ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE
June 2, 2006
11:06 a.m.

MEMBERS PRESENT

Representative Jay Ramras, Co-Chair
Representative Ralph Samuels, Co-Chair
Representative Jim Elkins
Representative Carl Gatto
Representative Gabrielle LeDoux
Representative Kurt Olson
Representative Paul Seaton
Representative Harry Crawford
Representative Mary Kapsner

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Mark Neuman

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: HB2004
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

WITNESS REGISTER

JOSEPH DONOHUE, Staff
Preston Gates and Ellis LLP
Anchorage, Alaska
POSITION STATEMENT: Presented HB 2004.

KEVIN JARDELL, Legislative Liaison
Office of the Governor
Juneau, Alaska
POSITION STATEMENT: Testified in support of HB 2004.

BOB LOEFFLER
Morrison & Foerster
Counsel to the Governor
Office of the Governor
Juneau, Alaska
POSITION STATEMENT: Answered questions regarding HB 2004.

DAVE VAN TUYL, Commercial Manager
Alaska Gas Group
BP Exploration (Alaska) Inc.
Anchorage, Alaska
POSITION STATEMENT: Answered questions regarding HB 2004.

WENDY KING, Director
External Strategies
ANS Gas Development
ConocoPhillips Alaska, Inc.
POSITION STATEMENT: Answered questions regarding HB 2004.

ACTION NARRATIVE

CO-CHAIR RALPH SAMUELS called the House Resources Standing Committee meeting to order at 11:06:51 AM. Representatives Elkins, Gatto, Olson, Seaton, Ramras, and Samuels were present at the call to order. Representatives LeDoux, Crawford, and Kapsner arrived as the meeting was in progress.

HB 2004-STRANDED GAS DEVELOPMENT ACT AMENDMENTS

11:07:21 AM

CO-CHAIR SAMUELS 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."

11:07:22 AM

JOSEPH K. DONOHUE, Preston Gates & Ellis LLP, noted that he has been working with the Department of Law on the [Alaska] Stranded Gas Development Act (SGDA) conforming amendments bill. He indicated that the materials he provided include a recommendation that the questions related to the in-state use of gas [asked during the June 2 House Resources Standing Committee meeting] be directed to Bob Loeffler, whom he said would be available some time during the meeting. He said a list of those questions was being typed at present [subsequently included in the committee packet]. He recollected that one of the questions had been whether or not there is a term limit for representatives appointed to the Municipal Advisory Group (MAG). He explained that the group is an informal entity created by statute and formed at the time an application is submitted under the SGDA. He relayed that the commissioner of the Department of Revenue notifies effected municipalities, and the mayor of the municipality appoints the representative, who serves at the pleasure of the mayor.

MR. DONOHUE specified that the proposed amendment in Section 15 of HB 2004 deals with extending the life of the MAG itself. He continued:

> The MAG ceases to exist under current law at the time the final auction is made, with regard to the application that the advisory group is formed to address. So, ... under the current law, the MAG entity would disband - would no longer serve the statutory purpose - at the time the legislature authorizes the proposed contract under the SGDA statutory provisions. The proposed amendment would extend the life of the Municipal Advisory Group through the end of the distribution of the impact payments, which are provided for under Article 18 of the proposed fiscal contract, which is a six-period following project sanction, or, with the commencement

of commercial operations of the pipeline - whichever comes first.

11:11:18 AM

REPRESENTATIVE SEATON said the language reads, "the latter of 90 days after final distribution," thus he asked if Mr. Donahue meant to say, "whichever comes last."

11:11:47 AM

MR. DONOHUE said he stands corrected; it's the later of the two events.

11:12:23 AM

REPRESENTATIVE GATTO asked what happens in a community in which "the impact" still lingers.

11:12:56 AM

MR. DONOHUE offered his understanding that under the proposed fiscal contract, the impact monies provided by the "mid-stream entities" will pay out over a six-year period up to $125 million. To the extent that there are impacts after that, he added, the state would have to deal with that through its own grant program, or many of the political subdivisions impacted would have revenue-producing PILTs [payments in lieu of taxes] directed to them. He said:

> So, there will be a constant stream of revenue based on the completed project. So, there will be an opportunity for the political subdivisions to offset those impacts with that revenue, which is kind of the normal process. During the construction period it's somewhat abnormal, because there's a limitation on the ability of the political subdivisions to impose taxes.

11:14:07 AM

REPRESENTATIVE GATTO predicted that even with a "start-up," it would be years before there would be "a revenue stream from which to take money to continue to serve as impact money."

11:14:29 AM

MR. DONOHUE responded that once a decision regarding project sanction is made, it is in everybody's interest to complete the project expediently.

11:14:53 AM

REPRESENTATIVE GATTO indicated that he is talking about the odds of impact money sources continuing or tapering down beyond the contract period, rather than just ending.

11:15:34 AM

MR. DONOHUE noted that the schedule of payments in Article 18 does taper off, but he recognized that that doesn't address Representative Gatto's concern about impacts beyond the period of the contractual payments.

CO-CHAIR SAMUELS noted that property tax money would start to flow once the gas starts to flow, and that money would go to the impacted community also. He said the impact money is for the construction phase, assuming that it is stretched out long enough to when gas flows and the property tax money kicks in.

REPRESENTATIVE GATTO asked, "You don't get the property tax money when the property's improved?"

CO-CHAIR SAMUELS answered that it would depend on the value, which has to do with when the operating systems are built.

11:16:53 AM

REPRESENTATIVE SEATON reminded everyone that in the contract the money is payment in lieu of taxes; therefore, there won't be a property tax. He asked, "Is that the schedule for through-put to start - it appears after project sanction, or do we have a gap there?"

11:17:03 AM

MR. DONOHUE answered, "I think that's the best estimate of the construction period, but again, Representative Seaton, I think ... it's in everybody's best interest to beat that schedule."

CO-CHAIR SAMUELS said he thinks "the construction should actually be shorter."

11:19:17 AM

KEVIN JARDELL, Legislative Liaison, Governor's Legislative Office, Office of the Governor, mentioned two questions brought up the day before that have not yet been answered: One question is regarding whether the state has ever waived its sovereignty to the degree that allowed the state to be sued in other jurisdictions. The other question, he noted, has to do with permanent fund assets. The answers to those questions, he said, would be available soon.

11:19:52 AM

MR. DONOHUE directed attention to question 2 on the handout, which asks whether a tax rate incorporated into a payment in lieu of tax provision of a contract ratified by the legislature can later be modified by mutual agreement of the parties. He said it is the view of the administration that there is no leeway for material amendments to the contract in subsequent years. However, there is a section in the proposed contract that deals with amendments to the fiscal contract, and that is in Article 39.1, he said. That language provides that the terms of the contract could be modified by mutual agreement, in writing. So, theoretically, he relayed, future administrations could agree to a different tax rate than the one proposed and authorized initially by the legislature. He reviewed the administration's suggestion regarding the question, which read as follows [original punctuation provided]:

> To avoid there being such an issue, the legislature could consider amending AS 43.82.435 by adding: "A contract authorized by this section and executed by the Governor may contain provisions that provide for amendment of contract terms without further action by the legislature except that any term relating to taxes described in AS 43.82.210(a), or payments in lieu of such taxes, may not be amended without further legislative authorization under this section."

11:22:42 AM

MR. DONOHUE turned to question 3, which asks for examples of the modifications of lease and unit agreements contemplated by the expanded authority proposed by amendments to AS 43.80.020 and 220. He said the administration sought answers to this question from the Department of Natural Resources, and the deputy commissioner responded. Mr. Donohue said, "I think the question initially was focused on unit agreements, and the best example

of modification of unit agreements is the example I gave yesterday, which is the Point Thomson article in the proposed contract." He continued:

> There is ongoing dispute between the lessees of that unit and the state as to whether or not they have properly pursued development of those leases in that unit, and the article in the proposed contract suspends that dispute for a period of time, sets a schedule for develop of Point Thomson, pursuant to the ... project plan, and, ... to the extent that there is a dispute about the rights and obligations and duties of the lessees, that is probably the primary example of modifications of ... a unit agreement."

MR. DONOHUE brought attention to the first paragraph of the response to question 3, which read as follows [original punctuation provided]:

> The proposed contract provisions (1) redefine upstream royalty responsibilities of the state with respect to payment of gas-related field costs such as cleaning, gathering, treating, and dehydration; (2) assign responsibility to the state for conditioning of royalty gas and disposal of impurities associated with the conditioning of that gas; (3) limit over the term of the contract the state's ability to switch between royalty in kind and royalty in value; (4) define points of delivery for royalty gas; (5) assign responsibility for downstream NGL [natural gas liquids] extraction; and (6) provide an optional alternate royalty rate for certain sliding scale royalty leases.

11:25:31 AM

REPRESENTATIVE SEATON, regarding the provision to "provide an optional alternative royalty rate for certain sliding scale royalty leases," asked if that allows a modification for royalty rates.

11:26:10 AM

MR. DONOHUE said he thinks the answer is yes, but he said that answer should come from DNR.

11:26:33 AM

CO-CHAIR SAMUELS proffered, "I believe that had to do with ... the net profit share leases that are already in existence - not ... the general leases ..., but there are some that are sliding scale, depending on the profit of the company already."

11:26:57 AM

REPRESENTATIVE SEATON said he would like "a definition of parameters" related to the aforementioned provision and what that could allow as far as changes in royalty rates by the commissioner under the contract.

11:27:19 AM

MR. DONOHUE directed attention to question 5 on the handout, which asks for a comparison of the case law relating to the phrases "in best interests of the state" versus "in the long-term fiscal interests of the state." He summarized the answer found on the handout. First, there is no case law outlining what "long-term fiscal interest" means, although it is a term of art that is consistently used throughout the SGDA. Conversely, the term, "best interests of the state" has been litigated within the state of Alaska and has generally been found under Article 8 of the Alaska State Constitution as meaning to "develop the resources for the maximum use consistent with public interest, and to utilize all resources belonging to the state for the maximum benefit of the people."

11:29:45 AM

CO-CHAIR SAMUELS noted that another new handout from Legislative Legal and Research Services addresses the same topic.

MR. DONOHUE opined that the idea of substituting "long-term fiscal interest" for "best interest" is still worthy of consideration, because the entire SGDA process is focused on fashioning a fiscal regime that both the state and producers can live with. He continued:

> To the extent that each one of these terms can be justified either by that or by the language in ... .200 (a)(7), as something ... reasonable and appropriate for the implementation of the various provisions of the act, such as obtaining an equity interest, taking your ... production tax payment in-kind, and committing to shipping positions on the ...

project. So, we do believe the language that we've proposed provides greater flexibility, but we cannot say that long-term fiscal interest is well documented in the caseload.

11:31:26 AM

REPRESENTATIVE LEDOUX suggested changing "the other statute" that refers to long-term fiscal interest of the state, in order to make it consistent with "best interest of the state."

11:31:51 AM

MR. JARDELL responded that because preliminary findings have already been made "under that statute," it would be problematic to change the standard "after those standards have already been utilized and the contract is out to the public for review."

11:32:15 AM

REPRESENTATIVE LEDOUX asked Mr. Jardell if he thinks the findings would have been different if [the Department of Law] had used "best interests of the state" rather than "long-term fiscal interests of the state."

11:32:50 AM

MR. JARDELL noted that the Department of Law used the "long-term fiscal interests" as a narrower definition than "best interests," thus, he said he does not believe "that would change the commissioner's decisions." He added, "However, I think it would certainly cast questions as to whether or not you had to begin the process anew, or what exactly that would entail from a process and procedural standpoint. So, I don't think there'd be substantive changes, but I think it could very well ... cause some questions and concerns over what does it mean if you've changed it - the process as we go forward."

MR. JARDELL said the case law was not the only thing researched; the minutes of the SGDA were also reviewed to see if there was any direction from the legislature. He said, "We could not find any direction as to why there would be two different standards." He continued:

Then, based on the Department of Law's review that the "best interest" is a broader standard than the more narrow one, we think the consistency would actually

just answer the question that, yes, keep consistent, keep the standard in place, and move forward. And so, we think there's still value in that. Is it necessarily something that is ... absolutely critical? Like we said, we think it's broader, so it may not be critical; but it does really ... pose the question, "Did the legislature intend it, what did they intend?" And there is no answer.

11:34:14 AM

REPRESENTATIVE GATTO asked, "Is not the long-term fiscal interest included in the best interest?"

11:34:28 AM

MR. JARDELL responded that it would be, because the long-term fiscal interest finding is narrower than the best-interest finding.

11:34:36 AM

REPRESENTATIVE GATTO asked, "So, would you say we lose nothing by staying with "best-interests," since we already include long-term fiscal interest?"

11:34:48 AM

MR. JARDELL replied:

I think there's value in establishing a clear process and procedure that doesn't open up questions as to why the legislature wanted us to use one standard in one place - a more narrow one - and then broaden it out to the other standard ... before you submit the contract. There is no answer to the question as to why it was done that way. The question: "Is it just a drafting issue; was there an intent to have a different standard; what was that different standard?" There is no direction. And so, by allowing it to remain, you allow that question to be asked - potentially litigated - and when we're looking at preliminary findings that we've already issued, and that everybody can ... read ..., we look at it and say, "Well, if you're making preliminary findings, you should move those findings to final findings." And we think continuing with the standard makes sense, answers that

question, and provides a more efficient and thorough process.

11:35:48 AM

REPRESENTATIVE CRAWFORD opined:

It seems to me that when the legislature used two different terms and weren't clear, and there's nothing to fall back in ... the records, that at that point you're supposed to fall back to the most basic, which is our constitution. And it's fairly clear that the constitution says that the best interest of the state and maximum benefit to the people of the state. So, it would seem to me that, rather than change it to the "long-term interest of the state," let's use a defined term, which is the "best interest of the state. I feel perfectly comfortable going with something that's in the best interest of the state. Even if there was a case where ... we might take less money for four or five years, because we were going to get it for 20 years longer, you could make the case in a court that that actually is in the best interest of that state. I don't think that what we want is to be able to make the case that, "Well, it's in the ... interest of the state to take ... less money for 25 or 30 years, because we might not get another chance to get a pipeline."

11:37:37 AM

MR. JARDELL responded:

I disagree that you fall back to the constitution. We start with the constitution; that's an overriding principle that we have to comply with, regardless of what state statute says. And so, the provisions that you cite in the constitution are always in force, and are always controlling over this contract, regardless of what standards ... the legislature set in the statute. ... This really gets to when the commissioner is supposed to make findings under a standard, what standard should the commissioner use? And the legislature said, "When you make your preliminary decision, you should do it in a long-term fiscal interest.

> It makes sense if you look at the context of the stranded gas Act when it was introduced and as it's been amended, because its focus is on the economics of the project, the purpose was to negotiate a deal that changed the economics so that we can market our gas. The fiscal nature of the stranded gas Act seems to make some sense. So, we made preliminary findings. So, now it is: "... When you get to the final, do you want a lesser standard? Do you want to broaden it out to where you don't really need the ... long-term fiscal interest?" Now maybe you could do what you suggested wouldn't be good and say, "Well, it's going to extend TAPS [Trans-Alaska Pipeline System] for 20 to 30 years; increase production ... through the oil TAPS pipeline. And that's in the best interests of the state, and so we're going to find it okay."

REPRESENTATIVE CRAWFORD interjected, "That's what I said."

MR. JARDELL continued:

> Long-term fiscal interest is a more narrow definition - it's actually a higher standard - but for us, it's one that is consistent, and so we don't have to go through and ask the question and answer the question, "Why the difference?"

11:39:25 AM

REPRESENTATIVE GATTO remarked that the constitution doesn't use the term "best interest," but it does use the term, "maximum benefit." He said, "Best interest could be jobs, it could be maintaining infrastructure; there could be several things that are not in the long-term fiscal stability interest benefit or any other term." He said he would be amenable to using "best interest, including long-term fiscal interest," rather than using one without the other.

11:40:54 AM

MR. DONOHUE moved on to question 6 in the handout, regarding whether LLCs could be subject to a corporate income tax in the future, specifically, whether LLCs formed to own some of the project segments could be subject to revisions to the corporate income tax. He continued:

> As a general, theoretical matter, the state could probably impose corporate income tax on limited liability companies. But specifically with regard to these companies, ... [they] would be protected by the fiscal stability provisions in Article 11. They would be exempt from the corporate income tax.

11:43:21 AM

MR. DONOHUE, in response to a question from Co-Chair Samuels, explained the following:

> The ConocoPhillips [Alaska, Inc.] entity that owns a membership interest in the main line ... LLC ... would be affiliated with the production company, possibly the parent, and it's part of the unitary business which files a corporate income tax under the PILT provision - I think it's Article 19, it's called SCIT, the state's corporate income tax - that affiliate is subject to corporate income tax, subject to a PILT. The ... PILT, ... there's a lot of small differences, but the main difference is that the SCIT, Article 19, locks in the corporate income tax as of October 2005. Now, if ConocoPhillips' affiliate, who owns the membership interest in the LLC, assigns that to an entity that is not affiliated with the producer, then that entity inherits some of the rights under the contract ..., except for the corporate income tax. So, [an] unaffiliated, new entrant to an LLC would be subject to corporate income tax. I think the way it actually works, it begins with the SCIT, but there's no guarantee that that would be limited. So, it could change during the life for that particular company.

11:45:03 AM

REPRESENTATIVE SEATON asked if an LLC member whose only business in the state is under this contract, would be required, under this contract, to file a separate income tax.

MR. DONOHUE answered yes, they would be subject to corporate income and would have to file and pay, based on their on activities in Alaska.

REPRESENTATIVE SEATON asked, "Even if those activities are totally limited to this LLC activity that's covered under the contract? Because normally LLCs do not pay any income tax on

the distribution. The corporations, if they're here and they have other activities are filing corporate income tax."

MR. DONOHUE confirmed Representative Seaton's comments are correct. The membership entity would be a taxable entity in the State of Alaska.

CO-CHAIR SAMUELS asked, "Even if they were an LLC ... not part of a big LLC ...?"

MR. DONOHUE asked, "Even if they were a single member LLC that becomes a member in this LLC?"

CO-CHAIR SAMUELS answered yes.

MR. DONOHUE said, "I think that if the single member -- you still have an entity that is owning the LLC, and I believe would still be subject to tax in the state, because the distributions would be running through two LLCs."

11:47:00 AM

REPRESENTATIVE SEATON said there is no other LLC taxing authority, thus he would like to see the language included that would tax the LLC.

11:47:31 AM

MR. JARDELL said he would make that language available to the committee.

11:48:04 AM

CO-CHAIR SAMUELS, following up on Representative Seaton's previous question, said:

> I own an LLC. The LLC pays no taxes. The income from that flows to me; I pay no taxes. So, if my LLC that I own bought out ConocoPhillips' ... portion of the main line entity, would then the state take a hit? Because Conoco is paying corporate income taxes on the income from the main line LLC, but my LLC would not, because I don't pay any taxes.

11:49:57 AM

BOB LOEFFLER, Morrison & Foerster, Counsel to the Governor, Office of the Governor, addressed question 4 in the handout, which asks for a discussion of HB 2004, Section 6(c), AS 43.82.220(1)(c), and the "ramp up of local gas use." He said he would walk through the normal sequence: the open season, post-open season, and what happens after the pipeline is operational. He continued:

> What the contract requires is that the project complete a study of the needs for gas in state before the open season. That's an improvement on what the federal legislation required, because they had it at a much later time. So, the very first step is that there will be a study either done by the state and adopted by the project, or done by the project, that identifies what the excavated in-state needs for gas are. And ... as you think about that, one of the parameters of that study will be when will gas be needed and what the ramp up will be, will any be needed to begin with? And it's better to have knowledge in the beginning, and you can sort of tailor the circumstances of tariffs and expansion, and even design to those needs. So, step one is this study of in-state needs before the open season.
>
> Number two, the contract requires that the project consult with the state on the locations for taking gas off inside Alaska. So, that's sort of step two. Another step is that the project shall fund up to four off-state points in Alaska. It's clear when you think about it, but the point there is to get, as much as possible, the off-tank points in Alaska designed into the project to begin with, before it's up and running, so you don't have to deal with ... tapping into a live pipe and things like that. Now, the requirement is they fund up to four, but beyond that maybe additional ones agreed upon or even required by FERC [Federal Energy Regulatory Commission].
>
> Another part of the contract is that the project is the main line, it is not the lateral that would feed Fairbanks or feed wherever. And the laterals can be owned by anyone. But the project is required to cooperate with the sponsors of the connecting pipe, in terms of the plans - the inner connection, and we ... added that to the contract. What happens then is you get to the open season, which, anyone's guess, but it

might be a year-and-a-half to two years from now. And at that time, the FERC regulations require the pipeline to offer two different categories of service. One category of service is the long haul out of the state to Alberta, or wherever. And the other service that is to be offered is a service for in state ... deliveries. And that, of course, should correspond to what the in state study tells about where the gas is needed in state. And so, in the open season, the pipeline will offer a rate for service in state. And the important thing about that rate is that the regulations require that it be defined, in terms of the costs that you incur inside Alaska to deliver gas, and not the costs of taking the gas long haul out of Alaska. So, there's ... two separate kinds of tariff offers, two kinds of rates, and then, when they come to evaluate the people who have put in bids for those rates, the bidding evaluation for the in-state service is supposed to be separate from the bidding evaluation for the out-of-state service.

11:55:17 AM

MR. LOEFFLER said people can bid according to what "the pipeline" offers for in-state service, but bidders can also suggest the need for different service - at a different point or time. Those bids, he noted, would be nonconforming to the offering of "the pipeline," but "the pipeline" would be required to evaluate them. He stated that the first critical juncture is open season, at which not everything will be known about the specifics of in-state deeds, but at least it may be identified where the desirable off-take points are or how much gas will be needed. He said "the pipeline" is offering shipper's rights - the right to transport gas from one place to another - it is not offering the gas itself, which he said is a separate question.

MR. LOEFFLER continued:

The next thing that happens is the pipeline assembles all these bids and awards capacity to people according to the most valuable bid, but again, it has to look at the in-state bid separately. And if it gets enough long-term bids, it takes those as part of its financing and puts it into its application to the FERC.

> Now, it is a requirement of the FERC regulation that if ... someone wants to make a late bid, and has a good reason for that, that person can submit a late bid for capacity, and the pipeline has to consider that. And that might have some value, because as the needs become clearer for Fairbanks or anywhere in state, because circumstances develop after the open season, there is the option - with conditions - of putting in a late bid.
>
> The other thing that is likely to happen is the pipeline probably will design somewhat more capacity than a 100 percent fit with the bid, because it wants to have some flexibility later on. If it designs in too much extra capacity, the FERC general rules require that it bears the cost of that extra capacity; they can't put it on shippers. So, to recap: You've got the open season and the requirements of the contract and the regulation designed to identify in-state deeds, in-state service, [and] in-state tariff, and you can say -- and then you've got this other late fee. And then the question is what the project must do, even if no one bids successfully for in-state delivery. And I'll quote what the FERC's said, and I had to refresh my own memory, but it says, "There is a continuing obligation for the perspective applicant to leave provision for such in-state service available in its tariff." They would not have to voluntarily propose it as part of its initial application. So, it's sort of a placeholder for later service.

11:59:33 AM

MR. LOEFFLER said once the project is up and running, there are some possibilities for dealing with someone coming along later who doesn't have in-state transportation rights and wants to get on the project. He said one possibility is related to extra capacity that may have been designed from the start or people releasing capacity. The second possibility would revolve around the need for expansion, and Mr. Loeffler noted that there are three types of expansions.

12:00:55 PM

REPRESENTATIVE CRAWFORD said there is a provision that none of the entities would be required to sell gas in state, and he said he was told that the state will have 20 percent of the gas in-

kind, thus, the state could "fill those needs that are going to be in state." He asked if it would be detrimental to the state to sell that gas in state - whether other companies would make more selling to Alberta, for example, than the state would by fulfilling the in-state needs.

12:02:00 PM

MR. LOEFFLER answered as follows:

> The amount of gas the state will have is 20 percent. A rough calculation is ... 800 million cubic feet per day, which is four times the current amount of in-state use, according to some numbers I've seen. So, yes, ... we heard that in the negotiations, the state's going to have all this gas and it can sell it.
>
> The next question is: [At] what price would the state want to sell that gas? That's going to be for a future administration to decide, but you ask whether they would make more money taking it to Alberta - not necessarily. The people who ship to Alberta have to pay all the costs to Alberta, so they pay more to ship it there. ... So, whoever sells it to ENSTAR [Natural Gas Company], for example, should be able to knock off the price in Alberta, the cost of shipping it beyond Alaska.
>
> ... Number two, the question of whether ... the state selling gas would want to reduce the price even further to meet in-state deeds is a question that a future state administration will have to settle. But if you believe that it's all based on a netback, so that the price in Alberta, for example, is the market price, if you were selling in Alaska you could make as much money if you wanted to, by knocking off the cost of transportation to Alberta and selling it for that lower amount, and it would work out the same as a seller.

12:03:58 PM

REPRESENTATIVE CRAWFORD asked if the state, as 20 percent owners of the pipeline taking a portion of the gas off the line in Alaska, would still share in the profits of taking the rest of the gas down the line to Alberta, or if, having taken the gas out, that would go to the other shippers.

12:04:26 PM

MR. LOEFFLER answered that the state gets its 20 percent, regardless, which he indicated is different from the way that TAPS is set up. He explained that all the revenues on shipping goes into one pot and Alaska gets 20 percent of that pot.

12:05:01 PM

REPRESENTATIVE SEATON directed attention to page 5 of the bill, [subparagraph] (C), beginning on line 13, which read as follows:

> **(C)** [(4)] the modification does not impair the ability of the approved qualified project or the state to meet the reasonably foreseeable demand in this state for gas within economic proximity of the project during the term of the contract developed under AS 43.82.020**; and**

REPRESENTATIVE SEATON said he would like clarification that "this provision of law would be fulfilled by the terms of the contract that ... you've just related."

12:05:58 PM

MR. LOEFFLER answered that that is his opinion. He stated, "I don't have the bill in front of me, but listening to it as you read it out, it seems to be an exact copy of what is [AS] 43.83.224. So, I don't know ... that we're modifying anything, but restating existing law, and ... it's my opinion that the requirements of the law are satisfied by the contract."

12:06:52 PM

REPRESENTATIVE LEDOUX directed attention to page 4, Section 6, line 29, and she noted that timing and notice provisions were to be deleted from the language. She asked for confirmation that that change would make the language broader.

12:07:38 PM

MR. DONOHUE confirmed that is so. He said the original intent of [AS 43.82.220] was restricted to the right of the commissioner to negotiate changes to royalty in-kind rules and royalty evaluation rules. This set of amendments broadens the language to "deal with the ability to negotiate modifications to

other portions of the oil and gas lease agreement and unit agreements, and what have you." He specified that a broader authority is being sought.

12:08:18 PM

REPRESENTATIVE LEDOUX turned back to the handout with answers to questions, and brought attention to the answer to question 2, which read:

> This administration does not view the fiscal contract as allowing for any material amendments to the tax related provisions.

REPRESENTATIVE LeDOUX asked if that answer is the administration's moral view of the contract, or if it's a legal view of the contract.

12:08:52 PM

MR. JARDELL answered as follows:

> The view of the administration is that the taxing power is a legislative power by constitution and that you cannot delegate that to the state administration to change that. We don't have the constitutional authority, and it's very clear through the Stranded Gas Act. And I think if you look at the discussion when the legislature added legislative ratification ... they added legislative ratification to the original Stranded Gas Act [because] it had to do with the taxation powers and the need for the legislature to weigh in on taxation. And so we do not view the administration as having the ability to negotiate tax rates to change this. However, we went back into researching it, as good attorneys do. They said, "You know I can certainly make an argument that the contract allows it, in which case somebody could try it, and then you could go to the court and see what the [Alaska] Supreme Court says. And so, what we've done is recognized that to ... provide a comfort factor, there is a solution to kind of do a "belts-and-suspenders" and say very clearly, "You can't do it."

12:10:11 PM

REPRESENTATIVE LEDOUX asked for an example of an immaterial amendment.

12:10:46 PM

MR. DONOHUE stated his belief that the general provision to allow for amendments to the contract would deal with things like who to notify when a dispute begins. If some entity is sold to another, an amendment that is administrative in nature would be necessary to ensure that the project goes forward with the new entity.

REPRESENTATIVE LEDOUX pointed out that the answer to question 2 in the handout refers to "material amendments to the tax-related provisions." She explained that her prior question had been an effort to find out the definition of immaterial amendments relating to tax-related provisions.

12:11:42 PM

MR. DONOHUE responded that he can't think off-hand of an example, but he suggested that possibly a creation of a new political subdivision might require redistribution of some of the PILT payments. He indicated that an immaterial amendment would be administrative and would not affect the "total obligations running ... to and from the parties."

12:12:52 PM

REPRESENTATIVE LEDOUX expressed concern over leaving "wiggle room" in tax provisions.

12:13:10 PM

MR. DONOHUE responded:

> Again, the language we've proposed would not have a materiality standard; it would simply say, "If you change a tax provision, it would be subject to reauthorization by the legislature."

12:13:28 PM

REPRESENTATIVE SEATON referred to the previously noted deletion from Section 6, on page 4 of the bill and asked Mr. Donohue what provisions other than those related to timing and notice he anticipates could change.

12:14:15 PM

MR. DONOHUE explained that the provision for contract administration and notice under Article 30 of the contract is a standard provision for when parties enter into a deal, and he indicated it relates to categories such as change of address, phone number, or company name.

12:14:55 PM

REPRESENTATIVE SEATON said he is confused. He referred back to Section 6 and said, "... We're taking out, on line 29, ... timing and notice provisions." He said the resulting language would allow the modification of provisions of the applicable oil and gas leases. He explained, "So, what I'm trying to do is figure out what are the provisions to the oil and gas leases that this will now allow modification?"

12:15:51 PM

MR. DONOHUE said the answer to question 3 in the handout is a general one. He said, "This outlines the primary modifications of lease and unit agreement terms that are presently incorporated in the proposed fiscal contract." He continued:

> The deletion of the term, "timing and notice," ... on page 4, line 29, that you're referring to ... is a specific reference to the royalty in-kind, royalty in-value provisions in which the state has to provide several months' notice before it changes the form in which it receives its royalties. This deletion of this ... particular timing notice was ... a consistency edit to make it clear that not just RIK [royalty in-kind] provisions can be modified by the contract, but [also] other provisions in the oil and gas leases and unit agreements.
>
> Perhaps what your question is: With the modification that we're proposing to [AS] 43.82.435, the issue might arise, "Well, what if the future administration wants to make further modifications to oil and gas leases that are not in the current proposed contract?" And the answer would be, "This legislation ... would allow modifications of those terms in subsequent years without coming back to the legislature."

12:17:52 PM

REPRESENTATIVE SEATON asked if changes in royalties would be considered modifications to the oil and gas leases, or something separate.

12:18:06 PM

MR. DONOHUE replied that under the proposed contract, the state has agreed "to take its royalty in-kind," thus there would be no opportunity to renegotiate royalty valuation methodologies, for example.

12:18:31 PM

REPRESENTATIVE SEATON asked Mr. Donohue to confirm that he is saying what would be allowed under the new provision is contained in the answer to question 3.

12:18:59 PM

MR. DONOHUE clarified:

> My testimony is that the answer to [question] 3 is a summary of the primary modifications to leases and unit agreements that are [contemplated] by the existing proposed fiscal contract to the extent that there's an amendment opportunity provided in Article 39 and you're foreclosing the use of that amendment opportunity for tax PILTS.
>
> The issue remains whether or not some royalty provisions, further modifications of lease agreements, could be entered into subsequent to the authorization; that would not be addressed by this legislation.

12:19:39 PM

REPRESENTATIVE SEATON asked Mr. Donohue if he could give the committee a list of those modifications that would be possible to oil and gas leases under the new language adopted through the change of Section 6.

12:20:21 PM

MR. JARDELL said the administration would provide a list of possible parameters, as well as a more detailed explanation of

what is in the contract for which the administration thinks it needs authority.

12:21:08 PM

MR. DONOHUE, in response to a question from Representative Neuman, offered his belief that progressivity rates are related to the PPT negotiations.

The committee took an at-ease from 12:21:58 PM to 12:32:35 PM.

12:33:55 PM

DAVID VAN TUYL, Commercial Manager, Alaska Gas, BP, said he would attempt to add context to yesterday's conversation about the various options available in providing an unknown in-state demand. He recalled that Mr. Loeffler had mentioned that a local distribution company (LDC), such as ENSTAR Natural Gas Company would have the opportunity to talk to "the pipeline" at the time of the open season with a view to getting a specifically structured service. He said that is commonly done. He noted that such consultation can actually take place before the open season. In response to a question from Chair Samuels, he explained that there is a specific process within the FERC construct, whereby the pipeline company has to make itself available to potential participants in the open season, prior to the open season, on a consultative basis. That, he said, would be the first opportunity an LDC would have to make its wishes known, so that perhaps during the open season the pipeline company may offer the specific service that a local distribution company had in mind, rather than, during the open season, saying, "I have something different in mind that's not the service you're offering."

MR. VAN TUYL reviewed the following eight options: First, the local distribution company buys its ultimate anticipated demand and any amount not used can be released back to "the pipeline," which could then auction it off to other interested parties. In response to a question from Representative Seaton, he clarified that all the options are related to capacity. He continued with the options, the next two being related: Second, the entity could negotiate a seasonal transportation services agreement or "structured capacity," which would allow varying capacities over periods of time. Third, the entity could negotiate a transportation services agreement that has a limited term, but with renewal rights built into it. Fourth, a local distribution company can negotiate an agreement that allows incremental

increases at the shipper's option. The local distribution company would pay a premium for that option. He inserted: "I believe all of these services would be cheaper than purchasing long-haul capacity all the way to Alberta to accommodate the same thing." He continued with the list: Fifth, a local distribution company could contract with a third party that has capacity. Sixth, the entity could take advantage of authorized overrun service - a service often offered by pipeline companies in the north. A pipeline company will offer for firm transportation service what it is confident it can make available daily and long term. He offered further details.

12:42:24 PM

MR. VAN TUYL, in response to a question from Co-Chair Samuels, confirmed that, in general, there is more capacity with authorized overrun service in the winter because compressors work more efficiently when the gas is cold and the outside ambient temperature is cold, and presumably that is when peak demand would occur in a place such as Fairbanks.

12:42:43 PM

MR. VAN TUYL, in response to a question from Representative Seaton related to temperature variation, explained that the pipeline is carefully designed so that the temperature is neither too hot nor too cold. The compressors are above ground, but the ambient temperature impacts the efficiency of the compressors.

MR. VAN TUYL returned to his list of options. Seventh, a pipeline service may offer interruptible transportation service. He explained, "If someone else needs that capacity, then the person buying the interruptible transportation would -- that capacity would get called from them. They'd be able to make use of it in the meantime. It's generally less expensive, because someone else has a call right on it." The eighth option is to expand the system itself overall, in which case, he said, there would be a (indisc.) open season, when local distribution companies would be able to go through the process again, state their needs, and bid for capacity accordingly.

12:44:33 PM

CO-CHAIR SAMUELS asked if there is a menu listing the options for the buyers to view. He also asked who makes the decisions.

12:44:58 PM

MR. VAN TUYL responded that the pipeline company will make the decisions as to what sort of service it offers; however, any customer also has recourse with the regulatory body, which in this case is FERC. As Mr. Loeffler had mentioned, he said the opportunity to bid for capacity after open season is totally unprecedented.

MR. VAN TUYL continued to discuss related points. He mentioned Mr. Loeffler's summation of the various provisions in Article 9 of the contract that relate to facilitating getting in-state gas through off-take points, doing an in-state needs study, and having a mileage-sensitive service offered for Alaska, and requiring cooperation with local distribution companies to bring that gas in state. He noted that there is language within Article 9 that says no party is obligated to provide gas for in-state use. He noted that the provision goes on to say, "but any party may supply [gas]." He said BP has an interest in bringing energy to customers and would certainly compete for any opportunity to supply gas to customers.

12:47:22 PM

CO-CHAIR RAMRAS noted that of the eight options, some cost more than others. He asked if a study would be able to rate those options to find which has a lower premium for the user. Regarding the contract, he asked, "Who is Pipe Co. looking out for? Are they looking out for the consumer, or ... is Pipe Co. part of the ... Alaska Natural Gas Company - whatever the larger entity is?"

12:50:10 PM

MR. VAN TUYL responded that there will be opportunity to look at those issues and make estimates, but he emphasized that any such analysis would be an estimate.

12:51:27 PM

MR. VAN TUYL, in response to Co-Chair Samuels, addressed sliding scales versus [net profit share leases] NPSLs, the latter of which he said would be left unchanged by the contract.

CO-CHAIR SAMUELS asked what the percentage of leases have "net profit share on them."

MR. VAN TUYL answered that he doesn't know, but he estimated that it is a small, single-digit percentage. He said there is a fixed royalty, which, for example, is 12.5 percent at Prudhoe Bay. On top of that, he said, certain leases have an incremental royalty, and there are three types: a sliding scale lease; net profit shares, which have a "step up" in the royalty rate once payout occurs; and supplemental royalties, as exist at the Northstar Unit. He said the contract provides for conversion of sliding scale leases to a fixed royalty percentage.

12:53:22 PM

WENDY KING, Director, External Strategies, ANS Gas Development, ConocoPhillips Alaska, Inc., pointed out that at 12.2(c) in the contract there is conversion for sliding scale leases. She explained that a sliding scale lease - at least those of ConocoPhillips Alaska, Inc. - is dependent upon the price of crude to determine the royalty rate. Ms. King, in response to Co-Chair Samuels, said she doesn't know what the range is, but she noted that the reference price is directly from the lease. She said there may be a point in time when ConocoPhillips Alaska, Inc. wants to produce gas from a certain field, and in the RIK world, a variable royalty changing with time makes it difficult to book capacity. She explained, "So, what we put in here was an option to say, ... 'If we decide to produce gas from that field, ... we'll go grab what the historic prices has been for those previous six months and you have the option to convert that to a fixed royalty percent - to just facilitate fixed royalty in-kind coming up in time."

CO-CHAIR SAMUELS asked, "The industry has the option, or the state has the option?"

MS. KING answered:

> It's upon notice by a producer, so it's our option to say, "We would like to convert this to a fixed royalty percent, and here's what the price has been. There's methodology clearly outlined in here using the same price marker that would have been with the new lease provisions to just convert that over." And it is for a small portion of leases, as I highlighted before, and ... specifically the reference in here ... to 12.2(c) is to facilitate converting those sliding scales over to a fixed royalty rate percent.

12:55:19 PM

REPRESENTATIVE SEATON asked, "And so that's a 12-month look-back at prices from whatever time the industry decides for that lease that they want to start production, or even ... just apply at any time during the lease?"

12:55:35 PM

MS. KING responded that there is requirement that an entity has to be capable of delivering gas from "that asset" within 365 days of making the notice. Regarding Co-Chair Ramras' previous comments, she stated:

> If we know that there's going to be off-take at any initial open season in state, ... the engineers will account for that in the design. And that is why, sometimes if you use the term "telescoping," that's not exactly an accurate term, because - ... for the order or magnitude of the volumes that we're talking about - you won't change the pipe size, but you'll change maybe your compressor stations at different places along -- to accommodate some off-take in state. So, that's exactly why, in mileage-sensitive service, part of that initial open season can offer a distinct cost advantage, is that we designed that from the very beginning. And so, I just wanted to ... highlight that point to make sure it was clear why there was a difference between the initial open season and afterwards.

MS. KING stated that Article 8.8 addresses authorized overrun service, and the language there ensures that if the pipeline [company] chooses to offer authorized overrun service, it be allocated in a nondiscriminatory fashion. She offered further details.

12:58:19 PM

CO-CHAIR RAMRAS asked if it would be worthwhile to direct authorized overrun service toward in-state service first.

MS. KING replied that that decision would be one for the state to make with respect to its capacity holdings.

MR. VAN TUYL added that it is up to each individual shipper to determine how it uses its capacity to be able to match its

markets to meet its gas supplies, and that would include its use of authorized overrun service or IT interruptible transportation, if it was made available.

12:59:21 PM

REPRESENTATIVE SEATON, returning to the discussion of conversion and the sliding scale, asked if it has to be done at the initial start up of the field or can it be done at any time.

12:59:44 PM

MS. KING answered that the conversion itself is "upon notice from the producer" that gas will be delivered within a year. She clarified, "You can make the conversion at any time, but if you haven't produced gas from that field within a year, then that provision would go away, you'd have to re-notice again if you haven't delivered gas within that time frame."

1:00:17 PM

CO-CHAIR SAMUELS asked if the Alaska Oil and Gas Conservation Commission (AOGCC) gets involved in the process.

1:01:01 PM

MR. VAN TUYL explained that AOGCC will typically establish "pool" rules for an entire field - a maximum efficient rate for the entire pool - and the operator of each unit will provide a plan of development that must be consistent with DNR's regulations, as well as the regulations set by AOGCC.

1:02:32 PM

MS. KING, in response to a question from Representative Seaton, reviewed that when gas is expected to be produced from a field, the entity would send notice "for that provision" and then be required to deliver the actual gas within 365 days. She continued:

> I would struggle as to why you wouldn't do right when you ... think you're going to start gas production, because the very issue you were trying to solve is: capacity doesn't work on a variable basis. So, if I'm fluctuating how much royalty gas there is with oil prices, it's difficult to ... manage the capacity in the total production from the field. So, it would

> seem to me ..., if this was your choice to exercise this option, you'd want to do that right when you start producing gas.

1:04:02 PM

MR. VAN TUYL noted for Representative Seaton that Section 6 is the language in the bill related to [AS] 43.82.220(a), as amended, and it provides for a broader revision to the terms of the oil and gas leases. To emphasize Ms. King's point, he stated:

> The whole reason we created the defined term, "incremental royalty" in the contract, and set that aside from "fixed royalty," was to facilitate this whole capacity management. The incremental royalty is going to be the gas taken in-kind. The NPSLs that have ... a fixed royalty is the gas taken in-kind. The incremental royalty that's above the fixed royalty would be paid in cash, specifically to avoid the problem, as they vary around, "How do I handle capacity that's, you know, one month it's up, one month it's down?"

1:04:55 PM

CO-CHAIR SAMUELS announced that he would open public testimony the following morning. He reviewed the schedule for hearing the bill.

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 1:05:55 PM.