

ALASKA STATE LEGISLATURE
HOUSE COMMUNITY AND REGIONAL AFFAIRS STANDING COMMITTEE

April 16, 2015

8:02 a.m.

MEMBERS PRESENT

Representative Cathy Tilton, Chair
Representative Paul Seaton, Vice Chair
Representative Shelley Hughes
Representative Benjamin Nageak
Representative Harriet Drummond
Representative Dan Ortiz

MEMBERS ABSENT

Representative Lora Reinbold

COMMITTEE CALENDAR

HOUSE BILL NO. 183

"An Act relating to the assessment of property for oil and gas exploration, production, and pipeline transportation property tax on a North Slope natural gas project; amending the definition of "taxable property"; adding a definition for "North Slope natural gas project"; and making conforming amendments."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 183

SHORT TITLE: NORTH SLOPE GAS PROJ PROP TAX;ASSESSMENT

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

04/07/15	(H)	READ THE FIRST TIME - REFERRALS
04/07/15	(H)	CRA, FIN
04/16/15	(H)	CRA AT 8:00 AM BARNES 124

WITNESS REGISTER

RANDALL HOFFBECK, Commissioner Designee
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: Presented a PowerPoint on HB 183.

NIKOS TSAFOS, Partner, Energy Consultant

enalytica
Washington, DC

POSITION STATEMENT: As consultant to the Alaska State Legislature, provided a presentation entitled "HB 183 Commentary."

JANAK MAYER, Partner, Energy Consultant
enalytica
Washington, DC

POSITION STATEMENT: As consultant to the Alaska State Legislature, provided a presentation entitled "HB 183 Commentary."

ACTION NARRATIVE

[8:02:26 AM](#)

CHAIR CATHY TILTON called the House Community and Regional Affairs Standing Committee meeting to order at 8:02 a.m. Representatives Seaton, Nageak, Ortiz, and Tilton were present at the call to order. Representatives Hughes and Drummond arrived as the meeting was in progress.

HB 183-NORTH SLOPE GAS PROJ PROP TAX;ASSESSMENT

[8:03:23 AM](#)

CHAIR TILTON announced that the only order of business would be HOUSE BILL NO. 183, "An Act relating to the assessment of property for oil and gas exploration, production, and pipeline transportation property tax on a North Slope natural gas project; amending the definition of "taxable property"; adding a definition for "North Slope natural gas project"; and making conforming amendments."

[8:04:14 AM](#)

RANDALL HOFFBECK, Commissioner Designee, Department of Revenue (DOR), referring to his PowerPoint on HB 183, directed attention to slide 2 entitled "Components of Property Tax that need to be Considered for the AKLNG Project." He delineated the three parts to the process of developing a property tax for the Alaska liquefied natural gas (AKLNG) project, as follows [original punctuation provided]:

- Impact Payments during the construction period in lieu of property tax payments
- Durable and predictable property tax payments during operational period
- Distribution of revenues among State and Local Government entities

COMMISSIONER HOFFBECK said there is a general understanding that there won't be a standard tax regime but rather will be limited payments to assist communities impacted during the construction period. With regard to the durable and predictable property tax payments, he expressed hope that they could be maintained beyond the operational period in order to avoid any conflicts at the end of the contracts, such as those currently being experienced with the Trans-Alaska Pipeline System (TAPS). He clarified that the distribution of the revenues refers to the revenue during construction and operation.

COMMISSIONER HOFFBECK reminded the committee that prior to the Walker Administration the Municipal Advisory Gas Project Review Board (MAGP Board) was established to provide the state, when negotiating with the producers, a full understanding of the local issues related to this project. The MAGP Board provided a report outlining its position to the governor. The aforementioned report, as outlined on slide 3, specifies that [the project] needs to be fair and equitable to all stakeholders, clear and easily understood, robust and durable such that it's able to cope with future changes in the operation of the pipeline, unambiguous such that matters aren't subject to judgment and interpretation, and commercially sound. As related on slide 4, the initial feedback from the AKLNG producers was for the project to be simple with few variables. In fact, the ultimate goal of the producers that is attempting to be accommodated is the use of a simple cents per thousand cubic feet (Mcf) or thousand thousand British thermal units (MMBtu) calculation for the property tax. The producers, he explained, prefer a general property tax formula that meets the AKLNG project economic expectations and is acceptable to the

municipalities. As mentioned earlier, the producers prefer a flow related property tax payment that is a fixed unit rate per actual throughput basis and adjusts annually by known non-variable factors. The department utilized the aforementioned input and developed the original formula that was brought before the MAGP Board. The formula, provided on slide 5 entitled "Formulaic Interpretation of Initial Feedback," multiplies the actual cost of construction, as audited upon the completion of construction, by a throughput adjustment. The throughput adjustment is the actual throughput divided by the design throughput and includes an exponential factor to allow for the nonlinear relationship between cost and the volume the pipeline can carry. The throughput is then multiplied by an inflation index and then multiplied by 20 mills. The result of the aforementioned is then multiplied by the adjustment factor. As related on slide 6, the additional feedback from the AKLNG producers included comments pointing out that the current mill rates for the LNG plants in Nikiski and Point MacKenzie are locally assessed rather than at the 20 mills of the oil and gas tax. The producers expressed the desire to have the project cost estimated at the final investment decision (FID) rather than the actual audited project costs at the completion of construction. The producers also pointed out the need for the aforementioned formula to include a depreciation component, not just an inflation component. He noted that the producers made several comments with regard to throughput. With regard to inflation, the producers [prefer] a fixed escalation rate rather than an index rate. The producers also felt that the adjustment factor was arbitrary and would introduce a lot of noise and uncertainty into the process, and therefore [would prefer] a formula that is sufficiently robust and avoid use of a separate adjustment factor.

[8:11:53 AM](#)

COMMISSIONER HOFFBECK moved on to slide 7 entitled "MAGP Board Recommendation (March 13, 2015)." He explained that with the aforementioned recommendations MAGP Board adjusted the formula with the capital cost being an FID estimate, inflation being a fixed rate that is then multiplied by a depreciation factor. A similar throughput in which actual throughput is divided by

design throughput with an exponent is used and multiplied by the statutory mill rate for the particular asset. He pointed out the inputs recommended by the MAGP Board located on slide 7, which include a 10 percent uplift on the estimated construction cost at the point of financial decision, a 4 percent per annum inflation, a depreciation factor that's based on a 50-year floating life, an exponent on throughput of 1, and the mill rate based on current statutes. He explained the depreciation factor is such that it's ever flattening and never reaches zero. Setting the exponent on throughput to one essentially eliminates the exponent, which was recommended by the producers. Changing the mill rate to be based on current statutes results in all projects being valued according to whatever statutory piece of language that piece of the project falls. The AKLNG producers' feedback can be found on slide 8. The producers offered that commercial soundness can be accommodated through adjustments in the formula. Further, the producers wanted the capital cost at FID not to include the uplift. The producers recommended a fixed rate for inflation, an averaged asset value over time, and [applying a single averaged factor]. The producers further recommended a lower initial property tax with an [agreed upon] escalation to provide some benefits over time. He noted that the early years are the most critical components for the project, particularly those years prior to revenue. Therefore, the producers are looking at opportunities to achieve at the front end while escalating the tax through the life of the project. Commissioner Hoffbeck then directed attention to slide 9, which provides a graphical representation of how providing opportunities at the front end might work; these are not hard numbers. He detailed the graph presented on slide 9. The final formula, the language for which is embodied in HB 183, can be found on slide 10 entitled "HB 183 Recommendation." He characterized the formula in HB 183 as a simplified formula that allows flexibility during fiscal negotiations. The formula multiplies the original cost by an inflation factor that is multiplied by a depreciation factor that is multiplied by a throughput adjustment that is ultimately multiplied by 20 mills. He explained that the original cost would be fixed by pre-FID project specific data/fiscal agreement, the inflation and depreciation factors would be fixed by a fiscal agreement, the actual throughput is an operational measurable, the design

throughput would be fixed at pre-FID with project specific data, and the mill rate would be fixed by statute with the total take adjusted by fiscal agreement.

8:17:59 AM

REPRESENTATIVE SEATON related his understanding that the FID estimate is not fixed until flow starts or five years after flow and will be present for the life of the project, no matter any cost overruns.

COMMISSIONER HOFFBECK said Representative Seaton's understanding is the position taken by the producers. The MAGP Board initially recommended a 10 percent uplift, and therefore it will have to be negotiated. However, whatever is negotiated will be in place through the life of the project. The adjustments, he explained, will be in the throughput. For instance, if there is an expansion, it won't be picked up as additional original cost rather it will be picked up in the value of the extra gas flowing through the pipeline.

8:19:17 AM

REPRESENTATIVE SEATON asked if the inflation factor is being set in the formula. He then inquired as to what the proposed value would be.

COMMISSIONER HOFFBECK clarified that the intent is to set the inflation factor at the beginning of the process rather than have it float with the consumer price index (CPI) or producer price index (PPI). Although information during the MAGP Board meeting reported the 10-20 year average of annual inflation to be 4 percent, Commissioner Hoffbeck recalled that long-term historically it has be 3 percent annually. He acknowledged inflation could be left as an index that floats, but also acknowledged that it's easier to run the economics with a fixed number as it's likely to stay at the historic average over the course of 20 years while some years it will be a little higher and others a little lower.

8:20:37 AM

REPRESENTATIVE SEATON recalled that in the past taxes or projects have been made robust [by using an inflation factor] that self-adjusts. However, this legislation specifies a formula with a fixed inflation factor that isn't related to real world economics. Representative Seaton expressed concern that the proposed formula isn't robust as it doesn't adjust to real world conditions. He expressed the need for the system to be such that it automatically adjusts to real world conditions rather than a fixed inflation factor.

[8:22:02 AM](#)

REPRESENTATIVE HUGHES inquired as to whether the 20 mills in the formula will be set for the life of the project or change over time.

COMMISSIONER HOFFBECK informed the committee that 20 mills has been statutorily in place for oil and gas properties since the 1970s. Commissioner Hoffbeck characterized 20 mills as a magic number in property taxes as it's difficult to go over a 20 mill levy. He then explained that there is a fixed 20 mill levy for all oil and gas properties under AS 43.56. Local property taxes are assessed under AS 29.45. He explained that although the state assesses the oil and gas property, the local jurisdictions can tax against it at the local mill rate. For instance, a local jurisdiction with a 14 mill tax rate would tax the oil and gas property at 14 mills. The owners of the oil and gas property would use the rate paid to the local jurisdiction as a credit against the 20 mills it pays to the state. Therefore, the owners of the oil and gas property would pay 14 mills to the local jurisdiction and 6 mills to the state. The local property tax would fall under the 20 mills, which is the overall levy on oil and gas properties. Although the aforementioned means that how much tax the state receives is dependent upon how much the local jurisdiction collected, he opined that the mill rate shouldn't be reduced to a level that is less than the local levy as it would result in other issues regarding constraining local taxing authority.

[8:25:03 AM](#)

COMMISSIONER HOFFBECK then explained that Section 1 adds a conforming reference to include the property exclusively used for a North Slope natural gas project. Section 2, similarly relates it to the full and true value of pipeline transportation property, and therefore places the AKLNG project within the pipeline transportation project section of AS 43.56 of the oil and gas property tax laws. Section 3 is the narrative of the formula presented earlier. He characterized the language in Section 3 on page 2, lines 25-27, which read: "(h) Starting on the construction commencement date, the full and true value of taxable property exclusively used for a North Slope natural gas project is determined on each January 1." as placeholder language. Commissioner Hoffbeck explained there was concern that without language referring to payments during construction, there might be the assumption that there were no payments to be made during construction. Therefore, it was envisioned that when the impact payment discussions are completed, the placeholder language would be replaced with language that defines the impact payments.

[8:28:05 AM](#)

REPRESENTATIVE SEATON inquired as to whether the impact payments would be payments rather than advances that are subtracted from later tax payments.

COMMISSIONER HOFFBECK said the idea is that the impact payments won't be advances on later taxation but rather will be tied to construction that is actually occurring. The impact payments will be less than the property tax, and therefore there will be no reason for repayment in the future.

[8:29:04 AM](#)

COMMISSIONER HOFFBECK, in response to Representative Hughes, explained that the MAGP Board was established in Senate Bill 138 [28th Alaska State Legislature]. The MAGP Board has had several meetings working through the issue of the payment in lieu of taxes (PILT) for the project. Ultimately, the MAGP Board produced a report for the governor at the end of the last

administration. Commissioner Hoffbeck remarked that the report was more of a wish list within the context of the [board's] disagreements. Under the Walker Administration, the MAGP Board reaffirmed that the PILT was the direction it wanted to take. He informed the committee that the MAGP Board has meet four times since the Walker Administration has been in office. In further response to Representative Hughes, Commissioner Hoffbeck specified that the MAGP Board consists of the commissioners or their designees of the Department of Revenue (DOR), the Department of Natural Resources (DNR), and the Department of Commerce, Community & Economic Development (DCCED) as well as the mayors or their designees of Anchorage, Kenai, Fairbanks, Mat-Su, Denali, North Slope Borough, and Northwest Arctic Borough. He noted that the producers have attended the MAGP Board meetings, and therefore he characterized it as an iterative and cooperative process.

[8:32:46 AM](#)

CHAIR TILTON MAGP inquired as to the MAGP Board's role in developing HB 183.

COMMISSIONER HOFFBECK answered that the most input from the MAGP Board was drilling down on the formula. He opined that the MAGP Board and the producers recognize that this is an interim step and the final step will be a more refined PILT or calculation of the tax burden during the project. He related his belief that the impact payments during construction will be some form of PILT. What's proposed in HB 183 can be morphed into a PILT structure, which he opined is the goal. The MAGP Board has been the forum for the discussion as well as a place for the producers to have input into the discussion. The legislation itself was totally drafted by DOR and the attorney general's office. He noted that the producers are working on a red-lined version to present, which the municipalities are awaiting prior to weighing in on the language. In further response to Chair Tilton, Commissioner Hoffbeck explained that as this model becomes calibrated during the fiscal negotiations the MAGP Board will be kept informed, although the MAGP Board does not have a seat at the table during negotiations. He mentioned, however, that the MAGP Board will have a tremendous amount of input

regarding the determination of the impact payments and where the impacts occur. Furthermore, the MAGP Board will be the forum for the local jurisdictions when the state decides how the revenues will be distributed. The reality of the tax is that a \$50 billion project with a 20 mill levy will result in \$1 billion annually in property taxes. He opined that the local jurisdictions realize that the aforementioned property tax will not flow to the jurisdictions that sit along the pipeline corridor. A portion of the property tax, he pointed out, will be reserved for its own operations or distribution elsewhere. The aforementioned discussion will be between the state and the MAGP Board. He then related that there has been a briefing on the Federal Energy Regulatory Commission (FERC) process and documents regarding the stranded gas were distributed. He noted that additional document research is being performed now.

[8:37:07 AM](#)

REPRESENTATIVE HUGHES asked if the MAGP Board is generally in support of HB 183 as currently written.

COMMISSIONER HOFFBECK indicated that to be the case since the formula embodied in HB 183 is a generic version of what the MAGP Board developed during its discussions. The inputs developed by the MAGP Board are not included in the formula in HB 183. Commissioner Hoffbeck highlighted that the Denali Borough doesn't have a property tax, and thus collects the PILT on the Usibelli Coal Mine, Inc. Therefore, the Denali Borough wants a PILT to ensure it receives revenue from the pipeline running through it without having to implement a general property tax. Commissioner Hoffbeck opined that the aforementioned issues remain, but the MAGP Board seems comfortable that HB 183 represents its input generically at this point.

[8:38:57 AM](#)

REPRESENTATIVE NAGEAK, drawing from his knowledge of Commissioner Hoffbeck since a young man, related his pleasure that Commissioner Hoffbeck is in the position of commissioner of DOR.

[8:41:12 AM](#)

COMMISSIONER HOFFBECK, returning to the sectional analysis, directed attention to the second part of Section 3, which is the narrative description of the formula and specifies that the throughput factor will be based on the annual averages of the throughput measured in Mcf. Section 4 references the project under the definition of "taxable property." He then explained that existing LNG plants are locally assessed and the language in Section 4 includes a carve out for them while placing the LNG project for this plan under the oil and gas tax laws. Therefore, the entire project is under the 20 mill levy, under AS 43.56. Although the aforementioned is primarily done for administrative purposes, it does increase the tax burden and thus needs to be addressed with the producers. If the state decides that a specific amount of the \$1 billion will flow to the state prior to any being distributed to the municipalities, it's critical for all [participants] to be under the same tax regime. He then moved on to Section 5, which is a definition of the project that adds subsection (7) defining the North Slope natural gas project and its components. He pointed out that the "gas pipeline" definition includes language on page 4, lines 20-21, that excludes "any pipelines downstream of an offtake point between a gas treatment plant and a liquefaction plant". Therefore, anything after an offtake point is not part of the project. With regard to the gas treatment plant (GTP), he recalled that prior testimony to the legislature has discussed the project starting at the point of production, which would mean that the pipeline feeding the gas treatment plant would be part of the project. However, for property tax purposes it works best if the start of the project is the inlet flange as it would allow future expansions in which other pipelines flow into the GTP will not cause confusion if those pipelines are taxable entities and not part of the existing PILT. The producers, he related, are concerned about the aforementioned issue. Section 6, the last section, is conforming language. Commissioner Hoffbeck informed the committee that the producers are concerned that there isn't enough enabling language to create a PILT in statute without a constitutional challenge.

[8:46:57 AM](#)

REPRESENTATIVE SEATON posed a scenario in which there is an offtake point for Fairbanks. He then asked if the flange that is the start would be the flange at the pipe or the flange at the outlet of the straddle plant that removes gas for Fairbanks. There would be quite a difference in the cost structure share depending upon which flange is the start.

COMMISSIONER HOFFBECK answered that currently [the start point] would be the flange at the pipe. However, if a straddle plant was part of the original design and construction costs of the pipeline, [the start point] could be on the outlet flange of the straddle plant. He expressed the need to avoid having a major offtake facility as part of the PILT on the pipeline when it was never part of the construction cost of the pipeline. The goal, he offered, is to balance the PILT with what would be generated by a standard property tax and avoid attaching assets that were never part of the original construction [to the PILT]. Therefore, if it's part of the original construction costs, [the start] could be the outlet flange of the straddle plant.

REPRESENTATIVE SEATON requested clarification of the aforementioned in the language of HB 183.

[8:48:46 AM](#)

REPRESENTATIVE SEATON asked if the design throughput will be the pipe size multiplied by an initial compression or will it be at the capacity of the liquefaction plant. He further asked if the [design throughput] would change if another train is added later in compression. Or, is that automatically getting controlled, he asked.

COMMISSIONER HOFFBECK explained that design throughput and cost will be locked in at the FID so they both stay in sync. Any additional capacity due to additions/changes would be picked up in the additional throughput. Therefore, additional gas creates a higher value, which could theoretically pick up the additional value of the train. With regard to where the design throughput is attached, Commissioner Hoffbeck said there will likely be three separate components such that there is a PILT for the GTP,

a PILT for the pipeline, and a PILT for the LNG plant. Since each of the aforementioned will have a different throughput, it's simpler to have three different PILTs.

REPRESENTATIVE SEATON requested more clarity with the formula, particularly in terms of having examples of using the formula with potential changes over time.

[8:52:38 AM](#)

CHAIR TILTON inquired as to whether the state will have to pay a property tax on the portion the state owns.

COMMISSIONER HOFFBECK answered that hasn't yet been determined as it will likely be based on the structure of the final ownership. In further response to Chair Tilton, Commissioner Hoffbeck related that fiscal negotiations are ongoing.

[8:53:18 AM](#)

CHAIR TILTON inquired as to how the throughput factor is calculated for the instate gas coming off the line prior to the LNG facility.

COMMISSIONER HOFFBECK said that's why multiple PILTs is being considered. However, he said it's likely that it will be based on the input into the pipeline, but obviously the LNG plant wouldn't be tagged with gas that never made it there.

[8:55:31 AM](#)

NIKOS TSAFOS, Partner, Energy Consultant, enalytica, referring to the slide entitled "PROPERTY TAX IN CONTEXT," directed attention to the chart on the left that shows how much property tax oil and gas properties pay per barrel of oil produced in the state. He noted that since it's normalized for inflation, it's in real terms. The chart on the left illustrates that there's a period of about 25 years of relative stability. The [property tax] per barrel, in real 2009 dollars, starts at about \$1.00 and then [levels] at about \$.75 per barrel until 2006. In 2006 there is a methodology change and the [property tax] per barrel

increases. Therefore, the [property tax] is about \$2.50 of a \$50-\$100 barrel of oil. He related that for an AKLNG project, the order of magnitude becomes much greater in terms of the impact of the property tax. Mr. Tsafos then directed attention to the chart on the right, which is an indicative value change for the AKLNG project. The AKLNG project has an estimated cost of \$45-65 billion, which means the discussion is about indicative economics until the cost can be narrowed down. Therefore, he cautioned the committee that the numbers are merely estimates. He then explained that the AKLNG plant may need a price in Asia of about \$12-13 per Mmbtu to be viable. The property tax could be as high as \$1 [per barrel]. He further explained that property tax is more than the shipping cost to Asia; it's \$1 out \$12-\$13 and thus the possibility of an increase to \$1.50-\$2 would have a huge impact on the economics. The chart illustrates that \$13 is the price in Japan when oil is \$90. If oil is \$70, the price in Japan is more like \$10. Mr. Tsafos emphasized that property tax is a large portion of the burden of this project. The aforementioned is the commercial context in terms of the costs and the importance of stability. For example, at some point [the property tax revenues] may increase from \$1 to \$2.50 per barrel of oil and in the context of the AKLNG project, it's the difference between a project being viable at \$90 or \$105-\$110 per barrel of oil.

[9:00:55 AM](#)

JANAK MAYER, Partner, Energy Consultant, enalytica, focusing on the specifics of HB 183, directed the committee's attention to the slide entitled "PILT VS. PROPERTY TAX." He then emphasized the importance of distinguishing between a PILT and things done directly through a property tax. The reason there is discussion about a PILT is that the Heads of Agreement explicitly laid out that the intention of all the parties was that AKLNG, as part of the fiscal arrangement, wouldn't pay property tax but rather have a negotiated PILT. The notion of a PILT then is a negotiated payment that is in place contractually and through whatever necessary legislative avenues. While the basis of negotiation may be what the liability of the project would otherwise be in terms of property tax based on assessed value and other things, eventually some negotiated payment is reached.

The Heads of Agreement established a payment that would be specifically about cents per Mcf that would be paid in lieu of property tax. He pointed out that although many of the concepts in HB 183 are familiar in terms of creating a payment that is a fixed per Mcf amount. The legislation, HB 183, seems to embody an effort not to create or authorize the negotiation of a PILT, but rather to create some of the economics of a PILT through the property tax system. He explained that it would be a situation in which the assessed value is fixed and subjected to throughput and other things to create a fixed Mcf payment that is made directly as a property tax rather than in lieu of property tax. He reiterated the importance of understanding that a PILT versus PILT-like economics through the property tax system are two different concepts and the ultimate aim. By going with the basic negotiated PILT, there are a number of benefits/options in terms of the ultimate payment structure. For example, the payment structure under the basic PILT could be one in which there aren't property tax payments during construction but only impact payments while shaping the eventual profile. There is flexibility under a negotiated PILT. Because [a PILT] is a contractual mechanism there is a degree of implicit stabilization, particularly when done with other things. Part of that implicit stabilization comes from the fact that once the PILT is negotiated and agreed upon, it is quite separate from the property assessment process. Property assessment was utilized in negotiating the PILT in terms of what the property tax might have been, and therefore what reasonable numbers might be. However, once the number is negotiated it's a cents per Mcf charge that is paid in lieu of the property tax and at that point the link to the property tax is severed. If the goal is to implement some of those economics through property tax directly, there is a wide scope for doing so and some of the ways in which to achieve the aforementioned seem to be reflected in HB 183. [To implement the economics through a property tax], one must begin by creating a firm assessment of the actual cost basis that will always be the case and will be adjusted by depreciation, throughput, and other factors to create a stable and predictable dollar per Mcf amount. The aforementioned, he specified, is a way to achieve PILT-like economics through the property tax, not itself a PILT.

[9:06:45 AM](#)

MR. MAYER said in comparison, the payment profiles are slightly more limited with the [property tax]. He opined that if it's done solely through property tax, the other AKLNG partners would have deep concern with regard to the stability of the arrangement. In fact, he surmised that the other AKLNG partners would want other forms of stabilization in place beyond statute that can be changed in order to guarantee it's durable for the time of the agreed upon duration of the project. The need for stabilization will be particularly acute because doing it through the property tax places it in statute, which is subject to change, and remains linked to property assessment. The aforementioned can be found in the language of HB 183. Mr. Mayer then turned to the fact that the project is placed under AS 43.56, the state level property tax. He acknowledged that it could make sense to levy a charge that has PILT-like economics through a property tax because it's a clean and uniform structure for the entire project rather than a patchwork of municipal level tax rates. However, from the perspective of the companies that would be a significant tax hike because currently the Kenai LNG facility is taxed through AS 29 solely at the municipal rate not at the full 20 mills. It makes sense that any negotiation of an ultimate tax rate may start at 20 mills and be negotiated down to what the project economics can support while having a uniform system that applies to everything. Although this is a large piece of making the project economically viable, it's important to understand that a company would become anxious regarding whether a PILT or property tax is being used while raising the tax rate. Therefore, he emphasized the need for clarity on such matters as the discussion continues.

[9:10:08 AM](#)

MR. MAYER, moving on to the slide entitled "OUTSTANDING QUESTIONS," addressed the treatment of transmission lines, which may be the difference between taking a pure negotiated PILT approach versus property tax legislation that has broader application. If the agreement is for a PILT with the parties of an AKLNG project, then it may be more manageable in terms of not

having subsequent effects on subsequent projects. Whereas if something is enshrined through general property tax legislation, the question of to whom else that might apply in the future becomes much more pertinent. Therefore, exclusion of the transmission lines from the definition of the natural gas project for the purposes of property tax is an effort to address that precisely because it's in general property tax legislation rather than a specific negotiated agreement with the parties. The administration, he offered, seems to be concerned with the need to be clear that if a very large and expensive pipeline were constructed to connect to the gas processing plant, it wouldn't be part of this arrangement. Mr. Mayer opined that the aforementioned is less of a concern with a PILT than it would be of concern when solely utilizing a property tax. Mr. Mayer continued:

That said, ... it will be an obvious issue of concern for the companies, particularly given that [Senate Bill] 138 specifically pushed the point of production from a legislative definition perspective back up to the unit level and excluded the transmission lines from -- deliberately included the transmission lines within the scope of the project and excluded them from the upstream. Part of the concern there was excluding the cost of those transmission lines from what would be deducted from an upstream oil tax perspective, but it seems to ... us that there needs to be some degree of consistency in whatever one chooses. It's a little difficult to say, "Well, transmission lines are part of this project from the perspective of making sure they can't be deducted against oil taxes, but they're not part of this project from the perspective of special treatment for property tax." That's an important issue to think about and to be aware of.

MR. MAYER then recalled the commissioner's comments with regard to payments during construction and that the Heads of Agreement specifies the project wouldn't pay property tax during that time, but rather impact payments directly related to construction impacts of the project would be made. Part of the reason for the aforementioned, he offered, is that property tax

is a large amount, potentially as much as \$1 billion a year, and that has a particularly detrimental impact on the project economics if the project pays the highest amount at the start of the project and pays prior to earning revenues from producing natural gas but during the construction phase. Mr. Mayer said although he was glad there remains agreement in commentary on the aforementioned principle, it isn't reflected in HB 183 as currently written. He then related the importance of meeting milestones in terms of what was established in the Heads of Agreement last year. A key milestone has been reaching a negotiation of a PILT for the project. A key milestone for this legislative session, he surmised, was to ensure authorization, if necessary, for the administration to undertake negotiations for an agreement that would be put before the legislature. He opined that meeting the milestones is particularly important in the broader context of ensuring that the very high level of spending on AKLNG is going to continue.

[9:15:19 AM](#)

REPRESENTATIVE SEATON said although he is supportive of stability, disruption can be caused by stability that creates future instability when future economics aren't taken into account, such as with the use of a fixed inflation rate no matter the inflation rate in the general economy. Therefore, he opined that the [proposed] design isn't very robust with the fixed inflation rate. He further opined that such a design doesn't create a stable relationship between those receiving the PILT or the property tax and those with the product in the project. He then inquired as to how more future alignment in this process can be created.

MR. MAYER highlighted the importance of distinguishing between HB 183 versus the conceptual discussions when the specifics are discussed. As written, he characterized HB 183 as a series of sign posts that lack any specifics. In fact, he opined, there is no indication as to the exact nature of any of these factors and how the math would work because there is a negotiation process yet to come. Therefore, it's difficult to comment on how inflation would be treated as it's a largely hypothetical discussion based on concrete terms. Still, predictability, he

offered, is going to be the most important thing as part of the question of stability. In talking to the companies involved; Mr. Mayer related that discussions of future expansions, one would expect future green field expansions because they benefit from having an existing project in place and tend to be less capital intensive per unit of gas put through them than the initial project. Therefore, in many ways having a pure fixed \$/Mcf amount actually subjects future expansions to a higher tax burden per Mcf than they might pay were they subject to either adjustments such as an exponent in the formula or renegotiations of the property value at the time. He opined that it says a lot that the involved companies want a fixed \$/Mcf that will apply, including to future expansions. The aforementioned likely means they pay more per Mcf in property taxes than they might pay if there was more flexibility. Mr. Mayer said that relates a lot about how much [the involved companies] value stability and the ability to know now for the future the entire tax burden, including for expansions. Potentially, [the companies] would rather pay more and have stability than have [inflation] that is subject to change. Mr. Mayer agreed with Representative Seaton that utilizing a fixed inflation rate somewhat divorces things from the reality of what inflation may be subsequently. However, in many cases inflation and depreciation offset each other and perhaps much greater stability and predictability could be achieved by stripping them out or developing something else that creates the greatest simplicity and stability possible. Without a detailed proposal, he pointed out that it's difficult to offer specific commentary, he said.

MR. TSAFOS noted his agreement with Mr. Mayer's comments. Addressing [the formula] from a common sense perspective, Mr. Tsafos opined that the inflation is the least disputable number as there is ample data on it. While the desire is for simplicity and predictability to trump everything, inflation is likely a variable of the formula that everyone could more or less agree upon. Although the number is subject to negotiation, he speculated that inflation is fairly transparent and clear.

[9:22:32 AM](#)

REPRESENTATIVE SEATON expressed concern with looking into the future with perhaps a 50-year project life and a fixed 4 percent inflation without any future flexibility. He requested the consultants provide mechanisms to achieve stability at the decision point as well as in the future to ensure a robust system.

[9:24:02 AM](#)

REPRESENTATIVE NAGEAK predicted that as the project ages there will be discussions of different evaluations according to those who pay and receive taxes. Therefore, there will be a lot of give and take over the course of the project because throughput will diminish over time. He characterized it as a fluid process over the life of the project.

[9:25:31 AM](#)

REPRESENTATIVE HUGHES recalled the January 1st deadlines for the full and true value of the gas or unrefined oil in HB 183. She then requested explanation of the 20 mill property tax rate and why that might be of concern.

MR. MAYER, addressing the January 1st deadline, explained the new section proposed in AS 43.56.060 to specifically deal with the natural gas project envisions an annual assessment until construction. From the start of construction onwards, full value is deemed to be the original value; presumably that means it's fixed and doesn't change. However, by doing it in the property tax it's explicitly linked to a property tax assessment process as illustrated in Section 1 of HB 183 with the addition of the language "**exclusively used for a North Slope natural gas project**". Furthermore, the language retains the reference to the fact that property tax is levied on the property used for the transportation of gas at its full and true value as of January 1st of the assessment year. He acknowledged that on one hand, there is reference to the full and true value instead of a fixed amount, but it's also the full and true value as of January 1st of the assessment year. The ambiguity of the aforementioned makes companies concerned about stability anxious. With regard to the 20 mill rate, Mr. Mayer explained

that property tax can be levied under AS 43.56 in which case it's a state level levy and municipalities can also levy a property tax at a rate below or up to the 20 mills. Whatever [property tax] is paid at the municipal level is creditable from the property tax such that the total amount paid by the taxpayer is no more than 20 mills combined. The difference between the municipal rate and the 20 mill rate is what ultimately goes to the state. The aforementioned, he noted, applies to oil and gas facilities including the pipeline going into the Kenai LNG facility. The Kenai LNG facility itself is taxed under AS 29, which is the municipal property tax. Therefore, the only property tax that Kenai pays is the Kenai municipal property tax, which is substantially below the 20 mill rate. If that status quo were to apply to the AKLNG, the property tax on the liquefaction would be substantially lower than the 20 mill rate because the state wouldn't be taking any property tax. The general idea of having a uniform framework that applies across the entire project is clean and makes sense, he opined. He also opined that it makes sense to start negotiations at the 20 mill rate to see what the project can support. The effect, he opined, of enshrining it directly in property tax statute is relative to the status quo to impose an increase in the rate.

[9:30:31 AM](#)

REPRESENTATIVE HUGHES surmised then that under HB 183, the state would collect [tax] that in the past only the municipality collected. She asked if the aforementioned would only occur at the North Slope and Nikiski ends or only at the Nikiski end.

MR. MAYER answered that [the collection] would occur at the liquefaction facility at the Nikiski end.

[9:31:16 AM](#)

REPRESENTATIVE SEATON pointed out the committee packet includes a letter dated April 14, 2015, from the Kenai Peninsula Borough.

[9:31:50 AM](#)

REPRESENTATIVE HUGHES asked if the MAGP Board will continue meeting in the interim.

COMMISSIONER HOFFBECK nodded yes.

9:32:39 AM

CHAIR TILTON inquired as to why HB 183 was brought forward now while more fiscal negotiations are necessary. She also inquired as to the processes that are being considered as the legislation moves forward and when more specifics will arise.

COMMISSIONER HOFFBECK answered that HB 183 was introduced now in order to bring the discussion forward to begin to fine tune the issues. The advantage of introducing the legislation now is that eliminates many of the issues that surrounded Trans-Alaska Pipeline System (TAPS) in terms of how the asset is valued. The legislation brings it down to five measureable terms from which work can begin to establish the base value of calculating a PILT. He surmised that ultimately everyone wants to reach that one \$/Mcf amount that provides stability moving forward. However, there had to be some foundation to measure that, he offered. [The legislation] is merely an interim step, not the final step. As the consultants mentioned, there was an expectation this session that a PILT agreement would be reached, but the reality is that the process isn't far enough along in the fiscal negotiations to pin down a PILT. The question is whether a project can bear that high of a PILT, which is why it needs to be left open as the process moves forward during the interim.

9:35:25 AM

COMMISSIONER HOFFBECK, in response to Representative Seaton, related his belief that ultimately the producers would like a property tax tied directly to the flow of the gas through the project. Essentially, if the formula is divided by the throughput, a tax per Mcf would result. The aforementioned, he opined, is ultimately what everyone is trying to achieve.

REPRESENTATIVE SEATON indicated the need to determine where the mill rate and Mcf calculations end up in "the mix" as the two seem a bit disparate.

[9:37:07 AM](#)

CHAIR TILTON inquired as how the PILT would be allocated as linear miles don't work because of the GTP and LNG facilities. She further inquired as to whether there are other alternatives.

COMMISSIONER HOFFBECK said that is a discussion that needs to occur. Currently, under TAPS the allocation is by the value of the asset within the particular jurisdiction. [The PILT] actually breaks out the pipeline, the pump station, and the Valdez marine terminal and calculates those values separately and then looks at the totality of the value of the pipeline. Then a certain percentage is given based on the total value of the pipeline versus the total value of construction within each of the jurisdictions. Commissioner Hoffbeck envisioned that the [PILT for the natural gas project] would be something similar to the aforementioned as most likely the PILT will be parsed at multiple pieces such that there would be a piece for the GTP and the pipeline. Therefore, the GTP wouldn't have to be calculated as to how it factors through while the pipeline could be calculated on a per mile basis "and then, of course, the LNG at the end." He noted that potentially, there could be a [PILT] for the upstream pipelines, the feeder pipelines, as well.

[9:38:57 AM](#)

REPRESENTATIVE HUGHES, referring to the MAGP Board and the participation by mayors who don't necessarily have expertise in oil and gas issues, asked if the municipalities have [oil and gas] consultants to help them with the AKLNG project.

COMMISSIONER HOFFBECK answered that most mayors have someone on their staff who attend the MAGP Board meetings with them. However, because property tax is the primary source of revenue for most municipalities most mayors understand property tax well. The overriding oil and gas 20 mill levy is an important piece that they need to understand. Certainly, Kenai,

Fairbanks, and the North Slope Borough understand the oil and gas 20 mill levy as they have been dealing with it for years. For instance, Kenai just hired Larry Persily, former federal coordinator of the Alaska Gasline Project and deputy commissioner of the Department of Revenue.

[9:41:10 AM](#)

CHAIR TILTON announced that HB 183 would be held over.

[9:41:43 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Community and Regional Affairs Standing Committee meeting was adjourned at 9:41 a.m.