HOUSE FINANCE COMMITTEE
April 13, 2014
1:05 p.m.

1:05:40 PM

CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:05 p.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair
Representative Bill Stoltze, Co-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

Representative Mark Neuman, Vice-Chair

ALSO PRESENT

Joe Balash, Commissioner, Department of Natural Resources; Michael Pawlowski, Deputy Commissioner, Strategic Finance, Department of Revenue; Angela Rodell, Commissioner, Department of Revenue.

SUMMARY

HB 89 AQUATIC INVASIVE SPECIES

CSHB 89(FIN) was REPORTED out of committee with a "do pass" recommendation and with one new fiscal impact note from the Department of Fish and Game, one new fiscal impact note from the Department of Natural Resources, one new zero fiscal note from the Department of Revenue, one new zero fiscal note from the Department of Environmental Conservation, one new zero fiscal note from the

Department of Environmental Conservation, and one new zero fiscal note from the Department of Natural Resources.

HB 287 APPROVE TESORO ROYALTY OIL SALE

HB 287 was SCHEDULED but not HEARD.

CSSB 138(FIN) am
GAS PIPELINE; AGDC; OIL & GAS PROD. TAX

CSSB 138(FIN) am was HEARD and HELD in committee for further consideration.

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Co-Chair Stoltze addressed the fiscal notes for HB 89 before embarking on the presentation on SB 138.

#hb89
HOUSE BILL NO. 89

"An Act relating to the rapid response to, and control of, aquatic invasive species and establishing the aquatic invasive species response fund."

Representative Costello discussed the fiscal notes attached to the bill. She cited the new fiscal impact note from the Department of Fish and Game (DFG) for $299.1 thousand in FY 15 and $154.9 thousand in FY 16. She noted the new fiscal impact note from the Department of Natural Resources in the amount of $94.1 thousand in FY 15 and was indeterminate for FY 16 through FY 20. The remaining zero fiscal notes were from the Department of Natural Resources (DNR), the Department of Environmental Conservation (DEC), and the Department of Revenue.

Representative Costello MOVED to REPORT CSHB 89(FIN) out of committee with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

1:10:35 PM
AT EASE

1:12:29 PM
RECONVENED

#sb138
CS FOR SENATE BILL NO. 138(FIN) am

"An Act relating to the purposes, powers, and duties of the Alaska Gasline Development Corporation; relating to an in-state natural gas pipeline, an Alaska liquefied natural gas project, and associated funds; requiring state agencies and other entities to expedite reviews and actions related to natural gas pipelines and projects; relating to the authorities and duties of the commissioner of natural resources relating to a North Slope natural gas project, oil and gas and gas only leases, and royalty gas and other gas received by the state including gas received as payment for the production tax on gas; relating to the tax on oil and gas production, on oil production, and on gas production; relating to the duties of the commissioner of revenue relating to a North Slope natural gas project and gas received as payment for tax; relating to confidential information and public record status of information provided to or in the custody of the Department of Natural Resources and the Department of Revenue; relating to apportionment factors of the Alaska Net Income Tax Act; amending the definition of gross value at the 'point of production' for gas for purposes of the oil and gas production tax; clarifying that the exploration incentive credit, the oil or gas producer education credit, and the film production tax credit may not be taken against the gas production tax paid in gas; relating to the oil or gas producer education credit; requesting the governor to establish an interim advisory board to advise the governor on municipal involvement in a North Slope natural gas project; relating to the development of a plan by the Alaska Energy Authority for developing infrastructure to deliver affordable energy to areas of the state that will not have direct access to a North Slope natural gas pipeline and a recommendation of a funding source for energy infrastructure development; establishing the Alaska affordable energy fund; requiring the commissioner of revenue to develop a plan and suggest legislation for municipalities, regional corporations, and residents of the state to acquire ownership interests in a North Slope natural gas pipeline project; making conforming amendments; and providing for an effective date."

JOE BALASH, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, related that SB 138 was the enabling legislation that supported all of the concepts and documents that the committee had been reviewing the last several weeks regarding a major natural gas project. He stated that there were a number of specific concepts and principles embodied in the Heads of Agreement (HOA) and the Memorandum of Understanding (MOU) that the state would pursue in the Alaska liquefied Natural Gas project (AK LNG) agreements. He reported that the department would provide a sectional analysis and describe how the legislation provided the tools for DNR, the Department of Revenue (DOR), and the Alaska Gasline Development Corporation (AGDC) to accomplish the agreements that had been outlined in the HOA.

MICHAEL PAWLOWSKI, DEPUTY COMMISSIONER, STRATEGIC FINANCE, DEPARTMENT OF REVENUE, pointed out that the House Finance Committee had listened to many hours of testimony from consultants regarding the HOA and the MOU. He clarified that the flow chart (copy on file) that was distributed to members should have been referenced as originating from DNR and DOR.

Mr. Pawlowski relayed that during his review of the legislation, he would refer to the flow chart and sectional analysis (copy on file) for HCS CSSB 138 (RES) provided to the committee. He directed the committee's attention to Section 1 of the legislation found on page 3, line 2.

Co-Chair Stoltze requested that during the presentation the departments address prior concerns that had been raised during the committee's public testimony on the bill.

Mr. Pawlowski agreed and noted that there were two particular areas of concern that would be addressed during the sectional analysis.

In response to a question by Co-Chair Austerman, Mr. Pawlowski responded that he would be referring to language in the bill, the sectional summary, and the Summary of Changes (copy on file).

Mr. Pawlowski explained that previous discussions had focused on the three "P's" that were necessary to advance a liquefied natural gas (LNG) project. The enabling legislation had to allow the state to participate in the project, establish a process to negotiate the project’s

enabling contracts, and define the percentage of the state's share of the project. He pointed out that the bill was broken up into three general areas; the first described how the state would participate in the project. He spoke to Section 1 of the bill and related that it amended AS 31.25.005, which were the powers and duties of AGDC as enacted by the prior legislature. He related that HB 4 provided for narrow and targeted participation for the state in a specific North Slope Gas project. He explained that Section 1 expanded the powers of AGDC to perform a dual mission and provided flexibility to the board to advance the small diameter pipeline project and the large scale AK LNG project. He cited page 3, lines 2 through 4 of the bill:

> …develop and have primary responsibility for developing natural gas pipelines, an Alaska liquefied natural gas project, and other transportation mechanisms to deliver natural gas…

Mr. Pawlowski noted that it granted AGDC a broader purpose as the "lead agency in developing the commercial agreements as a public corporation." He related that subsections 2 and 3 were added to Section 1 to give AGDC further direction in developing the projects for the purpose of delivering in-state gas and provide economic benefits and revenue to the state.

Mr. Pawlowski added that subsection 3, lines 9 through 11 authorized AGDC to:

> …assist the Department of Natural Resources and the Department of Revenue to maximize the value of the state's royalty natural gas, natural gas delivered to the state as payment of tax…

Mr. Pawlowski referenced subsection 4, page 3 beginning on line 13 and pointed out that subsection 4 contained the existing language from HB 4 related to advancing the in-state natural gas pipeline and the new language in subsection 5 advanced the Alaska Liquefied Natural Gas Project (AK LNG). He pointed to a key provision of subsection 5 on line 24 through line 28 and read:

> …if the corporation provides a service under this paragraph to the state, a public corporation or instrumentality of the state, a political subdivision

of the state, or another entity of the state, the corporation may not charge a fee for the service in an amount greater than the amount necessary to reimburse the corporation for the cost of the service…

Mr. Pawlowski elaborated that the administration requested the language to explicitly prohibit AGDC from profiting from its services to the state. He continued with Section 2 on page 4 and stated that it provided conforming language to the structure of AGDC and recognized that AGDC was acting in the "best interest" of the state for the purposes delineated in Section 1. In addition, on page 4, line 19 the language reiterated that AGDC would have a dual mission to advance an in-state natural gas pipeline or the AK LNG project.

Mr. Pawlowski moved to Section 3 beginning on page 4, line 21, which was new and removed a provision from the original HB 4 legislation that allowed the Commissioner of Department of Natural Resources (DNR) and the Commissioner of Department of Revenue (DOR) to serve on the AGDC board after the project under the Alaska Gasline Inducement Act (AGIA) had been abandoned. The original language bracketed on page 4 lines, 27 through 31 was deleted. He detailed that the prohibition recognized a potential conflict in the relationship between DOR and DNR as gas owners utilizing the services of the corporation [AGDC] that provided the services. He ensured the committee that the legislation contained language in later sections that established a working relationship between the departments and AGDC in order to advance the project together.

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Mr. Pawlowski turned to the newly added Section 4 beginning on page 5, lines 1 through 5 and pointed out that the section contained clarifying language that "a public member of the AGDC board was not required to be or has been a registered voter, and was not required to reside in the state."

Mr. Pawlowski related that Section 5 beginning on page 5, lines 6 through 22 was a new section related to the powers of AGDC and that it added some important parts. He noted that the language on page 5, line 8 directed the board to:

…maximize the efficient use of state resources…

Mr. Pawlowski explained that since AGDC was advancing two projects the administration guided the board to avoid duplicative expenditures for the state when possible. Conversely, subsection 2, beginning on line 9 mandated that AGDC:

> …establish appropriate separation within the corporation…

Mr. Pawlowski explicated that the board needed to maintain "appropriate firewalls" between the sensitive information of two projects "not governed under the cooperation agreements." He furthered that subsection (d) on page 5, lines 15 through 19 authorized the board to appoint program directors for the two projects that reported to the AGDC executive director.

Mr. Pawlowski examined Section 6 on page 5, beginning on line 22. He stated that the section amended the provisions regarding legal counsel for AGDC and Section 7 contained the "substantive" changes. He acknowledged that the Department of Law (DOL) provided the commercial attorneys and commercial and technical expertise for the negotiation process. He elaborated that Section 6 and 7 intended to recognize that the AK LNG project was a larger endeavor that required collaboration between the different agencies. The administration wanted unified legal counsel for the multiple agreements involved in the negotiations. He noted that AGDC retained the authority to retain legal counsel and that Section 7 clarified that the attorney general was the counsel for AGDC when involved in the development of contracts for AK LNG. The attorney general would provide legal counsel to DOR, DNR, and AGDC to maintain "a unified legal voice."

Mr. Pawlowski cited page 5, line 31 to page 6, line 1 and specified that the attorney general must consult with AGDC when procuring outside counsel for legal services. Typically, DOL contractually retained outside counsel that were experts from exceptional law firms to provide legal support for negotiations.

Mr. Pawlowski related that Section 8 contained clarifying language that added references for the powers and duties of AGDC in relation to the AK LNG project where needed.

Mr. Pawlowski stated that beginning on page 8, line 13 the legislation included the addition of a new power and duty in subsection 23 that granted AGDC the power to be directly involved in liquefaction. He stated that subsequent to the passage of HB 4 there had been a question whether AGDC could be primarily involved in liquefaction. The bill authorized AGDC to convey “the state's interest in the liquefaction plant." Subsection 23 gave AGDC the authority to acquire an ownership or participation interest specifically in the Alaska Liquefied Natural Gas Project. He related that subsection 24 on page 8 beginning on line 15 granted AGDC the authority to enter contracts for services related to the AK LNG project after consultation with the commissioners of DOR and DNR. The language clarified that the consultative relationship between the agencies and AGDC would be maintained prior to the execution of contracts. He noted that the bill contained similar language in relation to both commissioners' powers.

In response to a request by Co-Chair Stoltze, Mr. Pawlowski responded that the commercial agreements AGDC would enter into related to the described sections would not need subsequent legislative authorization but would require legislative appropriations. He voiced that advancing the project required the "commitment of capital." The legislative oversight for the commercial agreements would be maintained through the appropriation process. He reminded the committee that AGDC would enter into the contracts after consultations with the state agencies clarified on page 8, line 20. He noted that the contracts were dependent on the gas committed by the agencies. The agreements to commit the gas for the LNG plant would be entered into through the commissioner of DNR and would require legislative approval on an individual basis. The administration attempted to build checks and balances but the AGDC commercial contracts were a corporate activity with board oversight and "not necessarily a state disposition."

Mr. Pawlowski spoke to Section 9 of the bill and explained that the section clarified that the requirement for AGDC to submit a report to the legislature subsequent to an open season specifically applied to the in-state natural gas pipeline open season currently in AGDC statutes. The AK LNG project did not have an open season. He moved to Section 10 found on page 9, lines 7 through 10 and

elaborated that AGDC's authority to be involved in liquefaction was limited to the AK LNG project.

Mr. Pawlowski referenced Section 11 on page 9, lines 11 through 15 and stated that the provision enabled AGDC to share information with the commissioners of DOR and DNR related to the AK LNG project negotiations "subject to the limitations of confidentiality agreements." He cited the statute on line 15; AS 38.05.020(b)(10) and AS 38.05.020(b)(11) and pointed out that the statute was the broad reference that granted authority to the commissioners to negotiate contracts. He related that Section 13, line 9 established a specific fund for the AK LNG project as a way to advance the project and maintain legislative oversight. Therefore, Section 12 on page 9, lines 26 and 27 was necessary to clarify that money appropriated to the in-state natural gas pipeline fund was used solely for advancing the in-state gas pipeline project and maintained the separation of assets.

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Mr. Pawlowski addressed Section 14 on page 10, line 12 that revised AGDC's authority to create subsidiaries that were "used as a corporate tool" to advance projects. The bracketed language on page 10, line 25 that cited AS 10.20.146 through AS 10.20.166, which may have been read to limit subsidiary formation to not for profit subsidiaries, was removed from statute. He related that AGDC may use any "subsidiary mechanism" that could advance the AK LNG project. In addition, the language on page 10, lines 17 and 18 that related to the state's share of royalty natural gas was eliminated. The amendment clarified that AGDC may create subsidiaries for the advancement of the project and provide infrastructure, but the state agencies (DOR and DNR) "retained its role as the constitutional custodian of the state's royalty or tax resource."

Mr. Pawlowski identified Section 15 on page 11, lines 6 and 7 and lines 21 and 22 that made a conforming amendment to AGDC's budgetary reporting to the legislature to include the AK LNG project. He reported that Section 16 added a definition of the Alaska liquefied natural gas project according to the HOA and MOU agreements. He summarized that Sections 1 through 16 were the provisions related to AGDC which reflected how the state would participate in the project; AGDC will act as the state's corporate entity.

Mr. Pawlowski discussed Section 17 beginning on page 12, line 28 related to exemptions to the application of the state procurement code AS 36.30.850(b). The amendment exempted contracts for professional and technical services by the DNR and was added in support of AS 38.05.020(b) (10) and AS 38.05.020(b) (11) related to the authority of the commissioners to negotiate contracts.

Commissioner Balash related that highly specialized work would be conducted subsequent to adoption of the legislation and required aggressive timelines. In addition, the department needed some latitude that was not contained in the procurement code when evaluating contractors. He felt that under the "magnitude of the project," the department did not want to be constrained by choosing the lowest bidder in every situation. He pointed out that in cases of some of the "upstream work" related to off take and balancing agreements and "downstream" work involving the management of capacity and “disposition” of the state's share of natural gas and LNG the department needed the flexibility to work "quickly and nimbly" and exercise discretion when evaluating potential bidders. He believed the amendment was a "fairly narrow crafting of the exemption."

Mr. Pawlowski noted that there was an additional exemption for DOL on page 13 beginning on lines 1 through 5.

Mr. Pawlowski reviewed Section 18 starting on page 13, lines 6 through 25 that established the Alaska Affordable Energy Fund as a special non-dedicated account in the general fund used to develop infrastructure for the delivery of energy to areas in the state without direct access to a North Slope natural gas pipeline. He offered that there were areas in the Railbelt that were relatively far from direct access to the gas. The language recognized that not all parts of the state would have direct access to the resource. The fund helped provide resources for the infrastructure to deliver energy commensurate with the areas of the state with direct access to natural gas. He stated that the amount designated in the fund was found in subsection (b), line 14 and amounted to 20 percent of the money received from the state's royalty gas after payments to the Alaska permanent fund under AS 37.13.010. He reminded the committee that the project’s deposits into the permanent fund resulted from royalty gas as a share of gas that would be liquefied and portions would be exported. The

revenues DNR received after the payment of costs would be the royalty revenue. Twenty five percent of the royalty revenue would be deposited into the Permanent Fund and the Alaska Affordable Energy Fund would receive 20 percent out of the remaining 75 percent of the royalty. He estimated that the energy fund would receive $180 million per year.

Mr. Pawlowski remarked that the next several sections of the legislation focused on the process. He moved to Section 19, beginning on page 13, line 26 that amended AS 38.05.020(b); the Alaska Land Act and expanded the powers of the commissioner of DNR. He stated that the substantive changes began on page 14, subsection 10. The subsection allowed the DNR commissioner to enter into commercial agreements of not more than two years duration for project services related to a North Slope Natural Gas project. The agreements would not require legislative approval. The agreements were "operating agreements" that governed the project while the "firm agreements" that advanced the project were developing. He noted that the operating agreements and the "precedent agreement" with TransCanada governed the project during the two years of the PreFeed (pre-front-end engineering and design work) phase prior to the firm transportation services agreement, which actually was the full commitment to TransCanada. He added that the principle level agreements between DNR and the producers relating to off-take were interim agreements and would not come back to the state for approval.

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Commissioner Balash noted that Co-Chair Stoltze had instructed the department to highlight concerns that had been previously raised in public testimony. He related that the amendment granted the department the authority to enter into the agreements in the near-term. Once the project was operational the department retained the ability to deal with short-term needs such as a disruption in service. The longer-term contracts that obligated the state for long periods of time, as specified in subsection 11 required legislative approval. He pointed to subsection 12 on page 15, line 7 and noted that the provisions allowed DNR to enter into confidentiality agreements with other project entities that required the information remained confidential until the contracts were ready for public review and approval. He cited Page 15, line 12 and relayed that the terms of a proposed final contract must be made

available to the public at least 90 days before the proposed effective date. He added that beginning on line 17 the confidentiality agreements allowed the commissioner of DNR to share confidential information during the contract negotiation process with the legislature in executive session.

Co-Chair Stoltze requested that the commissioner describe for the public what confidentiality agreements were.

Commissioner Balash replied that as various contract options were considered with commercial entities confidentiality agreements would be entered into in order not to avoid compromising or exposing the entities position and negotiating strategies to its competitors. He stated that the department's goal was to bring forward contracts that would be approved by the legislature and that if it was to be successful, the department had to confer with both legislative bodies regarding the terms of the contract to determine the confines of acceptability for the legislature.

Mr. Pawlowski added that the administration understood the need for guidance from the legislature and the ability to interact with the legislature and its agents in order to move the process forward. He pointed to Page 15, lines 17 through 21 and stressed the importance of the administration’s ability to confer with the legislature, its agents, staff, or consultants and keep the information updated. He believed the provisions invited the legislature to have an active role in the development of the project as it unfolds. He added that on page 15, lines 22 through 26 the provision directed the DNR commissioner to consult with AGDC on specific contracts related to project services for gas treatment, the gas treatment plant, the pipeline, liquefaction facility, marine terminal, and transportation services.

Mr. Pawlowski addressed Section 20 on page 15, line 29 and noted that it amended Section 19. He indicated that the bill contained two series of effective dates. One is an immediate effective date that authorized confidential negotiations and the other effective date was January 1, 2015 related to tax provisions. On page 17, lines 29 through 31, Section 20 allowed the DNR commissioner, in consultation with the DOR commissioner, to take custody of gas delivered to the state under AS 43.55.014(b), to manage

project services for the gas. The provision created efficiency in allowing the DNR commissioner to manage tax gas on behalf of the state while managing royalty gas. All of the same precedents and conditions on tax gas applied to royalty gas.

Commissioner Balash interjected that DOR would absorb the management costs of the provision on behalf of DNR.

Mr. Pawlowski reported that Section 21 contained additions to some of the agreements and contracts under AS 38.05.020(b) (11). He reminded the committee that the statute referred to the contracts that would need legislative approval for a specified duration of time. He delineated that the section required that any agreement or contract negotiated under 38.05.020(b) (11) granted the state access to the data developed under the contracts if the commissioner of DNR determined the project was not adequately progressing. The state's terms of access should not be more restrictive than any other party to the agreement. He read the language on Page 18, lines 13 through 15:

> (b) A proposed agreement or contract associated with a North Slope natural gas project may not include a provision that changes a payment in lieu of property tax on property that was previously taxable under AS 43.56.

Mr. Pawlowski explained that AS 43.56. was the statewide oil and gas property tax statute. Article 9, Sections 3 and 4 of the Alaska Constitution clearly stated that exemptions to property tax were provided by law not by contract. The administration added the limiting language to assure municipalities that the administration was not attempting to make property tax changes that were prohibited by the Constitution. He added that the governor established a municipal advisory group via administrative order. The advisory group was comprised of mayors or their designees and would engage in an open public process to discuss the property tax issues related to the project, such as payment in lieu of tax and impact payments designed to address the infrastructure impact on municipalities. The administration would bring the advisory group recommendations back to the legislature for authorization of any necessary statute changes before engaging in property tax contract negotiations.

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Mr. Pawlowski related that Section 22 on page 18, beginning on line 16 was conforming language to a DNR exploration incentive credit. The broad production tax (AS 43.44) cited on line 28 was deleted and replaced with AS 43.55.011 (the traditional payment of production tax). The section clarified that a credit could be levied against AS 43.55.011 but not against a payment where the state received a share of gas as royalty. The situation appeared in several other sections throughout the bill related to the film tax credit and some education credits. He summarized that if a producer was paying its tax with gas the credits could not be used to offset a tax payment.

Mr. Pawlowski turned to Section 23 beginning on page 19, line 1. He pointed out that the section permitted the DNR commissioner to propose modifications to existing leases that related to switching between taking royalty gas in kind or in value, provided a method to establish a fair market value, and clarified what must happen before the commissioner can make changes to the lease. He noted that page 18, lines 21 through 24 allowed the modification of net profit sharing and sliding scales unless they transfer value. The commissioner must determine that the rate yielded the same value under the terms the state would have received before a modification.

Commissioner Balash emphasized that the section of statute was giving the commissioner of DNR the authority to modify leases. He reported that DNR had leases in place for over 50 years and a great many of those involved in the project had been in place since the original sale in 1969 at Prudhoe Bay. The department could only go as far as the law allowed in making changes to the leases. He voiced that AS 38.05.180 (hh) [Section 23 of the bill] authorized the commissioner of DNR to modify leases under very specific circumstances following the determination process specified in AS 38.05.180 (ii). The authorities granted the commissioner needed to be broad enough to accommodate any variety of circumstances. The department could not predict what other projects would present themselves in the future.

Commissioner Balash referenced DNR's ability to switch back and forth between in kind and in value. He explained that LNG was sold under very specific long-term agreements. He expected that the AK LNG contracts would be long-term. The

state's ability to switch options needed to be constrained in order to avoid commercial instability that created a lower price climate. Currently, the state had 90 and 180 day options to switch. He believed that under certain circumstances the state wanted to retain the right to switch albeit, under longer periods of time and in other circumstances the state would want to permanently modify the right to switch. He noted that Section 24 repeated the modifications to the commissioner's authority on lease changes related to gas delivered to the state under AS 43.55.014 found on Page 20, line 21.

Commissioner Balash spoke to Section 25 on page 21, lines 4 through 12 that amended AS 38.05.182. He expounded that the original statute directed DNR to take all of the states resource royalties in value except for oil and gas. He observed that the statute directed DNR to take its gas in-kind unless the commissioner finds that taking the royalty in value was in the state's best interest. He mentioned a study DNR conducted last year that determined a number of risks were associated with taking gas in kind and could eventually lead to a finding that taking gas in kind was not in the best interest of the state. He qualified that the department was aware of the issues with taking gas in kind and held discussions with the counterparties involved in the project. The issue was viewed as a "major stumbling block". He expressed major concerns with the state's ability to manage capacity, market LNG, and receive a price equal to the state's counterparties. The issue was addressed in the HOA in 8.3.1 wherein each of the companies individually agreed to negotiate disposition agreements at the state's request. The agreements allowed the state to leverage the producers marketing expertise and sales agreements to sell the state's share of the LNG.

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Commissioner Balash stated that in some instances it could be more beneficial for the state to market its LNG independently. He cited the new language on page 21, lines 8 through 12 that read:

> It is not in the best interest of the state to take royalty on gas in money from a lessee transporting gas in the North Slope natural gas project if the lessee has committed to dispose of or market the state's royalty gas taken in kind on the same terms and

conditions as the lessee markets or disposes of the lessee's gas.

Commissioner Balash reported that the language was added in the previous committee in an attempt to add limits to the circumstances under which the state takes its royalty in kind. He thought that the issue might be better addressed or improved through the House Finance Committee process. He pointed out that the HOA contemplated the risk and addressed mechanisms to mitigate the risk for the state. He thought that better language could be crafted that provided "sideboards" and established a comfort level for the legislature and public regarding the circumstances under which the state would take its gas in kind.

Mr. Pawlowski turned to Sections 26, 27, 28, and 29, that added language that referenced AS 43.55.014(b); the statute that allowed production tax to be paid in kind. He explained that each section governed how DNR disposed of royalty gas. The disposition and sale of tax gas would be governed exactly the same as the disposition and sale of oil. The bill was leveraging the same statutory precedents regarding the disposition of gas in kind.

Mr. Pawlowski moved to Section 30 on page 22, line 26 through page 23, line 6 and reported that the section added definitions employed throughout the section. He directed attention to the definition for "project services" found on page 23, line 4. He explained that the definition was used in the definition of "consultation" between DNR and AGDC. He read the language, "services provided by a gas treatment plant, pipeline, liquefaction facility…" and noted that the language reflected the types of agreements such as, the firm transportation services agreement with TransCanada; subject to legislative approval for use of a pipeline. He interjected that the contract allowing the state's use of the LNG plant would occur between the state and AGDC and was also subject to legislative review and approval.

Mr. Pawlowski related that Sections 31, 32, and 33 were conforming amendments to DNR. He explained that agencies must expedite a review on permit applications from any AGDC project.

Mr. Pawlowski indicated that Section 34 dealt with DOR. He reiterated the process of the agreements outlined in the legislation. He exemplified the relationship between the

state and TransCanada and detailed that if SB 138 passed, the state would enter into a precedent agreement using AS 38.05.020b (10), which limited the agreement's duration to two years. Subsequently, a term sheet attached as "Exhibit C" to the MOU would be used to create operating agreements between the state and TransCanada. He addressed some key items in the MOU. He detailed that the state would approve the work plan and budgets according to the terms contained in the term sheet and the relationship set up by the precedent agreement. The initial PreFEED stage of the joint venture agreement was a cost sharing activity. The state, in consultation with AGDC would review plans submitted by TransCanada and approve or deny expenditures. The precedent agreement would also commit the state to paying for development costs plus the AFUDC (allowance for funds used during construction) [a rate of 7.1 percent]. He reminded the committee that the development costs were the costs the state would have encumbered if it developed the project alone. A comparable agreement would be struck with AGDC over the LNG portion of the project. The next step in the process was development of a firm transportation services agreement between TransCanada and AGDC lasting more than two years and governed under AS 38.05.020b (11), which required legislative approval. He restated that as the agreements were developing the legislation granted the administration authority to consult directly with legislators. He believed that when the final contracts were presented to the legislature for approval 90 days before the effective date, the agreements would withstand public scrutiny.

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Mr. Pawlowski communicated that the rest of the legislation's focus was on the state's percentage of the project related to the tax sections under DOR. He indicated that the legislation was establishing a tax rate up front which provided predictability for investors. How the contract terms related to the tax rate would be developed with the legislature and the public through the process established in the legislation.

Mr. Pawlowski turned to Section 34 beginning on page 23, line 28 that exempted DOR from confidentiality related to information under AS 38.05.020(b) (12), which enabled DNR to share information with DOR. He reported that Section 35 on page 24, line 11 required public notifications on any

taxes paid as gas and would be noticed in the Revenue Source Book. The administration believed that receiving gas in kind needed to be a transparent process.

Mr. Pawlowski addressed Section 36 on page 26, lines 26 and 27 that contained conforming confidentiality language under AS 38.05.020(b) (11) and AS 38.05.020(b) (12) relating to the commissioner of DOR.

Mr. Pawlowski observed that Section 37 related to the duties of the commissioner of DOR. He cited page 28, line 1 that modified the powers of the commissioner of DOR to consult with the DNR commissioner on the management of contracts and the management of tax as gas.

Mr. Pawlowski spoke to Section 38 on page 29, lines 11 through 14 relating to AS 43.55.014(b), the reference to tax as gas, which was a conforming amendment to a previously amended section. He noted that throughout the legislation, there were two core sections; AS 38.05.020(b) (10) and AS 38.05.020(b) (11) concerning the powers of the DNR commissioner to negotiate, and AS 43.55.014(b) providing for gas in kind. The majority of the rest of the sections were conforming to the two concepts and the references to the statutes were repeated throughout the legislation.

Mr. Pawlowski moved to Section 39, page 29, line 15 that exempted the taxpayer confidentiality provisions and allowed the department to disclose the taxpayer's name paying the production tax in gas, the amount of gas, and the lease the production came from.

Mr. Pawlowski addressed Section 40 that amended the corporate income tax statutes to conform to paying tax in gas. He cited page 30, lines 1 through 6 that affected the sales factor of the state’s corporate income tax and explained that subsection (ii) clarified for the taxpayer that DNR would not "deem" the payment of tax as a sale. Similarly, the state does not tax "inter-company" transactions as sales. He noted that subsection (iii) on page 30, line 4 clarified that the fees on the project were not sales on corporate income tax.

Mr. Pawlowski drew attention to Section 41, page 31, lines 2 through 3 that clarified gas paid as a tax was included in the extraction factor. He elucidated that the payment of

gas as tax was still produced gas and the administration wanted the gas included in the corporate income tax. Section 41 "ensured an adequate and appropriate share of corporate income tax for the state." He commented that Section 42 amended the actual production tax AS 43.55.011(e), on page 31, line 31, and read "…on and after January 1, 2022…" He shared that after 2022, the tax on oil remained at 35 percent provided for in SB 21 [OIL AND GAS PRODUCTION TAX - Adopted 2013] but the tax on gas would change to 13 percent of the gross value at the point of production. He delineated that the administration had selected 2022 in order to allow the tax ceiling on gas produced on the North Slope and used in-state and subject to the same tax ceiling as Cook Inlet gas tax to expire as specified in statute. Taxes on gas were transferred through the sales contract on to rate payers. Currently, North Slope gas was contractually involved to supply the Interior energy project. The administration did not want to increase the cost of the contracts. In addition, the administration wanted to provide a predictable planning environment for both the in-state and AK LNG project so investment decisions would not be affected in the future. He qualified that the 13 percent production tax established in the legislation was in value and not in kind. The legislation established limited circumstances where in kind was authorized to pay tax as gas.

Mr. Pawlowski spoke to Section 43 beginning on page 32 that adjusted the minimum tax. He cited page 33, lines 3 through 35 that provided that the minimum tax would only apply to oil on and after January 1, 2022. The tax on gas production would be 13 percent of the gross value, well above the minimum set at 4 percent of gross value.

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Mr. Pawlowski pointed to Section 44 on page 33 that added AS 43.55.014, related to the payment of production tax in gas and page 33, line 28 that specified the option was available after January 1, 2022. He read the following:

> "…the department shall allow a producer to make an election, under regulations adopted by the department, to pay in gas the production tax levied by this section in lieu of the tax otherwise levied for the gas…"

Mr. Pawlowski emphasized the importance of page 33, line 31 to page 34, and read:

> …An election under this subsection applies only to gas produced from oil and gas leases modified under AS 38.05.180(hh)

Mr. Pawlowski explicated that the option to take royalty gas in kind was only available for leases modified by DNR. The provision had two important effects from DNR's perspective; it was consistent with the HOA. The commitment to accept in kind was subject to the development of project enabling contracts and satisfactory agreements for the disposition of the state's gas. Secondly, it allowed DNR to participate with DOR at the negotiation table. The state's production tax applied to more than just state land, without the commitments to produce gas and without the ability to interact with the leaseholder the state would not be able to obtain the contracts to provide the certainty to take gas in kind. The administration limited the provision solely to leases the commissioner modified. He noted that the provision did not apply to the National Petroleum Reserve Alaska, which were federal lands and leases.

Mr. Pawlowski turned to page 34, line 4 that set the rate and page 34, line 9, which allowed DNR to manage the gas ["the custody and disposition of gas delivered to the state"].

Mr. Pawlowski relayed that page 34, line 12 through page 35, line 10 established how DOR would deal with the over payment or underpayment of taxes and in particular allowed the interest rate to be paid in value or in kind. Sections 45 and 46 were amendments to the education credit. He stated that the language on page 35, line 20 was specific to the production tax since credits could not be taken against gas in kind. The provision included an addition of qualified expenditures for the education credit that included nonprofit regional training centers recognized by the Department of Labor and Workforce Development. He stated that Section 46 contained similar language due to the repeal and reenactment of the education credit.

Mr. Pawlowski addressed Section 47 on page 36, line 30, which clarified that the production tax was to be taken in value for the purposes of the credit.

Mr. Pawlowski spoke to Section 48 and related that it was a long section because the state had multiple production tax segments; the North Slope, middle earth, Cook Inlet, gas produced and used in the state, and Cook Inlet Gas. He noted the section directed the taxpayer on how to pay the tax. He delineated that the state currently collected tax in monthly installments based on estimates and were settled at the end of each year. On page 42, line 4 through page 44, line 19 the language specified that the tax ceiling for middle earth applied beyond January 1, 2022 and directed the taxpayer on how to pay the monthly tax.

Mr. Pawlowski discussed Section 49 and Section 50 that were conforming changes related to the monthly installment payments on the calculation of interest on underpayments or overpayments.

Mr. Pawlowski pointed out that Section 51 and Section 52 were conforming amendments related to a private landowner royalty owner. The state was not amending production taxes for private landowners.

Mr. Pawlowski spoke to Section 53 on page 47, lines 22 through 24 that required reporting by the taxpayer on the amount of gas produced from a lease for which tax is levied.

Mr. Pawlowski commented that Section 54 required calculation of annual production tax values to clarify the levy of tax under AS 43.55.011(e) (2) for oil and gas produced before January 1, 2022.

Mr. Pawlowski stated that Section 55 was related to lease expenditures. He delineated that lease expenditures would still be deductible under the legislation because it was extremely difficult to determine which portion of a lease expenditure was made for gas or and which expenditure was made for oil. Lease expenditures would most likely be deducted from the 13 percent tax on the gross value of the gas. The language would allow for the deduction. The result impacted the oil tax revenue in the near term but benefited from production and revenue when the production comes online. "Lease expenditures were still deductible in the calculation of an oil tax whether the calculation was made for gas or oil."

Mr. Pawlowski remarked that Section 56 and Section 57 were related to the gross value reduction established in SB 21 for certain oil and gas produced and did not apply to the value of gas produced after January 1, 2022.

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Mr. Pawlowski directed the committee's attention to Section 60 and Section 61 beginning on page 56. He explained that the "point of production" was the main factor in determining lease expenditures. Any expenditure "upstream" of the point of production was a lease expenditure and the costs were written off. Any expenditure downstream of the lease expenditure were recovered through tariffs. He emphasized that determining the point of production was significant in order to demark where deductible expenses occurred and where the expenses that were rolled into a tariff occurred. He cited Section 61 on page 57, lines 25 through 30 which deleted the definition of "the point of production" as defined in existing statute. He elaborated that the administration wanted to establish clarity on where the point of production for the AK LNG project was. He revealed that the point was "the entrance where the gas was leaving Pt. Thompson into the transmission line." The administration did not want the point of production to move downstream so that the pipelines and portion of the gas treatment plant were included as a lease expenditure. He illuminated that the effect of the amendments were to place the point of production upstream.

Mr. Pawlowski summarized that the first part of the legislation guided how the state would participate in AK LNG by expansion of the powers of AGDC. The second piece described how DNR would lead the process of negotiations along with AGDC and work with the legislature to develop the contracts slated for legislative approval. The third part dealt with the 13 percent tax rate on gross production. He noted that after royalty the state's share was approximately 25 percent. He offered that the following sections were concerned with other issues that were raised during the bills deliberations. He related that Section 65, page 59, lines 14 through 25 amended the powers of the Alaska Competitiveness Review Board to include recommendations to the legislature before January 15, 2017 regarding the state's tax structure, rates, and incentives for oil and gas production south of 68 degrees North latitude. The date allowed time for potential developers

and investors to plan for any potential changes before the existing incentives expired.

Mr. Pawlowski reported that section 66 repealed an AGDC statute that directed AGDC to cooperate with a large project as long as it did not delay progress on the in-state project. The statute was unnecessary since ADGC's purpose had been broadened to both projects.

Mr. Pawlowski reported that Section 67 required DNR to report to the legislature on how to make North Slope gas available for delivery and use in the state and recommend ways to address any risks identified in the report.

Commissioner Balash voiced that Section 67 addressed concerns that had been identified centered on the state's long term gas needs. The gas project was anticipated to last twenty to thirty years. He delineated that the demand for gas in the state was expected to grow over time. Since the state would own a certain percentage of the infrastructure and gas, the concern focused around how the states growing gas needs would be met, who would provide the gas, and whether the infrastructure's capacity would need to be expanded or reallocated, which created increased capacity downstream. The decisions around who would be responsible or how the gas would be allocated or reallocated amongst the parties currently remained undecided in negotiations. He thought that when the issues were addressed in contracts the required report and analysis would help the overall process and contract ratification. He noted that DNR supported but did not initiate the reporting provision in the legislation. The department would have the responsibility for the report and would consult with AGDC. He felt that the bill's language left out some matters that the committee might want to consider. The questions around the size and ultimate capacity of the pipeline after compression was added to increase capacity needed to be addressed. A 42 inch pipeline allowed for additional capacity with additional compression. A key question was how much more additional capacity the pipeline could handle efficiently until the need for more costly pipeline was necessary. He offered that there needed to be a set of terms and mechanisms built into the legislation that allowed for future exploration in the areas beyond Prudhoe Bay and Pt. Thompson. Discussions with the producers concluded that building a larger diameter pipeline might be warranted. The questions

addressing need, cost, and capacity needed to be answered. He recommended addressing the issue in the same report since some of the same issues linking back to the question of capacity would be examined.

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Mr. Pawlowski spoke to Section 68 on page 61 that established an interim advisory board to advise the governor on municipal involvement as requested by Mayor Hopkins [Fairbanks North Star Borough]. The board was established through executive order. He noted the reference to AS 44.19.028 on page 61, line 9 that established the board and felt that the statute was not as "durable" as the statute employed in the executive order. He noted that the bill's language was specifically designed to match the administrative order developed in consultation with municipal mayors. The Department of Revenue was designated as the lead agency for recommendations regarding property taxes in relation to the AK LNG project.

Mr. Pawlowski interjected that the administration did not request an additional appropriation in support of the advisory board. He related that when DNR initiated its royalty study last summer DOR joined in to leverage the allocation for consultants therefore, additional funding was not necessary. He notified the committee that the departments were creating efficiencies whenever possible.

Mr. Pawlowski spoke to Section 69 and pointed out that the section addressed the development of regional energy plans to benefit areas of the state not expected to have direct access to a natural gas pipeline at the direction of Alaska Energy Authority (AEA), in consultation with AGDC, other energy groups [including Alaska Industrial Development and Export Authority (AIDEA)], and DOR.

Mr. Pawlowski stated that Section 70 instructed the commissioner of DOR to identify and report to the legislature on financing options for state ownership and participation in a North Slope natural gas project. He noted that DOR was requesting an additional fiscal note appropriation for the effort.

ANGELA RODELL, COMMISSIONER, DEPARTMENT OF REVENUE, reiterated that Section 70 mandated the development of a financing options plan. The provision required two reports;

an interim report due before the beginning of next session to guide the legislature through the session and in preparation for a special session and a final report due prior to submitting contracts for approval. She expounded that the purpose of the comprehensive financing report was to outline all of the financing and investment options. The report would consider all of the state's financial resources as well as investment opportunities from individuals, regional corporations, and municipalities. The report would also examine all of the risks involved in financing the project for the state and individual investors, and any potential impacts on the state's bond rating. She informed the committee that tax attorneys and financial consultants were needed to assist in the preparation of the report and required additional fiscal note appropriation.

Mr. Pawlowski noted that the previous committee wanted an in-depth investigation regarding the financing alternatives in consideration of the time when the project advances past the Pre-FEED stage.

Mr. Pawlowski moved to Section 71 beginning on page 65 that required the parties to the AK LNG project to provide briefings to interested legislators, their staff, and consultants on the progress of the project at least once every four months and a report from DNR specified on page 65, lines 13 through 15:

> …A briefing under this section must be accompanied by a written report provided by the Department of Natural Resources of the amount of money the state may be obligated to pay a third party under an agreement or contract under AS 38.05.020(b)(10) or (11)…

Mr. Pawlowski reminded the committee that within the next two years the precedent agreement required the state to pay development costs which represented the relationship with TransCanada and the AFUDC. The provision mandated that DNR would report the amount expenditures at every four month briefing. He reiterated that the bill contained three main areas; participation, which expanded AGDC's powers; process, DNR leads contract negotiations developed in consultation with the legislature requiring legislative approval; and finally, the percentage of the state's share; a 13 percent tax on gas after 2022.

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Co-Chair Austerman instructed the committee members to submit their questions in writing.

Mr. Pawlowski pointed out that all of the questions and answers from previous committee hearings were included in the members' bill packets (copy on file).

CSSB 138(FIN) am was HEARD and HELD in committee for further consideration.

#hb287
HOUSE BILL NO. 287

> "An Act approving and ratifying the sale of royalty oil by the State of Alaska to Tesoro Corporation and Tesoro Refining and Marketing Company LLC; and providing for an effective date."

HB 287 was SCHEDULED but not HEARD.

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ADJOURNMENT

3:15:07 PM

The meeting was adjourned at 3:15 p.m.