

OIL & GAS COMPETITIVENESS REVIEW BOARD

October 15, 2014

9:00 a.m.

Taken at:

Alaska Gasline Development Corporation
3201 C Street, Suite 200
Anchorage, Alaska 99503

MUNICIPAL ADVISORY GAS PROJECT REVIEW BOARD:

Tom Hendrix, Chair
Commissioner Joe Balash
Commissioner David Mayberry
Deputy Commissioner Michael Pawlowski
Tom Maloney
Peter Stokes
Kara Moriarty
Rodney Brown
Curt Freeman
Director Kristin Ryan

Others participating:

Stephanie Alexander, Department of Revenue
Tim Ryherd, Department of Revenue
Deputy Commissioner Bob Swenson, Department of Natural Resources
Bill Barron, Department of Natural Resources
Sara Longan, Department of Natural Resources
Senator Lesil McGuire
Wanetta Ayers, Department of Labor

PROCEEDINGS

CHAIR HENDRIX calls the meeting to order and asks for a roll call. He moves to the agenda and asks for a motion.

MS. MORIARTY makes a motion to approve the agenda.

MR. STOKES seconds.

There being no objection, the motion is approved.

CHAIR HENDRIX moves on asking everyone to introduce themselves. He states that there is an opportunity in the agenda to have a discussion about board procedures. He continues that he would like to touch on the point about having more than three board members.

DEPUTY COMMISSIONER PAWLOWSKI states that as an advisory board this group functions under the typical Open Meetings Act laws, and explains that having more than three board members gathering and talking about specific board issues would violate the Open Meetings Act. He adds that there are staff attorneys with the Department of Law that can help with procedures and questions.

CHAIR HENDRIX thanks the Deputy Commissioner and explains voting, which is very important to the proceedings and the mission. He reads over the Boards and Commission Fact Sheet as found on the web, and then moves on to the Alaska Statute 43.98.050, explaining the duties of the board.

DEPUTY COMMISSIONER PAWLOWSKI clarifies that the “Department” reference for administrative support is the Department of Revenue.

MR. STOKES asks how the confidential information that is being reviewed and discussed being handled in the context of the Open Meetings Act.

DEPUTY COMMISSIONER PAWLOWSKI replies that when the Legislature debated adding this provision into Senate Bill 21 and then amending it in Senate Bill 138, the enabling legislation for AK LNG last year, the interest was to provide the opportunity for confidential information with the understanding that it is not necessarily required. He states the need to talk about when and how confidential information is required in the scoping session.

CHAIR HENDRIX moves on to the presentation from the Department of Environmental Conservation.

DEPARTMENT OF ENVIRONMENTAL CONSERVATION PRESENTATION

DIRECTOR RYAN begins with the slide that describes that the job of this department is to conserve, improve, and protect Alaska’s natural resources and environment. She states, that is done by controlling water, land, and air pollution in order to enhance the health, safety, and welfare of the people of the state. She continues that it is an obligation to the people of Alaska and has a public health aspect to it. It is not just about protecting the environment. She explains that the Department is quite small with just four divisions, plus the Commissioner’s office, which provides the policy direction and who is often the spokesperson on environmental issues for the Governor’s office. She states that the four divisions are: Division of Air, which focuses on permits for air, point sources and nonpoint sources; Division of Water Quality, which has recently gained primacy for discharge permits, which impact the oil and gas industry as well as many other industries; Division of Environmental Health, which encompasses the state veterinarian, food safety, drinking water, pesticides, and covers a lot of ground and has a pretty

broad authority; Division of Spill Prevention and Response, which is in the job of preventing oil and hazardous substance spills and responding to those spills when they occur. She moves on to NEPA, the National Environmental Policy Act, and states that the State of Alaska does not have an equivalent to NEPA. She continues that this is an overarching environmental statute which does participate in the federal NEPA process. She adds that sometimes they are stricter than the federal government, and they want to ensure that the federal process will comply with their standards as well. She states that one aspect of the Division of Environmental Health is solid waste. She continues that the solid waste program does permit oil- and gas-produced waste into temporary storage until it can be reinjected. She adds, that is the preferred method of disposing the waste. She explains the process.

A short discussion ensues.

DIRECTOR RYAN moves on to the Division of Water, which has a significant impact on the oil and gas sector in Alaska. She begins with the Alaska Pollution Discharge and Elimination System, APDES, which is equivalent to NPDES, the National Pollutant Discharge and Elimination System. It essentially means permits to discharge pollutants in the water. She states that approval has been obtained from EPA, and it now has primacy to this program and is implementing it. She goes through some aspects of the APES program. She states that the Division of Water has a fully staffed oil and gas section and is in competition with the industry to hire people. She explains the 404 assumption.

A discussion ensues.

DIRECTOR RYAN states that this Division is working on anti-degradation regulations and has a policy, but it needs to make regulations and implement the policy. She moves on to the Division of Air, stating that air is considered a natural resource that is protected under federal law. The federal government and the state are directed to ensure its availability for the public. The permitting process is very time consuming and highly technical. She continues that it is regulated under the Clean Air Act, and EPA has approved Alaska's program to implement the Federal Clean Air Act. She goes through the specific permits, beginning with the most significant for the oil and gas industry, which is the preconstruction permit. Then there is the operating permit after the facility is operating and functioning, to make sure there is compliance with the preconstruction expectations. She states that the Federal Clean Air Act requires that companies utilize the best available technology.

A short discussion ensues.

DIRECTOR RYAN moves on and explains , in great detail, how lines, pipelines, and flow lines are regulated.

MS. MORIARTY requests going back to the Spill Response Division, and asks about how those are funded and what the structure is.

DIRECTOR RYAN replies that a contractor provides services to the industry in that region, which are all nonprofit, and explains the process more fully.

MR. STOKES states that the oil and gas spill tax is part of the taxes paid to the Department of Revenue. He asks if any of that goes to fund any of the agencies and asks about the disposition of that tax.

DIRECTOR RYAN explains that there is a surcharge on oil production of 5 cents that funds the Division of Spill Prevention and Response; 4 cents pays for the Division; 1 cent goes into a response fund that is maintained for emergencies. She continues that it is capped at \$50 million, and the State is around that level. She adds that it is used occasionally throughout the year for responses. She explains that the 4-cent surcharge covers the Department's costs to review contingency plans and test the OSROs to make sure they can respond and deal with minor spills as they come up. She goes into greater detail of the response system. She then moves on to the Cook Inlet statistics and then some North Slope statistics. She states that the last slide is contaminated sites and adds that there are several contaminated sites in the oil and gas fields from previous activities. She adds that there are obligations from companies to clean up that waste and ship it out of state.

CHAIR HENDRIX asks for any further questions. He thanks Director Ryan for a very informative presentation, and calls a 15-minute break.

(Break.)

CHAIR HENDRIX welcomes all back, and moves on to the presentation by the Department of Natural Resources.

DEPARTMENT OF NATURAL RESOURCES PRESENTATION

DEPUTY COMMISSIONER SWENSON states that he is the deputy commissioner of the Department of Natural Resources and will start off the presentation. He adds that Director Bill Barron, Director of the Division of Oil and Gas, and Sara Longan, director of OPMP, Office of Project Management and Permitting, will also participate in the presentation. He states that an understanding of what the State's resource base is and what the potential is out there is important to looking at the competitiveness of the State. He begins with all of the geologic basins in the state, and where the resource potential is across the state. He states that there has been a tremendous amount of work done on understanding this resource potential, not only the reserves that are currently under production, but also what the exploration potential is in both the Cook Inlet and North Slope. He continues that the U.S. Geological Survey, working with the State and other organizations, have come up with estimates for the technically recoverable reserves. He goes through some of the numbers and states that the message from the estimates is not the individual number, but that these basins are incredibly prolific hydrocarbon basins. He states that, from the most recent analysis done by the USGS on a circum-arctic analysis, Alaska was No. 1 in oil potential; from a gas potential, Alaska was No. 3. He adds that this is just specifically conventional oil and gas resources that under current technology would be able to be developed. He continues that his does not include shale, hydrates, or the type oil or type gas; this is the conventional resource estimates. He gives a few examples of what is being done at the Department of Natural Resources to help with the competitiveness issue.

A short discussion ensues.

DEPUTY COMMISSIONER SWENSON continues with his presentation, explaining as he goes along. He introduces Director Barron who will go through the land and access issues.

DIRECTOR BARRON states that he has three aspects: One is the ability to acquire seismic information; the leasing program that the State has to dispose of the property; the State's land to oil and gas exploration. He continues that in talking about competitiveness there is a lot of issues around data acquisition, data storage, and data distribution to the industry and the private sector. He states that it is important to understand that in the State of Alaska a person does not have to be the leasehold owner to shoot seismic. He explains that a person can acquire a miscellaneous land use permit through the Division of Oil and Gas, and contractors quite often do that. He adds that is called a spec shoot. He continues that data is then for sale to the industry and to the private parties as part of the commercial business of that seismic company. He continues explaining this as he goes along, adding that the state has been very progressive in activities associated with sponsoring seismic activity and acquisition.

MR. FREEMAN asks if the Division has access to the data prior to release and what is done with it.

DIRECTOR BARRON explains that the information is used quite often and in multiple ways. He states that there are two ways that the State disposes of State land for exploration activities and addresses the area wide lease sales. He states that the lease is for oil and gas and the process is fairly straightforward, which he goes through, addressing questions as he goes along. He then goes over the terms on the lease sales and addresses questions as he goes along. He offers to anyone on the committee a copy of a publication that the Division puts out every year which is a recap of the lease sales that have gone on over time. He states that it has all the maps, all the tracts and is updated in January of every year. He adds that it is also available on their website.

DIRECTOR RYAN states that there are exemptions and incentives to encourage people to develop. She asks if they are coming more through Revenue or through lease sale.

DIRECTOR BARRON replies that from a royalty standpoint, the Cook Inlet and other areas have a rate threshold, and if a platform drops below a certain threshold, the royalty is automatically reduced. He gives a few examples.

DEPUTY COMMISSIONER PAWLOWSKI talks about the debate in Senate Bill 21 around some of the incentives for the newer fields. He states that some of the members were against the proposal in general and asked about timing out the incentive just as the production of that well is declining to a point of being shut down. He continues that the royalty and the taxes all come after certain expenses are deducted. He adds that one of the dilemmas with property taxes, particularly on the TransAlaska Pipeline, is they roll into the tariff which is a direct deduction prior to the calculation of royalty or production tax. He states that one of the challenges of this group is integrating all these things.

MR. FREEMAN asks if any of the incentives on any of the basins are tied to the benchmark price of crude.

DIRECTOR BARRON replies that ENI has a royalty modification in place that is triggered by a low product price. He states that in terms of disposal of State land is the ability to go through what is called an exploration license. He explains the process and the statutory requirements. He states that the frontier basins were brought up a couple years ago in session, and adds that these areas have special tax credits to encourage exploration in areas that have never been touched. He continues that the exploration basis in the state of Alaska is abysmal compared to areas of North Dakota, Texas, New Mexico, Arizona, Oklahoma, and California. He adds that the number of wells that have been drilled for exploration basis is inadequate to cover the acreage for these world-class basins.

COMMISSIONER MAYBERRY asks how much attention the Department has paid to the sheer cost of exploration in Alaska versus North Dakota or Texas.

DIRECTOR BARRON replies that the biggest limitation to exploration and to development in this state, in his opinion, is the lack of infrastructure. He states that the access to one of North America's largest oil fields has one single road and one pipeline coming out. He continues that access can only be done in winter on ice roads and on ice pads. He adds that those limitations have become inhibitive to the State.

COMMISSIONER MAYBERRY states that when comparing Alaska to other states, there are a lot of things that have to be factored in.

A discussion ensues.

DIRECTOR BARRON states that the Division felt that it would be most important to understand what the processes were, how they grounded with statute and regulations, how they are involving other State agencies, and what the interaction is between those agencies. He adds that it is a process and is understanding how we interact with the customers. He states that it is important to understand the scope of the Division of Oil and Gas in that they authorize two permits: the miscellaneous land use permit; and authorizations of easements on State land. He continues that the rest are authorizations of work, plans of operation, plans of exploration, and plans of development. He adds that the role then is reviewing and authorizing the general plan and the specifics of the plan, not the permits therein. He wraps up his comments, thanking the committee for the time. He states that he is prepared to come back at any time to talk about oil and gas. He recognizes Sara Longan.

DIRECTOR LONGAN states that she is the director of the Office of Project Management and Permitting in DNR. She gives a high-level overview describing OPMP's functions, how it is coordinated, and how the permitting efforts are kept efficient. She gives a specific update and progress report on the Division of Mining, Land, and Waters' efforts to build, establish, and maintain the unified permitting program. She states that OPMP works very closely with the industry, as well as the various state, federal, and local permitting agencies to coordinate oil and gas projects. She continues that they also coordinate large mines, transportation, renewable

energy projects, as well. It is a relatively small office with a very diverse job function. She explains that OPMP coordination through the permitting review for these projects is voluntary. Project applicants enter into a voluntary agreement with OPMP. She adds that OPMP works on reimbursable funds and operates on a very slight State government fund budget. She continues that OPMP works very hard to synchronize the State permitting process with the NEPA process. She continues going through her presentation.

MS. MORIARTY asks if anybody within DNR has any sense of how Alaska compares to other regions in processing permits.

DIRECTOR LONGAN replies that they have looked at other states and are a part of a very robust and ongoing dialogue in Alaska on the permit process. She states that each state has a different pattern under jurisdiction and authority, but the State of Alaska has been able to advise other states in what OPMP does.

CHAIR HENDRIX states that it is very informative to have that coordination to help the resource developers through that process.

DIRECTOR LONGAN states that they want to be a resource, not just to the applicant, but also to all the other people throughout State government with a tough job and not enough resources. She thanks the committee for the time and opportunity to speak, and asks for any other questions.

A short question-and-answer discussion ensues.

MS. MORIARTY states that OPMP is a model that other states, as well as the federal government, are trying to adopt and follow. She continues that it was the model that the off-shore companies went to the federal government with when asking for help. She asks about any permitting challenges that remain from the State side and what they are.

DIRECTOR LONGAN states that it is important to have a plan, internal processes, and standard operating procedures in place so that the challenges of staff transitions can be handled.

CHAIR HENDRIX thanks all and breaks for lunch.

(Lunch break.)

CHAIR HENDRIX moves on to the Department of Revenue's presentation.

DEPARTMENT OF REVENUE PRESENTATION

MR. RYHERD states that he is a commercial analyst with the Department of Revenue, and thanks the board for the opportunity to speak.

DEPUTY COMMISSIONER PAWLOWSKI states that Mr. Ryherd will be providing a lot of the analytical internal resource support to this board.

MR. RYHERD states that he is a trained geologist and gives a short background of his resume. He begins by putting Alaska in perspective globally, and talks about the origins of global oil supply. He states that the United States is the biggest oil producer in the world for 2013, followed by Saudi Arabia and Russia. He adds that this is oil and liquids, oil and condensate. Transitioning from countries to individual companies, he continues that the top ten are all NOCs, national oil company, versus IOC, international oil company. NOC is generally thought of as having a special relationship with a nation and having special access to reserves and resources from that nation. The big four from Alaska -- BP, Exxon, Chevron, and Shell -- are on the list of international oil companies. He points out that the four-year trend of all the for-profit international oil companies is a decline in their liquids production. He continues that there is an increase in production in oil and condensate, and these companies are somehow not participating in the increased production. He states that this is an important point. He continues that these companies are aggressively pursuing gas, although the numbers are not much different. He adds that these companies have challenges with access to reserves and resources because they are for profit, and the national oil companies have a large chunk of that already tied up. He goes through the graphs, explaining as he goes along. He then focuses on where the competition might come from and then makes a couple of points about shale and shale oil production. He states that world production is going up. He continues that the Persian Gulf and Caspian Sea areas have a huge reserve base, as does the former Soviet Union and Russia. He adds that North America also has a significant chunk of reserves.

CHAIR HENDRIX pauses the presentation and states that Senator McGuire has arrived. She is largely responsible for why we are all here today.

SENATOR McGUIRE thanks everyone for all the work and is mainly here to watch and get a chance to see how the first meeting is. She states hope that the organization will take on a life of its own and that the group feels empowered to move forward in whatever capacity it sees fit to guide the State. She continues that the thought was to have a group of public members and some subject-matter experts come together to think about how Alaska can become competitive in this case again. She wishes all the best of luck, and states that if there are any questions she will be happy to answer them.

CHAIR HENDRIX thanks the Senator and asks Mr. Ryherd to continue.

MR. RYHERD states that technology is amazing in its ability to continue to unlock new resources and turn them into reserves. He continues that the shale oil thing is a dramatic illustration of how that works. He adds that potentially shale oil needs oil prices to remain high because if prices decline so will production.

DEPUTY COMMISSIONER PAWLOWSKI states that to measure Alaska's competitiveness, a methodology for that systemic framework is needed. The challenge is how to create an adaptive process that will keep up with all of the changes in the world.

MR. RYHERD moves on to the rates of return, hurdles, benchmarks, and he goes through how it was assessed in the past and what to consider for the future.

A discussion ensues.

MS. MORIARTY adds that the average age in the oil and gas industry is not getting any younger, and he states the need to talk about the workforce development needs.

MR. RYHERD agrees that labor is important. He moves on to the inputs into project modeling and economic modeling of oil and gas. There are three variables that are notoriously difficult to predict: Price, volume, and costs. He states that it is important to consider what Alaska is seeing for some of these. He continues that the price of Alaska crude versus other crudes around the world is also important. He goes through a list of a variety of investment metrics when modeling from inside an oil company.

A discussion ensues

MR. RYHERD moves on to the elements of the fiscal system, stating that the major elements are a variety of taxes. He continues that the biggest for Alaska are production tax and royalties. He adds that the corporate income tax is also fairly significant. He continues that property tax has no direct tie to the production of the resource that is being developed, and adds that leases and bonuses are up front and relatively minimal. He moves on to a production-sharing contract, explaining as he goes along. He then talks about a service contract model and then moves on to bookable reserves under the scenarios of concession, production-sharing, and service contracts, and how bookable reserves apply in the three generalized scenarios.

CHAIR HENDRIX interrupts stating a break is scheduled. He asks the board to extend the day. After discussion, the decision to continue Mr. Ryherd's presentation is made.

MR. RYHERD continues with an example of Alaska's fiscal system, which is a net production tax system. He adds that most of the Lower 48 is a gross system. He shows the basic calculation behind a gross tax versus a net tax and the difference. He states that the other aspect of Alaska's tax system is progressivity versus a neutral tax. He continues that this is an important concept that was introduced when the State went to a net tax. It means that as the divisible income goes up, the tax rate actually goes up. So, as the company makes more money, the State should make more money. He continues, explaining that a regressive tax would be just the opposite. He states that taxes are statutorily set and can be changed; not easily, but they can still be changed. He concludes his presentation.

CHAIR HENDRIX calls a short break.

(Break.)

CHAIR HENDRIX begins by disclosing that his company has helped train drivers and made grants available, and that his son has been a recipient of the grant programs to train young people to fill the industrial positions.

MR. MALONEY states that the State of Alaska, Department of Labor, has trained and developed folks that were ultimately hired in IT and other places for projects like Point Thomson.

DEPARTMENT OF LABOR PRESENTATION

DIRECTOR AYERS states that she is the director for the Division of Business partnerships. She continues that the role of the Division of Business Partnerships is essentially to manage a portfolio of workforce development training funds on behalf of the State, as well as federal funds that are formula funds distributed to the State of Alaska. She adds that they work with employers, training providers, and educational institutions to help develop Alaskans for in-demand occupations across the state. She states that she will talk about what the Department is doing to develop the talent pipeline in preparation for not only the current growth in the oil and gas industry, but also in anticipation of future projects. She begins by going through some context and circumstances in relation to human capital around the globe, and adds that talent is in the driver's seat. She states that the availability of labor is going to be one of the greatest determinates of economic success in the future. She talks about some of the generational imbalances that are being seen in the labor market and how that impacts employers and the workforce development system. She states that one of the key things in the labor market in Alaska is that only 1 in 5 jobs require an advanced college degree; however, 60 percent of all jobs in the next decades will require more than a high school diploma. She goes through the ways that education, employment and job training activity align to deliver that skilled workforce. She adds that all the funding does not include capital dollars.

DEPUTY COMMISSIONER PAWLOWSKI adds that there are substantive capital dollar investments in this, as well.

DIRECTOR AYERS goes through a number of modalities in the workforce development system and moves to specifically looking at the oil and gas workforce development plan. She explains how and why the analysis was made, and then goes through the results. She states that the following priority occupations were identified: Engineering; geosciences; health, safety, security, and environmental; on-shore and off-shore maritime workers and transportation distribution area; and remote sensing inspection. She continues that one of the challenges of aligning workforce development is getting industry and education to talk to each other. She goes through the career clusters, and the career pathways explaining as she goes along.

A short question-and-answer discussion ensues.

DIRECTOR AYERS states that trends in the Alaska oil and gas industry were looked at in the development of the plan. She continues that linked to the Employment Security Division is a jobs domain page which was developed as a result of working on the plan and hearing about the needs of the employers. She explains that each of the links clicks through, providing needed information.

DEPUTY COMMISSIONER PAWLOWSKI asks if the Governor's performance scholarship translates to supporting activity for the training programs.

DIRECTOR AYERS replies that the performance scholarship does support those, and one of the challenges is with the nonacademic or noncollegiate version of the Alaska Performance Scholarship. She explains that anyone who qualifies for an Alaska Performance Scholarship can use it for an AA degree, a certificate or occupational endorsement through the university workforce programs. She continues that they are trying to align the training programs and talks about five priority occupational groups that cover 61 occupations in the industry. She adds that there has been an employer group that has been working on getting UAA to consider introducing a bachelor's degree in the OSHA occupations. She moves on to recruitment, stating that a detailed plan has not yet been developed. She continues that some of the things that they are doing are: working on establishing a collaborative partner in this plan; working on identifying needs for specific tasks and strategies; identifying the two occupational groups; and having a special assistant in the Commissioner's office that will continue working on the implementation of the plan. She states that the first review will be sometime before the next legislative session. She concludes her presentation.

A short question-and-answer period ensues.

MR. MALONEY states that it was a great presentation and especially finding out what the needs are and educating is for our young workforce.

MR. STOKES agrees on the good presentation, and asks about the focused-on priority occupations.

DIRECTOR AYERS responds by explaining a bit more clearly and then states that one of the great challenges is looking at the education system and realigning it with the opportunities available for young people. She continues that with greater opportunity for technical education at the secondary level, graduation rates are shooting back up into the 90-percent range. She adds, that's why this is critically important.

CHAIR HENDRIX thanks Director Ayers for a great presentation, and moves on to scoping for future discussions.

SCOPING FOR FUTURE DISCUSSIONS

CHAIR HENDRIX states that the one thing that resonates is that there is a deliverable deadline he would like to have this group meet on the 31st of January. He continues that it is important to figure out how to get there and is looking for ideas and input.

DEPUTY COMMISSIONER PAWLOWSKI states that one of the opportunities for this board is in the way the Office of Project Management and Permitting collects and provides a cross-perspective on the different permitting agencies. He adds that this board does not end at the end

of the year. There are multiple reports and it has just started. He continues that the first report is a kind of halfway vision on the issues. He states that it can be accomplished.

MR. MALONEY shares a few comments on what was shared in the presentations today.

MS. MORIARTY suggests mapping out the workload over the next three months, and then building a framework for getting into the Cook Inlet piece in 2017.

COMMISSIONER MAYBERRY suggests soliciting information from the public more broadly, including industry and nonindustry folks, to hear more voices on what other people think is significant and what factors should be looked at.

CHAIR HENDRIX likes involving the public, and adds the need to act swiftly on outlining what public comment is being sought and getting it out so that the information could get back in. He states that it is important to identify what time the board can meet, and then the tasks to tackle at each meeting can be broken down.

The discussion continues.

DEPUTY COMMISSIONER PAWLOWSKI suggests beginning with a review of the fiscal regime documents, seeing if there are pieces that are missing, things that definitely should be updated. He states that he is getting clear direction on that, so drafting and updating can be started.

COMMISSIONER MAYBERRY states that after reading the requirements for the first report more closely, they are actually much narrower than the overall mission of the board. He continues that in terms of meeting the deadline and managing the workload, focusing on what is required as specified and then discussing reports with a broader perspective. He adds that nothing says that updates cannot be published; so then it might just be updating existing data.

The discussion continues.

CHAIR HENDRIX states that the next meeting will be plugged in for October 30, at 9:00 a.m. and written assignments are due by noon October 27. He thanks and appreciates everybody's time.

DEPUTY COMMISSIONER PAWLOWSKI makes a motion to adjourn the meeting.

MR. MALONEY seconds.

There being no objection, the meeting is adjourned.

(Meeting concluded at 4:47 p.m.)