

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

March 19, 2014

1:06 p.m.

**MEMBERS PRESENT**

Representative Eric Feige, Co-Chair  
Representative Dan Saddler, Co-Chair  
Representative Peggy Wilson, Vice Chair  
Representative Craig Johnson  
Representative Kurt Olson  
Representative Paul Seaton  
Representative Scott Kawasaki  
Representative Geran Tarr

**MEMBERS ABSENT**

Representative Mike Hawker

**OTHER LEGISLATORS PRESENT**

Representative Andrew Josephson

**COMMITTEE CALENDAR**

COMMITTEE SUBSTITUTE 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."

- HEARD & HELD

#### **PREVIOUS COMMITTEE ACTION**

BILL: SB 138

SHORT TITLE: GAS PIPELINE; AGDC; OIL & GAS PROD. TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/24/14	(S)	READ THE FIRST TIME - REFERRALS
01/24/14	(S)	RES, FIN
02/07/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/07/14	(S)	Heard & Held
02/07/14	(S)	MINUTE(RES)
02/10/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/10/14	(S)	Heard & Held
02/10/14	(S)	MINUTE(RES)
02/12/14	(S)	RES WAIVED PUBLIC HEARING NOTICE, RULE 23
02/12/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/12/14	(S)	Heard & Held
02/12/14	(S)	MINUTE(RES)
02/13/14	(S)	RES AT 8:00 AM BUTROVICH 205
02/13/14	(S)	Heard & Held
02/13/14	(S)	MINUTE(RES)
02/14/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/14/14	(S)	Heard & Held
02/14/14	(S)	MINUTE(RES)
02/19/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/19/14	(S)	Heard & Held

02/19/14 (S) MINUTE(RES)  
02/20/14 (S) RES AT 8:00 AM BUTROVICH 205  
02/20/14 (S) Heard & Held  
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02/21/14 (S) RES AT 8:00 AM BUTROVICH 205  
02/21/14 (S) Heard & Held  
02/21/14 (S) MINUTE(RES)  
02/21/14 (S) RES AT 3:30 PM BUTROVICH 205  
02/21/14 (S) Heard & Held  
02/21/14 (S) MINUTE(RES)  
02/24/14 (S) RES RPT CS 2DP 4NR 1AM NEW TITLE  
02/24/14 (S) DP: GIESSEL, MCGUIRE  
02/24/14 (S) NR: FRENCH, MICCICHE, BISHOP,  
FAIRCLOUGH  
02/24/14 (S) AM: DYSON  
02/24/14 (S) RES AT 8:00 AM BUTROVICH 205  
02/24/14 (S) -- MEETING CANCELED --  
02/24/14 (S) RES AT 3:30 PM BUTROVICH 205  
02/24/14 (S) Moved CSSB 138(RES) Out of Committee  
02/24/14 (S) MINUTE(RES)  
02/25/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
02/25/14 (S) Heard & Held  
02/25/14 (S) MINUTE(FIN)  
02/25/14 (S) FIN AT 5:00 PM SENATE FINANCE 532  
02/25/14 (S) Heard & Held  
02/25/14 (S) MINUTE(FIN)  
02/26/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
02/26/14 (S) Heard & Held  
02/26/14 (S) MINUTE(FIN)  
02/27/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
02/27/14 (S) Heard & Held  
02/27/14 (S) MINUTE(FIN)  
02/28/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
02/28/14 (S) Heard & Held  
02/28/14 (S) MINUTE(FIN)  
03/03/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
03/03/14 (S) Heard & Held  
03/03/14 (S) MINUTE(FIN)  
03/04/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
03/04/14 (S) Heard & Held  
03/04/14 (S) MINUTE(FIN)  
03/05/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
03/05/14 (S) Heard & Held  
03/05/14 (S) MINUTE(FIN)  
03/05/14 (S) FIN AT 5:00 PM SENATE FINANCE 532  
03/05/14 (S) Scheduled But Not Heard  
03/06/14 (S) FIN AT 9:00 AM SENATE FINANCE 532

03/06/14 (S) Heard & Held  
 03/06/14 (S) MINUTE(FIN)  
 03/07/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/07/14 (S) -- MEETING CANCELED --  
 03/10/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/10/14 (S) Heard & Held  
 03/10/14 (S) MINUTE(FIN)  
 03/10/14 (S) FIN AT 5:00 PM SENATE FINANCE 532  
 03/10/14 (S) Heard & Held  
 03/10/14 (S) MINUTE(FIN)  
 03/11/14 (S) FIN AT 5:00 PM SENATE FINANCE 532  
 03/11/14 (S) Heard & Held  
 03/11/14 (S) MINUTE(FIN)  
 03/12/14 (H) RES AT 1:00 PM BARNES 124  
 03/12/14 (H) -- MEETING CANCELED --  
 03/14/14 (S) FIN RPT CS 6DP 1AM NEW TITLE  
 03/14/14 (S) LETTER OF INTENT WITH FINANCE REPORT  
 03/14/14 (S) DP: KELLY, MEYER, DUNLEAVY, FAIRCLOUGH,  
 BISHOP, HOFFMAN  
 03/14/14 (S) AM: OLSON  
 03/14/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/14/14 (S) Moved CSSB 138(FIN) Out of Committee  
 03/14/14 (S) MINUTE(FIN)  
 03/14/14 (H) RES AT 1:00 PM BARNES 124  
 03/14/14 (H) <Pending Referral>  
 03/17/14 (H) RES AT 1:00 PM BARNES 124  
 03/17/14 (H) <Pending Referral>  
 03/18/14 (S) TRANSMITTED TO (H)  
 03/18/14 (S) VERSION: CSSB 138(FIN) AM  
 03/19/14 (H) RES AT 1:00 PM BARNES 124

**WITNESS REGISTER**

MICHAEL PAWLOWSKI, Deputy Commissioner  
 Office of the Commissioner  
 Department of Revenue (DOR)  
 Anchorage, Alaska

**POSITION STATEMENT:** On behalf of the administration, provided a section-by-section review of CSSB 138(FIN) am.

**ACTION NARRATIVE**

[1:06:49 PM](#)

**CO-CHAIR ERIC FEIGE** called the House Resources Standing Committee meeting to order at 1:06 p.m. Representatives Seaton,

Tarr, Kawasaki, Olson, P. Wilson, Saddler, and Feige were present at the call to order. Representative Johnson arrived as the meeting was in progress. Representative Josephson was also present.

**SB 138-GAS PIPELINE; AGDC; OIL & GAS PROD. TAX**

[1:07:13 PM](#)

CO-CHAIR FEIGE announced that the only order of business is 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."

1:07:23 PM

MICHAEL PAWLOWSKI, Deputy Commissioner, Office of the Commissioner, Department of Revenue (DOR), on behalf of the administration, began a section-by-section review of CSSB 138(FIN) am. To aid his review he began with a PowerPoint presentation of four slides. Displaying slide 2, he pointed out that the Alaska Liquefied Natural Gas (LNG) Project is really three megaprojects in one: the gas treatment plant and transmission lines, the pipeline, and the LNG plant and marine terminal. While the infrastructure gets a lot of attention, the \$45-\$65 billion-worth of infrastructure is really a mechanism to take gas from the North Slope, provide opportunity for gas to Alaskans, and convert that gas to LNG for export to markets. As he reviews the bill, he said, he will be looking at places where the legislation differentiates between the gas resource, the management of that resource, and the management of the infrastructure. The parties listed under the gas treatment plant and pipeline are without the assumption that the state's equity option in the Memorandum of Understanding (MOU) is exercised. Thus, slide 2 depicts day one after SB 138 passes, should it garner the support of this committee and this body. The parties in the gas treatment plant and the pipeline would be "ExxonMobil, BP, ConocoPhillips, and TransCanada." The parties in the LNG plant would be "ExxonMobil, BP, ConocoPhillips, and the Alaska Gasline Development Corporation [AGDC]." The gas moves through this infrastructure and is then converted to LNG. The parties in that gas are "ExxonMobil, BP, ConocoPhillips, and then the Department of Natural Resources [DNR] and Department of Revenue [DOR] on behalf of the state." The state's gas share is the combination of the royalty gas plus the tax as gas.

1:10:50 PM

MR. PAWLOWSKI, moving to slide 3, stated CSSB 138(FIN) am poses three general questions to the legislature: Will the state participate in the Alaska LNG Project and, if so, how? What will be the process for developing the project-enabling contracts that will let the project progress through the phased, stage-gated approach? What will be the percentage of the state's participation?

MR. PAWLOWSKI, turning to slide 4, explained Sections 1-12 of the bill describe the state's participation and relate to the powers and authorities of the Alaska Gasline Development Corporation. Sections 14-15 are the primary sections related to

the process the state will use to develop and negotiate the project-enabling contracts that will be brought back for the legislature to review and approve or reject. The reference seen throughout the bill is AS 38.05.020(b) and it is referring back to the DNR powers granted in Sections 14 and 15. Percentage is the next major concept that the legislation is oriented around. The statute for tax taken as gas, AS 43.55.014, is talked about in Section 36 but is referenced throughout the bill.

[1:12:56 PM](#)

MR. PAWLOWSKI began his review of CSSB 138(FIN) am, turning to Section 1, page 2, line 16, through page 3, line 29. He noted AS 31.25.005 was passed last year in HB 4 and is the broad purpose section that gives the Alaska Gasline Development Corporation its overarching mission as a corporation. The proposed bill would amend the purpose of the Alaska Gasline Development Corporation to add in some larger overarching directions - these amendments are foundational elements of this legislation. Paragraph (1) would give the Alaska Gasline Development Corporation the purpose to develop and have primary responsibility for developing natural gas pipelines, an Alaska liquefied natural gas project, and other mechanisms to deliver gas in the state. Thus, AGDC would be charged not just with the advancement of in-state natural gas pipelines but actual direct participation in the Alaska LNG Project. Also key in this language is "primary responsibility for developing" those projects - AGDC would lead the state's effort in the commercial relationship in the development of the infrastructure. He reiterated the importance of separating the idea of the gas moving through the project from the actual infrastructure itself and said this provision gives AGDC the primary responsibility of development of the infrastructure.

[1:15:12 PM](#)

REPRESENTATIVE SEATON said the language "other transportation mechanisms" in paragraph (1) appears to be tied to just in-state natural gas. He surmised there is no inclusion of ocean tankers in the purpose here.

MR. PAWLOWSKI responded that could be a plain reading of the statute, adding that the limitations of this section have not been discussed in detail. Because it is for delivery of gas in-state, he said he does not believe it would apply to ocean tankers.

REPRESENTATIVE SEATON clarified he means ocean export tankers, as there has been discussion of small coastal tankers delivering to communities within the state.

MR. PAWLOWSKI said he understood.

[1:16:08 PM](#)

MR. PAWLOWSKI returned to review of the bill, saying addition of [paragraph (2)], on page 2, lines 23-25, provides clarity and direction to the Alaska Gasline Development Corporation, in that its primary responsibility to develop this infrastructure is done so as "to deliver natural gas in-state, provide economic benefits in the state, and revenue to the state", which gives AGDC a mission and a methodology to evaluate that mission.

MR. PAWLOWSKI said the addition of paragraph (3), page 2, line 26, through page 3, line 3, provides direction to the Alaska Gasline Development Corporation in its purpose to assist the Department of Natural Resources and Department of Revenue "to maximize the value of the state's royalty, natural gas, and natural gas delivered to the state as payment of tax, and other gas received by the state". This builds that collaborative relationship between AGDC and the departments, where AGDC is advancing the infrastructure, carrying the commercial interest of the state, and supporting the departments in their role as the resource agencies and custodians of that resource on behalf of Alaskans.

MR. PAWLOWSKI explained [paragraph (5)], page 3, lines 12-19, is the inclusion of direction for AGDC to advance an Alaska liquefied natural gas project by developing the infrastructure and providing related services. Those services include transportation, liquefaction, a marine terminal, marketing, and commercial support. This puts AGDC clearly front and center in supporting the state's effort and providing services to the state or other holders of gas that would be interacting with the state in that infrastructure. Line 15 gives additional direction that if AGDC provides a service to the state under this paragraph it may not charge a fee for the service in an amount greater than the amount necessary to reimburse AGDC for the cost of the service. This provision ensures that, for the state's gas, it is the lowest possible cost.

[1:18:46 PM](#)

MR. PAWLOWSKI addressed Section 2, page 3, line 30, through page 4, line 11, saying it is a conforming section. Page 4, lines 1-2, add the language "acting in the best interest of the state for the purposes required by AS 31.25.005," which is the statute that gives those broader purposes to AGDC. Page 4, line 10, adds the language "or an Alaska liquefied natural gas project." The bill addresses the question of the state's participation by giving that primary participation role to the Alaska Gasline Development Corporation.

MR. PAWLOWSKI noted Section 3, page 4, lines 12-24, is new law adding a new subsection that directs the AGDC board to maximize the efficient use of state resources, establish appropriate separation within the corporation, and appoint a program director for an Alaska liquefied natural gas project. A bill previously before the committee, HB 277, envisioned a distinct separation with a complete statutory subsidiary with a separate board. However, that is eliminated under CSSB 138(FIN) am, and an LNG project is brought in under AGDC as a unified corporation under the same board, in an effort to maximize the efficient use of resources and the appropriate separation.

[1:20:52 PM](#)

MR. PAWLOWSKI pointed out Section 4, page 4, line 25, through page 7, line 16, adds an Alaska liquefied natural gas project to the powers and duties of the Alaska Gasline Development Corporation that were granted last session in HB 4. A conforming section, it simply adds an Alaska liquefied natural gas project to the appropriate places within the statute. However, a substantive change is made on page 7, lines 5-16. New paragraph (23) provides the Alaska Gasline Development Corporation with the power to acquire ownership or participating interest in an Alaska liquefied natural gas project, thereby providing AGDC with the power to be involved in liquefaction, specifically when it is related to an Alaska LNG project. New paragraph (24) is built on the collaborative relationship between the departments and AGDC as the lead developer in the infrastructure. It directs there be consultation with the commissioners of revenue and natural resources when contracts on an Alaska LNG project are entered into for the specific services that AGDC is empowered to provide under AS 41.25.005.

MR. PAWLOWSKI explained Section 5, page 7, lines 17-29, is clarifying language because there is no open season on a large-scale LNG project. Section 5 clarifies that commitments for firm transportation capacity, and the recording required around

that, are related for the in-state pipeline. The Alaska Gasline Development Corporation is given two missions under one roof: to advance the Alaska Stand Alone Pipeline (ASAP) and to participate in and lead development of the Alaska LNG Project.

[1:23:21 PM](#)

MR. PAWLOWSKI said Section 6, page 7, lines 30-31, through page 8, line 2, is conforming language to the concept described in [Section 4], paragraph (23). Section 6 provides that the power to develop liquefaction is only related to advancing the Alaska LNG Project.

MR. PAWLOWSKI stated Section 7, page 8, lines 3-7, adds a new subsection directing the Alaska Gasline Development Corporation to provide the commissioners of natural resources and revenue access to information that is related to the development of contracts under AS 38.05.020(b)(10) and (11). This statute is the process that the commissioner of natural resources with the commissioner of revenue will lead in the negotiation of the project-enabling contracts that will allow the Alaska LNG Project to move forward. Under Section 7, AGDC will provide information, and access to information, to the commissioners when it is under the confidentiality protections of (g) and (h) of this [section]. In the Heads of Agreement (HOA) the state has access to information in its proprietary capacity and under relevant confidentiality protections. The intent is to capture that concept, which is that the departments have naturally separate functions as the partners, but when the departments are wearing their "proprietary hats" managing the state's gas interest and with the appropriate contracts, the state will have access to the information.

[1:25:43 PM](#)

MR. PAWLOWSKI noted Section 8, page 8, lines 8-19, is a clarifying amendment made necessary because of the addition of Section 9. The language added to this section on lines 18 and 19 clarifies that the money in the in-state natural gas pipeline fund established under HB 4 may be used to advance the in-state natural gas project or the other projects in-state that AGDC is empowered to pursue.

MR. PAWLOWSKI pointed out Section 9, page 8, line 20, through page 9, line 3, creates a separate fund within AGDC specifically directed to supporting the Alaska Liquefied Natural Gas Project. Before, bright lines and statutory separation of corporations

were being looked at. Now, the intent is to retain a clear separation of the financial resources to advancing the project so that the public and members of the legislature can see that separation within the structure of AGDC -- when resources are committed to the Alaska LNG Project they are in the Alaska LNG fund and committed. However, this retains the flexibility to appropriately share information - nonmonetary resources - to maximize the efficient use of state resources.

[1:27:14 PM](#)

CO-CHAIR FEIGE recalled [HB 277] separated out two subsidiary corporations. He asked whether there was a question of tax liability.

MR. PAWLOWSKI brought attention to Section 10, page 9, lines 17-18, which deletes specific language included in HB 4 regarding AGDC's powers to create subsidiaries. That language said a subsidiary corporation may be incorporated under AS 10.20.146 - 10.20.166, he explained. Those statutes are the nonprofit code, so there was concern that by implication it meant AGDC could only use the nonprofit code to develop a subsidiary. If that was the case, it potentially could have tax implications for the state. Section 10 removes this reference so as to allow AGDC to use any corporate mechanism that will maximize the efficient use of state resources. It is a clarifying amendment because the intent in the drafting of HB 4 was to provide that flexibility with the word "may." However, it could be construed that that was a limiting section. Continuing, Mr. Pawlowski turned attention to the purpose section of AGDC, page 3, paragraph (5) of Section 1. He noted lines 15-19 provide that when AGDC moves gas for an instrumentality, public corporation, or political subdivision, it may not charge a fee for the service in an amount greater than the amount necessary. The issue of taxes depends on the issue of profit or income and this section attempts to minimize the income or the opportunity for income when related directly to the state. Providing the corporate flexibility for AGDC to develop a subsidiary using whatever corporate mechanism it wants, as well as establishing a relationship when supporting the state, addresses those problems and enables both projects to come under one roof.

[1:29:53 PM](#)

REPRESENTATIVE P. WILSON drew attention to Section 8, lines 16-17, which state "appropriated to the fund without further appropriation for the cost of managing the fund ...." She

inquired whether there is money in the other fund now and, if so, how much.

MR. PAWLOWSKI confirmed there is money in the in-state natural gas pipeline fund, but deferred to AGDC to answer the question. He added that there is no money in the new fund under Section 9.

[1:30:48 PM](#)

REPRESENTATIVE SEATON requested clarification of paragraphs (5) and (6) on page 3. He offered his understanding that paragraph (5) would be limited to providing only gas because it applies to a political subdivision, whereas paragraph (6) does not restrict it to just gas because it applies to municipalities and industrial customers.

MR. PAWLOWSKI noted paragraphs (6) and (7) are language in HB 4 that was renumbered as new [paragraphs] were added. Concern about the additional level for the Alaska LNG Project comes from the issue that providing gas in-state is clearly a public purpose that benefits Alaskans, but supporting gas for export to foreign markets runs into a different level of corporate law. The relationship between the two must be looked at under the corporation's broader purpose for the benefit of Alaskans. How AGDC would structure that is, in his opinion, open to interpretation in the way this language is drafted.

[1:32:40 PM](#)

REPRESENTATIVE SEATON said he is pointing out issues that the committee might look at and resolve. Paragraph (5) relates to pipeline gas that must be delivered at the cost of providing the service. Paragraph (6) relates to propane and other hydrocarbons associated with natural gas other than oil, and these products can be delivered to communities at commercially reasonable rates, meaning above the cost of providing the service. He said he wants to ensure that natural gas and propane are dealt with on the same terms for people in coastal villages and along the rivers as for people in Fairbanks, Homer, or elsewhere.

MR. PAWLOWSKI urged caution. Noting that he wears another hat as DOR's representative on the Alaska Industrial Development and Export Authority (AIDEA) board, he said AIDEA is always conscious of creating competition with the private sector. He said [AIDEA] was comfortable with the language in paragraph (5) because it specifically relates to activity within the Alaska

LNG Project by the private sector that is directly part of the project. For the next step of moving beyond the Alaska LNG Project, there will be an amendment to provide opportunities to deliver low-cost energy to Alaskans when it is the state that is doing it. However, he advised, members will want to pay attention to how that might impact competition with the private sector to move with AGDC. The aforementioned is the reason paragraph (5) was done the way it is, and, he believed, the reason why previous paragraphs (3) and (4) were structured in AGDC's original purpose.

[1:35:31 PM](#)

REPRESENTATIVE KAWASAKI, regarding the topic of nonprofit versus commercially reasonable rates, requested there be discussion at some point on how the language would be interpreted on page 3, line 11, which states "at the lowest rates possible."

CO-CHAIR SADDLER pointed out the language on page 3, line 15, says "the corporation provides a service" to the state, not that the corporation is providing gas to the state.

MR. PAWLOWSKI confirmed Co-Chair Saddler is correct, explaining that that is for AGDC as a part owner in a project in which 75 percent, as the bill is currently written, is owned by the three producers. The intent of this section is setting up AGDC's relationship to the state as a shipper on the main project in relationship to the state's gas.

[1:37:02 PM](#)

MR. PAWLOWSKI resumed his review of CSSB 138(FIN) am, moving to Section 10, page 9, lines 4-24, which relates to AGDC's power to create subsidiaries, which, he said, is now a broad power. Drawing attention to lines 9-10, which delete the words "the state's royalty share of natural gas," he noted AGDC has the power to acquire natural gas from the North Slope. As part of the structure of bringing the Alaska LNG Project and making AGDC the primary developer of the project, the intent is to provide separation between AGDC as the developer of the infrastructure and the agencies as the custodians of the gas resource. This provides separation between the commercial activity and the management of the gas resource on behalf of the people. Lines 14-17 direct that when the subsidiaries are created there is still protection of the money between one fund or the other to retain that bright line of the resources appropriated by the

legislature to either the in-state ASAP project or the larger Alaska LNG Project.

MR. PAWLOWSKI said Section 11, page 9, line 25, through page 10, line 16, requires AGDC to provide annual reviews of the corporation's assets to the legislature. Creation of the Alaska liquefied natural gas project fund adds another fund on which AGDC must report to the legislature, so the changes made in this section are conforming changes.

MR. PAWLOWSKI addressed Section 12, page 10, lines 17, through page 11, line 19, which is the last of the AGDC sections. This section defines an Alaska liquefied natural gas project as it has been used through the previous sections, he said. It is a very detailed definition of the project-specific components that are discussed in the Heads of Agreement and the Memorandum of Understanding. While things are quite different than what was introduced at the outset in HB 277, he continued, on balance they bring together a rational level of separation while at the same time maximizing efficiency and bringing to bear the full expertise of the Alaska Gasline Development Corporation in developing the infrastructure in the LNG components of the project on behalf of the state.

[1:40:36 PM](#)

CO-CHAIR SADDLER said reading Sections 1-12 reminded him of the significant powers that were granted to AGDC, including the issuance of bonds, and that he had thought the role for the subsidiary was going to be taking management of all of those powers. He asked what other kinds of need there might be for subsidiaries that would have the powers laid out in the legislation that was passed last year. He further asked whether other subsidiaries will be proposed.

MR. PAWLOWSKI responded he does not see the state directing creation of subsidiaries unless there is a compelling reason for policy implications. Current structure of the bill puts the impetus on the AGDC board and executive team to use the tool of subsidiaries to manage what may become multiple projects and multiple efforts under AGDC. Giving AGDC the purpose of advancing the in-state line has moved the state forward. Now the state has an opportunity to participate in a large project and AGDC would do that as well. The broad powers in HB 4 allow AGDC to step beyond the core infrastructure and really work on delivering gas to Alaskans. Subsidiaries are typically created to protect assets and provide separation, and CSSB 138(FIN) am

contemplates that this will be done by the AGDC board rather than being directed by the state. That is consistent with the Heads of Agreement, which envisions that AGDC may or may not create a subsidiary to carry the interest, and the board and the executive team are the best equipped to manage that.

[1:42:44 PM](#)

REPRESENTATIVE SEATON inquired what the definition is of "off-loading" liquefied natural gas as used in the language on page 11, line 8. He surmised the definition is not foreign ports.

MR. PAWLOWSKI responded he will get back with the definition, but offered his belief that it is in reference to moving from storage and from the plant on to the ships that would then carry it to market.

[1:43:22 PM](#)

REPRESENTATIVE TARR asked about the language that would change the nonprofit status.

MR. PAWLOWSKI replied the language is on page 9, lines 17-18. He said it is not really a change in the status, but rather a clarification. Deleting that language removes the ambiguity that by specifically calling out a type of corporate structure it is implied that that may be the only corporate structure that can be used. He offered his belief that the original intent was for AGDC to have the maximum flexibility to use whatever corporate structure is available under any law to benefit the people and be efficient in the use of state resources.

REPRESENTATIVE TARR said she is trying to understand the relationship between AGDC as a nonprofit corporation that then would have a subsidiary with some other corporate structure. She asked how the relationship would work between AGDC and the subsidiary and how the relationship of those two entities to the state would work as it pertains to tax payments.

MR. PAWLOWSKI answered he will find someone to bring in to talk about corporate structure. However, he explained, AGDC is a public corporation, an instrumentality of the state, not a nonprofit. The reference here is the nonprofit code, which is separate from being a public instrumentality that was created by and empowered by the legislature. The relationship between AGDC and a subsidiary would depend on the corporate structure, and

AGDC has a direct relationship to the state through the board and as a statutorily created entity.

[1:45:47 PM](#)

CO-CHAIR SADDLER understood the project definition goes from the outlet of Point Thomsen and Prudhoe Bay gas treatment down to the terminal in Nikiski and stops there. He inquired whether consideration was ever given to expanding the project definition to include the tanker ships that would deliver the product to Asian markets or to small tankers that could re-gasify LNG for delivery to rural Alaska.

MR. PAWLOWSKI responded the broader AGDC retains powers to develop transportation mechanisms to deliver gas in-state. So, small LNG barges used today in countries such as Norway are in a separate part. The aforementioned is the definition of the Alaska LNG Project specifically and it is consistent with the Heads of Agreement (HOA) and Memorandum of Understanding (MOU). The state is extremely hesitant to step into transnational shipping arrangements directly.

[1:47:11 PM](#)

REPRESENTATIVE P. WILSON understood that, at this point in time, AGDC's responsibility is to the state to find an in-state gasline. She further understood [CSSB 138(FIN) am] would provide AGDC the power to create subsidiaries and a subsidiary's authority would be directed by the AGDC board. She asked whether AGDC would still be under the legislature's authority.

MR. PAWLOWSKI replied a subsidiary is a tool in AGDC's toolbox that can be used to advance the different projects that AGDC is charged with. The board and executives will figure out whether a subsidiary offers opportunities or inefficiencies. Currently, AGDC is charged with delivering gas in-state through ASAP. Once that gasline is developed, AGDC is charged with looking at the opportunity to move gas around the state. Under [CSSB 138(FIN) am], AGDC would also be given the task of taking the lead for the state in developing the Alaska LNG Project at the project level. How to do that will be up to the AGDC board. The bill directs for a separate program director, but would leave it up to AGDC to set the appropriate separation needed to do these things, which, commercially, have a tendency to get more and more complex as they move forward. [The administration] believes it is important to leave the maximum flexibility in the board to be able to manage those issues as they come up.

REPRESENTATIVE P. WILSON surmised that, in the process, AGDC may decide to join everything into one line.

MR. PAWLOWSKI answered the time at which the broader state would make a decision to advance either the ASAP Project or the Alaska LNG Project is in the future and will happen as more is known about both projects. That is not a blanket decision given to AGDC; AGDC has powers to advance projects. In the future there are agreements and additional steps that will be coming back to the legislature, but today it is to continue advancing the two projects to maximize the opportunity for Alaskans.

REPRESENTATIVE P. WILSON asked whether joining the two projects could happen.

MR. PAWLOWSKI responded [the administration] does not believe that two projects would be advanced for very long.

[1:51:12 PM](#)

REPRESENTATIVE TARR, in regard to public corporations, requested someone be made available to answer questions about tax liability to the state, how those financial relationships would work, and what the state's financial outlook would look like in a stress-case scenario.

MR. PAWLOWSKI agreed to do so. He added [the administration] had been finalizing answers to questions from committee members, but is now revising those answers to be appropriate to this bill, CSSB 138(FIN) am, rather than HB 277.

[1:52:23 PM](#)

MR. PAWLOWSKI returned to his review of CSSB 138(FIN) am, noting Section 13, page 11, line 20, through page 12, line 8, would add a new section to law that creates the Alaska affordable energy fund. The purpose of the fund, page 11, lines 24-25, is "to provide a source from which the legislature may appropriate money to develop infrastructure to deliver energy to areas of the state that are not expected to have or do not have direct access to a North Slope natural gas pipeline." It would be the source of funding for opportunities that are not directly related or expected to have direct access to the main trunk line, such as those described by Representative Seaton. The amount of money to be deposited into this fund, page 11, lines 28-31, is 10 percent of the revenue received from the state's

royalty gas after payment to the Alaska permanent fund. While money is deposited in this fund, page 12, lines 1-2, direct that it is the legislature that makes appropriations from the fund.

[1:54:06 PM](#)

CO-CHAIR SADDLER requested elaboration on how the calculations would be done to arrive at the 10 percent.

MR. PAWLOWSKI replied it is known a certain percentage of the gas moved through the Alaska LNG Project will be royalty gas. A certain amount of the LNG will be sold on behalf of the state either directly or through an arrangement for joint marketing with an individual producer. To demonstrate the calculation he worked backwards, starting with an LNG price of \$15, a price that he picked solely for the convenience of showing how the math would work. If the cost of shipping the LNG in a tanker is, say, \$1; and AGDC's charge to move the gas through the LNG plant is, say, \$4; and the cost of moving the gas through the pipe and gas treatment plant is, say, \$6 - then a balance of \$4, would be left, which, in essence, is the wellhead value. Of that \$4 remaining, 25 percent, or \$1, would go into the permanent fund, leaving a balance of \$3. Under the proposal, 10 percent of that \$3, or 30 cents, would be deposited [into the Alaska affordable energy fund]. The remaining \$2.70 would go into the general fund, although, he believed, a small portion of that \$2.70 would go into the public school trust fund since it is the sale of royalty.

[1:56:37 PM](#)

REPRESENTATIVE SEATON surmised the amount of LNG being sold would be royalty gas plus tax gas.

MR. PAWLOWSKI answered correct.

REPRESENTATIVE SEATON inquired whether in his calculation Mr. Pawlowski was backing both the royalty gas and the tax gas through the formula, such that 25 percent of the wellhead value of all of the gas sold is being considered as royalty gas.

MR. PAWLOWSKI responded no, the deposits to the permanent fund are based on the sale of the royalty gas. The tax gas would be sold separately and the Department of Revenue would direct that back to the general fund, which he will explain later.

[1:57:33 PM](#)

CO-CHAIR FEIGE, regarding use of the affordable energy fund to develop infrastructure, asked what would happen when all infrastructure is in place.

MR. PAWLOWSKI replied he does not believe that is contemplated. However, he pointed out, the fund is a repository of money and the legislature retains the power of appropriation and it is not a dedicated fund.

REPRESENTATIVE TARR said the language reads to her as if the affordable energy fund is a dedicated fund. She requested an explanation for why it is not considered a dedicated fund.

MR. PAWLOWSKI deferred to the Department of Law for a legal interpretation of why it is not a dedicated fund. He offered his belief that it is similar to other funds where it is designated that revenues go into the fund but the state maintains the power to appropriate from the fund.

CO-CHAIR FEIGE pointed out that page 12, line 3, states it is not a dedicated fund.

[1:59:25 PM](#)

CO-CHAIR SADDLER observed there are no provisions for how the proceeds of the affordable energy fund are to be invested or reinvested, as is often the case for other state funds. He inquired whether this is something that needs to be considered.

MR. PAWLOWSKI concurred the state has other funds similar to this. He explained that in its fiscal note for CSSB 138(FIN) am, DOR recognizes the affordable energy fund would be a fund within the general fund and would therefore be managed on a blended basis with the other funds, so there would be no management cost to DOR.

REPRESENTATIVE TARR surmised the idea is that these funds would be a supplement to existing state funds that would continue on in the future.

MR. PAWLOWSKI answered he thinks that is true, but commented that without the large project there is no revenue going into this fund. The fund is created but the funding source does not happen until royalty gas is produced, which is expected to be in the mid-2020s for the Alaska LNG Project. What other programs remain in place in the mid-2020s is hard to presume.

2:01:38 PM

MR. PAWLOWSKI resumed his review of the bill, bringing attention to Section 14, page 12, line 9, through page 15, line 30. The changes on page 13 are the core for how the project-enabling contracts will be developed, he explained. Section 14 revises AS 38.05.020(b), the reference used in the AGDC statutes about the sharing of information. The substantive provisions start on page 13, line 12, [paragraph (10)], which states that power is granted to the commissioner of natural resources to "enter into commercial agreements with a duration of not more than two years for project services related to a North Slope natural gas project." Page 20, lines 9-11, define "project services" as "services provided by a gas treatment plant, pipeline, liquefaction facility, or marine terminal, marine transportation services, or other services necessary to transport natural gas to market." These services are related to a "North Slope natural gas project" which is defined on page 20, lines 6-11, as "a project to produce natural gas from state oil and gas and gas only leases that include land north of 68 degrees North latitude for transport in a gaseous state from the North Slope." This language, he said, means that the commissioner of natural resources will be able to negotiate with a provider of a service, such as in the gas treatment plant. Under the concept put forth by the MOU that would be TransCanada; so, the state would enter into an interim agreement with TransCanada to provide treatment services for gas moving through on behalf of the state. Similarly, AGDC in the liquefaction plant would provide services in the liquefaction plant for state gas. Those interim agreements would have duration of not more than two years. Moving back to page 13, line 14, he read from [paragraph (11)] which states, "in consultation with the commissioner of revenue, participate in the negotiation of agreements that include balancing, marketing, disposition of natural gas, and offtake and contracts associated with a North Slope natural gas project." He reminded members that when the word including is used in statute it means including but not limited to. This is the large project-enabling contracts which, as seen on lines 18-19, are not effective unless the legislature authorizes the governor to execute the agreement or contract. In the MOU the state would enter into a Firm Transportation Services Agreement with TransCanada to provide transportation services to the state for a tariff. That Firm Transportation Services Agreement would be developed under AS 38.05.020(b)(11) and brought back to the legislature to authorize the governor to execute that contract. Similarly, in the Heads of Agreement, an offer is made by the

producers to enter into individual marketing arrangements with the state to dispose of the state's share of LNG. That disposition agreement would be negotiated under AS 38.05.020(b) and returned to the legislature for approval.

[2:06:29 PM](#)

REPRESENTATIVE SEATON requested an explanation of the context of a project services contract of not more than two years when talking about a liquefaction facility, pipeline, or marine terminal. He presumed that going forward there is going to be a longer term secure contract that is not renewed every two years.

MR. PAWLOWSKI concurred, saying the long term commercial arrangements will be done under long-term contracts, both in the project itself and throughout the daisy chain of relationships that get developed. Often a Precedent Agreement or some interim agreement is there prior to the firm agreement that comes back [to the legislature]. The timesheet in the MOU will need to get turned into a Precedent Agreement that can be a foundation for the more detailed agreement that comes back to the legislature.

REPRESENTATIVE SEATON surmised these agreements are in place but not really operating a liquefaction plant or anything else; they are just for going through the process while getting everything aligned.

MR. PAWLOWSKI agreed, saying it is a process of taking what are very short documents and making them bigger and then making them much bigger to come back to the legislature and the public.

[2:08:08 PM](#)

CO-CHAIR SADDLER understood that effective with passage of the bill the commissioner can make commercial agreements of not more than two years, so therefore not for services that would continue through the duration of the entire project. He inquired what those services might be.

MR. PAWLOWSKI replied it might be for two years because the parties are coming back with the contracts that are needed for operating over the long term. The timeline for the Pre-Front-End Engineering and Design (Pre-FEED) stage is 18-24 months. The state needs flexibility to enter into these interim agreements, but those are not binding in the way the long-term contracts are. In further response, he said it is Precedent Agreements for those services that are envisioned for those two

years, not that those services are actually there yet. The Precedent Agreement phase occurs before the Firm Transportation Services Agreement, which would govern the full operation.

[2:09:36 PM](#)

MR. PAWLOWSKI recommenced his presentation of CSSB 138(FIN) am, noting the next addition made in Section 14 is paragraph (12), page 13, lines 21-31. This provision, he said, empowers the commissioner to enter into confidentiality agreements to maintain the confidentiality of information related to these contract negotiations.

[2:09:57 PM](#)

REPRESENTATIVE SEATON asked how binding the two-year contracts would be, given that the long-term contracts coming back to the legislature for approval may include elements the legislature does not agree to.

MR. PAWLOWSKI responded the interim agreements are not binding in the way the full contracts are binding. The full contracts will be binding with the legislature's authorization. For example, under a Precedent Agreement the state will be entering into a relationship per the MOU with TransCanada to have offerings, and with those offerings associated development cost. Those agreements are binding in that the state is committing to something within those two years, but they are not the long-term agreements that then are precursors for the legislature's up-or-down approval.

REPRESENTATIVE SEATON inquired whether the two-year commercial contracts made by AGDC will have provisions that allow things to be cancelled without obligations if the legislature does not go with a longer term contract.

MR. PAWLOWSKI replied this section relates to the Department of Natural Resources and the commissioner of natural resources, not AGDC, entering into the resource agreements. It would piggyback on the royalty process the department goes through.

REPRESENTATIVE SEATON rephrased his question, asking whether the two-year commercial agreements that the Department of Natural Resources would be allowed to enter into could have provisions that bind the legislature or that commit to reparations if the legislature disapproves of the long-term contract. He presumed that agreements and contracts are viewed as the same thing.

MR. PAWLOWSKI answered he will look at the various possibilities and get back to the committee. He said the way the language is crafted, agreements are viewed as slightly different from contracts; it provides flexibility to enter into interim agreements and move things off the list prior to the large contracts that will come back [to the legislature].

[2:14:33 PM](#)

MR. PAWLOWSKI returned to his review of Section 14, paragraph (12), drawing attention to lines 29-31, which state "the commissioner may share confidential information obtained under this paragraph with the legislature only in committees held in executive session or under confidentiality agreements." The goal, he said, is to work with the legislative body over the period the contracts are developed so that a suite of agreements is created that will meet with success, rather than something the public and the legislature cannot support. Just as parties were brought together in the Heads of Agreement to move the project in Alaska forward, the idea is to now expand the circle to include the legislature to keep moving this project forward.

[2:16:09 PM](#)

REPRESENTATIVE TARR inquired whether the commissioner "shall" share confidential information would be stronger than "may" share. She said "may" might leave it open to the commissioner's discretion as to whether that information is shared with the legislature. If the intent is for the legislature to have access to that information, the language needs to be clear that that is the case.

MR. PAWLOWSKI offered his belief that this was a change made in the other body at the direction of Legislative Legal and Research Services. He said the committee and the administration can look back through the record to get an answer.

[2:16:55 PM](#)

CO-CHAIR FEIGE said the intent is clearly there that the legislature should participate with the department. Although not necessarily participating in the negotiations, the legislature would be aware of the process and would perhaps provide advice to the administration. If somebody starts down a path that legislators know is not going to fly, it is better for the administration to know that up front and not waste time

going down what the legislature would know to be a dead end. He said his reading of this language is that legislative members would have to sign confidentiality agreements and anyone uncomfortable with signing a confidentiality agreement would not be allowed to participate in those sessions.

MR. PAWLOWSKI concurred. Stating that this is a really important topic, he brought attention to the Heads of Agreement, page 14, Article 8.3.3. During the Pre-FEED stage, he said, individually the companies and the state are talking about initiating the process of assessing the LNG market to see if there really are opportunities for Alaska gas to compete. At the same time, the state will be working disposition agreements potentially, or preliminary disposition agreements, with each of the three producers individually or other parties that might be interested in managing LNG on behalf of the state. The state could be negotiating with, say, ExxonMobil, while at the same time negotiating a separate agreement with BP for the disposition of LNG, and one with ConocoPhillips. Under no circumstances would [the administration] want to put the legislature in a position of telegraphing the different terms in those agreements to the detriment of the state or allowing the parties to see what is going on between them. The confidentiality provisions are critical to protecting the state's interest as it steps into these commercial relationships. This can be seen today with the Department of Natural Resources and the disposition of royalty-in-kind oil. This is a key piece of the legislation that the administration looks forward to discussing with the committee.

[2:20:39 PM](#)

REPRESENTATIVE JOHNSON said he is unsure whether under the legislature's uniform rules a legislator could be kept out of executive committee, plus it is possible for a legislator to come in who is not a member of the committee. He therefore suggested that "or" may need to be changed to "and" on page 13, line 31. He requested that Legislative Legal and Research Services explore this as well as whether a legislator who does not sign a confidentiality agreement could be kept out of executive committee even if "or" is changed to "and" on line 31.

REPRESENTATIVE SEATON recalled that when doing this before, people individually signed confidentiality agreements and went to meetings, although meetings were not necessarily established legislative meetings.

REPRESENTATIVE JOHNSON said that is his point about "any committee or" and if a committee is convened, he does not think it has the right to restrict. While there may be a way around that he is unsure that this is the right answer.

[2:22:29 PM](#)

MR. PAWLOWSKI resumed his review of CSSB 138(FIN) am, noting Section 15, page 14, line 3, through page 15, line 30, is a repeat of Section 14. Throughout the legislation, he explained, a section is amended that was just amended. The bill has different effective dates for different provisions. Several years ago it was learned that having tax provisions take effect halfway through a tax year causes disaster for the Department of Revenue because taxes are paid on an annual basis, not a fiscal year basis. Thus, annualizing the tax laws is looked for. The tax provisions in the bill take effect 1/1/15 and the other provisions take effect immediately. The purpose of a section that is amending the section just amended is to incorporate the change in tax law that is happening later in the legislation. This is seen on page 15, where all of the language from the previous section is repeated, but a new paragraph (13) is added to reference AS 43.55.014, which is the concept of tax as gas. Tax as gas does not become an opportunity until the provision that enables tax as gas happens, which is 1/1/15. There are two sections because the commissioner of natural resources cannot be given direction to consult with the commissioner of revenue in a provision that does not exist yet. Paragraph (13) sets up in the powers of the commissioner of natural resources the direction to manage tax gas but in consultation with the Department of Revenue. Currently, the Department of Natural Resources (DNR) manages royalty-in-kind. A royalty board composed of commercial analysts and knowledgeable staff uses process, statute, and precedent to enter into disposition agreements and to manage oil and gas. However, the Department of Revenue (DOR) does not have this. When considering tax as gas, the administration looked at having DNR leverage its expertise to manage that on a day-in-day-out basis on behalf of DOR so that the tax gas would be disposed of in the same way as for royalty gas. This allows the state to be efficient and not bulk up two organizations when DNR can be relied upon to do it and to do it in consultation with DOR since it is DOR that takes proceeds from the sale of tax gas and designates it to the general fund or wherever else the legislature has directed.

[2:27:02 PM](#)

MR. PAWLOWSKI said Section 16, page 15, line 13, through page 16, line 15, is a conforming amendment to an exploration credit already on DNR's books. The amendment, which is on page 16, line 12, changes the statute from AS 43.55 to AS 43.55.011, which is the state's production tax. This change happens throughout the bill and relates to credits and the application of tax credits and this is the first instance of that change. Under this bill, a taxpayer, under specific circumstances, can pay tax obligations with molecules, just like what is done when the state takes royalty-in-kind. However, tax credit cannot be applied against a payment in molecules, so, wherever AS 43.55 is referenced, a conforming amendment must be made by changing it to AS 43.55.011, which is the regular payment in cash that the state receives from the taxpayer.

[2:29:03 PM](#)

REPRESENTATIVE JOHNSON inquired whether it is being said that the state would be able to take gas in lieu of taxes.

MR. PAWLOWSKI replied yes. Instead of a tax payment, the state under CSSB 138(FIN) am has an opportunity to take a larger share of the gas from certain leases and under certain circumstances.

REPRESENTATIVE JOHNSON posed a future scenario of the pipeline at 100 percent capacity and the three producers saying they want to pay their tax in gas. He posited that what the producers pay the state they would take up by selling their own, and therefore the state would have no way to transport that tax payment.

MR. PAWLOWSKI responded Section 17 is a precursor for the option to do tax as gas. The opportunity for a taxpayer to do tax as gas depends upon the Department of Natural Resources modifying the lease. If the lease is not modified, the option will not exist. State control is built in this way because, per the Heads of Agreement, the state sees a real opportunity in taking the molecules and maximizing that resource on behalf of the people of Alaska. At the same time, the opportunity for tax as gas is subject to certain agreements being struck to the satisfaction of the state. This provides a process and the mechanism to set that up because it is correct to be concerned about what happens to the state in a situation where it receives molecules but has no capacity to place them. The state must be careful and set up mechanisms that prevent that, which is why the state is being put into the driver's seat for enabling the option to begin with.

[2:31:03 PM](#)

REPRESENTATIVE SEATON observed Section 16 deals with exploration incentive tax credit credits that may not exceed 50 percent [of the payment toward which it is being applied]. He asked whether these credits are being applied against oil taxes or gas taxes.

MR. PAWLOWSKI answered this is a legacy credit which has only been used a few times. It is a credit against royalty payments or production tax payments, and is production tax on gas, royalty on gas, royalty on oil. This is a legacy power that the commissioner of natural resources has in statute and this is a conforming amendment to how that credit could be applied.

REPRESENTATIVE SEATON understood a new credit is not being created here. He said his question comes down to the problem that the state changed its tax system last year, especially in relationship to high amounts of credits that the state would be liable for, particularly at low prices. He expressed his concern that going forward the state does not have a system that relates to expenses in gas that then get applied to further reduce the state's oil revenue at low prices. If this is being revamped, he said, members need to understand how these credits are going to implicate the state's future liabilities if things do not go the way the state wants them to go.

CO-CHAIR FEIGE stated it would be useful, to that end, to know what the historical utilization of those credits is.

MR. PAWLOWSKI offered his belief that as this bill has moved through the process, the administration has answered and done a history on this particular credit, which he will provide to the committee. He added he knows that there has been other discussion of credits.

REPRESENTATIVE SEATON said his concern is that now the state is entering a phase not of history of where the credit was used, but of trying to make gas production accentuated. Therefore, he is worried more about the possibility of what the credit could do if left in place in the future than whether it was used in the past.

[2:34:32 PM](#)

MR. PAWLOWSKI, returning to his review of CSSB 138(FIN) am, explained Section 17, page 16, line 16, through page 17, line 23, amends the power of the commissioner of natural resources to

modify leases. Amendment of AS 38.05.180(hh) is a key section of the bill, he said, and is a precursor to the availability of the option for a taxpayer to pay its tax with gas. The commissioner has an opportunity after making a written determination to modify leases; leases are contractual relationships between the state and the lessor that may be modified. A key change that must be done to move a gas project forward is on page 16, lines 25-29. Under the current leases, the state has the right to switch from taking in-value to taking in-kind. This creates significant problems in a gas project because a gas project depends on capacity being subscribed for long periods of time and fully utilized. For example, say a producer enters into a long-term contract to sell a certain amount of LNG to a buyer for the next 25 years and the producer has made that decision with the state taking in-value. If six months later the state says it wants to take its gas molecules as molecules, that producer is now short molecules to turn into LNG to meet its contract. Under oil, this power to switch the state's lease terms makes a lot of sense; however, in long-term gas commitments it creates real instability for both the producer and the state. Likewise, if the state makes a commitment to provide LNG and there is the ability to move back and forth between in-value and in-kind, the state could be short the gas it has committed to those contracts. This would allow the commissioner to modify the leases to put limitations on the right to switch between in-value and in-kind so that they do not unreasonably interfere with the long-term marketing of natural gas by the lessee of the state or another person. It supports the long-term marketing of that natural gas and fulfillment of the contract.

[2:37:50 PM](#)

CO-CHAIR FEIGE agreed the term is important and inquired whether it is worth putting into statute here limitations on the terms or a minimum term period.

MR. PAWLOWSKI replied page 16, lines 21-23, state that "the modification shall be in effect during the initial project term that has acquired the major permits required for the work plan and budget ...." So, it is contemplated to be limited to that period of the initial contract.

CO-CHAIR FEIGE surmised the first 25 years.

MR. PAWLOWSKI agreed that would be about right.

2:38:30 PM

REPRESENTATIVE SEATON understood the modification being made is just switching an in-kind and is not a percentage of the bid amount.

MR. PAWLOWSKI replied correct, adding that he will be discussing the number in a few minutes.

2:38:55 PM

REPRESENTATIVE TARR drew attention to page 16, lines 28-29, which say, "the state's actions do not unreasonably interfere with long-term marketing of natural gas by the lessee, the state, or another person" and inquired how "unreasonably" interferes would be determined.

MR. PAWLOWSKI answered he will have to see whether there is a distinct legal standard around unreasonably and will get back to the committee in this regard.

2:39:45 PM

REPRESENTATIVE OLSON noted that historically LNG exported from Alaska has been sold on a British Thermal Unit (BTU) basis. He asked what unit was used for a tax base.

MR. PAWLOWSKI responded he cannot remember whether it is a BTU or a volumetric thousand cubic feet (MCF). He said he will get back to the committee with an answer, but added he knows that DOR takes a number and back calculates for the purpose of calculating a tax.

REPRESENTATIVE OLSON added that historically the state adjusted the BTU content due to the fluctuations and supply during the middle of winter. He said he is therefore confused on whether the state was doing it on volume for taxes and doing it on BTUs when there might not be correlation because the BTU content would change per load. He believed it was measured in Nikiski and again at "Tokyo Electric" when the delivery arrived.

MR. PAWLOWSKI replied he will get back to the committee regarding the way that that gets levied by DOR as well as how DNR does the royalty calculations. The predominant value in that exchange comes through the royalty, he added, which often uses a different number than the tax number. He believed the

production tax under the carve-out for Cook Inlet is based on a volumetric.

[2:41:48 PM](#)

CO-CHAIR SADDLER brought attention to page 16, lines 21-22, which state that the modification shall be in effect "during the initial project term" and inquired whether the language should instead read "during the initial term of a project."

MR. PAWLOWSKI agreed to look at the suggestion, but advised that "initial project term" is a defined term.

CO-CHAIR SADDLER pointed out that the "term" does not require permits; the "project" requires permits.

MR. PAWLOWSKI agreed.

[2:42:44 PM](#)

MR. PAWLOWSKI returned to his review of Section 17, noting page 17, lines 5-8, address setting an appropriate fixed royalty share. A dilemma in places like Point Thomson, he said, is that there are many royalties with a fixed share and some that are net profit share or sliding scale. This provision allows the Department of Natural Resources to move to a fixed value for that lease. After much discussion, this provision has evolved to require that the fixed royalty rate must "yield a value to the state that the commissioner determines to be not less than the value the state would have received under the terms of the lease before a modification under this subsection."

[2:44:05 PM](#)

CO-CHAIR FEIGE asked whether it is a general intent to make all gas leases across the North Slope the same, or fairly close to the same, royalty share.

MR. PAWLOWSKI answered it is not the intent to do that on leases across the North Slope, but rather to rationalize numbers within a unit. A unit will be made up of a suite of leases with different terms, he explained, and a blended number is needed to calculate the state's gas share for royalty purposes that, in conjunction with the production tax, creates the volume of gas that the state has to support its share in the project.

[2:44:48 PM](#)

CO-CHAIR SADDLER, regarding page 17, line 7, understood that the lease modification would not take place without both parties - the state and the producer - agreeing. He observed the proposed language of "not less than the value" does not include a cap. He inquired whether this means there is no prohibition against it being adjusted such that it is a higher value to the state.

MR. PAWLOWSKI replied he will discuss this with DNR and get back to the committee with an answer, but said that that is absolutely not the intent here. The intent is to arrive at a fixed percentage for variable leases that does not transfer value between the parties but sets a fixed percentage for the state to be able to move forward.

[2:45:46 PM](#)

REPRESENTATIVE SEATON, regarding page 17, line 5, asked why oil is included in the provision for modifying net profit shares rather than only gas.

MR. PAWLOWSKI understood it is because those are oil and gas leases; the leases may not be gas only leases.

REPRESENTATIVE SEATON said he wants to make sure apples and oranges are not being mixed when talking about royalty shares on gas and royalty shares on oil, and he wants to ensure that oil is segregated from gas.

MR. PAWLOWSKI responded that, given the length of the bill, he may not be able to get to this today, but he will come back to discuss it in a future conversation because there very much is a connection between oil and gas. Under the Heads of Agreement, he continued, Point Thomson is one of the anchor fields for this project and the production of oil is actually production of associated liquids that comes directly from the gas production. The relationship of lease expenditures being applied against the regular production tax will be discussed later. The ability to separate is a very difficult one, he said.

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MR. PAWLOWSKI resumed his review of CSSB 138(FIN) am, pointing out Section 18, page 17, line 24, through page 18, line 17, is another section that is being amended immediately after previously being amended, so it is a repeat of Section 17. The change on page 18, line 5, says that this also can include gas

delivered to the state under AS 43.55.014, which is the reference to tax as gas; thus, it is a conforming change to account for establishment of the tax-as-gas option.

MR. PAWLOWSKI explained Sections 19-22, page 18, line 18, through page 19, line 30, are conforming changes for tax as gas. These sections are statutes governing the Department of Natural Resources' disposition of royalty-in-kind. It is existing law, existing practice, for how DNR does the sale, exchange, or other disposal that comes as a royalty; it adds the tax as gas to these sections to give consistent treatment. It would go through the same process, leveraging the royalty board, providing the same side bars, just in the management of Department of Revenue's tax gas because these would already apply to the Department of Natural Resources' management of royalty oil. [The administration] wants the same custom and practice to apply to Department of Revenue tax gas.

MR. PAWLOWSKI addressed Section 23, page 19, line 31, through page 20, line 11, reminding members that these are the definitions reviewed earlier for the initial project term, the North Slope natural gas project, and project services.

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MR. PAWLOWSKI said Sections 24-26, page 20, line 12, through page 21, line 1, are an amendment that attempts to conform. Provisions in HB 4 directed the Department of Natural Resources to give priority to the in-state natural gas pipeline project when doing permitting. These sections delete the reference to the in-state natural gas pipeline project and insert a project under AS 31.25, the Alaska Gasline Development Corporation. So, rather than a narrow prioritization for AGDC in the permitting project process, it is given an expansive definition so the projects that AGDC is pursuing on behalf of the state get the same benefit whether it is an in-state project, the Alaska LNG Project, or a project to deliver gas to Alaskans under any circumstance.

MR. PAWLOWSKI noted Section 27 is the beginning of the bill's tax sections. He ended his review of the legislation, saying he would continue his review at the committee's next meeting [on 3/21/14].

[2:53:12 PM](#)

REPRESENTATIVE JOHNSON inquired where the tax is assessed on the gas.

MR. PAWLOWSKI responded the point of production for tax is modified in this legislation to provide clarity of where that happens. For the Alaska LNG Project, the point of production is the inlet of the transmission lines. For Point Thomson, it is the pipeline that takes the gas from Point Thomson to the treatment plant. For Prudhoe Bay it is the transmission line that takes the gas from Prudhoe Bay to the treatment plant even though the treatment plant is actually likely to be within the Prudhoe Bay unit.

REPRESENTATIVE JOHNSON understood the point of production is basically where the gas enters the treatment plant, or where it enters the pipeline to the treatment plant.

MR. PAWLOWSKI replied correct.

REPRESENTATIVE JOHNSON commented that that is almost wellhead.

MR. PAWLOWSKI answered it is very close to wellhead.

REPRESENTATIVE JOHNSON surmised if the state takes gas in taxes it will be on the hook for transportation.

MR. PAWLOWSKI responded correct.

REPRESENTATIVE JOHNSON asked whether the state is figuring that in. For example, the state is owed \$1, it takes the state 2 cents to [transport it], and so the state gives the producer 98 cents in credit; or, the state gives full value and eats the transportation. While the state gets to market the gas, he continued, it is also taking the risk of anything that might happen downstream from that opening.

MR. PAWLOWSKI concurred, saying the agreements in the Heads of Agreement to enable that are twofold. The upstream agreements guarantee delivery, the offtake for the state, and balancing between the two fields to provide the gas for the project. The disposition agreements allow the state to cover that cost in between, so it is correct that, in-kind, the state is taking that transportation responsibility. Whether that is shifted in the future is open for debate, but in today's circumstances that is what would be happening.

[2:55:56 PM](#)

REPRESENTATIVE JOHNSON inquired whether it is a one-way street in that only the producers can come to the state or whether it is a two-way street in that the state can go to the producers saying it wants gas in lieu of taxes.

MR. PAWLOWSKI replied that under the provision for modification of leases, the producers and the state will have to sit down and modify leases, particularly around the question of switching, and make a decision of in-kind or in-value. Once those leases are modified, a producer will have the right to choose to pay [*indisc.--microphone bumped*]. "So, it is the state election, collaboratively with the producers in the modification of the leases that enables the opportunity for tax as gas," he said.

REPRESENTATIVE JOHNSON remarked he still does not know that he has an answer to his one-quarter of the pipeline. He posed a scenario in which there is agreement to modify the leases and the state has 27 percent of the gas, but the producers still want their 25 percent, resulting in the state stranding its tax payment. It is taxed before it goes in the pipe, he said, so the state is stranding that payment.

MR. PAWLOWSKI responded that is why the state ownership of capacity must match up with the state opportunity for the gas payment. It is why those offtake agreements are so important and it is why the balancing agreements are so important. Those agreements clarify how the gas is delivered, how much the state has so it can match it up with the capacity and can manage that question. If one of those does not work, the opportunity itself will not work. So, all of those are negotiated in tandem and moved forward through this process as the project moves through the Pre-FEED stage and into the FEED stage.

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REPRESENTATIVE JOHNSON said he needs more clarity and still has questions because he can already see a way to game the system. The state is taking responsibility for that payment of the state's 25 percent; the state is taking the gas in-kind. He asked whether the state would be sacrificing some of its revenue to its partner if the gas is taken in-kind. The state is paying to have that gas moved, he continued, so the state would not get full benefit for that if it is taken as gas because the state must share it with somebody.

MR. PAWLOWSKI confirmed there is an obligation, a cost to the state, of that fixed tariff from having a partner in any element of the midstream. However, that comes at the benefit of the investment up front.

REPRESENTATIVE JOHNSON, qualifying that for purposes of his question it be ignored that the state has an investment and a partner, inquired why the state, knowing it must share that portion of the revenue it is taking in taxes, would ever take it in gas. He further inquired under what scenario would it make sense for the state to take any gas when the state must share it, be responsible, and market it. He said he cannot see why this is needed because he cannot see a situation where the state would ever want to take revenue for gas.

MR. PAWLOWSKI answered the opportunity [the administration] sees in taking tax as gas is the same opportunity the state sees with royalty-in-kind. The combination of the two, plus the state investment, allows the state to move the Alaska LNG Project forward with the partners in a way that allows the state to maximize value. [The administration] does not see the alternatives of reducing tax rates and royalty rates to enable the project as being in the long-term interest of the state or one that would move a project forward with the partners. [The administration] believes the state's co-investment and the state taking a larger share of the gas provides the maximum opportunity for making a project actually happen.

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REPRESENTATIVE JOHNSON opined that legislators are wasting their time if the profitability of a \$40-\$80 billion project is dependent upon the state taking gas instead of taxes; that is such a small number in the overall. He said he questions this incentive and does not know why it is needed, although he understands why the producers would want it. "If we are depending on that, this project is in trouble," he said.

MR. PAWLOWSKI responded he will bring the committee the economics for why it benefits the project. It is important to remember, he said, that in a traditional tax role the deduction for transportation, whether for royalty or for tax, is to get to the wellhead. The state is paying for transportation costs and the state does not have control over those costs and that is part of the litigation and valuation disputes that the state has had over the last 30-40 years regarding the Trans-Alaska Pipeline System (TAPS) tariffs. They come out in the in-value

equation in the same way they would if the state was paying the in-kind equation. He offered his belief that the state typically achieves a higher value in the in-kind scenario than it does in the in-value scenario.

REPRESENTATIVE JOHNSON said the difference between TAPS and what was just stated is that there is no partner with whom the state must share profits.

[3:03:21 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:03 p.m.