

**ALASKA STATE LEGISLATURE  
HOUSE JUDICIARY STANDING COMMITTEE**

June 6, 2006

11:08 a.m.

**MEMBERS PRESENT**

Representative Lesil McGuire, Chair  
Representative John Coghill  
Representative Pete Kott  
Representative Peggy Wilson  
Representative Les Gara  
Representative Max Gruenberg

**MEMBERS ABSENT**

Representative Tom Anderson

**OTHER LEGISLATORS PRESENT**

Representative Jay Ramras  
Representative Harry Crawford  
Representative Ralph Samuels

**COMMITTEE CALENDAR**

HOUSE BILL NO. 2004

"An Act relating to the Alaska Stranded Gas Development Act, including clarifications or provision of additional authority for the development of stranded gas fiscal contract terms; making a conforming amendment to the Revised Uniform Arbitration Act; relating to municipal impact money received under the terms of a stranded gas fiscal contract; and providing for an effective date."

- HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 2004

SHORT TITLE: STRANDED GAS DEVELOPMENT ACT AMENDMENTS

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

|          |     |                                 |
|----------|-----|---------------------------------|
| 05/31/06 | (H) | READ THE FIRST TIME - REFERRALS |
| 05/31/06 | (H) | RES, JUD                        |
| 06/01/06 | (H) | RES AT 9:00 AM CAPITOL 124      |
| 06/01/06 | (H) | Heard & Held                    |

06/01/06 (H) MINUTE(RES)  
06/02/06 (H) RES AT 9:00 AM CAPITOL 124  
06/02/06 (H) Heard & Held  
06/02/06 (H) MINUTE(RES)  
06/03/06 (H) RES AT 8:30 AM CAPITOL 124  
06/03/06 (H) Moved CSHB 2004(RES) Out of Committee  
06/03/06 (H) MINUTE(RES)  
06/04/06 (H) RES RPT CS(RES) 1DP 5NR 3AM  
06/04/06 (H) DP: CRAWFORD;  
06/04/06 (H) NR: KAPSNER, OLSON, SEATON, ELKINS,  
LEDOUX;  
06/04/06 (H) AM: GATTO, SAMUELS, RAMRAS  
06/05/06 (H) JUD AT 10:00 AM CAPITOL 120  
06/05/06 (H) Scheduled But Not Heard  
06/06/06 (H) JUD AT 11:00 AM CAPITOL 120

**WITNESS REGISTER**

KEVIN JARDELL, Legislative Liaison  
Governor's Legislative Office  
Office of the Governor  
Juneau, Alaska

POSITION STATEMENT: Presented HB 2004 on behalf of the  
administration.

JOSEPH K. DONOHUE, Attorney at Law  
Preston Gates & Ellis, LLP  
Anchorage, Alaska

POSITION STATEMENT: Assisted with the presentation of HB 2004  
on behalf of the administration.

THOMAS A. LAKOSH  
Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 2004 and  
offered suggestions.

**ACTION NARRATIVE**

**CHAIR LESIL McGUIRE** called the House Judiciary Standing  
Committee meeting to order at 11:08:04 AM. Representatives  
McGuire, Kott, Wilson, and Coghill were present at the call to  
order. Representatives Gruenberg and Gara arrived as the  
meeting was in progress. Representatives Ramras, Crawford, and  
Samuels were also in attendance.

HB 2004 - STRANDED GAS DEVELOPMENT ACT AMENDMENTS

11:08:12 AM

CHAIR MCGUIRE announced that the only order of business would be HOUSE BILL NO. 2004, "An Act relating to the Alaska Stranded Gas Development Act, including clarifications or provision of additional authority for the development of stranded gas fiscal contract terms; making a conforming amendment to the Revised Uniform Arbitration Act; relating to municipal impact money received under the terms of a stranded gas fiscal contract; and providing for an effective date." [Before the committee was CSHB 2004(RES); included in members' packets was a proposed committee substitute (CS) for HB 2004, 24-GH2046\F, Bailey, 6/5/06.]

The committee took an at-ease from 11:09 a.m. to 11:14 a.m.

CHAIR MCGUIRE outlined her intentions regarding how the meeting would proceed.

11:16:07 AM

REPRESENTATIVE KOTT moved to adopt the proposed committee substitute (CS) for HB 2004, 24-GH2046\F, Bailey, 6/5/06, as the work draft. He offered his understanding that Version F replicates the latest Senate version of the bill.

REPRESENTATIVE GARA objected to the adoption of Version F as the work draft, adding that he would prefer to work with CSHB 2004(RES) and just amend it as the committee sees fit.

REPRESENTATIVE COGHILL said he would like to discuss the amendments adopted by the House Resources Standing Committee.

REPRESENTATIVE GARA withdrew his objection.

CHAIR MCGUIRE announced that Version F was before the committee.

[Following was a brief discussion regarding how the committee would be proceeding.]

11:21:02 AM

KEVIN JARDELL, Legislative Liaison, Governor's Legislative Office, Office of the Governor, relayed that the Alaska Stranded Gas Development Act was passed in 1998 and amended twice since then in an attempt to bring the state's gas to market. House Bill 2004 is one more instance of bringing to the legislature

suggested changes that the administration feels are necessary to bring Alaska's gas to market, changes that are incorporated within the proposed Alaska Stranded Gas Fiscal Contract ("ASGF Contract") that the administration [will] sign with the producers: [BP Exploration (Alaska) Inc.; ConocoPhillips Alaska, Inc.; and ExxonMobil Alaska Production, Inc.].

MR. JARDELL, on the issue of why the amendments to the Alaska Stranded Gas Development Act are being sought after the [ASGF Contract was negotiated], said:

As we began negotiating the [ASGF Contract], it was clear from early on that there were probably going to be provisions that were going to have to be negotiated that would require ... [amendments to the Alaska Stranded Gas Development Act]. What those ultimately would be, it also became clear, would not be known until we finalized the negotiations and knew what the give and take was and what we were able to successfully achieve and then look back and say, "Okay, here's a thing we need to change; here's something we need to change." ...

And we acknowledged ... to each of you very early on that changes to the [Alaska Stranded Gas Development Act] would be necessary in the end. ... But we were comfortable - in talking with members that signed the confidentiality [agreement] and leadership, and looking at the purpose of the [Alaska Stranded Gas Development Act] - that ... [we were] going to develop [a] fiscal contract [and] that the fiscal terms that ... were somewhat outside were still within the purpose [of the Alaska Stranded Gas Development Act]. So that's why we are here before you, asking you, with a contract out that you can see, to agree to give us the authority, where it's necessary, to conclude [the ASGF Contract] and put it before you.

[11:24:36 AM](#)

REPRESENTATIVE GARA noted that some have questioned whether the legislature even has the right to approve a contract; a memorandum from Legislative Legal and Research Services indicates that the legislature's approval is probably not constitutional, though whether that is true won't be known until a court rules on the issue. He said:

This is the rabbit trail I want to make sure we don't go down: that you ask us for the amendments to make the [ASGF Contract] legal, which you need or else the [ASGF Contract] can't go forward, we give them to you, you come up with a contract, the legislature makes comments but the administration, for whatever reason, decides they're not appropriate - ... [for example], we've said "No" - you have the signed contract and we've given you all the amendments, [if] ... there's a ruling that the legislature's confirmation ... power is determined to be unconstitutional and not needed, is there a commitment from the governor that he would not go ahead with a contract that we've said "No" to? Because otherwise I don't want to give you the amendments that make the [ASGF Contract] legal until after we vote on the [ASGF Contract].

MR. JARDELL replied:

The only conversations that I've had with the governor and with other members of the administration have been that we will work through the [Alaska Stranded Gas Development Act], that it is necessary to work through the [Alaska Stranded Gas Development Act], it's necessary to have a full and open process so that we can consider their input, it's necessary to have the legislative process so we can have the legislator's input - just as the [Alaska Stranded Gas Development Act] tells us to do - and it will balance both of those before we're instructed by the legislature to go back and renegotiate a contract with those comments in mind and then ultimately bring that contract back to the legislature for the legislative approval or disapproval. We have never had discussions about not pursuing that path, and so all I can say is, ... I am operating under the [Alaska Stranded Gas Development Act] that is the law of the state of Alaska, and, whether it's constitutional or not, we are proceeding under the [Alaska Stranded Gas Development Act].

[11:27:36 AM](#)

REPRESENTATIVE GARA asked Mr. Jardell to ask the governor to provide the legislature with written assurance that if the legislature's role is determined to be unconstitutional, and yet the legislature says "No" to the [ASGF Contract], the governor won't go ahead with it.

MR. JARDELL said he would pass along that request, but noted that because of the way the Alaska Stranded Gas Development Act is written, his initial observation is that the authority within the Alaska Stranded Gas Development Act is "because of the ratification process and the process of the Act, and if that process was deemed not to be controlling or constitutional," it would be hard for him to see how the court would believe that the statutes giving authority on that basis would remain in effect or would give them meaning.

REPRESENTATIVE GRUENBERG asked whether the attorney general has yet issued an opinion on this same subject.

MR. JARDELL said he would research that issue.

[11:29:46 AM](#)

JOSEPH K. DONOHUE, Attorney at Law, Preston Gates & Ellis, LLP, relayed that in a bill-review letter that the attorney general issued at the end of the 1998 legislative process, the "authorization statute" was identified as possibly raising a separation of powers question while at the same time legislative approval was acknowledged as perhaps still being required because of tax provisions that would be modified through a contract. So there is a constitutional concern regarding whether lack of legislative authorization would constitute an unlawful delegation of the tax power, as well as a constitutional concern regarding whether a legislative authorization provision is an intrusion into executive branch authority. Therefore, he remarked, although this letter was not a formal opinion, "their basic view was that it would be constitutional as a result of balancing these two constitutional values." In addition, the [ASGF Contract] itself is an attempt to implement the "tax contracting authority" in Article IX, Section 1, of the Alaska State Constitution. So, again, "we" think there is a good argument that the [legislative] authorization provision in the [Alaska Stranded Gas Development Act] would be upheld as constitutional; therefore, the scenario that Representative Gara has proposed wouldn't arise, he said.

REPRESENTATIVE GRUENBERG remarked that if in fact the opinion expressed in that letter proceeds from the premise that the taxing power is the legislature's, would it not follow that that can't be divested by tying the legislature's hands for 40 years in the ASGF Contract? Wouldn't that be a logical conclusion of the same "opinion?"

MR. DONOHUE said:

No. ... There's two different considerations. One is ... whether authorization itself is constitutional ...; the separate question [is] whether or not the provisions in the [ASGF Contract] can provide fiscal certainty through the years. And that's a separate constitutional argument that will no doubt be raised in the judicial challenges that follow. But the 1998 Act specifically says that the administration is to pursue fiscal certainty to the maximum extent provided by the [Alaska State Constitution], so this will certainly provide a test case for that, [indisc.] and probably for the other two.

11:32:40 AM

REPRESENTATIVE GARA pointed out that in 1997 the Office of the Attorney General concluded that locking in the tax rate would be unconstitutional, but a few weeks ago the current attorney general issued an opinion stating that it would be okay to lock in the tax rate.

MR. DONOHUE, in response to a question, said that the governor's transmittal letter for HB 2004 discusses that issue only in a general sense as something that may or may not arise and would be addressed at the time that the final terms of the ASGF Contract were negotiated. Also in response to a question, he indicated that he would provide copies of the aforementioned bill-review letter to the committee.

MR. JARDELL said that the administration takes the [Alaska Stranded Gas Development Act] very seriously, that the information provided by the legislature's consultants is read and studied, and that legislators' comments and considerations are taken very seriously as is input from the public. He pointed out, for example, that the administration was advised by the Department of Revenue (DOR) and [various] attorneys to make the legislation broader than was absolutely necessary so as to be able to fully respond to comments and suggestions made by the public and the legislature. As early as 1998, the legislature instructed the administration to negotiate a fiscal contract and to take into consideration, and perhaps negotiate on, all state and municipal taxes so as to bring the gas to market - it was believed that the project was not viable from an economic basis without first "doing that" - and the administration has now done

just that, and is in the process of presenting to the public and legislature the current proposed contract; additionally, the administration has been instructed to take input from the legislature and public and negotiate the final deal.

[11:39:07 AM](#)

MR. DONOHUE explained:

During the course of the administration's negotiations of [the ASGF Contract], the administration made two fundamental policy decisions that drive most of the [proposed changes] ... that you'll be reviewing in ... [Version F of HB 2004]. ... One [policy decision] was to have the state become a full commercial partner in the project, and ... there's three different elements of that decision: one is to become an equity owner in the project; the second is to take royalty and production tax payments in-kind for the life of the contract; and third, to take a shipping position on the pipeline - i.e. take responsibility for shipping and marketing the state's oil and gas. Additionally, the second major policy decision was to incorporate terms which would provide oil fiscal certainty in addition to fiscal certainty relating to gas and the gas project itself. ... There is a third component of this bill, and it's contained in Sections 14-18, that has to do with reconsideration, generally, about how to deal with impact payments that would be payable by the [Pipeline Project Mainline Limited Liability Company (LLC) Entity ("Mainline LLC")] entities and the "midstream entities"; ... these payments are to be made to the State of Alaska and ultimately paid back out to the political subdivisions. ...

REPRESENTATIVE GARA asked whether being a 20-percent pipeline owner is what requires a capacity commitment from the state, or whether it is because the state will be receiving royalty and production taxes in-kind.

MR. DONOHUE offered his understanding that it is always in [an entity's] best interest to take a proportional share of ownership in a project which reflects the gas volumes that it intends to ship through the project. At this point in time, royalty in-kind (RIK) is about 12.5 percent, and the production tax on gas is about 7.25 percent; this explains the relationship between the volume of gas that the state is taking

responsibility for and the ownership interest [amount]. Additionally, in order to take responsibility and actually market [that gas], the entity has to take a shipping position on the pipeline.

REPRESENTATIVE GARA surmised, then, that taking payment in-kind is what engenders the commitment that the state pay for capacity.

MR. DONOHUE concurred. In response to other questions, he explained that Section 3 - proposed AS 43.82.020(2) - refers to Section 7 - proposed AS 43.82.220 - which is the portion of the bill that provides the broad authority for the state to take shipping positions with the state's "royalty gas," and that those two sections work together to highlight some of the major subject matters of the ASGF Contract that are in turn fleshed out via other sections of the bill.

[11:45:45 AM](#)

REPRESENTATIVE GARA asked whether [deletion of] Section 3 would allow the state to engage in whichever option [of payment] is most beneficial to the state at any given point in time as long as proper notice is provided.

MR. JARDELL indicated that Section 3 addresses the ability of the state to take payments in-kind, and that it would actually require doing so. He proffered that the administration has determined that including such provisions in the bill and in the contract is a way of ensuring that the project becomes economically viable to the producers while still providing revenue to the state through the sale of its gas. Furthermore, there is a significant difference in the commodity of oil and the commodity of gas and how each is shipped - for example, gas is not easily stored; thus it won't be acceptable to the producers for the state to simply switch back and forth between taking gas in-kind and taking gas in-value, because the producers must make a firm commitment regarding how much gas they will be transporting to their markets over the life of the pipeline.

REPRESENTATIVE WILSON asked whether the contract contains a stipulation that the producers are not required to sell their gas inside the state and, if so, whether that means that the state will have to do so instead of sending its gas down the pipeline.

MR. JARDELL said that the producers are entering into this project as a business, and so if there is a market in Alaska, the producers will sell gas to it, but not if there is no market and no value to selling the gas in state. The administration has made strong efforts to ensure that it has the opportunity to meet in-state needs.

MR. DONOHUE added that that is generally a question involving ratemaking and open seasons and the Federal Energy Regulatory Commission (FERC), and thus would be better answered by Robert H. Loeffler of Morrison & Foerster, LLP.

[11:52:54 AM](#)

REPRESENTATIVE GARA, noting that there is some risk that being forced to sell gas in state could cut into a company's profit margins, surmised that that is why the producers have resisted having the ASGF Contract include such a requirement. The state faces that same risk if it follows through on its opportunity to sell gas in state. Once the pipeline is built, those who sell gas into the pipeline will have a great benefit, thus the state could make it a condition of a [pipeline] lease that up to 3 percent of a lessee's production be made available for in-state use, he suggested, that way everyone will share the burden of a potentially lower in-state gas price.

CHAIR McGUIRE noted that access to gas and affordable energy are some of the issues that have been raised by constituents.

MR. JARDELL said: "We share those concerns. I can promise you that the administration has put forth tremendous efforts to make sure that if there's a viable gas market, we will have gas available - if it works." There are a lot of variables that will have to be considered throughout the life of the project, and the ASGF Contract now contains the provisions necessary to ensure that the state receives the information it will need to determine if there is a viable market in Alaska. And of course, if there is, then everyone will want to sell it. Countless hours have gone into resolving the issue of ensuring that gas will be available to Alaskans if there truly is a need for it.

CHAIR McGUIRE surmised that the concern is that it will be the state's legislators - rather than the producers - who will be faced with having to explain to constituents why they don't have a viable supply of gas when the state owns 20 percent interest in the project.

MR. JARDELL relayed that the administration also has the concern that "subsidizing gas to one area may not be bringing the overall value to another area." For example, Southeast Alaska does not get much from subsidizing gas to an area up north, and so the questions then become should the state give up revenue for the whole state and all Alaskans in order to subsidize gas into one place and, if so, how can that be offset.

[11:59:06 AM](#)

CHAIR MCGUIRE concurred, adding, "I would certainly hope we don't cut off our nose to spite our face."

MR. JARDELL said, "We have made every effort not to do that."

REPRESENTATIVE COGHILL said he is not a big fan of state ownership of big business; government's purpose is to regulate, tax, and give certainty in law, and by entering into this project as a business, it will raise conflicts for the state. In terms of agreeing to "this document," he said, Sections 3 and 7 become huge issues for him.

REPRESENTATIVE WILSON remarked that in deciding which legislative districts get the gas, it could end up being decided by which area has the most votes in the legislative process, which is not always fair; it will be difficult to figure out how to ensure fairness for all Alaskans.

CHAIR MCGUIRE raised the issue of power cost equalization (PCE) to illustrate that certain issues aren't decided wholly by which districts have the most legislators, that legislators do look at the state as a whole when casting their votes.

REPRESENTATIVE GRUENBERG said the question isn't just whether certain areas of the state will receive benefits from the pipeline; rather, the question is also at what price will those benefits come. The producers - like any merchants - just care about the bottom line, so will there be something in [the ASGF Contract] that guarantees that Alaskans - the current owners of the gas - will get part of the benefits of that ownership, which may very well include having access to a product for a price below what others pay?

MR. JARDELL indicated that that issue is being considered, but then noted that to require the producers to pull off a certain percentage of their gas at a time as yet unknown in order to guarantee that it will be sold to Alaskans will just add another

economic term to the project, terms which currently are not good. Furthermore the state has 20 percent of the gas, and it is hard to envision that that amount won't be sufficient to meet the state's needs. Again, if there is a market in Alaska and there is value in selling to that market, the producers will do so. He asked the legislature to provide suggestions for terms that it wants included in the ASGF Contract. He also pointed out, though, that the administration will still have to keep in mind the economics of the project as it renegotiates the ASGF Contract.

12:07:07 PM

REPRESENTATIVE GRUENBERG noted that the legislature will have the authority to legislate what is to become of the 20 percent of the gas that the state owns; for example, the legislature can stipulate that a certain percentage of its gas is to be set aside and sold to Alaskans for a reasonable price.

MR. JARDELL cautioned against that concept, and offered as an example a hypothetical situation in which the legislature decides to require that the Alaska Permanent Fund Corporation (APFC) invest half its funds in Alaska simply because doing so will benefit Alaskan businesses. Something like that would not be supported by the administration because it wouldn't be beneficial to the overall health of the permanent fund, and doing something similar with Alaska's gas could raise similar issues; for example, selling Alaska's gas on the open market might return a great deal more money to the state as opposed to selling it to Alaskans at a lower rate, and that extra money could do more for the state as a whole.

REPRESENTATIVE GRUENBERG pointed out, however, that the same logic could be applied throughout the ASGF Contract; for example, meeting "Alaska hire" requirements could result in less revenue for the state. Nonetheless, the state has set policy with regard to Alaska hire, and so should also set a similar policy with regard to ensuring that some of the gas comes to Alaskans at a reasonable price.

MR. JARDELL clarified that he was merely pointing out that any extra revenue received by selling Alaska's gas on the open market could do more for Alaskans than merely selling them gas at a lower rate, adding that the legislature will be able to make further decisions with regard to who to sell its own gas to once the state has a contract and a pipeline.

12:11:07 PM

REPRESENTATIVE GARA remarked that selling gas at a lower rate to Alaskans in some areas of the state could result in less revenue - and thus less service - to the residents of other parts of the state. He suggested that the producers be required to also put a certain portion of their gas production into the state market; the burden of selling gas to Alaskans at a reduced rate should be borne by both the state and the producers, rather than just the state, particularly given that the producers will be benefiting greatly by their involvement in the pipeline project.

MR. JARDELL indicated that the administration would consider that suggestion along with all the other suggestions it receives from the legislature and the public.

REPRESENTATIVE COGHILL referred to Sections 3 and 4, and offered his understanding that the term, "other agreements" pertains to "things that would revolve around the gas treatment plant and things like that." He asked whether the authority being provided for via [Sections 3, 4, and 7] address the need to renegotiate all the current leases on the North Slope.

MR. DONOHUE said:

We've provided the [House Resources Standing Committee] some examples of the types of modifications of lease agreements and unit agreements that are reflected by the [ASGF Contract], and ... part of the ... difficulty in presenting these conforming amendments is that we're talking about making these amendments retroactive to January 1, 2004. So there's ... three temporal perspectives ... in terms of reviewing these statutory amendments.

The first perspective is [one of] assuming that the administration came to the legislature in 2004 and said, "We don't have any applications, we don't have any contract yet, but we think we need all of this authority to start the process, and so we're seeking broad authority to modify leases, to modify unit agreements, to make shipping commitments, and what have you"; that's the pre-contract phase - it's basically the legislature deciding to send the administration forth to make the best possible deal.

Then you have the perspective of today, where you are basically making these amendments with the benefit of the contract before you so you can see what the administration did ... between 2004 and today ...; you can go through those modifications and determine whether the administration did a good job or a bad job [or] went beyond ... the types of modifications that the legislature thinks are appropriate.

And then the third temporal perspective is going forward; assuming this contract gets approved by the legislature ... and the contract is signed, then the perspective is: what is the authority of the [commissioners of the DOR and the Department of Natural Resources (DNR)] after the contract is in effect and going forward. And that is a function of the terms in the contract itself. ..

MR. DONOHUE continued:

Part of the reasoning for the broad language is ... we're putting ourselves in ... the perspective of [it] being January 1, 2004, and we wanted to cover all the possible modifications that might be involved in this negotiation. And as Mr. Jardell has indicated, it's possible [that] as a result of legislative comment or citizen comment that maybe ... other modifications may be proposed and negotiated.

So that's why we're looking for the broad language, but in the end it will be the legislature that makes the decision as to whether or not the scope of the modifications are appropriate and you're comfortable with what the administration has done with the authority it has requested.

[12:18:01 PM](#)

REPRESENTATIVE COGHILL asked whether the authority being asked for is so broad as to allow the administration to tie up every lease in Alaska.

MR. JARDELL attempted to clarify that the authority provided for in the aforementioned sections applies to negotiating terms for inclusion in the contract, and it is up to the legislature to determine whether that authority is too broad. He noted, though, that any terms negotiated must be reasonable to the

contract. He explained that there are a handful of leases that have a "sliding-scale royalty," which is price based, and that "when you're taking your gas and you're making firm transportation commitments, it's very difficult when your gas fluctuates based on royalty evaluations because of pricing"; so the ASGF Contract contains a methodology for dealing with [those leases], and the broad authority provided for via the aforementioned sections is necessary to evaluate them. He added, "Through the contract, you'll be able to see how we have used this authority, and you can today."

[12:20:34 PM](#)

REPRESENTATIVE GRUENBERG noted that the title of Version F is different from the title of CSHB 2004(RES).

MR. DONOHUE went on to explain that Section 1 [of Version F] provides an exception to the Revised Uniform Arbitration Act (RUAA), and relates to Section 5, which pertains to the waiver of sovereign immunity. Theoretically, Section 1 of the bill provides authority for the state to agree to arbitration under the federal arbitration Act, and avoids any possible argument that arbitration consented to by the State of Alaska is limited to the RUAA.

REPRESENTATIVE GRUENBERG said he has heard the arbitration clause in the ASGF Contract referred to as "baseball arbitration."

MR. DONOHUE said, "Baseball arbitration is provided for under Article 26 and Exhibit C; I believe some producers have insisted on it, and under certain circumstances I think a third producer has options between ... substantive arbitration as opposed to baseball arbitration." It's really a contractual agreement amongst the parties as to how they are going to resolve their disputes, and "baseball arbitration" could be implemented under the state law as well; in "baseball arbitration," each party puts forth its best position and the arbitration panel is limited to picking only one of those positions.

MR. DONOHUE went on to explain that Section 2 of Version F is intended to clarify the [administration's] ability to agree to terms that will grant fiscal certainty for oil. In response to a question, he relayed that the language, "including gas pipeline expansion pricing that encourages further gas exploration" came about as a result of a discussion in the Senate regarding "rolled-in pricing versus incremental pricing

for gas line expansions." The legislature's consultants suggested that the state mandate rolled-in pricing, but the administration's consultants advised that doing so would be impractical. The compromise arrived at was that a policy stipulating that expansion pricing be aimed at encouraging exploration would be included in the "purpose clause."

REPRESENTATIVE GRUENBERG referred to page 2, line 5, and asked whether there should be a comma after the word, "party".

MR. DONOHUE indicated that there should be.

REPRESENTATIVE GRUENBERG made a motion to adopt Amendment 1, to place a comma after the word, "party" on page 2, line 5. There being no objection, Amendment 1 was adopted.

[12:27:25 PM](#)

MR. DONOHUE explained that the term "related party" is defined in Section 19 and is intended to mean the entities that will own and operate the midstream entities of the project, and the midstream entities would include the main line from the North Slope to the Canadian border, the gas treatment plant on the North Slope, at least two gas transmission lines, and the possibility of a natural gas liquids [NGLs] plant; so to the extent that those entities are beneficiaries of fixed tax rates during the course of the agreement, this language was added to clarify that point. In response to a question, he offered his belief that the "rolled-in pricing requirement" is included in Section 14, which pertains to collateral agreements. He characterized Section 14 as the major difference between Version F and CSHB 2004(RES).

[There was a brief discussion regarding drafting.]

MR. DONOHUE went on to explain that Section 3, paragraph (1), ensures that "oil fiscal certainty" can be provided even though a sponsor's activity is not related to the project.

REPRESENTATIVE GRUENBERG questioned why the state should not limit that certainty to activities related to the project; that seems to be the intent of the original Alaska Stranded Gas Development Act. Section 3 broadens the commissioner's authority considerably; he/she could simply "take entity 'A' that happens to be a participant in a project, whether it's this one or another one, and give them all kinds of breaks that aren't related to ... [the gas pipeline project]," he added.

MR. DONOHUE replied:

Again, this is a statement of broad authority. To the extent that the administration provides a ... term of fiscal certainty that the legislature believes is inappropriate to the [ASGF Contract] and just totally unrelated, the legislature is free to disagree and to disapprove the contract. But the economic analysis from the ... representatives of the administration has been that oil fiscal certainty is a reasonable request and should be provided for a reasonable period.

REPRESENTATIVE GRUENBERG said he is not entirely sanguine with that answer.

[12:35:01 PM](#)

MR. DONOHUE said that paragraph (2) of Section 3 proposes a conforming change intended to broaden the ability of the administration to negotiate different terms related to royalty in-kind (RIK), treatment of RIK, and other lease conditions such field costs "and what have you." This issue will be dealt with in greater detail in Section 7 via its proposed change to AS 43.82.220; currently AS 43.82.220 only deals with royalty type issues.

REPRESENTATIVE COGHILL, in response to a question, said he is trying to get a feel for how the administration's authority is being broadened and to what extent.

MR. DONOHUE said that paragraph (3) of Section 3 clarifies the authority of the state to take its payment of production taxes under AS 43.55 in-kind or as a payment in lieu of production tax by payment and delivery of gas in-kind. He then noted that Section 3 of Version F appears to unintentionally be missing a proposed AS 43.82.020(4), which should say: "(4) acquisition by the state of an ownership interest in the project that is the subject of the proposed contract". He mentioned that at some point in the future, the administration may want to suggest collateral agreement authorization.

REPRESENTATIVE GARA relayed that one of his concerns could be alleviated if [the bill stipulates that] royalties and taxes taken in-kind are to provide substantially equivalent revenue as royalty and taxes taken in-value. If such a stipulation doesn't currently exist, either in the bill or in the ASGF Contract,

would Section 3 of the bill be the correct place to insert such a stipulation?

MR. DONOHUE offered his belief that the preliminary fiscal interest findings indicate that taking both the production tax payment and the royalty tax payment in-kind will result in approximately the same revenue stream as would result from taking those payments in-value.

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REPRESENTATIVE GARA asked whether the legislature's consultants are correct in stating that taking taxes in-kind will result in substantially less revenue because the state will be receiving as payment both sellable gas and non-sellable gas - in other words, gas that still contains impurities.

MR. DONOHUE relayed that that question might be better answered by representatives from the DNR.

MR. JARDELL concurred.

[Chair McGuire turned the gavel over to Representative Coghill.]

REPRESENTATIVE COGHILL surmised that that issue should be researched further. He noted that Section 7, paragraph (2), refers to, "relating to lease or unit expenses for separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation on or off the lease". Considering that the bill proposes to give the administration more authority on certain issues, it is important for the legislature to know what the cost will be for that authority.

MR. JARDELL agreed to work on that issue further.

REPRESENTATIVE GRUENBERG asked that a written amendment be brought forth by the administration regarding inserting the aforementioned proposed AS 43.82.020(4).

The committee took an at-ease from 12:45 p.m. to 1:11 p.m.

MR. DONOHUE relayed that the first change proposed in paragraph (1) of Section 4s will clarify that the ASGF Contract can provide fiscal certainty terms with respect to oil taxes. Legislative history regarding the Alaska Stranded Gas Development Act indicates that the commissioner of the DOR provided testimony that the citations to oil and gas taxes

referred to in AS 43.82.210 were not intended to cover oil; therefore, Section 4, paragraph (1), inserts the phrase "on oil or gas or both".

CHAIR McGUIRE characterized the phrase used in the CSHB 2004(RES) - "modifications of taxes on oil and gas, including terms providing for" - as rather vague.

MR. DONOHUE surmised that that was why the Senate chose to alter that provision. He went on to explain that the second change proposed via paragraph (1) relates to credits for investment in a project and references the commitment allowance in Article 20 of the ASGF Contract that proposes certain allowances or credits for investing in a gas treatment plant that are outside of the various credits included in the production profits tax (PPT) [legislation]. The thought was that [the administration] needed express authority [in statute] to support that particular provision of the ASGF Contract.

MR. DONOHUE relayed that paragraph (2) of Section 4 now references oil and gas agreements, unit agreements, and other agreements under Title 38, and this issue will be discussed further in relation to Sections 7-10. Paragraph (6) of Section 4 conforms current statute with the repeal of AS 43.82.445 [as proposed via Section 20 of the bill]; AS 43.82.445 currently outlines the administrative termination procedures, and are no longer needed as statutory provisions because two different but comparable termination procedures have been folded into Articles 5 and 28 of the ASGF Contract itself. The intent of paragraph (7) of Section 4 is to broaden and add flexibility to the "catchall provision"; this change is intended to encompass all the provisions necessary to implement the acquisition of an equity ownership. He drew attention to Exhibit I of the fiscal interest findings, and noted that it initially proposed the addition of seven specific powers, but it was then determined that such powers would be covered under the broad language of Section 4, paragraph (7), and that such was the preferable route to take.

MR. DONOHUE noted that paragraph (7)(B) of Section 4 proposes to replace the phrase, "best interests of the state" with the phrase, "long-term fiscal interests of the state". The reasoning behind this change is that that is the consistent finding that needs to be made, "and has been made with regard to the preliminary fiscal interest findings" that the commissioner of the DOR has already published and that are in part dependant on conforming amendments and edits to the current Alaska

Stranded Gas Development Act. Once the commissioner has made such a finding at the end of the process, he/she can then refer and recommend the matter to the governor who can then refer and recommend it to the legislature.

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MR. DONOHUE, in response to questions, explained that with the exception of AS 43.82.200(7)(B), the Alaska Stranded Gas Development Act uses - and always did use - the phrase, "long-term fiscal interests of the state". He added that he does not know why the phrase, "best interests of the state" was used in AS 43.82.200(7)(B); the change proposed to that provision via Section 4 is merely an attempt to conform the language for the sake of consistency.

MR. JARDELL concurred.

REPRESENTATIVE GRUENBERG asked whether the phrase being added via paragraph (7) - "the commissioner determines" - will require that specific determinations and factual findings be made.

MR. DONOHUE said that that is not the intention; rather, it is intended that the commissioner's basic finding that the ASGF Contract is in the state's long-term fiscal interest shall constitute the necessary finding.

REPRESENTATIVE GRUENBERG suggested that the administration consider removing the phrase "the commissioner determines" because by using the word, "determines", a reviewing court "might remand" if there are no specific findings.

REPRESENTATIVE GARA said he is concerned with removing the phrase, "best interests of the state" from proposed AS 43.82.200(7)(B) because he feels that the ASGF Contract should be in the best interests of the state rather than merely in the long-term fiscal interests of the state. He surmised that the phrase, "best interests of the state" is currently in AS 43.82.200(7)(B) because that provision pertains to the contract that gets negotiated. He suggested that they simply change AS 43.82.200(7)(B) to read, "in the best long-term fiscal interests of the state".

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MR. DONOHUE replied:

We've looked into the definition, the case law, relating to "best interests" and it basically ties back to the Article VIII provisions [of] the [Alaska State Constitution] requiring that resources be developed to the maximum benefit of the people. And the way we analyze it is, that's a supervening requirement; that is, this contract will have to meet that test. In addition, that particular test, in ... terms of the case law, is - even though there are cases discussing "best interest" - ... a fairly amorphous standard; it's obviously intended to be flexible, and it doesn't necessarily add light to the determination. Whereas [for] "long-term fiscal interests" ..., there are various factors that are set forth in the [Alaska Stranded Gas Development Act], so there's some parameters around that concept that we can use to help defend the contract ... if it's challenged on that basis.

REPRESENTATIVE GARA offered his belief that the phrase, "best interests" has been litigated and used for decades but the aforementioned provision of Article VIII of the Alaska State Constitution has never been enforced. For example, the economic limit factor (ELF) has been on the books for 15 years but [for the last few years] hasn't resulted in the resources of the state being developed and managed to provide for the maximum benefit of the state. He opined that there should be implementation of the phrase "best interests" at the statutory level rather than at just the constitutional level.

MR. DONOHUE, in response to a comment, said he is not familiar with any case law in which Article VIII of the Alaska State Constitution was used to strike down a state tax, though it has been used to impose controls on the commissioner of DNR in terms of the requirements of making written findings prior to final administrative action. For example, in Kachemak Bay, there was a gas lease sale but there were no written findings, and the court held that the commissioner had to make written findings. He concluded:

The ultimate control here is the legislature; the legislature will be making a judgment. It can apply the "best interests" test, it can make its own judgments about what's to the maximum benefit of the people with respect to this contract. What we're talking about now is, what findings does the commissioner of [the DNR] have to make in order to

present this proposed contract to the legislature for deliberation.

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REPRESENTATIVE GARA asked whether Section 4 could be interpreted to mean that the commissioner could change the oil tax rates that the legislature passes.

MR. DONOHUE indicated that Section 4 authorizes Payments in Lieu of Taxes (PILT), a fundamental concept underlying the Alaska Stranded Gas Act; for example, with respect to property taxes and other taxes, the commissioner has the authority to come up with different formulas, different rates, and different timing of impact. The PILT that the commissioner comes up with may vary from the precise methodologies contained in the statutes, and one concern voiced in a prior committee was whether that authority extends to the commissioner after a contract is approved by the legislature, and in that context, the administration's view is that "this contract" did not contemplate any material amendments to the contract being made solely by the commissioner's action. So to avoid that issue, the authorization statute has been altered so as to provide that the DOR, should it wish to change a particular PILT that's approved by the legislature this year, will have to come back to the legislature three years from now for authorization to change that PILT.

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MR. DONOHUE explained that Section 5 authorizes terms relating to arbitration and alternate dispute resolution that may provide for a waiver of the state's immunity from suit, and pertains to Article 26 of the ASGF Contract in which the state has agreed that an arbitration award against the state would first be entered as a judgment in the state of Alaska but then, if there is no satisfaction, the judgment could be entered in another jurisdiction. Also, if the superior court delays for more 365 days in confirming an award and entering a judgment, the producers would be allowed to go to another jurisdiction and enter the judgment and pursue the award.

MR. DONOHUE mentioned that under Article 22 of the ASGF Contract, an arbitration award is "part of the waterfall - ... part of the netting of obligations that run back and forth" between the state and the producers. So a producer that wins an arbitration has the right to an award, and it will be able to

offset that award against "its obligations running to the state"; so while the possibility of actually entering the award as a judgment and pursuing the judgment within the state is slim, it is still possible. If a judgment is pursued in the state courts, the only remedy a private litigant with an action against the state has is to go to the [Alaska] legislature and request payment, because the state is exempt from attachment and execution, and should the legislature deny an appropriation to pay that award - though such has never happened yet - the producer would be able to enter that award and pursue it in another state.

MR. DONOHUE said that "this" is all part of the "equal footing" concept discussed by the administration when the ASGF Contract was first released, and that the waiver of sovereign immunity is related to the provision in the ASGF Contract that allows pursuit of the State of Alaska in other jurisdictions. This waiver has two functions, one of them being to make it clear that the state has consented to arbitration using the federal arbitration Act as a guide. With respect to the pursuit of a judgment outside the state, there is the issue of what sort of immunity applies in that instance, and the primary immunity will be the doctrine of comity between the states; therefore, the state won't have sovereign immunity in another state's jurisdiction, but it will have the protection granted by the doctrine of comity.

MR. DONOHUE noted that it is very common for states to refuse to pursue another state within their jurisdiction unless that state has waived sovereign immunity "and consented to jurisdiction." Section 5 will allow implementation of the provision in Article 26 of the ASGF Contract and the arbitration procedures outlined in Exhibit C. The type of concurrence that's anticipated by the attorney general is his execution of the final fiscal contract; that [action] would constitute his concurrence, this statute would authorize the waiver, and the waivers are present in the ASGF Contract in Article 26.

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MR. DONOHUE noted two differences between Version F and CSHB 2004(RES) in the language of Section 5, and said that the language in Version F is intended to clarify and "line up" the contractual language with the statutory language. In response to questions, he offered his understanding that Article 26 of ASGF Contract stipulates that the producer would have to get a judgment entered in the state of Alaska, would have to go to the

legislature and seek compensation, and, if there was no appropriation, then that judgment, itself, could be entered in [another] state and would be enforced in that other state.

REPRESENTATIVE GRUENBERG suggested using a different term [than "sought" as used on page 4, line 6 of Version F] that more accurately denotes and connotes that concept. He asked whether the phrase, "immunity from suit" is meant to mean both sovereign immunity and comity immunity; if so, then perhaps such should be specified as well, he added.

MR. DONOHUE offered his understanding that the phrase, "other immunity" already covers "comity-type arguments"; the state would be precluded by the ASGF Contract from raising those types of arguments in another state's jurisdiction. The other state, in looking at that provision, would be more likely than not to allow pursuit of the State of Alaska in its jurisdiction.

REPRESENTATIVE GRUENBERG said he does not necessarily agree with either that [supposition] or with the policy, though if that is the intent he wants to ensure that the bill truly says what is meant. He suggested that the bill should state specifically that "other immunity" means comity immunity. He noted that under Section 5, the state would be waiving its right to require that a dispute be handled via a lawsuit in a court of law rather than in an alternative dispute resolution format.

MR. DONOHUE, in response to a question, offered his belief that it is quite common for states to enter into mandatory arbitration proceedings, which are usually statutory procedures with the waivers imbedded.

REPRESENTATIVE GRUENBERG sought assurance that there is no intent to waive sovereign immunity to a foreign jurisdiction.

MR. DONOHUE said that to the extent [that engaging in the gas pipeline project via the Alaska Natural Gas Pipeline Corporation ("ANGPC") results in the] State of Alaska doing business through subsidiaries and public corporations in Canada, the State of Alaska would be subjecting itself to the laws of Canada, and thus he doubts very much that a state law waiving immunity would have much impact on a Canadian court.

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REPRESENTATIVE GRUENBERG sought assurance that the language in Section 5 won't waive the state's immunity in a foreign court.

MR. DONOHUE indicated that it wouldn't.

REPRESENTATIVE GRUENBERG asked whether the ANGPC would be cloaked in the state's sovereign immunity.

MR. DONOHUE offered his belief that the ANGPC would be subject to suit - just like a private party - though there would be a test regarding the nature of the proprietary activity that that public corporation was engaged in.

REPRESENTATIVE GRUENBERG requested that Legislative Legal and Research Services be asked to provide the committee with information on this issue.

MR. DONOHUE, in response to another question, surmised that a subsidiary of the ANGPC - if it's incorporated as a for-profit corporation - is unlikely to be viewed as having sovereign immunity in either the U.S. or Canada.

REPRESENTATIVE GRUENBERG asked how any other state would get jurisdiction over the State of Alaska.

MR. DONOHUE said the intent is to allow a judgment to be entered in any other state where the State of Alaska has assets that can be pursued. In response to further questions, he again stated that Article 26 of the ASGF Contract provides that the state of Alaska shall waive sovereign immunity, and that Section 5 merely provides statutory authority for that article of the contract; furthermore, the waiver is for the term of the contract.

REPRESENTATIVE GRUENBERG asked whether there is precedent for a state to waive sovereign immunity in foreign jurisdictions for the life of a contract.

MR. DONOHUE said the administration has not found precedent for that, though there is precedent in terms of the State of Alaska becoming involved in arbitrations outside of the state. If the State of Alaska is acting in a proprietary capacity outside the state - for example, the Alaska Marine Highway System in British Columbia or Washington - there is, in effect, a waiver of comity jurisdiction; for example the State of Washington would likely pursue the State of Alaska for any negligence, taxes, or "what have you" that were required by the laws of Washington.

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THOMAS A. LAKOSH said he strenuously objects to the passage of HB 2004 because it conflicts with so many of the state's constitutional provisions, statutory provisions, and administrative procedures as presently established, adding that in his recent discussions with the commissioners of the DOR and the DNR, he's had an opportunity to take a broader view and hash out some broader perspectives that the committee might find useful in its deliberations, though he would prefer to have more time to address the issues of separation of powers, due process, the Administrative Procedure Act (APA), and fair and equitable treatment in administrative and executive investigations. He suggested that it might be valuable for the committee to consider other avenues for development of Alaska's stranded natural gas, though even the issue of whether it is stranded is debatable.

CHAIR McGUIRE encouraged Mr. Lakosh to submit any of his written information to the committee as well.

MR. LAKOSH said that the perspective he tried to offer the commissioners of the DNR and the DOR on the ASGF Contract was that the state is effectively being forced into becoming an oil company that owns a pipeline and that must market a large quantity of natural gas but must do so without any of the benefits held by a producer in control of facilities or production of gas, while the producers are, in effect, negotiating with nine trillion cubic feet (Tcf) of gas, which they have effectively had an expired lease on, that being Point Thomson. There is a clear question regarding whether it was legitimate for the commissioner of DNR to grant an extension on that [lease]; therefore, he said, he is asking that if the state is forced into a position of developing the state's natural gas by effectively becoming an oil company in conflict with other interests of the state's citizens with respect to pipeline tariffs, constitutional tax provisions, separation of powers, et cetera, then the state should clearly jump wholeheartedly into that prospect by causing the Point Thompson leases to be terminated, under provisions that the commissioner has already developed, for failure to develop Point Thomson, and then negotiate with the U.S. Department of Energy regarding building the pipeline in partnership with the federal government.

MR. LAKOSH noted that TransCanada already has a set proposal for development of the line through Canada, and expressed assurance that the state could come up with "some other arrangement" to develop the line and necessary facilities with the U.S. Department of Energy for those facilities that might be in

Alaska and in the Lower 48, and thereby have the ability to not only take all royalty and taxes in-kind but have an additional 100 percent of the nine Tcf of Point Thomson at the state's disposal for marketing. It is clearly illegitimate, he opined, for the citizens of Alaska to go into a debt of a minimum of \$4 billion and as much as \$56 billion with cost overruns and the execution of withdrawal by the producers from the contract. Instead, the state should clearly consider - if it is going to go the route of becoming an oil company with ownership of pipeline and facilities - simply developing Point Thomson itself and then negotiating with the federal government regarding construction of the gas pipeline from Alaska to the Lower 48.

MR. LAKOSH thanked the committee for the opportunity to speak, and suggested that everyone should take a few steps back and look at the larger picture of what the state is being forced to do with regard to relinquishing its rights as a democracy and a sovereign state. "We don't have to surrender those rights, given the fact that we are really the owners of the resources and we have the federal government, in its own stranded gas Act, suggesting that they will develop the pipeline in any event," he concluded.

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MR. LAKOSH, in response to a question, said he is a concerned citizen who has been involved in oil spill prevention and response issues ever since the Exxon Valdez oil spill, adding that as a pro per litigant in that issue he has become familiar with administrative law and due process issues as well as with dealing with the Department of Environmental Conservation (DEC) and ensuring that [the state] is obtaining the protections of law that were intended in the various pieces of legislation that were designed to prevent and mitigate Exxon-Valdez-type oil spills. He reiterated that he is very concerned that whatever protections the state has via a separation of powers and administrative procedures will be going out the window with passage of HB 2004. He noted that the commissioners of the DNR and the DOR seemed somewhat interested in his suggestions, though he'd not been able to fully develop his suggestions because of time constraints.

REPRESENTATIVE GARA again referred to proposed AS 43.82.200(7)(B), which would replace "best interests of the state" with "long-term fiscal interests of the state", and asked whether the administration would be willing to say on the record

that the proposed new standard is meant to require at least the same level of protection for the state.

MR. DONOHUE said that although the phrase, "best interests" is arguably broader than the phrase, "long-term fiscal interests", the "best interests" test is amorphous and doesn't provide solid guidance, whereas in the context of the Alaska Stranded Gas Development Act, the state does have some principles regarding what the phrase, "long-term fiscal interests" means because they are set out in statute; so from a litigation perspective, it would be better to have one consistent standard throughout. There is no intention to find something that isn't in the best interests of the state by using the standard of, "long-term fiscal interests".

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REPRESENTATIVE GARA asked Mr. Donohue to state on the record that "long-term fiscal interests" should be interpreted to also mean, "to maximize the revenue to the state."

MR. DONOHUE replied:

I can state on the record that this contract would be judged by the standards of Article VIII of the [Alaska State Constitution], and that ... there may be challenges on that basis once the contract is authorized and challenges arise. And the Alaska Supreme Court will determine whether this contract satisfies that standard.

REPRESENTATIVE GARA asked Mr. Donohue whether it is his position that the phrase, "long-term fiscal interests" should be interpreted to provide as much revenue to the state as the phrase, "best interests" would require.

MR. DONOHUE replied:

I think "long-term fiscal interests" can include a number of different considerations. And ... I think, in the end, you want at least the same amount of revenue, maybe more, by getting involved in this particular project. But you also want to incentivize the project, because the state will be better off with the project than without, under the analysis of administration consultants and officials.

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REPRESENTATIVE GARA said he needs an answer to his question before he agrees to delete what he considers to be a very important standard.

MR. DONOHUE replied:

There are a number of factors that go into the determination as to whether the long-term fiscal interests have been satisfied, and those are laid out in [AS 43.82.210(b)] and there are eight factors. ... [That statute] basically contemplates a balancing of a number of different considerations, so in some sense it's more defined than some broad constitutional standard, and ... from the litigation standpoint, to the extent that we're trying to defend ourselves within this particular set of findings - which have existed since 1998 - we want to be able to make sure that the lawsuit is confined to satisfying ... the balancing of these principles in [AS 43.82.210(b)].

REPRESENTATIVE GARA argued, though, that AS 43.82.210(b) doesn't say that "these" are the factors in determining whether something's in the long-term fiscal interests of the state; instead, it says that if it's consistent with the long-term fiscal interests of the state, the state can also develop terms that are consistent with "the following". But that is a circular argument and assumes that the phrase, "long-term fiscal interests" are defined elsewhere. He asked whether "long-term fiscal interests" is defined somewhere else, and whether "best interests" is defined in statute apart from the aforementioned court ruling.

MR. DONOHUE said that the definition of, "long-term fiscal interests" is not otherwise defined in the Alaska Stranded Gas Development Act, and that he is not familiar with any statutory definitions of, "best interests".

[HB 2004, Version F, as amended, was held over.]

#### **ADJOURNMENT**

There being no further business before the committee, the House Judiciary Standing Committee meeting was adjourned at 2:11 p.m.