

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON OIL AND GAS**

March 15, 2007

3:04 p.m.

**MEMBERS PRESENT**

Representative Vic Kohring, Chair  
Representative Kurt Olson, Vice Chair  
Representative Nancy Dahlstrom  
Representative Jay Ramras  
Representative Ralph Samuels  
Representative Mike Doogan  
Representative Scott Kawasaki

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Senator Charlie Huggins  
Representative David Guttenberg

**COMMITTEE CALENDAR**

HOUSE BILL NO. 177

"An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date."

- HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 177

SHORT TITLE: NATURAL GAS PIPELINE PROJECT

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

|          |     |                                 |
|----------|-----|---------------------------------|
| 03/05/07 | (H) | READ THE FIRST TIME - REFERRALS |
| 03/05/07 | (H) | O&G, RES, FIN                   |
| 03/06/07 | (H) | O&G AT 3:00 PM BARNES 124       |
| 03/06/07 | (H) | -- MEETING CANCELED --          |
| 03/08/07 | (H) | O&G AT 3:00 PM BARNES 124       |
| 03/08/07 | (H) | -- MEETING CANCELED --          |

03/13/07 (H) O&G AT 3:30 PM HOUSE FINANCE 519  
03/13/07 (H) Heard & Held  
03/13/07 (H) MINUTE(O&G)  
03/15/07 (H) O&G AT 3:00 PM BARNES 124

#### **WITNESS REGISTER**

PATRICK GALVIN, Commissioner  
Department of Revenue (DOR)  
Anchorage, Alaska

POSITION STATEMENT: On behalf of the governor, presented HB 177.

KEVIN BANKS, Acting Director  
Division of Oil and Gas  
Department of Natural Resources (DNR)  
Anchorage, Alaska

POSITION STATEMENT: Presented portions of HB 177.

MARCIA DAVIS, Deputy Commissioner  
Department of Revenue (DOR)  
Anchorage, Alaska

POSITION STATEMENT: Presented portions of HB 177.

LARRY OSTROVSKY, Chief Assistant Attorney General  
Statewide Section Supervisor  
Oil, Gas & Mining Section  
Department of Law (DOL)  
Anchorage, Alaska

POSITION STATEMENT: Explained possible legal issues associated with HB 177.

#### **ACTION NARRATIVE**

**CHAIR VIC KOHRING** called the House Special Committee on Oil and Gas meeting to order at [3:04:58 PM](#). Present at the call to order were Representatives Kohring, Doogan, Kawasaki, Olson, Dahlstrom, Samuels, and Ramras. Representative Guttenberg and Senator Charlie Huggins were also in attendance.

#### HB 177-NATURAL GAS PIPELINE PROJECT

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CHAIR KOHRING announced that the only order of business would be HOUSE BILL NO. 177, "An Act relating to the Alaska Gasline Inducement Act; establishing the Alaska Gasline Inducement Act

matching contribution fund; providing for an Alaska Gasline Inducement Act coordinator; making conforming amendments; and providing for an effective date."

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PATRICK GALVIN, Commissioner, Department of Revenue (DOR), gave an overview of today's planned testimony, noting that some of the planned testimony was in response to questions raised by committee members.

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KEVIN BANKS, Acting Director, Division of Oil and Gas, Department of Natural Resources (DNR), referred to a PowerPoint presentation and explained the concept of "in-state use" as contained in the Alaska Gasline Inducement Act (AGIA). He stated that AGIA requires that there be five off-take points, distance sensitive rates, and expansion provisions, and referred to slide 4 titled "In-State Use." The act requires an applicant to describe where the off-take points will be and to explain how distance sensitive rates will be established in the state. He noted that off-take points could also be in-take points at some point, which he thinks should be addressed in gas pipeline proposals the state receives. He opined that the important point is not where off-take points will be located, but how tariffs will be calculated and how expansion of off-take points will be developed in the future.

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MR. BANKS referred to slide 5 titled "Hypothetical: Gas Off-take in Fairbanks," and stated that the assumption is that the tariff from the North Slope to the Canadian border is about 72 cents. He went on to explain that mileage-based rates would suggest a tariff of 46 to 47 cents to Fairbanks. He referred to slide five titled "Fairbanks Gas Prices if capacity acquired at initial or subsequent Open Season," to explain what a Fairbanks utility may pay for gas. Assuming a \$5.50 Alberta, Canada gas price, one would subtract a tariff of \$2.14 to move gas all the way to Alberta. The netback value would then be \$3.36. A producer that wished to ship gas to Fairbanks through the gas line would have to pay the gas treatment plant (GTP) fee of 49 cents and Fairbanks's tariff of 47 cents, which would bring the price of gas at Fairbanks up to \$4.32. He said that without distance sensitive rates and a Fairbanks off-take destination, the price of gas delivered to Fairbanks would be \$4.62. He said

this is because the border tariff would be 72 cents all the way to the border.

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REPRESENTATIVE RAMRAS asked whether the Alberta gas price means the Henry Hub price and referenced the need to use consistent terminology for clarity.

MR. BANKS explained that the Alberta gas price is the Alberta Energy Company Ltd., (AEC), hub price and that there is a vigorously traded liquid market in Alberta. He opined that a North Slope producer selling gas to a Fairbanks utility would want to achieve the same netback the producer would receive by selling to the AEC hub. Under the example presented, if a producer is selling to the AEC hub for \$5.50, the netback would be \$3.36. The alternative would be to ship the gas to Fairbanks. However, to achieve the same netback price of \$3.36, the producer will have to charge \$4.32 for gas in Fairbanks to cover the costs of shipping and processing using the distance based tariff.

REPRESENTATIVE RAMRAS told the committee that currently Fairbanks Natural Gas charges \$16.80 per thousand cubic feet (Mcf), while the Henry Hub price is close to \$ 7.00. He observed that it appears under these calculations that the energy cost for gas in Fairbanks will be cut by almost two-thirds. He asked whether AGIA requires that producers be price sensitive as well as distance sensitive. He also asked about any possibility that the pricing may not meet constitutional requirements of maximum use of natural resources.

MR. BANKS said that the aforementioned hypothetical assumes the producer that will sell gas the Fairbanks utility at the same price they would have received had they sold the gas in Alberta. He noted that AGIA does not address issues regarding the state's decisions regarding royalty in kind (RIK).

REPRESENTATIVE SAMUELS asked whether, even if tariffs could be reduced for local use, the price of gas will remain the market price.

MR. BANKS replied that the state has to achieve some parity in the price when it switches from for royalty in value (RIV) to RIK. He noted that commercial producers could make arrangements to sell gas at prices higher or lower than those contained in the state's presentation.

REPRESENTATIVE SAMUELS asked if the rate charged to the consumer would be set by the utility and the Regulatory Commission of Alaska (RCA).

COMMISSIONER GALVIN explained that other mechanisms in state law, primarily the RCA, work to protect the consumer in the determination of utility services costs.

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REPRESENTATIVE DOOGAN asked if distance sensitive rates are a common feature in gas pipelines.

MR. BANKS answered yes. He referenced slide 7, titled "Fairbanks Gas Prices if no capacity available through expansion," to explain what happens when there is narrow capacity.

REPRESENTATIVE RAMRAS set forth the possibility that it may difficult for communities to switch from primarily using fuel for energy to primarily using gas because of the time it takes to replace boilers. With that in mind, he set forth his desire that a mechanism be proposed to assist communities in switching to gas use.

MR. GALVIN opined that during the initial open season, it is unlikely that many communities will be ready to use gas. However, he predicted that the market will expand as the gas pipeline expands. He noted that communities will benefit from the expandability of the gas pipeline, not necessarily just from the five in-state off-take points, which may not be in the line when it is initially built. However, the pipeline builder must commit to make arrangements for future off-take points when needed, he explained.

REPRESENTATIVE RAMRAS noted that Fairbanks is perhaps only 5 percent developed for gas, with the potential for much more development in its ability to use gas.

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MR. BANKS opined that off-take points are part of the issue, but the main point is the desire for a distance-based tariff to the off-take point, wherever it may be. Further, if there is failure to take advantage of the open season and there is no expansion ability built into the pipeline, there is a risk of

having to pay an AEC price in Fairbanks because of "stranded capacity beyond Fairbanks to the marketplace", which would result in one having to pay the full tariff price.

REPRESENTATIVE GUTTENBERG asked about the mechanism in AGIA for determining the correct size and structure of take-off points.

COMMISSIONER GALVIN agreed that there are significant issues to be considered to prepare the state of in-state gas use. He said he does not expect the initial proposals to detail the volume of off-take points. When the open season occurs, the location and volume of gas in-take and off-take points will be established for the initial design of the project. He opined that as a practical matter, not all areas of the state will be ready to receive gas at the time of the open season. However the expansion opportunities provide the ultimate solution by allowing communities to receive gas when ready, he indicated. He noted that there needs to be discussion regarding readiness for open season, but stated that "we need to get AGIA going" for that discussion to occur.

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CHAIR KOHRING expressed his desire that the gas pipeline include appropriate off-take points for various areas of the state.

MR. BANKS stated AGIA will establish within the tariff calculations that various pipeline segments will have different rates for delivery of gas to off-take points. He opined that there would be sufficient numbers of in-take and off-take points along the line to allow for expansion. He reiterated that recipients of gas would know they would be paying a distance sensitive tariff.

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COMMISSIONER GALVIN said that AGIA contains two significant evaluation criteria: value to the state and likelihood of success. Consideration of these criteria involves use of data and modeling to determine likely benefits to the state and the likelihood of success. Various sub-factors that are part of this evaluation include timing, cost overrun mitigation, favorable tariffs, initial capacity and expansion, and state match after open season. He noted that there are many factors to consider in the area of tariffs as producer proposals may vary. He set forth the possibility that a producer could propose something with a greater debt to equity ratio than 70 to

30 percent to provide a more favorable tariff. Producers may ask for a commitment for greater return on the equity that could also provide greater value to the state through a lower tariff. He went on to say that initial gas flow and expansion opportunities would be evaluated. The state will provide "one to one, 50 percent of the cost to get to open season," but beyond that producers will make their proposals for cost sharing, which the state will evaluate in determining the value of the proposal. A review of the likelihood of success includes many factors such as the feasibility of the work plan and budget, financial strength, technical expertise and track record, he said.

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REPRESENTATIVE DOOGAN asked whether the take-off points are considered in the initial evaluation of proposals.

COMMISSIONER GALVIN explained that there are certain items a proposal must contain in order to be considered. For example, a producer must have at least 70 percent debt, or their proposal will not be considered. He said that the five off-take points are not listed in the initial evaluation criteria because a proposal for more than five does not convey a quantifiable increased value in terms of comparing one application to another. The "must haves" are minimums qualifications for a proposal to be considered. Proposals that meet the minimum qualifications are evaluated against each other. He noted that additions beyond the "must have" list move into and are considered in the evaluation criteria.

REPRESENTATIVE DOOGAN clarified that if an application does not contain even one of the "must have" points, it is not considered. If the application has all 16 points, it is evaluated in accordance with the 7 criteria in the legislation.

COMMISSIONER GALVIN said he agreed with the aforementioned comment.

REPRESENTATIVE SAMUELS asked how about the process of weighing the different application components.

COMMISSIONER GALVIN explained that much consideration had gone into the evaluation criteria, including consideration of whether to assign points to various criteria and how objective or subjective evaluation should be. He opined that there are risks to either option. He said one concern was that requiring

extreme specificity could result in a proposal meeting the criteria, but not actually providing the best benefit to the state. Additionally, one of the risks associated with keeping the timeline going is that there may be a judicial challenge to the license selection. He set forth that it may be more likely a court will enjoin the project if the court feels it could substitute its judgment for that of the agency. He explained that discretionary agency decisions usually receive more deference when a court reviews them. He opined that the risk of the project being delayed by litigation is less if the decision makers have more discretion and subjectivity in the agency evaluation process. He stated that there needs to be clarity in what the state is looking for in a gas pipeline project, and he believes that the criteria provided in AGIA provides that clarity. Ultimately, the decision makers will consider which project is in the best interest of the state. He opined that state agencies, such as DNR, have substantial experience with weighing various factors to determine the state's best interest in complex resource decisions. He said the decision would be explained to the public and ultimately be subject to legislative review.

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COMMISSIONER GALVIN explained in response to a question that inclusion of a weighted point system for the evaluation of the seven initial criteria could result in an application scoring the highest, yet not really being the best proposal for the state.

REPRESENTATIVE DOOGAN asked whether weighted criteria would be preferable to determine the state's best interest.

COMMISSIONER GALVIN responded that a weighted criteria method for evaluation could be preferable if such a method was sure to result in the best project for the state. However, because of the complexity of the project and the probable variety of proposals that will be received, the decision makers need flexibility to carefully weigh and consider the risks of each project, he said.

REPRESENTATIVE RAMRAS noted that one criteria is to make the applications public. He opined that tariff-holders were likely to gain significant revenues. He said he was interested in seeing the alignment of different groups with the pipeline project. He further stated a desire to explore the possibility of a scoring mechanism that would consider inclusion of in-state

agencies or organizations' investment in the equity portion of the pipeline. He noted some larger organizations, such as the Alaska Permanent Fund Corporation, the Alaska Retirement Management Board (ARMB), or Native corporations could possibly participate in ownership of the pipeline, and noted that great financial benefits that could result from such participation.

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COMMISSIONER GALVIN explained that item six of the initial criteria requires an applicant to demonstrate its familiarity with the tasks that are required to build a pipeline, such as obtainment of necessary permits from Canada. Additionally, the applicant will have to describe its work plan in the application.

REPRESENTATIVE SAMUELS asked about possible delays that could be caused by legal challenges and expressed some concern regarding the application evaluation process.

COMMISSIONER GALVIN replied that there is a risk to assigning a point value to each component because of the difficulties in coming up with a number that would differentiate one proposal from another. He agreed that consideration of many issues would be part of the evaluation process. He set forth that one reason for providing a legislative opportunity to disapprove is to provide further analysis of the commissioners' decision. He went on to opine that there may not be an easy way to build a foolproof evaluation process into AGIA. He agreed with an observation that the Commissioners of DNR and DOR would in essence make a best interest finding based on the evaluation criteria and comparison of proposals to each other.

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REPRESENTATIVE SAMUELS raised the issue of business ethics and how such a subjective term is judged. He also noted that there may be considerable legislative debate on this issue.

COMMISSIONER GALVIN noted there were possible difficulties with the definition of the term "best interest finding," but explained that such an approach would allow the state to consider factors that are not in the application, such as the possibility that an applicant has a negative business history in another country.

REPRESENTATIVE OLSON asked whether the administration has begun dialog with First Nations' representatives.

COMMISSIONER GALVIN replied that some groups have spoken to the state about concerns regarding the pipeline route, but noted there is not a proposed route as yet. There are concerns about the pipeline route, tanker placement and other issues and those concerns would be particular to the project, which is why there is some flexibility in the evaluation process, he explained.

REPRESENTATIVE GUTTENBERG referred the need for a public record of the evaluation process.

COMMISSIONER GALVIN stated that the bill contains the criteria to be considered by the commissioners and opined that the best way to withstand judicial review is to have a substantive finding that weighs the issues identified by the legislature.

REPRESENTATIVE DOOGAN expressed concern over going forward with undifferentiated criteria and questioned whether there is a need for more participation at the decision making level to lessen subjectivity in the making of the final decision.

MR. GALVIN responded that part of the reason for the suggested procedure was timing and predicted that a board process would take longer to come to a decision.

REPRESENTATIVE DAHLSTROM suggested that perhaps one more commissioner be added to the decision-making team.

COMMISSIONER GALVIN stated he understands the nature of trust required to approve the proposed decision-making process. He reiterated that timing is of concern as DOR would like a decision made in a timely fashion.

REPRESENTATIVE SAMUELS noted that the decision may be made by a different governor and different commissioners depending on the timing of proposals received under AGIA.

COMMISSIONER GALVIN referenced other decision-making guidelines in Alaska law and noted that in other areas, the legislature gives the guidelines, but the executive branch makes the decision. He suggested it would be more unusual to tie the decision-making process down to more quantifiable point process. He suggested that the model presented here exists in Alaska law and has the added safety valve of legislative approval of the decision.

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COMMISSIONER GALVIN stated that increased predictability for the producers is a key component of AGIA.

MR. BANKS relayed that AGIA is designed to avoid royalty payment adjustments by creating a clear, easily used royalty formula. He referenced prior lengthy litigation regarding royalty oil and noted that DOR seeks to establish fiscal certainty and avoid litigation. He opined that the state can offer real value to the producers by providing clear royalty value definitions in the leases. He went on to say that several aspects of the past DL-1 leases have been adjudicated. In 1980 there was a settlement termed the "field cost settlement" which determined what costs the state would allow for deductions based on GTP costs. At the time, the state anticipated gas production and wanted to be prepared, he explained. In the early 1990s, there was a settlement between the state and producers on the question of royalty oil valuation. In each of those settlements, formulas were established to clarify lease provisions he described as "most confusing" to the lessees. He explained that the DL-1 lease defines five different values, two of which are not relevant as they concern posted prices. The other three provisions cover: what the lessee actually receives for oil or gas sold; what others receive in the same field, and what the market value for oil or gas is as determined by market factors. The lease requires the lessee to pay the highest of these three factors, he explained.

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MR. BANKS pointed out that a lessee will know what it receives for oil or gas sold, but will not necessarily know what other lessees receive. In the third option, there may be a question about what mechanism the state will use to determine market value. With the prior mechanism, the lessee does not know at the time of payment whether it has paid the correct royalty value, he opined. Because of this uncertainty, AGIA proposes to calculate royalty value based on market value where the gas is sold. He indicated one possible indices the state may use to determine market value for gas is the AEC hub price because that price represents a widely traded, publicized gas price. He noted that the indices used to determine gas price will likely be based on the format for the final project. He noted that the DL-1 leases also allow the state to take its royalty share in value on a three month notice to the lessee. He said that the

three month provision allows the state to plan ahead and know how much oil to take in-kind for customer's future needs.

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REPRESENTATIVE RAMRAS noted that the commodity market for oil is broad and queried whether there is the same kind of elasticity in the spot market for gas. He cautioned that perhaps the market for gas is less flexible than that for oil

MR. BANKS suggested that the issue is whether the state will be in the position to modify its request as to the amount of gas volume it wishes to take in kind so as to participate in the spot market. He indicated that in the Lower 48, there is a fair amount of daily trading activity to meet demands based on factors such as weather. He said that a long term gas contract may be for under a year. However, Alaska will likely be concerned with providing gas to its local communities, and would more than likely participate in longer term contracts with buyers. He suggested that the impact of the decision of whether to take royalty-in-kind will occur at the time the commitment is made. For example, the pipeline may be sized to move a certain quantity of gas to the Alberta hub or to Valdez. If the state then decides later to enter a contract with an in-state utility to take some of that royalty gas, it could leave the lessee with stranded capacity. He explained that AGIA proposes to give reasonable terms when the state switches from RIV to RIK. This will be accomplished by giving lessees sufficient notice to adjust their own capacity and to make commercial arrangements for the lessee to absorb some of the costs they may incur due to stranded capacity.

REPRESENTATIVE SAMUELS suggested it is not practical to have a 90 days' provision due to the risk of varying capacity.

COMMISSIONER GALVIN said that because of the gas contracts with lessees, they are at a commercial risk position because the state has the right to take RIK, but does not have to use it. He characterized this provision as "real value" because the lessees would be concerned about having stranded capacity or having to displace their gas. He opined that this is a valuable incentive.

REPRESENTATIVE SAMUELS offered his belief that this provision will discourage producers from participating in open season since there is the risk of the state will change its position to the detriment of the lessees.

COMMISSIONER GALVIN replied that this is a significant issue for lessees, which is why it is appropriate to include in the bill. He said that inclusion of the provision would help overcome concern and to provide a level of certainty. If a producer does not participate in the initial open season, it is likely that the producer will want to discuss possible changes with the state. He explained it will be the prerogative of the state whether to change it or not.

REPRESENTATIVE GUTTENBERG commented that economic factors built in to the contract must be compensated.

COMMISSIONER GALVIN replied that the state currently has the right to switch between RIK and RIV, and has had this provision in its leases for 30 years. However, in the "gas world" these provisions can be problematic because lessees have to take positions in regard to contracts and sales contracts that could be adversely affected if the state switches its position on its royalty take. Therefore, there are reasons for lessees will want restrictions on the state's ability to switch how it takes its royalty share, and that is a proper bargaining point, he indicated.

MR. BANKS answered a question by explaining that although Cook Inlet gas contracts contain RIK provisions, the state has never exercised its right to take the gas in-kind.

COMMISSIONER GALVIN said that the next issue is the production tax aspect of AGIA. He noted there is concern over the constitutionality of some provisions which limit the applicable tax rate. He offered his belief that the drafters of AGIA structured this as strongly as possible for constitutional reasons. He explained that it is being offered as an incentive for the gas community and opined that its value is based on its likelihood of withstanding constitutional challenge. He noted that this provision is a discrete part of AGIA, therefore it would not cause harm to the bill if this provision is not allowed.

MARCIA DAVIS, Deputy Commissioner, Department of Revenue, opined that AGIA's production tax exemption provision is allowable under the state constitution. She explained that it provides a production tax exemption that is measured as the value of the gas production tax obligation minus the gas production tax obligation during the open season. She explained that the open season is the benchmark year in which to set the economic value

of the expectation for the producer. It is only available for gas shipped in the same capacity as acquired in the binding open season because DOR views this as a contract. She explained that in exchange for this economic benefit, the producer must commit its gas in the first binding open season. Secondly, DOR is requesting that producers agree not to protest the rolled in tariff provisions that will be required of the successful licensee. This benefit is limited to 10 years of gas flow because 10 years is a reasonable time frame for return of capital investment, she opined. It is also the same time period as in the Alaska Industrial Incentive Act, and so has a history as a reasonable time period.

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REPRESENTATIVE SAMUELS asked about discussions establishing a tax rate and whether there was consideration that the tax rate be retroactive.

COMMISSIONER GALVIN emphasized DOR desires to provide a structure with the strongest legal arguments for constitutionality. He explained this is being provided as a contractual relationship, not as a limitation on the legislature's ability to change the tax rate. Since a contractual arrangement requires an exchange, he opined that it made sense to have the tax rate that applies at the time the open season commitment is made be the tax rate that applies for those 10 years.

REPRESENTATIVE DOOGAN asked how the oil companies would assign value to this provision.

MS. DAVIS explained that oil companies have significant business experience in many places besides Alaska, and are used to weighing various levels of risk factors and legal issues. She opined this is not a very complex legal issue, but one that is based on a determination of the intent of the framers of the Alaska Constitution. This determination will ultimately be for the Alaska Supreme court she said, but opined that guiding legal principles favor the constitutionality of this provision. She explained that oil companies are competent at considering many factors when deciding whether to enter a contract with the state.

COMMISSIONER GALVIN predicted oil companies would independently consider and value this provision's worth to them.

REPRESENTATIVE DOOGAN expressed concern that this provision is designed to be a main incentive, yet is possibly unconstitutional. He asked if there has been discussion on other, possibly less problematic, incentive provisions.

COMMISSIONER GALVIN replied that oil companies want to lock in the fiscal terms for some period of time. He explained that DOR has structured the provision as strongly as possible to withstand a legal challenge and to provide the best mechanism absent a constitutional amendment.

REPRESENTATIVE SAMUELS asked about the additional risk to oil companies of not knowing the future tax rate.

COMMISSIONER GALVIN explained that this issue has been considered. He opined that the state cannot control the companies' perception of the risks of investing in Alaska. He went on to say that each company evaluates the risk differently. He noted he does not consider it "too late" if the risks are not fully known at the time the proposals are due because the risk is not the "driving factor" at that particular moment. He set forth that the provision is intended to result in the gas commitment. The risk DOR is addressing is the tax rate at the time of open season and the tax rate at the time the gas begins to flow, he said.

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REPRESENTATIVE SAMUELS posed the possibility that there are greater rewards for acceptance of greater risk and whether DOR considered this issue in this way.

MS. DAVIS explained that oil companies will look for alignment and opined that the companies have confidence that the legislature will be not increase taxes at the time of open season.

REPRESENTATIVE SAMUELS asked about the possibility that oil companies will have the leverage at the time of open season.

MS. DAVIS replied that the state cannot change the fact that leverage exists when the state wants a certain behavior and the companies are in the position to provide it. She said the state cannot effect when the companies act, but said that other provisions of AGIA address elements of certainty in the state's favor. She explained that AGIA resolves commercial issues outside of the state's control, such as pricing and design

capacity, in such a way as to make it problematic for a producer to attempt to leverage the state at a late stage.

LARRY OSTROVSKY, Chief Assistant Attorney General, Statewide Section Supervisor, Oil, Gas & Mining Section, Department of Law (DOL) informed the committee that the question of whether the state can offer fiscal stability is a matter of opinion. He said the DOL's position is that a fiscal stability provision has a better chance of surviving a legal challenge if it is narrowly focused, limited in time, and consistent with past practices. He said he believes that providing production tax stability in AGIA will survive constitutional challenge under the Alaska State Constitution, Article 9, Section 1 which provides:

The power of taxation shall never be surrendered.  
This power shall not be suspended or contracted away,  
except as provided in this article.

He explained that the language of many state constitutions, and as originally proposed to the Alaska Constitutional Convention by the Public Advisory Service, ends at the comma. There was some debate on this point during the Alaska Constitutional Convention because the Public Advisory Service informed the convention that states had on occasion suspended or contracted away their taxing powers. He opined that there would be no question that there would be an absolute prohibition on the legislature's authority to provide tax certainty if Article 9, section 1 ended after the word "away." However, the Alaska Constitutional Convention delegates rejected that approach, leaving the meaning of the phrase "except as provided in this article" to be determined. He opined that "just about everyone" who has considered this issue agrees that there is only one section in Article 9 of the Alaska Constitution that is applicable here and that is section 4 which reads in part:

The real and personal property of the State or its political subdivisions shall be exempt from taxation ... [P]roperty used exclusively for non-profit religious, charitable, cemetery, or educational purposes, ... shall be exempt for taxation. Other exemptions of like or different kind may be granted by general law. All valid existing exemptions shall be retained until otherwise provided by law.

MR. OSTROVSKY told the committee DOL believes that the phrases in Article 9, sections 1 and 4, provide the legislature with the ability to suspend or contract away, to some degree, taxing

authority. He offered that rules of statutory construction support this conclusion. One rule of statutory construction provides that every word, sentence, or provision in a statute has some force or effect. He opined that if there was an absolute prohibition on the legislature's ability to suspend taxation authority, one would not expect the clause "except as provided in this article" to be in the Alaska State Constitution, Article 9, section 1.

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Additionally, rules of statutory construction provide that statutes be construed so that effect is given to all provisions and no parts are left inoperative, superfluous, void, or insignificant. He opined that this requires there be some meaning given to the last phrase of Article 9, section 1. He stated it is reasonable to find that meaning in Article 9, section 4 which allows exemptions to be granted "by general law." He offered that AGIA is a general law because the exemption is available to anyone who participates in the first open season. A related question is whether there are any limits on this power to suspend or contract the power of taxation. He said that in the past, legislation has been passed which authorized tax credits for a 10-year period in what were to be considered contracts between the state and taxpayers. He noted that contracts are generally protected by the Constitution of the United States, although he indicated there is no direct case law on this point. He opined that AGIA is crafted to be limited to a narrowly described tax exemption that follows the legislative model.

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MR. OSTROVSKY referred to some discussion on this last year and stated that nobody knows for certain where the state can cross the law of fiscal certainty. However, he opined that certain facts are more likely to withstand a constitutional challenge -- AGIA's provisions are limited to one tax for a 10-year period, which he indicated is identical to past state statutes that "were tied to Article 9." In contrast, the Stranded Gas Development Act (SGDA) contained sweeping provisions that covered all state taxes for up to 45 years. He opined that AGIA's provisions are much more likely to withstand constitutional scrutiny.

REPRESENTATIVE DOOGAN asked how long a legal challenge will take.

MR. OSTROVSKY responded that AGIA contains a provision that requires constitutional challenges to it be brought within 90 days. He offered his belief that a challenge would present only a legal issue which he hoped could be resolved expeditiously, but noted that nobody knows an exact time period.

REPRESENTATIVE RAMRAS relayed the possibility that uncertainty is damaging to development and indicated that he likes AGIA, but he needs "for this AGIA project to be tightened up." He offered that the production tax exemption, even though severable from the rest of AGIA, creates an element of uncertainty.

[5:18:10 PM](#)

COMMISSIONER GALVIN discussed how much gas is needed to make project work. He explained that AGIA is open to a wide variety of projects and offers to the interested parties the opportunity to relay what the appropriate project size will be. He opined that the size of the project will become more apparent as the project moves forward. He reminded the committee that Prudhoe Bay is the primary source for proven North Slope gas reserves. He noted that recently an Alaska Oil and Gas Conservation Commission (AOGCC) staff report concluded that the AOGCC cannot at this time recommend a specific gas off-take rate. He went on to say that the report warned that an "early, high-rate gas sale" could result in a loss of a substantial volume of hydrocarbons. However, the report went on to say that "even greater volumes may be at risk if gas sales are indefinitely delayed," he said. He offered that the AOGCC is tasked to prevent physical waste and is authorized to allow gas off-take as long as it results in the maximum amount of hydrocarbon recovery. He reminded the committee that AOGCC does not consider the economic value of various approaches, but instead considers "how much physically" will be removed. He noted that the issue of how much gas can be taken off, and at what rate, is currently an open question that he hopes will be resolved by open season.

[5:22:07 PM](#)

COMMISSIONER GALVIN reminded the committee that the Point Thompson leases terminations are currently being litigated. He opined that the is likely to prevail in that litigation, but that it will likely take three years to reach the Alaska Supreme Court. If the state prevails, the Point Thompson reserves will be available for the gas pipeline project. In addition, there

is some ongoing exploration in other areas of the North Slope which may uncover some additional gas reserves.

[5:26:20 PM](#)

COMMISSIONER GALVIN summarized that AGIA provides increased predictability and incentives for the producers, referring to slide 17. He opined it would provide jobs and gas for Alaskans. He went on to opine that development of the North Slope gas basin is key to Alaska's long-term future economic success. He stressed that the gas pipeline project needs to "get moving," so as to provide gas revenue before oil revenues drop drastically, which will reduce Alaska's leverage. He opined that AGIA is designed to eliminate uncertainties so as to positively change the commercial perception of the project.

[HB 177 was held in committee.]

#### **ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at [5:31:52 PM](#).