

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

February 18, 2015

3:29 p.m.

MEMBERS PRESENT

Senator Cathy Giessel, Chair
Senator Mia Costello, Vice Chair
Senator John Coghill
Senator Bert Stedman
Senator Bill Stoltze
Senator Bill Wielechowski

MEMBERS ABSENT

Senator Peter Micciche

OTHER LEGISLATORS PRESENT

Senator Charlie Huggins

COMMITTEE CALENDAR

AKLNG UPDATE

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

DAVID VAN TUYL, Regional Manager
BP Alaska
Anchorage, Alaska

POSITION STATEMENT: Said he has been working with BP for the last 30 years, the last 15 of which have been dedicated to working to get Alaska's gas to market.

DARREN MEZMARICH, Integration Manager for the AKLNG Project
ConocoPhillips
Anchorage, Alaska

POSITION STATEMENT: Said he is very proud to be a part of this significant project.

BILL MCMAHON, Senior Commercial Advisor
ExxonMobil Corporation
Anchorage, Alaska

POSITION STATEMENT: Said Alaska is an important part of ExxonMobil's worldwide portfolio and they are encouraged by the progress they have seen on the AKLNG Project as described by Mr. Butt on January 3.

VINCENT LEE, Director
Major Project Development
TransCanada

POSITION STATEMENT: Said he serves as the commercial lead for TransCanada in the AKLNG Project.

DAN FAUSKE, President
Alaska Gasline Development Corporation (AGDC)

POSITION STATEMENT: Said the AGDC is involved in both the Alaska Stand Alone Project (ASAP) and the AKLNG Projects.

MARTY RUTHERFORD, Deputy Commissioner
Department of Natural Resources (DNR)

POSITION STATEMENT: Said she was also the administration's lead on the AKLNG Project.

DONA KEPPERS, Deputy Commissioner
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: Said she was part of the transition team from the prior year when the project was started under the previous administration.

RANDY HOFFBECK, Commissioner
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Related that there had been some concern with how the MAGP group is fitting in with the process.

ACTION NARRATIVE

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CHAIR CATHY GIESSEL called the Senate Resources Standing Committee meeting to order at 3:29 p.m. Present at the call to order were Senators Costello, Coghill, Stedman and Chair Giessel.

AKLNG Update

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CHAIR GIESSEL announced that today the committee would get the second portion of the required quarterly updates on the AKLNG Project. They heard earlier from Steve Butt about the project itself, and today they would hear about gas production, the commercial, fiscal and regulatory terms, as well as the external affairs and governmental relations units.

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SENATOR WIELECHOWSKI joined the committee.

SENATOR STOLTZE joined the committee.

DAVID VAN TUYL, Regional Manager, BP Alaska, said he had been working with BP for the last 30 years, the last 15 of which have been dedicated to working on getting Alaska's gas to market. His current role is on the joint fiscal team and the management committee of the Alaska LNG (AKLNG) Project. Today, he said the right parties are aligned in a way to collectively advance the project. That was true last February and it is true today, but a lot of work has yet to be done. However, they remain on track for a 2016 decision to move the project into the next phase of development, the front end engineering and design (FEED) stage.

He said the companies before the committee had all dedicated their resources to meet that challenge, and so has the new administration. They are all now actively engaged on a variety of fronts to continue to progress the project and the associated commercial work that is required to meet that goal. Any one of them, even with their very best efforts working in isolation can't make this project a success, but all of them working together cooperatively can.

They have taken some very important and very successful steps along the way. Last year this body passed SB 138 and entered into an agreement to begin the current pre-FEED phase. They filed for a Department of Energy (DOE) export license application and initiated the Federal Energy Regulatory Commission (FERC) pre-filing process. The project has momentum and they look forward to continuing this journey together.

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DARREN MEZMARICH, Integration Manager for AKLNG, ConocoPhillips, Anchorage, Alaska, said he very proud to be a part of this

significant project. ConocoPhillips sees two key steps before going to the FEED decision; first is commercial and second is fiscal. First, they are building a commercial foundation for the project, in particular, completing two key agreements: the gas supply and the governance agreements that must be in place before the fiscal package is considered by the legislature. The second step is finalization of the fiscal legislation package. With the commercial and the fiscal foundations in place and the completion of the technical pre-FEED work, they would expect to have the information necessary to make a FEED decision.

MR. MEZNARICH said when he refers to a gas supply agreement, he is just talking about matching a company's cash investment with the share of gas or LNG they get out of the project. ConocoPhillips, like everyone else, expects to be making a cash investment based upon their gas percentage share to the project. Once that investment is made, they need to make sure they can deliver that share of gas to the project on a day-to-day basis, and that they have the ability to get that same share of gas or LNG from the project on a day-to-day basis. The concept is relatively simple: their investment share equals their gas throughput equals their product offtake.

Governance agreements can be called venture agreements; these are where the business is set up like how costs are shared and voting rights, who is in charge of what and how to pay the bills. Today, the commercial agreements are not complete, neither is the fiscal package, but they are working hard to meet the schedule. Everyone wants to find a way to make this project successful.

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BILL MCMAHON, Senior Commercial Advisor, ExxonMobil Corporation, said Alaska is an important part of their worldwide portfolio and they are encouraged by the progress they have seen on the AKLNG Project as described by Mr. Butt on January 3. The signing of the Heads of Agreement (HOA) and the passage of SB 138 were key achievements last year. Since that time, the five parties represented at the table and the Department of Natural Resources (DNR) and Department of Revenue (DOR) have been actively engaged in working on the things that need to be complete to be able to set up the decision to go through the next gate, to enter FEED. Their target for that decision is in 2016.

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VINCENT LEE, Director, Major Project Development, TransCanada, said he serves as the commercial lead for TransCanada in the

AKLNG Project. In 2014, he said TransCanada signed an HOA with the Alaska Gasline development Corporation (AGDC), the state and the three producers. At the same time, TransCanada and the state agreed on a memorandum of understanding (MOU) that established the material terms for TransCanada to provide gas treatment and transportation services to the state for the state's share of the gas in the AKLNG Project.

Following the passage of SB 138, Mr. Lee said TransCanada entered into a precedent agreement (PA) and equity option agreement with the state. The PA formalized the material terms that were agreed on in the MOU. The equity option agreement provided the state an option to buy up to 40 percent of TransCanada's ownership interest in the gas treatment plant (GTP) and pipeline segments of the AKLNG Project. As a party to the joint venture agreement for AKLNG pre-FEED, TransCanada has to bring on highly skilled and experienced pipeline and project management employees including the pipeline manager who leads all technical activities for the pipeline segments of the project.

TransCanada is negotiating with the state administration to reach agreement on the long-term transportation services agreement (TSA) that would replace the PA. They are working to have the firm TSA finalized and ready to present to the legislature for review and approval later this year. TransCanada is also working diligently with the other participants in advancing the commercial agreements to prepare for the FEED decision.

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DAN FAUSKE, President, Alaska Gasline Development Corporation (AGDC), said the AGDC is involved in both the Alaska Stand Alone Project (ASAP) and the AKLNG Project and it is very reassuring that seasoned professionals from all walks of life are participating in these projects.

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MR. MCMAHON (ExxonMobil) said he would walk them through a description of how the project is structured and the work that is going on to get to the FEED decision.

He said the sponsors are representatives from the seven parties (DNR, DOR, AGDC, TransCanada, ConocoPhillips, BP, and ExxonMobil) that meet regularly to facilitate moving the AKLNG Project forward. As with any mega-project, a stage gate process is used to authorize sets of work; the project is now in pre-

FEED, the next stage is FEED. He said it's all about driving alignment, so that when they get to that decision all sponsors can give a thumbs-up to moving to the next stage.

This sponsor group is concerned with all aspects of the project. The joint venture parties (AGDC, TransCanada, ConocoPhillips, BP, and ExxonMobil) are doing the project pre-FEED work. This is also the group that filed the FERC applications to get the process going that will result in the environmental impact statement (EIS) that will allow the construction permits to be issued.

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MR. MCMAHON explained that last year an application needed to be filed with the DOE to start the process of getting export licenses and that a legal entity was needed to file it. So, affiliates of ExxonMobil, BP and ConocoPhillips formed an LLC and put that application in. This application would also cover any potential state royalty in kind (RIK) or production tax as gas (TAG), so a "future parties" box was used to allow for the state to have a representative join the LLC so all the gas could be properly represented.

CHAIR GIESSEL asked if future parties potentially could be the AGDC or another private company.

MR. MCMAHON answered that is the administration's call, but it would be someone from the state.

MR. FAUSKE added that AGDC had internal discussions with the working group and preliminary discussions with DOR and DNR and will come to a resolution on that issue soon.

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MR. MCMAHON said that next, each sponsor group would talk about what they bring to the project. The first group was the state administration with the DNR administering the state's royalty and pipeline rights-of-way and the DOR administering the regulation and collection of taxes. Depending on the state's election to take royalty in kind and a subsequent election by ExxonMobil, BP and ConocoPhillips for the state to take its production tax as gas (TAG), the state could receive about 25 percent of the resulting gas production.

The DNR and DOR would also represent the state's interest as a resource owner, as a potential shipper, and as the sovereign including fiscal issues and security of gas supply. He explained

that if the state takes RIK and TAG it will be keenly interested in how gas flows from Prudhoe Bay and Pt. Thomson into the project. The state has also made it clear that it is interested in facilitating expansion of the AKLNG Project in the future to ensure third-party access to the facility.

CHAIR GIESSEL remarked that "the election by ExxonMobil, BP, and ConocoPhillips for the state to take TAG" was interesting wording.

MR. VAN TUYL (BP) responded that the disposition of the state's royalty gas and production tax was articulated in SB 138. Clearly, the state has to decide whether or not it takes its royalty in value or in kind. If it makes an RIK election, then each taxpayer would have the right to make an election to pay that obligation of production tax in money or as gas. So, subject to the state making an RIK decision, each one of the producers will have an election to pay their liability of production tax as gas. That would result in the 25 percent of total production accruing to the state.

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MR. MCMAHON said AGDC and TransCanada represent the state's infrastructure interest in the project in the pre-FEED process. AGDC represents the state's ownership interest in the LNG plant and TransCanada represents the state's ownership interest in the pipeline and GTP.

He said ConocoPhillips, BP, and ExxonMobil hold rights to produce natural gas from the Prudhoe Bay and Pt. Thomson units. As owners of those units, they are working now to commercialize those resources. This includes ownership in the new AKLNG Project facilities.

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CHAIR GIESSEL asked for a breakdown of ownership in the two units.

MR. MCMAHON answered that ExxonMobil has about 62 percent ownership of Pt. Thomson, BP about 30 percent, ConocoPhillips 5 percent, and a group of minor owners that make up 1 or 2 percent.

MR. VAN TUYL said that BP operates the Prudhoe Bay field and owns about 26 percent, another 36 percent-ish is owned by ExxonMobil, ConocoPhillips has another 36 percent, and under 2 percent is owned by Chevron.

MR. MCMAHON said the Project Team is made up of an integrated group of experienced personnel from ExxonMobil, who is the lead, TransCanada, BP and ConocoPhillips. They are currently in pre-FEED and advancing the engineering for the AKLNG Project facilities. Plans are being drafted on how to move materials and personnel onsite to construct the three main facilities. The overall costs and schedules are being refined so that they can be put into the economic analyses of the individual parties for the FEED decision. The Project Team is doing the important technical work that is going to underpin the environmental permitting applications that will allow the project to be built.

He said a cooperation agreement is in place with AGDC, so that field data they collect that may be of interest to ASAP can be shared and vice versa - under the principal of paying for data just once. The Project Team is interested in legislation called the Park Right-of-Way Act that would help the project secure pipeline right-of-way through the various parks the pipeline will traverse.

MR. MCMAHON said the heart of the project is the LNG plant, currently planned for the Nikiski area. It will include LNG storage tanks as well as a jetty for LNG loading onto the ships. The 800-mile pipeline goes from the LNG plant to the North Slope and connects to a gas treatment plant (GTP) that conditions the gas to the right specifications so it can be run through the LNG plant. Two transmission lines connect the GTP to both Pt. Thomson and Prudhoe Bay. The Pt. Thomson transmission line will be about 60 miles and given the location of the GTP, the Prudhoe Bay unit transmission line will be measured in feet.

He said important work was being done by the owners of Pt. Thomson and Prudhoe Bay to get those fields ready to deliver gas into the AKLNG Project.

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CHAIR GIESSEL asked if any of the construction costs are eligible for reduction of their oil tax liabilities.

MR. MCMAHON answered that these costs, as downstream expenditures, do not qualify for credit or deduction under the production tax.

SENATOR STEDMAN recalled that they didn't qualify for capital credits anyway under ACES.

MR. MACMAHON said that was correct.

SENATOR WIELECHOWSKI asked if any portions of the project would be eligible for tax credits.

MR. MCMAHON answered that all the expenditures in the red dotted circle are all downstream investments and would not qualify under SB 21.

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SENATOR STEDMAN asked how the oil and gas will be kept separate for the tax structure. What complexities need to be addressed and how does Kuparuk/Prudhoe Bay interact with Pt. Thomson with Prudhoe Bay being dominated historically by oil and Pt. Thomson being classified as a gas field. How would Pt. Thomson gas being re-injected into Prudhoe Bay be accounted for?

MR. MCMAHON said those answers are being worked on. The sponsor group has a broad purview on this project and is certainly interested in the gas production into the project, the commercial agreements that will underpin the project as it moves forward, the fiscal and regulatory work, and building support for the project.

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He said preparations are under way right now to commercially produce natural gas from both Pt. Thomson and Prudhoe Bay. Prudhoe Bay will be transitioning from oil production to the simultaneous sale of oil and gas, and new facilities will need to be installed to do that. In the context of this mega-project, those may not seem significant in size, but they are essential to allow gas sales from Prudhoe Bay.

The Pt. Thomson Unit development is on track with first production of oil and condensate happening in May 2016 consistent with the Pt. Thomson settlement agreement. This initial development is focusing on the producing of gas, stripping out of liquids and reinjection of that gas back into the reservoir.

To accommodate deliveries of natural gas into the new LNG project, the Pt. Thomson owners will have to undertake significant natural gas development; wells will have to be drilled, gas production and dehydration facilities will have to be installed and the transmission line will have to be built.

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MR. VAN TUYL, BP, commented that a number of upstream modifications are required to accommodate gas sales at Prudhoe Bay. For instance, they plan to install two gas offtake points at the central gas facility, either one of which will be able to accommodate the whole flow of gas anticipated from Prudhoe Bay to the project. Given the importance of having reliable delivery, they thought redundancy was essential.

The project will also require installation of a metering run to measure the gas before it's delivered to the transmission line. The flow needs to be stable for an accurate meter reading, so a number of feet will probably be needed. They also plan to upgrade each of the gathering centers and flow stations and the gas dehydration capabilities to ensure the on-spec delivery of gas to the project. These would be done at gathering centers upstream of either the central compression plant.

Finally, the anticipation is that those two transmission lines, one taking Prudhoe Bay gas and one taking Pt. Thomson gas, go into the GTP where impurities are removed, so a pure gas stream can be delivered to the pipeline and sold to markets. The CO₂ (the acid gas that comes off the GTP) will need to be re-injected - now at Prudhoe Bay (but that gas would include Pt. Thomson gas, which will require an area injection order to be reviewed and authorized by the Alaska Oil and Gas Conservation Commission (AOGCC). Commercial terms will be required to enable that to happen. He said this is an example of one of the complexities that still remains to be worked - essential to the overall operation of the project, but complicated because of the commercial implication, but also doable in the timeframe they are looking at.

CHAIR GIESSEL said he was describing complex technology requiring some in-depth knowledge on the part of the AOGCC commissioners and asked if those commissioners will need a substantial background in petroleum engineering, geology, etc.

MR. VAN TUYL answered yes and are prepared to initiate a series of in-depth workshops next month with the AOGCC to provide them with the information needed to be able to make those determinations.

MR. MCMAHON, ExxonMobil, said the current design base at Pt. Thomson is to put in gas facilities and produce that gas into the AKLNG Project. There are no current plans to produce that gas and inject it over at Prudhoe Bay.

Regarding the lease expenditure questions and their impact on the calculation of production tax, as was the case in the ACES regime, the activities at Prudhoe Bay and Pt. Thomson are lease expenditures and they would expect them to be deducted as part of the More Alaska Production Act (MAPA) calculation. Although, it may be worth asking the administration about their interpretation.

SENATOR WIELECHOWSKI asked if they have confidence in the competence of the AOGCC commissioners.

MR. VAN TUYL answered yes; they are a very competent body.

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SENATOR STEDMAN said they should consider what throwing all those gas expenditures against the oil will do to the severance tax; it will be zero or close to it, he thought. He wants a positive severance on oil that is stable.

MR. MEZMARICH, ConocoPhillips, clarified that the tax as gas and royalty in kind is taxation for the project as it's envisioned in the HOA right now (slide 8).

MR. MCMAHON went to slide 11 and started with activities authorized under SB 138. The DNR has been given the authority to modify leases in two different areas. One is to address the royalty in kind (RIK)/royalty in value (RIV) switching rights that are under the current lease agreements. It's envisioned that the commissioner can consider modifying those rights to be consistent with the way LNG is marketed under long term contracts.

Also, SB 138 provided for conversion of certain leases to a fixed percentage. For example, Pt. Thomson has some sliding scale royalty (SSR) leases, so it authorizes the commissioner to work with the Pt. Thomson owners and to see if the parties can agree on a fixed percentage that could be used to replace the sliding scale royalty, another way to remove some uncertainty in the project and potentially increase the state's RIK share and, therefore, the state's ownership in the project. Ownership in the project should match the expected gas production into the project.

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Pt. Thomson also has net profit share leases that go through a very complex calculation to figure out what additional royalty will be paid based on the "profits" coming from the lease. So,

SB 138 also provides the opportunity to potentially negotiate a fixed percentage for that portion. So, commercial work is being teed up in that area.

MR. MCMAHON said the DNR commissioner has a decision to make around state RIK (versus RIV). Under the HOA, the state is envisioned as owning a portion of this project and a decision around RIK would be consistent with triggering an election by the taxpayers for TAG in an amount that would flow into the state's share of the project, another piece of important commercial work that needs to be done. So, ExxonMobil, BP, and ConocoPhillips are in dialogue with DNR on what they can do to facilitate that decision.

SENATOR STEDMAN asked him to explain the difference between RIK and RIV and why it's such a big deal. How does it impact the sovereign's net income potential?

MR. MCMAHON explained they believe that RIK and state ownership of the project are a key enabler for it, because it avoids traditional disputes on paying royalty, over values received for the hydrocarbon when sold into the market, and over values deducted from that for transportation and shipping. When the HOA was negotiated and signed, it was viewed by the parties as being a key enabler. The financial impact to the state for RIK and RIV are equivalent, because they are based on the same thing: selling LNG and deducting costs to ship it, create it, transport it and clean it.

MR. MEZMARICH added that the HOA envisions state participation and that alignment is really key to a successful project. SB 138 built upon that HOA roadmap.

MR. VAN TUYL, BP, said that the state taking RIK and, therefore, direct participation in the project encourages all parties, because they all commercially look similar. It creates an alignment that doesn't exist today, which is very important and will tend to help avoid potential future disputes. State participation provides a strong voice to potential buyers of LNG about host government support for the project, which is usually one of the things a buyer will ask. Being able to say the state is a direct participant in the project is an "amazing" thing to be able to say.

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SENATOR STEDMAN asked him to explain the net back difference between oil and gas and why this project isn't structured as an oil line instead of a gasline.

MR. VAN TUYL responded that there are a number of differences. One key difference with this gas project is the manner in which it is regulated, which is under FERC Section 3 of the Natural Gas Act. It provides commercial flexibility as to how the actual costs of the project are allocated to different segments. LNG projects are typically structured on long term contractual arrangements between sellers and buyers; it is not typically sold on a spot market and oil has a deep liquid spot market. This creates a difference in the manner of not only how those commodities are sold, but how those two different sorts of projects would be regulated - contract for gas versus common carriage for oil side where anyone can bring additional oil onto the system. He said there are many other differences, but those are some of the major ones.

SENATOR WIELECHOWSKI asked if capital spending for gas-only infrastructure such as gas feeder lines and gas wells are deductible from the oil production tax.

MR. MCMAHON answered if the expenditures are qualified lease expenditures they are deductible.

SENATOR WIELECHOWSKI asked if any gas related expenditures related to Pt. Thomson are being deducted now.

MR. MCMAHON answered the Pt. Thomson lease expenditures that do qualify are deducted.

MR. VAN TUYL had a similar response for Prudhoe Bay: qualified lease expenditures are deductible, but he wasn't aware of any gas project costs at Prudhoe Bay being incurred today.

SENATOR STEDMAN remarked that it is difficult to not be able to separate Pt. Thomson from Prudhoe Bay and they used to be able to until three years ago when the ownership changed. "We haven't had that information delivered to the legislative side, so frankly, we're clueless on that subject other than the aggregate number. It could all be in Pt. Thomson or all be in Prudhoe Bay. There is no way we can separate the two," he said.

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CHAIR GIESSEL asked if the RIK decision by the DNR commissioner could be delayed until next year for the negotiations to continue to the FEED decision.

MR. MCMAHON replied that decision is critical to the FEED decision in 2016. SB 138 also requires there to be separate commercial discussions between the State of Alaska and ExxonMobil, BP, and ConocoPhillips regarding offers to purchase the state's share of gas and LNG before the lease modification applications can be approved. It is a key component of SB 138 and is driving discussions as they speak.

Other Commercial agreements need to be sufficiently complete to underpin a FEED decision by 2016; for instance, the governance agreement (for FEED and beyond) that will control how the venture acts on the long term. There will also be agreements on how gas is taken off the pipeline and how LNG is lifted from the tanks and onto the ships. There will be agreements around in-state gas and expansion.

Finally, Mr. McMahon said, a long term firm transportation service agreement (FTSA) needs to be completed between TransCanada and the state.

CHAIR GIESSEL asked if there is a time certain on that agreement.

MR. LEE replied the current Precedent Agreement has a date of December 31, 2015 for the state and TransCanada to enter into an FTSA.

CHAIR GIESSEL asked if there is wiggle room.

MR. LEE replied that they are currently working with the state administration to finalize the FTSA and that deadline will be met.

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MR. MCMAHON said given the unprecedented scale of this project and the need to compete in global energy markets, a competitive predictable and durable fiscal environment is required. Establishing these fiscal terms is a key enabler for the LNG project and it is also important for the LNG buyers, the potential lenders and investors. He said good progress had been made during 2014 with the HOA and SB 138. Along with the election of RIK and setting up state participation, all the work they are doing in fiscals is important to enabling the project.

MR. MCMAHON said they are also here to work with the administration and legislature on ideas related to property tax payments during construction and are keen to see the work products coming out of the Municipal Advisory Gas Project Review Board. Legislative review and approval will be necessary to any changes to the property tax system that might support the FEED decision.

SENATOR STEDMAN asked if Pt. Thomson is an oil or gas field from AOGCC's current regulatory viewpoint and when do those discussions take place.

MR. MCMAHON replied that they are in active discussions with the AOGCC. With the initial production system coming on line early next year, they will need field rules to produce condensate and oil. At the same time, they are having discussions about having gas offtake authorizations to support the AKLNG Project.

SENATOR WIELECHOWSKI said the state is paying out \$100 million more in tax credits than it is receiving in production tax revenue and that is expected to go to \$400 million or more next year; there is a \$3.5 billion deficit this year and billions of dollars in deficit for years to come and asked if the legislature should be expecting them to request more tax cuts for oil and gas.

MR. VAN TUYL answered that the fiscal discussions they are having now with the administration are focused on identifying the terms necessary to make the AKLNG Project a success. The current environment will look very different in 10 years' time when first gas is seen. They believe the modifications made in SB 21 are doing the things they need to do; increased activity and production is being seen. They don't control oil price; the problem they are facing with revenue is a common one. They also receive 100 percent of their revenues from oil and gas production; the problem is with the oil price and not the tax regime.

MR. MEZMARICH seconded Mr. Van Tuyl's comments and said he believed that the HOA lays out a good road map for the project; SB 21 and SB 138 are the right steps to enable the project.

SENATOR WIELECHOWSKI he said he took that as a "no," they aren't requesting any tax concessions.

MR. MEZMARICH replied that they have no plans to request oil tax reductions.

CHAIR GIESSEL asked what is in the term sheets that they will be negotiating before 2016.

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MR. MCMAHON replied that term sheets are a tool that commercial negotiators use to walk through a complicated agreement. They are used to exchange ideas, to document where they have agreement and to resolve open issues. Everything on the commercial and fiscal page lends itself to the use of term sheets. The essence of a deal are in these agreed upon terms and then the actual language can be drafted with confidence.

MR. MCMAHON said they are often asked what is meant by predictable and durable terms and balance. Predictable means the state royalty and taxes are calculated in a way that is consistent and as unambiguous as possible. Durable means the terms would last for a time commensurate with the risk being taken. Balanced is the idea that parties' revenue shares are clearly defined in a way that improves the probability that a commercially viable project will be achieved.

He said fundamentally, the AKLNG Project is world-scale, so all the investors, including the SOA, need to understand the investment structure and the commercial terms before proceeding. These terms need to recognize the risk and balance of the needs of the state, ExxonMobil, BP, and ConocoPhillips.

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The ongoing regulatory work falls into two categories: DOE export permits and FERC activities. The applications for the DOE export permits were filed and the export permit for free trade agreement (FTA) countries has been received. Deliberations are continuing for a permit for export to non-FTA countries.

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SENATOR STEDMAN asked him to expand on which countries are FTA and if the country has to be specified on the permit.

MR. VAN TUYL explained that there are 20 FTA countries. The Pacific Rim includes Korea and Singapore and a number of South American and Middle Eastern countries. It does not include Japan, the Philippines, China and Malaysia. The non-FTA countries are country-specific. The U.S. government is in active discussions with a number of countries to see if that status can change.

SENATOR STEDMAN asked how long that will take and if it's a potential roadblock if Japan or China aren't allowed to trade.

MR. MEZMARICH replied that may happen towards the end year, which would be consistent with when the Kenai LNG Project got its export authorizations.

MR. MCMAHON said the other key regulatory activity is the project's interactions with the Federal Energy Regulatory Commission (FERC). They are currently in the National Environmental Regulatory Act (NEPA) pre-file process, which sets the foundation for the Environmental Impact Statement (EIS) that will allow the FERC to issue permissions to start construction of the project. He explained that the pre-file process allows interaction on a preliminary basis with the regulator, so a higher quality formal application can be built.

He said a key part of that application is the 12 resource reports and the first draft had been filed with FERC this month; it is over 9,000 pages. The FERC and their contractor will be following up with talks with different communities and different stakeholders to get their input on understanding the impacts of the project. That information will be used in filing another draft report. Then they would be able to file a very good final submission that has good stakeholder engagement, a key measure of the quality of an EIS.

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External affairs and government relations work is about facilitating public dialogue about the AKLNG Project. They will reach out to federal, state, municipal, and tribal governments including agencies and legislative bodies, because a project of this magnitude and complexity cannot succeed without broad support. That is one of the things looked for in making the FEED decision.

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He said pre-FEED project deliverables will come out of the project team and include development plans at Prudhoe Bay and Pt. Thomson, AOGCC gas offtakes, the key agreements necessary for the commercial underpinning and the fiscal work around property tax, RIK, and predictable and durable terms, the DOE export license, progress on the NEPA process with FERC and, finally, the broad support.

He closed saying the people at this table and the administration are all targeting a FEED decision in the second quarter (2Q)

2016 and these initiatives have been resourced accordingly. Consistent with SB 138, they are planning for a 90-day public review period prior to formal legislative review.

MR. MCMAHON said given the magnitude of the FEED decision for each party, representing more than \$1 billion of commitment, which is bigger than some projects are, it is essential to take the time necessary to satisfactorily complete all the deliverables.

CHAIR GIESSEL asked what AGDC's role would be in the project.

MR. FAUSKE answered that AGDC would represent the state's equity share in monitoring the project and there could be marketing. AGDC also has the role, under SB 138, of offtake valves and possibly intake valves.

[4:54:00 PM](#)

SENATOR HUGGINS was present in the audience.

SENATOR WIELECHOWSKI asked if it is reasonable to expect to have a special session in October. If the parties aren't ready, is it okay to push it off?

MR. MCMAHON answered that the deliverables are being driven forward as fast as possible, but he wanted to temper that with the recognition of needing a quality product to make good decisions.

MR. VAN TUYL responded that not all elements are within their direct control. One can't force things to happen, and quality deliverables are needed.

[4:56:57 PM](#)

MARTY RUTHERFORD, Deputy Commissioner, Department of Natural Resources (DNR), said she was also the administration's lead on the AKLNG Project. She said she began back at the DNR on December 1 and by December 2 the gasline team began briefing her on what then was non-confidential information. That began an intense effort that included, once Commissioner Hoffbeck and Commissioner Meyers and the Attorney General were available, to begin to brief them on the non-confidential aspects.

MS. RUTHERFORD said that she signed the seven-party confidentiality agreement and began to receive very in-depth confidential briefings. She was impressed with not only the structure made available to the state through SB 138 and the

HOA, but the quality of the people involved in the leadership team. That technical team has been retained in the form of five individuals that work directly within the DNR, some as employees and some as contractors: Steve Right, David Degruyter, Steve Swaffield, Audi Setters and Black & Veatch. The Department of Law (DOL) has maintained its contract with Greenburg Traurig, the Department of Revenue has maintained its contract with Gaffney Kline, and the various agencies of DOL, DOR and DNR continue to commit significant resources from within the agencies.

She said the new administration also continues to keep the same principals of the work put into place by the previous administration and those are to continue to prioritize and protect the state's interest, to identify, assess and address the full spectrum of opportunities and benefits, risks and costs, associated with this project through commercial arrangements that protect the state's interests. Additionally, all the parties are continuing to progress this project under the framework of SB 138 and the HOA and are moving forward on all the commercial agreements that will allow them to make the significant FEED decision in the early second quarter of 2016.

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The DOR, working with Lazard, is looking at its financing options that will be made available to the legislature. Finally, while many are on a steep learning curve coming back into this project discussion, the team members continue to have regular meetings and continue to progress the technical discussions and elements of the commercial agreement so that everybody is working towards alignment.

Their next steps are many of the commercial agreements: gas supply and balancing the offtake, expansion and access, access to domestic gas, LNG disposition marketing, the RIK decision and the lease modifications associated with net profit share and sliding scale leases, the associated lease provision with switching and the financing.

[5:02:29 PM](#)

Additionally, MS. Rutherford said they are having to deal with several organizational issues that include the ultimate operating model for the project, the governance aspects of that model, and what a joint venture (JV) might look like as they progress into FEED. They are looking very significantly at the mechanisms that might be available to the state for providing some durability to the various elements of the fiscal regime,

some of which were identified in SB 138, specifically, the 13 percent production tax as gas, and what the actual royalty in kind should be if the state chooses to take its royalty in kind. It will not be a flat 12.5 percent, because of deviations at the Pt. Thomson unit.

[5:03:42 PM](#)

DONA KEPPERS, Deputy Commissioner, Department of Revenue (DOR), Juneau, Alaska, said she was part of the transition team from the prior year and came to Alaska in 2008 as an audit master within the Tax Division. Previous to that, she spent nine years with Mapco Alaska Petroleum and nine years with Alyeska Pipeline Service Company in various leadership roles in both commercial and accounting areas. She was part of the AKLNG Project under the previous administration working with the governance and operating model and tax implications. In December, she became the deputy commissioner and became exposed to all areas of the project.

MS. KEPPERS explained that the DOR is highly integrated with state gas team members imbedded in all fiscal and governance areas. They are pretty much in lock-step with DNR and AGDC in several of these areas. They have daily internal meetings and integrated meetings with sponsor parties to connect. It has been moving rapidly. A couple of major areas for the DOR are the next phase of the financing alternative, work with Lazard and First Southwest, to do the further analysis in order to generate a report in the fall. The other piece of work deals with the Municipal Advisory Gas Project Review (MAGP) Board, which Commissioner Hoffbeck would provide more detail on.

[5:06:26 PM](#)

RANDY HOFFBECK, Commissioner, Department of Revenue (DOR), Anchorage, Alaska, related that the MAGP group is meeting on Friday to consider the payment in lieu of taxes (PILT) structure to be introduced into the economics of the project. He said the mayors and municipal representatives had been very open to the process.

MS. RUTHERFORD added that she and the entire administration feel that the device structured in SB 138 is very workable and allows conflicts to be resolved.

SENATOR COGHILL said he was relieved to hear about them working together, because the legislature doesn't get to see that. What they do see is that several members of the AGDC board haven't

been appointed yet. People will have to come up to speed like she and others are.

[5:10:01 PM](#)

MR. FAUSKE responded that he was not privy to actions being taken. He pointed out that the corporation is doing fine; the board has four members and has held one meeting, which went very well.

SENATOR COGHILL urged that all hands need to be on deck and need to get going.

CHAIR GIESSEL thanked the presenters.

[5:11:56 PM](#)

SENATOR GIESSEL adjourned the Senate Resources Committee meeting at 5:11 p.m.