SENATE FINANCE COMMITTEE
February 25, 2010
2:39 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 2:39 p.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice-Chair
Senator Johnny Ellis
Senator Dennis Egan
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

None

ALSO PRESENT

Donald Bullock Jr., Legislative Counsel; Susan Pollard, Assistant Attorney General, Oil, Gas And Mining Section, Department Of Law; Senator John Coghill; Senator Joe Paskvan; Senator Gary Stevens; Senator Hollis French.

SUMMARY

^Gas Tax

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Co-Chair Stedman addressed the flexibility of the legislature regarding Alaska Clear Equitable Share (ACES) and the Alaska Gasline Inducement Act (AGIA). He introduced Mr. Bullock and acknowledged his vast experience pertaining to gas and oil in Alaska.

DONALD BULLOCK JR., LEGISLATIVE COUNSEL, discussed the memo dated February 22, 2010, titled "Gas production tax

limitation in AS 43.90.320." The question in the memo addressed whether the state is bound by the tax exemption in AS 43.90.320 and how much flexibility is allowed. The tax exemption works to counter any tax increase subsequent to the tax that goes into effect beginning the first day of open season. He opined that the exemption approach is the most consistent with Article 9, section 4, which allows for the creation of exemptions by general law.

Mr. Bullock explained that statute outlining the exemption could be amended or repealed and he noted the memo addressed potential repercussions of any changes that may be enacted. He provided background information regarding the agreement with TransCanada, the licensee for the AGIA project. Prior to awarding TransCanada with the license the legislature determined that amending statutory terms and conditions would have significantly altered the proposal's terms. He clarified that the relationship with the licensee is different than the relationship with producers as inducements offered encourage a producer to make a firm commitment during the first binding open season as opposed to a later time. The inducements that are based on the first open season will expire if there are no binding commitments after the first open season, making all producers equal in the event of a future open season. He conveyed that TransCanada may argue that the change to inducements caused impairments to their project if the inducements under AS 43.90.320 were amended to become less attractive, and insufficient producers were to commit during the first open season.

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Co-Chair Stedman asked about the deadline of May 1, 2010 as the start of the first binding open season.

Mr. Bullock responded that TransCanada notified the Federal Energy Regulatory Commission (FERC) that the open season would begin on May 1st. The qualifications for resource inducements are located in AS 43.90.300 and require that the first commitments qualify for the inducements. He stated that those qualified for a resource inducement are entitled to an annual exemption from the state's gas production tax in the amount equal to the difference between the amount of the person's gas production tax obligation calculated under the gas production tax in effect during that tax year. The tax year would be a future

year within a ten year period, which is the ten year period the exemption would be exercised. He explained that future production and tax law are used to calculate this number, which is compared to the amount of the person's gas production tax in effect on May 1, 2010, the start of the first binding open season. It would be clear as of the May 1st date that a person considering making a commitment into the pipeline project could determine whether their tax obligation under current law would impact their decision to make a firm commitment during the first open season.

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Co-Chair Stedman wondered whether making a structural change within the tax program after May 1st would potentially cause problems with TransCanada.

Mr. Bullock noted thatwhile there is nothing to prevent making changes to the law after May 1st, it would definitely muddy the waters. He recommended getting the base tax rate in place before the May 1st open season start date to avoid potential problems.

Senator Thomas referenced Section (a) of AS 43.90.320 and asked Mr. Bullock to describe what is meant by "a person qualified" for a resource inducement under this section.

Mr. Bullock responded that a person's qualification for the inducements is based on whether they have made a firm commitment during the open season. The conditional commitment does not constitute a firm commitment. The tax inducement is specific to gas. As oil and gas are combined for tax purposes, the Department of Revenue would need to separate the gas tax and compare it to a future tax on gas. He remarked that the process would have been less complicated prior to passage of the Petroleum Production Tax (PPT), when oil and gas were taxed separately.

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SENATOR JOE PASKVAN, inquired about the intended impact of AS 43.90.320.

Mr. Bullock replied that the statute determines tax liability based on gas production tax in the future compared to tax on future production using current law. An

exemption would occur only in the event of a tax increase and would equal the difference.

Senator Paskvan remarked that a presentation by the Department of Revenue (DOR) projected decreasing gas prices between the years 2020 and 2030 resulting in an annual revenue loss of $2 billion under current law. He wondered if that was the effect statutory language intended.

Mr. Bullock communicated that he was not able to answer the question and noted the administration may be better equipped to respond.

Senator Paskvan requested that Mr. Bullock address the DOR estimate.

Mr. Bullock could not attest to the accuracy of the DOR estimate. He examined the two tax rates under AS 43.55.011(g). The first is 25 percent and the second is determined by the average barrel of oil equivalent value compared to $30. He relayed that six million BTU's of gas have the energy equivalent of one barrel of oil. Combining gas with oil would decrease the average value, resulting in lower tax. The AGIA exemption would also be impacted.

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Senator Paskvan wondered whether official statements by the commissioner of DOR regarding revenue issues would have legal implications.

Mr. Bullock reported that the statutes and regulations would govern over statements made by the department.

Senator Paskvan asked if Mr. Bullock had any knowledge of documentation pointing to inconsistencies between DOR statements and statutory language.

Mr. Bullock disclosed that he was not aware of any and noted he was not privy to all of the department's statements on the subject.

Senator Paskvan inquired whether official statements made by a department were of greater evidentiary value than opinions voiced by a department.

Mr. Bullock clarified that the court considers legislative intent. If a state agency has adopted regulations the court may defer to department expertise to interpret regulatory language.

Senator Paskvan solicited information about the lock-in date of May 1, 2010.

Mr. Bullock remarked that under AS 43.90.320 the pertinent tax would be the tax in effect at the beginning of the first binding open season. May 1st could change if the start of the open season changed.

Senator Paskvan asked if the most appropriate time to make changes would be prior to May 1, 2010. Mr. Bullock agreed.

Senator Paskvan noted that Department of Revenue Commissioner Galvin indicated that the legislature would have until May 1, 2010 to make changes. He questioned whether changes made after May 1st could have negative repercussions for the state.

Mr. Bullock stated that he did not have the factual information to answer the question. He referenced his earlier testimony regarding issues that may arise between the licensee and producers.

Senator Paskvan asked Co-Chair Stedman if amendments should be made before May 1, 2010.

Co-Chair Stedman opined that making changes prior to May 1st could help avoid potential problems that may arise if changes were made subsequent to May 1st.

Senator Paskvan requested verification of possibility there may be serious legal consequences if a change were made after May 1, 2010.

Mr. Bullock acknowledged the possibility of potential problems.

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Senator Paskvan stated that prospective constitutional effects raised in Mr. Bullock's memorandum denote that a change in the law after a binding commitment has been made is a prohibited state action.

Mr. Bullock clarified that the law reserves the legislature's flexibility and permits the amendment of law at its discretion. He likened the flexibility to the lease the Legislative Affairs Agency enters into, which is subject to review and appropriation by each legislature. Neither are statutory contractual.

Senator Paskvan asked what legal consequences TransCanada might consider if the state failed to honor the May 1, 2010 lock-in date.

Mr. Bullock recommended waiting until the end of the open season to review what occurred during the season. He alleged that if firm transportation commitments were obtained TransCanada may assert the inducement had no impact. TransCanada could claim the reduction of the inducement value limited the number of commitments secured and that their expectations under the license were impaired. Mr. Bullock noted the claims would be difficult to prove as statutes are subject to legislative discretion.

Senator Paskvan requested verification that dealing with the potential annual revenue loss of $2 billion prior to May 1, 2010 would be in the state's best interest.

Mr. Bullock reiterated that making changes prior to May 1st would help avoid potential issues that may arise if changes were made after May 1st.

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Co-Chair Stedman recapped that action taken by the legislature before May 1st could lessen risk exposure.

Mr. Bullock pointed out that the key statutory language is "the production tax in effect at the start of the first binding open season."

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SUSAN POLLARD, ASSISTANT ATTORNEY GENERAL, OIL, GAS AND MINING SECTION, DEPARTMENT OF LAW, discussed several questions previously provided to her by the Department of Revenue. The first question related to possible liabilities the state could face if AS 43.90.320 were amended or repealed. She noted the statute provides the clear ability

for the legislature to make changes. She stated it could be argued that the AGIA applicants were made aware of potential statutory amendments during discussions in the 2007 legislative session. She voiced that the Department of Law was not currently prepared to publicly address specific litigation issues. She observed that when analyzing who may possess a vested interest in the pipeline project, shippers may not feel invested until a much later time when they are required to sign a Transportation Services Agreement (TSA).

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Ms. Pollard expounded on who would be entitled to the inducement under AS 43.90.300. The commissioners of the Department of Revenue and Department of Natural Resources (DNR) have to agree that a person is qualified. Proposed regulations for the vetting process are reviewed and potentially amended by DOR and DNR based on public comment.

Ms. Pollard addressed the second question, which focused on DOR's proposed regulation regarding the definitions of gas production tax and gas tax obligation. She discussed the committee's concerns about lock-in provisions and the apprehension around the ability to make changes related to the production tax obligation. She recommended looking at general statutory authority and the necessary requirements for agencies to implement a statute.

Ms. Pollard pointed out that regulations must be within statutory authority and are reviewed by the Department of Law (DOL) and the Legislative Affairs Agency. She noted that there are a couple of issues in AS 43.90.320 that requires agency interpretation regulation. The DOR regulation defines the gas production tax and how it applies under current law. She clarified that the legislature would lock in a formula, which would reflect a separation of gas from oil and gas production tax under AS 43.55.011. The regulation delineates the gas that is to be committed during open season by volume, term of years, and gas shipped through the North Slope. She indicated the absence of regulation would make it unclear how a producer would determine gas production taxes in the future. She advised that the regulation would provide a baseline calculation for comparison in order to determine qualifications for exemption.

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Ms. Pollard commented on the concern that the relationship between oil and gas, also known as the "parity" issue, would restrict the ability to make changes to the oil and gas production tax. She detailed that DOL contends that there is currently no obligation that would apply to a future calculation, regardless of what the future tax may be.

Co-Chair Stedman offered that the fundamental issue concerning the committee is the May 1st deadline and potential risk exposure to TransCanada that may arise if changes are made to the tax structure subsequent to this date.

Ms. Pollard asked for clarification on the question.

Co-Chair Stedman restated his previous concern regarding potential risk exposure to TransCanada if changes to the tax structure were made following the start of the first binding open season on May 1, 2010.

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Ms. Pollard provided an example in which she compared combined oil and gas tax to a tax in which gas is separated from oil. Under current law, there is an oil and gas production tax, with regulatory action by DOR to define gas production tax for the purpose of the AGIA exemption. She used a May 15 date related to the separate oil and gas tax. She highlighted an exemption comparison between the tax on the books at May 1 and the gas tax as of May 15.

Co-Chair Stedman wondered if the state's risk exposure introduced by the potential annual revenue loss of $2 billion would increase if amendments were made after May 1, 2010.

Mr. Bullock voiced that the state has a contract with TransCanada to carry the project forward. He observed that AGIA includes a provision preventing the state from soliciting a competing gasline to provide inducements. He observed that if the state makes changes to inducements subsequent to May 1, 2010 the issue is whether the amendments would impair the contract between the state and TransCanada. The risk lies in the potential contract

impairment as there is a prohibition against legislation that may impair contract obligations.

Ms. Pollard agreed and reiterated her earlier testimony that AGIA applicants were made aware of potential statutory amendments during discussions in the 2007 legislative session.

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Senator Thomas pointed out that people rely on existing statutory language and noted that changes made prior to May 1, 2010 would be more of a public relations issue than a legal one. He inquired whether the state would be exposed to legal action by TransCanada-Exxon if the legislature were to make amendments to current law by separating gas and oil tax before the start of the open season. He wondered if TransCanada could claim that the value of their exclusivity license had been reduced as a result of changes made by the state.

Ms. Pollard restated the question and asked if any changes would be made to the gas production tax exemption under AS 43.90.320.

Senator Thomas affirmed and explained that oil and gas tax would be separated. He repeated his previous question regarding potential risk exposure to legal action brought by TransCanada-Exxon.

Ms. Pollard replied that she was not prepared to expound on license details and potential litigation.

Mr. Bullock stated that according to statute the pertinent tax would be the tax that is in effect on the first day of the open season. He pointed out that the inducements are only applicable to the first open season. If the first open season fails the legislature will have to determine whether inducements are necessary in the future. He purported that other inducements could be introduced to offset the devaluation if an amendment subsequent to May 1, 2010 resulted in devaluation of the inducement. The purpose of the inducements is to encourage firm commitments that would allow the pipeline to commence operation.

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Senator Thomas commented on the hopes for a successful open season. He relayed the concern that a successful open season may make it difficult to make tax amendments as a future profit decrease may encourage the licensee or others involved to take legal action against the state.

SENATOR JOHN COGHILL, asked for clarification on the language in AS 43.90.320(c). He questioned whether the section reflected the legislature's intention that the inducement was created for the exclusive licensee to offer to producers.

Mr. Bullock explained that subsection (c) referred to the person who has made a firm commitment and is claiming the exemption. He detailed that statute outlines that a person or person's affiliates will not protest or appeal a filing by the licensee to roll in mainline expansion costs up to the level that the licensee is required to propose and support. Mr. Bullock referenced the rolled-in rate issue, which aimed at diminishing the burden on new production by preventing them from carrying the full cost of the pipeline expansion. He stated that ultimately the determination of the rate will be up to either the Federal Energy Regulatory Commission or the Regulatory Commission of Alaska (RCA).

Senator Coghill wondered if there was a condition related to the rate if conflicts arose with the section.

Mr. Bullock observed that a person must agree not to protest the rolled-in rates and must make a firm transportation commitment during the open season as a condition of the tax exemption.

Senator Coghill observed that the start of the binding open season was a central topic. He conveyed the importance of understanding any issues that may violate AS 43.90.320(c) and questioned whether the start of an open season would be applicable if it were a conditioned open season.

Mr. Bullock did not believe a conditioned open season would be binding. He elaborated that there would need to be a firm commitment during the open season and if there was a condition that could not be met during the open season the commitment could not be classified as firm. He noted the existence of different types of commitments such as changes that TransCanada might make to their project compared with conditions that TransCanada would have no control over.

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Senator Paskvan asked if TransCanada-Exxon's announcement of the open season effectively put the state on notice that any statutory changes should occur prior to May 1, 2010.

Mr. Bullock clarified that statute specifies taxes will be determined on the first day of open season regardless of the start date. Original AGIA terms require the licensee to have an open season within a set time period. May 1, 2010 was selected as the specific date within the set time parameters.

Senator Paskvan questioned whether, during a contingent open season, it was allowable to resolve contingencies by December 5, 2011, which would at that time become a binding open season and lock in the tax at May 1, 2010.

Mr. Bullock addressed language in AS 43.90.320, regarding acquisition of firm transportation capacity in the first binding open season. He communicated that a discrepancy exists between statutory language and FERC regulations, and noted that FERC doesn't specify a period of time in which the open season will occur. The purpose of the open season and firm commitments are to demonstrate the necessity of a pipeline. A lack of firm commitments could give the impression there is not a basis or need for a pipeline.

Senator Thomas asked whether the state would have liability in the future under AS 43.90.320 if oil and gas were decoupled, and noted decoupling would result in an increase in oil tax and no change to the gas tax.

Mr. Bullock observed the exemption is based on the tax at the start of the open season compared to tax on gas in the future. There is no link between the gas tax under the exemption and the oil tax.

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ADJOURNMENT

The meeting was adjourned at 3:42 PM.