

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

February 19, 2014

3:30 p.m.

MEMBERS PRESENT

Senator Cathy Giessel, Chair
Senator Fred Dyson, Vice Chair
Senator Peter Micciche
Senator Click Bishop
Senator Anna Fairclough
Senator Hollis French
Senator Lesil McGuire

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

SENATE BILL NO. 138

"An Act relating to the purposes of the Alaska Gasline Development Corporation to commissioner of natural resources on the custody and disposition of gas delivered to the advance to develop a large-diameter natural gas pipeline project, including treatment state in kind; relating to the authority of the commissioner of natural resources to and liquefaction facilities; establishing the large-diameter natural gas pipeline project propose modifications to existing state oil and gas leases; making certain information fund; creating a subsidiary related to a large-diameter natural gas pipeline project, provided to the Department of Natural Resources and the Department of Revenue including treatment and liquefaction facilities; relating to the authority of the exempt from inspection as a public record; making certain tax information related to an commissioner of natural resources to negotiate contracts related to North Slope natural election to pay the oil and gas production tax in kind exempt from tax confidentiality gas projects, to enter into confidentiality agreements in support of contract negotiations provisions; relating to establishing under the oil and gas production tax a gross tax rate and implementation, and to take custody of gas delivered to the state under an election for gas after 2021; making the alternate minimum tax on oil and gas produced north of to pay the oil and gas production tax in kind; relating to the sale, exchange, or disposal 68 degrees North latitude after 2021 apply

only to oil; relating to apportionment factors of gas delivered to the state under an election to pay the oil and gas production tax in of the Alaska Net Income Tax Act; authorizing a producer's election to pay the oil and kind; relating to the duties of the commissioner of revenue to direct the disposition of gas production tax in kind for certain gas and relating to the authorization; relating to revenues received from gas delivered to the state in kind and to consult with the monthly installment payments of the oil and gas production tax; relating to interest payments on monthly installment payments of the oil and gas production tax; relating to settlements between producers and royalty owners for oil and gas production tax; relating to annual statements by producers and explorers; relating to annual production tax values; relating to lease expenditures; amending the definition of gross value at the 'point of production' for gas for purposes of the oil and gas production tax; adding definitions related to natural gas terms; clarifying that credit may not be taken against the in-kind levy of the oil and gas production tax for gas for purposes of the exploration incentive credit, the oil or gas producer education credit, and the film production tax credit; 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

WITNESS REGISTER

MIKE PAWLOWSKI, Deputy Commissioner
Department of Revenue (DOR)

POSITION STATEMENT: Continued sectional analysis of SB 138.

LENNY DEES, Audit Master
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: Answered questions about how production tax is calculated relative to SB 138.

SUSAN POLLARD, Assistant Attorney General
Department of Law (DOL)
Juneau, Alaska

POSITION STATEMENT: Answered tax questions on SB 138.

BILL WARREN, representing himself
Nikiski, Alaska

POSITION STATEMENT: Opposed SB 138.

JEREMY HOLAN
Teamsters Local 959
Fairbanks, Alaska

POSITION STATEMENT: Supported SB 138.

LISA WEISSLER, representing herself
Juneau, Alaska

POSITION STATEMENT: Opposed SB 138.

RACHAEL PETRO, President and CEO
Alaska Chamber of Commerce

POSITION STATEMENT: Supported the principals in the HOA and SB 138, but were still evaluating SB 138.

PAUL GROSSI
Alaska Pipe Trades and Ironworkers
Juneau, Alaska

POSITION STATEMENT: Supported SB 138.

MIKE NAVARRE, Mayor
Kenai Peninsula Borough

Kenai, Alaska

POSITION STATEMENT: Supported SB 138 but with added provisions for municipal input.

MERRICK PEIRCE, CFO

Alaska Gasline Port Authority (AGPA)

Fairbanks, Alaska

POSITION STATEMENT: Opposed SB 138.

JASON RUTMAN, Director of Operational Projects

Nana Development Corporation

Anchorage, Alaska

POSITION STATEMENT: Supported SB 138.

GEORGE PIERCE, representing himself

Kasilof, Alaska

POSITION STATEMENT: Commented on SB 138 that the state should own 52 percent of the pipeline.

KRISTA GONDER

Alaska Support Industry Alliance

Wasilla, Alaska

POSITION STATEMENT: Supported SB 138.

LUKE HOPKINS, Mayor

Fairbanks Northstar Borough

Fairbanks, Alaska

POSITION STATEMENT: Supported SB 138.

RICK RODGERS, Executive Director

Resource Development Council (RDC)

Anchorage, Alaska

POSITION STATEMENT: Supported SB 138.

LAKE WILLIAMS, President

International Union of Operating Engineers Local 302

Fairbanks, Alaska

POSITION STATEMENT: Supported SB 138.

DOUG TANSY

President, Fairbanks Central Labor Council

Business Representative, International Brotherhood of Workers (IBEW) Local 1547

Fairbanks, Alaska

POSITION STATEMENT: Supported SB 138.

JOHN HOZEY, City Manager

City of Valdez
Valdez, Alaska

POSITION STATEMENT: Supported SB 138.

LISA VONBARGEN, representing herself
Valdez, Alaska

POSITION STATEMENT: Supported SB 138 if municipalities are at the table.

ACTION NARRATIVE

[3:30:58 PM](#)

CHAIR CATHY GIESSEL called the Senate Resources Standing Committee meeting to order at 3:30 p.m. Present at the call to order were Senators Fairclough, Dyson, Micciche, and Chair Giessel.

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

[3:31:15 PM](#)

CHAIR GIESSEL announced that Mr. Pawlowski would continue reviewing the sectional analysis of SB 138. She was also interested in seeing a map of possible pipeline routes.

SENATOR DYSON said they are interested in duplication and wanted to know what work had been done.

[3:32:48 PM](#)

MIKE PAWLOWSKI, Deputy Commissioner, Department of Revenue (DOR), said he would work with the Gas Pipeline Project Office at the Department of Natural Resources (DNR) to see what they have to put out and with the AKLNG project sponsors to see if anything is upcoming in the studies.

[3:33:03 PM](#)

SENATOR FRENCH joined the committee.

SENATOR DYSON asked to include the AGIA and Denali projects and he wanted to know of any gaps in geotechnical data and land ownership/access issues.

CHAIR GIESSEL said she would convey that request to the DNR.

[3:34:19 PM](#)

MR. PAWLOWSKI said today he intended to go through some of the tax provisions a little bit slower and call out some critical issues, and then step back a look at the bill as a whole and

take questions from the committee. He directed members to slide 13 of the sectional analysis presentation where the tax provisions start. He actually started in section 27 of SB 138 on page 24, line 7.

[3:35:45 PM](#)

SENATOR BISHOP joined the committee.

MR. PAWLOWSKI said when the administration looked at the challenge of setting tax rates for a North Slope natural gas project they recognized the dilemma the state faced in that the legislature and the administration had set a specific tax for gas produced and used in-state on the North Slope and throughout the state to mirror the tax rates on gas produced in the Cook Inlet to equalize the tax treatment of tax across the state as long as it was used in-state for heat or power. That provision just like many of the other tax ceilings are set to expire in 2022.

When the administration engaged in the Heads Of Agreement (HOA) discussions and looked forward to a fixed gross tax rate for gas, they also recognized that the project was not in any reasonable way likely to be in effect in 2020, because in-service date went out to the mid-2020s. Therefore there was no reason to upset anyone planning around the tax treatment for gas in the state prior to 2022. One example of that is the Interior energy project which is looking at procuring gas from the North Slope, running it through the liquefaction project on the North Slope, and trucking it to Fairbanks. So, any change in the tax rate would have affected the price of gas shipped to consumers. So, the legislature made January 1, 2022 the expiration of these current ceilings and the changes to the gas tax proposed in SB 138 are only effective for gas produced after that date.

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Section 27 starting on page 24, line 7, makes substantive changes on lines 22-29, which breaks out the tax treatment of oil and gas. The tax on oil produced on or after January 1, 2022 is 35 percent (in SB 21 last year). The subsequent section 25-29(b) puts a general levy on gas of 10.5 percent of the gross value at the point of production of the taxable gas (not the effective tax rate); offsets could occur.

The HOA introduced the concept that instead of paying a tax obligation with money, a producer could pay it with gas (the state would take a larger share of the gas being produced). That is the change made in section 29 on page 26, line 17. This

introduces at the same time (after January 1, 2022) an option for a producer to make an irrevocable election to pay a production tax in kind - AS 43.55.014(a)(b) on page 26, line 18- page 27, line 12. The key is this is the taxable gas.

3:40:54 PM

MR. PAWLOWSKI said it is important to think of the gas as it comes out of the ground. When it's produced two events are created at that moment: one is a royalty event (the state's right under the leases) and the other is a taxable event - but royalty gas is not taxable. So, the production tax of 10.5 percent is applied on whatever gas is produced after the royalty share has already been deducted.

CHAIR GIESSEL asked if the tax in kind set at 10.5 percent and the state's royalty at 12.5 percent - a total of 23 percent - equates to the 20-25 percent ownership.

MR. PAWLOWSKI answered no; what is different is the 10.5 percent tax rate. Assume royalty is 12.5 percent (actually it's not; it varies by field), the royalty is about 13 percent for this project (Pt. Thomson and Prudhoe Bay blended). That means the 10.5 percent tax rate is applied to 87 percent of the gas. You don't take the 10.5 percent plus the 13 percent; you take the 10.5 percent of 87 percent plus the 13 percent, and you come up with something around 22 percent (which the royalty study viewed as base cases and reasonable ranges as crossover point for the state's share of the modified status quo world versus what it would get through the gross tax rate). The 10.5 percent number was chosen by the administration, because the state couldn't introduce a bill with a range in a tax rate. They had to pick a number and picked what they thought was the crossover number.

3:43:35 PM

SENATOR FRENCH asked why 7-13 percent was the boundaries.

MR. PAWLOWSKI answered that that is roughly what would lead to a state gas share of 20-25 percent, assuming a certain royalty rate. This is what the administration agreed to in the HOA, which should in no way be taken as anything other than that was what they were able to agree on (the power to levy a tax being reserved for the legislature).

SENATOR FRENCH asked if a value between 7 and 13 percent is acceptable to the administration.

MR. PAWLOWSKI said they had agreed in the HOA that a rate between 7 and 13 percent would be acceptable to the administration and the other parties have also agreed to it. Deciding ultimately where it should be is a key knob that the legislature has a large role to play in. He also reminded members that the concept in the HOA is that the state will invest in the infrastructure at a commensurate share of what its state gas share is. So a 13 percent tax rate gets a larger share of the infrastructure in the near term and in the medium term a larger share of the costs. It's the balancing act they looked at.

SENATOR FRENCH remarked the more you buy the more you pay for.

MR. PAWLOWSKI said that was correct.

[3:45:33 PM](#)

SENATOR BISHOP said the money in this project is in the midstream, so consequently one would want a bigger share of the project.

MR. PAWLOWSKI responded that when they look at the numbers and ran multiple cases and the consultants are absolutely right in a large range of the cases: an ownership in the infrastructure is really where the value is. And there are a lot of other cases where the cash flow from the sale of the LNG provides meaningful revenues, as well. Looking between those cases is where opportunity can be seen that large scale gas sales provide the state from a revenue perspective. In looking at the upper limit on what the state's share could be there was a lot of concern for the scale of investment and commitment the state would be making.

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MR. PAWLOWSKI said page 14 of the HOA, 8.22, is where that tax as gas provision 7-13 percent is set. He said one of the key points of this tax-as-gas provision is the phrasing of the payment in kind of tax for gas on page 26, line 18, and it could be closer aligned with the concept of tax as gas in the HOA. But why would the Department of Revenue (DOR) allow a producer to make an irrevocable election for the payment of the tax as gas?

One of the things they looked long and hard at was that the irrevocable nature of the election provides stability for both the state and the producers. Just as the producers are concerned about the ability of the state to switch in the royalty shares back and forth from in value or in kind the DOR was concerned

about the ability of a producer to do that to the state. Remember the concept is that the state's gas would be committed through long term contracts to the marketplace through Asian buyers. The concern was that if the state made commitments for delivery of gas through the LNG plant to the market as LNG, and a producer had the opportunity to decide they didn't want to pay their taxes with gas anymore the state would find itself short of molecules to meet those contracts. That is why they view the irrevocable nature of this commitment being done initially and needs to be irrevocable to provide stability for the state.

[3:50:39 PM](#)

SENATOR FAIRCLOUGH asked on page 26 to clarify the irrevocable election in section 43.55.014 is for a defined piece of molecule and not for all molecules.

MR. PAWLOWSKI said that was an important clarification. As members will see on page 26, beginning on line 19, the payment is from oil and gas leases that have been modified under AS 38.05.180(H)(h), the key being that the DOR recognized the state does not have the relationship at the civil level that the DNR does in the lessee/lessor relationship where they have an ability to work with the lessee to manage, in oil, the barrels and, in gas, the molecules. What concerned the DNR was they needed the nexus of the state's engagement on those particular leases to allow this opportunity. So, in order for this opportunity to even become available, it has to be on production from the specific leases that DNR has modified in the previous section to commit to this project. So, they are very careful about when this possibility is available, and it's only available in the specific molecules produced from leases that DNR has actively been engaged in the management of in the state's interest.

SENATOR FAIRCLOUGH said what that might mean in more simplistic terms is that DNR will decide which molecules may be committed and they may be committed but the producers still would have an opportunity to pay in cash for other molecules that they might produce somewhere else.

MR. PAWLOWSKI said that was exactly correct.

[3:53:03 PM](#)

SENATOR FRENCH asked what the ability to switch between in kind and in value on the oil side and now on the gas side is worth; he understood the rationale.

MR. PAWLOWSKI couldn't answer that because it was outside his realm of his expertise.

SENATOR FRENCH asked if there was any thought given to making a 10-year reopener. In the past they have had second thoughts about bills they passed and things they do where they later wished they had given themselves a little more leeway - just a year to two after - for example, treble damages on the TransCanada line and the \$500 million constrictor. They should pause over the word "irrevocable" and ponder how long that is.

MR. PAWLOWSKI said when DOR paused over "irrevocable," they asked themselves how to provide the maximum stability to the state. This is an election offered to a producer and the state wants the maximum ability to protect its interests, in this case, which in the DOR may be different than the DNR, which has a constant relationship with the lessee. They put a lot of thought into making sure that the provisions do not apply until after January 1, 2022, and if anything, that telegraphs the preliminary nature of a lot of these discussions. The HOA describes the work on these future questions of durability and how to implement consistency in the long term. So, the idea that this exact provision is forever locked and unchangeable at this stage is not what is being put on the table. This is an option that is structured to provide stability to the state that the legislature will have an opportunity to revisit as the project continues along.

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SENATOR FAIRCLOUGH wanted to confirm that line 20(e) said "may" giving the state the flexibility to have as much knowledge as possible at a particular point in time before entering into that type of agreement.

MR. PAWLOWSKI answered that the "may" is required because of the subjectivity of whether the leases are modified or not. The "may" doesn't modify the irrevocable election in a way that she was concerned.

SENATOR FAIRCLOUGH said the department "may" allow a producer to do that. Is that correct?

MR. PAWLOWSKI said that was correct.

SENATOR FAIRCLOUGH said a producer could have different molecules moving from different projects and asked if the

department "may" choose to allow that to be in kind or not if it benefits the state.

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MR. PAWLOWSKI answered that the state would have an option to not modify leases and, therefore, they would get paid in cash, the traditional way taxes are paid.

SENATOR FAIRCLOUGH asked if the administration considered that the irrevocable election is made on a particular number of molecules that move. She was wondering if one reason the state wants it to be irrevocable is if you are entering into a 20-year contract the person who is receiving the gas also wants stability in the price they are paying and builds that into their contracts. Would the state negotiate that particular lease so it could be modified in another number of years based on matching market conditions or something different? Could a time period or a volume production be part of the irrevocable conversation?

MR. PAWLOWSKI said yes, that is part of the ultimate discussion the administration is asking for the ability to enter into. He mused that no one can predict which of the two fields will be produced first - Prudhoe Bay or Pt. Thomson - how much, how it will blend. That is part of what the HOA balances. The agreements between the state and producers whose leases are being modified to enable this will have to encapsulate all of those very complicated issues before those contracts come back to the legislature for consideration.

[4:00:19 PM](#)

SENATOR MICCICHE added that the irrevocable elections can vary in duration and quantity dramatically.

MR. PAWLOWSKI responded that they had caveated this with "under regulations adopted by the department" to protect the state. The word "irrevocable" describes a very high standard that was used for the state's stability.

SENATOR FRENCH said he appreciated the amount of dialogue they are having on these issues, because for the 30-50 year duration of this pipeline the state's gas will be royalty gas and gas as tax.

MR. PAWLOWSKI disagreed saying the concept of tax as gas goes back to specific leases. If the gas in Prudhoe Bay and Pt. Thomson is exhausted, the concept of state gas filling the pipe

would depend on whether it's from state lands and is available for this type of election. There may be other gas that comes into the project to fill that capacity. Prudhoe Bay and Pt. Thomson will fill up a majority of the project for the foreseeable future, but the election here and taking in kind and value really comes back to how many reserves there actually are. It's well in excess of 20 years.

[4:03:06 PM](#)

He said the third bullet recognizes language from the HOA that this election like RIK is subject to the execution of project enabling contracts including satisfactory arrangements for disposition of the state's gas share of LNG. That telegraphs the administration's recognition that the full commitment to this concept depends on working out more details before finalization to guarantee how the state is going to get gas that is produced.

Slide 14 reiterates to the public that the levy on the tax as gas is 10.5 percent of the taxable gas produced (AS 43.55.014(b)). As the production happens then the tax obligation is created.

[4:04:30 PM](#)

A couple of other points are dealt with in AS 43.55.014(b) that are important to attend to; on page 27, lines 2-7, talk about what happens if there is a deficiency on the tax as gas. It can't be made up in terms of additional molecules if there isn't the ability to sell them. So, the department said in subsection (d) if there is somehow a tax deficiency the penalties will be calculated as if it were in value.

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The filings will be on an annual basis just as they are with the regular production tax and section 25 on page 23, lines 12-16 says: in tax law a person is the taxpayer and the amount of gas produced subject to the gas as tax election will be public information.

SENATOR FAIRCLOUGH asked for clarity on tax deficiency in the calculation (AS 43.55.011(e)) and if that would be calculated on an annual basis.

MR. PAWLOWSKI deferred to the online auditor.

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LENNY DEES, Audit Master, Department of Revenue (DOR), Juneau, Alaska, explained that although the production tax is a yearly

tax, there is a requirement for monthly installments. So, the deficiency would be determined on a monthly basis. If it were to be handled the same way deficiencies are handled now, that gas would be valued at the prevailing value of like-kind product in the month that deficiency occurred and the interest would be based on from the point of the deficiency until the point the payment is made.

SENATOR FAIRCLOUGH said that sounds like it is in regulation and maybe it should be inserted for clarity.

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SUSAN POLLARD, Assistant Attorney General, Department of Law (DOL), Juneau, Alaska, said her answer was probably partially already in statute, because the monthly gross value at point of production already has to be done. So, they made amendments to the bill on page 34, line 26, where it says 10.5 percent gross value at the point of production for the gas that is levied under AS 43.55.011(a)(3). Mr. Dees might want to point out how the regulations for prevailing value works.

MR. PAWLOWSKI said the reference on page 34 is to a section that begins on page 28, lines 9-10, which describes how tax gets paid in a calendar year and that is the amendment for the monthly description of value.

[4:12:03 PM](#)

MR. PAWLOWSKI said the other provisions that are important for development of this tax as gas provision are how the state takes delivery of the tax as gas, and that is found on page 26, lines 27-29. Rather than 10.5 percent of the value, it's 10.5 percent of the taxable gas produced, but that is delivered to the state at the entrance of the transportation facility specified by the state. The intent behind that language was to be very clear about where the point of production is, because of how lease expenditures work upstream or downstream from the point of production. He recommended that the subjectivity of the facility specified by the state may want to be revised to be specifically "at the point of production." He explained that in drafting this, they looked at all of the ways to protect the state and thought that that level of flexibility may cut both ways in a way that doesn't derive the necessary clarity and the intent is that the state designate the point of production and that should be specified.

[4:15:01 PM](#)

He explained that the state would receive molecules; those molecules will be managed under previous sections of the bill as the DNR in the normal course of its business is managing the RIK gas; the DOR doesn't have the expertise or people to manage those molecules and DNR does. The bill contemplates that the DOR would essentially piggyback on the expertise of the DNR and the tax molecules would be managed just as the royalty molecules are with the same rules about how they are valued, handled, sold, but that the DOR commissioner would direct the disposition of revenues from the tax as gas. DNR puts portions of royalty into the Permanent Fund and tax is directed to the General Fund, he explained.

The state created a fixed tax rate of 10.5 percent of the gross value on all gas post-January 1, 2022. For certain gas from specific leases that the DNR has modified, the election to pay tax with molecules (instead of with revenues) will be an option. After that there is still the dilemma of what to do with lease expenditures, because now lease expenditures are deductible against the company's production tax value. He went to section 42 on page 43, line 13, that treats how lease expenditures would be deducted. For oil produced on and after January 1, 2022 this is how the production tax value is calculated and basically it says that gas produced doesn't go into the calculation of the production tax value, because the tax is being levied on the gross value. While this looks like a conforming change, one of the effects it has is when a company is making an expenditure on the North Slope to develop oil or gas the facilities are co-mingled.

He explained that the wells are producing oil and gas on the North Slope and the department has made a policy call not to try and distinguish and count the expenditures separately. So, the lease expenditures would be deductible against the production tax value on oil and a separate payment on gas would be made. This is not immediately recognizable to people, but the effect is that lease expenditures can be deducted against the production tax value on oil if and when gas is produced.

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MR. PAWLOWSKI said the impact that has takes them to section 39 on page 41, line 21. When lease expenditures are deductible, the state has an implicit support for whatever that spending is based on what the tax rate is and 35 percent provides an incentive for reinvesting in the state when the lease expenditures happen. The lease expenditures in section 39 allow the expenditures of - say - a gas-only producer to generate a

loss carry forward credit - providing the same benefit for that producer who may not have other expenditures. Everyone has the same benefit and that includes a new gas producer.

[4:20:36 PM](#)

Section 26, on page 23, line 17, is another substantive section that amends the state's corporate income statutes. Now when a producer pays production tax, they have still produced the resource. This section insures that the business activity happening in Alaska - that creation of production - whether it's paid to the state in molecules or not is still counted as part of a company's business activity in the state. That matters for the calculation of corporate income tax. So, they are ensuring that the payment of molecules is counted in the extraction factor for the purposes of calculating the corporate income tax. If this were not done, it would reduce the corporate income taxes to the state.

[4:22:26 PM](#)

MR. PAWLOWSKI said the last substantive provision in the tax sections is in section 45 on page 47, beginning on line 28, the definition of "point of production." Earlier he explained the deduction of lease expenditures as a deduction in the calculation of a production tax value, and lease expenditures are those upstream of the point of production. So, where the point of production is fixed is very important for what is available to be deducted in the lease expenditures.

He explained that previous statute was not as specific as the department thought was important for this particular project and in general when it came to gas (because the state has not had to deal with large-scale gas before). This section (page 48, lines 9-13) sets the point of production "the furthest upstream of 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." According to the HOA and the MOU, that means the inlet to the Pt. Thomson transmission line or the inlet of the transmission line from Prudhoe Bay to the GTP. He explained that presentations by the AKLNG project indicate that the transmission line from Prudhoe Bay to the GTP may actually still be within the Prudhoe Bay unit and this ensures those millions of dollars in expenditures are not lease expenditures and are not deductible. That capital will be recovered through the tariffs, not through the deductions in the lease expenditures.

SENATOR FRENCH asked what section in the HOA buttresses that.

MR. PAWLOWSKI directed him to page 5, number 1.4 in the definition of the AKLNG project. It means collectively: the project components consisting of the LNG plant, gas pipeline, gas treatment plant, the PBU (Prudhoe Bay Unit), gas transmission line and the PTU (Pt. Thomson Unit) transmission line.

SENATOR FRENCH remarked that there is maybe a half billion or so riding on that transmission line and he wants to make sure it's as clear as can be.

[4:25:42 PM](#)

SENATOR MCGUIRE joined the committee.

SENATOR MICCICHE clarified that he was saying if the Pt. Thomson pipeline was completed several years before this project even kicks off that those expenses could be included as the cost of the project.

MR. PAWLOWSKI responded that in designing the general law on the point of production, they have made it very clear that a Pt. Thomson pipeline whether it goes to this project or is just built on its own is downstream from the point of production, so it would not be included in the lease expenditure.

[4:27:06 PM](#)

SENATOR DYSON asked if the Pt. Thomson gas gets treated before it is sent west and would not go through the central gas treatment plant.

MR. PAWLOWSKI answered the exact mechanics of what goes on with the Pt. Thomson gas was outside of his expertise to answer. But language on page 48, lines 9-25, set even more stringent examples of what it has to be upstream of: there's the inlet of any pipeline transporting the gas to the GTP or any pipeline system transporting gas to market or the inlet of the furthest upstream of the first point where the gas is actually metered downstream of. They are trying to fix a very specific point of production that is as far upstream as possible in the concept around the projects.

SENATOR DYSON asked him to repeat what he said about where that point is on the Pt. Thomson pipeline.

MR. PAWLOWSKI said it's the inlet of the point where the gas is leaving the unit and going to the treatment plant. But he was

not knowledgeable about what level, if any treating, would go on a Pt. Thomson.

[4:29:02 PM](#)

SENATOR BISHOP wanted that question answered by an expert.

CHAIR GIESSEL noted that Commissioner Balash would answer that at a future meeting.

[4:31:32 PM](#)

MR. PAWLOWSKI said those were the broad substantive changes in the tax sections of the bill and there are conforming changes. -
-Section 27 establishes the gross tax rate on gas produced after January 1, 2022,
-Section 29 allows the ability of certain gas tax to be paid in molecules for the state to get a larger share of gas as opposed to tax payments,
-Section 42, which provides for the calculation of lease expenditures,
-Section 39, which allows for the creation of the carry forward loss credit,
-Section 26, which is that clarification about the corporate income tax treatment of gas paid in molecules, and
-Section 45 around the point of production

It's also important to note a couple of things that aren't happening in SB 138, Mr. Pawlowski said. They talked before about the AGDC's core missions (1-3) in AS 31.25.005 and those are not amended. The oil and gas exploration production pipeline transportation property taxes in AS 43.56 are not modified in this bill either. The HOA has a broad description of the administration's intent subject to consultation with local governments, to begin working on the property tax issues around this project but the power to set tax rates is the province of the legislature. The administration contemplates working with local governments in the HOA to bring back conceptual changes that the legislature will consider in the future. It would be done as a consensus work with local governments. Nothing in this bill changes the current state of property taxes in the State of Alaska; it does not change the disposition of royalty or tax revenues and where they go. It makes no changes to deposits to the Permanent Fund and with royalty revenues it leaves all the underlying architecture about how revenues are distributed the same. It doesn't change the oil and gas production tax limitations.

[4:33:22 PM](#)

SENATOR FRENCH asked if the changes to the tax starting in section 27 affect the legal status of the repeal effort of SB 21 effort.

MR. PAWLOWSKI said he would ask the Department of Law (DOL) to answer that.

[4:33:57 PM](#)

MS. POLLARD said the department was not prepared to address that broader question today, but they had reviewed this bill and did not see anything in Alaska law that would prohibit bringing this bill forward now.

SENATOR FRENCH asked if this bill would knock the repeal of SB 21 effort out.

MS. POLLARD repeated that the department was not ready to answer that broader question today.

[4:36:45 PM](#)

SENATOR FRENCH asked how much the state paid for work on the AGIA project that will be obsolete if this bill goes forward.

MR. PAWLOWSKI said the full AGIA report with the geographic breakdown had been emailed to members and they were continuing to work on the map format that Senator Dyson had requested.

SENATOR FAIRCLOUGH said she thought TransCanada said probably 30-50 percent of the material they collected would still be relevant to this new project.

CHAIR GIESSEL said she had posed Senator Dyson's earlier question about the data collected for the stand alone pipeline and Denali pipeline.

SENATOR FRENCH asked if the legislature decides to go forward with SB 138 and gets to FID and decides not to go forward, what the state would owe TransCanada.

MR. PAWLOWSKI answered that was presented in a previous hearing and it was in the \$360-390 million range at FID and it depends also on who terminates. TransCanada might terminate in a number of situations. There are off ramps well ahead of FID, but until you go through the pre-FEED stage those are broad estimates.

[4:40:55 PM](#)

SENATOR MICCICHE asked how much it would cost if the state terminates the agreement before FID; that number might not exist at all.

MR. PAWLOWSKI said the range of the number depends a lot of whether or not the state has exercised the equity option with TransCanada to re-assume 40 percent of the costs of the midstream.

The development cost concept is the underlying agreement with TransCanada that they will spend money on behalf of the state and if they terminate and walk away, the state will not pay any interest on that money. So, it's like a zero interest loan if they walk away. If the state terminates the relationship with TransCanada, which can be done for multiple reasons, the state would pay the AFUDC, which is significantly below TransCanada's return on equity in general. That is the business trade off the state made in the MOU and should be separated from the state's dollars at risk, because regardless of the relationship with TransCanada, the state is contemplating a 20-25 percent share of this project.

[4:42:57 PM](#)

SENATOR FRENCH asked where in the big line process they stop working on the bullet line.

MR. PAWLOWSKI said that decision would be made at the end of pre-FEED around 2016. Look at HOA on page 3, subsection (i) that talks about the relationship between the AKLNG project and the ASAP project during the pre-FEED phase. Another important point was in the HOA on page 12, Article 6.5, about the relationship. Thinking about the work the ASAP project is doing over the next year; they are going to hold an open season. The idea is the AKLNG will be pushing towards the FEED decision in the later part of 2015, so there is a nice synergy between the two. Article 6.5 recognizes that the off take points will be done as determined by the administration in consultation with AGDC, which will have gone through the process of gathering information, and bids about demand for gas in-state. At FEED the decision to maintain both projects will be up to the legislature, and that is seen as natural.

[4:45:53 PM](#)

CHAIR GIESSEL asked why they chose the approach of an AGDC subsidiary, because it seems so complex in that AGDC is not a state entity, has a separate board, and they are not state

employees. Yet, under them, they are creating a subsidiary that is a state entity and consists of state employees.

MR. PAWLOWSKI said they were trying to build on the concept of the Alaska Industrial Development and Export Authority (AIDEA) and the Alaska Energy Authority (AEA), which are co-located with each other. The intent of the administration is to preserve the ace in the hole: keep that ASAP project with momentum moving forward at the same time they are pursuing this AKLNG option. The bright lines in the division between the accounts of the subsidiary and the parent corporation were done recognizing at this stage those are two horses. But what happens in the future is an open question.

SENATOR MCGUIRE asked if there was another way to do it.

MR. PAWLOWSKI said potentially; at this stage part of their initial concern is nexus to the state in that there is a big difference between the projects as they are now contemplated. One is a large scale energy export project and one is primarily geared for in-state use. They explore continually for better ways to maximize the efficiency and are still wrestling with it.

SENATOR MCGUIRE wanted to hear more conversation about preserving our ace in the hole.

[4:52:53 PM](#)

MR. PAWLOWSKI replied the work AGDC is doing on the Alaska Stand Alone Project (ASAP) is critical in continuing progression of options available for Alaskans no matter what. One of the benefits TransCanada brings to this project is it's working on the pipe just as AGDC is working on the pipe aspect of the ASAP project. At the same time the state doesn't have an agency working on the liquefaction side; just as TransCanada is valuable in the momentum, trying to stand up and entirely new corporation to stand in the state's shoes in that liquefaction plant for four or five months. We're on an aggressive timeline and AGDC has the expertise and a lot of the power, and they saw it as expanding their powers and mission while providing the degree of insulation to protect ASAP. "It is all about the momentum," he said, and having people in place to execute these agreements and get the projects going forward on those parallel paths for the near term as fast as possible.

SENATOR MCGUIRE asked what would be involved in creating a subsidiary that was not derived from AGDC statutes, but involved the AGDC board chairman.

[4:55:44 PM](#)

MR. PAWLOWSKI answered it was fairly close to what is in SB 138 now on page 7, line 7.

SENATOR MCGUIRE said one fear is potential cross pollination between missions and she might want to keep AGDC completely pure and asked what she would lose by doing that.

MR. PAWLOWSKI said that was a difficult question and when you start to reinvent wheels you start to lose things. She probably recognized that AGDC isn't just about the ASAP project. Their mission on page 3 gets some of the language from HB 4, because they are amending it by expanding AGDC's powers. Subsections (2) and (3) are broader missions to get gas to Alaskans. It's long term strategically in the interest of the state to have that sort of combination of effort so that if the ASAP project stops, there are people who are aware of what is going on with the AKLNG project to start working on all of the questions that really matter to the state at that point.

[4:59:17 PM](#)

SENATOR BISHOP asked who's to say AGDC's mission is still to get gas to Alaskans as cheap as possible and their core mission revolves down from a lateral to a community getting gas to Alaskans as cheap as possible.

MR. PAWLOWSKI said his reading of existing AGDC statutes is that language on page 3, lines 10-14, talks about developing natural gas pipelines and other transportation mechanisms to deliver natural gas, propane, and hydrocarbons to public utility and industrial customers in areas of the state, may be delivered at commercially reasonable rates, and providing access for other shippers for that gas. That mission is baked into AGDC long term.

SENATOR BISHOP said his point was that they still have a mission.

[5:00:41 PM](#)

At ease from 5:00 to 5:30 p.m.

[5:30:20 PM](#)

CHAIR GIESSEL opened public testimony on SB 138.

[5:30:54 PM](#)

BILL WARREN, representing himself, Nikiski, Alaska, opposed SB 138. Fire TransCanada and move AGDC forward, he said - must have in-state gas. Bring a small service line to Fairbanks and use hi-tech plastic to Wasilla and down the Parks Highway. The cost is cheap compared to what has been spent and what will be spent. This smaller system could be tied into a larger export line later. "Remember, Alaskans first!"

[5:33:04 PM](#)

JEREMY HOLAN, Teamsters Local 959, Fairbanks, Alaska, supported SB 138. He based his support on: 1. gas for Alaskans; 2. jobs for Alaskans; and 3. more revenue for the state. He added that they as elected officials are assure that the bill meets those points and in the end is cost effective for the state.

[5:34:17 PM](#)

LISA WEISSLER, representing herself, Juneau, Alaska, opposed SB 138. She said she was staff council to the House Democrats while the Stranded Gas Development contract was being discussed and rejected and she was astounded to see that the HOA had essentially the same terms. She did a side-by-side comparison of the two for the committee and noted that the 2006 Legislature was smart enough to reject those terms because they were bad for Alaska. They are still bad for Alaska and she hoped they would also reject them. It offers no guidelines or criteria for the DNR commissioner's negotiations and the starting place is at the rejected terms from eight years ago.

SENATOR FRENCH said he would like to see the side-by-side comparison.

CHAIR GIESSEL said she would attach it to the bill as a submitted document.

[5:36:07 PM](#)

RACHAEL PETRO, President and CEO, Alaska Chamber of Commerce, supported the principals in the HOA and SB 138, but were still evaluating SB 138. They chiefly like: the state participation in an Alaska gas project, the state taking a percentage gas share and participating in an Alaska gas project at the same percentage of gas share, and establishing a very clear process to move the project forward, which must include the necessary tools for confidentiality to be able to develop the various project enabling arrangements that any business needs to do, and having a clear public process and steps along the way for legislative oversight, review, and approval.

[5:38:18 PM](#)

SENATOR MICCICHE asked why this project is important to the Alaska Chamber.

MS. PETRO answered that access to Alaska's resources is important to all Alaska businesses and Alaskans. They very much support sustainable and sound development of them.

SENATOR MICCICHE asked if it's safe to say that businesses just don't exist because reasonably priced energy is not available.

MS. PETRO replied absolutely; economies of scale are a challenge.

CHAIR GIESSEL commented then maybe we could compete with Iceland that has cheap power and refines aluminum.

[5:40:04 PM](#)

PAUL GROSSI, Alaska Pipe Trades and Ironworkers, Juneau, Alaska, supported SB 138. They support the building of a pipeline for a number of reasons, the main one being the direct jobs building a pipeline would bring. Another one is that their members live here and in-state gas is important to them. It's important because it will allow for future development and having the kind of capital budgets that promote jobs that is important for the building trades.

[5:41:58 PM](#)

MIKE NAVARRE, Mayor, Kenai Peninsula Borough, Kenai, Alaska, supported the project and said there was a great deal of potential in it, but consulting with communities is not really adequate in terms of negotiations. They would like to the opportunity to negotiate on their own behalf be a part of determining what the local tax structure will be, particularly if the state is going to own an equity interest, which creates somewhat of a conflict with the state and local governments. They will live be living with the impacts long after the project is finished.

SENATOR DYSON asked if he was talking about more than property taxes.

MR. NAVARRE no; property taxes is what they are interested in, because that is their tax base.

SENATOR FAIRCLOUGH asked if he had suggested language for putting in the bill.

MR. NAVARRE said yes.

SENATOR FAIRCLOUGH asked if he heard earlier testimony today that indicated that particular issue had not been resolved nor does the language in SB 138 limit that opportunity.

MR. NAVARRE said that it does not, but the HOA suggests that they will consult with local governments. But when the state is negotiating the local governments will likely not be in the room with them. So, it doesn't give them a comfort level that when it comes back to the legislature for consideration particularly if it's late and it could be a close call. He spoke with the governor who said it's too early for that type of discussion. But Mr. Navarre said he had been in the legislature for a number of years and knew that it's never too early to start a conversation.

SENATOR FAIRCLOUGH said she wanted to hear his proposal.

5:45:30 PM

MR. NAVARRE said it would amend section 10 to read:

...in consultation with the commissioner of Revenue participate in the negotiation of contract and development of terms for including a proposed contracts associated with North Slope natural gas project provided the contract shall not alter the taxation of property taxable under AS 29.45 or AS 43.56 including the taxability, rate of taxation or full and true value of property. A contract negotiated under this paragraph to which the state is a party is not effective unless the legislature authorizes the Governor to execute the contract.

He said they don't want to stand in the way of a gas pipeline, but at the same time they want to protect the interests of local governments' ability to tax.

SENATOR MICCICHE commented that he spoke to the mayor earlier who made it clear that the municipalities he represents are not wolves waiting to hop on the taxation bandwagon and even had talked about a holiday during construction and that sort of thing. Just the long term impacts would be taxed.

MR. NAVARRE added that the HOA provides for impact money, which makes sense, and he recalled how they double-shifted at schools

for a while when Cook Inlet was being developed because so many people came in.

SENATOR FAIRCLOUGH said she appreciated protecting local determination, but what happens if communities set up different criteria. One of the challenges in establishing a tariff charge on TAPS has been continued property value changes which have resulted in litigation.

[5:48:46 PM](#)

MR. NAVARRE said conflicts are there not because local governments are setting different types of criteria; it's because of how the value is determined. It's always struck him with TAPS that the state at least has a neutral position on that if not an incentive to reduce the tariff, because it nets back to a wellhead, whereas local governments would rather see a higher value on the pipeline even if that means a higher tariff, because that is where their tax base comes from.

[5:49:32 PM](#)

SENATOR FAIRCLOUGH said his language seemed to define the issue in each community and letting them come up with their own way to resolve the valuation and asked if he would have the time to work with Alaska Municipal League (AML) folks to come up with how value should be determined. People are looking for certainty in the way it is done and to have it consistent across the state.

MR. NAVARRE said yes and he thought there was a way to get to a value determination to apply different mil levies against and to have the ability to go beyond the 20 mil cap for bonding.

SENATOR MICCICHE asked which entities he worked with on the letter he presented them.

MR. NAVARRE replied the Fairbanks North Star Borough, the Kenai Peninsula Borough and Valdez. Valdez and Fairbanks are worried that some fiscal agreement would roll into including existing oil and gas infrastructure, which would undermine their existing tax bases and bonding that is already in place.

[5:52:39 PM](#)

MERRICK PEIRCE, CFO, Alaska Gasline Port Authority (AGPA), Fairbanks, Alaska, opposed SB 138. He said they have a voter mandate to see a large-diameter gas line built from the North Slope to Valdez and this legislation nearly guarantees a gas pipeline will not be built reasoning that:

The same consultants who have failed to make any progress on the gas line after wasting hundreds of millions of dollars and half a decade of time are now asking for cart blanche. One critical problem this administration has is its failure to understand its alignment with a transnational corporation that has LNG projects that compete with Alaska ensures that no pipeline is built unless these outside interests provide approval. Why would we want Alaska to be in such a foolish subordinate position?

He related a story about Governor Parnell and ExxonMobil had "effectively sabotaged" a project under the Alaska Gasline Inducement Act (AGIA).

SENATOR FRENCH asked Mr. Pierce his background for working on matters relating to oil and gas and pipelines.

MR. PEIRCE said he worked with Governor Palin on her transition for the Department of Revenue and then on this issue for the last seven years on behalf of the voters. Their mandate is straight-forward: large diameter gasline North Slope to tidewater. He was doing this because the voters were right; they picked a project that was economic and makes a lot of sense.

[5:56:40 PM](#)

JASON RUTMAN, Director of Operational Projects, Nana Development Corporation, Anchorage, Alaska, supported SB 138. He said Nana has over 35 years of expertise on Alaska's North Slope and more than a dozen companies aligned to meet the needs of the oil and gas sector. Many of these companies provide direct services to the Alaska oil and gas industry that is one of the largest employers in the state with over 4,000 Alaskans (1,000 of which are Nana shareholders) working with a payroll of over \$180 million.

They recognize that passage of SB 138 will allow the AKLNG project to move through the next phase, which is the initial step in identifying challenges and evaluating feasibility. They understand that the results from this phase including detail on state participation in the project would come before the legislature in the next session to determine whether the state would proceed to the next stage. They also recognize the opportunity presented by recent announcements. As the Governor stated, for the first time all the necessary parties have aligned to make an Alaska gasline project go: three producers, a

preeminent pipeline builder, the AGDC, and the state agencies responsible for the people's royalties and taxes. Capitalizing on this necessary alignment they support the effort to maximize the benefit of Alaska's gas for Alaskans and growing Alaska's economy.

[5:58:54 PM](#)

GEORGE PIERCE, representing himself, Kasilof, Alaska, commented on SB 138 that the state should own 52 percent of the pipeline. But public process is missing. The state signed off on an agreement before discussing any of the details with the public. The same thing happened with the Pt. Thomson settlement.

[6:02:00 PM](#)

KRISTA GONDER, Alaska Support Industry Alliance, Wasilla, Alaska, supported SB 138. She said their members know Alaska needs a gas pipeline whether it is a large diameter natural gas pipeline or the Alaska Stand-Alone Pipeline (ASAP) that focuses on in-state gas delivery. The members do not want the legislature to spend years studying the issue; they need real progress now. The Alliance supports many of the basic concepts in SB 138: an opportunity for state ownership, a simplified tax structure, the ability for AGDC to continue to pursue the ASAP. They appreciate that this legislation requires the state to return to the legislature for review and approval as the project moves forward.

[6:03:45 PM](#)

LUKE HOPKINS, Mayor, Fairbanks Northstar Borough, Fairbanks, Alaska, supported SB 138. One of his concerns was the same as Mr. Navarre's, specifically with how the HOA has already negotiated that a (Payments in Lieu of Taxes) PILT would be put forth for the municipalities without consulting with them. Property taxes under AS 29.45 and AS 43.56 are how his municipalities have worked - both on the TAPS line and now as they hear about the large diameter gas line. They are asking for an opportunity to be at the table to actually be in the negotiations and be a part of the decision making, as they have in the past, not just sitting on the side. They do not want to renegotiate property taxes on existing oil and gas infrastructure.

SENATOR FAIRCLOUGH said that Fairbanks is requesting hundreds of millions of dollars to meet its energy needs, and asked if there was a way to come up with a standard valuation so that those costs are incorporated into the structure and still make it economical to actually sell gas in a foreign market.

MR. HOPKINS said the issue in AS 43.56 for oil and gas properties says: "for the determination of full and true value." They think there is a way to go forward, but they want to be at the table in the discussions and seek a way to acquire a revenue stream for the impacts that will happen to their community and property values that others will have to pay.

[6:09:42 PM](#)

RICK RODGERS, Executive Director, Resource Development Council (RDC), Anchorage, Alaska, supported SB 138. Alignment and durability are important to this discussion and the HOA brings alignment that is unprecedented. It has made him much more optimistic about this process "getting to where we want to be." In terms of durability LNG, unlike oil, is sold in long-term, multi-decade contracts requiring durable fiscal terms. SB 138 has a lot of the elements in place to hold this together. It will require a lot of work and he added that he was impressed with the deliberate due-diligence this committee is undertaking in weighing the risks and rewards with a realistic eye on the need to compete globally with dozens of other jurisdictions and projects in hoping to secure project backing.

The most beneficial gas line in his view for Alaskans is a large capacity line, if it's sanctioned by the producers in partnership with the state, has a much better chance of success, but most of the project economics that will determine whether this project goes forward are largely out of our control.

MR. RODGERS summarized that we need to maintain a robust oil industry on the North Slope; oil pays the bills and supports the vast complex infrastructure. He encouraged due diligence and passing SB 138 this session recognizing that there are more legislative gates and off ramps to take.

[6:12:57 PM](#)

LAKE WILLIAMS, President, International Union of Operating Engineers Local 302, Fairbanks, Alaska, supported SB 138. They are looking forward to the construction jobs associated with this project as well as the jobs afterwards, energy relief for Alaska, and value-added jobs that could come with industry coming in.

He thought the larger diameter pipeline would be the best for the state and a small diameter just wouldn't provide the tax revenue needed. He urged anything they could do to strengthen local hire provisions and state ownership. TAPS has proven you

have to be at the table. It's a big bill, but their job is to "trust but verify."

[6:15:27 PM](#)

DOUG TANSY, President, Fairbanks Central Labor Council, and Business Representative, International Brotherhood of Workers (IBEW) Local 1547, Fairbanks, Alaska, supported SB 138. He said Mr. Lake had already made a lot of his points. He was happy with the process, so far, and supported this project, and giving Alaskans priority.

[6:16:36 PM](#)

JOHN HOZEY, City Manager, City of Valdez, Valdez, Alaska, supported SB 138, but had concern that such momentum undermines the ability of local governments to adequately provide for municipal services that residents depend upon, their tax base. They were concerned that under previous agreements to commercialize natural gas both the oil and gas infrastructure were offered up as tax incentives to the producers to pursue development of the gas line. So, it's reasonable to think that what was once negotiated could be negotiated again. He implored them to not change property tax structures without consulting the municipalities. He supported the comments of Mayor Navarre and Mayor Hopkins, and the language Mayor Navarre read into the record.

He said the City of Valdez would be willing to be involved in any discussions to determine certainty. So, to the extent they could help get there they welcome that effort, but they have to be part of the discussion now and going forward.

[6:19:12 PM](#)

LISA VONBARGEN, representing herself, Valdez, Alaska, supported previous comments and SB 138 if municipalities are at the table. Her prepared remarks echoed almost exactly what Mayor Navarre, Mayor Hopkins and Mr. Hozey already said, so she relinquished the floor.

CHAIR GIESSEL thanked everyone, and finding no further comments, closed public testimony. [SB 138 was held in committee.]

[6:21:22 PM](#)

CHAIR GIESSEL adjourned the Senate Resources Standing Committee meeting at 6:21 p.m.