

**ALASKA STATE LEGISLATURE**  
**SENATE SPECIAL COMMITTEE ON NATURAL GAS DEVELOPMENT**

July 26, 2006

9:19 a.m.

**MEMBERS PRESENT**

Senator Ralph Seekins, Chair  
Senator Lyda Green  
Senator Gary Wilken  
Senator Con Bunde  
Senator Fred Dyson  
Senator Bert Stedman  
Senator Lyman Hoffman  
Senator Donny Olson  
Senator Thomas Wagoner  
Senator Ben Stevens  
Senator Kim Elton  
Senator Albert Kookesh

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Senator Gary Stevens  
Senator Hollis French  
Senator Charlie Huggins  
Representative Max Gruenberg  
Representative Ralph Samuels  
Representative Kurt Olson

**COMMITTEE CALENDAR**

**SENATE BILL NO. 3001**

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the production tax; amending the definition of 'gas' as that definition applies in the Alaska Stranded Gas Development Act; making conforming amendments; and providing for an effective date."

HEARD AND HELD

**SENATE BILL NO. 3002**

"An Act relating to the Alaska Stranded Gas Development Act; relating to municipal impact money received under the terms of a stranded gas fiscal contract; relating to determination of full and true value of property and required contributions for education in municipalities affected by stranded gas fiscal contracts; and providing for an effective date."

HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SB3001

SHORT TITLE: OIL/GAS PROD. TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

07/12/06	(S)	READ THE FIRST TIME - REFERRALS
07/12/06	(S)	NGD
07/13/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/13/06	(S)	Heard & Held
07/13/06	(S)	MINUTE(NGD)
07/14/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/14/06	(S)	Heard & Held
07/14/06	(S)	MINUTE(NGD)
07/24/06	(S)	NGD AT 1:30 PM SENATE FINANCE 532
07/24/06	(S)	Scheduled But Not Heard
07/25/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/25/06	(S)	Heard & Held
07/25/06	(S)	MINUTE(NGD)
07/26/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532

BILL: SB3002

SHORT TITLE: STRANDED GAS AMENDMENTS

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

07/12/06	(S)	READ THE FIRST TIME - REFERRALS
07/12/06	(S)	NGD
07/13/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/13/06	(S)	Heard & Held
07/13/06	(S)	MINUTE(NGD)
07/14/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/14/06	(S)	Heard & Held
07/14/06	(S)	MINUTE(NGD)
07/24/06	(S)	NGD AT 1:30 PM SENATE FINANCE 532
07/24/06	(S)	Heard & Held
07/24/06	(S)	MINUTE(NGD)
07/25/06	(S)	NGD AT 9:00 AM SENATE FINANCE 532
07/25/06	(S)	Heard & Held
07/25/06	(S)	MINUTE(NGD)

07/26/06

(S)

NGD AT 9:00 AM SENATE FINANCE 532

**WITNESS REGISTER**

JIM CLARK, Chief Negotiator  
Office of the Governor  
PO Box 110001  
Juneau, AK 99811-0001

**POSITION STATEMENT:** Discussed fiscal certainty and answered questions during the hearing on SB 3001 and SB 3002.

DR. PEDRO VAN MEURS  
Consultant to the Governor  
Office of the Governor  
PO Box 110001  
Juneau, AK 00911-0001

**POSITION STATEMENT:** Discussed fiscal certainty and answered questions during the hearing on SB 3001 and SB 3002.

BOB LOEFFLER  
Morrison & Foerster LLP  
Counsel to the Governor  
Office of the Governor  
PO Box 110001  
Juneau, AK 99811-0001

**POSITION STATEMENT:** Answered questions during the hearing on SB 3001 and SB 3002.

ROGER MARKS, Economist  
Department of Revenue  
PO Box 110400  
Juneau, AK 99811-0400

**POSITION STATEMENT:** Answered questions during the hearing on SB 3001 and SB 3002.

WILLIAM A. CORBUS, Commissioner  
Department of Revenue  
PO Box 110400  
Juneau, AK 99811-0400

**POSITION STATEMENT:** Answered questions during the hearing on SB 3001 and SB 3002.

DAVID VAN TUYL, Commercial Manager  
Alaska Gas Group  
BP Alaska  
Anchorage, AK

**POSITION STATEMENT:** Discussed the need for fiscal certainty and answered questions during the hearing on SB 3001 and SB 3002.

WENDY KING, Director of External Strategies  
ANS Gas Development Team  
ConocoPhillips Alaska, Inc.  
PO Box 100360  
Anchorage, AK 99510

**POSITION STATEMENT:** Testified on fiscal certainty during the hearing on SB 3001 and SB 3002.

S.A. (BILL) McMAHON JR., Commercial Manager  
Alaska Gas Development  
ExxonMobil Production Company  
Houston, TX

**POSITION STATEMENT:** Spoke about fiscal certainty during the hearing on SB 3001 and SB 3002.

PATRICK COUGHLIN, Senior Counsel  
BP

Anchorage, AK

**POSITION STATEMENT:** Answered questions during the hearing on SB 3001 and SB 3002.

DAVID W. MÁRQUEZ, Attorney General  
Department of Law  
PO Box 110300  
Juneau, AK 99811-0300

**POSITION STATEMENT:** Gave a presentation and answered questions during the hearing on SB 3001 and SB 3002.

SENATOR HOLLIS FRENCH  
Alaska State Legislature  
Alaska State Capitol  
Juneau, AK 99801-1182

**POSITION STATEMENT:** Asked and answered questions during the hearing on SB 3001 and SB 3002.

#### **ACTION NARRATIVE**

**CHAIR RALPH SEEKINS** called the Senate Special Committee on Natural Gas Development meeting to order at [9:19:34 AM](#). Present at the call to order were Senators Fred Dyson, Bert Stedman, Gary Wilken, Lyda Green, Ben Stevens, Con Bunde, Donny Olson, Kim Elton, Lyman Hoffman and Chair Ralph Seekins; Senator Thomas Wagoner arrived shortly thereafter, and Senator Albert Kookesh arrived as the meeting was in progress. Also in attendance were

Senators Gary Stevens, Hollis French and Charlie Huggins, and Representatives Max Gruenberg, Ralph Samuels and Kurt Olson.

**SB 3001-OIL/GAS PROD. TAX**  
**SB 3002-STRANDED GAS AMENDMENTS**

CHAIR SEEKINS opened the hearing on SB 3001 and SB 3002, noting today's topic would be fiscal certainty.

[9:24:11 AM](#)

JIM CLARK, Chief Negotiator, Office of the Governor, gave a brief history. After the 2003 legislature amended the Alaska Stranded Gas Development Act ("Stranded Gas Act"), the administration began working on how to approach the producers and structure the gas line agreement. In mid-2004, Dr. Pedro van Meurs, longtime consultant to the state, met with the governor to discuss the basic proposal, which was submitted to the producers in October 2004. The state was to get a gas line, with its economic benefits, and would: 1) take its gas in kind, 2) take ownership in the gas line and 3) grant fiscal certainty. Mr. Clark emphasized the goal of making Alaska competitive worldwide. He turned the discussion over to Dr. van Meurs.

SENATOR DYSON asked to hear, at some point, a summary of yesterday's discussions in the House about the relative merits of a gross tax versus a net-profits tax, in which Dr. van Meurs had participated.

CHAIR SEEKINS agreed, noting Senator Wagoner had indicated his own draft proposal would be ready today.

[9:27:47 AM](#)

SENATOR BUNDE highlighted conflicting legal opinions, and reported that mail he has received indicates the issue of certainty is the most difficult for the public. He asked Mr. Clark whether any new information would raise the public's comfort level or allay his concern that the supreme court will reject this, making the legislature's efforts a waste of time.

MR. CLARK surmised two basic questions will appear before the supreme court. First, what does Article IX, Section 4, of the state constitution mean by granting exemptions to Section 1 of that article, which says the taxing power cannot be alienated except as provided in this article? Mr. Clark opined that Section 4 provides a way to do that. Second, even if the power exists, does exercising it for 30 years in the case of oil, or

45 years in the case of gas, go beyond a reasonable period to exercise the power in Article IX, Section 4?

He indicated while the first issue is for the attorney general (AG), Dr. van Meurs would explain what the administration has done. Mr. Clark expressed openness and hope that there will be dialogue with this committee and the Senate as a whole, with this being a vehicle for reaching a satisfactory resolution.

SENATOR BUNDE acknowledged Mr. Clark's answer as one he'd been looking for.

9:31:53 AM

DR. PEDRO VAN MEURS, Consultant to the Governor, provided a handout, "Aspects of Fiscal Certainty, May 16, 2006, Presentation to The Alaska Legislature." He reminded members that the legislature, with the Stranded Gas Act, had crystallized the concept that perhaps Alaska's gas couldn't be developed without providing a degree of fiscal certainty. Having participated in developing that Act, he recalled discussion of a liquefied natural gas (LNG) project to Asia, where low gas prices and high costs would result in a marginal project but the reverse would yield a highly profitable one; investors would have to balance the downside with the certainty that the balance would be maintained if there were an upside.

He explained that fiscal certainty wasn't put in the Stranded Gas Act for this particular project, but was included because Alaska's resource is so far from the market, with such high transportation costs, that it is inherently risky; he still thinks it was a good decision by the legislature. Dr. van Meurs said when he went to the governor to propose the current package, therefore, fiscal certainty was an essential component.

He noted two things are a little unusual here. First, fiscal certainty through a contractual relationship is rare in Organisation for Economic Co-operation and Development (OECD) nations, though common in developing countries, and applied by OECD nations in the past and when there are large infrastructure projects. Dr. van Meurs cited the example of Hudson's Bay Company, where contractual certainty was beneficial when Canada wanted to develop its frontier and granted extensive resource and transit rights. He acknowledged the concern of providing fiscal certainty in Alaska when Britain and Norway don't have it. Second, it is unusual to start with fiscal certainty for gas and then add it for oil, where it hasn't existed. Dr. van Meurs indicated he hoped to address these concerns.

9:38:00 AM

DR. VAN MEURS specified that fiscal-certainty contractual arrangements typically occur in the world if: 1) investors don't trust the political stability of the governments involved, as seen in Angola, or 2) the risk profile of the investment is so dramatic that there must be absolute certainty when weighing positive conditions against negative ones, as illustrated by the aforementioned Hudson's Bay Company example.

He pointed out that the contemplated project has an immensely unusual risk profile: If costs were high and prices low, it would be the worst in the world in terms of net present value; if the reverse were true, however, the net present value would be more than for any other project in the world. Dr. van Meurs emphasized the difficulty for an investor to weigh now whether to actually start construction in a few years. Because the outcome is unknown, the justification for putting so much on the line is to really benefit from a positive scenario.

He highlighted cost escalation, noting Alberta, Canada, is under enormous stress from this. Dr. van Meurs said Shell announced a week ago that it is postponing its oil-sands project because costs have risen 50 percent in just one year, and cost estimates for the Mackenzie Valley project have gone up 50 percent over the last three years. This escalation poses a huge risk.

9:44:01 AM

DR. VAN MEURS pointed out changes in oil and gas prices since his presentation two months ago. He said gas prices in relation to oil are lower today than ever in the U.S. However, oil prices on an energy-equivalent basis are 14 times the price of gas; typically, they're 6 times higher because, on an energy-equivalent basis, they compete. If gas prices stay low in North America relative to oil, it makes this project highly unattractive on an international scale, since gas prices in Europe and the Far East are holding up far better in the last few months.

He told members that the volatility of these factors is an immense risk to investment. If investors can benefit from large profits, however, they are willing to risk escalating costs and prices that continue to slip relative to crude oil. This project will go forward only if investors can positively evaluate this balance, Dr. van Meurs predicted.

He noted reasonable legislators could differ by as much as 10 percent on what the government take should be. Without fiscal stability, a future legislature could decide to add 10 percent to the government take, another billion dollars a year. If oil prices then collapsed and costs increased, the project would be a disaster. Dr. van Meurs said these are reasons for fiscal stability.

[9:51:51 AM](#)

DR. VAN MEURS explained four methods for providing fiscal stability around the world: 1) an exemption system such as in Malaysia or Egypt, where a law exempts the investor from certain taxes and then other taxes are agreed to contractually; 2) a guarantee system in which a nation passes a law guaranteeing the terms of the contract; 3) the "pay on behalf" system in which a national oil company and a private oil company do a deal together, with the former agreeing to pay taxes on behalf of the latter if conditions change, and guaranteeing the fiscal structure will stay the same; and 4) the fiscal balance system wherein a country says, in the contract, that the deal is based on today's conditions for oil and gas, and if any condition changes, there will be renegotiation.

He pointed out that Alaska's proposed contract combines the exemption system with a "pay on behalf" system. If there are tax overpayments, there will be a refund to investors.

[9:55:37 AM](#)

DR. VAN MEURS asked: If the investment is in gas, why is fiscal stability needed for oil? He answered that, first, the legislature could decide to take another billion dollars on oil because of being unhappy with the gas contract, for example. In response, companies likely would refuse to reinvest; because there is no work commitment for oil, they'd be free to do so in order to minimize the extra government take on oil, as they'd perceive it. Second, oil and gas are found together in most new exploration. If terms aren't known for both, it isn't possible to make an investment. If there is a guarantee on the fiscal system for gas but not oil, then the economics of that exploration venture are discounted because of the risk on oil.

[10:00:52 AM](#)

DR. VAN MEURS asked: Why is it so beneficial for Alaska that companies have the maximum incentive to explore for gas? He answered that gas almost invariably contains condensates and large volumes of liquids at the same time; typically, 50 barrels of condensates occur with every million cubic feet of gas. So

far, there is only enough gas to fill this line for 18-20 years. If the line can be filled for 40 or 50 years instead, Alaskans will be the big beneficiaries, along with the investors.

He noted the current sponsors might not even be the owners of the extra gas. Dr. van Meurs said fiscal stability for oil isn't a one-way street, given to satisfy investors. It is also fundamental to an exploration strategy to fill this line with gas for decades to come - for two generations of Alaskans.

He discussed how long fiscal stability is needed. Looking at international exploration contracts that have fiscal stability, and having analyzed about 46 countries that do that, Dr. van Meurs reported that 35 years is the average or typical time that companies receive fiscal stability for oil and gas. Why 45 years for gas? In many countries it is customary to give a longer period of fiscal stability for gas than oil, by 5, 10 or 15 years. Even if gas is found, governments realize that an infrastructure must be put in place, that customers must be found and that the gas must be marketed. This can take 10 or 15 years.

10:06:35 AM

DR. VAN MEURS addressed why this is essential for Alaska. Emphasizing the desire to have the pipeline full for 50 years, he suggested thinking of a new explorer that must find gas before the first open season or first expansion. This could be soon. He asked whether someone would commit tens of millions of dollars to explore without knowing whether it is possible to get in the pipeline, or with a concern that fiscal stability will be taken away before first gas.

He offered that the least the state can do, for new explorers for gas, is to say if they take a double risk - exploration risk plus the chance the pipe might not be available if gas is found - then they'll get the same fiscal stability as those that built the gas line. Dr. van Meurs suggested this shows appreciation for new explorers, who'll fill that line if Alaska is fortunate. The periods exist to satisfy basic concerns about risk and reward, but the concepts are also good for Alaska. Thus fiscal-stability provisions are in the contract.

10:09:16 AM

SENATOR BUNDE agreed that encouraging exploration and more investment is essential for Alaska's economic well-being. Acknowledging the need of investors and the corporations for fiscal certainty, he requested a reaction from Dr. van Meurs and

Mr. Clark about a notion discussed in the House: indexing taxes to investment so the state can have some certainty as well.

MR. CLARK responded that if there is no decision to invest, there won't be 30 years of fiscal certainty on oil, and thus there is a linkage between investment and the fiscal-certainty period. The contemplated contract has two periods of fiscal certainty. The first, about 4 years, is from the date of signing the proposed gas contract until project sanctioning. If the decision is not to build the project, there'd no longer be a contract or fiscal certainty on oil. When talking about 30 years or 45 years, it assumes success in moving forward.

DR. VAN MEURS added that international governments typically don't link fiscal systems to levels of investment. They focus more on the level of production of oil and gas. Some differentiate between base production and incremental production, and some have sliding scales and better deals for marginal fields.

SENATOR BUNDE said he'd been led to believe there is a relationship between investment and production. He asked: Because of the 45-year certainty for gas, would the state benefit with respect to certainty if there were a index on gas taxes that had an escalator as prices rose?

DR. VAN MEURS replied that, internationally, there typically isn't indexing of gas fiscal terms to oil prices or vice versa; he couldn't think of any such example. The prices themselves seem to accommodate for escalation and inflation over time. Today's higher prices for oil and gas, for the most part, are due to escalation and inflation; for instance, gas prices today aren't much higher than in 1922 if looked at in 1922 dollars.

He added although some governments link gas prices to oil prices in order to establish a local market price, the fiscal system isn't indexed, but the gas price itself is; this occurs in nations where prices are controlled. Dr. van Meurs referred to previous discussion of progressive and regressive systems, noting that the indexing of systems to a number of variables can occur in that way.

[10:21:01 AM](#)

SENATOR BUNDE clarified that he wants to ensure for the state that there will be some progressivity for gas through the period of tax certainty, much as progressivity is being discussed for

oil. He suggested he'd perhaps used the term "indexing" inaccurately.

MR. CLARK pointed out that oil is treated differently than gas in the proposed contract. The state is taking its gas in kind. Thus the contract specifies the split, which is what continues for 45 years. As the value of gas escalates, the state will get increased value in the marketplace. For oil, there will be a tax. There are two different systems, though interrelated.

10:23:02 AM

DR. VAN MEURS emphasized that progressivity for gas and oil internationally are entirely different. For oil, it means grabbing an extra share for the state if conditions are better than expected. For gas, it means lowering the government take if conditions are less than expected. He referred to his previous comments on this matter, reminding members that he is a proponent of progressive systems and had advocated for such in the original Stranded Gas Act.

He acknowledged some countries have "take/take" systems. Dr. van Meurs cited Canada's Mackenzie Valley pipeline as an example where there is a progressive system based on profit. However, the purpose there isn't to grab an additional share of gas revenues if conditions are favorable; rather, it is to ensure that the government take is less if conditions are worse. Australia and Russia did likewise. For large-distance exporters of gas, analyzing the contracts on a price-sensitive basis as he'd shown previously in graphs, Dr. van Meurs said all these systems go pretty flat when the price goes over a certain minimum price of \$2 per million Btu at the wellhead; he cited Qatar as a further example.

He highlighted the difference between the bargaining power the State of Alaska has for oil versus gas. Dr. van Meurs said oil is becoming scarce, as reflected in the prices; hence Alaska is establishing strong incentives for new development and a progressive system. For gas, however, there are 150 "North Slopes" and people willing to sell at a discount, either in price or in fiscal terms; thus the state is securing a massive new development that will have only very slight progressivity - not doing what Canada and Australia did, but saying that if the price of gas goes down, there won't be a better deal.

He explained that Alaska's system will be flat if the gas price goes either down or up. The state benefits when there are low prices, although the companies have a tough time. But under

high prices there will be an attractive profit for the companies. Dr. van Meurs concluded by saying Alaska is maximizing its bargaining power, being somewhat careful with gas and somewhat more progressive on oil; this is the best combination for Alaska's future.

10:28:37 AM

SENATOR ELTON asked how many countries provide fiscal certainty on oil for a gas project, or vice versa.

DR. VAN MEURS replied that the normal practice internationally, in all 46 contracts he'd analyzed, is that fiscal stability is granted for oil and gas together. He cited Qatar as the best example of a country that successfully exports massive quantities of gas, with a "pay on behalf" system to guarantee tax stability on oil as well as gas for a typical gas-export deal; the 50 barrels a day of condensates make the projects attractive, and Qatar is becoming an important oil exporter because of them. He reiterated that Alaska is somewhat unusual in granting stability on oil where none existed before, for the reasons he'd explained.

10:31:14 AM

SENATOR STEDMAN asked about pages 16 and 17 of the handout, relating to how net present value changes over time as a project nears development. Comparing it with the fiscal interest findings on page 73 of the proposed contract, he said it shows there is more value to the state in oil than in gas. He also said tax policies in the state haven't been erratic, changing every few years. He asked: With the value to the state being in oil in today's dollars, especially at higher prices, why give away the sovereign right to modify the oil tax for such an extended period, instead of keeping some flexibility?

DR. VAN MEURS acknowledged the validity of that concern, but explained that states which enter into fiscal-stability contracts don't perceive it as giving away sovereignty; rather, they see it as exercising sovereignty to achieve the best benefit.

He noted the graphs in his handout show that the fundamentals of the proposed project are extremely sensitive to the timeline. Dr. van Meurs said the profitability increases enormously after this contract is begun and the first couple of billion dollars are spent, providing more certainty of moving forward. Without fiscal stability, however, reasonable legislators in 10 years would more likely want to increase taxes if prices were high;

this is the concern of investors. If only gas were locked up, the tendency would be to take an extra billion from oil. And while the legislature has been equally stable in its handling of taxes when compared with Western countries, the opinions of legislators differ as to what is reasonable, justifiably so.

10:36:23 AM

SENATOR STEDMAN asked: If fiscal certainty is given for both oil and gas, how does the state protect itself from negative economic changes in 15-25 years, until there is an "opener"? He suggested the state would go to the aid of the industry in that instance, since the state depends on its revenues.

DR. VAN MEURS acknowledged that concern, noting similar ones are expressed worldwide when a contract of this nature is entered into. As mentioned previously and in his petroleum production tax (PPT) report, Dr. van Meurs said he sees the government take rising worldwide for oil. Companies are increasingly concerned about booking reserves. With the change in oil prices, many governments are reassessing their rightful share from their resources, which he reported as one consideration in designing the PPT. Whether there is a similar trend for gas isn't so clear, however.

He surmised 20-30 years from now there'll be a very different oil and gas industry. Giving some personal history, Dr. van Meurs noted he began as a geologist in 1970, when theories and technology were quite different.

10:41:04 AM

DR. VAN MEURS stressed how critical it is that Alaska put everything in place to have the gas project go forward this time. He emphasized immense resources of stranded gas around the world. Small political changes could unlock massive resources. For example, Russia appears to be sitting on 40 percent of the world's gas resources, perhaps equal to 40 or 50 North Slopes, although the world has room for only 1 more a year. He gave other examples. Predicting a 30 percent chance that this gas project might not go forward, even with a contract, he suggested focusing unconditionally on getting this project. Otherwise, it could be lost for a long time.

He reiterated concern about the low price of gas relative to oil today, warning that Alaska could be in dire straits without a gas project for the next decade. Dr. van Meurs acknowledged that hindsight in the future may show there could have been a better deal, but highlighted the need to put an extra \$2 billion

to \$6 billion a year into Alaska's economy and to secure it now, while companies are interested in developing gas in Alaska.

10:45:07 AM

SENATOR STEDMAN requested further discussion of Alberta, where he recalled incentives for the industry were followed by an economic boom, which the government wants to slow because of housing and labor challenges and so forth. He asked whether it is overstimulated there.

DR. VAN MEURS explained that Alberta did what is proposed for the PPT. Alberta's oil sands and heavy oil deposits were developed using a profit-based system. Over the last 20 years - particularly the last 3 or 4, with high oil prices - success has led to an immense escalation of costs. They cannot get the workers, and municipalities cannot accommodate more people. He agreed it is a sign of overstimulation. The hope had been to go to \$2.5 million barrels a day 10 years from now, and to add the Mackenzie line. Now it is all in doubt. If costs increase so much with this overstimulation of the economy, then everybody starts to reassess investments, Dr. van Meurs noted.

He pointed out that what makes this proposed gas project so risky is its target market, Alberta, which is almost out of control economically now. Dr. van Meurs said Alberta is pleading with Canada's federal government to allow more immigration so that more people coming to the province can develop the resources. Agreeing that these are serious problems, Dr. van Meurs suggested this could well be the Achilles' heel of the Alaska gas project.

10:48:52 AM

SENATOR STEDMAN remarked that he hopes to see the day when Alaska has an overheated economy and the problems Alberta has, trying to help communities expand their infrastructure.

SENATOR DYSON offered his sense that people are concerned that the State of Alaska will perhaps enter into a suboptimal agreement, with no chance to fix it later. He recalled the perception in the 1970s with the Trans-Alaska Pipeline System (TAPS) that the state, in its inexperience, got the short end of the stick and could have done much better if advice had been received from experts like Dr. van Meurs.

He surmised fiscal certainty will be a major concern of investors. Senator Dyson asked if there is some way to have certainty for a significant period that gets investors past the

permitting process and politically affected issues, including those in Canada, and through the construction period and some time during which there could be a good shot at recovering major portions of the investment, thereby diminishing risk without going all the way out to 45 years.

[10:52:05 AM](#)

DR. VAN MEURS replied that the international practice is to have fiscal stability for the term of the contract. That is also how the stranded gas contract is being structured. As for doing a suboptimal deal, Dr. van Meurs said he has the same concern whenever there is a deal, and also understands concern about the duration of fiscal certainty. He pointed out that the longer there is fiscal certainty, the more secure investors feel and vice versa.

He explained that fiscal certainty is about ensuring extra profits - well over a reasonable rate of return - to compensate for the enormous risk. Dr. van Meurs noted it is a difficult equation and agreed, from an Alaskan point of view, that it would be more desirable to shorten that period, creating more flexibility for the future. The problem is, it doesn't address the risk issue. For that reason, contracts that have fiscal stability always do it for the term of the contract.

[10:56:20 AM](#)

SENATOR DYSON said that was a helpful and frank response. He asked Mr. Clark what the administration is considering to mitigate concerns about locking in the tax structure.

MR. CLARK called it a work in progress. He said the risks are asymmetrical: the downside risk of high costs/low prices is much bigger on the downside for these companies than the benefits of low costs/high prices, which gives the extra profits Dr. van Meurs discussed. Mr. Clark indicated the desire to find a way to attend to Alaskans' concerns about this issue and still address the risk, dealt with in the contract by giving 30 years of certainty for oil and 45 years for gas. "We know we need to do something," he added.

[10:58:52 AM](#)

SENATOR DYSON asked whether, once the capital risk has been recovered, this will give a guaranteed cash return for investors.

DR. VAN MEURS answered that there is an immense difference between the midstream and upstream. As soon as the industry

makes the shipping commitments - the core risk element - a pipeline company can construct a line and have a relatively low-risk, long-term, regulated existence. However, these pipelines cannot be built without a \$60 billion or \$40 billion shipping commitment, which "upstreamers" must make to ship their gas through a pipeline. The extra reward is not for constructing the pipeline and getting a reasonable rate of return; once the shipping commitment is in place, many parties could do that if they offered the lowest-cost-possible transportation system. Instead, the risk is in making that immense shipping commitment.

He noted this risk goes against the upstream, not the pipeline. The producer, which has ship-or-pay commitments, is immensely exposed if gas prices fall and regulated pipeline tariff costs rise. Dr. van Meurs agreed with Mr. Clark that it is an asymmetrical risk. If everything is negative, the company would be stuck, performing badly in terms of the typical earning power of an international company; this would be received poorly by shareholders. On the other hand, this must be balanced against the extra profits discussed previously. Dr. van Meurs said guaranteeing the shipping commitments for a midstream project isn't a regulated activity; it is a high-risk venture.

11:02:50 AM

SENATOR DYSON requested confirmation that once those firm transportation (FT) commitments are obtained, the risk for the upstream folks, the producers, is that prices will fall or transportation costs will go up. He surmised there is also some risk of not having the anticipated volume that was committed to, as well as risk related to market prices.

DR. VAN MEURS affirmed that.

MR. CLARK added that a tremendous upside potential could be captured after the period of the contract if the infrastructure exists. The key is getting the infrastructure in place, because information indicates there could be 100-200 trillion cubic feet (Tcf) of gas on the North Slope, not counting potential gas hydrates. Currently, there is 36 Tcf of gas, with the expectation of more. He stated the desire to run the pipeline at 6 billion cubic feet (Bcf) a day, which means finding another 35 Tcf to put in the line, and then to go beyond the life of this contract. He likened it to the 1862 Pacific Railway Act in its effect.

11:05:16 AM

CHAIR SEEKINS brought attention to Alberta's high real estate prices and manpower problems, including that they are looking to immigration to fill positions during peak construction of the Mackenzie Valley pipeline, which anticipates first gas down the pipeline in perhaps 2012.

SENATOR BUNDE remarked that what goes up must come down. Referring to Senator Stedman's previous comment, he told how in 1985, in Anchorage, neighbors lost businesses and homes because of the overheated economy there.

CHAIR SEEKINS recalled that after the oil pipeline was built, Fairbanks had more than 30 percent unemployment.

SENATOR STEDMAN clarified that the issue isn't to overheat the economy and then tank it, but to have an "earnings trap" on the oil revenue to stimulate exploration and growth; this will put the state in the position of managing a growing economy. Alluding to SB 3001, he suggested that is the purpose of the 20 percent credit in the proposed oil tax.

The committee took an at-ease from [11:10:19 AM](#) to [11:30:21 AM](#).

SENATOR WILKEN reported hearing from hundreds of people over the last few months who are concerned there will be a 30-year lock on oil prices, with a gas pipeline in return, through a "trust me" model. While recognizing the work of Dr. van Meurs and Mr. Clark, he emphasized the need to avoid having a reserves tax rammed down people's throats, in particular. He urged the administration, with its consultants; the legislature, with its consultants; and the producers to come together to figure out how to answer the question, "How do you know?" He expressed his belief that it will be such a team that fixes this.

[11:35:30 AM](#)

MR. CLARK accepted the challenge on behalf of the administration, relating his opinion that the producers would agree as well. However, he emphasized that this is in two parts. The "how do you know" question isn't for 30 years, but 4 or 5 years, the time to get to project sanction and make a yes-or-no decision. Any certainty for that period is a putative 20 percent split if the gas pipeline is built. If the investment decision is affirmative, it continues through the remaining period. If not, nothing has been done with respect to gas. With respect to oil, under what the administration has proposed, for 4 or 5 years there'd be a locked-in rate, whatever the legislature decides is an appropriate tax.

Mr. Clark acknowledged that the administration hasn't clearly communicated to the public why the contract doesn't contain a firm schedule. He clarified that this contract is a step, not the whole project. Just as fiscal and administrative terms were worked out at the federal level, this contract works out fiscal terms. There is still a need to go before federal agencies for permitting to see what additions will affect the economics; other items affecting the project include the Canadian link. While \$4 billion has been talked about as the state's 20 percent interest, it is based on data several years old and will change. Acknowledging that the legislature won't want to go forward without knowing details, Mr. Clark emphasized that what is being discussed is a progression leading to an answer in 4 or 5 years.

He opined that the contract will move this forward significantly because the economics are nailed down. Fiscal certainty will attract capital and make the leases held by the producers more valuable, giving them incentive to invest. As to whether this deal is suboptimal, Mr. Clark said they all wondered whether it was the best deal they could have gotten for the state. Calling these fair questions, Mr. Clark reiterated the administration's preparedness to sit down with the legislature and the producers.

11:40:36 AM

SENATOR WILKEN related his belief that Alaskans aren't looking for finite, discrete steps, but are looking for broad benchmarks that show the state, with its resources, is holding the producers to their promise, given a signed contract, to build a gas pipeline. He suggested the need to provide some comfort level for the voters. Senator Wilken added that he would do what he could to help move it along.

SENATOR DYSON said he shared that concern. Although acknowledging the difficulty of firm deadlines, he reported that some people with vast experience in the pipeline business have suggested there could be fairly firm deadlines in the work commitment, including filing of the application and submitting the environmental impact statement (EIS), and a firm date on the open season and Federal Energy Regulatory Commission (FERC) certificate. He noted that this is provided that the commissioner of the Department of Natural Resources (DNR), or whoever is appropriate, could allow relief based upon a presentation of cause.

He suggested those firm dates could be included with somewhat draconian "clubs" in the contract - losing protection from the

reserves tax, for instance, or losing Point Thomson or fiscal certainty. Senator Dyson requested a response on the merits of the aforementioned strategy.

11:43:28 AM

MR. CLARK replied that what exists isn't dissimilar. In the summary of the Qualified Project Plan is a Gantt chart setting out a time period for each item mentioned by Senator Dyson. The producers can change that chart by changing "x" to "y" in terms of time. The state can file a notice of dispute and terminate the contract if something doesn't wash, based on a two-part standard: Advance the project diligently, as is prudent under the circumstances. Mr. Clark noted the latter part relates to the prudent man rule, which ties in with the two-phase FERC process, presenting a tariff in order to get into the open season and doing standardized preapplication work with FERC.

He emphasized this is a clear, step-by-step process. The state will know whether it is being advanced as is prudent under the circumstances, using the prudent man rule, which is akin to common law. Mr. Clark explained that an arbitrator would apply those standards to the facts and circumstances that exist when a notice of dispute is brought because of dissatisfaction. When the pieces are put together with respect to what will be confronted on the ground, he said it is tighter than the administration has been able to communicate well to the public.

11:46:35 AM

SENATOR DYSON asked: If the state files a notice of dispute, with whom would it be filed?

MR. CLARK answered that under the system put together, it would be with the arbitration tribunal. During the preapplication phase, for example, when there should be advancement to the open season, the producers might stop their progress. The state would file a notice of dispute. The arbitrator could agree that the project wasn't being advanced as diligently as prudent under the circumstances, and the contract would terminate. There would be \$1 billion of project-design and permitting work into it, and the producers would lose that and the fiscal certainty. If a reserves tax has been passed in November, that would enter into it. There would be a lot to lose.

11:48:11 AM

SENATOR DYSON asked about having firm dates that "x" will get filed 24 months after the contract is signed by all parties, for instance, making it incumbent upon the producers to explain why

they cannot reasonably do it if the deadline isn't met. He agreed with Senator Wilken that having something firm will give Alaskans more comfort. Senator Dyson noted it has been represented to him that this arbitration process is a bit unusual, weighted against the state. He asked Dr. van Meurs how other sovereign entities deal with such issues.

DR. VAN MEURS answered that internationally there is an enormous distinction between upstream contracts and mega-projects of this type. The former involve a contract just to explore, develop and produce, whereas the latter have both upstream and midstream components. It is a normal practice in production-sharing contracts or concession contracts to have firm periods for exploration, and they often include certain minimum work obligations with deadlines.

SENATOR DYSON asked about the midstream.

DR. VAN MEURS clarified that he agreed with testimony that these deadlines and work commitments are common internationally, but only if restricted to exploration, development and production. For comprehensive international projects that include upstream and midstream components - all of which he'd looked at - that philosophy isn't found. Rather, there is a far more flexible approach because governments realize these projects are too complex, with too many facets, to guarantee deadlines.

He opined that Alaska's proposed contract is quite good compared with other large upstream-midstream contracts. Dr. van Meurs cited examples such as Sakhalin, noting there are firm commitments for certain upstream components, but no firm commitments for the large projects. For instance, Sakhalin has no Qualified Project Plan to move it forward, and the large projects don't have a 10-year schedule or a diligence requirement, with termination ability if there is no diligence.

11:54:33 AM

SENATOR DYSON asked whether there is a provision for incremental penalties that don't throw the producers off the playing field.

MR. CLARK asked Mr. Loeffler to join in with respect to arbitration. Mr. Clark then emphasized the desire for good progress. If there is termination, the contract gives an ability to cure it; this is for the time up until it is built. The state will look at facts and circumstances, wanting to resolve problems and not rush to judgment because of a timeline. Although it isn't a penalty for failure to perform, it is a

wake-up call, and the producers would have to explain to their board of directors and, he surmised, would want to come back in. He elaborated, suggesting it is perhaps equivalent to, though not the same as, what Senator Dyson was talking about.

SENATOR DYSON expressed doubt that it is equivalent in any way. He asked Dr. van Meurs whether any North Sea midstream development rises to the level of a mega-project.

DR. VAN MEURS replied some do; he mentioned Ormen Lange. In further response, he explained that all North Sea developments aren't contractual. There are licenses whereby producers can have a large amount of freedom to go forward. From an upstream perspective, there are certain deadlines in these licenses. As in Alaska, if oil or gas isn't discovered in 10 years, the lease expires. Similar provisions are in the British and North Sea licenses. However, Norway won't put a firm deadline on building the gas line from Ormen Lange to Great Britain. So there are restrictions on the upstream side, but not on the total project.

[11:59:05 AM](#)

BOB LOEFFLER, Morrison & Foerster LLP, Counsel to the Governor, recalled a fair amount of commentary that the state should have applied a prudent operator standard. Reporting that he'd looked at that standard, Mr. Loeffler read from Williams and Meyers, calling it perhaps the leading treatise on oil and gas, and saying what he would read, from the U.S. Supreme Court, is similar to what was adopted. He related it as follows:

No breach of the prudent operator standard can occur save where the absence of such diligence ... is both certain and substantial - clear and convincing - in view of the actual circumstances at the time, as distinguished from mere expectations on the part of the lessor and conjecture on the part of mining enthusiasts.

He explained that the prudent operator standard typically is applied to leases, and this is midstream. Mr. Loeffler said, "We were aware of this when we constructed the diligence language that Jim [Clark] has read." He added that the tests are remarkably similar, but the prudent operator standard looks a lot at what a hypothetical person would have done, whereas this looks at what actually happened and also what didn't happen. Noting that elsewhere the treatise says one looks at a wide variety of factors, Mr. Loeffler remarked, "We think we've

got language which is tantamount to the prudent operator standard."

He offered to provide the quotations he'd referenced. "It works very, very well," Mr. Loeffler added. He recalled under then-President Carter, in about 1977, a deadline for TAPS was included: winter season 1982, in operation. From 1980 to 1982, a collaborative design-and-engineering board involving perhaps eight or nine pipelines, the three largest producers and the State of Alaska met monthly to review progress; however, the deadline proved meaningless. Noting this current project is complex, passing through two countries and requiring much coordination, Mr. Loeffler concluded, "You just can't fix it into, we believe, any better mode than what we have in the work commitments clause of the contract."

MR. CLARK suggested it would be useful for Dr. van Meurs and Mr. Loeffler to talk about arbitration in this context, to address the point raised by Senator Dyson.

SENATOR DYSON replied it wasn't necessary.

12:03:29 PM

SENATOR BEN STEVENS referred to comments by Senators Wilken and Dyson with respect to what the public needs to know, as well as the timing requirements in place. He emphasized that the certificate of public convenience - the authority to build and finance the pipeline, as well as authorization for expenditures by the sponsors - is issued by FERC. Thus decisions by the legislature aren't the final determination of whether the project will go forward.

He recalled that Congress, in October 2004, set out a timeline under which the State of Alaska or any sponsor had 18 months to submit an application to FERC; it expired April 10, 2006. Senator Ben Stevens said FERC and Congress also recognized that any prospective sponsor of a project needed to be in agreement with the state for the rights to the gas and the upstream field contracts. He indicated this project is behind schedule from the congressional Act in terms of submitting an application.

He said Congress has timelines under which FERC, the environmental conservation agency, the U.S. Department of the Interior and the Bureau of Land Management all must "do diligence" and have their determination within 48 months after submission of an application. Senator Ben Stevens also recalled a vote by this committee in the prior special session on an

amendment crafted by members that said if there isn't a pipeline, none of the provisions on fiscal certainty in the contract will be in place. However, the legislature is now back to ground zero, trying to explain to the public about a 35-year and 45-year time period.

He fully agreed with a prediction by his father, U.S. Senator Ted Stevens: If there is failure to act this year, legislators will be at this table in June 2008 hashing over the same issues. As for the costs of delay, Senator Ben Stevens noted the House analyzed what tax rate must be imposed for each year that there isn't a project in order to get the same net-present-value return; he said Representative Samuels had shown that to him, and it is about a 1 percent a year increase. Thus the consequences of failure to act are enormous, not only affecting benefits to the state, but also affecting the people in terms of jobs, opportunities for education and so forth.

[12:08:25 PM](#)

CHAIR SEEKINS interpreted the concerns of Senators Wilken, Dyson and Ben Stevens, as well as some constituents, to be this: If the contract is signed, what is being agreed to? He told Mr. Clark that many people don't understand that this is a fiscal-terms contract, not a construction contract or gas pipeline contract. People also don't want to be flimflammed.

He emphasized the desire to build the pipeline, and highlighted the search for another remedy beyond cancellation if there is lack of diligence. Chair Seekins also noted that people aren't familiar with the burden of proof, clear and convincing, and only understand it isn't the highest burden of proof and thus may see it as the lowest; however, it's a middle level. He emphasized the need for a prod to ensure that the companies are moving forward with due diligence; he noted some people think that can be accomplished through a reserves tax as a threat, since the only other remedy appears to be termination of the contract, which nobody wants.

He thanked Mr. Loeffler for his explanation of the prudent operator standard. Chair Seekins said he has run into the same thing Senator Wilken has: people who say they understand certainty if it's mutual. Chair Seekins agreed with Senator Wilken that most people want a gas pipeline built, but not at all costs; they want it to be fairly done and to represent, under the Stranded Gas Act, the maximum interests of the people of Alaska. Chair Seekins emphasized that this is a fiscal-terms

contract, even though everyone wishes it were a contract to actually build a pipeline.

The committee took an at-ease from [12:13:55 PM](#) to [1:51:39 PM](#).

MR. CLARK returned to Senator Wilken's question of what Alaska gets in return, informing listeners that it had been discussed over the noon hour, with Mr. Loeffler taking notes.

[1:52:19 PM](#)

MR. LOEFFLER alluded to previous negotiations for the proposed contract, explaining that the state got the companies to consent to an oil-tax increase that should produce about \$1 billion a year, as part of the package decided by the chief executive officers (CEOs) and the governor. He acknowledged it is controversial.

He noted the list on pages 112-113 of the contract talks about a number of considerations for the deal, including the following: the right to own 20 percent of the project; the work commitments clause; clarity on the agreements on all the monetary payments in lieu of taxes (PILTs), Articles 11-19 and 22, many of which are adjusted for inflation under the individual terms of those articles; the capacity management provisions in Article 10, which are unprecedented and reduce the state's risk in getting its gas to market; the right to have production taxes paid in gas as opposed to cash, which increases the amount of gas Alaska has for its use; and a number of individual items on in-state needs, including timely studies of in-state needs, natural gas liquids (NGL) processing in Alaska, clarity on in-state mileage-sensitive service and a labor clause. Mr. Loeffler suggested Dr. van Meurs or Mr. Clark might want to add to this list.

MR. CLARK added the agreement to move the project forward to the sanctioning point, at the expenditure of (indisc.) dollars. He also mentioned the \$125 million in impact payments for municipalities.

[1:55:24 PM](#)

SENATOR BUNDE suggested two of the aforementioned should be taken off the list, since to his belief they are not state's rights, but "gimmies" for the companies, insisted on for the deal and not in the state's best interest. Those two are Alaska's taking its gas in kind and investing in the pipeline.

CHAIR SEEKINS asked how those two benefit the state.

MR. CLARK answered that the federal Minerals Management Service (MMS) had related its experience: making more money by taking its gas in kind than in value, and lowering of the transaction costs because there no longer were disputes about previous valuations and look-backs on valuations - which Mr. Clark said the state has had many times over the years. He reported that both of those were seen as valuable to the State of Alaska.

DR. VAN MEURS added that in the economic valuation, the whole deal was analyzed to protect state revenues. His field analysis assumed the state's marketing costs could be as much as 5.5 cents per million Btu. Whereas he'd viewed that as a negative, MMS is experiencing it as a positive. Thus he might be underevaluating the benefits to the state, on a cumulative basis, by as much as \$1 billion. Dr. van Meurs said he didn't have much experience in North American gas marketing, which some DNR experts have; however, he has done a lot of this work internationally. He related his experience that transaction costs on very large blocks of gas are quite low.

[1:58:29 PM](#)

CHAIR SEEKINS requested details about supplies for in-state use.

DR. VAN MEURS pointed out that Mr. Loeffler is far more familiar with the rates and decisions on that. He then explained that the contract provides for four offtake points where another party can tie in to the pipeline. These are predetermined in consultation with the state, and there doesn't have to be major reconstruction to add or tie in a line. This is important because any third party with a commercial contract that wants to get into the first open season has the ability to tie in.

He noted some people have asked why 1 Bcf of gas isn't shipped to Valdez for export as LNG. Dr. van Meurs said if North American gas prices continue to decline and Asian prices strengthen, perhaps LNG to Asia will be a good idea two years or four years from now. At that point, if a person has a commercial contract to sell LNG to Asia at 1 Bcf a day, for example, a spur line can be built to Valdez and the project can be put in place. Nothing in this contract prevents it. Thus the importance of these offtake points is an enormous option for any entrepreneur in Alaska to secure gas resources in Alaska for use in the state, for export or for any other use.

[2:00:54 PM](#)

CHAIR SEEKINS asked about the intention of the state to utilize its gas to satisfy in-state demand, rather than ship it to the Midwest market.

MR. CLARK reported that Governor Murkowski announced yesterday another effort to look into that more closely. Mr. Clark said the contract provides three things that matter: 1) taking gas in kind, 2) the offtake points and 3) the mileage-sensitive rates. Once the state has the gas, it is the state that decides how to use it. One barrier identified by the Alaska Natural Gas Development Authority (ANGDA) is that the first open season would come within two years under the summary of the Qualified Project Plan, as proposed now.

He explained that there is some concern that this is too soon. For some potential players, particularly those that might be distributors of gas in Anchorage, there is also concern about gas availability too late on the Kenai Peninsula. "We're worried about both," Mr. Clark told members, indicating the administration will try to help prepare anyone who wants to bid in the open season, and has committed to using state gas, once it is obtained, to satisfy in-state needs.

He said an inventory would be done to find out how much is needed, both in the Anchorage Bowl and on the Kenai Peninsula; the governor, in his announcement, had mentioned seeing whether there is some way to speed up getting gas to the latter in order to keep the plants there going. Mr. Clark concluded by saying several plans and ideas are afoot to ensure there is a good way to use in-state gas. That will show up in the fiscal interest finding, currently being put into final form.

[2:03:10 PM](#)

SENATOR WAGONER related his understanding that the current leases on the North Slope require the producers - whoever has the lease - to market the state's share of gas at no cost to the state and at the "higher of" price; these leases will be rolled in to the contract, and the current terms will be nullified, since the lease terms will become the terms under the contract. He asked: Was any concession given by the companies to make up for what the state is losing in this manner?

MR. CLARK requested that Dr. van Meurs, Mr. Loeffler or Roger Marks talk about the economics. He then offered his belief that the state never received it for free. Rather, the question was where the state paid. Because it was taken in value, Mr. Clark

said he believed it was paid on the back end, through the tariffs.

DR. VAN MEURS agreed that under the current leases there is a "higher of" option; companies market the gas for the state, and the state has a benefit. He said that option was evaluated, and a DNR study concluded it was worth about 2 percent of the value of the gas. In his own economic analysis, therefore, with respect to the status-quo option with which it was compared, he'd added 2 percent to the status quo. Thus it was taken completely into account in structuring the deal.

He emphasized that an entirely new package is being put in place of an older one, and he explained: "We are not trying to offset every little thing with another thing; that's not how you negotiate. You negotiate one package versus another package." In comparing the packages, Dr. van Meurs said, the 2 percent differential in value was taken into account in order to ensure that, under the stranded gas contract that was negotiated, a fair share of the revenues was received. However, it wasn't offset by any specific issue, because that isn't practical.

2:06:14 PM

ROGER MARKS, Economist, Department of Revenue (DOR), clarified that under the current system, there actually are upstream deductions for royalties on Prudhoe Bay and for tax on all fields. As Dr. van Meurs noted, however, the state incorporated the additional marketing costs and "higher of" provisions. Mr. Marks emphasized that the state came to the table wanting more than the status quo, while the producers expected to pay less. As it evolved, however, it settled on the status quo.

He suggested focusing on the total deal, not just items where something was given up. For example, the 7.25 percent severance tax is quite a bit higher than the status quo in terms of money. Mr. Marks explained that for Prudhoe Bay, the average severance tax over the next 35 years is about 5.9 percent, but 7.25 percent under the contract. All fields are put together, so the average severance tax is about 0.4 percent higher than the status quo. It is actually quite a bit of money: 0.4 percent of 20 percent of 4.5 Bcf a day for 35 years. When it is put together, Mr. Marks opined, it comes out fairly even at all prices compared with the status quo.

2:08:38 PM

MR. LOEFFLER offered another point: Downstream marketing costs under a netback system would be deducted and thus affect the

netback received by the state at the North Slope. Companies marketing gas downstream would deduct all their legitimate costs to produce that lower netback figure. Marketing costs downstream are paid by the state under the current system.

2:09:12 PM

CHAIR SEEKINS asked Mr. Marks what the status quo is and how it was arrived at.

MR. MARKS specified that the status-quo severance tax is a 10 percent nominal rate and an economic limit factor (ELF) quite a bit different from the oil ELF. The gas ELF is simply 3,000 Mcf per well per day tax-free. The effective severance tax rate varies on different fields. Over 35 years, the average rate is about 6.8 or 6.9 percent, whereas the state would get 7.25 percent under the contract. As for other fiscal terms in the contract compared with the status quo, royalties are pretty much unchanged; corporate income tax is unchanged; and property tax is changed quite a bit, from a tax based on value to one based on throughput.

CHAIR SEEKINS summarized that the current severance tax on natural gas is 10 percent, with an ELF that is really an in-field allowance of 3,000 Mcf per well per day tax-free. He suggested it is similar to a proposal for a field allowance under the PPT bill.

MR. MARKS replied that it is similar to the current oil ELF under which 300 barrels per well per day is tax-free, but there is also a field-size element that affects it. For gas, there is no field-size component. It is simply based on well productivity.

2:11:40 PM

SENATOR BUNDE voiced appreciation for the list given earlier, suggesting it would be wise to add, for consideration, what Dr. van Meurs had said about other potential players in the world. Senator Bunde opined that what the state gets out of the deal is someone who will participate. He said the public should be aware of all the potential "Prudhoe Bays" elsewhere in the world and that Alaska isn't in the driver's seat when it comes to negotiating for gas because of the supply and demand.

CHAIR SEEKINS pointed out that most legislators would see a tax increase as a state prerogative, whereas here there is an agreement by the CEOs for a tax increase.

[2:13:27 PM](#)

MR. LOEFFLER, in response to Senator Wagoner, explained that for oil, for the most part, the state takes it in value, not in kind. All costs between the point at which it is sold back to the wellhead are deducted, including the TAPS tariff, tankers and commissions on the sale of the oil wherever it is sold.

MR. CLARK highlighted the value of a seat at the table. He recalled serious debate in the Egan administration on whether to take an ownership interest in TAPS, which failed by two votes in the Senate but passed the House. He surmised Alaska would have profited by having a seat at the table then. "We will here," he predicted, saying it relates back to the point about work commitments, since the state will be a member of the ownership group, the limited liability company (LLC) that will oversee development of the project. It is another way to have far more information about what is going on in terms of diligent advancement of the project as is prudent under the circumstances, for example.

[2:15:54 PM](#)

CHAIR SEEKINS indicated that a recent e-mail relayed a concern that the permanent fund would be used to finance and build the gas pipeline. Having previously been on the Board of Trustees of the Alaska Permanent Fund Corporation (APFC), which has returned about 8 percent over time, Chair Seekins said he looked at ownership of the pipeline, with about a 14 percent guaranteed return, as a fairly stable investment that perhaps should be taken advantage of by APFC.

[2:17:17 PM](#)

WILLIAM A. CORBUS, Commissioner, Department of Revenue, noted he is a trustee for APFC. He suggested there are three ways for the state to come up with its equity portion of the pipeline. The first is through direct appropriations, for which the legislature put aside \$300 million last session; DOR recommends that the remainder come from direct appropriations in the future. Barring that, further options are to sell more obligation revenue bonds or to ask APFC whether it is interested in making an equity investment.

He informed the committee that the Board of Trustees has begun an education process to get familiar with this complex subject. Responding to concern that investing in the pipeline would endanger the permanent fund, for example, Commissioner Corbus gave assurance that if invited to invest in the gas pipeline, APFC would scrutinize it the same as all investments.

He opined that the 14 percent rate of return on equity, apparently the going rate for FERC, is an attractive return, one APFC would consider if it came to that. In response to Chair Seekins, Commissioner Corbus said two or three years ago APFC embarked on private-equity investments. Some have a rate of return of that order, but certainly it's at the higher end of returns for the corporation as an asset class. Private equity, in his assessment, is considered more risky than the pipeline.

SENATOR STEDMAN pointed out that an 80 percent government guarantee doesn't exist in private-equity markets. It is a handsome benefit if it can be secured.

CHAIR SEEKINS agreed, saying he'd like to own the whole thing if he had the money.

[2:22:29 PM](#)

MR. LOEFFLER urged care, however, because those who want a lower tariff will argue that the presence of the federal guarantee reduces the risk of the project and thus the rate of return on equity should be lower than normal.

COMMISSIONER CORBUS reminded members that the federal loan guarantee just provides assurance to the people who lend the money that they will be repaid. The state, along with the producers, would be borrowing the money, and would still be on the hook in the event of a default.

SENATOR BEN STEVENS remarked that the challenge to get the project built isn't the financing package, but getting financial commitments to ship the gas. He referred to Senator Wagoner's comments and said the policy call is whether to take the royalty gas and tax gas in kind, and whether to make the commitment to ship that gas in the capacity. He suggested going through this element by element: the upstream, the gas treatment plant (GTP), and the midstream. He said most important to the state is the upstream, and the policy call proposed in the agreement is this: whether taking the gas in kind is the proper thing to do and will result in a deal and a good return for the state, compared with the alternative.

[2:25:35 PM](#)

CHAIR SEEKINS inquired about the qualification process in order to get the loan guarantee.

COMMISSIONER CORBUS explained that the U.S. Department of Energy (DOE), which is responsible for this process, hasn't issued regulations or provided much information on the exact process. He pointed out that the project must be built beforehand, so there is an issue of interim financing. That is where the completion-risk issue comes in.

CHAIR SEEKINS surmised the loan guarantees are for long-term financing of the pipeline, not for construction or interim financing.

COMMISSIONER CORBUS affirmed that and deferred to Mr. Loeffler.

MR. LOEFFLER agreed there is little guidance on what DOE will want for the loan guarantees. He noted his law firm represents a number of federal agencies in loans for overseas energy projects and thus has some experience. He said they'll want to be satisfied on their own, like a bank, that it is a viable project. Thus it wouldn't surprise him if they hired their own investment bankers, financial consultants and construction engineers to look at making a creditworthy loan. He pointed out that a big question is whether they'll want their own fee on top of the terms of the loan.

[2:28:58 PM](#)

MR. CLARK emphasized the critical nature of the completion guarantee, touched on by Commissioner Corbus. Mr. Clark said it is probably the single most important piece. For construction financing, this guarantee is given on the strength of one's balance sheet. Once there is construction and first gas, revenue will flow to pay going forward. The risk lies between sanction and first gas, during construction. The completion guarantee is probably the biggest risk for someone in order to reach the \$18 billion.

He noted this issue has come up with the Alaska Gasline Port Authority ("Port Authority") project, for example, where they say they'll build it on the basis of the federal loan guarantees. Mr. Clark said that cannot be reached unless something is constructed, but construction cannot be completed without the completion guarantees. He deferred to Mr. Loeffler and Commissioner Corbus, saying this is highly important to understand with respect to the financing.

[2:30:31 PM](#)

MR. LOEFFLER suggested perhaps the companies also could speak to this. Equating interim financing to construction financing, he

explained that it is secured by demonstrating the following: that there are customers, which means having shipping commitments, although those are conditional; that there is a viable project, with enough reserves behind the project; that there is a realistic construction plan and cost estimate; that all necessary permits have been secured; and that the project will be built on a particular schedule.

He said to get that construction financing, one needs the basic permits in hand: for the Alaska portion, a certificate of public convenience and necessity in order to understand the terms attached to it and the costs; the right-of-way leases, along with their terms and conditions; perhaps clean-air permits; and numerous others. Mr. Loeffler added that lenders will look at the cost of complying with those permits and whether they are feasible or realistic.

He reported that companies typically have their own construction people. If there will be outside financing for the construction loan, however, the outside financing people hire their own experienced construction supervisors to ensure it is a realistic plan and can be built within the timetable and conditions. Mr. Loeffler also reported they'll hire their own reserve engineers to double-check the reserves behind the project.

He gave his understanding that once the certificate of public convenience comes from FERC - assuming the conditions are acceptable and don't have to be clarified or changed - there will be a rush period of six months or a year during which the sponsors of the project, if borrowing outside money, work with the banks. There will be a financing plan, Mr. Loeffler noted, but the deal cannot be closed until the certificate is obtained and people are satisfied that there is a viable project, under viable regulatory permits.

2:33:32 PM

COMMISSIONER CORBUS highlighted a virtue of the state's future partners on this project: their strong balance sheets. In response to Chair Seekins, he explained that interim financing will be based on the strength of the project. As backup, however, it doesn't hurt to have three of the world's great corporations involved, which the banks are certainly aware of.

SENATOR DYSON raised a concern that the state will likely deal with subsidiaries of major companies, and the parent companies won't be on the hook for the obligations.

COMMISSIONER CORBUS responded that if he were a banker lending money, he'd point out to the borrowers that they need to get repaid if something goes wrong. He said there is a difference between a "parent guarantee" for purposes of this contract and the purposes of a construction loan.

SENATOR DYSON asked: Has the state done as good a job as the banks with regard to looking after its own interests?

MR. LOEFFLER said he believed the answer was yes. Recalling discussion before the committee about the need for a coordinating agreement to pull all the pieces together, and discussion of ensuring there is a party of ample economic strength backing up the obligations, Mr. Loeffler said the subsidiaries of the company signing the contract, as it stands today, have huge assets. The real test is whether the assets are good enough to back up the obligation; this is what the banks will ask too. He suggested asking the companies, but offered his understanding that in many of their huge financings, an intermediate-layer subsidiary provides the guarantee, instead of the parent company.

[2:38:05 PM](#)

COMMISSIONER CORBUS brought up the question of how deep the state's pockets are in the event of a cost overrun. He told members, "We have wrestled with that, and want to be sure that we do not adversely impact the state's general credit rating to carry on our normal functions while the pipeline is being constructed." Thus Commissioner Corbus said the following is envisioned: For interim financing commitments, there must be a standby line of credit or some other instrument to protect the state against a cost overrun; that would be done before the project starts, rather than when the money is needed.

[2:39:22 PM](#)

CHAIR SEEKINS mentioned a recent letter to the governor from TransCanada. He asked whether TransCanada has the balance sheet necessary to get financing for a project like this.

MR. CLARK recalled, from the last letter, that TransCanada believed it necessary to have the Alaska North Slope (ANS) producers to proceed. Mr. Clark said it is partly because of the need to underpin this with the FT commitments that will lead to the financing of this agreement, a position taken in conversations with them. TransCanada is a very good \$7 billion company that could perhaps play an important role. However, in terms of financially underpinning the project - for example,

getting the completion guarantees necessary to build the line - Mr. Clark opined it would take more than that. Furthermore, the assessment was that it would have taken more for the state if TransCanada had been involved instead of the producers.

He made a final point: Because of the cost of using those federal loan guarantees, it isn't a foregone conclusion that the state will use them to support long-term financing. Mr. Clark acknowledged there might be other ways that will cost the project less, reducing the tariff and thereby increasing the value of the state's gas.

[2:41:44 PM](#)

SENATOR DYSON asked: Will the federal loan guarantees after completion of the project apply to cost overruns and other obligations?

MR. LOEFFLER related his expectation that if they are used for permanent financing, that would cover the cost of the pipeline as built, which means including cost overruns.

SENATOR DYSON asked: Would it be an incentive to the companies to contain cost overruns if the federal loan guarantees didn't apply? He highlighted concern about project "creep" and higher tariffs as a result of a significantly larger construction bill.

MR. LOEFFLER said he needed to think it through, but pointed out that if the federal loan guarantee money is the cheaper money and only covers part of the project cost, the part not covered would be higher-cost debt. The higher overall cost of capital would increase the tariff. Thus it might not work out right. Mr. Loeffler again said he needed to think about it further.

COMMISSIONER CORBUS reiterated that DOE hasn't articulated its policy on the federal loan guarantees. He relayed one concept considered by the state: Finance the debt portion without the loan guarantees, but keep a portion of the unused federal loan guarantee in reserve in case of cost overruns.

SENATOR BEN STEVENS recalled from previous presentations that the \$18 billion resulted from an 80 percent loan-back guarantee of what was then termed a \$22.5 billion project, halfway between \$20 billion and \$25 billion. He also recalled talk that, depending on the outlook, Congress may consider increasing this number as a result of the costs of steel and labor, as well as a prolonged delay affecting construction costs.

[2:45:52 PM](#)

SENATOR WAGONER asked when the new study by Lukens Energy Group would be available.

COMMISSIONER CORBUS gave his understanding that it would be within a week or so, from discussions with Ken Griffin of DNR.

MR. CLARK indicated it would be provided to the committee.

[2:46:27 PM](#)

CHAIR SEEKINS reminded members of Senator Wilken's chart on the timeframe, labeled "Oil Tax Certainty, Amendment 4, SB 2004," dated 6/4/06, as well as the amendment adopted to SB 2004 that came from Senator Ben Stevens. Chair Seekins asked whether the testifiers had had a chance to look at those.

MR. CLARK recalled that amendment had passed the Senate as well.

CHAIR SEEKINS concurred.

CHAIR SEEKINS reminded listeners that the concept was having no certainty on the oil tax until the point of project sanction; a period of 5 years, plus or minus, to procure and build; a period of 9 years for capital cost recovery; and then some remaining time at the end of that, if capital cost recovery hadn't been reached, during which if the legislature raised the taxes, the commissioner would be authorized to enter into a balancing agreement for the remainder of time necessary to do that. He requested comment from Mr. Clark and Dr. van Meurs.

[2:48:29 PM](#)

MR. CLARK affirmed it had been looked at, with the producers as well. He recognized the point made by the public and legislators, driven home by what passed the Senate: Something must be done differently with respect to fiscal certainty on oil. Mr. Clark indicated the administration is looking to see whether this is the best way to get at the issue Dr. van Meurs discussed, that the risk of something going wrong with high costs/low prices is a bigger risk to the companies and the state than the upside potential.

He recalled Dr. van Meurs' discussion of the need to maintain the opportunity not only to recover costs, but also to gain the upside as a justification for taking on that asymmetrical risk. Mr. Clark deferred to Dr. van Meurs, suggesting the desire is to see whether there is something the administration can bring to

the committee and to Alaskans to fine-tune this and provide the necessary risk coverage to maintain the existing agreement.

2:50:27 PM

DR. VAN MEURS noted he wasn't involved in preparing the aforementioned amendment, but had participated in some preliminary discussions. He said countries satisfy fiscal stability and fiscal certainty objectives in different ways. During feedback, public hearings and previous discussions with the legislature about introducing a completely new PPT, concern was expressed that there should be an experimentation period, with changes in regulations, auditing procedures or other areas before the PPT can be stabilized. Saying it's a reasonable concern, Dr. van Meurs advised members that a period of tinkering is typical when a whole new system is introduced. He suggested it might be beneficial here.

He highlighted the concept, at the end of the period proposed here, of a fiscal stabilization clause. Dr. van Meurs explained that some governments consider the "pay on behalf" and "fiscal exemption" systems, in the contract now, a little inflexible. Their agreements have a simple stabilization clause that says if there is any material change in fiscal terms, they'll renegotiate the contract to establish the fiscal balance; this in turn is subject to arbitration. This approach allows modifying the tax without destroying the core objective: guaranteeing that companies can count on extra profits to offset possible losses. Common internationally, these clauses are accepted by oil companies around the world, Dr. van Meurs said.

He observed there are some problems with every way of dealing with fiscal certainty. For the fiscal-stabilization clause, the most important problem is defining a material change; this requires either relying on arbitration procedures or putting criteria in. Dr. van Meurs noted another possible problem: Substantial changes for oil might result in a commitment to negotiate a substantial change to the gas contract, with possible undesirable side effects.

He suggested there are ways to make fiscal certainty more flexible - as he understands this proposal is - as long as the state sticks with the basic concept: the central need for investors to have certainty that if there is a really good upside, taken into account when they made the analysis, it will balance against the downside, and that the companies want to count on fiscal stability for oil. Dr. van Meurs said the procedures in the contract are widely used internationally and

have certain advantages; for instance, the exemption system is easy to handle and administer, and is less disputable.

He opined that an initial period of "no stability" could be a very good idea as well. Dr. van Meurs noted it would allow the state to make some improvements to the PPT law if administrative details weren't working, thus perhaps addressing Alaskans' concerns. He concluded by lauding the Senate for coming up with ideas that are creative but still very much in line with international practices.

2:59:30 PM

CHAIR SEEKINS mentioned concern about the length of time for freezing a tax rate, as well as whether the legislature has that ability constitutionally. He noted that Senator French had provided a white paper on this.

He highlighted features of Senator Ben Stevens' proposal: In that 4-year period, the question is answered, likely through the courts; there is an opportunity for the legislature to adjust the tax scheme; and at that point there is some incentive to get to project sanction, because the tax rate can be changed if that point isn't reached within a reasonable time or if there isn't some diligence in proceeding. Saying this was presented to help solve some of legislators' concerns, Chair Seekins asked whether the AG would be available to give his opinion on this subject.

MR. CLARK affirmed that.

CHAIR SEEKINS asked: If the contract is passed as is, but the supreme court says no, is everyone willing to take that risk with that unanswered question in negotiating the contract?

3:03:30 PM

MR. CLARK suggested two issues are involved, discussed this morning: Under Article IX, Section 4, of the constitution, is there power to contract away the taxation powers of the state for any period of time? If so, is 30 years for oil and 45 years for gas too much? Mr. Clark opined that the supreme court would uphold it.

He discussed the expected timeline. Mr. Clark explained that within 60 days of ratification by the legislature, the governor would sign the agreement, assuming it was the contract already worked out. The planning process would start 90 days later. Around that time, 120 days after signing of the contract, anyone with a constitutional complaint must file it.

He said the administration hopes to persuade the legislature to have such a case go directly to the supreme court; now it must go through the normal process. Mr. Clark noted that under the contract, planning would go forward for 15 months, contemplated in the Gantt chart discussed earlier, up to an expenditure of \$120 million; at that point, if there were no decision from the supreme court, it would stop unless the state wanted to put in money to keep the process going.

He added that what is contemplated is getting the process moving and then having the supreme court decide within that time period whether this is constitutional or not. If the latter, the court would explain why not. Mr. Clark pointed out that the state and the producers would figure out what needs to be changed to win the next round, and whether they are willing to do so. If so, another contract would come back to the legislature. If not, something else must be done.

[3:07:18 PM](#)

SENATOR BUNDE reported that an ExxonMobil representative recently told him any PPT beyond the "20/20" - 20 percent tax and 20 percent credit - would kill the deal. Senator Bunde asked whether the administration is ready to address that eventuality.

MR. CLARK affirmed that. He noted over the last year many things were laid on the table as immovable, which is why completing the contract took until May 10. Calling the deal remarkable for all the obstacles overcome to get to an agreement, Mr. Clark said he would view the issue raised by Senator Bunde as another obstacle to overcome. The focus of this administration and its gas team has been to get a gas line because of its overwhelming importance to the state, and to negotiate towards that position in a way that the legislature hopefully can support after necessary changes are made.

[3:09:28 PM](#)

SENATOR ELTON surmised it is out of the question to have a severability clause in the contract dependent on whether the supreme court decides it is unconstitutional to provide the fiscal certainty sought by the producers. He opined that the legislature hasn't been rapacious over the last 30 or 35 years when it comes to taxing natural resources.

MR. CLARK suggested looking at TAPS-related history, when a number of changes in tax law were made.

SENATOR ELTON recalled a separate-accounting tax system, backed off during that time, which the supreme court later found acceptable. He said the tax system which was moved to didn't bring in the revenues that separate accounting would have "if we had stuck to our guns."

MR. CLARK observed that the PPT would return to separate accounting, in a way, which is one advantage. He indicated that from 1967 through construction of TAPS, seven or eight changes were made to the tax laws, all increases. Offering to provide specific information, Mr. Clark reported that a point cited during negotiations was the number of times the State of Alaska changed the tax laws during TAPS construction; the concern was inability to accomplish the goal of the fiscal contract: pinning down this project's economics.

He agreed, if the supreme court determines either the fiscal certainty or anything else isn't constitutional, there would be no contract because there is no severability clause. If that happens, Mr. Clark indicated, the administration's current plan is to sit down with the producers and go through the court's rationale, to try to negotiate around it and get to a contract.

CHAIR SEEKINS asked whether the aforementioned position was taken uniformly by the major producers.

MR. CLARK answered that some were more adamant about fiscal certainty, while others were more concerned about issues such as capacity or expansion. For the most part, there were nuances among the parties, an additional challenge in negotiating.

[3:14:21 PM](#)

DR. VAN MEURS pointed out that there is an important tradeoff in investors' minds between fiscal stability and government take. He said the fiscal stability in Alaska's contract is why it was possible to get significant revenues equal to the status quo. This is in contrast to Canada, with its far higher government take under lower prices; he gave details about the Mackenzie Valley project.

He emphasized that if the supreme court orders renegotiation of the contract, it will be important to explain the following to the court: The more fiscal stability is reduced, the more government take is reduced in order to create the same risk/reward balance for investors. Dr. van Meurs cited Australia as an OECD country that has large LNG projects without

fiscal stability; under low gas prices, there is no royalty, severance tax or production tax - just corporate income tax. He asked whether Alaska would be willing to live with that.

MR. CLARK added his belief that the risk from an adverse supreme court decision is this: Time isn't on Alaska's side in terms of waiting and renegotiating and doing it later. Suggesting Mr. Marks speak to this, since he'd done the modeling, Mr. Clark explained that the administration had looked at the current TAPS system without a gas pipeline, and had deemed TAPS would stop by about 2030. With 10 years' lead-time to get a gas line in place, that allows only 10 years of wiggle room. The state will have a far less favorable negotiating position.

[3:21:54 PM](#)

DR. VAN MEURS, in response to Senator Dyson, explained that it isn't unusual around the world that if a government negotiates a contract with a petroleum company, parliament approves it or it goes back to the bargaining table; he cited examples including Egypt and Kuwait. Agreeing with Mr. Clark that time isn't on Alaska's side, and expressing deep concern, Dr. van Meurs cautioned that if this contract is delayed and it is reported internationally, companies eager to market gas to the U.S. will see a new opportunity and capitalize on it. It will become difficult to get into that market slot again; gas prices and technology, especially LNG transportation technology, might go against it. This contract could fade away as easily as the gas contract in the 1970s. Acknowledging it is unfortunate that time is so short, Dr. van Meurs suggested making the best of it.

MR. CLARK concurred with Senator Ben Stevens' assessment that if it isn't done soon, there will be a two-year delay. Regardless, there will be the supreme court issue.

The committee took an at-ease from [3:26:23 PM](#) to [3:45:08 PM](#).

CHAIR SEEKINS invited representatives from BP, ConocoPhillips and ExxonMobil to testify on fiscal certainty.

[3:45:49 PM](#)

DAVID VAN TUYL, Commercial Manager, Alaska Gas Group, BP, informed members that topics discussed this morning also arose during negotiations and were worked through with the administration. He assured the committee that others have had sleepless nights wondering whether the deal struck is suboptimal, but from a company perspective. He recalled hearing questions from BP's internal groups similar to those heard

today. During the hard negotiations, many contract provisions were resolved in a way BP didn't necessarily prefer. As a whole, however, BP believes the contract is fair and provides the fiscal stability necessary to attract the massive investment required to allow the project to advance.

He noted the essence of the Strand Gas Act is to allow a contract to be developed to provide the fiscal stability necessary to enable a gas pipeline. For this project, really a series of mega-projects, Mr. Van Tuyl said the biggest cost to investors isn't the capital cost, but is the government take. This risk can be mitigated through a contract. Simply, investors want to know the rules so the necessary investments can be made. One reason for fiscal certainty is linked to the size of the investment and associated risk. That is why BP requires fiscal certainty in this project.

He emphasized that including both oil and gas is critically important to BP; as Dr. van Meurs had discussed, this is the international norm for attracting investment for major projects, since oil and gas are inextricably linked, physically and commercially. Mr. Van Tuyl explained that to underpin the project, the shippers - the producers - will commit to long-term FT agreements. Thus they will commit to maintaining those same oil and gas facilities for the term of the FT agreements and decades longer, which is a significant challenge and undertaking and is an implied work commitment for oil.

He reported that at BP they talk about the 50-year future underpinned by this gas pipeline. Mr. Van Tuyl explained that because of upfront commitments, BP believes it is essential to protect investors from after-the-fact tax increases, which have happened in Alaska during the last 30 years.

[3:51:47 PM](#)

MR. VAN TUYL recalled a series of reports generated by the Anchorage Chamber of Commerce this year that highlight the importance of fiscal stability. He read the following excerpt:

As to why the State should even consider entering into tax contracts under the Stranded Gas Act, the reason is to substantially reduce or eliminate one of the major risks that would-be investors perceive in going forward with a Gas Pipeline.

And what, exactly, is this risk that would be reduced or eliminated? The risk is that - once the investors

have irrevocably committed to build a Gas Pipeline, and especially once it is built – the State would "change the rules" by raising its taxes on the Pipeline and materially lowering the financial performance of the investment below the investors' expectations for it. By then, of course, it would be too late for the investors to change their mind.

How important do potential investors see this risk to be? It's very important, at least for some parties. Once built, a project that costs as much as \$20 billion or more becomes far more tempting to tax than, say, enacting a state sales tax or personal income tax or using any portion of the earnings of the Permanent Fund to pay for the costs of state government.

If investors don't have assurance that taxes on them and their project won't be raised once the Gas Pipeline is underway, they will make some assumption about the likelihood that this would happen, and they will factor that assumption into their economic calculations about whether to invest in the Gas Pipeline or not.

Of all the things that are in the State's power to change or influence, the elimination both of the actual taxation risk and of investors' perception that this risk exists is among the most powerful things the State can do to help move the construction of the Gas Pipeline forward.

The taxation risk appears particularly great in light of Alaska's own historical track record with the \$8+ billion trans-Alaska oil pipeline and the development of the Prudhoe Bay field on the North Slope. After the pipe for TAPS had been ordered and started arriving in Alaska, the State changed the tax laws applicable to Prudhoe Bay and TAPS 14 times in the next decade, and the great majority of those changes were tax increases for Prudhoe Bay or TAPS, or both.

[3:54:08 PM](#)

MR. VAN TUYL listed taxation legislation enacted in Alaska, reminding members that the Prudhoe Bay discovery occurred in late 1967: In April 1968, the oil production tax was tripled. Two years later, the gas production tax was raised from

1 percent to 4 percent, with a stair-step system for rates on oil related to the production rate. Two years after that, the stair-step rate was changed and a credit against the cents-per-barrel rate was applied against royalty. A year later, in 1973, after the pipe had arrived in Alaska, that credit was repealed and the stair-step rates were increased; the 20-mill ad valorem severance tax now in place was enacted; and a conservation tax was enacted.

He continued, noting in 1975 a temporary new two-year ad valorem tax was enacted. In 1976, the limit on a municipality's ad valorem tax (AVT) was raised from \$1,000 per capita to \$1,500 per capita, and the concept of prevailing value was instituted. In May 1977, still before first oil from Prudhoe Bay, the ELF factor for production taxes was passed. After first oil, in July 1978, the separate-accounting income tax, referenced by Senator Elton at this meeting, was originally passed. In 1980, the personal income tax was repealed. In 1987, separate accounting was repealed and replaced with a modified apportionment system, and an ELF "rounding rule" effectively increased the ELF rate. Perhaps a month later, legislation raised the oil conservation tax and imposed a gas conservation tax. In 1989, legislation amended the ELF formula, and other legislation created the 5-cents-a-barrel tax surcharge on oil.

[3:57:17 PM](#)

MR. VAN TUYL concluded the taxation history, noting 1994 legislation increased the amount of the spill-response fund to greater than \$50 million, and legislation last year again modified the production tax system, with ELF aggregation. Of the aforementioned changes, particularly important were the ones near the time of the investments associated with TAPS and Prudhoe Bay. That is why BP seeks fiscal stability to underpin the investment of this project.

He explained that the fiscal-stability model is used internationally, as mentioned by Dr. van Meurs, to enable projects that investors otherwise wouldn't find sufficiently attractive. Mr. Van Tuyl reported that a prime example for BP is the recently completed Baku-Tbilisi-Ceyhan (BTC) mega-project, which many predicted wouldn't happen because of complexities and yet was made possible by a fiscal-terms contract similar to what is discussed here; it has a term of 40 years from first oil, with two optional 10-year extensions, and thus in effect is up to a 66-year term, since it was entered into 6 years before first oil.

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MR. VAN TUYL highlighted Dr. van Meurs' testimony today on a typical work commitment in a production-sharing contract (PSC), where there might be specific wells drilled by a certain date and so forth, versus a midstream mega-project, which typically doesn't have a work commitment. Noting the BTC fiscal agreement is publicly available on the Internet, which is a bit unusual, Mr. Van Tuyl read an excerpt, which specifies that no participant is in any manner obligated to any of the state authorities to undertake any project activities; to carry out the project; or to continue any project activities that may have begun in reliance on that or any other project agreement, or otherwise.

He pointed out that the language is almost the opposite of a work commitment. Mr. Van Tuyl said it clarifies that what the contract provides for is long-term fiscal stability, relying on that stability to attract the investment - not compelling the investment with a specific work commitment. He emphasized the end result: The BTC project was built and is now shipping oil.

He recalled recent meetings on the North Slope at which the current contract and project were discussed with employees. Two people from Baku attended who'd worked on that project, and were intrigued with the similar Alaska project. Mr. Van Tuyl reported they'd talked about jobs and new opportunities created in Baku. A South Caucasus pipeline in the same area has been built under a similar fiscal-terms contract, with a 60-year term instead of a 40-year term with two extensions.

He closed by saying BP wants the same result for the Alaska project. The company develops projects around the world, entering into agreements that enable those projects to be developed. Mr. Van Tuyl emphasized BP's view: The fiscal stability provided in the contract is essential to allowing the project to go ahead.

[4:02:58 PM](#)

SENATOR ELTON referred to Mr. Van Tuyl's testimony with respect to taxes and asked: Given BP's history with the state, has it been mutually beneficial?

MR. VAN TUYL offered his belief that it has been mutually beneficial. He reiterated earlier points, including BP's 50-year future in Alaska; that the key is the gas pipeline project; that what enables the project is this fiscal contract, which provides fiscal stability; and that anywhere in the world there

is investment of this kind, there is a need to manage risks where possible, including fiscal risks, which can be managed through a contract.

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WENDY KING, Director of External Strategies, ANS Gas Development Team, ConocoPhillips Alaska, Inc., characterized fiscal stability as a core pillar to the contract. She explained that in 2001-2002, when the three companies looked at updating the engineering and costs, trying to assess risk versus rewards, they concluded more work was needed to try to mitigate risks. Some of this happened through so-called government frameworks: the federal Alaska Natural Gas Pipeline Act (ANGPA), supported by all three companies, and reauthorization of the Stranded Gas Act, also in 2003, which ConocoPhillips supported as a tool to allow developing government frameworks needed to go forward with this project with the state.

She said a key purpose of the Stranded Gas Act was to allow the fiscal terms, applicable to a qualified sponsor or members of a sponsor group, to be tailored to the particular economic conditions, and to establish those fiscal terms in advance, with as much certainty as the state constitution allows. Ms. King informed members that ConocoPhillips therefore envisioned all along that there'd be a question of constitutionality.

She recalled discussion in 2003, and specifically when negotiating Article 27 of the contract. Ms. King explained that this critical article addresses judicial challenge; it says the project sponsors should continue diligent advancement through either completion of project planning, 15 months, or, to her belief, \$120 million, even though the constitutional question won't have been addressed yet. Ms. King said there is a recognition that the final answer will need to come with the constitutional test.

She referred to Mr. Van Tuyl's testimony. Ms. King specified what is sought with respect to fiscal stability: removing the risks associated with changes to Alaska Statute, regulations and interpretations as the project is being moved forward. She pointed out that although this removes one risk - fiscal risk with the State of Alaska - it doesn't remove others such as permitting or construction delays, labor shortages, procurement challenges, cost overruns and market-price volatility.

[4:09:13 PM](#)

MS. KING observed that a number of provisions out there help achieve fiscal stability. For example, there is a fiscal-stability term right now with the State of Alaska with respect to leases signed for Prudhoe Bay; that contract has existed since the 1960s. She related personal experience, including involvement with life-of-project contracts that give stability with respect to the contract as long as a project is producing, as well as involvement with the exploration-production PSCs discussed by Dr. van Meurs. Most of those are confidential, Ms. King pointed out, although Dr. van Meurs had distributed publicly available model contracts and Mr. Van Tuyl had mentioned one contract in the public arena.

She turned to issues raised by Senators Dyson and Wilken. Ms. King surmised, because of confidential negotiations, that it is hard for the public to understand that the companies have been diligently advancing the project. She predicted diligent advancement will be easy to determine, however, since the project is so big. The companies will be spending millions, soon to be hundreds of millions, advancing it. Drawing attention to the project summary - a separate document on the website that clearly describes what the schedule is believed to be right now - Ms. King said it will need to change, but is publicly available and will be updated annually so people can see whether the project is advancing diligently.

She told members that there are real penalties - primarily termination of the contract and thus fiscal stability - if the state doesn't believe the project is being advanced diligently. Ms. King emphasized there also may be opportunities to cure. Addressing motivation to keep costs, she called this a key driver in alignment among the parties, since the majority of value in the project comes from delivering gas at the lowest cost possible.

[4:13:24 PM](#)

SENATOR ELTON clarified that penalties are incurred if an arbitrator - not the state - decides a company isn't acting diligently. Furthermore, an arbitrator cannot find in favor of the state if the company makes a compelling argument that there was an error in judgment.

MS. KING, in response to Chair Seekins as well, specified that it will be a tribunal with three members and that technically Senator Elton is correct: the state would file a notice of dispute to begin the termination process, and it would go to a tribunal as outlined in Article 5, work commitments. With

respect to dispute resolution, she recalled that Article 5 was important to the state because of wanting a rapid decision on contract termination. Thus the informal dispute-resolution process had been waived. With respect to the opportunity to cure within the contract, she noted this is at the time of filing a notice of dispute, but also exists if the tribunal rules that there hasn't been diligent advancement.

4:15:13 PM

S.A. (BILL) McMAHON JR., Commercial Manager, Alaska Gas Development, ExxonMobil Production Company, began by saying he would echo comments by the administration as well as Mr. Van Tuyl and Ms. King about fiscal stability. As for leaving the PPT open before sanction so it could change, Mr. McMahon highlighted that it would expose the producers to significant risk, since close to \$1 billion will be spent to get to project sanction. For example, the legislature could increase taxes to pressure the companies to hurry the project. He referred to previous testimony about increased risk of failure for projects that become schedule-driven, especially mega-projects, if there is pressure to go faster than prudent.

He estimated that an increase in PPT taxes by 50 percent in the last two years before sanction would increase the producers' tax burden such that a \$20 billion project would become a \$23 billion project. Looking at it another way, Mr. McMahon said it would consume half of the first year of production from the project. Leaving that open increases risk for the project.

He recalled that in discussing the PPT with the administration, the sponsor group sought a 12.5 percent tax rate, but agreed to 20 percent - doubling production taxes at today's prices - in return for stability with respect to oil, because that is how important the stability is. Mr. McMahon noted if the project is to the point of sanctioning but something has gone wrong and the economics aren't right, the production taxes will have been doubled but there still won't be a pipeline. Thus uncertainty about building the pipeline hits both sides.

He emphasized that fiscal stability is critical to ensure commercial viability for this project. Mr. McMahon reported that during contract negotiations it was agreed from the onset that significant steps needed to be taken to mitigate risk and improve commercial viability. On May 24, 2006, a final agreement was reached that he opined meets the state's needs and provides fiscal stability for the producers. Adverse changes to taxes on oil and gas, including a reserves tax, would clearly

undermine the fiscal stability necessary to advance the project, Mr. McMahon warned. He closed by saying the three producers are prepared to sign this fiscal contract and progress the project when it is approved by the legislature and signed by the governor.

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MR. McMAHON, in response to Senator Wilken, said the LLCs are being discussed between the sponsor group and the administration, and are being advanced at this point. He added that those agreements are highly important for the full understanding of this contract, and he wouldn't expect the fiscal contract to be signed without being able to see them.

SENATOR BEN STEVENS highlighted the number of decisions to be made. While the producers say they're ready to execute the contract, the legislature is still at the point of approving changes to the Stranded Gas Act. He said the public comment period closed two days ago on the contract, for example, but under statute the legislature cannot address that until the fiscal interest finding is presented by the commissioner of revenue. Suggesting the need for clarity on how to proceed, and indicating the contract probably won't be executed until a template is seen for the LLC or pipeline corporation, he pointed out that the contract cannot be fulfilled without such an entity in place.

CHAIR SEEKINS noted today's discussion relates to amendments to the Stranded Gas Act when talking about as much fiscal certainty as the state constitution allows, but some ancillary issues are inextricably linked. With respect to the calendar, he agreed with Senator Ben Stevens, saying he wasn't sure what was happening in response to the public comment period that closed on the 24th regarding any potential modifications to the contract that will be proposed to the legislature under the Stranded Gas Act. He suggested perhaps this wasn't as far along as everyone hoped.

SENATOR BUNDE said he also feels the pressure of time and frustration of spinning of wheels. Alluding to SB 3002 and SB 3001, he expressed hope that the chairman would focus the committee more tightly on amendments to the Stranded Gas Act and the other first step, the PPT.

CHAIR SEEKINS suggested the need to hear about related issues, however. For example, tomorrow the committee would hear from Anadarko with respect to the draft contract. Then the committee

would address proposed amendments to the Stranded Gas Act. He indicated he would ask Attorney General Márquez to testify about the language "with as much certainty as the Constitution of the State of Alaska allows" in SB 3002.

4:28:08 PM

SENATOR WILKEN asked what happens in the following scenario under the fiscal contract: As the project-sanction point approaches, one producer decides this doesn't meet the hurdle rate, for example, and thus that company doesn't want to proceed for legitimate business reasons.

4:29:42 PM

PATRICK COUGHLIN, Senior Counsel, BP, replied that the fiscal contract addresses that possibility. If one of the group doesn't wish to go forward, it can terminate, with consequences. The others can continue by picking up the obligations of that entity. The consequences to the withdrawing company depend upon timing. After the state has made a FT commitment in an open season, a producer cannot withdraw without severe consequences: relinquishing interests in all of Alaska. That producer would be forced to either sell, in a distress sale, or give everything up to the State of Alaska. All investment would be lost and would become the property of the state.

He noted if that happens, options allow the project to continue. If the other sponsors elect not to go forward, Mr. Coughlin explained, the sanctions again depend upon timing. After an open season in which the state has taken FT commitments, the consequences will be severe. Once the state has made those types of commitments, it would be putting itself at risk; thus the state negotiated this to ensure adequate protection.

SENATOR WILKEN recalled discussion of that at Centennial Hall. He asked which article in the contract addresses those options.

AN UNIDENTIFIED SPEAKER offered his recollection that it is Article 31, paragraph (5).

MR. COUGHLIN, in response to Senator Wilken, reported that one provision relating to judicial challenge provides that if any portion of the contract is declared unconstitutional, a participant may elect to terminate; it is a participant-by-participant decision. It is possible the supreme court will declare something unconstitutional that might not be so bad and the parties might decide to go forward anyway. So that option exists. If a party elects to withdraw at that point, however,

the party faces the consequences of losing the investment and also losing fiscal stability and becoming subject to whatever tax the state chooses to impose.

He explained that the other producers still would have the option of picking up the obligations and continuing with the project, or else finding someone else to substitute in. Mr. Coughlin noted if someone is substituted in, there are protections for the state. It couldn't be just any mom-and-pop organization and would have to be approved by the state. So the state would have comfort that the new entity would fulfill the obligations agreed to by the withdrawing company.

[4:35:07 PM](#)

DAVID W. MÁRQUEZ, Attorney General, Department of Law (DOL), provided a handout labeled "Excerpts of Attorney General's Presentation to the Legislature at Centennial Hall Regarding the May 10, 2006 Attorney General's Opinion on the Authority to Provide Fiscal Certainty Under Article IX, Sections 1 and 4 of the Alaska Constitution." Noting this would be the basis of today's slide presentation, he referred interested persons to DOL's website for the full presentation; the May 10 opinion; and opinions from legislative counsel and others, as well as DOL's responses.

He explained that many aspects of this contract will present unique issues to the Alaska Supreme Court. Pointing out that he couldn't predict how the court would address fiscal certainty or any other issue that might be raised, Attorney General Márquez offered his belief that the May 10 opinion thoroughly examined the issue. It was conducted over a couple of years, starting before he became AG. Prior to devoting resources to developing a contract, the administration had wanted some assurance on whether it was worth the time and effort.

He noted that, through the Stranded Gas Act, the legislature had directed the administration to develop a contract, recognizing a possible constitutional issue with respect to fiscal certainty and allowing people to bring suit in an expedited manner. Giving further history, Attorney General Márquez said a good case was made as to why the supreme court likely would find the fiscal contract constitutional; thus DOL felt confident enough to devote thousands of staff hours and, with the legislature's appropriations, millions of dollars, to develop it. Similarly, he surmised the producers spent much time and money with the expectation that the supreme court, more likely than not, would find it constitutional. Thus it was thoroughly researched.

He told members the administration and legislature would be shirking their duty if they didn't address the policy issues, deciding whether to enter into this contract with the expectation that DOL will do everything it can to defend its constitutionality. Attorney General Márquez said the legislature often passes laws in spite of constitutional concerns. He opined that the legislature has the right and the obligation to go forward with legislation it deems in the citizens' best interest. The Alaska Supreme Court will decide when a case is brought before it.

He turned to the slides, duplicated in the handout. Attorney General Márquez said the question is whether Sections 1 and 4 of Article IX of Alaska's constitution permit the state to enter into a long-term fiscal contract under the Stranded Gas Act. He noted that slide 3, with respect to whether states can enter into binding fiscal contracts that cannot be modified by subsequent legislative enactments, says the federal contract clause provides that no state shall pass any law impairing the obligation of contracts.

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ATTORNEY GENERAL MÁRQUEZ continued, reporting that in a series of cases, starting in the 1800s, the U.S. Supreme Court held that the contract clause applied to contracts in which state legislatures agreed to specific tax obligations. He read from slide 4, saying although the court found there are certain inherent and essential elements of sovereignty - "reserved powers" - that can never be contracted away, the court also held that the taxation power isn't one. Rather, it is "alienable" and can be bargained away for consideration because it is incidental to the exercise of governmental functions and exists to facilitate inherent and legitimate governmental functions.

He continued with slide 4, saying any such alienation must be allowable under the state's constitution and must be expressed in a clear and unequivocal manner; it must be unmistakable. Attorney General Márquez said passage of an Act authorizing the governor to execute the contract on behalf of the state would be such a clear and unequivocal expression of the alienation. Furthermore, a state can be held to a contract despite subsequent state legislation that alters the fiscal terms in a manner that substantially impairs the contract and isn't otherwise justified as reasonable and necessary to serve an important public purpose.

He turned to slide 5, saying Sections 1 and 4 of Article IX, read together, provide the authority to enter into a fiscal contract that would be enforceable under the federal contract clause. Noting Section 1 provides that the power of taxation shall never be surrendered, Attorney General Márquez opined that many critics of the fiscal contract stop there; however, the constitution goes on to say that this power shall not be suspended or contracted away except as provided in this article. Section 4 provides for specific exemptions from taxes, such as for properties owned by state and local governments and nonprofits, and also provides that other exemptions of like or different kind may be granted by general law.

He said the history of Sections 1 and 4, depicted in slide 6, shows that the Framers chose to give the legislature the flexibility to provide for tax exemptions by general law to develop industries in Alaska. They rejected stricter language, endorsed economic development incentives and were familiar with contemporaneous industrial incentive Acts. Turning to slide 7, Attorney General Márquez pointed out that the Framers specifically considered and rejected a model provision put forward by the National Municipal League that said the taxation power shall never be surrendered, suspended or contracted away.

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ATTORNEY GENERAL MÁRQUEZ reported that the Framers instead adopted Article IX, Section 1, which says the power of taxation shall never be surrendered, and shall not be suspended or contracted away except as provided in this article. They rejected the stronger wording and adopted more flexible language. He opined that the stricter wording arose from concerns of some states that it restricted the power to tax businesses through approval of long-term tax rates and corporate charters which were later upheld by the U.S. Supreme Court under the contracts clause in the cases he'd discussed in the opinion.

He continued with slide 7. Attorney General Márquez said consultants to the Framers noted that without the model provision - the stricter wording - Alaska could be bound by the types of fiscal contracts other states had authorized to be bound by. Nonetheless, the Framers rejected this stricter language in light of Alaska's unique circumstances as a resource-rich but sparsely populated state without local capital available to develop its resources.

He read from slide 8, posing the following question: What did the Framers mean when they stated that the power of taxation

shall not be suspended or contracted away, except as provided in this article? Attorney General Márquez told members the official commentary about Section 1 explained that the power to tax is never to be surrendered, but under terms that may be established by the legislature, it may be suspended or temporarily contracted away. This could include industrial incentives, for example.

He continued, noting the convention history demonstrates that the Framers were referencing the tax-exemption power provided in Section 4, which says other exemptions of like or different kind may be granted by general law. Attorney General Márquez went on to say that the official commentary to Section 4 explained that the legislature is authorized to make further tax exemptions to encourage, among other purposes, new industry.

He related historical information from slides 9 and 10. Attorney General Márquez said Delegate White had indicated the last paragraph of Section 4 provides that other exemptions may be provided by general law, and that this would allow, among other things, granting of tax incentives to new industries; Delegate Nerland had said this is the provision that allows for some exemption or inducement to industries or similar things; Delegate Smith had asked whether that isn't, in effect, saying exemptions of any kind may be granted; and Delegate Nerland had responded to Delegate Smith, "Yes, that was the purpose of it." He opined that such archival history demonstrates the following: Although the prohibition against surrendering taxation power may be absolute, the prohibition against suspending or contracting away taxing power is not absolute, but is qualified by the permissible-exemption provision in Section 4.

He turned to slides 11 and 12. Attorney General Márquez said that consistent with the Framers' intent, the Stranded Gas Act provides fiscal certainty for the length of the project in order to realize the state's long-term goal of an ANS gas line necessary to monetize its vast gas resources. The Finance and Taxation Committee of the Framers had expressly considered but chose not to include any time limit on tax exemptions provided for in Section 4.

He further opined that if tax liability could constitutionally be entirely extinguished by granting an exemption for a particular industry, it follows that tax liability could also constitutionally be extinguished in favor of fixed payments in lieu of those taxes for a set term. In short, Attorney General Márquez said, the proposed Stranded Gas Act contract is within

the parameters established by the Framers in Sections 1 and 4 of Article IX to use the state's tax structure to encourage development for the maximum benefit of the people.

He turned to slide 13. Attorney General Márquez said that to address the need for an economic base, Congress granted 103 million acres of federal land to Alaska - including land containing the North Slope oil and gas fields - as an endowment that would yield income to meet the costs associated with becoming a state. He opined that the Framers recognized that developing Alaska's resources according to the mandate of Article VIII might require an innovate tax regime, as reflected in their rejection of the highly restrictive model provision wording in favor of Section 1 of Article IX and the adoption of the "like or different" exemption language in Section 4 of Article IX.

He turned to slides 14 and 15. Attorney General Márquez said it is significant that fiscal contracts have been employed in Alaska to attract new industries since territorial days. In 1949, the territory authorized the tax commissioner to enter into fiscal contracts for new industrial enterprises. In 1957, after Alaska's constitution was ratified, the territory enacted an industrial incentive Act to permit businesses to apply for fiscal contracts to encourage new investments. In 1968, the legislature enacted the Alaska Industrial Incentive Tax Credits Act. And in 1971, the Alaska Supreme Court held that the grant of tax relief provided for in the 1968 Act was in the broadest possible form, and that the legislature intended that a credit could be provided for almost any tax within the State of Alaska.

He opined that the proposed contract is more favorable to the state than the tax exemptions previously required to attract industry to Alaska. Attorney General Márquez cited the following reasons: It is not a complete exemption from taxes; it requires continuous payments in lieu of taxes; and it will provide a steady source of state revenue while providing an incentive to the sponsor group to build a gas line in order to develop Alaska's gas resources.

He relayed the conclusions on slide 16. Attorney General Márquez said there is always a degree of uncertainty in trying to anticipate what action a future legislature might take and how a court might rule on that action. He opined that the proposed contract is within the parameters established by the Framers in Sections 1 and 4 of Article IX to use the state's tax structure to encourage development for the maximum benefit of

the people. Additionally, Article 11.1 of the proposed contract, coupled with a legislative Act authorizing the governor to sign the contract, will constitute a clear and unequivocal statement of intent to alienate the power to change taxes for the terms established in the contract; thus the contract will be enforceable under the contracts clause.

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SENATOR HOLLIS FRENCH, Alaska State Legislature, expressed concern that a wealth of legal opinion contradicts some of the foregoing testimony. He recalled that Jack Coghill and Vic Fischer, Founding Fathers from opposite ends of the political spectrum, recently opined that this sort of long-term tax freeze was never in their minds when drafting and voting on the proposed state constitution. Senator Hollis reported hearing from former attorneys general and assistant attorneys general that a long-term tax freeze isn't constitutional, and hearing something similar from Tamara Cook, head of Legislative Legal and Research Services Division, and from legislative attorney Don Bullock. Senator French explained that he'd been looking for some authority outside DOL that took the view expressed by Attorney General Márquez, but couldn't find it.

He asked whether Attorney General Márquez was concerned about that lack of legal authority in view of the supreme court's one pronouncement on this topic - that the state couldn't and didn't contract away its power to tax in a tax case involving ARCO, BP and Exxon. Senator French also asked: What do you think about this general law as being the parameters that the Founders put on the authority to contract away the taxing authority?

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ATTORNEY GENERAL MÁRQUEZ referred Senator French to his reply to Senator French's earlier letter for a definitive response to that question and for a reference to the Atlantic Richfield Company case. Expressing utmost respect for Jack Coghill and Vic Fischer and their work as Framers, he nonetheless suggested a couple of Alaska Supreme Court opinions would indicate their present view of the constitutionality of the Stranded Gas Act or a fiscal contract would not be considered by the court.

He added that in legal cases for which he could get the cites, legislators had tried to testify about what they intended when voting on legislation; the supreme court has rejected this type of evidence as to whether it is controlling in deciding what a statute means. Furthermore, in an early royalty-dispute decision, then-Judge Carpeneti wouldn't allow a state expert to

testify on what he meant when writing the lease form, Attorney General Márquez reported.

He opined that the following were the reasons: 1) what people say 50 years later might be different from what was in their minds at the time; 2) if only a couple of Framers are heard from, there won't be a full sampling of what everyone thought; and 3) particularly with respect to Alaska's constitution, explanatory documents were made available to the public at the time, and thus what was in the people's minds at the time of ratification is what's important. Attorney General Márquez emphasized his belief that the Alaska Supreme Court will take a view of this that won't consider the opinions of 2 of the 55 Framers of the constitution.

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CHAIR SEEKINS asked whether Mr. Coghill or Mr. Fischer were among those involved in the committee which drafted that particular article.

SENATOR FRENCH replied that he didn't know. He said the AG had made a perfect analysis, that it is difficult to look outside the language of the constitution itself to try to get an answer. He suggested, for the same reason, it undercuts much of the discussion at the convention about what was happened to be embodied in the document itself. Ultimately, they'll look not at what someone said, but at what is written, which says "general law." He opined that the Alaska Supreme Court has been clear that what that means is statute, which the legislature can change whenever it sits down.

He said he has yet to see anything that even begins to move him away from that position. Senator French expressed appreciation for Attorney General Márquez's discussion, but offered his belief that "general law" is not a complex term, and that the supreme court has repeatedly set forth how it goes about analyzing these cases - looking to the plain meaning of the term, for instance.

He opined that the court will decide that the Framers put constraints on the limits to give away the taxation authority; it said to go ahead and give a property-tax exemption, for example, but it can be taken away, and the same is true when granting municipalities the authority to provide exemptions. Senator French suggested it is all bound and constrained by the term "general law."

[4:59:05 PM](#)

CHAIR SEEKINS acknowledged he isn't an attorney, as Attorney General Márquez and Senator French are, but said he has read a lot of supreme court and superior court opinions having to do with statutes passed while he has been in the legislature. In every case, to his recollection, the courts referenced the record in the committee having to do with the legislature's intent as the process went forward; this is in contrast to what is remembered afterwards. He asked whether the courts have ever not considered the record of the committee process in reaching these kinds of interpretations.

ATTORNEY GENERAL MÁRQUEZ affirmed that the courts consider contemporaneous documents such as legislative history in interpreting statutes when there is a dispute. The contemporaneous evidence can be important to the supreme court. As to whether it is always controlling, he said no. He added, "I think the record that we've put forth in our opinion will be considered by the Alaska Supreme Court, what people said at the time, what these committee members said at the time."

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SENATOR FRENCH surmised Attorney General Márquez would agree it typically depends upon how difficult it is to understand what is written in a statute or the constitution; if it is abstract and not clear, then the history is looked at. Senator French opined that the history here shows that what many delegates meant was attracting new industry to Alaska, as mentioned in the document provided by the AG and also in other parts of the minutes; it was not about granting a tax exemption to an existing, robust and healthy industry. To the extent the supreme court looks at minutes of the constitutional convention, Senator French suggested the justices might be of a divided mind about what the delegates really meant.

ATTORNEY GENERAL MÁRQUEZ offered his belief that this is way too a restrictive a reading of "new industry." Saying he knows of no gas pipeline industry on the North Slope or through Alaska, he suggested this will open a whole new basin of gas exploration. As for general law, he said it isn't confusing: a general law is one passed by the legislature that isn't special legislation; for example, a case dealing with Northstar legislation held it to be a general law, not a special one. He said the Act approving the governor's signature on a Stranded Gas Act contract will be a general law, as is the Act itself. Both will provide a general law that the Alaska Supreme Court

will require as evidence of a clear and unequivocal alienation of the taxing power in substituting it for these payments.

[5:03:06 PM](#)

CHAIR SEEKINS asked: If the proposed contract containing fiscal-terms agreements or related items is approved and the legislature then decides to increase the severance tax on oil, would that increase apply to every other producer other than those covered under this contract?

ATTORNEY GENERAL MÁRQUEZ answered that he believed so.

CHAIR SEEKINS surmised that the legislature wouldn't be contracting away the general power to change oil taxes, then, but would be doing it for this particular contract and project.

ATTORNEY GENERAL MÁRQUEZ noted if there were a huge oil discovery in Bristol Bay, for example, the legislature could do what it wanted with respect to taxes on that development. In further response, he said the power would be contracted away to help underpin this project.

[5:04:43 PM](#)

SENATOR ELTON related his belief that there is no discussion in the commentaries or the constitution itself about how to define a tax. He asked whether it could be defined as narrowly as suspending a tax to a corporation, not just a general tax, and whether it is correct that neither the commentaries nor the constitution speak to one being okay, but not the other.

ATTORNEY GENERAL MÁRQUEZ acknowledged he didn't have that thorough a knowledge of the commentaries, but said, "We certainly haven't decided that." He added that a couple of exemptions granted before and after ratification of the constitution weren't just to provide for incentives, and were in the minds of the drafters of the constitution.

SENATOR ELTON referred to slide 8, which quotes the official commentary on Section 1 as saying, in part, "[t]he power to tax is never to be surrendered, but under terms that may be established by the legislature, it may be suspended or temporarily contracted away." He asked whether there has been any discussion at DOL of what "temporary" means. He said it seems a multigenerational term of 30 or 40 years goes beyond "temporary" as referenced in that commentary.

ATTORNEY GENERAL MÁRQUEZ referenced slide 11, which says the Finance and Taxation Committee expressly considered but chose not to include any time limit on tax exemptions provided for in Section 4. He said this indicates they were leaving things flexible for the legislature to determine what a good term is. Indicating discussions at DOL were that "temporary" is the opposite of "permanent" and so could be for any length of time, he specified that is his own view.

SENATOR ELTON expressed concern that it is an expansive view.

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CHAIR SEEKINS suggested that the power in question relates to the ability to bind future legislatures through a contract, regardless of the length of time.

SENATOR HOLLIS highlighted the magnitude, noting it has to do with binding the next legislature with respect to its power over what constitutes 80-90 percent of the revenue that supports the state. He voiced concern that it removes the ability to address the fiscal health of the state.

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CHAIR SEEKINS announced that the committee would hear from Anadarko and others tomorrow, and Dr. van Meurs would testify on gross versus net tax systems. After that, amendments to the Stranded Gas Act would be addressed.

SENATOR ELTON informed members that he wouldn't prepare any amendments because he thought it premature to amend the Stranded Gas Act until there was more information. He referenced previous discussion about the LLC and the fact that the contract hadn't been seen yet.

[5:12:23 PM](#)

MR. COUGHLIN referred to Senator French's question of whether other attorneys support the AG's position that the effort here is constitutional. Mr. Coughlin reported that BP has spent millions of dollars in the last couple of years to try to bring this contract to fruition in a manner that allows the project to proceed. Before even beginning contract negotiations, BP did a legal analysis of the constitutionality of such a clause; based on that, the company went forward with negotiations. Mr. Coughlin said he didn't intend to debate with Senator French the merits of his memorandum, other than to state disagreement.

He opined that the negotiated position has a sound constitutional basis, noting BP, along with the other companies, has agreed to risk \$120 million to find out the answer. Mr. Coughlin emphasized the importance of an answer from the supreme court in order to have a contract that is durable and acceptable to the people of Alaska and all three branches of government - executive, legislative and judicial. With respect to whether it is constitutional, Mr. Coughlin concluded, "We believe it is. We have received many legal opinions to that effect. And that is the basis upon which we have gone forward with this key provision in the contract."

CHAIR SEEKINS thanked participants and held SB 3001 and SB 3002 over.

There being no further business to come before the committee, Chair Seekins adjourned the Senate Special Committee on Natural Gas Development meeting at [5:15:03 PM](#).