

HOUSE FINANCE COMMITTEE
April 26, 2002
9:25 AM

TAPE HFC 02 - 95, Side A
TAPE HFC 02 - 95, Side B

CALL TO ORDER

Co-Chair Williams called the House Finance Committee meeting to order at 9:25 AM.

MEMBERS PRESENT

Representative Eldon Mulder, Co-Chair
Representative Con Bunde, Vice-Chair
Representative Eric Croft
Representative John Davies
Representative Richard Foster
Representative John Harris
Representative Bill Hudson
Representative Ken Lancaster
Representative Carl Moses
Representative Jim Whitaker

MEMBERS ABSENT

Representative Bill Williams, Co-Chair

ALSO PRESENT

Representative Drew Scalzi; Pat Pourchot, Commissioner, Department of Natural Resources; Michael Hurley, Phillips Petroleum Company, Alaska;

PRESENT VIA TELECONFERENCE

There were no teleconference testifiers.

SUMMARY

HB 519 "An Act authorizing priority treatment under the Right-of-Way Leasing Act for an Alaska North Slope natural gas project; expanding the scope for the kinds of gas development projects that may become qualified projects under the Alaska Stranded Gas Development Act; extending the deadline for submitting applications under the Alaska Stranded Gas Development Act; exempting an Alaska North Slope natural gas project from state property tax and all municipal taxes during construction; and providing for an effective date."

#hb519

HOUSE BILL NO. 519

"An Act authorizing priority treatment under the Right-of-Way Leasing Act for an Alaska North Slope natural gas project; expanding the scope for the kinds of gas development projects that may become qualified projects under the Alaska Stranded Gas Development Act; extending the deadline for submitting applications under the Alaska Stranded Gas Development Act; exempting an Alaska North Slope natural gas project from state property tax and all municipal taxes during construction; and providing for an effective date."

Representative Mulder observed that committee substitute 22-LS1651\W was adopted on 4/25/02(copy on file).

Representative John Davies MOVED to ADOPT Amendment 1, 22-LS1651\R.2, which was drafted to the previous R version. Co-Chair Mulder OBJECTED for the purpose of discussion. Representative John Davies explained that the amendment would allow the municipalities to apply for grants through the Department of Community and Economic Development to deal with the impact of the pipeline construction. The grants would be subject to legislative appropriation and would separate the issue of impacts to communities from the tax holiday. The state would front the funds through the normal appropriation process. The amendment was modeled on provisions, which applied to the Trans-Alaska Pipeline System construction.

Co-Chair Mulder spoke in support of the amendment. He stressed that it would be appropriate for the state to take responsibility and offer support to communities since the state is providing the exemption. He acknowledged that roads, schools, police and fire protection would be direct costs, which should be assisted by the state.

Representative Lancaster questioned if an emergency would have to be declared to receive funding. Representative John Davies understood that "emergency" had been used in prior provisions without difficulty. Co-Chair Mulder noted that it would be his intent that any [future] legislature step forward to help the communities.

Representative Harris spoke in support of the amendment. The amendment would help communities and give some oversight to the state legislature.

Representative Whitaker clarified that state general fund dollars would be made available for emergency impact. Representative John Davies explained that "emergency" would be extra ordinary impact.

There being NO OBJECTION, it was so ordered and Amendment 1 was adopted.

Co-Chair Mulder MOVED to ADOPT Amendment 2:

(c) Before issuing bonds to provide the financing described in AS 42.40.250(31), whether for a facility to be owned by the corporation or for a facility to be owned as described in (b) of this section, the corporation shall obtain the prior approval of the governor.

Co-Chair Mulder explained that the amendment would relate to the railroad provisions and issuance of bonds. The amendment clarifies that the governor would be in charge.

Representatives Whitaker and Davies expressed support for the amendment.

There being NO OBJECTION, it was so ordered and Amendment 2 was adopted.

Representative John Davies MOVED to ADOPT Amendment 3:

(9) requires that its agents and contractors, the agents and contractors of a person acting under contract, or the agents and contractors of a project sponsor, negotiate to obtain, a project labor agreement for the employment of laborers and mechanics for the construction, operation, and maintenance of the project.

Co-Chair Mulder OBJECTED. Representative John Davies explained that the amendment would speak to the Alaska hire issue. The amendment would require those that contract for labor to obtain labor agreements for employment.

Co-Chair Mulder noted that producers acknowledge the need for project labor agreements. The amendment was offered, but not adopted, in federal legislation. He spoke against the amendment and pointed out that oil companies would like to negotiate any Project Labor Agreement (PLA). He stressed that it is a legitimate tool and a good way to ensure Alaska hire, but that he would like to see the producers do the negotiations, as opposed to a legislative mandate.

Representative Croft pointed out that the intent of the legislation is to take some items out of negotiation. He acknowledged that it is appropriate to have a "tax holiday" but emphasized that the state could require a labor negotiation contract. He noted that, under the state Constitution, the state cannot require that Alaskan workers and contractors be hired, but the state can influence Alaska hires through negotiations. The best way to assure Alaskan

hiring is through a PLA. He emphasized that as the state gives away a substantial amount of state and municipal property tax that there should be a requirement to hire Alaskans by the most effective manner [a PLA].

Representative Hudson summarized that the amendment would require a PLA as opposed to requiring an attempt to negotiate where possible. He noted the difficulty of reaching agreements in all cases and stated that he would support the amendment with the addition of "where possible".

Representative John Davies clarified that the amendment would only require a negotiation.

Representative Whitaker questioned what would happen if the negotiations were unsuccessful. Representative Davies indicated that the project would continue unhindered. Representative Hudson reiterated his desire to see "where possible" added to the amendment.

Representative John Davies MOVED to AMEND Amendment 3: add "where possible" after "obtain" on line 5. There being NO OBJECTION, it was so ordered. Amendment 3 was adopted.

Co-Chair Mulder WITHDREW his OBJECTION. There being NO OBJECTION, it was so ordered and Amendment 3 was adopted.

Representative Whitaker MOVED to ADOPT Amendment 4. Co-Chair Mulder OBJECTED.

Representative Whitaker explained that the amendment would change the tax holiday to a tax deferral. The potential revenues would be deferred until they could be paid back. Sometime in the future the tax repayment would be negotiated if the project were successful. Section 4 would clarify that there is no new tax referral on the existing infrastructure. He observed that the intent is to help with the upfront costs to the producers while protecting the interests of the citizens.

Vice-Chair Bunde spoke against the amendment. He stressed that producers would be content to go elsewhere. He emphasized that "100 percent of something is better than 100 percent of nothing."

Representative Hudson clarified that the cutoff date would be 2015.

Co-Chair Mulder spoke against the amendment. He did not characterize the legislation as a "give away". He observed that this is the first time that producers have been interested [in developing an Alaskan natural gas project] due to positive changes in federal legislation. He stated that he is willing to make a \$500 - \$700 million dollar

investment in order to get 50 years at \$250 million dollars a year. When the gas pipeline comes on line the state should negotiate to recover costs. It is a legitimate negotiated item, which should occur under HB 393. He pointed out that the tax holiday is tied to the Stranded Gas Act. The holiday would only occur if there were negotiations.

PAT POURCHOT, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, provided information on the legislation. He noted that the department prefers the overall negotiation structure of the Stranded Gas Act to address the issues involved. He observed that once specifics are separated, difficulties occur in backtracking. He stated that how municipalities would be compensated for very real impacts during construction, when there is a statutory exemption from property tax, is a legitimate concern. He acknowledged that adoption of Amendment 1 would help to mitigate concerns, but stressed that it is complicated to negotiate after the fact. He felt that it was conceivable that there would not be a resolution. He argued that it would be appropriate to [negotiate repayment] up front. He acknowledged that the Administration would try to negotiate further under the terms of the Stranded Gas Act, but emphasized that something would have to be given up in the negotiations if taxes have already been taken off.

Representative Hudson asked if the intention of the amendment would be to allow some forgiveness. He questioned if a new subsection could be added: "When in the state's best interest the deferral could be made permanent." He observed that there might be occasions when the best interest would be to make a deferral permanent.

Representative Whitaker stressed that the current language would allow the option of a permanent deferral.

Co-Chair Mulder interpreted the amendment to mandate a deferral. Representative Whitaker pointed out that the amendment states that: the commissioner shall negotiate the amount of and the period of repayment of tax deferred". He stated that he would accept a friendly amendment to change the amendment to "may".

Co-Chair Mulder referred to section 4: deferral of state tax collections. Section 4 notes that the collection of the tax imposed by the amendment is deferred for collection. He concluded that the amendment is a mandate.

Representative Whitaker interpreted "negotiate" to mean that the range of possibilities is not limited. He stressed that if there is no money to pay back, then the conclusion would be that the negotiation would not allow for a repayment schedule.

Representative John Davies questioned what would be the hammer that closes the negotiation. He noted that a company could continue negotiations indefinitely. Representative Whitaker responded that the court system would determine a negotiation impasse.

Vice-Chair Bunde asked if there is anything in the legislation that would prevent an increase.

Representative Croft observed that taxpayer and commissioner would negotiate the amount of and period of repayment. He concluded that the addition of "amount" indicates that there could be a holiday, but that it would need to be proved that a holiday is necessary. He felt that the state was negotiating poorly on the issue [by giving a tax holiday]. Producers have provisions in federal legislation pending that would set a minimum price on the gas, which would take the risk out of the project. The only question becomes: How much money can be made at that price. The risk is taken out. There is a structure under the Stranded Gas Act for producers to demonstrate to the state of Alaska that it is not enough. He questioned why the state is circumventing the Stranded Gas Act to give away something that is no longer needed with the federal floor for the project to proceed. The amendment would presume deferral but ask to be shown the necessity.

Representative Croft referred to the method of negotiation. He stressed that the main negotiation point is being given away before the necessity is demonstrated. There should be a presumed deferral unless they show a holiday is needed. He compared state employee negotiations and questioned if it would make sense to pass a pay raise and then try to negotiate working conditions. The main issue would be given away before anything was conceded.

Representative Whitaker maintained that it would be unreasonable to try to tax the industry if the state finds that the project is not profitable. The intention is to further a project in a reasonable manner that precludes unreasonable action in the future. He observed that the Stranded Gas Act allows negotiation if a need is established.

Co-Chair Mulder questioned what is "reasonable". He maintained that a \$700 million dollar "kick start" is reasonable when the return to the state is considered. He observed that no one has negotiated to this point in time. No one has come to the table; no one has negotiated under the Stranded Gas Act. The intent is to bring producers to the table and to get them to put an application in if HB 393 takes place. He did not think the project would happen without [the tax holiday].

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Co-Chair Mulder noted that the federal delegation has indicated its desire to see a state effort toward encouragement of the project.

Representative Hudson summarized that the choice is between an out right holiday or a deferral. He suggested that the amendment be amended: to insert "terms of" and "forgiven". Representative Whitaker stated that he would welcome the amendment.

Representative Hudson emphasized that the deferral would be subject to negotiation, which is a holiday, depending on the contractual relationship with the state of Alaska. Representative Whitaker spoke in support of the amendment to Amendment 4. Representative Croft felt that the federal provisions, which provide a floor and tax credits (to make the floor of \$3.25) should be mirrored. He noted that the federal government does not just give without a quid pro quo. There would still be a significant advantage.

Representative Hudson MOVED to Amend Amendment 4: to insert "terms of" and "forgiven". Representative Whitaker stated that he would welcome the amendment. There being NO OBJECTION, Amendment 4 was amended.

RECESSED

The meeting was recessed at 10:13 A.M.

RECONVENED

The meeting was reconvened at 2:35 P.M.

Representative Hudson observed that the references to the Stranded Gas Act in Amendment 4 amended would need to be added. He MOVED to AMEND Amendment 4 by adding:

*5ec --. AS 43.82.210(a)(2) is amended to read:
(2) oil and gas exploration, production, and pipeline transportation property taxes under AS 43.56; a periodic payment in lieu of the tax described in this paragraph shall include an amount that takes into consideration amounts of the tax that, after negotiation, are deferred or forgiven under AS 43.56.035(c)

*Sec -- . AS 43.82.210(a)(6) is amended to read:
(6) municipal property taxes under AS 29.45.010 - 29.45.250 or 29.45.550 - 29.45.600; to the extent that taxes described in this paragraph include oil and gas exploration, production, and pipeline transportation

property taxes under AS 43.56 on a qualified project that are subject to limitation of municipal levy by AS 29.45.080, a periodic payment in lieu of the tax described in this paragraph shall include an amount that takes into consideration amounts of the tax that, after negotiation, are deferred or forgiven under AS 43.56.035(c)

There being NO OBJECTION, Amendment 4 was amended.

Representative Lancaster questioned what would happen with a change of ownership. Representative Whitaker thought that liabilities, responsibilities and opportunities would transfer with the ownership.

Co-Chair Mulder noted that in addition to changing the "exemption" legislation to a "loan" bill that the loan would expire when the project is placed in service. The legislation currently allows 24 months after the project comes on line to allow for ramp up.

Representative Whitaker noted that Amendment 5 would not be offered, which would have addressed the issue. Amendment 4 would end the deferral period when the project is placed into operation, or no later than December 31, 2015.

Co-Chair Mulder spoke against the amendment. He pointed to the size of the project and emphasized that the project would not be operating at peak capacity for a period of time while the details of operation are worked out.

Vice-Chair Bunde envisioned that the project would occur in stages. He questioned when the pipeline would be considered to be in operation. Co-Chair Mulder responded that as soon as the first molecule goes through.

Representative Croft noted that the automatic deferral ends when the project is placed in service, but that there would be an opportunity to negotiate a longer period; there is no mandate.

Representative Whitaker stated that he would not object to reinstating the two-year deferral from the project date.

MICHAEL HURLEY, PHILLIPS PETROLEUM COMPANY, ALASKA, stated that the amendment would change the legislation from an exemption to a loan. The payback would be unspecified. He stressed that the assumption would be that the loan would be repaid as soon as possible. The deferral sends a different message. The value of the bill would be in how the project is negotiated, but it would not provide a tool that he could take to his management. He would assume a conservative position in regards to the project.

Representative Harris noted that the producers are receiving a boost from Congress and questioned how much difference the change in the legislation would make. Mr. Hurley stated that it would make a difference. Sub-economic projects would not become economic through the adoption of the legislation. The size of the exemption with the impact of lower tariffs on increased royalty and severance taxes to the state is a lot smaller. The exemption would reduce the tariff by a nickel; that nickel flows through the oil head value and generates additional value in severance and royalty to the state.

Representative Croft asked if the federal legislation would be in the form of a tax deferral. Mr. Hurley explained that the floor is setup to score zero. He did not anticipate the floor to be used and it has no impact on the economics; it changes the risk profile of the project. The intent is to reduce the risk with market volatility.

Representative Croft questioned if there are provisions to payback the tax credit. Mr. Hurley affirmed and explained that the repayment would occur at 150 percent of the floor value.

Representative Whitaker summarized that the legislation with the addition of Amendment 4 amended would be an interest free loan that would not be paid back until 2017, subject to negotiations in 2017; and as result of the negotiations the loan could never be paid back.

Representative Hudson explained that he added a negotiation for deferral and forgiveness to provide something more substantial to take to the investors. Mr. Hurley noted the value of clarity and certainty regarding the tax status, but emphasized that oil companies do not want to be in a position to pay a lot in lawyer fees in order to achieve clarity.

Vice-Chair Bunde asked if the state would be more or less likely to see the construction of a gas pipeline in the next five years [with adoption of Amendment 4 as amended]. Mr. Hurley responded that it would be less likely.

Representative Whitaker noted that it would be more likely if all taxes were taken off forever. He observed that over the term of its life the project would be worth \$1 billion dollars. He emphasized that the Legislature must refer to the Constitution and maximize the public interest and benefit. He concluded that Amendment 4 as amended would allow the possibility to achieve maximum benefit, while providing incentive. He observed that the gas pipeline has been in consideration for a long time. He stressed that it is the duty of the Legislature to uphold the provisions of section 8 of the Constitution.

Co-Chair Mulder stressed that there is little benefit if resources stay in the ground.

A roll call vote was taken on the motion to adopt Amended Amendment 4.

IN FAVOR: Davies, Hudson, Lancaster, Moses, Whitaker, Croft
OPPOSED: Foster, Harris, Bunde, Mulder

Co-Chair Williams was absent from the vote.

The MOTION PASSED (6-4).

Representative Whitaker WITHDREW Amendment 5.

Representative Whitaker MOVED to ADOPT Amendment 6:

"deferral is not allowed as to taxable property used by the taxpayer

- (A) that, on the effective date of this section or at any time before that date, is subject to tax under this chapter;
- (B) to inject natural gas into a reservoir in the course of operations for purposes of repressuring or conservation, including enhanced recovery; or
- (C) in conjunction with gas consumed for production operations for the lease or property from which it is recovered.

Co-Chair Mulder OBJECTED.

Representative Whitaker explained that the amendment would clarify exemptions and leave no gray area in regards to what is covered.

Co-Chair Mulder summarized that the thrust of the amendment is to assure that only those things associated with the gas pipeline be exempted. He observed that Commissioner Pourchot is working on an amendment to implement the intent. He noted that he did not disagree with the concept but questioned if the amendment would succeed. The issue is complex.

Representative Croft noted that the pipeline should automatically be exempted. Other items might be part of the negotiations.

Representative Whitaker WITHDREW Amendment 6.

Representative John Davies MOVED to ADOPT Amendment 7. Co-Chair Mulder OBJECTED. Representative John Davies stated that the intent is to draw the line with the pipeline and

take other conditions out of the exemption. He WITHDREW Amendment 7.

Representative John Davies WITHDREW Amendments 8 and 9.

Co-Chair Mulder MOVED to ADOPT Amendment 10:

Page 7, lines 21 - 22:

Delete "until December 31 of the second calendar year after the calendar year in which the project is placed in service"

Insert "until 24 full calendar months after the project is placed in service"

Page 7, line 23:

Delete "December 31, 2015"

Insert "December 31, 2012, but the cc project construction has commenced if that construction is delayed due to litigation or to shortages of supplies for construction that are not due to or under the control of a taxpayer who is a producer, as that term is defined in AS 31.05.170, or not due to or under the control of a project sponsor"

Co-Chair Mulder explained that the amendment would provide certainty and allow the commissioner to extend the exemption.

Representative Croft questioned if [the deferral] could go past the year 2015. Co-Chair Mulder stated that it could. He explained that it is difficult to determine the reasonable point. The three biggest issues are permitting, litigation and type of availability. If the permitting and litigation aspects are extended the timeline could be continued. The amendment encourages prompt development but recognizes that there may be some circumstances beyond the producer's control.

Representative John Davies MOVED to AMEND Amendment 10: delete "24" and insert "12".

Representative Hudson thought that testimony indicated that it would take at least a year and perhaps another 6 months to come into full production. He spoke in support of 24 months.

A roll call vote was taken on the motion.

IN FAVOR: Croft, Davies, Moses

OPPOSED: Bunde, Foster, Harris, Hudson, Lancaster, Whitaker, Williams, Mulder

Co-Chair Williams was absent from the vote.

The MOTION FAILED (3-7).

There being NO OBJECTION, Amendment 10 was adopted without amendment.

HB 519 was heard and HELD in Committee for further consideration.

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ADJOURNMENT

The meeting was adjourned at 3:28 PM