

HOUSE FINANCE COMMITTEE  
April 8, 2014  
1:34 p.m.

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CALL TO ORDER

Co-Chair Austerman called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair  
Representative Bill Stoltze, Co-Chair  
Representative Mark Neuman, Vice-Chair  
Representative Mia Costello  
Representative Bryce Edgmon  
Representative Les Gara  
Representative David Guttenberg  
Representative Lindsey Holmes  
Representative Cathy Munoz  
Representative Steve Thompson  
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Donald Bullock, Legislative Counsel, Division of Legal and Research Services, Legislative Affairs Agency; Representative Benjamin Nageak, Sponsor; Jacob Adams, Chief Administrative Officer, North Slope Borough, Barrow; Angela Rodell, Commissioner, Department of Revenue.

SUMMARY

HB 379 OIL & GAS PROPERTY TAX

HB 379 was HEARD and HELD in committee for further consideration.

PRESENTATION: LEGISLATIVE LEGAL SERVICES: REVIEW OF MOU

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DONALD BULLOCK, LEGISLATIVE COUNSEL, DIVISION OF LEGAL AND RESEARCH SERVICES, LEGISLATIVE AFFAIRS AGENCY, relayed that he and Emily Nauman were the primary drafters for oil and gas issues. He stated that the legislature would not be voting on the Heads of Agreement (HOA) or Memorandum of Understanding (MOU). He detailed that the legislature would vote on legislation that would empower the administration to enter into certain agreements. He provided a PowerPoint presentation titled "Memorandum of Understanding MOU" (copy on file). He addressed slide 2 titled "Parties":

State of Alaska, through the commissioners of natural resources and revenue

TransCanada Alaska Company, LLC and  
Foothills Pipe Lines, Ltd. (Jointly as Licensee)

TransCanada Alaska Development Inc.

Mr. Bullock elaborated that TransCanada and Foothills were the licensees under the Alaska Gasline Inducement Act (AGIA). TransCanada Alaska Development Incorporated (TADI) was expected to have a limited partner interest for the portion of the pipeline TransCanada would initially own under the MOU. He relayed that ExxonMobil had been working with TransCanada on the Alaska Pipeline Project, but was not a part of the MOU. Additionally, the Alaska Gasline Development Corporation (AGDC) did not participate in the MOU.

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Mr. Bullock turned to "MOU Issues" on slide 3:

Should the state have an ownership interest?

How should the state transition from AGIA?

Should the state share its interest with a partner?

Mr. Bullock expounded on slide 3. He referred to discussions about how the state would finance a project if it chose to have no partners. He relayed that one of the purposes of the MOU was to enter into an agreement with TransCanada; TransCanada would own part of the project initially, which would represent the state's percentage of gas on the North Slope that would be produced and what the state would receive in the form of royalty-in-kind and the TransAlaska Pipeline System (TAPS). He noted that there had been a major focus on the open season during AGIA discussions; it had been expected that producers and other shippers would commit to use the project. Part of the MOU required the state to enter into the type of agreement that would have been acquired in a successful open season. He detailed that the state would pay the cost of transporting its gas for the term of the contract (20 to 25 years).

Mr. Bullock relayed that the MOU was a cost and was not like TAPS. He used a grocery store as an example and explained that a delivery truck would be part of the store's cost as opposed to an independent profit center. He communicated that terms of identifying tariffs, operating as a common carrier, allowing an owner to recover costs, and return on investment were all TransCanada's business. He addressed what the connection would be between the MOU and AGIA if TransCanada was the same party in the MOU as the licensee under AGIA. He expressed intent to discuss several ways to get out of AGIA. He noted that under the MOU TransCanada would initially own approximately one quarter of the project; the state would have the opportunity to buy into TransCanada's limited partnership interest. He detailed that the limited partnership would continue to own one quarter of the project subject to the limitation that TransCanada could not sell more than 40 percent of its interest and TransCanada could not have less than 14 to 15 percent of the overall project after the state acquired its equity interest. He detailed that if the state's interest was about 25 percent (with royalty and tax combined) and TransCanada had 14 percent, the state's interest in the overall project would be approximately 10 to 11 percent.

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Mr. Bullock turned to slide 5 titled "State Ownership":

How does the state acquire an equity interest in the midstream part of the Alaska LNG Project?

How will the state finance an investment in a project?

Mr. Bullock elaborated on slide 5 and relayed that AGDC had the power to issue revenue bonds. He detailed that AGDC was a separate corporation that was intended to shield the state from some liability. When bonding a project, decision makers determined whether a project was a good idea and bond purchasers determined whether it was a good deal. He added that the interest rate would change depending on risk. He continued that the interest in the MOU related to the part of the project north of the liquid natural gas (LNG) facility. Under the agreement terms the midstream project started at the transmission lines from Prudhoe Bay and Point Thomson. He elaborated the process of sending gas through the pipeline.

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Mr. Bullock moved to slide 6 titled "State Ownership":

Under the MOU, an affiliate of TransCanada would hold that portion of the midstream project equal to the percentage of North Slope gas the state may receive as royalty in kind and production tax on gas paid as gas.

May be 20 - 25% of the total project depending on amount of royalty gas in kind and production tax paid as gas.

Mr. Bullock highlighted the importance of the issue given that it addressed the percentage of production on the North Slope. The bill included a new section pertaining to production tax that allowed producers or lessees paying royalty-in-kind the choice to pay tax with gas rather than dollars. He advised that the legislature would need to consider whether a company committing to pay with gas would be around in the future. He asked the legislature to consider what would happen if a producer decided to leave the state or sell its interest to another producer. He noted that the state was considering locking interest in for the initial term of the contract, which could be 20 to 25 years; the MOU referred to the initial contract term as 25 years, but also included language stating the term would be nothing below 20 years. He reiterated the importance of

the issue. He communicated that the state was not the driving force behind the percentage of gas the state would receive. He likened the producers to train engines and the state to the caboose; when the producers decided to move the state would move, but until then there was no movement on production.

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Mr. Bullock directed attention to two agreements anticipated under the MOU (slide 7):

Precedent agreement & Firm Transportation Services Agreement commits the State to ship its gas in the part of the midstream project owned by TransCanada for 20 - 25 years.

State may obtain an option to buy 40% of TransCanada's interest.

Mr. Bullock expounded on slide 7. The precedent agreement was the first step to moving towards the firm transportation services agreement. He detailed that Exhibit C under the MOU specified that the firm transportation services agreement was expected to come before the legislature for approval. TransCanada would be the initial owner of the pipeline and the state would have an option to buy in. He relayed that TransCanada was a transporter (it did not own or market gas) and was not in the same alignment as producers shipping gas. He looked at slide 9:

AGDC may participate in the LNG plant while TransCanada initially holds an interest in the midstream portion that the state may have an option to acquire.

Mr. Bullock shared that AGIA had discussed a competing natural gas pipeline, but the relevant piece for the current discussion was the allowable 500 million cubic feet per day. He continued that at one point the amount was an estimate of the gas needed to fill in-state demands at a reasonable cost. He asked the legislature to consider what gas would be taken out of the state's share of royalty and tax for in-state delivery because the quantity would not be available to be liquefied or exported. He pointed to a comparison of revenue the state would receive for the sale of gas in-state versus the sale of gas to Asia. He shared

that the issue had come up in discussions on Cook Inlet and the regulation of Enstar; legislation had been passed due to Enstar's argument that Cook Inlet gas was subject to a broader market and more cost. He advised the committee to keep in mind the amount of the state's gas that would be using the facility when it considered the part of the LNG project it should participate in. He communicated that if the state had greater ownership in the LNG facility or pipeline it was the part of the project that may be flexible to new producers and new forms of gas. The producers' part of the pipeline would be dedicated. He compared it to the transmission lines on the North Slope; it was what it took to get the producers' gas liquefied and shipped. The state's offtakes also pertained to the regulation. The discussion had been that the producers' part of the project would be just a cost; the in-state gas would be subject to different regulation. He was uncertain how the issue would be handled.

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Mr. Bullock directed attention to slides 10 and 11 titled "Enabling Legislation." He discussed that there had been "must haves" in AS 43.91.30 for AGIA that talked about expectations for applications. He referred to the enabling legislation as a jack-in-the-box where the legislature would decide on what it wanted, the size, and what could go into it, but it could not know what would come out when it came to contracts.

Mr. Bullock moved to slide 12. He believed it was unclear which components of the enabling legislation were critical. He surmised that legislation would be enabling if it empowered the administration to act on items in the MOU and HOA; if the legislature decided that the MOU should not go into effect, any changes would raise the issue of who would participate in state ownership. He turned to slide 14:

Is there a situation in which enabling legislation may allow the Heads of Agreement to go forward, but not the MOU?

Ask!

Mr. Bullock elaborated that TransCanada, AGDC, and the producers were all parties to the HOA. He remarked that it would be helpful to receive guidance from the

administration. He added that the cost would be protected. He discussed the range of acceptable tax rates in the HOA and advised the legislature to consider whether a comfortable range was built in.

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Mr. Bullock turned to slide 16 titled "AGIA":

Transition out of AGIA

To Alaska LNG Project?

Is the AGIA Project to Alberta uneconomic under AS 43.90.240?

Mr. Bullock referred to a memorandum from Legislative Legal Services [addressed to Representative Mike Hawker, dated February 15, 2013] (copy on file). The memorandum addressed some of the risk associated with ending AGIA. He asked whether the project was the Alberta project or something else. Additionally, he queried whether there was an acceptable modification in the amendments to the project entered into by the administration that required TransCanada to look at the LNG option.

Mr. Bullock turned to slide 17:

MOU addresses "uneconomic" exit from AGIA in the recitals.

What if enabling legislation fails to pass?

What if the MOU is not implemented?

Mr. Bullock elaborated on slide 17 and relayed that if enabling legislation passed the commissioners would begin the process of determining the project under AGIA was uneconomic (a subsequent section discussed that TransCanada would agree to go along with the change). He referred back to questions listed on slide 17. He relayed that if the MOU was not implemented the state would be back where it was currently with AGIA.

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Mr. Bullock looked at slide 18 and discussed the treble damages provision under AS 43.90.440. He listed the three ways to get out of AGIA: 1) the licensee violated the agreement terms; 2) the project was deemed uneconomic (if the license was abandoned the state would have the opportunity to pay the balance of the qualified expenditures to receive data compiled by the expenses); or 3) via the treble damages provision, which related to whether the state was providing similar inducements to a competing pipeline. He surmised that due to TransCanada's involvement in the project the treble damages may not be an issue. He observed that AS 43.90.440 did not include a waiver of any action that TransCanada may have. He noted it would be a more pertinent issue if the enabling legislation changed or the MOU did not allow TransCanada to continue as an involved party.

Mr. Bullock turned to slide 20 titled "Why TransCanada?":

Is the MOU the best deal?

Should the state solicit proposals from others?

Mr. Bullock addressed the questions on slide 20 and relayed that there were not many gas pipeline companies that had dealt with the northern environment; TransCanada had the experience. He did not know about TransCanada's involvement with gas treatment plants; it had been a question under AGIA whether TransCanada would do the work or hire another party. The company Enbridge had a pipeline from Alberta to Saskatchewan. He advised that the legislature may want to consider what would happen in the event of other proposals. He noted that the state did not really know about the producers' relationship with Canada. He remarked that TransCanada was a good company and surmised that the relationship was probably positive; TransCanada's business was building and operating pipelines. He observed that if three producers had 75 percent of the gas they would have significant input on how the project was built and would be concerned with cost. He advised that it would be helpful to know where the producers stood. He continued that TransCanada was also involved and was looking forward to participating in a competing project; he referred to a 460-mile pipeline that would originate in Prince Rupert, British Columbia. He believed Alaska had an advantage over the British Columbia project. He noted that the natural gas and the fields were not developed in northeastern British

Columbia; the state had the ability to produce and ship gas much sooner subject to limitations on taking off the amount of gas.

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Mr. Bullock turned to slide 24 titled "Things We Don't Know":

Things we don't know:

What happened during the first open season in 2010? Why did it fail?

Why did it take from July 2010 to May 2012 to conclude that the first open season failed?

Mr. Bullock detailed that TransCanada had an open season from April through July 2010. He pointed to the second question on slide 24 and noted that TransCanada and ExxonMobil had reported to the Federal Energy Regulatory Commission that the first open season had failed. He advised the committee to think of ways to stay informed about the process. He discussed that the legislature always had the power to appropriate; therefore it could always ask the hard questions (i.e. what the state was getting for the money and what the status was). He referred to the Legislative Legal Services memorandum that addressed the AGIA project (copy on file); the memo specified that the AGIA project would go down the highway and had been considered in 2008. TransCanada had been interested to know whether anyone was interested in shipping gas to an LNG facility. He continued that even though the AGIA project was the highway project, TransCanada was soliciting proposals and shipment commitments that would have gone to tidewater. Therefore, the state did not know what happened. He believed it would be beneficial to know why the particular LNG project did not move forward if TransCanada had been discussing LNG. Since that time the production tax structure had changed, which increased the attractiveness of doing business on the oil fields.

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Mr. Bullock remarked that the administration had talked to the committee about the MOU. He thought it would be more advantageous to suggest things for the legislature to think

about in order to develop the bounds to move forward on the project. The administration had stated that it would offer the contracts to the legislature for approval before finalizing them. He noted that former Governor Sarah Palin had relayed that the license for AGIA would go to the legislature for approval. He remarked that the approval of the license was controversial; the effective date of the legislation had failed, which meant the contract had not been issued until December 2008. Under the separation of powers there was a risk that the administration could enter into the contract without legislative approval; the legislature would continue to have the power to appropriate. He expounded that generally the legislature designed the bounds under which the administration may act; an executive function was different than a legislative function. He hoped it would not happen, but it depended on how contentious the issue was. He advised the committee to be aware of the separation of powers issue. He commented that whether the governor could exercise his executive power without legislative involvement had recently come up related to some of the governor's appointments.

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Representative Gara thanked Mr. Bullock for his work. He had concerns about the issue but wanted to find a way to vote for it. He wondered whether it would be constitutional if the governor decided to lock in tax rates or royalty-in-kind provisions for 20 or 30 years with the oil companies. He stated that in the past oil companies had wanted fiscal certainty (i.e. a 20-year lock-in). He referred to memorandums written by Mr. Bullock addressing whether preventing a future legislature or voters from making changes was unconstitutional.

Mr. Bullock replied that Article 9, Section 1 of the Alaska Constitution stated that the power of the tax would not be surrendered or contracted away. He relayed that under former Governor Frank Murkowski's initial contracts a dispute had occurred about whether taxes could be solidified for a given period of time. He stated that the words to the constitution prevented setting taxes in stone for a given time period and included a prohibition against dedicated funds. Additionally, he pointed to unforeseen occurrences such as earthquakes or floods. He shared that the provisions were consistent with language that advised against giving away the state's power to tax and from

preventing future legislatures from demanding for needs. Along the same lines there had been discussions related to payment in lieu of taxes; it also brought up whether it was constitutional to set aside the state's power to tax in exchange for contractual payment. He noted the issue was similar to whether a city council or borough assembly could bind future assemblies or councils from making tax changes.

Mr. Bullock continued that the legislature always had the opportunity to pass a law that may be deemed unconstitutional; it was up to the legislature to decide whether it wanted to take the risk. He referred to a University of Alaska lands case that was struck down three years after the law had been implemented. In the past the legislature had decided to not risk the possibility a law may be unconstitutional. He spoke to the current version of SB 138 that had been amended in the Senate and in the House Resources Committee. A provision in the bill added a new section to the production tax AS 43.55.014, which allowed producers who agreed to pay royalty-in-kind or royalty adjustments to have the option of paying their production tax in the form of gas. He did not believe the idea was bad, but he was uncertain about how the tax in the form of gas related to the tax percentage. Additionally, the state would be committed to using a fraction of the pipeline that would represent the amount of gas the state was expected to receive. He remarked that royalty was a sure-thing and had flexibility that tax did not; there was authority in the gas leasing statute AS 38.05.180 defining that certain fields needed a royalty reduction in order to make the fields feasible.

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Mr. Bullock continued to address Representative Gara's question. He addressed what would occur if the legislature increased the tax; if tax was paid in the form of gas the state would need to look at expanding its portion of the pipeline. Similarly, if the state legislature decided to lower the tax rate it would be short on gas. He believed it was an important consideration. He noted that an earlier version of the bill included language specifying that paying the tax in the form of gas was an irreconcilable election. Whether someone could sell out had not been discussed. He did not believe it was clear whether future owners or producers would honor the agreement. He stressed

that the issue was a big deal because it would impact the extent the state would commit to a project.

Representative Gara referred to what he believed was a tilted relationship with TransCanada. He spoke about the idea of a tax rate lock in for 20 to 30 years. He noted that the legislature was split on the issue. He believed the legislature would be playing with constitutional fire if it locked the state in. He was concerned about spending millions of dollars while risking that the locked in rate may be deemed unconstitutional and that producers may walk away. He wondered about including a provision stating that in the event that parts of the law were deemed unconstitutional it did not give producers the right to walk away from the project.

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Mr. Bullock replied that all of the agreements would be between the producers and initially TransCanada. Due to the MOU the state was not at the project table. The MOU included a provision specifying that some of the negotiations TransCanada engaged in would be confidential. He stated that contracts had risks and the state could only cover itself as much as possible. He noted that the project's primary driver was the market for gas and what sellers could expect to receive. He communicated that it did not matter how much the project cost if there was no market; if there was a market the question became how to get the product to market at the lowest cost. He relayed that TransCanada had brought some of its projects in under budget, but contracts were inherently risky. He believed binding producers to a contract would be difficult and would result in litigation.

Representative Wilson pointed to the current partnership with TransCanada. She wondered whether the state would need to go through a process to terminate the partnership if it chose to do so.

Mr. Bullock answered that TransCanada was the licensee under AGIA and there were ways to statutorily get out of AGIA. He detailed that the MOU specified that if the state signed the option to purchase part of the project and secured firm transportation agreements, TransCanada would agree that the Alberta project was uneconomic. He elaborated that if the legislation did not satisfy

TransCanada the uneconomic issue would persist and AGIA would remain. Currently under the agreement with TransCanada the state was reimbursing accrued costs that had been expended since December 31, 2013.

Representative Wilson wondered if it was possible to do a cost comparison on what it would cost the state if it had to prove using TransCanada was uneconomical versus moving forward with the agreement under discussion. She pointed to potential court cases that would occur if the state chose not to continue a partnership with TransCanada. She was wondering if the state had an opportunity to get out of the contract with TransCanada without significant court costs and other.

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Mr. Bullock responded that there may be a way to determine the different costs. He referred to language in the MOU stating that the commissioners would move forward to show that the project was uneconomic because there was not room for two pipelines. He referenced the AGIA provision AS 43.90.440 that discussed competing pipelines versus the abandonment provision AS 43.90.240 that was based on no money at the wellhead (transportation costs were too high). He questioned whether the project was already uneconomic if it was the Alberta project. He stated that if the argument was that the state had drawn back from the allegation that the Alberta project was the only option, there would be a dispute about whether modifications had turned the project into something else. He agreed that if litigation occurred it could "go on." He addressed what it would take for the state to enter the project on its own. He discussed that the state would pay TransCanada to operate its portion of the project under the agreement; if the state chose to move forward alone it would be responsible for bonding costs and taking on its own risk. He observed that there was no simple solution to determine the best course of action.

Representative Guttenberg pointed to Mr. Bullock's caboose and engine analogy. He wondered how the state guaranteed production or delivery of gas when the state did not have control of production. He wondered if the cost of the state's ability to market gas was devalued. He asked if the contracts considered the situation.

Mr. Bullock answered that purchasers would take into consideration how reliable the gas supply was. He continued that if the seller did not have the power to ensure supply, it may result in reduced cost. Additionally, if there was a slowdown in production the state would be competing in the same market with three of the best energy companies in the world; the state would have one pot to draw from, whereas the other entities could probably find another LNG source. He thought it was logical that the state's price may have to reflect some of the risk, but he could not quantify it.

Representative Guttenberg noted that the producers would own 75 percent of the project and that TransCanada would build and operate it. He wondered if there were scenarios built in that would allow the producers to decline participation.

Mr. Bullock replied that there had been talk about the advantage of having TransCanada as a skilled pipeline builder and operator, but the state was not included in discussions related to who would build. He stated that under the MOU the decision would be between the producers and TransCanada. He noted that the producers had northern experience (albeit not with a project as large as the one proposed), but they may have another builder in mind. He believed the producers would discuss the option of using TransCanada as a builder. He opined that producers would approach the project with a goal of keeping costs down. He compared the project to TAPS, which was a regulated common carrier owned by producers (owners received profit). In 1986 when wellhead prices had been low the state had been concerned about continued production. He noted that if an entity owned the production and received a return on the pipeline and retail outlets it could afford to take a financial hit somewhere along the way. He stated that if a pipeline was not an independent profit center costs should be minimized to receive the maximum revenue from the gas.

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Representative Guttenberg observed that producers had done well under TAPS when they could keep their tariffs up and the wellhead price down. He remarked that the state received less money at the wellhead but producers had recouped their charges by costing back to themselves.

Mr. Bullock replied that it was a business. He expounded that when tariffs had been higher wellhead prices had been low, but the municipalities taxing the pipeline property had been in a better position; there had been dissatisfaction with the TAPS tariff settlement that kept tariffs down, which devalued the pipeline. The state was now looking at increasing tariffs partly due to the value change to the pipeline and to lower throughput.

Vice-Chair Neuman wondered if TransCanada would continue to collect money from the state at a 90 percent reimbursement (until the passage of legislation) if AGIA was found uneconomic under the abandonment clause.

Mr. Bullock replied that AGIA was still alive. He elaborated that in the current post-first season phase costs that were qualified expenditures under AGIA were reimbursable at the 90 percent rate. He communicated that AGIA would end if the MOU went into effect. He explained that the liability to reimburse TransCanada would enter a different phase, which would refer to certain costs in the MOU. He detailed that if the state terminated the contract it would be liable to pay different amounts of money to TransCanada depending on when the contract was terminated. He noted that although the reimbursement rate under AGIA was 90 percent, the costs were more easily identified by what they related to. The MOU included a provision to provide a credit for reimbursement paid after December 31, 2013. The agreement and the administration both anticipated that AGIA would end in the first half of the current year. He noted that Legislative Legal Services had become aware of the administration's intent when the Department of Natural Resources' (DNR) budget did not include funding for the pipeline office that worked with the AGIA project. He reiterated that the expectation that AGIA would end on June 30, 2014 would change if enabling legislation did not reach expectations or if the state took a different ownership approach.

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Vice-Chair Neuman wondered if TransCanada could encumber funds or enter into contracts for work to be performed that went beyond the trigger event. Mr. Bullock answered that the legislature had enacted AGIA in a reimbursement mode; reimbursing costs that were expended protected the state from costs that had not been paid by TransCanada. The

effort had been to avoid funding the license upfront. He shared that the Department of Revenue had published a report in January related to AGIA.

Vice-Chair Neuman referred to development cost reimbursement under the MOU. He noted that if the contract was terminated for reason other than the execution of transition agreements, the state would be liable to reimburse TransCanada for all post December 31, 2013 development costs (less the amount equal to the allowance for funds used during construction at a rate of 7.1 percent and at the AGIA reimbursement rate). He asked Mr. Bullock to elaborate.

Mr. Bullock replied that AGIA was still a contract to reimburse qualified expenditures, which would continue until the license ended. He detailed that the provision was included in Exhibit C under the section related to the termination of the agreement (page 8). The provision related primarily to the reimbursement of costs that TransCanada would have expended; it also included a credit for any payments that had been made to the affiliate TransCanada Alaska (the licensee).

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Representative Holmes expressed concern about exhibit B. She pointed to Section 3 of Exhibit B (equity option term sheet) where TransCanada had the right to make all decisions on behalf of the limited partnership with several exceptions. She believed the language provided TransCanada with the seat at the table with producers on the gas treatment plant and pipeline decisions. She pointed to discussions in the legislature that the state appeared to bare 100 percent of the financial risk, but had no seat at the table. She thought the idea made no sense. She read from Section 8 that "the parties acknowledge the confidentiality provisions of the Alaska LNG project agreements to which the limited partnership may become a party, may prohibit or restrict disclosure of project information to the state." She summarized that she felt uncomfortable that the state would bare all the financial risk, would have no say in the project negotiations, and may not have access to the information.

Mr. Bullock answered that under AGIA TransCanada was responsible for 10 percent of the qualified expenditures.

He surmised that the company was probably paying additional costs because there were limitations on qualified expenditures. He remarked that under the MOU it was not clear to him what costs the state would reimburse. The state would pay the costs plus the allowance for funds used during construction (7.1 percent). He agreed that under the MOU the parties developing the project were the three producers and TransCanada and that TransCanada would ship the gas received by the state through the project that it owned and managed. At some point if the state decided to buy into the project it would be liable for the operating costs as well. He relayed that between July 30, 2010 and May 2012 the state had not been privy to the status of the project, the success of the open season, or conditions that had prevented the open season. The MOU did include a confidentiality agreement that may restrict TransCanada's ability to share information. He stated that the MOU could be looked at as a draft. He believed it should be taken into consideration so the state would know as costs were accrued up to various termination points whether the project was viable.

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Mr. Bullock returned to the issue of reimbursement. The MOU specified seven ways the MOU could be terminated (page 7). Only the execution delivery of all transition agreements did not potentially involve the state paying money. He was not attempting to provide an opinion on the MOU, but to provide questions the committee could think about.

Representative Holmes observed that the MOU was not currently binding. Mr. Bullock interjected that one part of the MOU was binding pertaining to development costs. He explained that if the MOU did not go into effect page 7 of the memorandum addressed what the state would be liable if the MOU was terminated for any other reason other than the passage of enabling legislation.

Representative Holmes noted that the MOU included references that if enabling legislation passed the commitment by the state and TransCanada to move forward to terminate AGIA as uneconomic was binding.

Mr. Bullock replied that the agreement did not mention the termination of AGIA due to a competing pipeline, which was risky. Additionally, the MOU did not contain language

specifying that regardless of the uneconomic provision that TransCanada and the administration mutually agree to end the license. He referred to a discussion in the House Resources Committee about what would happen if TransCanada did not agree. The commissioner of DNR had testified that the state would take advantage of arbitration provisions included in the uneconomic provision and that the state would have a good chance. He relayed that the commissioners and TransCanada could determine that the Alberta project was uneconomic; however, if it went to arbitration there would be more objective standards the panel would consider. He elaborated that the panel would look at what it would cost to get the gas to market and whether there was money to be made in selling or shipping gas or purchasing affordable gas. He noted that the in-state project faced the same issue where delivery costs were low enough that purchasers were not paying more than they would for oil.

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Co-Chair Stoltze recalled sitting through the AGIA vote in August 2008. He believed TransCanada had bullied the state in the past. He wondered how to determine when and if the state should discontinue moving forward with a partner.

Mr. Bullock replied that it came down to the market (i.e. who would buy the state's gas and how much they were willing to pay). Once the market had been established and a range of prices had been determined the state could look at the project itself to determine whether it could keep the cost of delivery down low enough and make money on the gas. He noted that the state would only earn money on the gas (transportation would be a cost until the state reached a point where another entity could pay it to transport or liquefy the gas). Once a market had been identified the producers and TransCanada would determine how to move forward to protect the project from cost increases. He noted that both the producers and TransCanada had an interest in keeping costs low. The state would only be a shipper of gas, which was why it had entered into the firm transportation services agreement; the state was a customer, not a transporter.

Co-Chair Stoltze believed the House Resources Committee had discussed the issue and appeared to be proceeding on an option that included TransCanada. He noted that it would be

part of the House Finance Committee's responsibility to discuss the issue.

Mr. Bullock believed consultants would speak with the committee later in the week about options for alternative financing and its impact. He relayed that the state would take on significant liabilities if it took on ownership upfront (in addition to ensuring a market existed to cover the state's costs). There was also the consideration that the agreement with TransCanada was possibly a good deal; it took on some of the state's risk and potentially what the state paid above cost would be reasonable.

Co-Chair Stoltze noted that the issue needed to be vetted. He wondered if the deal was a good or bad. He had not received a straight answer from consultants.

Mr. Bullock advised the legislature not to vote for something it did not understand. He compared the legislature to a jury receiving advice from expert witnesses who had the role of providing information to make the decision makers comfortable. He believed the committee should consider what the state would receive from ownership of the pipeline.

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Co-Chair Austerman asked Mr. Bullock for confirmation that he would be available to discuss the topic in the future. Mr. Bullock replied in the affirmative. He remarked on the importance of the issue and noted that the decisions would impact the future of Alaskans.

Co-Chair Austerman thanked Mr. Bullock for his service.

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AT EASE

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RECONVENED

#379

HOUSE BILL NO. 379

"An Act relating to the limitation on the value of property taxable by a municipality; and providing for an effective date."

2:54:34 PM

REPRESENTATIVE BENJAMIN NAGEAK, read from a prepared statement on HB 379:

Thank you for having me here today to present HB 379, "An Act relating to the limitation on the value of property taxable by a municipality; and providing for an effective date."

HB 379 seeks to make a legislative change to the formula how a municipality may use oil and gas tax revenue. This is not a bill to raise taxes; it is a bill to give municipalities the flexibility to raise the cap which they can then use for their operating budgets.

I have a long history with this issue, having served on the North Slope Borough Assembly and as Borough Mayor and can go on and on about it - which as you know I am very happy to do! But also here today from the North Slope Borough is Mr. Jake Adams, who served on the first North Slope Borough Assembly and as the second mayor of the Borough and was here at the very beginning of the process that got all this started. At the committee's pleasure Mr. Adams is available to take you through a little of the history and the importance of this issue to the Borough.

Mr. Chairman I also have two other employees from the North Slope Borough, John Bitney and Rob Elkins, to answer technical questions about the formula and how that would work with this bill.

JACOB ADAMS, CHIEF ADMINISTRATIVE OFFICER, NORTH SLOPE BOROUGH, BARROW, thanked the committee for hearing the bill. He shared that his work with the borough had begun in 1972. He provided prepared remarks:

It was a struggle for us in the early days to form the North Slope Borough. We were sued by the state and by the oil companies. They said the Eskimos weren't capable of governing themselves and managing finances. When the oil and gas property tax laws were passed in 1973 the cap was written into state law about how much property tax revenue could be used for municipal

operating budget. That was 40 years ago. Today the North Slope Borough is my home and it's the home of my children and grandchildren. It is a success story due to the wealth of resources that are on the North Slope Borough. We've built up our infrastructure with schools, roads, airports, water and sewer system, health clinics, and others. We pay for these services that are provided by the State of Alaska and many other regions. We basically pay for it while other areas depend on the state for financial resources to pay for those services. For example, we provide rescue services for the entire North Slope. We also have a fish and wildlife department that cooperatively works with the North Slope, the State of Alaska, and federal government. We have built up these services with property tax revenues allowed by the state law. The state taxes on oil and gas properties are at 20 mills. The North Slope Borough has always kept property taxes lower than the State of Alaska. We take all of the revenues available to us and have been taxing at primarily about 18.5 mills over the last 40 years; there has been only one exception when we went to 19 mills. That's the only time we have deviated from 18.5 mills.

The bill before you today is a request to allow us to raise the cap on the amount of revenue that can be used for our operating budget. We will not raise the property tax mill rate; we need that 18.5 mill to be there so we try hard not to raise our mill levy much beyond 18.5 mills (most other municipalities depend on bond rating by rating agencies). We simply do not need as much revenue for debt services these days because we pretty much built all of the infrastructure that we need in our communities, but need the operating revenues to keep the maintenance up on these infrastructures. Thank you for your time today.

[3:01:07 PM](#)

Co-Chair Stoltze asked the department to join the table.

ANGELA RODELL, COMMISSIONER, DEPARTMENT OF REVENUE, shared that the department had worked closely with Representative Nageak to craft a solution to address the North Slope Borough's need to acquire additional operating budget funds, while refraining from impacting the state's revenue

received from state property tax, along with the need to keep as neutral as possible. She believed the bill achieved all of the aforementioned purposes. She pointed to an indeterminate fiscal note from the Department of Revenue (DOR). The note included a potential impact of \$10 million. She noted that currently the North Slope Borough had a rate of 18.5 mills, which had been in place for a number of years. The borough had always had the opportunity to go to 20 mills; if it chose to go to 20 mills the impact to the state would be approximately \$10 million. She did not believe the borough should be criticized or held accountable for keeping its property taxes low and allowing the state to collect some of its share of oil and gas property tax.

[3:03:46 PM](#)

Co-Chair Stoltze wondered if DOR was satisfied with the current legislation. Commissioner Rodell replied that the department had spoken with the borough and sponsor about adding a couple of timing pieces to clarify when the multiplier would be calculated with the assessed value and when the state would be noticed. The goal would be to remove any confusion about when valuations were locked in. The language had been provided to the sponsor's office as a potential amendment.

Co-Chair Stoltze asked his staff to provide the department's amendment language to committee members.

Representative Wilson wondered how how pipeline revenue was collected by the North Slope Borough compared to Fairbanks North Star Borough. Commissioner Rodell replied that the calculation on the value of oil and gas property tax was done separately from traditional residential property tax valuations. The calculation was converted into a mill rate and adjusted. She did not believe Fairbanks was anywhere near its limits. She detailed that because Fairbanks had a low mill rate the bill would allow the borough to use the higher end of the 375 percent oil and gas property valuation in the calculation evaluation for the mill rate.

[3:06:10 PM](#)

Representative Wilson pointed to page 34 of a handout titled "Alaska Taxable 2013" (copy on file). She asked if

the Fairbanks tax had to go towards debt service and the operating budget.

Commissioner Rodell replied that the calculation was combined. She explained that the debt service calculation was not capped and would continue to be uncapped. There had been a cap of 20 mills in practice on the state's property tax rate because the local property tax was fully deductible from the state property tax. An extra calculation was required on the valuation for oil and gas property in addition to the traditional residential property tax to compile an overall valuation that the operating mill rate was applied to; the calculation was combined with the debt service to determine an overall mill rate (the figure was typically less than 20 mills). She believed the current Fairbanks rate was significantly below 20 mills.

Representative Wilson wondered why the state mandated how communities used the 12 mills from the pipeline (i.e. for debt or operations). She thought communities should have the ability to choose how to use the funds. She surmised that if residents were taxed at 12 mills the pipeline could only be taxed at 20 mills. She noted that 8 mills from the pipeline tax went to the state. She understood that initially the structure had been a way to encourage the construction of infrastructure in communities, but she did not believe the calculations were needed any longer.

Commissioner Rodell replied that originally the issue had been about fairness on the state property tax and a way to redistribute oil and gas property wealth throughout the state to communities that may not have the same benefit. She believed the state was indifferent about whether the funds were used for operating budgets versus debt service. The bill addressed reallocation and allowing increased operation. She relayed that if the percentage was lifted all together it would create a substantial tax increase because it would triple the valuation the calculation was based on; that tax would increase the cost of transportation, which was deductible from the oil production tax. She summarized that changes to oil and gas property taxes had a direct cost to the state.

Vice-Chair Neuman wondered how the tiered formula had been derived and how it would impact other municipalities and jurisdictions. Commissioner Rodell answered that the tiered

formula was an effort to minimize the impact on tax payers and the state, while giving communities the flexibility to determine whether they wanted property tax to go to operations or debt service. Additionally, the goal had been to ensure that the bill would not impact a community's ability to raise or lower their mill rate (whether the community was like Fairbanks with a low tax rate or like Valdez with a tax rate at 20 mills). She concluded that the tiered solution had been the most balanced and had addressed concerns regarding oil and gas property tax.

[3:11:45 PM](#)

Vice-Chair Neuman asked if the department proposed to work with the legislation specifically for the North Slope Borough. Commissioner Rodell replied that the North Slope Borough had raised the concern. The department had worked with the borough to make the bill as neutral as possible to limit the impact on the state's property tax collection.

Vice-Chair Neuman believed the response to his prior question may have been affirmative. He asked how the issue would impact future gas pipelines and taxation (whether the pipeline went through the North Slope, Fairbanks, Mat-Su, or other). He asked whether the bill could reduce the tax revenue to the state.

Commissioner Rodell answered that the department was not yet in a position to make any recommendations on oil and gas property with respect to the Alaska LNG project. She referred to the creation of a municipal advisory group that allowed the department to work with communities from Kenai to the North Slope Borough and communities that may not have the pipeline but that were impacted by a project like the gasline. After the creation of an advisory board there would be discussion about property tax implications and impact payments. She did not believe the legislation would affect the discussion or prohibit it from moving forward in any way.

Vice-Chair Neuman surmised that if there was a natural gas pipeline running through the North Slope Borough and others that all communities would expect the same gratitude. He believed it would impact the state's general fund revenue. He remarked on the expense of a pipeline sitting on \$45 billion land.

Commissioner Rodell replied that the state would have to work with municipalities on oil and gas property tax in relation to AK LNG. For example, law currently excluded LNG facilities from being considered taxable property. She believed the state would want to talk about what a \$20 billion LNG facility in Nikiski meant for oil and gas property tax; it was a conversation the administration intended to have with municipalities because it would like to have consensus with municipalities on how the property was taxed. There were currently laws that would need to be considered in light of the AK LNG project.

Co-Chair Stoltze surmised the gasline proposal must be serious because municipalities had broken their previous silence on the issue.

[3:16:37 PM](#)

Vice-Chair Neuman asked about the effect of the fiscal note. He asked for verification that the current analysis estimated a potential cost of \$10 million per year.

Commissioner Rodell agreed that the cost could be \$10 million per year if the municipalities all increased rates to 20 mills. The department did not anticipate that the communities would all implement the increase.

Co-Chair Stoltze wondered if the department's amendment would impact the fiscal note. Commissioner Rodell replied in the negative.

Vice-Chair Neuman asked whether the North Slope Borough currently received impact assistance representing a certain percentage of the royalty paid toward the Permanent Fund Dividend. Mr. Adams answered that the North Slope Borough and communities within the National Petroleum Reserve - Alaska (NPRA) received impact funds. He estimated that the funds were about \$4 million in the current year.

Representative Nageak added that the state distributed the funds to the communities.

Representative Munoz addressed the North Slope Borough's desire to allocate a greater percentage of its tax revenue to operations. She wondered whether the legislation would provide sufficient flexibility for the borough to pick up more debt if it chose.

Mr. Adams did not believe the borough wanted to pursue any more changes in the way it administered property tax. The bill would provide the borough with the flexibility needed to ensure that municipality operations were well taken care of. He remarked that the community had sufficient infrastructure and did not have more need for the selling of general obligation bonds. Maintenance of the existing facilities was what concerned the community.

[3:19:58 PM](#)

Co-Chair Stoltze wondered if members had questions or concerns about the proposed amendment from the department. He intended to bring the language back in a CS the following day.

Vice-Chair Neuman asked for a more defined fiscal note from DOR.

Co-Chair Stoltze asked the department to work with Vice-Chair Neuman on his fiscal note questions. Commissioner Rodell replied in the affirmative.

Co-Chair Stoltze CLOSED public testimony.

HB 379 was HEARD and HELD in committee for further consideration.

Co-Chair Stoltze discussed the schedule for the following day.

#

ADJOURNMENT

[3:22:56 PM](#)

The meeting was adjourned at 3:22 p.m.