

HOUSE FINANCE COMMITTEE
April 29, 2002
1:56 P.M.

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CALL TO ORDER

Co-Chair Williams called the House Finance Committee meeting to order at 1:56 P.M.

MEMBERS PRESENT

Representative Bill Williams, Co-Chair
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

None

ALSO PRESENT

Representative Beth Kerttula; Representative Mark Chenault;
Representative Jeannette James; Representative Pete Kott;
Representative Beverly Masek; Representative Sharon Cissna;
Senator John Torgerson; Representative Brian Porter;
Representative Vic Kohring; Larry Persily, Deputy
Commissioner, Department of Revenue; Dr. Doug Reynolds,
Consultant for the Joint Oil and Gas Committee, Economist,
Legislative Contract; Patrick Kaufflan, Senate Resources
Committee, Senator John Torgerson.

PRESENT VIA TELECONFERENCE

Randy Hoffbeck, Tax Division, Department of Revenue,
Anchorage; Joe Marushack, Phillips Oil Alaska, Anchorage;
Rob Shilab, Exxon Mobil, Anchorage; Ken Conrad, British
Petroleum (BP), Anchorage; Bob Lohr, Division of Insurance,
Anchorage; Robin Procter, Emergency Medical Technician,
Anchor Port Fire Department, Homer; Ron Wilhoit, Anchor
Point Manager & Administrator, Homer; Steve Van Sant, State
Assessor, Department of Community & Economic Development,

Anchorage; David Tyler, Alaska State Fire Chiefs Association, Fairbanks; Eric Mohrmann, Chena Goldstream Volunteer Fire Department, Fairbanks.

SUMMARY

HB 6 An Act relating to optional exemptions from municipal property taxes on residential property.

CS HB 6 (FIN) was reported out of Committee with a "do pass" recommendation and with fiscal note #1 by the Department of Revenue.

#HB315

HB 315 An Act requiring a single insurance provider for all state employees and allowing small employers to join as a group; and providing for an effective date.

HB 15 was SCHEDULED but not HEARD.

#HB464

HB 464 An Act relating to statewide school district correspondence study programs.

HB 464 was SCHEDULED but not HEARD.

#HB489

HB 489 An Act relating to cruelty to animals.

HB 489 was SCHEDULED but not HEARD.

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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.

CS HB 19 (FIN) was reported out of Committee with a "do pass" recommendation and with new fiscal notes by the Department of Revenue and the Department of Natural Resources.

#HB6

HOUSE BILL NO. 6

An Act relating to optional exemptions from municipal

property taxes on residential property.

REPRESENTATIVE JOHN DAVIES explained that HB 6 would allow a municipality the option to increase the residential property tax exemption from the current level of \$10,000 to \$40,000 dollars through voter approval. The exemption would apply only to homes that are the primary residence.

He advised that Section 1 would raise the limit from \$10,000 to \$40,000 dollars. Section 2 would allow a municipality, when approved by the voters, the ability to add an additional \$10,000 to the amount provided in Section 1 to those residents donating time as a volunteer fire fighter or emergency medical services.

Representative J. Davies recognized the burdens that are placed on residential property owners, pointing that the bill would grant greater relief from property tax. The bill recognizes the commitment to the community by volunteer fire fighters and those providing emergency medical services by allowing municipalities the ability to increase their property tax exemption another \$10,000 dollars. The bill would be entirely optional at the local level.

LARRY PERSILY, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, noted that the number indicated in the fiscal note was correct. If every community took the full exemption allowed under the statute and made up for that lost revenue by raising the mill rate rather than cutting spending or finding alternative revenue sources, could place a burden on the oil and gas property owners. He requested that Mr. Hoffbeck, the Department's Tax Division, testify regarding specific questions. He added that the bill's passage could amount to a \$1.6 million dollar impact to the State.

RANDY HOFFBECK, (TESTIFIED VIA TELECONFERENCE), TAX DIVISION, DEPARTMENT OF REVENUE, ANCHORAGE, commented that Mr. Persily had adequately covered all information.

STEVE VAN SANT, (TESTIFIED VIA TELECONFERENCE), STATE ASSESSOR, DEPARTMENT OF COMMUNITY & ECONOMIC DEVELOPMENT, ANCHORAGE, offered to answer questions of the Committee.

DAVID TYLER, (TESTIFIED VIA TELECONFERENCE), ALASKA STATE FIRE CHIEFS ASSOCIATION, FAIRBANKS, spoke in support of the legislation. The legislation provides an opportunity for the State to recognize the contributions of volunteers to the community. He commented that there are two types of volunteers in service, one being the young person who comes to fire service as a career. The proposed incentive targets those people, who are homeowners and who have families that intend to stay in the community for many years. He reiterated his support for the legislation.

ROBIN PROCTER, (TESTIFIED VIA TELECONFERENCE), EMERGENCY MEDICAL TECHNICAN, ANCHOR PORT FIRE DEPARTMENT, HOMER, urged support for HB 6. She claimed that the legislation would help to address the retention of fire fighters. She stated that it would provide a cost recovery recouping of expenditures. The legislation would make it possible for municipalities to provide a tax benefit for volunteers. In a small way, that would assist them with the recovery of some of the personal expenditures associated with their effort. Volunteers not only respond to medical and fire emergencies, but they must also attend a number of training classes and continuing education to remain current on their certification. Ms. Procter urged that Committee members pass the bill. She commented that it would be a small effort in showing appreciation and could be a significant dividend in recruitment and retention issues.

RON WILHOIT, (TESTIFIED VIA TELECONFERENCE), ANCHOR POINT MANAGER & ADMINISTRATOR, HOMER, explained that the fire department was bound by federal mandates regarding the number of minimum personnel on the operation of a fire site. If there are not enough people, there are two choices, attack the exterior or pursue operations and be out of compliance. He noted that if he had more volunteers, he could save more houses. Mr. Wilhoit added that anything that could be done to help recruite and retain personnel would help save lives and property.

ERIC MOHRMANN, (TESTIFIED VIA TELECONFERENCE), CHENA GOLDSTREAM VOLUNTEER FIRE DEPARTMENT, FAIRBANKS, encouraged members to support HB 6. He noted that volunteers contribute approximately 23,000 hours of volunteer time in a year. The bill recognizes the savings that volunteers provide the State.

Vice-Chair Bunde asked about the Internal Revenue Service (IRS) impact.

Representative Davies explained that it was not a repayment for services but rather an appreciative recognition of volunteer services. It would not be tied to a specific number of hours. In the worse case scenario, the IRS could tax the benefit.

Vice-Chair Bunde understood that in other cases of "in-kind" services, those taxes had been taxed.

Representative Croft MOVED to ADOPT Amendment #1, #22-LS0075\C.1, Cook, 4/17/02. He explained that the amendment would address a potential ambiguity that came up in the last Committee hearing. The amendment clarifies that only one exemption could be used per household.

There being NO OBJECTION, Amendment #1 was adopted.

Representative Foster MOVED to report CSHB 6 (FIN) out of Committee with individual recommendations and with the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

CS HB 6 (FIN) was reported out of Committee with a "do pass" recommendation and with fiscal note #1 by the Department of Revenue.

#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.

Co-Chair Mulder advised that he had invited industry members to provide Committee members a presentation on the gas project study.

JOE MARUSHACK, (TESTIFIED VIA TELECONFERENCE), PHILLIPS OIL, ANCHORAGE, introduced the "Alaska Producer Pipeline Update" handout. (Copy on File). He referenced Page 4, Project Overview from the handout, which:

- Developed feasibility cost estimates for a world-class pipeline project, Gas Treatment Plant, and a Natural Gas Line (NGL) facilities. The cost estimates accounted for:
- \$125 million spent for that phase of the project;
- 110 owner company representatives and over 1 million staff-hours (including contractors) with about 20% in the field;
- Performed multiple environmental field studies along 5,400 miles of right-of-way.

ROBBIE SHILAB, (TESTIFIED VIA TELECONFERENCE), EXXON ALASKA, ANCHORAGE, referenced Page 5, the Conclusions:

- Project currently not commercially viable as the risks outweigh the rewards. There is substantial additional engineering work not justified at the present time and the future activity must match

progress with governments and commercial viability.

- Governments will play a key role in reducing project costs and schedule risks. He noted the U.S. Federal regulatory enabling legislation, the NEW/First Nations regulatory process clarity and the Alaska fiscal certainty.

KEN CONRAD, (TESTIFIED VIA TELECONFERENCE), BRITISH PETROLEUM (BP), ANCHORAGE, referenced Page 7, the Statistical Summary (Alaska to L-48). The project would begin with a gas treatment plant moving the supply from Alaska into an Alberta pipeline, moving into a NGL plant along the way and then into Alberta to a L-48 pipeline.

- 4.5 (bcfd) pipeline design rate
- 5.6 (bcfd) expansion potential
- 24-28 compressor stations
- 1.2 - 1.4 million total pipeline horsepower
- 1,800 - 2,100 miles Alaska to Alberta
- 1,500 miles - Alberta to market
- 52 inches pipe diameter
- 2,000 - 2,500 (psi) operating pressure
- 5 - 6 million tons of steel
- 50 million + construction staff-hours

Mr. Conrad pointed out that Page 8 indicates the gas treatment plant (GTP), located on the North Slope. The picture indicates the central compression plant and the central gas facility. The primary purpose of the plant would be to remove carbon dioxide from the gas stream. The facility would use as an amine system to remove the acid gas, and then dehydration using glycol. The total cost would be approximately \$2.6 billion dollars. The average fuel consumption would be over 150 million cubic feet a day.

Mr. Conrad commented that Page 9 shows the Alaska to Alberta technical challenges. Those common challenges are:

- Permafrost
- River Crossings
- Skilled Labor
- Pipe availability
- Logistics

He continued, Page 10 indicates the elevation profile and the route profiles for both the northern and southern routes. The northern route takes a more gradual incline.

Mr. Conrad continued, Page 11 demonstrates the Alberta to market route. He pointed out that it would run 1,469 miles from Ft. Saskatchewan area to Chicago.

Mr. Conrad pointed out that Page 12 indicates Environmental Field Studies:

- Vegetation & soil surveys;
- Wildlife, including threatened and endangered species;
- Wetlands, fisheries, hydrology & water quality;
- Cultural & archaeology resources;
- Marine mammal studies, and
- Traditional knowledge consultation.

Mr. Marushack overviewed the project feasibility study outlined on Page 14.

- Joint project feasibility work results in significantly improved project definition and a better understanding of the risks and opportunities.
- Updated study results indicate higher capital costs, increased volumes delivered, lower operating costs, reduced fuel consumption, current capital cost estimates have accuracy to approximately +/-20%, and achieving lower costs and less cost uncertainty would require substantial future investment.
- The project continues to have significant risks such as regulatory, political, and fiscal costs, long-term prices and market volatility.

Vice-Chair Bunde understood that the producers would prefer the northern route, as it would be shorter and less challenging. He asked if incentives would continue to be made available if the northern route was chosen.

Mr. Conrad emphasized that it was not the intention to move forward with a project unless both governments supported it. Routing concerns would be a decision made by the governments. To make a project happen of this magnitude requires the support of all governments.

Mr. Marushack added that Phillips would be "happy" to focus on the southern route. He referenced Page 15, a Summary of the Capital Costs and Tolls, comparing the southern and northern routes. Alaska's project share for the southern route would be \$19.4 million dollars and for the northern route, \$18.6 million dollars. The uncertainty of each project creates a +/- 20%.

Representative Croft understood that under federal legislation, guaranteed \$3.25/bbl price in Alberta or a \$3.75/bbl price within the U.S. market. At that range, there would be a tariff even at the 20% number and that would provide less than one dollar of minimum guaranteed wellhead price.

Mr. Marushack explained that with the \$3.25 price and given the \$1 dollar wellhead cost, the operating costs would still have to pay the royalty and severance costs. That mechanism currently covers only the market risks. The mechanism referenced by Representative Croft would not cover capital risks. The project is not design engineering and those costs amount to hundreds of dollars. Any overrun in the project would be directly reflected in higher tariffs. There is no cost containment in the number. He emphasized that the project has an extreme amount of risk and that there is a lot of caution around the project.

Mr. Conrad added that to make the project successful, the industry is attempting to reduce costs and other risks. The project will require substantial future investment. There is a history in Alaska of lawsuits resulting from regulatory over-runs. He indicated that a +/- 20% had been the number provided.

Representative Whitaker asked if the wellhead, less the operating costs, would result in the pipeline or field operational costs.

Mr. Marushack replied that it would result in costs for the field operations.

Representative Whitaker remarked that the pipeline operational costs would be included in tariff fees.

Mr. Marushack responded that would be the cost of the pipeline operation plus the profit on that plus depreciation and taxes.

Representative Whitaker asked if the operation would be separate from the operation on the pipeline and if it would include the return on the investment.

Mr. Marushack stated that what had been included was all the operational costs of the pipeline and the gas treatment plant and would include the servicing costs for those new buildings. That price has nothing to do with what it will take to get the gas to the treatment facility.

Mr. Conrad added that it would not address costs associated with royalty taxes or the oil losses.

Representative Whitaker asked if there would be a return on the investment over and above the wellhead cost.

Mr. Marushack remarked that was correct and that it would amount to an assumed percentage of 70/3%, projecting a minimum of a 12% rate of return.

Mr. Shilab interjected that the 12% would be used for the pipeline portion.

Mr. Marushack referenced Page 16, the Estimated Government Take. He advised that the revenues would be roughly equivalent for both the northern and southern routes. The increased government take was based on a higher system throughout, the longer project life and the 51 TCF Alaska gas reserves produced including 16 TCF yet-to-be-discovered gases. He suggested that the State of Alaska could anticipate \$50 billion dollars in revenue.

Co-Chair Mulder asked about the \$28 and \$50 billion dollar discrepancy in the numbers as provided by the Department of Revenue. He asked if that was the known reserves and the estimated reserves.

Mr. Marushack responded that he did not know how the State achieved their numbers. He added that if the pipeline were built, people would discover gas.

Representative Whitaker asked about the distribution of the income number and the amount that the industry would receive on that amount.

Mr. Shilab understood that the industry would receive about 40% of the government amount, making nearly a 60%-40% split.

Representative Whitaker inquired what 40% would be the amount of.

Mr. Shilab responded that it would be 40% of the government take.

Representative Whitaker asked if that amount would be net dollars.

Mr. Shilab thought that they would be net dollars. He explained that the \$120 billion dollars would be "net" to the government and the \$40 billion would go to the producers.

Mr. Marushack interjected that the industry was using the Environmental Impact Assessment (EIA) forecast.

Representative Croft noted that if the government takes 60% and the producers take 40%, the producers would be making \$80 billion dollars.

Mr. Conrad suggested that they get back to the Committee with the correct numbers.

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Mr. Conrad indicated that the industry is attempting to make the risks balance with the rewards. Substantial revenues are anticipated. He added there will be substantial costs.

Mr. Marushack referenced Page 17, the expansion, and major expansion with new discoveries.

- Expandability built into the system design;
- System de-bottle-necking likely to yield small volume improvements;
- Approximately 1 bcfd expansion with intermediate compression;
- Cost effective expansion facilitated by large diameter pipe; and
- Expansion will provide access to new gas discoveries.

Representative Whitaker understood that there would be no expansion until there is an additional bcfd added per day for efficiency.

Mr. Conrad advised that an expansion of such magnitude would be a function of how much horsepower the State wants to add. It would depend on what the customers want and/or need at that time. He added that lower volume expansion could be done but might be less efficient if there is a continuum of opportunity depending on the needs of the market.

Mr. Shilab referenced Pages 18, 19, & 20, the Three-legged Stool for Government Framework:

- Viable Government Framework is Essential;
- U.S. Enabling Regulatory Legislation; and
- Alaska Fiscal Certainty.

If all the stakeholders do not support the project, the investors, the government, the 1st Nations and Native communities and the consumers will determine the success of the pipeline. Predictable expenditures require having a framework in place. Hopefully, once the framework is established, a viable pipeline project will be found.

Mr. Shilab pointed out that the U.S. regulatory process follows the Senate Energy bill and creates a market-driven process for any viable project. That office will create an office in the executive branch to coordinate all related federal agency activity.

Mr. Shilab discussed Page 20, The Alaska Fiscal Certainty. That aspect will provide certainty in the State government take for predictable disposition of State royalty gas, consistent with:

- Firm transportation commitments;
- Clear, simple predictable gas valuation for royalty and severance tax payments;
- Severance tax rates and the economic limit factor (ELF);
- Ad valorem tax rates and valuation methodology;
- Corporate income taxes; and
- Stable fiscal terms over the life of the pipeline project.

Co-Chair Mulder inquired about the federal ceiling and the floor agreements.

Mr. Conrad stated that the process was moving forward.

Mr. Marushack pointed out that the bill had made it through the Senate and through the Conference Committee. The bill needs to be thoroughly debated. The State of Alaska must help move the bill, adding that this is not a "done deal".

Co-Chair Mulder asked if the project be a "non starter" without the federal provisions.

Mr. Marushack explained that the bill is extremely important. There must be federal enabling legislation, a federal tax incentive, and State fiscal certainty in order for the producers to move forward.

Mr. Marushack acknowledged that the federal side would help the downside risks, however, that does not address economics. It is important that Alaska demonstrate that they want this project to happen.

Mr. Shilab mentioned that Exxon Mobil would not seek or support government subsidy on the project. He commented that the project would need to "stand on its' own feet" in order to move forward.

Representative Harris pointed out that in regard to Alaska fiscal certainty, no tax holiday had been indicated. He

asked if during construction, a tax holiday could determine the project's feasibility.

Mr. Conrad replied that there is no "one point" which makes or breaks the project. There needs to be clarity and predictability on the regulatory and fiscal portion. He outlined the key points. Costs will need to be reduced and that a property tax holiday would be a way to help reduce costs.

Representative Harris questioned previous statements made by Mr. Shilab regarding the economics of the project and how it must "stand on its' own merits".

Mr. Shilab stated that was correct. He noted that Exxon does not seek or support incentives or subsidies. A project of this size must be able to stand alone on its' merit.

Co-Chair Mulder asked if Exxon believed that the project was economically viable.

Mr. Shilab replied they did.

Representative Hudson referenced comments made regarding Alaska's fiscal certainty and asked if that was a concern.

Mr. Conrad agreed that it was. He noted that Alaska does have a history of disputes and changes in settlements. The project cannot economically tolerate such scenarios. He pointed out that the "overall" fiscal picture in Alaska is "wobbly", thus there needs to be a high degree of confidence. Whatever "rule" is decided, it cannot change. He noted that the producers were supportive of reenacting the old Stranded Gas Act.

Representative Croft commented that a tax holiday was a subsidy.

Mr. Marushack pointed out that there was a philosophical difference between the companies presenting at the meeting. Phillips position is that the project is one of several building blocks which will help make the project viable. He added that the legislation would send the right message to move the project along.

Mr. Conrad interjected that BP should evaluate the project with the rule in place. Fiscal predictability is very important and taxes by far would be the biggest cost of the project. He added that property taxes are a decision made by the government, and then the industry can evaluate the project against that information.

Representative Croft noted Page 15, the southern route. He noted that it would cost \$1.77 to get the gas to Alberta,

creating a \$3.25 minimum price. He pointed out that number would be 50% off, not 20%, which would yield a tariff to Alberta of \$2.66 leaving a \$.60 wellhead value for the gas.

Mr. Marushack advised that the \$1.36 would get the gas to Gordondale. He stressed that the project is very risky and the industry is concerned about moving forward and finding that it is over the 20% mark. The industry does not agree that price could likely make the project happen.

Mr. Conrad interjected that the operating costs had not been shown and those costs would mitigate the oil losses.

Representative Croft questioned if the producers had been involved in drafting the U.S. Energy authorization.

Mr. Conrad replied that they had and that was legislation, which the industry proposed in order to regulate the risks. He noted that the industry worked closely to create an appropriate form.

Representative Whitaker referenced Page 20, and asked if the statement "predictable disposition of State royalty gas, consistent with firm transportation commitments" was sufficient for the industry.

Mr. Conrad explained that the producers were supportive of the State taking the gas in-kind and thought that could be a form of fiscal stability.

Representative Whitaker questioned the "clarity" of the existing regime.

Mr. Conrad replied that it is important that the interpretation is clear. Problems need to be addressed before they occur.

Representative Whitaker inquired if there were impediments within the existing project because of the uncertainty.

Mr. Conrad responded that it could be determined by bringing simplicity and clarity to the scheme.

Representative Whitaker asked if reducing the rate had been included.

Mr. Conrad stated that what was being discussed was "simple and predictable".

Representative Whitaker asked about severance.

Mr. Conrad reiterated that "simple, clear and predictable" are the answer to all the elements; otherwise it would be impossible to evaluate the project.

Representative Whitaker thought that there was a "mechanism" inherent to the proposed legislation. He pointed out that the Stranded Gas Act would provide the necessary clarity.

Mr. Conrad advised that it would not solve the problems, but would rather establish a process to address it.

Vice-Chair Bunde asked if Mr. Shilab had participated in crafting the federal legislation.

Mr. Shilab responded that Exxon Mobil had participated in crafting the base language for the enabling legislation.

Vice-Chair Bunde inquired if they were supportive of the results.

Mr. Shilab responded that Exxon Mobil was supportive of the July 2001 legislation, however, that they did not support some of provisions regarding access, expansion, and royalty in-kind.

Vice-Chair Bunde inquired if Exxon Mobil had been supportive of the subsidy and/or financial aspects.

Mr. Shilab stated that they do not support the financial subsidy.

Mr. Shilab outlined Page 21 - Predictable New/First Nations Regulatory Process. He outlined it:

- Establishes clear regulatory processes between New and First Nations;
- Details plans for cooperation among Canadian Federal, Provincial, Territorial and First Nations regulatory authorities; and
- Predicts expedited process that fully complies with all environmental and regulatory laws.

He continued illustrating why it was essential:

- Ensures timely completion of regulatory and environmental assessment process;
- Lacks clear New/First Nations permitting process increases project risk; and
- Avoids duplication of environmental assessments and conflict among Canadian governmental agencies and First Nations.

Mr. Shilab reviewed Page 23, Wrap-up. He stated that the intent was:

- Project is currently not commercially viable.
- A viable government framework is essential.
- Joint team resources have been redeployed.
- Companies will collaborate as appropriate on future work.

Representative Harris asked if there had been any on going talks with the Canadian government regarding incentives or tax holidays.

Mr. Marushack replied that there have not been any at this time. The industry has focused only on the federal guidelines. The benefits to the Canadians, especially on the southern route, are significantly less than they are to Alaska and the federal government. Canadians see the project as an opportunity for jobs.

Mr. Conrad interjected that there has been some discussion initiated by the Canadian government regarding accelerated depreciation. In terms of property tax, most of the jurisdictions in Canada already have a system that is less burdensome than it is in Alaska.

Representative Davies questioned why the southern route would be less valuable to the Canadians.

Mr. Marushack explained that scenario assumed that the MacKenzie Valley was developed. Part of the \$29 billion revenue dollars is associated with separate MacKenzie lines.

Representative Davies asked if the Mackenzie River portion was built, would a tax holiday play a role.

Mr. Shilab advised that if the southern pipeline were built, there would then be no association with the MacKenzie project.

Co-Chair Mulder pointed out that "tax holidays" are not new concepts, however, relatively new to Alaska. He inquired how often the tax holiday was used around the world.

Mr. Marushack advised that on several large projects throughout the states, municipalities do compete for the projects by offering the tax holiday. That is a common practice. On the world scale, opportunities are negotiated on a different base. He noted that the legislation does not allow the industry to compete against other municipalities. He indicated that the proposed project is world scale and has enormous risks involved.

Co-Chair Mulder asked if Exxon Mobil had used the tax holiday anywhere else in the world.

Mr. Shilab was not aware of that.

SENATOR JOHN TORGERSON introduced Dr. Doug Reynolds, Oil and Gas Economist, Legislative Contract, and Mr. Patrick Kaufflan, Senate Resource Staff.

Senator Torgerson outlined items that he felt were missing from the proposed report. He indicated he was disappointed with the report. The financial summary consists of eight numbers, three subtotals, and one tariff range. He was outraged that the State was expected to respond to only eight numbers being provided, given the size of the project.

Senator Torgerson listed missing items from the report:

- Does not show the liquid price
- Evaluation criteria
- Rate of return
- Pipeline tariff model
- Benefit for the federal price
- Federal loan guarantee
- State tax exemption
- State property tax exemption
- Other fiscal changes that could affect the economics of the projects
- Expect jurisdictions to reduce their take
- Information on when the pipeline would be expanded
- Cost benefit of any expansion
- Oil loss models

Senator Torgerson claimed that the \$50 billion dollar figure was a new number with no appropriate indication of how it was determined. He noted that using the producer's numbers would provide them a much higher value than 15%. Senator Torgerson noted that the preliminary analysis indicates that the property tax exemption during the four-year construction period would provide a greater return.

Representative Davies asked Senator Torgerson how long he had been chair of the Joint Committee on Oil and Gas.

Senator Torgerson replied for one year.

Representative J. Davies asked during that time, how often had the industry requested a tax holiday.

Senator Torgerson informed members that there had been many requests. He noted that in March 2002, he requested that the proposal be submitted in writing. Senator Torgerson acknowledged that working with that group had been

frustrating. The industry continually has requested that the State provide fiscal certainty.

Representative Croft requested that the industry to provide feedback regarding the background of the project.

Mr. Conrad did not know what Senator Torgerson was attempting to determine but offered to negotiate any used assumption.

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Mr. Conrad acknowledged that the State had used a different number evaluation.

Representative Croft suggested that there should have been substantial work done to determine the \$2.39 tariff.

Mr. Konrad explained that there is "not a specific tariff but rather a range". He noted that there is uncertainty around that number.

Representative Croft requested to see reports on whatever work had been done to date. He commented that for \$100 million dollars, there should be more information than that contained in the presentation.

Mr. Conrad replied that most of the money had been spent on engineering and time in the field. He added that the industry "would be happy to have any conversation with Senator Torgerson".

Vice-Chair Bunde thought that it would be more in the State of Alaska's interest to have a gas pipeline than it would be in the producer's interest.

Senator Torgerson pointed out that the estimated rate of return, including the floor, would be around 18.8% percent. He emphasized that the industry does not need any incentive with a predicted rate of return that high. He warned that incentives should not be provided until they are needed.

Vice-Chair Bunde questioned why producers would not begin a project if they were assured a 15%-18% percent profit.

Senator Torgerson commented that the producers need to get federal legislation to pass before they began. He reiterated that the industry only had eight numbers at this time and asked how a decision this large could be made with only eight numbers. He encouraged that the numbers "prove out mathematically" when undertaking such a huge risk for the State.

Co-Chair Mulder pointed out that Exxon had indicated that the project "could be non-economic". He asked if Senator Torgerson believed that the project was economic.

Senator Torgerson reiterated that at this time, the numbers indicate that the project would produce over 15%. Each company has their own internal hurdle rate. Exxon Mobil is a large corporation and could have two or three projects this size happening in any given year. Each company must determine both their internal and external rates in order to approach the hurdle.

Co-Chair Mulder noted that he was not willing to risk \$22 billion dollars. He believed that the margin band was narrow and that it would be unreasonable to have a guaranteed good rate of return for such a risk.

Senator Torgerson reiterated that his concern was not the rate of return but the fact that he does not have enough numbers to make an informed decision.

Co-Chair Mulder stated that the actual dollar return would lessen the cost of construction, would lower the tariff, increase the wellhead price and at the same time, the exemption would be marginal.

Senator Torgerson acknowledged that there was truth to that assumption, however, needed further consideration and numbers being provided.

Co-Chair Mulder understood that the State could recoup their costs over time with the high wellhead price.

Senator Torgerson acknowledged that it was fair to presume that the State would receive the return over a 50-year period. He asked what the projected length was.

Co-Chair Mulder thought that now is the "window of opportunity" for the project to enter the market.

Senator Torgerson pointed out that Cambridge had indicated that there could be a new window of opportunity coming in 2015. He reiterated that there are many issues surrounding the proposed project.

Co-Chair Mulder observed that there is more gas now in the lower 48 than there was a couple years ago.

Senator Torgerson advised that usually there is a seven-year supply ratio, which now has increased to eleven. He noted the price of gas had increased, indicating that the amount of product had declined.

Co-Chair Mulder stated that in order to get into the market place, the State needs to be aggressive or they will lose their opportunity. If this window of opportunity is lost, it might never happen.

Senator Torgerson disagreed.

Representative Whitaker referred to the Alliance pipeline.

Senator Torgerson replied that pipeline had come online in 1998.

Representative Whitaker remarked that at that time, the price of gas had gone through the ceiling. The demand was significant and growing. The point being that the window of opportunity is a moving target and the market could absorb the gas.

DR. DOUG REYNOLDS, CONSULTANT FOR THE JOINT OIL AND GAS COMMITTEE, ECONOMIST, JUNEAU, noted that in addition to the federal legislation, the industry has indicated that they need a 15% cost of return. If costs were higher, they could get a lower rate of return. If the revenue side risk was taken care of and the cost side addressed, from 12 years of past data, Exxon Mobile has received a 12% rate of return. Risks have been taken into account. If cost risks were added back, a 13% rate of return would result.

Co-Chair Mulder inquired what type of cost risk Dr. Reynolds was referring to.

Dr. Reynolds replied that a +/-20% cost risk, noting that a 100% cost risk was not possible. From costs of similar projects around the world, most costs are lower.

Co-Chair Mulder asked if any other pipelines had to run through the Alaskan-type terrain.

Dr. Reynolds advised that in Russia, there was mountainous and permafrost terrains. There have been studies done and they have a "good feel" for their numbers. He added that everything should be on the table during the negotiations.

Representative Whitaker referenced the Trans Alaska Pipeline System (TAPS) and asked if there was sufficient data to determine a reasonable cost estimate.

Dr. Reynolds explained that the problem regarding TAPS was that the situation was changing and that there was work that needed to be done to appease environmental concerns. Additionally, it had to be above ground. The TAPS pipeline is significantly different than any other oil pipeline system. The proposed pipeline would be more similar to other types of constructed pipelines.

Representative Whitaker commented about the problems associated with thawing Arctic concerns.

Dr. Reynolds agreed.

Co-Chair Mulder questioned Dr. Reynolds's credentials.

Dr. Reynolds advised that he had studied oil energy economy and was a mechanical engineer. He noted that he had not built a pipeline. He noted that he spoke "purely" from the studies he had read on pipeline construction. He stressed that he had not been involved and that neither had Co-Chair Mulder and that the State was currently involved in expensive negotiations with the industry.

Representative Hudson summarized that before the Committee was two initiatives for the natural gas industry to put together a portfolio in the interest of the industry and the State. He added that one would use the Alaska Railroad's tax-free bonding capabilities.

Dr. Reynolds noted that they had looked at that and that it would depend on how the project would be financed. There would be some savings. He added how that affects the rate of return would be difficult to measure.

Representative Hudson asked if there had been any project within the last ten years where governments negotiated with producers and provided an advance incentive.

Dr. Reynolds replied that there were a number of huge projects in which the government did provide incentives. He did not know the exact incentive. In response to Representative Hudson, Dr. Reynolds explained that he had only studied the finances of this particular project and not the negotiation process.

PAT KAUFFLAN, SENATE RESOURCES COMMITTEE, SENATOR JOHN TORGERSON, advised that the North Star unit was a similar process of negotiation as the present one facing the Legislature. Through that process, a negotiation transpired between the producers and the Administration. During the process, the State received a great deal of information regarding financial and engineering information and the volume of reserves. The State then went to outside experts to verify what was a fair arrangement. The deal was negotiated using the net profit share and presented to the Legislature for approval.

Representative Whitaker questioned if it would be an issue if a tax holiday were not given.

Mr. Kauffman replied that was logical.

Representative Whitaker referenced the EIA projections through 2020, which was the base from which the numbers came. He did not understand if the floor could provide an economic advantage.

Mr. Kaufflan replied that the floor price was not established in the current federal legislation based on the lower 48 prices. That number was based on a price in Alberta. Historically, that price has been lower than the one in the lower 48 states.

Representative Whitaker thought that it would be more advantageous given that floor price.

Mr. Kaufflan replied that would be so if the starting price were calculated as the price in the lower 48 states.

Representative Whitaker asked if that would be an economic advantage and would affect the rate of return.

Dr. Reynolds advised that to take the legislation at \$3.25 cost in 2010 in Alberta, would translate to \$2.56 cents in 2002 dollars. He reiterated that the \$3.25 price shown in the Alberta scenario would amount to roughly \$2.55 dollars. In 2002 dollars, it would amount to little advantage.

Representative Croft noted that the advantage would lower the construction costs and the tariff and it would make the well head value higher. At \$.125 cents for each, the State would only be getting a $\frac{1}{4}$ of their money back.

Co-Chair Mulder agreed that was correct if it was done on a continuum basis, however, he thought that the one time up front would eventually be made up.

Representative Croft did not agreed that the numbers would balance out.

Co-Chair Mulder stated that the producers had indicated that the difference in the end would be negligible over the life of the project. He admitted that he did not know the modeling and how long it would take to pay.

Mr. Kaufflan explained that there were two concerns, the first being the time-value-money issue and that when running the models, the answers are not always obvious.

Representative Croft asked what information Senator Torgerson would like to see from the producers to confirm the numbers.

Co-Chair Mulder MOVED to RESCIND action taken in adopting Amendment #4.

Representative Croft OBJECTED.

Recess: 4:05 P.M.
Reconvened: 4:15 P.M.

Co-Chair Mulder restated the MOTION to RESCIND.

Representative Whitaker OBJECTED.

Representative Whitaker explained that Amendment #4 agrees that a deferral would be a reasonable course to follow. He stated that the holiday was a more reasonable approach. He pointed out that Senator Torgerson had spent \$1 million State dollars to determine what a "reasonable" course would be. He remarked that there has not been enough information provided to make this decision. He warned that 15 years of free money might never be paid back. Representative Whitaker emphasized that the House Finance Committee had made a decision that there should only be a deferral for the State's best interest.

Representative Croft spoke against the motion. He pointed out that that all the tariff rates indicate a profit. He commented that the industry wrote the federal legislation to produce a result that made a profit at the low end. If that legislation passes, the industry will have taken the market risk out of their court. He surmised that any business would like that deal. Rescinding action on the amendment gives away the people of Alaska's money and that the Legislature would not be a good trustee in doing that. Representative Croft emphasized that such an action would be bordering on "insulting" to force the municipalities to give it away without having sufficient data to indicate it is appropriate.

Representative Davies commented that it would be a problem to change the legislation to a tax holiday. He noted that at each meeting, each producer had been asked about a tax holiday and the question was "stone-walled". He pointed out that Senator Torgerson's letters had never been responded to.

Representative J. Davies pointed out that a gas pipeline would significantly impact Fairbanks. When giving away that amount of money, there should be at least a spreadsheet to show how the money would be given away. The industry should not be faulted for asking for a tax holiday; however, the State should be equally aggressive asking for the industry to step forward and help build the pipeline under terms that are profitable to the State of Alaska and its' citizens. The idea of rescinding action taken on Amendment #4 would be

irresponsible. He stressed that there has not yet been an appropriate analysis and that the idea is premature.

Representative Lancaster shared concerns with Senator Torgerson regarding the amendment. He thought that the oil industry was not willing to share information to help make a better determination for the State. He reiterated that the tax holiday should be negotiated.

Representative Hudson referenced Amendment #4, stating that it was in the State's best interest. After the numbers are determined, then the forgiveness consideration should be considered.

Co-Chair Mulder acknowledged that the Legislature was the trustee for the State of Alaska to keep it. He claimed that the Legislature is attempting to stimulate the wavering gas pipeline. If there were federal support for the pipeline, the removal of the amendment would provide an incentive to get the enterprise over the "hurdle". He asked why wait. He commented that "not that much money was being left on the table".

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Co-Chair Mulder continued, that the proposal is a non-economic deal even with the incentives. He stressed that the Legislature needs to get the producers on "our" side and that the State might need to sacrifice to achieve that goal. The deferral will not work and would accomplish nothing. The deferral is a loan with unspecified repayment terms.

Vice-Chair Bunde interjected that the bill as amended does nothing. Gas would be "money in the bank". He claimed that the producers would have no reason to go forward without the proposed tax holiday.

Co-Chair Williams acknowledged that the "tax holiday" concern was an important issue. The State of Alaska and the Governor are negotiating and the State is seeking middle ground. Co-Chair Williams noted that the House Finance Committee would not be the last place that the amendment could be addressed. The amendment indicates that the Finance Committee supports the bill. He commented that he did support the bill with or without the amendment and concluded that when negotiating, there must be "give and take".

Representative Whitaker acknowledged that the Committee was beginning negotiations with the industry. He noted that without the amendment, there would be a significant amount "taken off the table". He pointed out that giving the

industry a tax holiday would not be a good way to begin the negotiation process. He strongly recommended not to rescind previous action taken on adopting Amendment #4. He emphasized that Amendment #4 sends a clear message to the producers.

A roll call vote was taken on the motion.

IN FAVOR: Bunde, Foster, Harris, Moses, Williams,
Mulder

OPPOSED: Whitaker, Croft, Davies, Hudson, Lancaster

The MOTION PASSED (6-5).

Co-Chair Mulder MOVED to report CS HB 519 (FIN) out of Committee with individual recommendations and with the accompanying fiscal notes.

Representative Whitaker OBJECTED.

A roll call vote was taken on the motion.

IN FAVOR: Moses, Bunde, Davies, Foster, Harris, Hudson,
Lancaster, Mulder, Williams

OPPOSED: Whitaker, Croft

The MOTION PASSED (9-2).

CS HB 519 (FIN) was reported out of Committee with a "do pass" recommendation and with new fiscal notes by the Department of Revenue, Department of Natural Resources and the Department of Community & Economic Development.

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ADJOURNMENT

The meeting was adjourned at 4:34 P.M.