

Sectional Analysis

Commercialization of North Slope Natural Gas

SB 138 / 28-GS2806\A

February 7, 2014

Department of Law

Senate Resources

Three subject areas of SB 138

- Sections 1 – 9** amend AS 31.25 to expand the general purposes of the Alaska Gasline Development Corporation (AGDC) to include a subsidiary corporation of the state to pursue an equity option in the midstream portion of a gas pipeline and in associated treatment and liquefaction.
- Sections 10 – 22** amend statutes related to the authority of the Department of Natural Resources (DNR) commissioner to negotiate agreements and confidentiality for negotiations, related to the authority of the DNR commissioner to work with lessees to amend certain oil and gas leases and related to the sales of royalty in-kind to include tax gas.
- Sections 23 - 47** amend tax statutes related to authority of the commissioner of the Department of Revenue (DOR) to participate in negotiations with the DNR commissioner, confidentiality, the corporate income tax and the oil and gas production tax - the most significant proposal is to amend the oil and gas production tax to levy a gross tax on gas after 2022, and to allow, for certain leases, a producer to pay tax on gas in kind.

Terms

"large-diameter natural gas pipeline project"

Bill sections 1 – 9

"statutory subsidiary"

Bill section 7

"tax as gas or TAG"

Bill section 29 - not used in bill – refers to production tax paid in gas for production on and after January 1, 2022 from modified leases.

"modified leases"

Bill sections 13 and 14 - not used in the bill – refers to North Slope leases modified based on certain determinations.

"North Slope natural gas project"

Bill section 19

Creation of the statutory subsidiary

Section 1 expands the purpose of the AGDC

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1 the fullest extent possible,
2 (1) advance an in-state natural gas pipeline as described in the July 1,
3

20 **(4) advance to develop a large-diameter natural gas pipeline**
21 **project other than the in-state natural gas pipeline described in (1) of this section**
22 **by acquiring an equity interest in a large-diameter natural gas pipeline project**
23 **through the subsidiary under AS 31.25.122;**

24 **(5) advance to develop, finance, construct, and operate facilities**
25 **for liquefaction and treatment in connection with a large-diameter natural gas**
26 **pipeline project other than the in-state natural gas pipeline described in (1) of**
27 **this section through the subsidiary under AS 31.25.122.**

28
29 **Sec. 31.25.010. Structure.** The Alaska Gasline Development Corporation is a
30 public corporation and government instrumentality located for administrative purposes
31 in the Department of Commerce, Community, and Economic Development, but

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Creation of the statutory subsidiary

Section 7 - AS 31.25.122 - establishes a **statutorily created subsidiary** and instrumentality of the state to hold the state's equity interest in the large-diameter LNG pipeline and associated facilities.

- Subsidiary - hold state equity ownership and act as its investment entity during the LNG project, and return revenues to the state.
- Subsidiary - in AGDC chapter for administrative purposes; has a separate legal existence.
- **Advantages of a statutory subsidiary instrumentality of the state** - powers flow directly from legislature, and over which the state maintains control include
 - **State Revenues** - flow net revenues received from the state's equity interests into the state permanent fund and the general fund,
 - **State Revenues Federal Tax Exempt** - maintain state revenues exempt from the Federal income tax.

Creation of the statutory subsidiary

Attributes of the statutory subsidiary as instrumentality of the state include

- Created by statute as an instrumentality of and integral part of the state and state has authority to terminate the Subsidiary,
- State directs its revenues,
- Its employees are state employees,
- The state retains control over its operations,
- It is subject to general laws that apply to other governmental entities.
- The governor retains board member appointment and termination powers.

Creation of the statutory subsidiary

Section 4 amends the in-state natural gas pipeline fund language to clarify that money appropriated to the AGDC in-state natural gas pipeline fund may be used for the in-state natural gas pipeline, but not for the purpose of advancing the large-diameter LNG project.

Section 5 establishes a new separate fund in the statutory subsidiary for the large-diameter LNG project and provides that money appropriated to the LNG project fund is separately accounted for to be used for purposes of the large-diameter LNG project and not for the in-state natural gas pipeline.

Department of Natural Resources and Department of Revenue Participation in a North Slope natural gas project

Sections 10 and 11 provide authority for the DNR commissioner to

- Enter short-term commercial agreements for project services;
- Negotiate terms for inclusion in proposed contracts related to a North Slope natural gas pipeline;
- Enter into confidentiality agreements related to the negotiations and contracts;
 - A proposed contract presented to the legislature for the purpose of obtaining authorization is *not confidential*.
- Manage project services and take custody of the TAG.

Department of Natural Resources and Department of Revenue Participation in a North Slope natural gas project

Sections 23 and 24 provide that the DOR commissioner shall

- consult with the DNR commissioner on negotiations associated with a North Slope natural gas project;
- direct the disposition of revenues received from the TAG.

Oil and Gas Lease Modifications for a North Slope natural gas project

Bill sections 13 and 14 –AS 38.05.180(hh)

Provide authority for the DNR commissioner to propose modifications to existing oil and gas leases.

Oil and Gas Lease Modifications for a North Slope natural gas project

What may the DNR commissioner include in the proposed lease modifications ?

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2 (1) switching between taking the state's royalty gas in value and in
3 kind to ensure that the state's actions do not unreasonably

4 (A) cause the lessee or other person to bear disproportionate
5 transportation costs with respect to the state's royalty gas; or

6 (B) interfere with long-term marketing of natural gas by the
7 lessee or other person;

8 (2) providing a method for establishing a fair market value for each
9 component of the state's royalty gas and using appropriate adjustments to reflect fair
10 market value deductions for actual and reasonable transportation and processing costs
11 for the state's royalty gas from the North Slope to the first destination market; and

12 (3) establishing fixed royalty rates and modifying net profit shares
13 under leases subject to this subsection.

ng between taking the state's royalty gas in value and in
's actions do not unreasonably

cause the lessee or other person to bear disproportionate
with respect to the state's royalty gas; or
interfere with long-term marketing of natural gas by the
m;

ng a method for establishing a fair market value for each
royalty gas and using appropriate adjustments to reflect fair
r actual and reasonable transportation and processing costs
om the North Slope to the first destination market; and
hing fixed royalty rates and modifying net profit shares
subsection.

nacted in sec. 13 of this Act, is amended to read:
ng any other provisions of this chapter, if the commissioner
tion that a North Slope natural gas project has sufficient
work plan and budget necessary to support major permits
quired by state and federal agencies, and sufficient
sses, the commissioner may propose modifications to

ng between taking the state's royalty gas in value and in
's actions do not unreasonably

cause the lessee or other person to bear disproportionate
with respect to the state's royalty gas or gas delivered to
43.55.014(b); or

interfere with long-term marketing of natural gas by the
m;

ng a method for establishing a fair market value for each
royalty gas and using appropriate adjustments to reflect fair
r actual and reasonable transportation and processing costs

for the state's royalty gas from the North Slope to the first destination market; and

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Oil and Gas Lease Modifications for a North Slope natural gas project

What is the process for the commissioner of the Department of Natural Resources to propose lease modification?

- The commissioner makes a **written determination** that a North Slope natural gas project has
 - Sufficient **financial commitment** for a work plan and budget necessary to support major permits and regulatory filings required by state and federal agencies; and
 - Sufficient **commitment of gas** by lessees.
- **Concurrence of lessees** to the proposed modifications.

Tax As Gas “TAG”

Bill section 29

What gas may be part of the TAG?

- Taxable gas
- Produced from a modified lease
- On and after January 1, 2022
- Subject to an irrevocable election by a producer to pay a production tax in kind
- **AS 43.55.014(a) & (b)**

TAG

Why may the DOR allow a producer to make an *irrevocable election* for payment as the TAG?

- The *irrevocable* nature of the election provides **stability for the state and the producers**.
- The *election* for the TAG recognizes the **distinction between royalty and tax**.
- “This election, like RIK, is ‘subject to the execution of project enabling contracts including satisfactory arrangements for disposition of the State Gas Share of LNG’ “.

TAG

What is the levy on the TAG?

- **10.5% of the taxable gas produced**
- **AS 43.55.014(b)**

When is the levy on the TAG?

- **when and as that gas is produced**
- **AS 43.55.014(b)**

TAG

What if there is a tax deficiency on the TAG?

- The amount of the deficiency and the tax amount on which the interest or penalty percentage is calculated will be treated (for the calculation) as if the tax was levied under AS 43.55.011(e)(i.e., payable in money rather than in kind).
- **AS 43.55.014(d)**

How will the TAG be reported in annual filings?

- The producer is required to identify the gross amount of gas produced from each lease or property subject to an election for payment in kind and the amount of gas delivered to the state.
- **Bill section 37 – AS 43.55.030(a)(3)**

What will be public information about the TAG?

- **Bill section 25** - provides that the **name of the person** that has made an election for the TAG and **the amount of gas produced** from each lease or property subject to the TAG election is **public information**.

TAG

How does the state take the TAG?

- The TAG is **delivered to the state at the entrance of the transportation facility** specified by the state.
- The **DNR manages the custody and disposition** of the gas delivered to the state.
 - **AS 43.55.014(b) & (c)**

How does the state receive revenues from the TAG?

- The sales of the TAG are subject to the same provisions as sales of royalty gas in kind.
 - **Bill sections 15-18**
- The **DOR commissioner directs the disposition of revenues** received from the TAG.
 - **Bill section 24**

What would the Oil and Gas Production Tax look like for oil and gas produced on and after January 1, 2022?

- **Bill sections 27-47.**
- **TAG = Levy of 10.5% of the gas, otherwise taxable under AS 43.55.011(e)(3), produced from a modified lease that a producer has made an irrevocable election for payment in kind of the gas.**
 - **Bill section 29.**
- **Levy of 35% of the production tax value of taxable oil produced.**
 - **Bill section 27**
- **Levy of 10.5 % of the gross value at the point of production for taxable gas.**
 - except for gas produced from modified leases that have elected the TAG.
 - **Bill section 27.**
- **North Slope minimum tax = Levy of 4%-0% of the gross value at the point of production for North Slope oil depending on the price of ANS.**
 - **Bill section 28 – AS 43.55.011(f)(2).**
- **“Middle Earth” oil and gas production: May be subject to AS 43.55.011(p) tax ceiling and AS 43.55.024(a) and (b) tax credit.**

SB 138 does NOT change

- The Alaska Gasline Development Corporation's core mission, AS 31.25.005(1)-(3).
- The Oil and Gas Exploration, Production, and Pipeline Transportation Property Taxes, AS 43.56.
- Disposition of royalty and tax revenues.
- Current oil and gas production tax limitations.



Conforming and clarifying amendments

Questions?