

HOUSE FINANCE COMMITTEE
March 10, 2003
1:40 PM

TAPE HFC 03 - 31, Side A
TAPE HFC 03 - 31, Side B
TAPE HFC 03 - 32, Side A

CALL TO ORDER

Co-Chair Williams called the House Finance Committee meeting to order at 1:40 PM.

MEMBERS PRESENT

Representative John Harris, Co-Chair
Representative Bill Williams, Co-Chair
Representative Kevin Meyer, Vice-Chair
Representative Eric Croft
Representative Richard Foster
Representative Mike Hawker
Representative Carl Moses
Representative Bill Stoltze
Representative Jim Whitaker

MEMBERS ABSENT

Representative Mike Chenault
Representative Reggie Joule

ALSO PRESENT

Representative Hugh Fate, Larry Persily, Deputy Commissioner, Department of Revenue, Dan Dickinson, Director, Division of Oil and Gas Audit, Department of Revenue, Wendy King, Conoco/Phillips, Ken Konrad, Senior Vice President, BP Exploration, Dave McDowell, BP Exploration.

PRESENT VIA TELECONFERENCE

Roger Marks, Petroleum Economist, Economic Research Section, Tax Division, Department of Revenue, Mark Meyers, Director, Division of Oil and Gas, Department of Natural Resources.

SUMMARY

HB 14 "An Act relating to an absence from the state while providing care for a terminally ill grandparent for purposes of determining eligibility for a permanent fund dividend; and providing for an effective date."

HB 14 was REPORTED out of Committee with a "do pass" recommendation and with previously published fiscal impact note: REV #1.

HB 16 "An Act amending the standards applicable to determining whether, for purposes of the Alaska Stranded Gas Development Act, a proposed new investment constitutes a qualified project, and repealing the deadline for applications relating to the development of contracts for payments in lieu of taxes and for royalty adjustments that may be submitted for consideration under that Act; and providing for an effective date."

HB 16 was HEARD and HELD.

#HB14
HOUSE BILL NO. 14

"An Act relating to an absence from the state while providing care for a terminally ill grandparent for purposes of determining eligibility for a permanent fund dividend; and providing for an effective date."

JIM POUND, STAFF, REPRESENTATIVE FATE, SPONSOR, testified in support of the bill. He noted that currently a Permanent Fund exemption existed to allow an absence from the state in order to care for a terminally ill family member. He pointed out that "grandparent" was omitted from the list of family members allowable. The bill adds the language "for grandparents" to allow this exemption.

LARRY PERSILY, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE provided information regarding the bill. He confirmed that several exemptions for allowable absence exist in statute, including one that pertains to care for terminally ill family members. He observed that the bill would add grandparents to the list, which currently includes parent, spouse, children and stepchildren. He stated that there is no fiscal impact to the Department of Revenue. He pointed out that the small number of added eligible applicants might slightly reduce the size of dividend payments, since a few more applicants would now qualify. He pointed out that if ten more applicants became eligible, the dividend payment would be only pennies lower.

Representative Stoltze asked the Division's position on adding any legislation pertaining to the Permanent Fund.

Mr. Persily stated that he was not aware of any opposition to amend existing statute to add allowable absences.

Co-Chair Harris asked if the department was concerned that other amendments would be added to the bill.

Mr. Persily conceded that the department maintained concern that no other exemptions would be added to the bill. He stated that as long as the bill was well written, it would not present an administrative problem.

In response to a question by Co-Chair Harris, Mr. Persily noted that an absence of up to 180 days was allowed for any reason. He noted that a longer absence needed to fall under allowable absence exemptions. He pointed out that if, during an absence, residency was severed in some manner, then the absence was no longer allowable.

Representative Stoltze raised concerns about amendments that may be added to the bill. He maintained that three people had recommended amending the bill already. He requested that the bill be kept specific.

Mr. Pound expressed the Sponsor's commitment to keeping the bill language as it stands and not to expand it. He conceded that amendments had been proposed in an earlier committee, and indicated that the amendments carried a far broader intent than the original bill. He stated that the proposed amendments did not pertain to absence exemptions, and that they had not been passed.

Representative Foster MOVED to report out of Committee with the accompanying fiscal note and recommendations

There being NO OBJECTIONS, the MOTION PASSED.

HB 14 was REPORTED out of Committee with a "do pass" recommendation and with previously published fiscal impact note: REV #1.

#HB16
HOUSE BILL NO. 16

"An Act amending the standards applicable to determining whether, for purposes of the Alaska Stranded Gas Development Act, a proposed new investment constitutes a qualified project, and repealing the deadline for applications relating to the development of contracts for payments in lieu of taxes and for royalty adjustments that may be submitted for consideration under that Act; and providing for an effective date."

Committee members were provided with two proposed amendments as follows:

23-LS0101\Q.2
Chenoweth

A M E N D M E N T #1

OFFERED IN THE HOUSE
TO: CSHB 16(RES)

BY REPRESENTATIVE HARRIS

Page 1, line 8, following "**terms;**":

Insert "**providing a statement of intent for the Act relating to use of project labor agreements;**"

Page 1, following line 9:

Insert a new bill section to read:

"* **Section 1.** The uncodified law of the State of Alaska is amended by adding a new section to read:

LEGISLATIVE INTENT. It is the intent of the legislature that, in awarding contracts under the Alaska Stranded Gas Development Act, a qualified sponsor or qualified sponsor group and contractors of the qualified sponsor or qualified sponsor group may develop and enter into a project labor agreement with appropriate collective bargaining organizations for each project for which a contract is entered into."

Page 1, line 10:

Delete "**Section 1.**"
Insert "**Sec. 2.**"

23-LS0101\Q.3
Chenoweth

A M E N D M E N T #2

OFFERED IN THE HOUSE
TO: CSHB 16(RES)

BY REPRESENTATIVE WHITAKER

Page 1, line 4, following "**group**":

Insert "**and whether a project plan submitted may be approved as a qualified project plan**"

Page 3, following line 1:

Insert a new bill section to read:

"* **Sec. 3.** AS 43.82.130 is amended to read:

Sec. 43.82.130. Qualified project plan. A proposed project plan submitted under AS 43.82.120 may be approved as a qualified project plan under AS 43.82.140 if the proposed project plan

(1) reflects a proposal for diligent development of the project on the part of the applicant;

(2) does not materially conflict with the obligations of a lessee to the state under a lease or under a pool, unit, or other agreement with the state; [AND]

(3) describes satisfactory methods and terms for making gas available to meet the reasonably foreseeable demand in this state for gas within the economic proximity of the project during the term of the proposed contract; and

(4) does not unreasonably exclude from participation in the project any person that, in the judgment of the commissioner, is capable of participating and willing to participate in the project substantially on the terms set out in the project plan as submitted; in evaluating an application for compliance with this paragraph, the commissioner may require a qualified sponsor or qualified sponsor group to amend and resubmit a proposed project plan to include one or more other interested persons."

REPRESENTATIVE HUGH FATE, SPONSOR, testified in support of the bill. He highlighted changes from the existing Stranded Gas Act. He noted that the new bill gives more flexibility to investigate other products. He also noted that it expands the area of exploration, and gives a new deadline for application of March 30, 2005. The original deadline was June 30, 2004, which he maintained did not allow adequate time.

Representative Fate pointed out that the current threshold of participation for a qualified sponsor was 33 percent of the net worth of a project, which he observed could be a very significant amount. He gave the example that, with the new area expansion, the amount could range between nine and ten billion dollars. He went on to note that the current bill lowers the level of qualified sponsorship to 15 percent.

Representative Fate pointed out that the bill makes contractor(s) plural, speculating that the state normally negotiates with more than one contractor. Finally, he pointed out language that was added to the section pertaining to \$1.5 million reimbursement to clearly limit redundancy. He explained that this language was intended to prevent the filing of lawsuits by making the bill as clear as possible.

Representative Fate pointed out that the bill would be submitted to Congress during its examination of an energy package this month. He stressed that the bill was intended

to communicate that the State of Alaska was active in getting gas from the North Slope to market.

Vice-Chair Meyer asked about the fiscal note from the Department of Revenue and whether the \$870 thousand figure was accurate.

Representative Fate speculated that it was the department's best estimate of cost.

Vice-Chair Meyer maintained that \$750 thousand of contractual and \$25 thousand of travel costs seemed high.

Representative Fate briefly addressed the changes proposed by the amendments. He stressed that, since the changes proposed by Amendment 1 were intent, the bill would still remain clean. He also referred to changes proposed in Amendment 2, pertaining to project plan qualifications. He stated that he had no objection to the changes, since the intent language kept the bill specific, while allowing more activity to occur.

Co-Chair Harris asked for clarification about the Act, and referred to Section 43.82.510, which pertains to the municipal advisory group. He recalled community contention regarding previous agreements. He asked for confirmation that the Act would be left intact with the bill.

Representative Fate confirmed that the current Act would remain intact. In response to another question by Co-Chair Harris, Representative Fate noted that there was no language that dictated routing. He stressed that the intent was to develop the resource and get the stranded gas to market.

Representative Croft asked about the nature of the broadened region, and where it was specified in the legislation.

Representative Fate stated that it was specified in the original Stranded Gas Act, indicating the region as 64 degrees north.

Representative Croft asked about the nature of qualified projects as referred to in Section 1 of the bill. He asked about the function of the "only if the " language.

Representative Fate speculated that the language was intended to clarify the project qualifications. He noted that the commissioner retained the final authority, and that removing the word "only" broadened the authority to the entire Commission.

Co-Chair Williams suggested that other agency personnel would provide additional information.

Co-Chair Harris referred to the language in the bill's fiscal note which pertains to routing, and asked whether in eliminating the "over the top" route it also eliminated other routes.

Representative Fate responded that this language, contained in the Department of Revenue's fiscal note analysis for the Resource Committee Substitute was not correct.

In response to a question by Representative Whitaker, Co-Chair Williams clarified that his comments referred to Page 2 of the fiscal note analysis.

Representative Whitaker concurred that such route restrictions should not be included in the bill language. He stressed that the record should reflect route neutrality.

Co-Chair Williams directed that the fiscal note language be corrected.

Representative Fate stated that the language had been extracted earlier in the process and had been inadvertently included in the Resources committee substitute fiscal note analysis.

DAN DICKINSON, DIRECTOR, DIVISION OF OIL AND GAS AUDIT, DEPARTMENT OF REVENUE, testified in support of the bill. He addressed the history of the Division, which had been combined into what is now called the Tax Division. He read from prepared testimony as follows:

My name is Dan Dickinson, Tax Division director at the Department of Revenue. With me is Roger Marks, a Petroleum Economist with the Tax Division, who will speak briefly about the history, intent and mechanics of the Stranded Gas Act. But first I think it is important to introduce ourselves, as the Department of Revenue has many responsibilities under the Stranded Gas Act, and the Tax Division has considerable expertise and experience in oil and gas matters.

Five years ago we were three divisions - the Oil and Gas Audit Division, the Income and Excise Audit Division and the Charitable Gaming Division. We are now merged into a single division.

What we do can be seen from the FY 2002 Comprehensive Annual Financial Report for the State of Alaska. You should have a copy of an excerpt from Table 1 .13. Of total governmental fund revenues of \$3.5 billion:

- \$1.6 billion comes from the Feds
- Taxes are \$1 billion
- Royalties are \$0.9 billion
- Interest and investment income, plus all the other

ways the government raises money (charges for services, fines and forfeitures and "other"), was more than offset by investment losses in FY 2002.

The Tax Division administers 19 of the 20 tax types that comprise \$1 billion tax figure. Of the billion dollars in taxes, all but a couple hundred million were oil and gas taxes. The state's oil and gas take is often characterized as four bites of the apple, and we are experienced at all four bites.

For the first bite: We are charged with auditing royalties and net profit share leases, and work with DNR on those matters.

The other three bites of the apple cover the three areas that we anticipate will be "focus" in any Stranded Gas Act negotiation.

The second bite of the apple is the oil and gas property tax. Last Friday, the Tax Division's Oil and Gas Property Tax assessor and his staff mailed out the 2003 tax roll, showing oil and gas property valued at about \$13.5 billion. As petroleum economist Roger Marks will explain later, property taxes play a unique role in determining any natural gas project's profitability.

The third bite of the apple is the oil and gas corporate income tax. Income taxes are focused on taxing profits. As Roger will elaborate later on – the more we focus on taxing profits, the more progressive our system becomes. This is one of the stated goals of the Stranded Gas Act. We have a large experienced group in our division that works these issues and we expect them to be critical.

The last bite of the apple is the production tax. Like royalty, the production tax focuses on the commodity value of the resource at or near the wellhead. We have lots of experience in this area

– market pricing, inter-company transfer pricing, how markets work, how energy contracts work, business practices and cost analysis.

Now, let me add a personal observation – but one that I think reflects what many of us in the division believe about what the state should be trying to achieve in any Stranded Gas Act negotiation.

Taxes – and the government take in general that is the subject of the Stranded Gas Act – should not distort commercial realities. The government's take should not be what is red-lighting this project.

As Roger will explain, our current fiscal system intensifies some of the risks faced by the producers. Ironically, not only the producers but the state could be better off changing those same aspects of its fiscal system. Stranded Gas Act negotiations should be about risk sharing, and who among the state and the commercial entities involved can best handle which risks. As soon as HB 16 becomes law we can start discussing how price risk will be shared or how return on the investment in the pipeline will be taxed, or really figure out what each party wants to get from this project – aside from "more." There are lots of specifics that can be set aside until it is clearer how our gas will fit in with the market mechanisms that will be in place when we are ready to market. The state's role should not be to increase risks. Maybe we can make the project fly by reducing risk.

On the other hand, we have to make sure that the state is not naively underwriting a risky project. As the only ones who will still be around if things go sour, we don't want to be left holding a bag we didn't quite understand the dimensions of.

That's my quick overview of the Department of Revenue Tax Division. The administration strongly supports reauthorizing the Stranded Gas Development Act. We believe it creates a great mechanism to work these difficult issues we face. The Tax Division looks forward to being able to play our part in that work.

Thank you for the opportunity to testify.

In response to a previous question by Vice-Chair Meyer, Mr. Dickinson explained that close to \$1 billion of revenue could come to the state from this venture. He stressed that the Division wished to involve world-class experts to examine the negotiations. He also pointed out that the expenses were to be reimbursed. He noted that the \$750 thousand was in statutory designated receipts, whereby the division took authority to have the applicant pay the expenses.

Vice-Chair Meyer questioned whether the fiscal note should then be zero, since the applicant was absorbing the costs.

Mr. Dickinson clarified that the \$750 thousand per year would be designated program receipts. He noted that the total general fund expenditure would include travel expenses incurred with the negotiations. He noted that the state would pay \$117 thousand, with the remainder of the expenses being reimbursed.

Representative Croft referred to page 2 of the fiscal note from the Department of Revenue. Mr. Dickinson confirmed that the routing language in an earlier version of the bill was more restrictive, but that the current version should not contain this language.

Co-Chair Harris asked why there was a \$4 thousand difference in costs between FY 04 and FY 05 reflected in the proposed fiscal note. Mr. Dickinson speculated that the cost difference would be for equipment.

Co-Chair Williams commended the Division on its plans to get expertise in negotiations. He asked about the effectiveness of the current negotiation process.

Mr. Dickinson explained that currently the production tax and royalties comprised approximately 80 percent of the state's revenue. He pointed out that the tax is regressive, due to the relationship between price and the state's income. He noted that in a regressive system, the government would accept a higher percentage when prices were higher, and a lower percentage when prices were lower. He stressed that with a gas line, the tariff could use up the majority of the profits. He maintained that the importance was to focus on income tax and investment return. He explained that the fiscal system would be devised based on those issues.

ROGER MARKS, PETROLEUM ECONOMIST, ECONOMIC RESEARCH SECTION, TAX DIVISION, DEPARTMENT OF REVENUE testified via teleconference. He read from prepared testimony as follows:

Good afternoon, Mr. Chairman and members of the committee. My name is Roger Marks. I am a petroleum economist with the Tax Division of the Department of Revenue. I worked on the original Stranded Gas Act in 1998 and am familiar with its history, intent, and mechanics. I would like to provide a very brief overview of the Act at AS 43.82. A more detailed synopsis is with the fiscal note.

The Act originated in HB 250 in 1997 which established a North Slope Gas Commercialization team in the Administration to research and recommend changes to state law to encourage commercialization of North Slope gas. The team concluded that the project faced considerable risk, namely gas price risk and cost overrun risk, and that the state's fiscal system actually exacerbated those risks. Two of the risks of particular concern were fiscal uncertainty and the state's regressive tax system.

(A brief comment on the price risk: The cost of the

project is very large: \$20 billion. That is a lot of money to any corporation, even ones the size of Exxon, BP or Conoco/Phillips. If this project is built and something goes wrong, such as low prices, the sponsors face very large losses. And even if these are relatively low-probability events, the project may not be built if a company cannot tolerate a loss of that size. That is why the risk-reduction mechanism proposed in Congress, which is currently in place for non-conventional gas in the Lower 48, may be a very necessary linchpin in making this project a reality.)

By fiscal uncertainty we mean the threat of changes in fiscal provisions after a project is built, that may change the project's viability after it is too late to do anything about it. A project may be feasible under one tax system. If it is built under the assumption that the tax system in place will stay in place, but the tax system changes, the changes could cause heavy financial losses.

Second, there are two significant elements of the state's fiscal system that make it regressive. By regressive we mean that the state's take is a high percentage of income at low prices, and a low percentage at high prices. First, the property tax is based on cost. The higher the cost, the higher the tax. This is a double whammy to an investor who incurs a cost overrun. Moreover, the property tax is payable when construction begins, years before revenues start accruing. On a time value of money basis this diminishes the rate of return, and increases the risk of not recovering the investment.

The second regressive elements are the severance tax and royalty. They are based on the value at the point where the gas comes out of the ground, and ignore upstream costs such as capital and operating costs. Thus when costs are high and prices are low, the state's take is a high percentage of low income. Again, this intensifies the danger of low prices.

I might add that a regressive system also limits the state's take at high prices. Fixing that could be very important to the state for securing more revenue when prices are high, without threatening the viability of the project.

The Stranded Gas Act was the result of trying to fix these shortcomings. The law provided a mechanism for converting the state's fiscal system from a statutory basis to a contractual basis. This would provide for greater fiscal certainty. The fiscal system would be negotiated between the state and the project sponsors,

and approved by the legislature, after a public review period. Payments to the state would be made in-lieu of taxes. And per the Act the contract terms would provide for a more progressive (less regressive) system.

Most of the provisions subject to negotiation are the tax provisions. Given that the royalty represents the state's ownership share, there was not interest in making the royalty rate subject to change. The only royalty provisions subject to negotiation would be the gas valuation method, and the timing of royalty in-kind and in-value notices.

The Commissioner of Revenue would be the primary agent for negotiating and implementing the contract. However, the Commissioner of Natural Resources is also responsible for reviewing the project plan for acceptability, and for negotiating any changes in those royalty issues.

There was concern by municipalities that a contract could compromise their property tax revenues. Accordingly, the Act created a municipal advisory group to participate in developing contract terms, and the Act requires that a fair and reasonable share of the payments due under the contract be paid to affected municipalities with regard to the size of the tax base that may be exempted, and the economic and social burdens imposed by construction and operation.

The Act also has provisions for sponsors to help make gas available to communities, to promote local hire, to deal with confidential information provided by the sponsors, and to reimburse the state for contractors it may use to assist in the negotiation process.

Finally, there were some questions raised as to whether this would surrender or contract away the power to tax, which is forbidden by our constitution. It was the administration's judgment that this would not preclude future legislatures from imposing other taxes, but this contract would represent a solemn pledge, a moral commitment by the state, and a message to future legislatures that once it agrees to the terms it will not change them.

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Responding to an observation by Representative Whitaker, Mr. Marks noted that in Section 43.82.210 of the Act, pertaining to contract terms of payment in lieu of taxes, eight principles were outlined. He pointed out that one of the principals recommended progressivity as an attribute of a

revised fiscal system. He also noted that, since progressivity reduced the price risk for the sponsoring entity, it created an alignment of interest for those crafting a progressive tax system.

Representative Whitaker also noted that another guiding principal was the necessity for certainty in the process.

Mr. Marks noted that the intent of converting the fiscal system from a statutory to a contractual basis was to create certainty.

Representative Whitaker continued by observing that the culmination of the negotiations between sponsor groups and the Administration would be contractual. He noted that, while not possible to restrict future legislatures, there was an essential responsibility to uphold the arrived upon contract.

Mr. Marks agreed that a moral responsibility would be handed on to future legislatures.

Representative Whitaker pointed out that the agreement between the state and a sponsoring entity was for a limited period of time, which was that required for amortizing the financial commitment.

Mr. Marks maintained that per AS 43.82, the contract was limited to 30 years.

Representative Whitaker asked whether this was a "one time deal" - a single opportunity for the Administration to negotiate a deal, and for the legislature to approve that deal.

Mr. Marks noted that re-opener clauses existed, and stressed that the future was impossible to predict. He suggested the benefit of being able to re-negotiate certain contract terms in the future. However, he stated that it was appropriate to characterize the situation as a one-time deal.

Representative Whitaker stressed the imperative that the agreement be negotiated fairly and strongly from both sides of the equation. He agreed with Mr. Marks' conclusions.

MARK MEYERS, DIRECTOR, DIVISION OF OIL AND GAS, DEPARTMENT OF NATURAL RESOURCES (DNR) testified via teleconference. He emphasized the importance of the gas pipeline, enabling the development of Alaska's gas resources for the next 50 years or more. He predicted that, just as the Trans-Alaska Pipeline System (TAPS) had exceeded original expectations, the Act set the stage for broad-based technical negotiations between project sponsors and the Administration.

Mr. Meyers noted that, in addition to dealing with issues involving taxes, the Act addresses major royalty and resource ownership issues managed by DNR. He credited the State's sale of royalty in-kind oil for stimulating the Alaska refinery industry. He further suggested that royalty sales from gas could be used as a vehicle for a major petrochemical business in Alaska, or exploration of potential, untapped resources.

Mr. Meyers also pointed out the potential for the Act to open negotiations in other resource management areas with respect to oil production on state lands. He stated that, while it was premature to discuss the extent of negotiations, at least one major producer had expressed interest in negotiating movement of gas between units, carbon dioxide treatments, and other technical and economic issues.

Mr. Meyers stressed the extensive experience in oil development projects of those in his division. He gave examples of those with direct experience with oil and gas projects on the North Slope. He offered this expertise for use by the Administration.

Representative Croft asked about the level of inaccuracy of original oil production estimates in Prudoe Bay.

Mr. Meyers stated that the first estimates of oil production for that area was 9 billion barrels and that current estimates were for 14 billion barrels.

Representative Croft asked whether, if a similar negotiation had been used on TAPS employing original estimates and payments in lieu of taxes, those estimates would also be largely incorrect.

Mr. Meyers concurred that since original estimates were 12 billion, and that current estimates included 14 billion barrels, with another 8 billion in known reserves, those estimates would be off by approximately 50 percent.

Responding to another question by Representative Croft, Mr. Meyers stated that the gas line was very early in the exploration stage, and that current knowledge and positive expectation was similar to that of the initial discovery at Prudoe Bay. He added that current expectation exceeded a 30-year time period.

Representative Croft referred to the moral vs. legal obligation of the settlement. He asked whether, if the legislature ratified an agreement, it would limit future ability to make tax decisions, or if it would make tax decisions subject to a lawsuit, allowing companies to recover an equivalent amount in damages.

Mr. Meyers deferred the question to the Department of Law, in considering the legal implications of the contract.

WENDY KING, GAS STRATEGIES, CONOCO/PHILLIPS testified in support of the bill. She outlined a three-pronged strategy for creating a gas pipeline in Alaska: 1) federal legislation streamlining the permitting process, 2) federal fiscal legislation, providing insurance against extreme price volatility, and 3) state legislation re-authorizing the Stranded Gas Act.

Ms. King credited current statute as providing a framework for negotiating an agreement between the State and other parties. She noted the importance of modifying the current Act with the bill in order to apply the Act to other products and to extend its application deadline. She maintained that, were these two limitations not contained in current statute, corporations such as Conoco/Phillips could already be further along in the negotiation process. Ms. King stated that her company supported the bill in the cleanest form possible, simply addressing the two limitations.

Co-Chair Williams asked Ms. King to comment on Amendment #1.

Ms. King stated that Conoco/Phillips would oppose the current amendment. She noted that the size of the project, along with Conoco's belief in organized labor, would necessitate use of a project labor agreement. She maintained, however, that mandates would add undue cost to the project. She suggested that if the amendment read "agreement(s)", in the plural, it might be more palatable.

Ms. King also addressed Amendment 2, noting that she had only briefly reviewed the amendment. She stated that her company was not supportive of mandates limiting contracts, which the amendment appeared to do.

Vice-Chair Meyer asked about Conoco's position on local hiring.

Ms. King noted that her company had always been a supporter of Alaska hiring, and in support of requirements in existing statute (AS 43.82.230).

Vice-Chair Meyer asked about the progress of the federal energy bill. Ms. King stated that she did not have current information on this legislation.

Representative Croft asked about the legally binding nature of the agreements contemplated under the Stranded Gas Act.

Ms. King speculated that Concoco's position was that it must be addressed during the negotiation process. She suggested that the Department of Law should be consulted.

MARK SCHULTZ, ASSISTANT ATTORNEY GENERAL, OIL GAS AND MINING SECTION, DEPARTMENT OF LAW, commented via teleconference. Responding to the question reiterated by Representative Croft, he referenced the Alaska State Constitution, Article 9, Section 1, saying, "The power of taxation shall never be surrendered. This power shall not be suspended or contracted away, except as provided in this article."

Mr. Schultz commented that, regarding the Stranded Gas Act itself, it did not raise the issue of binding future legislatures, but could potentially become a hurdle to the form of the contract developed under the Act. He summarized that it was not an impediment to the Act itself, but a potential legal obstacle, depending on the contract.

Representative Croft asked if a contract would be crafted that allowed for some form of damages if tax structure was changed during the terms of the agreement.

Mr. Schultz responded that if a contract were for multiple years, it would be possible to include language that gave each legislative session the opportunity to ratify the contract.

Representative Croft asked if the negotiations were public or confidential.

Mr. Schultz noted that portions of the negotiations were made private under the Act.

Representative Croft asked why a simple debate for a less regressive tax structure could not be publicly arrived at in committee, rather than through a private negotiation procedure.

Mr. Schultz conceded that the same results could perhaps be arrived upon, but that private negotiations were more flexible.

Representative Croft also asked if the legislature would vote on the contract in its entirety.

Mr. Schultz confirmed that this was true, and added that the contract would also be presented for public comment, and information would be provided to the legislature throughout the negotiations.

KEN KONRAD, SENIOR VICE PRESIDENT, BP EXPLORATION, testified in support of the bill. He observed that a gas pipeline

project was an enormous opportunity with tremendous risk and uncertainties.

Mr. Konrad noted that BP viewed four key areas to address, one of which was cost. He stated that BP was looking for cost saving opportunities, and was identifying areas through a technology program. He noted that the other three areas required government cooperation in order to reduce risk: 1) an efficient and predictable regulatory process in Canada, 2) federal legislation to clarify the regulatory process and fiscal terms, and 3) simple, clear and predictable fiscal terms surrounding the pipeline in Alaska.

Mr. Konrad noted BP's support of the Act since its inception. He cautioned against adding amendments that may inadvertently increase risk and costs of the project. He stressed the importance of a clean bill.

In response to a question by Co-Chair Williams, Mr. Konrad briefly addressed Amendment 1. He noted that, although organized labor would certainly be used in a project of this size, he felt that apparent mandates would better be handled in negotiations between industry and unions. He speculated that a labor agreement would not occur until governmental and permitting discussions were completed.

Regarding Amendment #2, Mr. Konrad observed that the language was fairly broad. He noted concern as to whether specific ownership was mandated by the legislature.

Co-Chair Harris asked about BP's plans for development of natural gas in Alaska.

Mr. Konrad noted that the first step was to create a viable pipeline project. He projected a bright future for additional gas, but noted that without establishing government actions, no pipeline and therefore no exploration was possible.

Co-Chair Harris asked about BP's position on a Gas-to-Liquids (GTL) project.

Mr. Konrad noted BP's view that a gas pipeline was the leading opportunity for commercialization of Alaska gas. He acknowledged that the GTL facility was developing technology to be used around the world.

Co-Chair Harris asked if BP believed in a Canadian route.

Mr. Konrad noted that BP had been focused on an Alaskan route for some time, since the cost difference between routes was not a factor. He stated that the company would not participate in a project that was not supported by

government. Therefore, a southern route was the focus since Alaska had stated it did not support an over the top route.

Co-Chair Harris MOVED to ADOPT Amendment 1. Co-Chair Williams OBJECTED.

Co-Chair Harris proposed an AMENDMENT to the Amendment. He suggested that the Amendment be changed to read, "enter into project labor agreement(s)".

Vice-Chair Meyer suggested that the word "may" on line 9 carried the intent proposed by Co-Chair Harris. He asked if the Sponsor's position had been affected by industry testimony in opposition to the amendments.

Representative Fate noted indicated that the original intent of the bill had been to improve the availability of equity. He maintained that Amendment #1 requires the Commissioner to qualify the sponsor/sponsor groups. He speculated that the amendment might forward this intent.

Representative Fate agreed with the producers that certain mandates were better left to negotiations. He noted that he did not believe that the intent language would compromise the negotiations.

Representative Hawker expressed his difficulty in supporting the amendment. He felt that language was vague and clouded the intent of the Act. He proposed that the language would be more appropriate in the hiring or contract sections.

Responding to an inquiry from Co-Chair Williams, Ms. King reiterated that she must consult her company before commenting more specifically on the amendments.

Co-Chair Harris asked for clarification on the intent of Conoco/Phillips to negotiate with organized labor in the project.

Ms. King confirmed the likelihood of working with organized labor in a project of this size, but took exception to any mandate.

Co-Chair Harris asked whether the company perceived a mandate in the amendment as it was stated. He pointed out that Line 9 stated that sponsors "may develop and enter into project labor agreements".

Co-Chair Harris expressed his personal commitment to organized labor. He conceded that producers did not wish to be bound by any legislation. However, he noted a desire to ensure a place in the project for organized labor, and stated that this amendment simply added intent.

Ms. King acknowledged the changes to the amendment and its intent, but once again reiterated the need to consult with her company before making definitive comment.

Representative Whitaker commented on the language in Amendment 1, and its apparent simplicity. He observed that the amendment simply indicated that the legislature had no objection to the sponsor groups entering into agreements with a project labor group.

Co-Chair Williams noted the producers' desire for a clean bill. He also pointed out that the intent language should send a clear message. Co-Chair Williams suggested that perhaps a Letter of Intent would be more appropriate.

Co-Chair Harris suggested that such a letter would have the same effect as legislation.

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Vice-Chair Meyer acknowledged Representative Whitaker's observations, but questioned the need for amendment, since producers have already stated their intent to work with labor groups. He suggested that a Letter of Intent might be the best vehicle.

DAVE MCDOWELL, BRITISH PETROLIUM EXPLORATION (BP), testified against amendment 1. He expressed BP's desire to create the most certainty surrounding the project, and contended that the amendment did not contribute to that certainty.

Representative Whitaker questioned how the amendment detracted from certainty.

Mr. McDowell pointed out that, as the Committee was debating the meaning of the amendment, others might also question its meaning.

Representative Whitaker stated that he did not understand the uncertainty contained in the amendment. He contended that the intent language was not so vague as to limit his support of the amendment.

Representative Croft suggested that an amendment was the most constitutional way to add intent to the legislation. He expressed concern about the statement sent if the Committee was not able to support such a simple amendment. He speculated that the intent supported the right of Alaskan workers to be considered in the negotiations.

Vice-Chair Meyer maintained that local hiring was already included in statute.

Representative Croft contended that few Alaska-hire laws contained strong terms due to constitutional concerns. He suggested that simply adding a contract provision requiring adherence to all existing laws did not send a strong enough message.

Vice-Chair Meyer suggested that the amendment might be amended to include stronger language pertaining to local hiring.

Representative Croft reiterated his belief that project labor agreements were the most constitutionally defensible way to ensure local hiring. He suggested that stronger language could also be added in a House Floor amendment. He expressed his support of the amendment.

A roll call vote was taken on the motion.

IN FAVOR: Stoltze, Whitaker, Croft, Foster, Meyer, Williams, Harris

OPPOSED: Hawker

Representatives Chenault, Joule, and Moses were not present for the vote.

The amendment PASSED on a VOTE of 7-1.

Representative Whitaker MOVED Amendment 2. Co-Chair William OBJECTED for discussion.

Representative Whitaker expressed his support of the amendment. He pointed out the extreme difficulties inherent in the negotiation process and stressed the importance of providing the Administration with tools for the process. He referred to questions surrounding the fairness of the TAPS tariff and suggested that making equity positions available to certain key groups would prevent such contentions in the future. He stated that the intent was to give every opportunity for the free market to work, and proposed that this would benefit the state to the maximum extent possible, as constitutionally obligated.

Representative Fate added that the original intent of the legislation was not to disallow any groups from equity opportunity. He speculated that the burden of negotiation was placed upon the Commissioner and the negotiating team, and that it would stimulate the economy. He proposed that, rather than being a detriment to negotiations, it may in fact benefit them.

Co-Chair Harris referred to Line 18 of the Amendment and asked how "unreasonably exclude" was defined [by law].

Representative Whitaker maintained that the meaning was straightforward.

Co-Chair Harris suggested that the language gave latitude for legal interpretation.

Mr. Schultz did not provide a specific legal definition, but pointed out that the term "unreasonably" was routinely used without further definition in a number of statutes.

Co-Chair Williams asked whether the language "any person that" excluded, for example, a legislator from participating.

Representative Whitaker responded that "in the judgment of the commissioner" placed participation at the discretion of the commissioner, to be judged according to the financial terms of the contract.

Co-Chair Williams suggested that the language might be interpreted differently in the future.

Representative Whitaker responded that the bill proposed extending the time period through 2005 and speculated that one could forecast the players at that point.

Vice-Chair Meyer asked about the intent of the bill.

Representative Fate stated that the bill was intended to increase participation. He cited the example of the Port Authority project, which required financial qualifications that excluded many businesses from participating. He proposed that the bill would allow more Alaskan businesses or groups to benefit from the venture, while still upholding high standards at the determination of the Commission. He maintained that, without the bill, businesses or groups might be excluded as they had been in the Port Authority. He conceded that to have too broad a participation would limit the benefits to each.

Responding to a question from Co-Chair Harris, Ms. King reiterated that Conoco/Phillips supports a clean reauthorization of the Act. She questioned whether the amendment added a potential barrier to an economically challenged project. She stated that her company opposed the amendment, and maintained that it did not add value to the project.

Representative Whitaker voiced his disagreement and asked for specific reference to mandates.

Ms. King referred to line 22, which states, "may require", implying a requirement of the Commission to mandate parties to a contract.

Representative Whitaker suggested that the word "may" mediated the requirement.

Ms. King noted that the word "require" was objectionable.

Representative Whitaker suggested that the amendment be changed to read "may negotiate with a qualified sponsor" (line 22).

Ms. King noted that the Act itself did not appear to contain restrictions regarding sponsoring qualifications, and questioned how adding "may negotiate" might impact its meaning.

Co-Chair Harris referred to AS 43.82.110 of the Act, which pertains to qualified sponsor or sponsor groups. He observed that a qualified sponsor must meet two separate criteria, with the second criteria having several possible financial criteria. He maintained that the amendment was intended to allow those organizations that do not meet the criteria to participate to a lesser degree, upon the determination of the commissioner.

Ms. King responded that the amendment still contained the word "require".

Mr. McDowell expressed BP's welcome of any group whose participation in the project added value. He referred to amendment sponsor's desire to see the bar kept at a "reasonably high level". He observed that the placement of "the bar" was left to the commissioner. He speculated that the amendment would increase risk for the project, create uncertainty, and would not be helpful in moving the project forward.

Responding to a question from Representative Whitaker, Mr. McDowell reiterated his discomfort with Amendment #2. He maintained that since the Commission set the requirements for project participation, this allowed for a lack of clarity about those requirements.

Representative Whitaker contended that the language was explicit, stating, "in the judgment of the commissioner, is capable of participating". He maintained that this inferred the commissioner's belief that a participant was financially capable. He commented that to imply that a participant would not "add value" was a very subjective statement, since the determination of value might vary depending on the perspective.

Co-Chair Williams noted that he also had questions regarding the amendment.

Mr. McDowell clarified that he did not mean to imply that a participant "would not have value". He maintained that a competitive marketplace is the best indicator of project participation and hoped that the players in the marketplace would position themselves using their ability to add value by playing a role.

Representative Whitaker reiterated that this was a subjective conclusion. He pointed out that if a participant was disadvantageous to another sponsor, they might be deemed of no value to that sponsor. He contended that the amendment might provide the commissioner and State the opportunity to include another competitor. He suggested that this encouraged a free market, rather than one subject to the internal dynamics of a single company or group of companies. He proposed that it was inherent upon the legislature to provide the Governor with leverage to negotiate a free market play with North Slope gas.

Co-Chair Williams asked for clarification on: the meaning of participation, the qualifications for participation, and the right to appeal denial in participation. He recommended that these questions be further investigated.

Co-Chair Williams stated that the bill would be HELD so the parties could work together on the amendment.

Representative Whitaker stated his belief that it is imperative that not only the three major producers be heard on these issues, but also independents who might significantly benefit from a free market play. He suggested that the perspective of independent producers might reveal the advantage of a free market.

Co-Chair Harris suggested that smaller, independent producers, or others who are interested in participating in the project, be encouraged to testify.

Co-Chair Williams stated that testimony at the next hearing would be by invitation only. He requested that interested parties contact his office. He noted that his office would work with the sponsor, committee members and industry representatives.

HB 16 was heard and HELD in Committee for further consideration.

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ADJOURNMENT

The meeting was adjourned at 4:08 PM

