

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 21, 2014

1:08 p.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Dan Saddler, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Mike Hawker
Representative Paul Seaton
Representative Scott Kawasaki
Representative Geran Tarr

MEMBERS ABSENT

Representative Craig Johnson
Representative Kurt Olson

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
02/20/14 (S) MINUTE(RES)
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) READ THE FIRST TIME - REFERRALS
 03/19/14 (H) RES, L&C, FIN
 03/19/14 (H) RES AT 1:00 PM BARNES 124
 03/19/14 (H) Heard & Held
 03/19/14 (H) MINUTE(RES)
 03/21/14 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

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

POSITION STATEMENT: On behalf of the administration, provided a section-by-section review of CSSB 138(FIN) am, a continuation of a presentation he began on 3/19/14.

SUSAN POLLARD, Assistant Attorney General

Oil, Gas & Mining Section
Civil Division (Juneau)
Department of Law (DOL)
Juneau, Alaska

POSITION STATEMENT: During the administration's section-by-section review of CSSB 138(FIN) am, answered questions.

ACTION NARRATIVE

[1:08:48 PM](#)

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 1:08 p.m. Representatives Hawker, Kawasaki, P. Wilson, Saddler, and Feige were present at the call to order. Representatives Seaton and Tarr arrived as the meeting was in progress. Representative Josephson was also present.

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

[1:09:06 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."

[1:09:15 PM](#)

MICHAEL PAWLOWSKI, Deputy Commissioner, Office of the Commissioner, Department of Revenue, continued his section-by-section review of CSSB 138(FIN) am, which he had begun presenting on 3/19/14. He reminded members that Sections 1-12 of the enabling legislation are related to the Alaska Gasline Development Corporation (AGDC) and how the state will participate in the [Alaska Liquefied Natural Gas Project (LNG) Project]. He further reminded members that the other sections of the bill he discussed on 3/19/14 were related to the Department of Natural Resources and the process for negotiating the project-enabling contracts. He said today he will discuss the tax-related sections of the bill, Sections 27 and onward, which are "the percentage questions." The state's percentage of gas share will, in turn, determine what level of the infrastructure the state will invest in.

MR. PAWLOWSKI noted Section 27, page 21, lines 2-15, is a conforming amendment to confidentiality and protecting taxpayer information. Previous provisions are related to the Department of Natural Resources (DNR) and AS 38.05.020, a statute that links back to the powers of DNR to negotiate the agreements and contracts that will come back to the legislature for approval. Because the Department of Revenue (DOR) will play a consultative role with DNR and will need to have confidentiality protections, language needs to be added into the confidentiality protection sections so that DOR can keep the information under those negotiations confidential.

[1:11:41 PM](#)

MR. PAWLOWSKI explained Section 28, page 21, lines 16-29, is an amendment. He reminded members about previous discussion regarding effective dates and amending sections just previously amended, which is needed because the tax provisions are effective 1/1/15. The language inserted on page 21, line 21, is an exception to information that [DOR] keeps confidential and is related to the publication of the tax as gas provision.

MR. PAWLOWSKI drew attention to Section 29, page 21, line 30, through page 24, line 1. He said page 23, line 31, through page 24, line 1, references AS 38.05.020(b), which is the DNR provision for the negotiation of those agreements. [Section 29 amends AS 40.25.120(a) to establish an exception in public records for information confidential under the new provisions of AS 3.05.020(b) (related to contract negotiations for a North Slope natural gas project).]

MR. PAWLOWSKI said Section 30, page 24, line 2, through page 25, line 8, expands the powers of the duties of the commissioner of revenue. Page 25, lines 6-8, is the new language that deals with consultation with the commissioner of natural resources. Just as the commissioner of natural resources is directed in the DNR section to consult with the commissioner of revenue, in the revenue section the commissioner of revenue is directed to consult with the commissioner of natural resources.

[1:13:35 PM](#)

MR. PAWLOWSKI stated Section 31, page 25, line 9, through page 26, line 19, is the same section amended to account for the effective date. Page 26, line 16, inserts new paragraph (17), which references AS 43.55.014(b), the statute for tax as gas, where the tax is taken as a percentage of the molecules produced. Section 31 relates to the commissioner of revenue and calls out that it is the commissioner of revenue who directs the disposition of revenues received from the gas delivered to the state in lieu of tax, gas that is then sold under agreements with the commissioner of natural resources. Statutes have been passed throughout time that direct the disposition of revenues, so this provision clarifies that it is the commissioner of revenue who directs that tax as gas. In the DNR sections, the sale of royalty gas is talked about along with the calculation and direction of a percentage that goes to the permanent fund. If there are similar directions to the commissioner of revenue, they would do that with the tax proceeds. Today, proceeds from tax go into the general fund and are available broadly for the legislature to appropriate.

1:15:02 PM

MR. PAWLOWSKI noted Section 32, page 26, lines 20-24, provides an exception to taxpayer confidentiality for those parties electing to pay their tax with gas. The department is allowed to publish the name of the person and the amount of gas produced from each lease or property that is effective for that election. He clarified that in the tax sections, "person" typically refers to a corporation. Section 32 ensures that when a company pays its taxes with gas, that information is public and is included in DOR's revenue sources book so Alaskans can see it and account for it.

1:15:52 PM

CO-CHAIR FEIGE asked whether DOR will be required to have three producers, as is currently the case, before the department can publish a total number.

MR. PAWLOWSKI responded the reason for the specific exemption is so that those provisions do not apply. This will provide a higher level of public disclosure around the tax as gas concept.

CO-CHAIR FEIGE surmised the people of the state will then know exactly how much gas has been conveyed to the state, either for royalties or for [the tax as gas].

MR. PAWLOWSKI replied correct. For the tax as gas, the people of Alaska will know how much, where it came from, and who provided that gas.

1:16:46 PM

REPRESENTATIVE TARR inquired how the dollar amount for that gas will be arrived at. She recalled that analytica estimates the amount will be up to \$350 million a year. She understood the provision is that it will be in the revenue sources book as projected from where it will be coming from, rather than the actual dollar amount. She presumed the dollar amount would be found through the budget documents.

MR. PAWLOWSKI answered the point in Section 31 is for DOR to direct the disposition of revenue received for the gas delivered to the state under the tax as gas provision. The state will have an accounting of the sale of that gas, so the proceeds will be known. Also, DOR will have the essential payment of the

terms of moving the gas through the infrastructure and ultimately a number that goes into the general fund.

REPRESENTATIVE TARR understood that Section 32 would make available to the public all the information absent a dollar amount associated with it.

MR. PAWLOWSKI responded correct.

CO-CHAIR FEIGE said that is because the dollar amount is really up to the state to sell that gas by whatever means, such as selling in-state or to a local utility.

MR. PAWLOWSKI replied correct.

[1:18:20 PM](#)

MR. PAWLOWSKI returned to his sectional analysis, pointing out that Section 33, page 26, line 25, through page 27, line 15, is an amendment to the corporate income tax provisions in Alaska statute. The changes on page 27, lines 1-15, are intended to capture what is a business activity in the state. When a company produces gas and pays a production tax, that volume of gas is included in the company's apportionment factor, which affects the company's level of corporate income tax paid to the state under current statute. Section 33 provides that the state will include in the apportionment factor the tax paid as gas.

[1:19:16 PM](#)

MR. PAWLOWSKI, in response to Co-Chair Saddler, defined apportionment factor, explaining that Alaska's corporate income tax takes the broad business activity of a company and apportions the income, for tax purposes, based on the business activity in the state. Section 33 is a clarifying amendment to ensure the status quo of the regular production tax, or taxable gas, will continue to be included, whether it is paid in-kind or under the normal production tax. Previous versions of the bill in the other body included clarifying language intended to capture the status quo treatment of inner-company transactions, which are not taxed under Alaska's corporate income tax. He said the administration may be looking to work with the committee to provide that clarifying language in statute to this section. It is not intended to change DOR's treatment of corporate income tax and there may be some opportunities to provide additional clarity. However, the corporate income tax apportionment factor is in a separate section. The intent is

not to change corporate income tax, but rather provide clarity to taxpayers. It is believed that this section clearly does that for the extraction factor, while providing that the business activity is taxed in the state of Alaska.

MR. PAWLOWSKI, in response to Representative P. Wilson, explained the extraction factor is part of the equation that determines the business activity within the state of Alaska. In further response, he confirmed that the corporation is worldwide and it is the part that the corporation does in Alaska. A proxy is being created, he said, so the State of Alaska (SOA) can calculate a corporate income tax liability.

[1:21:40 PM](#)

MR. PAWLOWSKI resumed his sectional analysis, noting that Section 34, page 27, line 16, through page 28, line 7, relates directly to the production tax, which is found under AS 43.55.011. Section 34 calls out the specifics of how the tax regime will work after 1/1/22. The operative language is on page 27, line 31, through page 28, line 7, which state that on and after 1/1/22, the production tax for oil is separated out at 35 percent and the tax on gas is equal to 13 percent of the gross value at the point of production of the taxable gas.

[1:22:41 PM](#)

REPRESENTATIVE HAWKER recalled that when introduced SB 138 had a figure of [10.5] percent, which has been changed to 13 percent. He requested the administration's opinion on the change.

MR. PAWLOWSKI responded the original figure of 10.5 percent was chosen by the administration because, when looking at the broad range of economics in a status quo world, 10.5 percent seemed to be the most likely crossover where the state preserved the value that it would receive from going in a status quo world. The intent of the state was to preserve value, not to say that a status quo would actually work to advance a project. The royalty study that DNR previously presented to the committee talked about fiscal changes that needed to be made to improve the economics. One opportunity was to do something like is done under royalty relief - reduce the royalties, reduce the state's share - but the governor and the administration said that was not the intent. The intent was to move the project forward, preserving the value that the state would get and that is where the concept of co-investment came. The 10.5 percent was that crossover. In the Heads of Agreement (HOA), the parties have

agreed that an appropriate production tax is somewhere between 7 and 13 percent. The other body turned the dial to the maximum of 13 percent which, when coupled with the royalty, moves the state to an approximately 25 percent share. In that it is within the boundaries of the range contemplated in the HOA, it is something that will continue momentum on the project and the administration is supportive of the change.

[1:25:03 PM](#)

MR. PAWLOWSKI returned to his discussion of Section 34, stating the administration chose the date of 1/1/22 because there are several ceilings designed in statute to limit the production tax. The administration was extremely conscious of the legislature's direction that until 2022, gas produced and used in-state, outside of the Cook Inlet, receives the same tax rate as Cook Inlet gas. With the "Interior energy project" looking at entering into gas contracts today, that change in that tax rate would have an impact on consumers in the Interior during the time period that that tax rate was provided by the legislature. The administration also looked at the timing of advancing projects and decided that allowing that tax ceiling to expire provided the predictability that people needed to plan the projects they are looking at today, but provide the type of clarity that the Alaska LNG Project needs to go forward.

MR. PAWLOWSKI explained Section 35, page 28, line 8, through page 29, line 25, is an amendment to the minimum tax provision. Under last year's SB 21, the state retained a minimum tax of 4 percent on the gross value for oil. That was particularly important for the sliding scale credits that were per barrel and developed in this committee; those credits could not be used to offset a tax liability below that minimum tax. Now that there will be two tax rates for oil and gas after 1/1/22, and one of those is a gross tax rate on gas, it makes no sense to maintain a minimum 4 percent gross tax rate on gas if the tax rate is just 13 percent of the gross value. So, the change on page 29, line 3, is that the minimum tax only applies for oil and that is because the oil tax remains on the net value of 35 percent, whereas the tax rate on gas is 13 percent of the gross value.

[1:27:48 PM](#)

REPRESENTATIVE SEATON, in regard to the gross value at the point of production for oil after gas is out, inquired whether there are gas expenses that will be subtracted from the value.

MR. PAWLOWSKI replied the issue is not at the gross value at the point of production; it is at the calculation of the production tax value. Lease expenditures come out of the gross value at the point of production. Lease expenditures will be taken against the production tax value overall and there will not be a calculation of a gas production tax value because, under CSSB 138(FIN) am, gas is 13 percent of the gross value at the point of production.

[1:28:45 PM](#)

MR. PAWLOWSKI turned back to his sectional analysis, pointing out that Section 36, page 29, line 26, through page 30, line 22, is the core section of the tax provisions, is the opportunity for a company to pay tax as gas, and includes a couple of triggering events. Page 29, lines 28-31, provide that [for gas produced on and after 1/1/22], "the department shall allow a producer to make an election ... to pay in gas the production tax levied by this section in lieu of the tax otherwise levied for the gas by AS 4.55.011(e)." This means that after 1/1/22, a producer will have an opportunity to pay its production tax with gas. Page 29, line 31, through page 30, line 3, provide that an "election under this subsection applies only to gas produced from oil and gas leases modified under AS 38.05.180(hh)". This subsection is in the powers of the commissioner of natural resources, which begins on page 16, line 16, and which states that the commissioner of natural resources is allowed to modify lease terms on specific leases to do a couple of things. One is to make changes related to the ability to switch back and forth between in-kind and in-value. The state has to make the decision to modify the leases to provide the clarity so that all the parties can go forward and make determinations on what gas they have to be able to market it; it is a predictability issue. When those leases are modified, the opportunity to pay tax as gas under Section 36 is enabled.

[1:31:50 PM](#)

MR. PAWLOWSKI noted, however, that for federal leases, DNR plays no role and cannot modify the lease because DNR is not the landowner and therefore there would be no opportunity under this bill to pay tax as gas. Under the Heads of Agreement, Article 8, the decision to take gas in-kind, both for royalty and tax purposes, is subject to a couple of things, the first being the successful negotiation of project-enabling contracts. Those are described as offtake supply agreements and balancing agreements, as well as the satisfactory disposition of the LNG. The state

needs to know it has the right contracts in place and the predictability to get its gas supply, just as the producer parties need to know that the state is not going to change how the state takes gas share during year five of a contract in which the producer has committed to provide gas as LNG to a buyer. With the agreements that the legislature will assist the administration in drafting, and which come back to the legislature for approval, the state will be in a position to allow the modification of leases to occur and the opportunity to pay tax as gas to happen. The administration crafted a targeted and limited opportunity. Once the leases are modified by the state, that opportunity is available to the taxpayer; DOR does not get to take it away and, through the contractual arrangements, DOR will work how that election is determined. The point is to provide predictability of gas for all of the parties to be able to enter into the type of arrangements the committee's consultants have described as critical to underlying the project.

[1:33:43 PM](#)

CO-CHAIR FEIGE inquired whether the decision to pay the royalty in-kind is still an irrevocable decision.

MR. PAWLOWSKI answered that the original language in this tax provision to pay the tax was an irrevocable decision and was modified with the word "may". The other body deleted "may", inserted "shall", and repealed "irrevocable". So, [page 29, line 29,] now says that [DOR] shall provide an election for the taxpayer to make its payment with gas. The decision to take royalties is the province of DNR.

CO-CHAIR FEIGE asked whether the taxpayer can switch back and forth between in-kind and in-value.

MR. PAWLOWSKI replied the key is the contracts which underpin the modification. The satisfactory contracts that will be the foundation for the modification of leases are where the state will bind the parties in their ability to make an election.

[1:34:53 PM](#)

REPRESENTATIVE P. WILSON understood the state is binding itself and the taxpayer to make that decision. She inquired whether the taxpayer can change it later through an agreement.

MR. PAWLOWSKI responded that is part of the agreements which will be developed under the earlier sections. In no way can the state allow the other parties to switch, just as the state cannot switch.

REPRESENTATIVE P. WILSON said she is confused, then, given that "irrevocable" was deleted.

MR. PAWLOWSKI answered Legislative Legal and Research Services thought the term "irrevocable", as introduced in HB 277, raised some issues around tax and binding around tax. The operative term was taken out because "shall" provide an election provided the necessary clarity for the state and the taxpayer.

[1:36:10 PM](#)

CO-CHAIR FEIGE understood the departments are being given the opportunity to make the choice available to the companies. Then, when time comes to sign the final contracts between the producers and the state, the parties become bound in a long-term contract.

MR. PAWLOWSKI replied correct. [The administration] envisions the companies will have to commit to how they will make that election in the contracts for the contract term. There may come a point after the initial contract term where the necessity for tax as gas is not in the same place as it was to get the project up and moving. That flexibility down the road may be important.

[1:36:59 PM](#)

CO-CHAIR SADDLER asked whether there is a risk if the producers choose to not exercise their provision to pay tax in gas, given the project is envisioned [with the state taking tax as gas].

MR. PAWLOWSKI responded [the administration] believes that is unlikely, and he does not believe the state would execute the associated contracts necessary to move the project forward if the state allowed the producers that opportunity. For the same reason the state wants clarity on these provisions, the producers want clarity. He recalled the committee's 3/19/14 discussion about this dilemma of switching when a company makes a long-term commitment to provide LNG to a buyer. The company must have molecules to move through the LNG plant for turning into LNG for shipping out. If, five years into the project, the state says it wants some of that gas for something the state wants to do and takes the gas in-kind instead of in-value, the

company would then not have the gas necessary to meet the contract it had committed to. It is a predictability issue for the companies as well as the state, because the state will also be entering into contracts either directly or through the producers or other agents or other parties. The disposition agreements for sale go through the royalty process with all the associated statutory protections and governing precedent.

[1:38:50 PM](#)

MR. PAWLOWSKI resumed his discussion of Section 36, drawing attention to page 30, lines 4-7, which state that a "production tax levied by this section is equal to 13 percent of the gas otherwise taxable under AS 43.55.011(e)(3) produced from each oil and gas lease to which an effective election under (a) of this section applies, when and as that gas is produced." He said the difference here is an operative one. The key is that the state is not doing a value calculation and then turning it into molecules. The state is actually taking a percentage of the gas produced. That is important because gas is used in the project as fuel. The state was concerned that doing a value calculation would present an opportunity for that to get lost. Just as with royalty, the state will get the gas produced and will then be able to use gas to meet the fuel obligations that the state will have in the project.

[1:40:13 PM](#)

REPRESENTATIVE SEATON requested a refresher on where is the point of production.

MR. PAWLOWSKI answered the definition of the point of production is being modified to be the farthest upstream of the inlet to the transmission lines going to the treatment plant. For Point Thomson it will be the entry of the pipeline leaving the Point Thomson field. For Prudhoe Bay it will be wherever the gas is leaving the infrastructure at Prudhoe Bay to go to the treatment plant.

REPRESENTATIVE TARR inquired what the actual monetary value is of doing the tax as gas provision modeled against several ranges of production tax.

MR. PAWLOWSKI believed [the administration's consultant], Black & Veatch, have done some of this in its presentations. He complimented the legislature's consultants [analytical], however, as doing the best work on this by showing how in-kind across a

range of prices delivers better production to the state. He encouraged members to look at [analytica's] modeling for in-kind versus in-value when the consultants come before the committee.

CO-CHAIR FEIGE advised that the most recent posting on the Legislative Budget and Audit Committee's web site includes about 22 pages from analytica in which there is a specific section dealing with this modeling.

REPRESENTATIVE TARR clarified she is asking about the tax as gas provisions, not the royalty-in-kind.

MR. PAWLOWSKI answered that is what he is referring to.

MR. PAWLOWSKI, in response to Representative P. Wilson, reiterated the definition of point of production as being the farthest upstream of the inlet of the pipelines that lead to the gas treatment plant.

[1:42:38 PM](#)

MR. PAWLOWSKI returned to his sectional analysis, addressing Section 37, page 30, line 23, through page 31, line 16. Noting that credits are available for taxpayers to apply against their tax liability, he pointed out that page 30, line 25, deletes "due under this chapter" for the education credit applied against the production tax. Under current law the credit can be applied against the tax "due under this chapter", but the dilemma is that under Section 36 a producer will have an opportunity on certain gas on certain leases to pay its tax liability with molecules. However, as discussed on 3/19/14, a tax credit cannot be taken against a molecule because it does not make sense. Section 37 clarifies that the tax credit for education may be used only against the tax paid in-value. The [Senate] expanded this tax credit to allow the education credit against the production tax to be generated on investment in a nonprofit regional training center or an apprenticeship program that is registered under the U.S. Department of Labor, page 31, lines 2-6. This expansion of applicable expenditures did not change the limit of those expenditures. Responding to Co-Chair Feige, Mr. Pawlowski said a list of the qualifying nonprofit regional training centers is currently being put together.

[1:44:48 PM](#)

MR. PAWLOWSKI resumed his sectional analysis, stating Section 38, page 31, line 17, through page 32, line 3, is a similar

amendment to the education tax and expands what qualifies for the education credit. It provides for vocational education courses, programs, equipment, and facilities by a state-operated vocational technical education and training school.

CO-CHAIR FEIGE inquired whether Section 38 eliminates several credits under an effective date of 2022. He understood that between sections 37 and 38, some credits are dropped from the statute. He further inquired whether that is because those credits expire.

MR. PAWLOWSKI deferred to the Department of Law for an answer.

REPRESENTATIVE SEATON understood the aforementioned deals with the education tax credit under which there is a number of different termination dates. Thus, to remain, the tax credits must be repeated throughout several sections.

SUSAN POLLARD, Assistant Attorney General, Oil, Gas & Mining Section, Civil Division (Juneau), Department of Law (DOL), confirmed the amendment in Section 38 addresses a springing sunset date for the education credits, which is seen again in the effective date of Section 63 on page 56, line 8.

[1:47:16 PM](#)

MR. PAWLOWSKI turned back to his sectional analysis, noting that Section 39, page 32, lines 4-8, is a clarifying amendment to the regular production tax under AS 43.55.011(3), hence the deletion on line 6 of the words "this chapter".

MR. PAWLOWSKI explained Section 40, page 32, line 9, through page 39, line 24, addresses the monthly installment payments of production tax that are paid to the State of Alaska. The changes begin on page 37, line 9, for oil and gas produced on or after 1/1/22. A good example of the change is the 35 percent for oil which is on page 38, line 20, and the 13 percent for gas which is on page 38, line 27. The language clarifies to a taxpayer how to make its monthly installment payments against its production tax for the world as it will exist after 1/1/22 should this legislation pass.

[1:49:19 PM](#)

REPRESENTATIVE TARR asked why the language "for oil and gas produced" is added in paragraph (1) on page 32, line 12, and in paragraph (5) on page 35, line 4.

MR. PAWLOWSKI believed it is a conforming amendment related to the state's tax ceiling. He deferred to Ms. Pollard.

MS. POLLARD explained Section 40 is the monthly installment payments for the production tax; although the tax is levied annually, it is paid in monthly installments. [Under CSSB 138(FIN) am], there are three different scenarios for those monthly installment payments. [Oil and gas produced] before 1/1/14 is addressed on page 32, line 10, through page 35, line [3]. Oil and gas produced after 1/1/14 and before 1/1/22 is addressed on page 35, line 4, [through page 37, line 8]. The reason "oil and gas" is underlined is to clarify or flag what is happening in this long section.

MR. PAWLOWSKI interjected the point is that the production tax is on both oil and gas.

REPRESENTATIVE TARR observed that the third scenario is for oil and gas produced on or after 1/1/22 [addressed on page 37, line 9, through page 39, line 24].

MS. POLLARD responded correct, noting this is addressed on page 37, line 9, [through page 39, line 24].

[1:52:13 PM](#)

MR. PAWLOWSKI continued his sectional analysis, stating Section 41, page 39, line 25, through page 40, line 15, and Section 42, page 40, line 16, through page 41, line 4, are conforming changes for interest on overpayment or underpayment of the aforementioned monthly installment payments. The additions on page 40, line 7 and lines 18-19, are to account for the renumbering in Section 40.

MR. PAWLOWSKI advised Section 43, page 41, lines 5-23, and Section 44, page 41, line 24, through page 42, line 14, are conforming amendments for oil and gas produced before 1/1/22 and for after 1/1/22 as it relates to the private landowner royalty. No change is made to the private landowner royalty, it is just a clarification.

[1:53:11 PM](#)

REPRESENTATIVE SEATON asked about paragraph (8) on page 39, lines 15-18, which states, "an amount calculated under (7)(C) of

this subsection may not exceed four percent of the gross value at the point of production".

MR. PAWLOWSKI responded the 4 percent is the minimum tax.

REPRESENTATIVE SEATON said that is why he does not understand. He asked whether the amount calculated under (7)(C) is the oil and gas produced from leases subject to [AS 43.55.011(p)].

MR. PAWLOWSKI deferred to Ms. Pollard for an answer.

MS. POLLARD replied that (7)(C), on page 38, lines 17-19, is the reference to the tax ceiling that applies to Middle Earth -- oil and gas produced south of 68 degrees and outside the Cook Inlet sedimentary basin. That particular tax limitation on oil and gas is that it not exceed 4 percent of the gross value at the point of production and that limitation is extended until 2027.

MR. PAWLOWSKI apologized, saying he got his "4 percents mixed up." He concurred it is the tax ceiling for Middle Earth.

[1:56:30 PM](#)

MR. PAWLOWSKI moved back to his sectional analysis, explaining that Section 45, page 42, line 15, through page 43, line 13, is an amendment to the annual statements made by the producers and explorers to require the separate identification of the amount of gas produced and the lease to which it is effective. A previous section sets up the tax delivered to the state as gas as separately reported, so a change must be put in statute to require the producer to identify that to the state on the producer's annual statement. Thus, it is conforming to the transparency of that public information.

REPRESENTATIVE SEATON inquired what the reason is for this.

MR. PAWLOWSKI answered the opportunity to pay tax as gas depends on certain leases being modified. The state wants to know where that gas is coming from because the leases may be different between, say, Point Thomson and Prudhoe Bay. The state wants to be able to identify where the tax as gas is coming from and the state wanted to error on the side of transparency of public information.

REPRESENTATIVE SEATON understood the leases may have different royalty rates but said he does not think different tax rates are being established.

MR. PAWLOWSKI confirmed different tax rates are not being established for gas to the royalty rate under Section 45. He said amendments to that effect are in future sections.

REPRESENTATIVE SEATON understood the royalty rates will be maintained throughout for gas produced from those leases that have differing royalty rates.

MR. PAWLOWSKI replied correct; there will be different royalty rates between the Point Thomson unit and the Prudhoe Bay unit, for example. Point Thomson typically has a higher royalty rate than the Prudhoe Bay unit. The tax will apply to the taxable production and it will be a uniform tax between the two units.

[1:58:54 PM](#)

MR. PAWLOWSKI turned back to his sectional analysis, noting that Section 46, page 4, line 14, through page 45, line 22, is the calculation of the annual production tax values and is a clarification for oil and gas produced before 1/1/22, except as provided in (b), (f), and (g) of this section. It is about the tax ceilings that are in statute for Cook Inlet, Middle Earth, and gas produced and used in-state.

MR. PAWLOWSKI advised that Section 47, page 45, line 23, through page 46, line 11, provides for the determination of excess lease expenditures for the purpose of calculating a carry forward loss credit. This section clarifies that "or (h)" must be included in the calculation, the (h) being added in Section 50.

MR. PAWLOWSKI skipped to Section 50, page 47, line 15, through page 48, line 22, explaining it is the operative section that deals with lease expenditures. On the North Slope, lease expenditures are those qualifying expenditures made above the point of production, which are currently deductible in Alaska's production tax system. Those expenditures are made for what really are blended oil and gas; oil and gas come out of the same wells typically on these units and on the North Slope. The purpose of Section 50 is to allow lease expenditures to continue to be deductible for the purposes of determining a taxpayer's production tax value. The production tax value is the number against which that 35 percent tax rate is applied. Separately, there is the 13 percent tax rate on the gross value of gas. There will not be separate accounting for determining which expenditures are for gas and which are for oil.

2:02:00 PM

REPRESENTATIVE SEATON asked whether a chart is available for how the aforementioned would work and what the effect would be since all of the gas expenditures will be taken against oil.

MR. PAWLOWSKI answered that both the administration's and the legislature's consultants have provided such charts and these charts have been run on [the administration's] predictions as well as with cost overruns. Lease expenditures for gas happen when the gas is going to be produced, so internal rates of return on that deduction for the state have also been looked at. For the prior few years, the effect ranges somewhere between \$200 and \$300 million a year depending on the number that was used. This information has been presented in other committees and when the consultants come before this committee they will call out where those numbers are happening.

2:03:23 PM

REPRESENTATIVE TARR stated the aforementioned is what she was referencing earlier when she related that enalytica said it could be between \$250 and \$375 million per year, but also that this could reduce oil tax collections from Point Thomson to nearly zero.

MR. PAWLOWSKI responded Point Thomson is tricky because it is confidential information. He said [enalytica] has some modeling assumed around that and encouraged that this question be asked of [enalytica]. The idea that it reduces oil taxes on Point Thomson toward zero is not something he has seen or would be able to testify to. Modeling presented to the other body by Ms. Poduval of Black & Veatch pointed out that expanded production at Point Thomson to develop gas leads to higher liquids production and in the model the additional production was about 6 percent of the total revenues that the state was receiving. He said he will work with DOR's legal counsel on how to answer Representative Tarr's question.

REPRESENTATIVE TARR remarked it is important to know the overall impact because that loss of revenue is not reflected in the fiscal notes, which only reflect the state's financial contributions to moving forward.

MR. PAWLOWSKI replied the timing of those impacts typically will fall outside the range of a fiscal note right now. The impacts have been in every model the state has presented and have been

put out in every committee in which [the administration] has testified. When reading Section 50 it is hard to see that that is what is actually happening, so [the administration] has put it on the record in every committee and it is in the Heads of Agreement for the deduction of lease expenditures. It is part of the economics of the project, and the revenues the state receives in the long run are from that gas production and additional liquids production.

[2:06:20 PM](#)

MR. PAWLOWSKI returned to his sectional analysis, specifying that Section 48, page 46, lines 12-30, relates to the issue raised by Representative Seaton about creating essentially different effective tax rates based on different royalty rates. He explained these are the gross value reductions that were included in SB 21 last year. Section 48, [lines 25-27], state, "This subsection does not apply to gas produced before 2022 that is used in the state or to gas produced on and after January 1, 2022." Thus, the value of gas is being pulled out of the determination of those gross value reductions. Section 48 is an exclusion section because it would be inappropriate for the gas to create that gross value reduction with the way the tax system is being done.

MR. PAWLOWSKI advised a similar change is made in Section 49, page 46, line 31, through page 47, line 14. He reminded members that in addition to a 20 percent gross value reduction there is an additional 10 percent gross value reduction; Section 49 [excludes the additional 10 percent gross value reduction] for the gas produced after [1/1/22].

MR. PAWLOWSKI stated Section 51, page 48, line 23, through page 51, line 22, is a clarifying amendment. Page 49, line 26, provides that tax as gas is not considered lease expenditure under AS 43.55.014 [or AS 43.55.011]. Section 51 is all the things that are not considered lease expenditures.

[2:08:34 PM](#)

MR. PAWLOWSKI pointed out that Sections 52-55, page 51, line 23, through page 53, line 7, are amendments on the point of production. He said this is important because the point of production is the point at which things upstream towards the wells are lease expenditures and things downstream are recovered through tariffs in the charges for the infrastructure.

MR. PAWLOWSKI directed attention to Section 53, page 52, [lines 9-10], which delete the language "OTHER THAN GAS DESCRIBED IN (C) OF THIS PARAGRAPH", and to [lines 12-15] which state "farthest upstream of the first point where the gas is accurately metered, the inlet of any pipeline transporting the gas to a gas treatment plant, or the inlet of any gas pipeline system transporting gas to a market". The deleted language in Section 53, page 52, line 27, through page 53, line 1, is legacy language the administration thought potentially unclear about where the point of production is. The administration believes the language, as amended, provides very clear direction of where that point of production is. The concept of an integrated gas processing plant and gas treatment facility, the inlet of the pipeline, has the effect of clarifying, for example, that the Point Thomson pipeline would not fall into a lease expenditure, which would be deductible in the production tax, and which is the reason the administration defined the point of production consistent with the Heads of Agreement and the description of what is contained in the Alaska LNG Project.

[2:10:32 PM](#)

MR. PAWLOWSKI specified Section 54, page 53, lines 2-4, is an amendment adding a new definition of "gas treatment plant".

MR. PAWLOWSKI said Section 55, page 53, lines 5-7, is a recommendation from Legislative Legal and Research Services to fix the definition of "point of production" for the purposes of AS 43.90.900. It is related to the inducements that were offered under the Alaska Gasline Inducement Act (AGIA), which included an exemption from changes in gas production tax for 10 years after commercial production for those producers that bid during the first binding open season. Because the point of production plays an important point in the calculation of that production tax, Legislative Legal and Research Services believed Section 55 was necessary in case an inducement was available to a taxpayer. The administration does not believe there is an inducement available to a taxpayer. Section 55 is an amendment added in the other body for clarification on this statute.

CO-CHAIR FEIGE inquired whether Section 55 would be clearer if the language was the text [of AS 43.55.900] as it read on [the date of 6/8/07].

MR. PAWLOWSKI answered it is stylistic.

[2:12:26 PM](#)

MR. PAWLOWSKI turned to Section 56, page 53, lines 8-13, explaining the change made on line 11 makes the film production tax credit applicable specifically against the production tax. Tax as gas is excluded from the film production tax credit.

MR. PAWLOWSKI reminded members that Section 57, page 53, line 14, was discussed during his review of the Alaska Gasline Development Corporation (AGDC) statutes. This section repeals AS 31.25.080(f), which directs AGDC to cooperate with a large diameter project. This directive is now unnecessary given the re-purposing of AGDC under Sections 1-12 to participate in a large gasline development project under the unified umbrella of AGDC.

MR. PAWLOWSKI specified that Section 58, page 53, lines 15-25, directs the governor to establish an interim advisory board to bring together interested and affected communities to make recommendations around the property tax system as described in the Heads of Agreement. Subject to consultation, the administration will engage with communities to develop a payment in lieu of tax (PILT) system, as well as impact payments. Large-scale construction projects like this have an impact on communities throughout the state in addition to the communities that are directly affected. The recommendations will be brought back to the legislature for consideration, most likely in the 2015 legislative session.

CO-CHAIR FEIGE understood the aforementioned is a specific term within the Heads of Agreement (HOA).

MR. PAWLOWSKI responded correct.

[2:14:29 PM](#)

REPRESENTATIVE TARR understood the HOA envisions the PILT, but said it is an issue around which there is tension and not full agreement. The mayors of four cities have written a letter about wanting to be a part of this. Questions have been asked about the kind of modifications that could be made to those existing documents before it becomes a deal breaker. She inquired how the interim advisory board can participate in a meaningful way based on the limitations of the HOA and the requirement that it be within the PILT framework.

MR. PAWLOWSKI replied the administration believes the PILT framework offers the best opportunity for predictability on the

project. In testimony on the Alaska LNG Project, the mayors have not necessarily objected to the PILT; they have asked to be at the table. The other key piece is that there are impact payments. There are impacts prior to the real taxable value being achieved. The concept in the Heads of Agreement was subject to consultation. Under the direction of Section 58, the administration intends to bring together the mayors of affected communities, as well as the mayors of communities not directly affected, to work on the broader concept of the impacts of this project and the property tax for this project. The administration believes this open process will provide the maximum flexibility for the administration and communities to come back to the legislature with a unified recommendation for that project. This is important because recommendations that come outside of that process will not carry the same weight with the legislature and the public as those recommendations deliberatively developed with the communities at the table. The governor has described his work on the administrative order underlying this concept. This is an opportunity consistent with the HOA. How the framework gets designed will be the subject of much work going forward with the municipalities at the table.

[2:17:06 PM](#)

REPRESENTATIVE TARR remarked that Section 58 reads more like intent language that does not have the same strength as statutory language. Further, it does not include any permission for those affected municipalities to be a voting member in that decision making. She asked to what extent the language in Section 58 will give the municipalities the opportunity to participate in a meaningful way.

MS. POLLARD answered it is uncodified law which is typically done when something is perhaps of limited duration and perhaps will not be in effect for five years. A direct answer to the question is "no, it is not a statutory provision that is going to ... have absolute legislative direction," although the language is very clear. This is typically the type of provision where lawmakers express their intent. Lawmakers have listened to municipalities and have asked for the governor to establish this board.

MR. PAWLOWSKI interjected that in the state constitution, Article 9, Sections 3 and 4, clearly state that the property tax, as well as changes to the value, are prescribed by law. Concern was expressed about whether the state can contractually do something. Under the state constitution, changes to the

property tax are necessary prior to any execution or development of a project. Changes must come back to the legislature for consideration.

2:19:18 PM

REPRESENTATIVE SEATON inquired whether the information that this board is going to look at will be required to be confidential.

MR. PAWLOWSKI responded the way this is structured now he does not believe so. The opportunity for confidential information is a tricky one that the administration would want to carefully work on with the committee to see how that is authorized. He offered his belief that the language itself in uncodified law does not extend the confidentiality protections available to the department for taxpayers.

CO-CHAIR FEIGE said he does not think the information that will be discussed under this will include trade secrets. It is all about how to structure a PILT or a property tax so as to take care of the expected impacts and expected future needs of those municipalities impacted by this project.

REPRESENTATIVE SEATON pointed out that the deliberative process of advisory committees within an administration is sometimes confidential. He said he wants to ensure this statute will not establish a deliberative process which then muzzles the municipalities. Saying he knows this is not the intention, he asked whether something should be included in this language to clarify that the deliberations of this board will be public.

MR. PAWLOWSKI replied the administration will be happy to work with the committee. He said the intent is to make this a very open process of consultation with the local governments to put forward the best product possible to support the state through impact payments and provide predictability to taxpayers throughout the life of the project.

REPRESENTATIVE SEATON offered his appreciation that everyone has the same intent, but reiterated it would be beneficial to make Section 58 clear in this regard.

2:22:10 PM

CO-CHAIR SADDLER requested further elaboration regarding the difference between payment in lieu of property taxes and impact

aid, given one might apply to every place and some might apply to just where the impact is greater.

MR. PAWLOWSKI answered the concept of impact payments is that values are associated with a project and the infrastructure being developed during construction. There are also effects on the communities as well as needs of the state. The impact payment concept is to schedule a series of predictable payments during that time period so that when the state and the producers are running their economics in their investment they can plan on it because that is upfront cash prior to operation. The next stage is the payment in lieu of tax during the operation of the life of the project that on the infrastructure is intended to be designed as something that is predictable for the parties, given that property taxes is a massive number on this project. A traditional property tax starts out high and then depreciates and declines over time as the value of the property depreciates. The opportunity contemplated in the Heads of Agreement, however, is for potentially escalating payments -- starting off low and growing. As municipalities think about their needs and as the state thinks about its needs going forward, it might be found that an escalating payment is more in the state's interest. That needs to be hashed out around the table and brought back to the legislature for consideration and authorization.

[2:24:07 PM](#)

CO-CHAIR FEIGE inquired whether the administration has any intent to morph this PILT concept over to existing oil-related facilities.

MR. PAWLOWSKI hesitated before responding, but then said that the concept is centered on the definition of infrastructure in the Alaska LNG Project. The reason for his hesitation, he explained, is there are other parties potentially involved, meaning some of the local governments have been talking about property tax on existing structure. He said he does not want to make an intent statement when he knows other parties may want to bring that up.

[2:25:01 PM](#)

REPRESENTATIVE TARR requested the committee receive further information given recent news reports about some contentious discrepancies between values of existing oil infrastructure. This is of concern in regard to how the committee resolves this situation in terms of the value on the assets that would be

built during the construction and throughout the life of the Alaska LNG Project. The concern with impact payments is timing and whether those payments will fully cover the expense and true impact to those communities during that timeframe, so it is important for the committee to have good information.

MR. PAWLOWSKI concurred, saying it is very important for the state to collaboratively determine the impacts on communities by sitting around the table with the communities, rather than just the state making determinations. Impact payments are also especially important in that communities like the Municipality of Anchorage and potentially the Fairbanks North Star Borough may not have a direct taxing interest on this project because the route may go outside of their borders but yet have distinct municipal impacts. Communities that do not have a direct taxing interest, such as those in Southeast Alaska, have an interest through the statewide property tax which goes to the general fund. While at the table, the state will play the role of looking out for the interests of all of Alaska.

CO-CHAIR FEIGE understood that the initial concept of the PILT, as laid out in the Heads of Agreement, is it will be based on the throughput of the pipeline.

MR. PAWLOWSKI replied that is the initial concept that is put on the table for discussion and the administration sees plenty of benefits around that.

[2:27:18 PM](#)

MR. PAWLOWSKI resumed his sectional analysis, noting Section 59, page 53, line 26, through page 54, line 18, is another piece of uncodified law. He reminded members that Section 13 of the bill creates the Alaska affordable energy fund to provide resources to build infrastructure for those communities not expected to directly benefit from the gas moving throughout the project corridor. Section 59 empowers the Alaska Energy Authority (AEA) to work with AGDC, the Alaska Industrial Development and Export Authority (AIDEA), and DOR to develop regional energy plans for delivering various types of energy sources to areas of the state that do not have direct access to the gas pipeline.

MR. PAWLOWSKI specified that Section 60, page 54, line 19, through page 55, line 30, gives direction to DOR to develop a plan for municipalities, regional corporations, and residents to directly participate in investment in the North Slope natural gas pipeline. This plan, which will be a challenge to DOR, will

be brought back to the legislature under AS 38.05.020(b)(11), which is the contracts that come back to the legislature for approval that are negotiated under the DNR sections.

2:29:16 PM

REPRESENTATIVE TARR recalled there was another piece of legislation that was the permanent fund dividend opportunity. When SB 138 was amended in the other body, this provision was swept in for municipalities and regional corporations. She asked whether any municipality or regional corporation has expressed an interest in being a participant in the ownership of this project. She further asked whether more information is available on the mechanics of how this will work.

MR. PAWLOWSKI believed it premature to answer [the latter] question, saying this is why it is an important step in challenging DOR to come up with a plan to enable this. At the same time as DOR is developing that plan, it will also work with the communities in the advisory group. While he does not know the degree of interest, he said he can see synergies and opportunities to maximize value for Alaskans by having those two discussions in parallel, potentially led by DOR.

REPRESENTATIVE TARR observed that page 55, line 2, paragraph (2), states "through the purchase of stock in a publicly traded corporation that invests". She inquired whether that is envisioned to be potentially the AGDC subsidiary.

MR. PAWLOWSKI offered his understanding that page 54, line 29, paragraph (1), is to lay out options for DOR to consider. He offered his belief that page 55, lines 2-5, is not an intention to take the Alaska Gasline Development Corporation public. It is to put every option on the table for DOR to consider, which is not an easy thing to do given there are very clear and strict rules about engaging individuals in investment opportunities. A regional corporation or municipality may have a different level of sophistication. He reiterated that the synergy of doing this work while DOR is engaging the municipalities provides the opportunity for people to broaden their thinking in this regard. Because this is not a simple thing, DOR has a fiscal note associated with the anticipated work that it will take.

2:32:24 PM

REPRESENTATIVE TARR understood there is not at this time a publicly traded corporation associated with the project that an

individual Alaskan, corporation, or municipality would be able to invest through.

MR. PAWLOWSKI answered there are four because Alaskans can buy shares in any of the corporations involved in this project today. However, there is not a state entity.

REPRESENTATIVE TARR commented that a previous section changes AGDC's ability for subsidiaries, so she would like to understand whether the two sections are related.

MR. PAWLOWSKI offered his belief that this is not set up that way, but, in theory, it could be read to imply what is being said by Representative Tarr. For example, the state could spin off, say, the equity option with TransCanada through a publicly traded corporation. However, that would create expenses that would be inefficient for the state.

[2:33:23 PM](#)

REPRESENTATIVE HAWKER opined that Section 60 has many defects and is fraught with challenge and peril if the committee fails to get it right. For this provision to stay in the bill, the committee is going to have to spend some resources on it. Taking statute literally, he said his attention is caught by the language on page 55, lines 22-23, which states "the means by which an individual may qualify as a resident for purposes of investing in an ownership interest." In regard to municipality, he asked whether this section should state "Alaska municipality" unless the intent is to open this up to any municipality. Given that [paragraphs (a)(1)-(a)(7)] specifically state what is wanted, he asked whether the committee might want to consider adding things like addressing the ability of those equity interests to, say, [meet] cash calls on the project or cash calls for expansion. He said he does not want to give anybody the impression that investing one's permanent fund dividend will result only in collecting money. One way or the other there are consequences. The committee may want to specify in this section that depending on the ownership interest involved, there could be tax consequences where a person could be attributed the taxable income allocable to that equity interest without having received a penny in cash distribution. Because there could be huge hidden tax implications for people, the committee should ensure that the report identifies those concerns. Regarding the limitation to an Alaska municipality, Alaska corporation, or Alaska resident, the committee may want the report to address possible constitutional and interstate commerce issues related

to restricting [investment] to Alaskans only. If Section 60 is kept in the bill, he reiterated, it needs to be fleshed out more thoroughly.

CO-CHAIR SADDLER said he understands people's desire to own a piece of what he thinks will be a profitable enterprise for the state. He said he thinks the private interest is subsumed in the public interest -- the vision of having money come to the State of Alaska, which will help provide for the needs of Alaskans. Additionally, he noted, stock can be purchased in the three publicly owned companies that will have the majority ownership of this pipeline.

[2:37:24 PM](#)

MR. PAWLOWSKI appreciated the aforementioned guidance on Section 60, saying constructive additions will help DOR in the report it prepares and brings back to the legislature for consideration. He recalled the concept of "mini bonds" where in the past the state has done a municipal issuance in denominations at a size that is available for the public to purchase.

MR. PAWLOWSKI concluded his sectional analysis, by pointing out that Section 61, page 55, line 31, through page 56, line 5, allows the Department of Natural Resources and the Department of Revenue to adopt regulations. Sections 62-64, page 56, lines 6-10, are the effective dates; the tax sections would take effect 1/1/15 and the powers that enable the departments to initiate the negotiation process would happen immediately.

[2:39:23 PM](#)

MR. PAWLOWSKI, at the committee's request, reviewed the flow chart, or decision tree, that he had provided in the committee packet. He began at the top left of the chart, noting the date of January to April 2014 is the introduction of SB 138 in which the administration is asking for opportunity to enact "the three P's": the state participating in the project, a process to negotiate the enabling contracts to move this project forward, and setting the general percentage of the state's share. The decision tree depicts a 25 percent share [for the state] because that is the percentage currently in CSSB 138(FIN) am. The legislature is wrestling with three options for the State of Alaska. The first option is the state going it alone, taking the full 25 percent equity share. The second option is for the state to participate at 25 percent share, but with TransCanada as a partner per the Memorandum of Understanding (MOU). The

third option is recognition of the opportunity later in the process to re-assert a 40 percent share of the 25 percent share that TransCanada is carrying on behalf of the state in the gas treatment plant and the pipeline. The question before the committee is whether to pass enabling legislation. If enabling legislation is not passed, the state has an opportunity to continue with the abandonment of AGIA. At that stage, the state can choose to exercise an opportunity to buy the data that TransCanada and the Alaska Pipeline Project (APP) partners have developed during the AGIA time. The value of this data is somewhere less than \$130 million.

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MR. PAWLOWSKI continued his review, specifying that if the state goes forward with the Alaska LNG Project, the data collected by TransCanada and APP, as well as the data developed by BP and Conoco under the Denali Project, will be contributed to the effort. That would take the project into the Pre-Front-End Engineering and Design (Pre-FEED) stage, which is the stage that the legislature is looking at enabling. The timeline for Pre-FEED is May 2014 to December 2015. The question confronting the state is the three options. In the first option of the state going it alone, the state's direct expenditure to support a 25 percent share during Pre-FEED is roughly \$108 million. In the second option with TransCanada, the state is paying 25 percent of the LNG plant and TransCanada will be paying 25 percent of the pipeline and gas treatment plant, which reduces the state's [direct] cost to \$43 million during Pre-FEED. He clarified that these direct costs do not include the appropriate contingencies or agency costs that advance the project, which are included in the fiscal notes. [The third option] envisions the [40 percent] equity option being exercised after December 2015, with the state's direct cost again being at \$43 million.

MR. PAWLOWSKI continued, explaining that after moving through Pre-FEED by December 2015, the question before the legislature will be whether to stop or to advance the project to the stage of Front-End Engineering and Design (FEED). If the project stops, the legislature by not enacting the contracts can exit the project. In exiting the project, the state is committed under the MOU to pay TransCanada the development costs it has incurred on behalf of the state, which will be about \$65 million in Pre-FEED plus \$6 million in allowance for funds used during construction (AFUDC). That total of \$71 million is the off-ramp of the state's risk in the decision. If the state moves forward with the project, the next step is the FEED stage. He noted

that the cost estimates in the flow chart from this point onward are broad ranges based on the understanding that is had today.

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CO-CHAIR SADDLER understood that exercising the off-ramp, which would generate the payment to TransCanada, can be activated by either the state or TransCanada deciding to not go ahead. He asked whether it is reasonable to require that expense only if the state elects not to go forward, positing that if TransCanada decides not want to go forward then it should bear some of those costs.

MR. PAWLOWSKI responded the MOU is structured such that if TransCanada exercises one of its several options to walk away from the project, the state would owe TransCanada development costs but none of the AFUDC. Thus, it would be essentially a 0 percent interest loan for the state through that time period. If the state asks TransCanada to leave, the state then owes the AFUDC cost.

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REPRESENTATIVE KAWASAKI asked what timeframe the legislature has between December 2015 and expiration of the MOU or HOA.

MR. PAWLOWSKI replied the times in the flow chart are the best that can be done to predict timing. The HOA, Article 7.5, page 13, states "legislation in 'a' 2015 legislative session", rather than "the" 2015 legislative session. It is recognizing that the amount of work on these larger contracts will likely require one or more engagements in 2015 with the legislature.

MR. PAWLOWSKI, responding to Representative P. Wilson, explained that AFUDC is the acronym for allowance for funds used during construction, a concept in the pipeline tariff-making world that can be thought of as an interest expense.

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REPRESENTATIVE TARR cited a recent report by legislative consultant Roger Marks which states that the aggressive timeline to get Alaska gas to market may not be ultimately in the state's long-term interest. She requested Mr. Pawlowski to comment.

MR. PAWLOWSKI responded delays in the project are material to not just the state but also the other investors in the project.

Modeling by the state's consultant, Black & Veatch, estimates that \$800 million is the impact on the net present value of a delay. A broad number of projects are currently looking at competing into the market. The administration believes delay is not in the state's interest because the momentum behind the project matters for the signal it sends the world that Alaska is moving forward, building on the success that has occurred in the state's petroleum province over the last two years.

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CO-CHAIR SADDLER observed that the MOU prohibits the state from selling its equity share to a competitor of TransCanada. He inquired whether the state, under the MOU, could sell its share to any of the three producer companies.

MR. PAWLOWSKI replied he does not have a commercial attorney present to whom he could defer for an answer. He explained the administration has a large team that worked on these documents.

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REPRESENTATIVE P. WILSON commented this is not going to be an easy task because from the time the Pre-FEED stage is finalized in 2015 until construction begins in 2019, there will have been three new and different legislatures working on the project.

MR. PAWLOWSKI answered that in addition to three new legislatures there will also be different administrations and administration personnel. He agreed the opportunity for change during this process is material. However, the partnership, the companies, and the stability of AGDC, can be looked to for continuing to move this project forward. The project is immensely challenging and is not easy for anybody involved.

REPRESENTATIVE HAWKER remarked that the flow chart shows the project commencing in January 2014, but in reality this effort commenced about June 2003.

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MR. PAWLOWSKI resumed his review of the flow chart, saying the numbers on the chart are daunting for this major endeavor by the state. The state's long-term outlay will range between \$13.8 and \$9.6 billion. However, 75 percent of the investment [\$41.2 billion] is being carried by the other partners -- ExxonMobil, ConocoPhillips, and BP. The administration believes putting

that private sector at the table with the state as a co-investor offers the best efficiency and chance for the state to maximize value. The administration has pushed for a commensurate staged process because it is unknown all the way how this project is going to work out. The state is making commitments as the other parties make commitments. Diligent steps are being taken together and commensurate investment is increased as more and more diligence is done.

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CO-CHAIR FEIGE drew attention to the MOU, Exhibit C, Page 9, Conveyance of Transporter Alaska LNG Project Interest to Shipper, which states, "Within a period of 5 years of SOA exercising its termination right, if SOA participates in a pipeline project to commercialize North Slope gas that is 'substantially similar' to the Alaskan LNG Project" He asked whether "substantially similar" would include the in-state bullet gasline.

MR. PAWLOWSKI responded he would have to talk to the partners in the MOU, but the intent when this was being discussed was that it would not apply to the in-state gasline.

CO-CHAIR FEIGE understood it would have to be a large diameter line as opposed to a smaller diameter line.

MR. PAWLOWSKI noted that following the aforementioned language it states, "conditions consistent with those set forth in this Term Sheet, except the cost of debt and ROE [return on equity] to be negotiated based on conditions existing at the time."

REPRESENTATIVE HAWKER posed a scenario in which the Alaska LNG Project falters and goes away, so the state reverts to an AGDC-only project that is no longer under the AGIA constraints. In this case, he posited, it would be highly likely that the AGDC project would not be configured as it is today, which is a restriction to 500 million cubic feet per day. The project might be substantially larger because that would be the right size project for the time, which could be construed to be a substantially similar project. Cautioning about absolutes, he said he does not want the take-away here to be that the state will remain restricted to an AGDC project of under 500 million cubic feet per day if the Alaska LNG Project goes away.

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CO-CHAIR SADDLER inquired whether DOR's opinion is that the Alaska Stand Alone Pipeline (ASAP), as currently configured, is not substantially similar.

MR. PAWLOWSKI replied correct.

CO-CHAIR SADDLER presumed that if the Alaska LNG Project fails to happen, the aforementioned five-year provision might counter the idea of increasing the ASAP line to a larger capacity line.

MR. PAWLOWSKI responded he will get back to the committee with an answer.

[CSSB 138(FIN) am was held over.]

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ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:00 p.m.