individuals.

Ms. Keppers answered that it was a little early to hold the discussion, but she believed that FirstSouthwest and the Lazard team could speak to the options. She would follow up with the financial consultants.

Co-Chair MacKinnon expressed that the committee was anxious to show support for the project in a more personal way. She

relayed that the framework would help the committee to see if Alaskans would be willing to invest in the project.

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Co-Chair MacKinnon referred to the department's request of \$1,381,000 and new responsibilities the department had been assigned in relation to the AKLNG project. She listed responsibilities including coordinating MAGPR, negotiating property tax payments, and making recommendations for changes to property tax statutes. She reasoned that several of the responsibilities should be close to fruition or completed. She wondered why there was no visible cost shift as opposed to the cost request. She believed most of the work should be finished.

Ms. Keppers asked for clarification on the question.

Co-Chair MacKinnon explained that it appeared some of the property tax issues asked of DOR were complete or close to completion; however, there were recurring costs imbedded in the budget to support the activities. She wondered why the department was requesting additional funds and not using the funds that were already allocated to the positions.

Ms. Keppers answered that the department was at a different phase on the property tax work with the MAGPR Board related to the impact payment process, creating process, and working with the board on the allocation and distribution systems as part of the stakeholder engagement. She explained that the property tax issues were coming to alignment on a target with the producers, but currently the department was working through the discussions with the MAGPR Board; therefore, the department's work stream had remained the same and had just shifted to a different type of work within property tax.

Co-Chair MacKinnon asked how many new employees the department was planning to hire under its personal service request.

Ms. Keppers replied that DOR could not hire any new personnel; the department was using its current audit masters, commercial analyst, herself, and Commissioner Hoffbeck. Additionally, DOR had one employee who was part of the North Slope Gas Commercialization Office and was totally dedicated to the AKLNG property tax work. She

reiterated that the department was not able to hire any new employees. She elaborated that it would take one to two years to hire individuals and to train them; it would be very difficult to do.

Co-Chair MacKinnon asked for clarification on the supplemental appropriation request for DOR for \$1,381,000, which showed personal service increases of \$794,000. She believed some money was being added to the deputy commissioner allocation. She pointed to page 3 of a document from OMB titled "FY2016 Supplemental Request for State Agencies - \$13.6 Million" (copy on file).

Ms. Pitney explained the DOR request for \$793,000. She detailed that the individuals under the request had shifted out of their existing roles to support AKLNG related work, which left divisions without the capacity to do their typical work. She elaborated that the budgeted positions had been taken out of the work they normally did, reduced the capacity, and were trying to substitute the work that was not getting done. She explained that it would have to be done on a temporary basis or by contract. She furthered that the increments represented what the added requirement would be going forward. For example, the two audit masters had been taken out of the Tax Division and the division did not have the ability to backfill the positions. The increment would enable the Tax Division to bring on capacity to conduct auditing.

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Co-Chair MacKinnon reasoned that the expenditure of \$1.4 million for DOR was backfilling something. She believed new employees must be coming in somewhere. Ms. Pitney replied that the position focus was \$793,000; the bankability study was \$500,000, which was contractual and not related to additional people; and the related supplies and travel. She explained that the funds would go towards the lost capacity in the divisions for the employees being wholly dedicated to the AKLNG effort.

Co-Chair MacKinnon referred to the lost work capacity and wondered how the work would be completed if no new employees would be hired. She wondered who would do the work. Ms. Pitney replied that the work would be done either with contractual or temporary support.

Co-Chair MacKinnon noted that a request for a personal services increment usually pertained to bodies. She wondered if non-permanent employees would be hired. She reasoned that a fiscal note would provide clarity. She was aware that the positions would not be full-time, but surmised that someone would have to work the hours. Ms. Pitney replied that the intent was to provide capacity to allow the department to complete its typical work, which was currently not possible because the individuals had been assigned to substantial AKLNG related work.

Co-Chair MacKinnon asked for verification that the department was not planning to hire anyone to complete the work. Ms. Pitney answered that a non-permanent position may be needed, especially related to audit work. She stated that in the future it would be necessary to restore capacity to the divisions as the project moved forward.

Senator Bishop surmised that the funds could be backfilling part of the supplemental for the positions that had not been funded in the regular budget. He noted that some of the positions were affiliated with money that would have come from DNR [funds were not received due to cuts to the DNR budget].

Ms. Pitney responded that there had been an expectation under DNR's original \$13 million request that RSA funds would be provided to DOR; however, that had not occurred. Additionally, there had been reductions to DOR, which had compounded the capacity loss.

Co-Chair MacKinnon relayed that the committee would work with the Legislative Finance Division to clearly understand how the money was flowing to personal and contractual services. She asked for verification that the \$13,607,000 was a supplemental request related to the expansion and growth of the work plan for the pre-FEED stage of the AKLNG project.

Ms. Pitney asked for clarification.

[5:03:26 PM](#)

Co-Chair MacKinnon observed that the bill contained a TransCanada buyout for around \$70 million, which included some form of interest payment. Additionally, the bill contained a work plan to demonstrate the state's desire for

an AKLNG project. She noted the intent to approve and fund the work plan. According to a letter from Governor Walker, the work plan had changed from \$511 million to \$693 million and the state was responsible for picking up its share. She thought the \$13,607,000 was not only a supplemental for the state, but a part of the work plan.

Ms. Pitney replied that the \$13.7 million was the state's support related to AKLNG, but it was not within the work plan budget. She stressed that the state paid cash calls for the specific AKLNG project. The bill included three components including the TransCanada buyout; the remaining cash calls; and the supplemental request for the agencies to support the commercial agreements, tax implications, and contractual services for law firms associated with the bankability.

Co-Chair MacKinnon looked at the capitalization of funds in Section 1 of the bill, which showed that approximately \$70 million would buyout TransCanada. She observed that the state's portion of the increase in the work plan for pre-FEED was approximately \$74 million. She stated that the third component was a supplemental appropriation for department work to support the project at the state level.

Ms. Pitney agreed.

Senator Hoffman discussed that the supplemental request included \$144 million for capital; \$68 million of the total request would go to reimbursing TransCanada and \$75.6 million would go towards funding remainder of the state's pre-FEED share. He referred to slide 20 of a DOR presentation ["TransCanada's AKLNG Participation: Financing Issues" dated October 24, 2015 (copy on file)] and addressed the department's recommendation to use CBR funds and the earnings reserve fund for the project. He noted that the CBR was shown as the funding source for SB 3001. He observed that the slide included the option of using long-term financing to be reimbursed once bonds were sold. He believed that under the scenario (on slide 20) the department was not considering the bill's current structure, the pre-FEED of \$144 million, and the FEED of \$675 million. He asked about long-term financing and also wondered if everything was under consideration for direct appropriations from sources to be determined at a later date.

Ms. Pitney replied that the \$157 million to get through FY 16 for the agencies and pre-FEED would be an additional draw on the CBR. There would then be a decision on FEED, which the administration did not yet have a recommendation on. She believed a likely recommendation would be the concept of a rolling the principal of the FEED cost into a project revenue bond and having interest only payments until a construction decision was reached. She emphasized that how the state would get through FEED from a financing standpoint was high on the administration's priority list. The administration felt that given the current risk level, the pre-FEED would be funded with existing savings. She added that FEED would entail a larger cost that the administration would want to finance.

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Senator Hoffman referred to slide 20, which eluded to the fact that the pre-FEED cost of \$144 million could also be rolled into the long-term financing. He wondered if the option was off the table. Ms. Pitney responded that the scenario (on slide 20) was a possibility, but this was a timing issue. She explained that the state had to have the funds for the upcoming work plan and budget decision in early December [2015].

Senator Hoffman wondered if the decision on rolling in the pre-FEED cost of \$144 million needed to be made prior to passage of SB 3001. Alternatively, he wondered if the determination could be made at a later date and could be rolled into long-term financing.

Ms. Pitney believed that the bill did not preclude the state's ability to finance the portion if desired. She would verify her accuracy.

Senator Hoffman asked for verification she was referring to long-term financing. Ms. Pitney replied in the affirmative.

Co-Chair MacKinnon looked at Section 2 of the bill that contained a \$5 million statutory program receipt request for field work. She wondered if the state was currently collecting statutory receipts from its partners for other items. Ms. Pitney replied that the request was for a new concept. She detailed that the state had the ability to bill and collect funds from its partners for work that had been done; the collected funds would revert to the General

Fund. The statutory program receipt authority would allow the funding to go to AGDC to offset its costs for providing the work.

[5:12:10 PM](#)

Co-Chair MacKinnon asked why the state would not hold the amount as a credit inside the working group that could later be deducted from money owed by the state. Ms. Pitney agreed to provide that information. She thought Mr. Dubler could help answer the distinction between the cash call component and the AGDC organizational work. She believed the reasoning was that it was AGDC organizational work that the project could pay for.

Co-Chair MacKinnon referred to the \$13 million supplemental request. She surmised that DNR was able to quantify the new personnel that Alaska was considering taking on. She believed Senator Dunleavy and others had discussed the long-term implications [of bringing on new personnel] when the state was trying to balance or reduce its budget to a sustainable level in order to have revenue to support the budget. She asked for verification that DOR was not bringing in new state employees (exempt or non-exempt).

Ms. Pitney responded that the positions listed in the detail were existing positions. She detailed that by dedicating existing department positions to the AKLNG project, it had left divisions without the capacity to do their work. She relayed that it was necessary to determine how to ensure that the divisions could get their work completed. She stated that the work could be done through short-term full-time temporary or contract positions. She added that if the capacity for the AKLNG project extended, it would require some backfill in the divisions.

Co-Chair MacKinnon asked Ms. Pitney to work with the Legislative Finance Division to clarify whether the workers would be temporary, part-time, or new state employees. She wanted more clarity on DOR's personal service request.

Co-Chair MacKinnon thanked Ms. Pitney for her testimony. She addressed the schedule for the week.

SB 3001 was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

5:16:23 PM

The meeting was adjourned at 5:16 p.m.