

HB

519

Alaska State Legislature

House of Representatives

RULES COMMITTEE, CHAIR
COMMITTEE ON COMMITTEES
LABOR & COMMERCE COMMITTEE
MILITARY & VETERANS AFFAIRS
LEGISLATIVE COUNCIL



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ALASKA STATE CAPITOL
JUNEAU, AK 99801

House Bill 519 Sponsor Statement Version: 22-LS1651J

The time has come for Alaska to engage in the development of a natural gas pipeline. With declining production from Alaska's large oil fields, the scaling back in exploration efforts by some of Alaska's largest producers, apparent substantial delays in any work that might come from exploration and hopefully production on the coastal plain of ANWR, layoffs of oil industry employees, and problems in other resource industries such as fishing, mining, and timber. The gas pipeline offers the only hope for substantial near-term work for Alaska's oil and support industries. In our fiscal crisis, it is imperative the legislature enact legislation this session to encourage construction of a natural gas pipeline before this opportunity for our economy disappears for perhaps another decade or longer.

HB 519 provides an encouragement to the producers that helps diminish the huge risks in this largest of construction projects. In exchange, it also contains provisions, important to the State of Alaska, as conditions for obtaining the benefit of such incentive, such as the pipeline follow the "southern" route, and provisions for Alaska hire, buy, and build. Of course, the major benefits to the State, if this incentive results in construction of the line, will be a substantially positive effect on the economy with jobs and construction activity, and taxes and royalties from the production and sale of natural gas. These benefits may never come to be, or may not come from decades, if this window of opportunity is missed.

HB 519 offers an incentive in temporary relief from the ad valorem tax that would be imposed on the pipeline for the period, from before construction through the second year of commercial operations. This would provide tax relief in an important period of the project when a large amount of cost is experienced but no income is yet being generated, and early into commercial operations of the project. The project entails very substantial financial risk as to price, and the cost of this mega-project through a federal income tax credit. This would provide important risk protection, but possibly leave the project developers at risk for project construction cost overruns. The tax relief in HB 519 could provide a means of reducing one element of the costs during construction and thereby reduce the risk. This would not effect any other taxes or royalties the state collects. After the relief period has expired, the State and local governments will have a natural gas pipeline upon which to collect property taxes. If the project does not go forward, these benefits to the State will not be realized.

The gas pipeline must be constructed along the "southern" route. All the companies involved in the engineering, construction, and operation of the pipeline must pledge their best effort to hire Alaskans, buy from Alaskans, and build facilities in Alaska.

HB 519 also reopens the Alaska Stranded Gas Development Act, AS 43.82, enacted in 1998. It contains important provisions regarding Alaska hire and contracting with Alaska businesses, making gas available to meet reasonably foreseeable demand for in-state use, and provides a mechanism for the state and project sponsors to reach agreement or clarify certainty on fiscal terms and on other issues important to the parties.

HB 519 has the advantages of offering an incentive rather than threatening a disincentive. It will demonstrate that the State wants a natural gas pipeline to be constructed, is prepared to help this risky and enormous project be less risky, and will work with the current producers to their and the State's mutual advantage. At least one producer has indicated a willingness to go forward if the State makes this showing.

Representative Pete Kott

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VECO Corporation, Inc.

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Testimony of Bill Allen
Before the House Oil and Gas Committee Hearing (HB 519)
April 19, 2002

Thank you Mr. Chairman and members of the committee.

For the record my name is Bill Allen, I am Chairman and CEO of VECO Corporation, an Alaskan company with its headquarters in Anchorage.

Before I begin, I would ask the committee to please bear with me. Because of an accident I suffered last summer, my speech is sometimes broken and I must speak slowly. I will do my best, and submit written testimony to fill in any gaps.

With your permission I will have my Vice President Rick Smith read my testimony. These are my words, but it will go much quicker if Rick reads them for me.

Testimony:

Mr. Chairman, and members of the committee, it is a pleasure to be here with you today and I appreciate the opportunity to speak with you on an issue of utmost importance to Alaska.

I know each of you personally. Over the years, we have had the chance to work together on many issues important to Alaskans. Creating jobs and local hire, improving education, encouraging business and economic development – to name just a few.

I'm here today to tell you that, in my opinion, no single issue is more important to Alaska's future – than the legislation you now have before you.

Alaska is truly at a cross-roads. Many of our traditional industries are struggling – often through no fault of their own. Our oil resources are declining, our timber, mining and fishing industries are on the ropes – because of factors largely beyond their control.

But the bottom line is that as those traditional mainstay Alaskan industries struggle – Alaska struggles – and Alaskans find themselves out of work and unable to provide for their families.

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In addition, as our state's economy shrinks, so does your ability to ensure better schools, better communities and a better quality of life for all Alaskans.

Mr. Chairman, I believe the legislation before you offers an opportunity for Alaska to control its own destiny. We know that the North Slope has enough proven reserves of natural gas to fill a pipeline to capacity for the next 50 years. 35 trillion cubic feet – and that's just the known reserves. Estimates suggest there may be much more – perhaps enough to keep the pipeline – and the jobs and revenues it will create – operating for the next 100 years.

Unfortunately, before Alaska can realize any of those benefits, a pipeline must be built.

A few years ago, like most Alaskans I was enthusiastic about the prospects for the gas line. With prices soaring – it looked as if the pipeline was just around the corner.

Well, we all know what happened next. Just as quickly – prices dropped – and the economics suddenly changed.

After months of study, it's now clear that without some economic incentives, private industry is not going to be willing to risk the billions of dollars necessary to construct the gas line at this time. The project simply does not math out at current and foreseeable prices -- unless some of the construction and start-up risks are offset.

We know that we have some of the largest known gas reserves in the world. We know that we have reliable, private sector partners who can help Alaska develop and market our vast, untapped resource.

But we also know that Alaska is not the only place in the world where natural gas exists. And as with our other industries, international competition increases every year.

I guess more than anything, I am here today to urge you to act quickly to seize a unique opportunity that can help ensure Alaska's future.

I believe the window of opportunity is still open – if we act now to help make this project a reality. I also strongly suspect that if that window shuts – it may never open again.

In the past several weeks, I have talked with senior officials from the production companies. They have indicated a willingness to proceed providing federal and state legislation is passed to help offset some of the project's tremendous risk. They also seek reasonable assurances of stability in our tax and economic climate.

In that regard, for the past several months members of our Congressional delegation have worked hard to enact federal incentives to help make the gas line a reality. But as with

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any Alaska resource development issue, they are fighting a difficult uphill fight – and they need our help.

Last week Senator Murkowski called me and said that opponents of the gas line are now pointing out the absence of state action on the issue – and using that point to try to defeat our delegation's efforts in D.C. “If Alaska does not care enough to offer incentives,” they say, “why should we?”

Senator Murkowski and the rest of our delegation have indicated that passage of HB 519 will go a long way toward demonstrating Alaska's commitment to this project. It will send a clear signal to Washington and the producing companies that Alaska is ready to step up to the plate and invest, along with them, in Alaska's future.

I have been asked what this legislation will cost Alaska. My answer has been very simple. Absolutely nothing. Because without this legislation, the gas line will likely never be built.

You can't tax something that doesn't exist.

So any taxes potentially deferred by this legislation – would never have been realized anyway.

On the other hand, I believe the true cost to Alaska – lies in doing nothing. If this legislation does not pass, and the gas line is not built, what will that cost Alaska?

The gas line will create thousands of new jobs and billions in new revenue and economic activity. It can help provide a stable economic climate for Alaska at least well into this century – and long after you and I are gone.

At a time when Alaska is desperately seeking new economic opportunities – I suggest to you – that the best opportunity is very close at hand, if we will simply reach out and grasp it.

Thank you again for the opportunity to testify. I would be happy to answer any questions you may have.

Testimony of Ken Konrad
Senior Vice President - BP Exploration (Alaska) Inc.

House Oil & Gas Committee
Friday, April 19, 2002

My name is, Ken Konrad, Vice President Gas for BP Exploration (Alaska) Inc. I am here this morning to testify in support of HB 519.

Creating a supportive government framework is an essential ingredient toward developing a successful ANS gas project. An international project of this magnitude brings many inherent risks. Governments, working constructively with industry, can play a major role in reducing these risks by setting clear and predictable rules under which a project would be undertaken.

BP, with our partners, has previously laid out key government actions that would facilitate future investment on this massive undertaking. Specifically –

- A clear and efficient US federal regulatory process. Progress is being made with Alaska gas provisions currently part of the pending US Senate energy bill.
- An efficient and predictable Canada / First Nations regulatory process. BP remains very active working in Canada to establish such a process and progress is being made.
- A simple, clear, and predictable fiscal framework in Alaska such that the massive long payout investments being contemplated can be undertaken with the knowledge that the rules won't change.

HB 519 would be a positive step toward achieving the necessary fiscal framework in Alaska. The bill is modeled after HB 393, which was passed in 1998. As we did in 1998, we continue to support the content and approach inherent in the Stranded Gas Act, which this legislation refreshes, updates, and makes available for a gas pipeline project.

HB 519 and the Stranded Gas Act would:

- Demonstrate leadership and an intent by the legislature to provide stable fiscal terms that encourage development of ANS gas while fully and fairly compensating the people of the state.
- Establish a protocol, beginning with an application, and followed by a process to exchange information between investors and the state.

- Empower the state to enter into a contract negotiation to achieve clear and simple tax and royalty terms. These terms would need to be subsequently approved by both the executive branch and the legislature.
- Provide a process with the state and investors while providing for municipal input.
- Provide for contract review, approval, and termination provisions, inclusive of municipal input, legislative authorization, and judicial review.
- Provide for prioritization of state agency support for a qualifying project.

In aggregate, it would set out a thoughtful and workable framework to work through important fiscal issues subject to subsequent approval by the legislature.

The bill also encourages Alaska hire, training, and purchasing. BP has and continues to support the use of in-state capability. However, some technical modifications should be considered to ensure the bill's language does not draw legal challenge.

Passage of HB 519 would send a positive message to investors and provide a framework to achieve fiscal clarity and predictability. BP is fully supportive.

Thank you. I would be happy to answer any questions at this time.

**Phillips Petroleum Company
House Oil and Gas Committee April 19, 2002
HB-519 Testimony**

Good morning Mr. Chairman, and members of the Committee. For the record, my name is Joe Marshack. I am Vice President of ANS Gas Commercialization for Phillips Alaska. My primary responsibility is the development of Phillips' ANS gas resources and Phillips' is committed to achieving our goal in a timely and economic fashion. We appreciate the opportunity today to testify in support of HB-519.

As you know, we have been focusing this year on those areas that we believe are most likely to result in an economically viable gas pipeline project to the Lower 48. We have completed our joint analysis of the work the producers initiated last year and will be setting up a time to brief you on the results of that work. For the past several months however, most of Phillips gas emphasis has been directed at the federal level to achieve congressional legislative changes to advance the project. These include:

1. New Federal Legislation that creates permitting certainty. I believe you are well aware of the current federal legislation in the Senate Energy bill.
2. A Federal tax mechanism that would help mitigate the unacceptable market risk of a project of this magnitude. I understand you are aware of current drafts of this mechanism that provides down-side mitigation but also provides for repayment of any credit if used, and that is currently assessed by the U.S. government as having a zero cost. This piece of legislation is in Phillips' view a most critical element in moving our project forward. It shares the benefits the Lower 48 consumers will see from ANS gas coming to market while addressing the risk inherent in such a large and costly project.

Given achievement of the federal legislation (at this point it is not a certainty), it is important to the economic viability of the project to progress fiscal matters at the state level.

Fiscal matters include fiscal certainty, and what we really mean is that we need to know, with a fair degree of specificity, how our taxes and royalties will be calculated and administered. We would also like to address potential opportunities to gain assurance that those taxes and royalties won't change once we've made our investment. We also believe that strategic participation by the State in mechanisms to improve the economic viability of the project are important.

While there may be a need for minor clarifying language, we are encouraged by the committees' consideration of HB-519 that proposes both a temporary property tax abatement and the revival of an existing statutory process by which pipeline project sponsors can work with the state to gain the kind of fiscal certainty and clarity which will reduce the risks and help the project move forward. The temporary property tax abatement is an important signal to the US Congress that Alaska has stepped up to try to make a project happen. By itself, an ad valorem holiday is not of sufficient size that it can singularly make a challenged project economic. However it is an important step in a series that along with other actions at the state and federal level, and potential technological improvements, can reduce the risks and improve the economics of the project.

Thank you for this opportunity to testify today and express our support of HB-519. I'll be happy to try to answer any questions you may have.

ALASKA STATE CHAMBER OF COMMERCE

Testimony on HB 519
by Pamela LaBolle

Good morning, I am Pam LaBolle, President of the Alaska State Chamber of Commerce. The Alaska State Chamber represents 35 local chambers and 700 businesses, most of whom are small businesses deeply concerned with the economic future of Alaska. As the Voice of Alaska Business and the leading advocate for business headquartered here in Juneau, we always appreciate the opportunity to address bills of importance to the economic development of the state. Our legislative priorities are developed at the grassroots level by our membership through a several month long process of proposal, review and debate. Our top five priorities include urging the legislature and the governor to encourage the producers to proceed with development of a southern gas line route through Alaska.

The Chamber speaks in favor of HB 519 and urges its passage. Alaska absolutely needs a gas pipeline. For our members to have their businesses thrive or even just stay viable Alaska's resources must be developed. It sometimes seems that people outside our state have a much greater say in what happens in our state than we do. With the defeat of ANWR in Congress just yesterday, there are no other large developments on the horizon that will spur the growth of our economy in the near term. Our executive committee meets monthly around the state often in smaller communities. As a result, we are very concerned about the state's economy. What is the state doing to encourage economic growth, to try to have a hand in our own destiny.

While the final results of the producers' study haven't been released yet, it should be apparent to everyone that this is a project of enormous cost and risk. The state and local governments would benefit greatly for years to come if we can encourage the producers to take the risks inherent in this huge project and develop the North Slope gas resources by building a project through Alaska. The temporary tax exemption provided by this bill should be looked upon as an investment by the state and municipalities to encourage the producers to go forward with a project that will create jobs, benefit municipalities, spur economic opportunity for businesses and start a whole new industry - a gas industry. By revitalizing the Alaska Stranded Gas Development Act and having it apply to this project, the state and producers can create a contract that will assure tax clarity and certainty and protect vital interests of the state and affected municipalities. How often does the state have an opportunity to take such a bold step to encourage large-scale economic growth. Several states and cities around our nation have offered to businesses tax incentives to encourage them to invest. The state should be less concerned with perhaps giving away too much and more concerned with not missing a significant opportunity for economic growth, perhaps the only one in the next few decades. Thank you.

Testimony of David Marquez in support of HB 519
House Oil and Gas Committee
April 19, 2002

I am David Marquez. My address is 18546 Osprey Circle in Anchorage. I am an attorney in Anchorage and today I represent VECO Corporation, an Alaska company headquartered in Anchorage. I speak in support of HB 519 and urge its passage.

VECO Corporation is an engineering, construction, and oil and gas service company that has been active in the Alaska oil patch for several decades. It has also been a good employer and an active member of the greater Alaska community participating vigorously in philanthropic and community activities. VECO urges passage of this bill because it believes that Alaska desperately needs a gas pipeline for its economy. VECO has seen and experienced over the last 15 years, significant reductions in the oil industry workforce in this state with the most recent one being announced within the last few weeks by Alyeska Pipeline Service Company. Coincident with all these reductions have been the elimination of contractor positions staffed by employees of VECO. VECO needs a gas pipeline to keep its Alaska employees employed and hopefully even to increase its workforce.

Despite the high costs and risks of the huge project for the development and construction of the Alaska North Slope natural gas pipeline, VECO believes that it is still possible to achieve this dream. Some producers have indicated that work will continue when three legislative actions are taken: (1) federal enabling legislation (2) federal legislation that

helps reduce the risk of gas prices cycling to low levels and (3) Alaska legislation that provides both an incentive, and tax and royalty certainty and clarity. As to the federal legislation, some have questioned why any federal assistance should be provided if the state of Alaska is unwilling to step forward. HB 519 will send a clear signal that the state is willing to participate. It grants a temporary exemption to the project from local and state property taxation under the 20-mill property tax (AS 43.56) for a period from commencement of the project's construction through the first two years of operation of the pipeline. The bill calls for expeditious priority treatment by state officials and agencies in support of development and construction of the project.

The Bill puts back into action the Alaska Stranded Gas Development Act that expired last June. This legislation was enacted after very substantial effort by the legislature, the administration and the industry to encourage the development of an LNG project to commercialize Alaska North Slope Gas. HB 519 makes it applicable to a North Slope gas line as well as an LNG project and extends until June 2005 the deadline for filing an application for a contract with the State. Such a contract would be approved by the legislature and would contain provisions addressing the issues of tax and royalty clarity and certainty, and other fiscal issues important to the parties.

A little more on the temporary property tax exemption provided in the Bill. It does not apply to any taxes currently being collected so present revenues will not be affected by this bill. Only if a pipeline is built and the state enjoys the benefits of that development will the investment of this temporary tax exemption be made. It is temporary and lasts

only for the period of construction and the first two years of operations. At its expiration, if this Bill in fact encourage the producers and a pipeline is built, the state and local governments will have a pipeline on which to levy taxes for many years, a new industry - a gas industry - will have been created, in-state use of gas will be possible, and Alaskans will be employed. If it is not built, there will not be any of that.

Just a year or so ago when gas prices were very high, everyone thought the pipeline was just around the corner. Now reality has set in and the project's enormous costs and risks make it very doubtful that it will be built unless action is taken to keep the project alive. VECO together with Fluor performed the recent study for the producers. VECO recognizes the great risks involved with the project, but believes that if the state takes action to reduce the risks and costs, we can make it happen. There may be concern that this will be seen as a give away and that, instead, the state should negotiate with the gas owners before any incentives are given. VECO feels a great sense of urgency. If action is not taken this year, the only opportunity for a significant boost to the state economy may be lost. If we take a year or two or three to negotiate any incentives, the opportunity may be lost as the producers move on to other projects. There will be time in the coming years under the Alaska Stranded Gas Development Act to negotiate a total fiscal regime, but VECO believes concrete action must be taken this year to keep the project going.

Further, the Bill requires that the producers must meet certain conditions to be eligible for the temporary tax exemption. First, it must be a pipeline that follows the southern route. The Bill lists six other conditions, including compliance with the federal acts relating to

natural gas pipelines. Amendments to those acts that would be favorable to Alaska are being considered as part of the currently pending federal enabling legislation. Also included as requirements are Alaska hire, buy and build.

The Alaska Stranded Gas Development Act, which this bill reopens, provides the opportunity for tax and royalty certainty and clarity that will benefit both the state and the producers. The state and the oil owners were locked in long, costly and antagonistic disputes over issues relating to the determination of the taxpayers liability for severance tax and royalty. VECO has been informed that the producers strongly desire that such disputes be avoided as to gas and that the risk associated with tax and royalty uncertainty and lack of clarity is one more risk that burdens this already risky project. The Stranded Gas Act provides a good process for the state and producers to negotiate such clarity and certainty and in fact the opportunity to negotiate what fiscal regime would be in the long-term fiscal interest of the state, while accommodating affected municipalities, and the project sponsors under a wide range of economic conditions, potential project structures and marketing arrangements. The legislature retains the power to authorize execution of the contract. The Act gives the municipalities an important role through the formation of a municipal advisory group.

There has been testimony today that reflects basic agreement on certain issues. First, there is the recognition that some incentive will be necessary for this project. Second, there is acknowledgment that a property tax exemption would be the most leveraging of the available incentives. Where there is disagreement is at what point the incentive

should be granted. VECO feels strongly that the incentive should be granted now, and then negotiations between the state and producers can address the total fiscal regime that would apply.

In summary HB 519 is crucial and contains perhaps the only chance left to try to keep the possibility of a gas line project alive for the next few years or it may be decades before the opportunity arises again. VECO also wants to make it very clear that it does not consider this to be a producer bill. This is an Alaska bill that provides for a short-term investment by Alaska that will pay off in a project that could be shipping gas for a hundred years.

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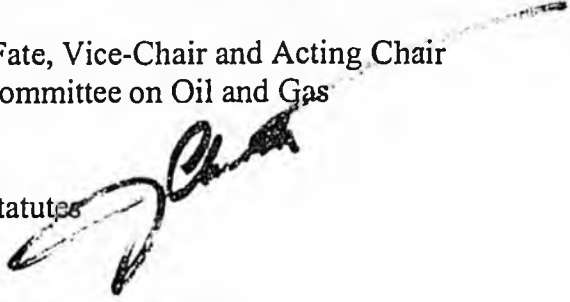
MEMORANDUM

April 18, 2002

SUBJECT: House Bill 519 -- response to inquiry (22LS-1651J)

TO: Representative Hugh Fate, Vice-Chair and Acting Chair
Attn: House Special Committee on Oil and Gas

FROM: Jack Chenoweth
Assistant Revisor of Statutes



To the question of the second paragraph of your Wednesday memo:

The second clause of the bill title, "expanding the scope for the kinds of gas development projects that may become qualified projects under the Alaska Stranded Gas Development Act", is sufficiently broad to allow gas-to-liquids to be added to the definition of "qualified project" under the measure's bill section 9. This definition of "qualified project" operates with respect to AS 43.82, the Stranded Gas Development Act, but not necessarily as to the tax relief and other provisions that constitute the remainder of the measure. The definition of "Alaska North Slope natural gas project," set out at page 6, lines 5 - 9 of the bill, is more generally applicable to this measure. This definition speaks in terms of a project "to transport natural gas," so conversion of gas to liquid for purposes of its transportation may not technically fit the language of that key definition.

This is a bill that is being considered in its house of origin. You may conform -- by broadening or narrowing -- the measure's title to cover the content of the bill as the committee may choose to redraft it.

JBC:bjc
02-044.pjc

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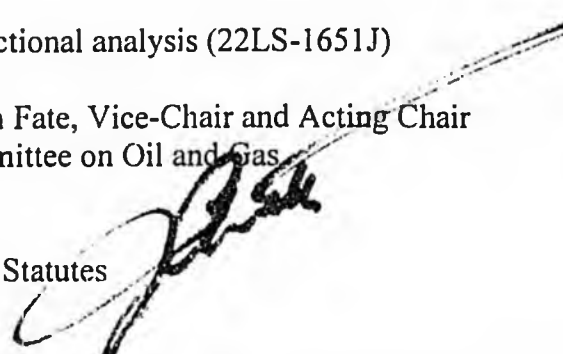
MEMORANDUM

April 18, 2002

SUBJECT: House Bill 519 -- sectional analysis (22LS-1651J)

TO: Representative Hugh Fate, Vice-Chair and Acting Chair
House Special Committee on Oil and Gas

FROM: Jack Chenoweth
Assistant Revisor of Statutes



House Bill 519 amends various statutes in furtherance of the construction and operation of the Alaska North Slope natural gas project. For purposes of the bill, the project is identified, in proposed AS 38.35.240(b), added by sec. 2 of the measure, as

[the] project [that] has the meaning given to "North Slope natural gas pipeline" in AS 38.35.120(a)(1)(B), and related facilities, constructed to follow generally a route that parallels the Trans Alaska Pipeline System and the Alaska Highway to the Canadian border to transport natural gas derived from the area of the state lying north of 64 degrees North latitude.

Bill section 1, an uncodified provision, sets out a set of findings and intent for the measure.

Bill section 2. This bill section amends AS 29.45.030(a), adding oil and gas related property to the general municipal tax exemption.¹ The exemption that is added by this

¹ The addition of new paragraph (10) mentions "property exempted from municipal taxation under AS 43.55.017, AS 43.56.020, or [AS] 43.56.030." The texts of AS 43.56.020 and 43.56.030 are set out later in the bill. The text of AS 43.55.017 reads:

Relation to other taxes. (a) Except as provided in this chapter, the taxes imposed by this chapter *[the oil and gas production taxes and associated surcharge -- generally, the "severance" tax]* are in place of all taxes now imposed by the state or any of its municipalities, and neither the state nor a municipality may impose a tax upon

- (1) producing oil or gas leases;
- (2) oil or gas produced or extracted in the state;

Representative Hugh Fate

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bill section is *not* limited to property or production associated with the Alaska North Slope natural gas project. Inclusion of this provision, I note, is not covered in the title for the bill as introduced; if the provision is retained, the bill title should be amended.

Bill section 3. This provision adds a new section to the Alaska Right-of-Way Leasing Act, AS 38.35, defining the "project" and directing state officials and agencies to take expedited action for the project "consistent with the provisions of the law administered by the official or agency, by issuing or granting necessary permits, certificates, authorizations, and similar actions required to be taken at the earliest practicable date."

AS 43.56.020(a) exempts from *local* property taxation under the 20-mill property tax certain property used in the exploration, production, and pipeline transportation of oil and gas property. **Bill section 4** extends that tax exemption to an interest in property used in the project for a period that begins on the project's construction commencement date and runs through December 31 of the second full calendar year after the project is placed in service. The exemption is conditioned upon the project's complying with the requirements of new AS 43.56.020(d), set out in bill section 6.

AS 43.56.020(b) exempts from *state* property taxation under the 20-mill property tax certain property used in the exploration, production, and pipeline transportation of oil and gas property. Like the preceding provision, **bill section 5** extends that tax exemption to an interest in property used in the project for a period from the project's construction commencement date to December 31 of the second full calendar year after the project is placed in service. The exemption is conditioned upon the project's complying with the requirements of new AS 43.56.020(d), set out in the next following bill section.

Bill section 6. This provision adds a new subsection setting out conditions under which the tax exemptions provided under the preceding two bill sections may operate. To gain the benefit of the exemptions, the taxpayer or project sponsor, or the contractor of one of them, must meet each of the six requirements identified in the subsection.

AS 43.56.030 asserts that the taxes that are levied under the 20-mill property tax of AS 43.56 are levied in place of all other ad valorem taxes on property subject to the tax and all taxes that may be levied by a municipality on property subject to the tax. As a limited exception, existing law allows a municipality to levy and collect a limited sales and use tax on sales or use of goods and services in conjunction with the taxable property

(3) the value of intangible drilling and exploration expenses.

(b) The taxes imposed by this chapter are in place of all taxes imposed by a municipality upon oil or gas in place or nonproducing oil or gas leases or properties.

(c) The taxes imposed by this chapter are not in place of the tax imposed by income taxes, franchise taxes, or taxes upon the retail sale of oil or gas products.

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up to "the first \$1,000 of each sale". The amendment set out in **bill section 7** deletes that limited exception for taxable property used or committed by contract to the project.

Taxable property subject to AS 43.56 becomes subject to the 20-mill levy on and after the "construction commencement date." The existing language defining "construction commencement date" contemplates the Trans Alaska Pipeline System project for exploration, production, and pipeline transportation of crude oil. The amendment made by **bill section 8** limits that definition as it applies to the TAPS oil pipeline and revises the definition as applicable to the natural gas pipeline project.

Bill sections 9 and 10 amend provisions of the Alaska Stranded Gas Development Act (AS 43.82).²

The amendment made in **bill section 9** amends the definition of "qualified project" for which the provisions of that Act may operate by adding the natural gas pipeline project.

The amendment made by **bill section 10** extends the deadline under which the Alaska Stranded Gas Development Act may operate; the deadline in existing law has already passed.

Bill section 11 declares that the amendments proposed in bill sections 9 and 10 are retroactive to the day following the deadline for applications under the Alaska Stranded Gas Development Act as set out in existing law.³

Bill sections 12 and 13 are effective date provisions. **Bill section 12** makes provisions applicable to taxation effective January 1, 2003. **Bill section 13** gives the remainder of the bill an immediate effective date.

JBC:pjc
02-045.pjc

² The Alaska Stranded Gas Act, a 1998 enactment, authorizes the commissioner of revenue to negotiate proposed contracts with private entities for the commercialization of natural gas resources. The contracts, which require future legislation to become binding, may propose periodic payments in lieu of certain taxes and other payments, as well as other terms to induce stable fiscal policies to encourage development of natural gas resources. The Act sets out procedures under which an application may be considered. Under existing law, applications would have had to be filed by June 30, 2001, and is limited to use in development of a project "for the export of liquefied natural gas (LNG)."

³ Inclusion of the provision is made consistent with AS 01.10.090:

Retrospective statutes. No statute is retrospective unless expressly declared therein.

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB 519
 () Publish Date: _____
 Dept. Affected: Natural Resources
 BRU: Oil and Gas Developmen
 Component: Oil and Gas Developmen
 Component Number: 439

Revision Date/Time (Note if correction): _____
 Title: Natural Gas Pipeline: Special Provisions
 Sponsor: House Rules Committee
 Requester: House Oil and Gas

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services	<i>See Note on Page 2:</i>					
Travel	40.0	40.0				
Contractual	125.0	125.0				
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	165.0	165.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()			*See Below			
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	40.0	40.0				
1005 GF/Program Receipts						
1037 GF/Mental Health						
1108 Stat. Des. Prog. Receipts	125.0	125.0				
TOTAL	165.0	165.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2002) cost: none

Check this box (X) if funding for this bill is included in the Governor's FY2003 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill, in reviving the Alaska Stranded Gas Development Act, allows the state, with the concurrence of its North Slope oil and gas lessees, to: (1) establish a valuation methodology for the state's royalty share of gas production, and (2) modify existing requirements regarding the timing and notice of the state's right to take royalty in-kind or in-value.

Continued on next page.

Prepared by: Bonnie Robson Phone 269-8800
 Division: Oil and Gas Date/Time 18-Apr-02
 Approved by: Pat Pourchot Date 18-Apr-02
 Agency: Natural Resources

ANALYSIS: (continued)

* HB 519, by extending the Stranded Gas Act, authorizes negotiations to "establish" a valuation method for the state's royalty share of gas production from an approved qualified project. Actually, a valuation methodology already exists in the state's oil and gas leases. Generally, that methodology requires the payment of royalties on the highest of: (1) the market value of the gas; (2) the lessee's actual proceeds from the sale of its own gas; or (3) an average of the actual proceeds of other proximate lessees from the sale of their own gas. Consequently, any valuation methodology agreed to through negotiations conducted under HB 519 may result in the collection of lower royalties than would be available under the existing valuation methodology. In fact, every \$0.01 difference in royalties due under alternative valuation methodologies results in a \$36.5 million impact on the state treasury over 20 years for a 4 bcfd pipeline, and a \$54.7 million impact for a 6 bcfd pipeline. However, it is impossible to determine at this time whether a new valuation methodology would be agreed to under HB 519 and, if so, whether and to what extent it would reduce royalty payments to the state.

DNR estimates that HB 519, if passed, would require at least \$330,000 in expenditures to address any application to "establish" a royalty valuation method, \$250,000 of which would be reimbursed over a 2-year period by the applicant for change in methodology. DNR will need to obtain access to and review extensive documentation pertaining to the economics of any proposal, then engage in complex negotiations with multiple sophisticated oil and gas corporations. This effort will require diversion of existing and proposed staff from their currently assigned duties, the retention of one or more experts, and travel. Currently, we anticipate that much of the work envisioned by this bill would fall on the Division's Petroleum Investments Manager, Petroleum Market Analyst, and a Commercial Analyst, as well as an additional Pipeline Commercial Analyst, requested in the FY03 budget. One or more experts would need to be retained to assure that royalty relief is not inadvertently or imprudently given, though the cost of that expert or those experts is to be borne by the applicant. Finally, significant sums would be needed for travel and document reproduction and indexing expenses.

The cost of the independent consultants allowed under AS 43.82.240 to assist in the evaluation of a request to change the royalty valuation methodology could be reimbursed by the applicant. The statute allows the state to condition any contract on agreement by the applicant to reimburse the state for the expenses of the independent contractors. Those funds are requested as authority to receive and expend statutorily designated program receipts. Those costs are \$125,000 each in Fiscal 2003 and Fiscal 2004.

NOTE:

The estimated costs are split into two years for purposes of this fiscal note, however it is difficult to determine how much would actually be required in each year. The solution is to fund the full amount (\$330,000) as a single appropriation with a two-year lapse date.

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB519
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Natural Gas Pipeline BRU Administration and Support
Special Provisions Component Office of the Commissioner
 Sponsor House Rules Committee
 Requester House Oil and Gas Committee Component No. 123

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services	83.0	83.0				
Travel	30.0	30.0				
Contractual	250.0	250.0				
Supplies	5.0	5.0				
Equipment	6.0					
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	374.0	368.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()			(1,000.0)	(22,000.0)	(35,000.0)	(53,000.0)
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	124.0	118.0				
1005 GF/Program Receipts						
1037 GF/Mental Health						
Statutorily Designated Receipts	250.0	250.0				
TOTAL	374.0	368.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2002) cost: 0.0
 Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

See attached pages.

Prepared by: Larry Persily, Deputy Commissioner Phone 465-5469
 Division Department of Revenue Date/Time 4/18/02 12:34 PM
 Approved by: Wilson Condon, Commissioner Date 4/18/2002
 Agency Department of Revenue

HB 519
Department of Revenue

OVERVIEW

This legislation would reauthorize the Alaska Stranded Gas Development Act under AS 43.82. The act expired June 30, 2001, and this legislation would extend the application date for a project sponsor from June 30, 2001 to June 30, 2005.

The Stranded Gas Development Act, adopted by the 1998 Legislature, authorized the Commissioner of Revenue to negotiate a contract for payments in lieu of taxes with the developer of an LNG project to commercialize Alaska's North Slope natural gas reserves. No project sponsor applied under the act before it expired last year. The intent of the legislation was to provide a mechanism whereby the state could help promote commercialization of its natural gas reserves by structuring payments in lieu of taxes to help relieve the burden on a project sponsor in the early years, when cash flow is not positive, and in return receive a larger share of the revenues in later years after the project sponsor had recovered its heavy development costs. This also would allow the state to receive a greater share of the revenues in later years if gas prices increased.

The act allows for a negotiated contract for payments in lieu of one or some or all of the following taxes:

- Production taxes and surcharges
- Oil and gas production property taxes (state and municipal portions) under AS 43.56)
- Municipal property taxes
- Municipal special assessments
- Corporate income taxes
- Municipal sales and use taxes

This legislation (HB 519) also expands the definition of a qualifying project under the Stranded Gas Act to include a natural gas pipeline to serve markets outside Alaska. In addition, this legislation clarifies the definition of a qualifying LNG project to include one that serves Lower 48 states or overseas markets.

A negotiated contract would make it possible to tailor the fiscal arrangements to meet the needs of the proposed project while, at the same time, ensuring that the public benefits from the project. A set of arrangements providing for contractual payments in lieu of taxes could provide fiscal terms that potential investors will believe are likely to remain permanently in place over the life of the project.

HB 519
Department of Revenue

COST OF LEGISLATION

The fiscal note for this legislation includes the following costs and assumptions leading up to the costs:

- We assume the state would receive a project application early in Fiscal 2003.
- Negotiating the contract for payments in lieu of taxes would start immediately, and would be completed at the conclusion of the 2004 legislative session.
- Project construction would start in Fiscal 2005 and continue through Fiscal 2008.
- Natural gas production would start in Fiscal 2009.
- A special assistant to the commissioner would be hired for Fiscal 2003 and 2004 to coordinate the Department of Revenue's work with the project sponsor and the affected communities.
- Travel, supplies and equipment costs would be associated with the new position and with the department's overall effort to meet with the project applicant and officials of the affected communities.
- The contractual expenses would be incurred in two areas:
 1. Oil and gas economic and tax consultants to advise the department in negotiating with the project applicant and structuring a contract for payment in lieu of taxes that is both advantageous to the project and provides for a fair return to the state on the publicly owned resource.
 2. Additional consultants to help the department prepare socioeconomic impact studies on the affected communities, to be used in determining the financial needs of the communities and negotiating with the project applicant.

The cost of the new position, travel, contractual and supplies is requested from the general fund. That total is \$116,000 in Fiscal 2003 and \$110,000 in Fiscal 2004.

The cost of the independent consultants allowed under AS 43.82.240 to assist in the department's evaluation of the project application and in developing terms of the contract could be reimbursed by the applicant. The statute allows the commissioner to condition the contract on agreement by the applicant to reimburse the state for the expenses of the independent contractors. Those funds are requested as authority to receive and expend statutorily designated program receipts. Those costs are \$250,000 each in Fiscal 2003 and Fiscal 2004.

HB 519
Department of Revenue

PROPERTY TAX WAIVER

Although the Stranded Gas Development Act calls for the commissioner to negotiate a contract for payments in lieu of taxes, including property taxes, Sections 4 and 5 of this legislation waive all state and municipal property taxes on the project during construction and the first two full years of project operation. This would be imposed upon the municipalities, which would not have any option in accepting or rejecting the property tax waiver.

The Department of Revenue believes it is premature to waive an estimated \$500 million in state and municipal property taxes without first determining if the tax relief would in fact be needed to make the project economical.

The Stranded Gas Act allows tax relief or deferral, but the explicit mandate of the Stranded Gas Act was to tailor the state's fiscal terms to the particular economics of the project and to maximize the benefit to the people of the state from the development. For example, the Stranded Gas Act enables the state to give tax relief where needed to make the project economic, but then recoup its foregone revenue — or more — when the project economics improved.

Under this bill, however, the state would get nothing in exchange for property tax relief. What happens if the price of gas goes up to \$5 or more per mcf? The project developers would profit enormously from the upside, and the state would lose out on sharing in that additional profit potential as "repayment" for any tax relief granted early in the development. Yes, the legislature could then raise taxes, but this is not the fiscal certainty that the state and potential project sponsors seek from this legislation.

The department strongly recommends a change in the property tax waiver provision of this legislation to (1) include an opportunity for the state to share in the potential benefits from a highly profitable project as part of the package for any tax relief, (2) provide an opportunity for the affected communities to participate in the tax relief discussions, and (3) a needs test for the tax relief.

HB 519

Department of Revenue

DECREASE IN STATE and MUNICIPAL REVENUES

Under Sections 4 and 5 of this legislation:

- The state would lose an estimated \$212 million in property tax revenues during construction and through the second full year of project operation.
- The Fairbanks North Star Borough and North Slope Borough would lose an estimated \$302 million in property tax revenues during construction and through the second year of production.
- Although the state and the municipalities would never receive this property tax revenue if the project is not built, there is no opportunity to determine whether the tax relief provided by this bill is needed to make the project economic.
- This bill does not provide a mechanism to provide funding to affected municipalities that experience additional costs because of the impact of the project on the community.
- The above estimates are based on a natural gas project carrying North Slope gas to Alberta, for distribution to markets in the Lower 48 states. The estimate of lost revenues would be different and would include additional municipalities if the project was an LNG line to tidewater at Valdez or Cook Inlet.
- The affected municipalities would face higher expenses during the influx of construction workers and the resulting demand for increased school, police, road and various other public services. Meeting those demands without the ability to tax the project itself would put a severe strain on local resources.
- One option for localities would be raise property taxes on all other property within their jurisdiction. The state's share of property taxes on the Trans-Alaska Oil Pipeline and other oil and gas facilities already in place is reduced dollar for dollar by property taxes paid to local communities. Therefore increased municipal property taxes in the affected municipalities would reduce the state's oil and gas property tax receipts.

Section 7 of this legislation would exempt the natural gas project from municipal sales and use taxes. The department is unable to estimate the fiscal impact of this provision on municipalities.

Alaska State Legislature

House of Representatives

RULES COMMITTEE, CHAIR
COMMITTEE ON COMMITTEES
LABOR & COMMERCE COMMITTEE
MILITARY & VETERANS AFFAIRS
LEGISLATIVE COUNCIL



INTERIM:
10928 EAGLE RIVER RD., SUITE 141
EAGLE RIVER, AK 99577

SESSION:
ALASKA STATE CAPITOL
JUNEAU, AK 99801

House Bill 519 Sponsor Statement Version: 22-LS1651V

The time has come for Alaska to engage in the development of a natural gas pipeline. With declining production from Alaska's large oil fields, the scaling back in exploration efforts by some of Alaska's largest producers, apparent substantial delays in any work that might come from exploration and hopefully production on the coastal plain of ANWR, layoffs of oil industry employees, and problems in other resource industries such as fishing, mining, and timber. The gas pipeline offers the only hope for substantial near-term work for Alaska's oil and support industries. In our fiscal crisis, it is imperative the legislature enact legislation this session to encourage construction of a natural gas pipeline before this opportunity for our economy disappears for perhaps another decade or longer.

HB 519 provides an encouragement to the producers that helps diminish the huge risks in this largest of construction projects. In exchange, it also contains provisions, important to the State of Alaska, as conditions for obtaining the benefit of such incentive, such as the pipeline follow the "southern" route, and provisions for Alaska hire, buy, and build. Of course, the major benefits to the State, if this incentive results in construction of the line, will be a substantially positive effect on the economy with jobs and construction activity, and taxes and royalties from the production and sale of natural gas. These benefits may never come to be, or may not come from decades, if this window of opportunity is missed.

HB 519 offers an incentive in temporary relief from the ad valorem tax that would be imposed on the pipeline for the period, from before construction through the second year of commercial operations. This would provide tax relief in an important period of the project when a large amount of cost is experienced but no income is yet being generated, and early into commercial operations of the project. The project entails very substantial financial risk as to price, and the cost of this mega-project through a federal income tax credit. This would provide important risk protection, but possibly leave the project developers at risk for project construction cost overruns. The tax relief in HB 519 could provide a means of reducing one element of the costs during construction and thereby reduce the risk. This would not effect any other taxes or royalties the state collects. After the relief period has expired, the State and local governments will have a natural gas pipeline upon which to collect property taxes. If the project does not go forward, these - benefits to the State will not be realized.

The gas pipeline must be constructed along the "southern" route. All the companies involved in the engineering, construction, and operation of the pipeline must pledge their best effort to hire Alaskans, buy from Alaskans, and build facilities in Alaska.

HB 519 also reopens the Alaska Stranded Gas Development Act, AS 43.82, enacted in 1998. It contains important provisions regarding Alaska hire and contracting with Alaska businesses, making gas available to meet reasonably foreseeable demand for in-state use, and provides a mechanism for the state and project sponsors to reach agreement or clarify certainty on fiscal terms and on other issues important to the parties.

HB 519 has the advantages of offering an incentive rather than threatening a disincentive. It will demonstrate that the State wants a natural gas pipeline to be constructed, is prepared to help this risky and enormous project be less risky, and will work with the current producers to their and the State's mutual advantage. At least one producer has indicated a willingness to go forward if the State makes this showing.



Representative Pete Kott

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VECO Corporation, Inc.
3601 C Street, Suite 1000
Anchorage, Alaska 99503

Testimony of Bill Allen
Before the House Oil and Gas Committee Hearing (HB 519)
April 19, 2002

Thank you Mr. Chairman and members of the committee.

For the record my name is Bill Allen, I am Chairman and CEO of VECO Corporation, an Alaskan company with its headquarters in Anchorage.

Before I begin, I would ask the committee to please bear with me. Because of an accident I suffered last summer, my speech is sometimes broken and I must speak slowly. I will do my best, and submit written testimony to fill in any gaps.

With your permission I will have my Vice President Rick Smith read my testimony. These are my words, but it will go much quicker if Rick reads them for me.

Testimony:

Mr. Chairman, and members of the committee, it is a pleasure to be here with you today and I appreciate the opportunity to speak with you on an issue of utmost importance to Alaska.

I know each of you personally. Over the years, we have had the chance to work together on many issues important to Alaskans. Creating jobs and local hire, improving education, encouraging business and economic development – to name just a few.

I'm here today to tell you that, in my opinion, no single issue is more important to Alaska's future – than the legislation you now have before you.

Alaska is truly at a cross-roads. Many of our traditional industries are struggling – often through no fault of their own. Our oil resources are declining, our timber, mining and fishing industries are on the ropes – because of factors largely beyond their control.

But the bottom line is that as those traditional mainstay Alaskan industries struggle – Alaska struggles – and Alaskans find themselves out of work and unable to provide for their families.

Testimony of Bill Allen
· VECO Corporation, Inc.
House Oil & Gas Committee
4/19/02

In addition, as our state's economy shrinks, so does your ability to ensure better schools, better communities and a better quality of life for all Alaskans.

Mr. Chairman, I believe the legislation before you offers an opportunity for Alaska to control its own destiny. We know that the North Slope has enough proven reserves of natural gas to fill a pipeline to capacity for the next 50 years. 35 trillion cubic feet – and that's just the known reserves. Estimates suggest there may be much more – perhaps enough to keep the pipeline – and the jobs and revenues it will create – operating for the next 100 years.

Unfortunately, before Alaska can realize any of those benefits, a pipeline must be built.

A few years ago, like most Alaskans I was enthusiastic about the prospects for the gas line. With prices soaring – it looked as if the pipeline was just around the corner.

Well, we all know what happened next. Just as quickly – prices dropped – and the economics suddenly changed.

After months of study, it's now clear that without some economic incentives, private industry is not going to be willing to risk the billions of dollars necessary to construct the gas line at this time. The project simply does not math out at current and foreseeable prices -- unless some of the construction and start-up risks are offset.

We know that we have some of the largest known gas reserves in the world. We know that we have reliable, private sector partners who can help Alaska develop and market our vast, untapped resource.

But we also know that Alaska is not the only place in the world where natural gas exists. And as with our other industries, international competition increases every year.

I guess more than anything, I am here today to urge you to act quickly to seize a unique opportunity that can help ensure Alaska's future.

I believe the window of opportunity is still open – if we act now to help make this project a reality. I also strongly suspect that if that window shuts – it may never open again.

In the past several weeks, I have talked with senior officials from the production companies. They have indicated a willingness to proceed providing federal and state legislation is passed to help offset some of the project's tremendous risk. They also seek reasonable assurances of stability in our tax and economic climate.

In that regard, for the past several months members of our Congressional delegation have worked hard to enact federal incentives to help make the gas line a reality. But as with

Testimony of Bill Allen
VECO Corporation, Inc.
House Oil & Gas Committee
4/19/02

any Alaska resource development issue, they are fighting a difficult uphill fight – and they need our help.

Last week Senator Murkowski called me and said that opponents of the gas line are now pointing out the absence of state action on the issue – and using that point to try to defeat our delegation's efforts in D.C. “If Alaska does not care enough to offer incentives,” they say, “why should we?”

Senator Murkowski and the rest of our delegation have indicated that passage of HB 519 will go a long way toward demonstrating Alaska's commitment to this project. It will send a clear signal to Washington and the producing companies that Alaska is ready to step up to the plate and invest, along with them, in Alaska's future.

I have been asked what this legislation will cost Alaska. My answer has been very simple. Absolutely nothing. Because without this legislation, the gas line will likely never be built.

You can't tax something that doesn't exist.

So any taxes potentially deferred by this legislation – would never have been realized anyway.

On the other hand, I believe the true cost to Alaska – lies in doing nothing. If this legislation does not pass, and the gas line is not built, what will that cost Alaska?

The gas line will create thousands of new jobs and billions in new revenue and economic activity. It can help provide a stable economic climate for Alaska at least well into this century – and long after you and I are gone.

At a time when Alaska is desperately seeking new economic opportunities – I suggest to you – that the best opportunity is very close at hand, if we will simply reach out and grasp it.

Thank you again for the opportunity to testify. I would be happy to answer any questions you may have.

Testimony of Ken Konrad
Senior Vice President - BP Exploration (Alaska) Inc.

House Oil & Gas Committee
Friday, April 19, 2002

My name is, Ken Konrad, Vice President Gas for BP Exploration (Alaska) Inc. I am here this morning to testify in support of HB 519.

Creating a supportive government framework is an essential ingredient toward developing a successful ANS gas project. An international project of this magnitude brings many inherent risks. Governments, working constructively with industry, can play a major role in reducing these risks by setting clear and predictable rules under which a project would be undertaken.

BP, with our partners, has previously laid out key government actions that would facilitate future investment on this massive undertaking. Specifically –

- A clear and efficient US federal regulatory process. Progress is being made with Alaska gas provisions currently part of the pending US Senate energy bill.
- An efficient and predictable Canada / First Nations regulatory process. BP remains very active working in Canada to establish such a process and progress is being made.
- A simple, clear, and predictable fiscal framework in Alaska such that the massive long payout investments being contemplated can be undertaken with the knowledge that the rules won't change.

HB 519 would be a positive step toward achieving the necessary fiscal framework in Alaska. The bill is modeled after HB 393, which was passed in 1998. As we did in 1998, we continue to support the content and approach inherent in the Stranded Gas Act, which this legislation refreshes, updates, and makes available for a gas pipeline project.

HB 519 and the Stranded Gas Act would:

- Demonstrate leadership and an intent by the legislature to provide stable fiscal terms that encourage development of ANS gas while fully and fairly compensating the people of the state.
- Establish a protocol, beginning with an application, and followed by a process to exchange information between investors and the state.

- Empower the state to enter into a contract negotiation to achieve clear and simple tax and royalty terms. These terms would need to be subsequently approved by both the executive branch and the legislature.
- Provide a process with the state and investors while providing for municipal input.
- Provide for contract review, approval, and termination provisions, inclusive of municipal input, legislative authorization, and judicial review.
- Provide for prioritization of state agency support for a qualifying project.

In aggregate, it would set out a thoughtful and workable framework to work through important fiscal issues subject to subsequent approval by the legislature.

The bill also encourages Alaska hire, training, and purchasing. BP has and continues to support the use of in-state capability. However, some technical modifications should be considered to ensure the bill's language does not draw legal challenge.

Passage of HB 519 would send a positive message to investors and provide a framework to achieve fiscal clarity and predictability. BP is fully supportive.

Thank you. I would be happy to answer any questions at this time.

Phillips Petroleum Company
House Oil and Gas Committee April 19, 2002
HB-519 Testimony

Good morning Mr. Chairman, and members of the Committee. For the record, my name is Joe Marushack. I am Vice President of ANS Gas Commercialization for Phillips Alaska. My primary responsibility is the development of Phillips' ANS gas resources and Phillips' is committed to achieving our goal in a timely and economic fashion. We appreciate the opportunity today to testify in support of HB-519.

As you know, we have been focusing this year on those areas that we believe are most likely to result in an economically viable gas pipeline project to the Lower 48. We have completed our joint analysis of the work the producers initiated last year and will be setting up a time to brief you on the results of that work. For the past several months however, most of Phillips gas emphasis has been directed at the federal level to achieve congressional legislative changes to advance the project. These include:

1. New Federal Legislation that creates permitting certainty. I believe you are well aware of the current federal legislation in the Senate Energy bill.
2. A Federal tax mechanism that would help mitigate the unacceptable market risk of a project of this magnitude. I understand you are aware of current drafts of this mechanism that provides down-side mitigation but also provides for repayment of any credit if used, and that is currently assessed by the U.S. government as having a zero cost. This piece of legislation is in Phillips' view a most critical element in moving our project forward. It shares the benefits the Lower 48 consumers will see from ANS gas coming to market while addressing the risk inherent in such a large and costly project.

Given achievement of the federal legislation (at this point it is not a certainty), it is important to the economic viability of the project to progress fiscal matters at the state level.

Fiscal matters include fiscal certainty, and what we really mean is that we need to know, with a fair degree of specificity, how our taxes and royalties will be calculated and administered. We would also like to address potential opportunities to gain assurance that those taxes and royalties won't change once we've made our investment. We also believe that strategic participation by the State in mechanisms to improve the economic viability of the project are important.

While there may be a need for minor clarifying language, we are encouraged by the committees' consideration of HB-519 that proposes both a temporary property tax abatement and the revival of an existing statutory process by which pipeline project sponsors can work with the state to gain the kind of fiscal certainty and clarity which will reduce the risks and help the project move forward. The temporary property tax abatement is an important signal to the US Congress that Alaska has stepped up to try to make a project happen. By itself, an ad valorem holiday is not of sufficient size that it can singularly make a challenged project economic. However it is an important step in a series that along with other actions at the state and federal level, and potential technological improvements, can reduce the risks and improve the economics of the project.

Thank you for this opportunity to testify today and express our support of HB-519. I'll be happy to try to answer any questions you may have.

ALASKA STATE CHAMBER OF COMMERCE

Testimony on HB 519
by Pamela LaBolle

Good morning, I am Pam LaBolle, President of the Alaska State Chamber of Commerce. The Alaska State Chamber represents 35 local chambers and 700 businesses, most of whom are small businesses deeply concerned with the economic future of Alaska. As the Voice of Alaska Business and the leading advocate for business headquartered here in Juneau, we always appreciate the opportunity to address bills of importance to the economic development of the state. Our legislative priorities are developed at the grassroots level by our membership through a several month long process of proposal, review and debate. Our top five priorities include urging the legislature and the governor to encourage the producers to proceed with development of a southern gas line route through Alaska.

The Chamber speaks in favor of HB 519 and urges its passage. Alaska absolutely needs a gas pipeline. For our members to have their businesses thrive or even just stay viable Alaska's resources must be developed. It sometimes seems that people outside our state have a much greater say in what happens in our state than we do. With the defeat of ANWR in Congress just yesterday, there are no other large developments on the horizon that will spur the growth of our economy in the near term. Our executive committee meets monthly around the state often in smaller communities. As a result, we are very concerned about the state's economy. What is the state doing to encourage economic growth, to try to have a hand in our own destiny.

While the final results of the producers' study haven't been released yet, it should be apparent to everyone that this is a project of enormous cost and risk. The state and local governments would benefit greatly for years to come if we can encourage the producers to take the risks inherent in this huge project and develop the North Slope gas resources by building a project through Alaska. The temporary tax exemption provided by this bill should be looked upon as an investment by the state and municipalities to encourage the producers to go forward with a project that will create jobs, benefit municipalities, spur economic opportunity for businesses and start a whole new industry - a gas industry. By revitalizing the Alaska Stranded Gas Development Act and having it apply to this project, the state and producers can create a contract that will assure tax clarity and certainty and protect vital interests of the state and affected municipalities. How often does the state have an opportunity to take such a bold step to encourage large-scale economic growth. Several states and cities around our nation have offered to businesses tax incentives to encourage them to invest. The state should be less concerned with perhaps giving away too much and more concerned with not missing a significant opportunity for economic growth, perhaps the only one in the next few decades. Thank you.

Testimony of David Marquez in support of HB 519
House Oil and Gas Committee
April 19, 2002

I am David Marquez. My address is 18546 Osprey Circle in Anchorage. I am an attorney in Anchorage and today I represent VECO Corporation, an Alaska company headquartered in Anchorage. I speak in support of HB 519 and urge its passage.

VECO Corporation is an engineering, construction, and oil and gas service company that has been active in the Alaska oil patch for several decades. It has also been a good employer and an active member of the greater Alaska community participating vigorously in philanthropic and community activities. VECO urges passage of this bill because it believes that Alaska desperately needs a gas pipeline for its economy. VECO has seen and experienced over the last 15 years, significant reductions in the oil industry workforce in this state with the most recent one being announced within the last few weeks by Alyeska Pipeline Service Company. Coincident with all these reductions have been the elimination of contractor positions staffed by employees of VECO. VECO needs a gas pipeline to keep its Alaska employees employed and hopefully even to increase its workforce.

Despite the high costs and risks of the huge project for the development and construction of the Alaska North Slope natural gas pipeline, VECO believes that it is still possible to achieve this dream. Some producers have indicated that work will continue when three legislative actions are taken: (1) federal enabling legislation (2) federal legislation that

helps reduce the risk of gas prices cycling to low levels and (3) Alaska legislation that provides both an incentive, and tax and royalty certainty and clarity. As to the federal legislation, some have questioned why any federal assistance should be provided if the state of Alaska is unwilling to step forward. HB 519 will send a clear signal that the state is willing to participate. It grants a temporary exemption to the project from local and state property taxation under the 20-mill property tax (AS 43.56) for a period from commencement of the project's construction through the first two years of operation of the pipeline. The bill calls for expeditious priority treatment by state officials and agencies in support of development and construction of the project.

The Bill puts back into action the Alaska Stranded Gas Development Act that expired last June. This legislation was enacted after very substantial effort by the legislature, the administration and the industry to encourage the development of an LNG project to commercialize Alaska North Slope Gas. HB 519 makes it applicable to a North Slope gas line as well as an LNG project and extends until June 2005 the deadline for filing an application for a contract with the State. Such a contract would be approved by the legislature and would contain provisions addressing the issues of tax and royalty clarity and certainty, and other fiscal issues important to the parties.

A little more on the temporary property tax exemption provided in the Bill. It does not apply to any taxes currently being collected so present revenues will not be affected by this bill. Only if a pipeline is built and the state enjoys the benefits of that development will the investment of this temporary tax exemption be made. It is temporary and lasts

only for the period of construction and the first two years of operations. At its expiration, if this Bill in fact encourages the producers and a pipeline is built, the state and local governments will have a pipeline on which to levy taxes for many years, a new industry - a gas industry - will have been created, in-state use of gas will be possible, and Alaskans will be employed. If it is not built, there will not be any of that.

Just a year or so ago when gas prices were very high, everyone thought the pipeline was just around the corner. Now reality has set in and the project's enormous costs and risks make it very doubtful that it will be built unless action is taken to keep the project alive. VECO together with Fluor performed the recent study for the producers. VECO recognizes the great risks involved with the project, but believes that if the state takes action to reduce the risks and costs, we can make it happen. There may be concern that this will be seen as a give away and that, instead, the state should negotiate with the gas owners before any incentives are given. VECO feels a great sense of urgency. If action is not taken this year, the only opportunity for a significant boost to the state economy may be lost. If we take a year or two or three to negotiate any incentives, the opportunity may be lost as the producers move on to other projects. There will be time in the coming years under the Alaska Stranded Gas Development Act to negotiate a total fiscal regime, but VECO believes concrete action must be taken this year to keep the project going.

Further, the Bill requires that the producers must meet certain conditions to be eligible for the temporary tax exemption. First, it must be a pipeline that follows the southern route. The Bill lists six other conditions, including compliance with the federal acts relating to

natural gas pipelines. Amendments to those acts that would be favorable to Alaska are being considered as part of the currently pending federal enabling legislation. Also included as requirements are Alaska hire, buy and build.

The Alaska Stranded Gas Development Act, which this bill reopens, provides the opportunity for tax and royalty certainty and clarity that will benefit both the state and the producers. The state and the oil owners were locked in long, costly and antagonistic disputes over issues relating to the determination of the taxpayers liability for severance tax and royalty. VECO has been informed that the producers strongly desire that such disputes be avoided as to gas and that the risk associated with tax and royalty uncertainty and lack of clarity is one more risk that burdens this already risky project. The Stranded Gas Act provides a good process for the state and producers to negotiate such clarity and certainty and in fact the opportunity to negotiate what fiscal regime would be in the long-term fiscal interest of the state, while accommodating affected municipalities, and the project sponsors under a wide range of economic conditions, potential project structures and marketing arrangements. The legislature retains the power to authorize execution of the contract. The Act gives the municipalities an important role through the formation of a municipal advisory group.

There has been testimony today that reflects basic agreement on certain issues. First, there is the recognition that some incentive will be necessary for this project. Second, there is acknowledgment that a property tax exemption would be the most leveraging of the available incentives. Where there is disagreement is at what point the incentive

should be granted. VECO feels strongly that the incentive should be granted now, and then negotiations between the state and producers can address the total fiscal regime that would apply.

In summary HB 519 is crucial and contains perhaps the only chance left to try to keep the possibility of a gas line project alive for the next few years or it may be decades before the opportunity arises again. VECO also wants to make it very clear that it does not consider this to be a producer bill. This is an Alaska bill that provides for a short-term investment by Alaska that will pay off in a project that could be shipping gas for a hundred years.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

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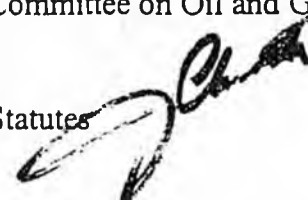
MEMORANDUM

April 18, 2002

SUBJECT: House Bill 519 -- response to inquiry (22LS-1651J)

TO: Representative Hugh Fate, Vice-Chair and Acting Chair
Attn: House Special Committee on Oil and Gas

FROM: Jack Chenoweth
Assistant Revisor of Statutes



To the question of the second paragraph of your Wednesday memo:

The second clause of the bill title, "expanding the scope for the kinds of gas development projects that may become qualified projects under the Alaska Stranded Gas Development Act", is sufficiently broad to allow gas-to-liquids to be added to the definition of "qualified project" under the measure's bill section 9. This definition of "qualified project" operates with respect to AS 43.82, the Stranded Gas Development Act, but not necessarily as to the tax relief and other provisions that constitute the remainder of the measure. The definition of "Alaska North Slope natural gas project," set out at page 6, lines 5 - 9 of the bill, is more generally applicable to this measure. This definition speaks in terms of a project "to transport natural gas," so conversion of gas to liquid for purposes of its transportation may not technically fit the language of that key definition.

This is a bill that is being considered in its house of origin. You may conform -- by broadening or narrowing -- the measure's title to cover the content of the bill as the committee may choose to redraft it.

JBC:pjc
02-044.pjc

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
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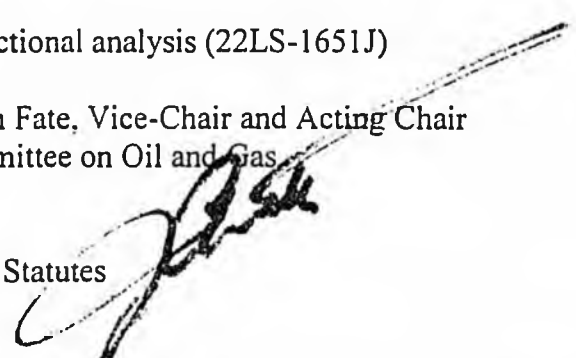
MEMORANDUM

April 18, 2002

SUBJECT: House Bill 519 -- sectional analysis (22LS-1651J)

TO: Representative Hugh Fate, Vice-Chair and Acting Chair
House Special Committee on Oil and Gas

FROM: Jack Chenoweth
Assistant Revisor of Statutes



House Bill 519 amends various statutes in furtherance of the construction and operation of the Alaska North Slope natural gas project. For purposes of the bill, the project is identified, in proposed AS 38.35.240(b), added by sec. 2 of the measure, as

[the] project [that] has the meaning given to "North Slope natural gas pipeline" in AS 38.35.120(a)(1)(B), and related facilities, constructed to follow generally a route that parallels the Trans Alaska Pipeline System and the Alaska Highway to the Canadian border to transport natural gas derived from the area of the state lying north of 64 degrees North latitude.

Bill section 1, an uncodified provision, sets out a set of findings and intent for the measure.

Bill section 2. This bill section amends AS 29.45.030(a), adding oil and gas related property to the general municipal tax exemption.¹ The exemption that is added by this

¹ The addition of new paragraph (10) mentions "property exempted from municipal taxation under AS 43.55.017, AS 43.56.020, or [AS] 43.56.030." The texts of AS 43.56.020 and 43.56.030 are set out later in the bill. The text of AS 43.55.017 reads:

Relation to other taxes. (a) Except as provided in this chapter, the taxes imposed by this chapter [*the oil and gas production taxes and associated surcharge -- generally, the "severance" tax*] are in place of all taxes now imposed by the state or any of its municipalities, and neither the state nor a municipality may impose a tax upon

- (1) producing oil or gas leases;
- (2) oil or gas produced or extracted in the state;

bill section is *not* limited to property or production associated with the Alaska North Slope natural gas project. Inclusion of this provision, I note, is not covered in the title for the bill as introduced; if the provision is retained, the bill title should be amended.

Bill section 3. This provision adds a new section to the Alaska Right-of-Way Leasing Act, AS 38.35, defining the "project" and directing state officials and agencies to take expedited action for the project "consistent with the provisions of the law administered by the official or agency, by issuing or granting necessary permits, certificates, authorizations, and similar actions required to be taken at the earliest practicable date."

AS 43.56.020(a) exempts from *local* property taxation under the 20-mill property tax certain property used in the exploration, production, and pipeline transportation of oil and gas property. **Bill section 4** extends that tax exemption to an interest in property used in the project for a period that begins on the project's construction commencement date and runs through December 31 of the second full calendar year after the project is placed in service. The exemption is conditioned upon the project's complying with the requirements of new AS 43.56.020(d), set out in bill section 6.

AS 43.56.020(b) exempts from *state* property taxation under the 20-mill property tax certain property used in the exploration, production, and pipeline transportation of oil and gas property. Like the preceding provision, **bill section 5** extends that tax exemption to an interest in property used in the project for a period from the project's construction commencement date to December 31 of the second full calendar year after the project is placed in service. The exemption is conditioned upon the project's complying with the requirements of new AS 43.56.020(d), set out in the next following bill section.

Bill section 6. This provision adds a new subsection setting out conditions under which the tax exemptions provided under the preceding two bill sections may operate. To gain the benefit of the exemptions, the taxpayer or project sponsor, or the contractor of one of them, must meet each of the six requirements identified in the subsection.

AS 43.56.030 asserts that the taxes that are levied under the 20-mill property tax of AS 43.56 are levied in place of all other ad valorem taxes on property subject to the tax and all taxes that may be levied by a municipality on property subject to the tax. As a limited exception, existing law allows a municipality to levy and collect a limited sales and use tax on sales or use of goods and services in conjunction with the taxable property

(3) the value of intangible drilling and exploration expenses.

(b) The taxes imposed by this chapter are in place of all taxes imposed by a municipality upon oil or gas in place or nonproducing oil or gas leases or properties.

(c) The taxes imposed by this chapter are not in place of the tax imposed by income taxes, franchise taxes, or taxes upon the retail sale of oil or gas products.

up to "the first \$1,000 of each sale". The amendment set out in **bill section 7** deletes that limited exception for taxable property used or committed by contract to the project.

Taxable property subject to AS 43.56 becomes subject to the 20-mill levy on and after the "construction commencement date." The existing language defining "construction commencement date" contemplates the Trans Alaska Pipeline System project for exploration, production, and pipeline transportation of crude oil. The amendment made by **bill section 8** limits that definition as it applies to the TAPS oil pipeline and revises the definition as applicable to the natural gas pipeline project.

Bill sections 9 and 10 amend provisions of the Alaska Stranded Gas Development Act (AS 43.82).²

The amendment made in **bill section 9** amends the definition of "qualified project" for which the provisions of that Act may operate by adding the natural gas pipeline project.

The amendment made by **bill section 10** extends the deadline under which the Alaska Stranded Gas Development Act may operate; the deadline in existing law has already passed.

Bill section 11 declares that the amendments proposed in bill sections 9 and 10 are retroactive to the day following the deadline for applications under the Alaska Stranded Gas Development Act as set out in existing law.³

Bill sections 12 and 13 are effective date provisions. **Bill section 12** makes provisions applicable to taxation effective January 1, 2003. **Bill section 13** gives the remainder of the bill an immediate effective date.

JBC:pjc
02-045.pjc

² The Alaska Stranded Gas Act, a 1998 enactment, authorizes the commissioner of revenue to negotiate proposed contracts with private entities for the commercialization of natural gas resources. The contracts, which require future legislation to become binding, may propose periodic payments in lieu of certain taxes and other payments, as well as other terms to induce stable fiscal policies to encourage development of natural gas resources. The Act sets out procedures under which an application may be considered. Under existing law, applications would have had to be filed by June 30, 2001, and is limited to use in development of a project "for the export of liquefied natural gas (LNG)."

³ Inclusion of the provision is made consistent with AS 01.10.090:

Retrospective statutes. No statute is retrospective unless expressly declared therein.

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB 519
 () Publish Date: _____
 Dept. Affected: Natural Resources
 BRU: Oil and Gas Development
 Component: Oil and Gas Development
 Component Number: 439

Revision Date/Time (Note if correction): _____
 Title: Natural Gas Pipeline: Special Provisions
 Sponsor: House Rules Committee
 Requester: House Oil and Gas

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services	See Note on Page 2:					
Travel	40.0	40.0				
Contractual	125.0	125.0				
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	165.0	165.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()			*See Below			
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	40.0	40.0				
1005 GF/Program Receipts						
1037 GF/Mental Health						
1108 Stat. Des. Prog. Receipts	125.0	125.0				
TOTAL	165.0	165.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2002) cost: none

Check this box (X) if funding for this bill is included in the Governor's FY2003 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill, in reviving the Alaska Stranded Gas Development Act, allows the state, with the concurrence of its North Slope oil and gas lessees, to: (1) establish a valuation methodology for the state's royalty share of gas production, and (2) modify existing requirements regarding the timing and notice of the state's right to take royalty in-kind or in-value.

Continued on next page.

Prepared by: Bonnie Robson Phone 269-8800
 Division Oil and Gas Date/Time 18-Apr-02
 Approved by: Pat Pourchot Date 18-Apr-02
 Agency Natural Resources

ANALYSIS: (continued)

* HB 519, by extending the Stranded Gas Act, authorizes negotiations to "establish" a valuation method for the state's royalty share of gas production from an approved qualified project. Actually, a valuation methodology already exists in the state's oil and gas leases. Generally, that methodology requires the payment of royalties on the highest of: (1) the market value of the gas; (2) the lessee's actual proceeds from the sale of its own gas; or (3) an average of the actual proceeds of other proximate lessees from the sale of their own gas. Consequently, any valuation methodology agreed to through negotiations conducted under HB 519 may result in the collection of lower royalties than would be available under the existing valuation methodology. In fact, every \$0.01/mcf difference in royalties due under alternative valuation methodologies results in a \$36.5 million impact on the state treasury over 20 years for a 4 bcf pipeline, and a \$54.7 million impact for a 6 bcf pipeline. However, it is impossible to determine at this time whether a new valuation methodology would be agreed to under HB 519 and, if so, whether and to what extent it would reduce royalty payments to the state.

DNR estimates that HB 519, if passed, would require at least \$330,000 in expenditures to address any application to "establish" a royalty valuation method, \$250,000 of which would be reimbursed over a 2-year period by the applicant for change in methodology. DNR will need to obtain access to and review extensive documentation pertaining to the economics of any proposal, then engage in complex negotiations with multiple sophisticated oil and gas corporations. This effort will require diversion of existing and proposed staff from their currently assigned duties, the retention of one or more experts, and travel. Currently, we anticipate that much of the work envisioned by this bill would fall on the Division's Petroleum Investments Manager, Petroleum Market Analyst, and a Commercial Analyst, as well as an additional Pipeline Commercial Analyst requested in the FY03 budget. One or more experts would need to be retained to assure that royalty relief is not inadvertently or imprudently given, though the cost of that expert or those experts is to be borne by the applicant. Finally, significant sums would be needed for travel and document reproduction and indexing expenses.

The cost of the independent consultants allowed under AS 43.82.240 to assist in the evaluation of a request to change the royalty valuation methodology could be reimbursed by the applicant. The statute allows the state to condition any contract on agreement by the applicant to reimburse the state for the expenses of the independent contractors. Those funds are requested as authority to receive and expend statutorily designated program receipts. Those costs are \$125,000 each in Fiscal 2003 and Fiscal 2004.

NOTE:

The estimated costs are split into two years for purposes of this fiscal note, however it is difficult to determine how much would actually be required in each year. The solution is to fund the full amount (\$330,000) as a single appropriation with a two-year lapse date.

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: HB519
() Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
Title Natural Gas Pipeline BRU Administration and Support
Special Provisions Component Office of the Commissioner
Sponsor House Rules Committee
Requester House Oil and Gas Committee Component No. 123

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services	83.0	83.0				
Travel	30.0	30.0				
Contractual	250.0	250.0				
Supplies	5.0	5.0				
Equipment	6.0					
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	374.0	368.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()			(1,000.0)	(22,000.0)	(35,000.0)	(53,000.0)
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	124.0	118.0				
1005 GF/Program Receipts						
1037 GF/Mental Health						
Statutorily Designated Receipts	250.0	250.0				
TOTAL	374.0	368.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2002) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

See attached pages.

Prepared by: Larry Persily, Deputy Commissioner Phone 465-5469
Division Department of Revenue Date/Time 4/18/02 12:34 PM
Approved by: Wilson Condon, Commissioner Date 4/18/2002
Agency Department of Revenue

HB 519
Department of Revenue

OVERVIEW

This legislation would reauthorize the Alaska Stranded Gas Development Act under AS 43.82. The act expired June 30, 2001, and this legislation would extend the application date for a project sponsor from June 30, 2001 to June 30, 2005.

The Stranded Gas Development Act, adopted by the 1998 Legislature, authorized the Commissioner of Revenue to negotiate a contract for payments in lieu of taxes with the developer of an LNG project to commercialize Alaska's North Slope natural gas reserves. No project sponsor applied under the act before it expired last year. The intent of the legislation was to provide a mechanism whereby the state could help promote commercialization of its natural gas reserves by structuring payments in lieu of taxes to help relieve the burden on a project sponsor in the early years, when cash flow is not positive, and in return receive a larger share of the revenues in later years after the project sponsor had recovered its heavy development costs. This also would allow the state to receive a greater share of the revenues in later years if gas prices increased.

The act allows for a negotiated contract for payments in lieu of one or some or all of the following taxes:

- Production taxes and surcharges
- Oil and gas production property taxes (state and municipal portions) under AS 43.56)
- Municipal property taxes
- Municipal special assessments
- Corporate income taxes
- Municipal sales and use taxes

This legislation (HB 519) also expands the definition of a qualifying project under the Stranded Gas Act to include a natural gas pipeline to serve markets outside Alaska. In addition, this legislation clarifies the definition of a qualifying LNG project to include one that serves Lower 48 states or overseas markets.

A negotiated contract would make it possible to tailor the fiscal arrangements to meet the needs of the proposed project while, at the same time, ensuring that the public benefits from the project. A set of arrangements providing for contractual payments in lieu of taxes could provide fiscal terms that potential investors will believe are likely to remain permanently in place over the life of the project.

HB 519
Department of Revenue

COST OF LEGISLATION

The fiscal note for this legislation includes the following costs and assumptions leading up to the costs:

- We assume the state would receive a project application early in Fiscal 2003.
- Negotiating the contract for payments in lieu of taxes would start immediately, and would be completed at the conclusion of the 2004 legislative session.
- Project construction would start in Fiscal 2005 and continue through Fiscal 2008.
- Natural gas production would start in Fiscal 2009.
- A special assistant to the commissioner would be hired for Fiscal 2003 and 2004 to coordinate the Department of Revenue's work with the project sponsor and the affected communities.
- Travel, supplies and equipment costs would be associated with the new position and with the department's overall effort to meet with the project applicant and officials of the affected communities.
- The contractual expenses would be incurred in two areas:
 1. Oil and gas economic and tax consultants to advise the department in negotiating with the project applicant and structuring a contract for payment in lieu of taxes that is both advantageous to the project and provides for a fair return to the state on the publicly owned resource.
 2. Additional consultants to help the department prepare socioeconomic impact studies on the affected communities, to be used in determining the financial needs of the communities and negotiating with the project applicant.

The cost of the new position, travel, contractual and supplies is requested from the general fund. That total is \$116,000 in Fiscal 2003 and \$110,000 in Fiscal 2004.

The cost of the independent consultants allowed under AS 43.82.240 to assist in the department's evaluation of the project application and in developing terms of the contract could be reimbursed by the applicant. The statute allows the commissioner to condition the contract on agreement by the applicant to reimburse the state for the expenses of the independent contractors. Those funds are requested as authority to receive and expend statutorily designated program receipts. Those costs are \$250,000 each in Fiscal 2003 and Fiscal 2004.

HB 519
Department of Revenue

PROPERTY TAX WAIVER

Although the Stranded Gas Development Act calls for the commissioner to negotiate a contract for payments in lieu of taxes, including property taxes, Sections 4 and 5 of this legislation waive all state and municipal property taxes on the project during construction and the first two full years of project operation. This would be imposed upon the municipalities, which would not have any option in accepting or rejecting the property tax waiver.

The Department of Revenue believes it is premature to waive an estimated \$500 million in state and municipal property taxes without first determining if the tax relief would in fact be needed to make the project economical.

The Stranded Gas Act allows tax relief or deferral, but the explicit mandate of the Stranded Gas Act was to tailor the state's fiscal terms to the particular economics of the project and to maximize the benefit to the people of the state from the development. For example, the Stranded Gas Act enables the state to give tax relief where needed to make the project economic, but then recoup its foregone revenue — or more — when the project economics improved.

Under this bill, however, the state would get nothing in exchange for property tax relief. What happens if the price of gas goes up to \$5 or more per mcf? The project developers would profit enormously from the upside, and the state would lose out on sharing in that additional profit potential as "repayment" for any tax relief granted early in the development. Yes, the legislature could then raise taxes, but this is not the fiscal certainty that the state and potential project sponsors seek from this legislation.

The department strongly recommends a change in the property tax waiver provision of this legislation to (1) include an opportunity for the state to share in the potential benefits from a highly profitable project as part of the package for any tax relief, (2) provide an opportunity for the affected communities to participate in the tax relief discussions, and (3) a needs test for the tax relief.

HB 519
Department of Revenue

DECREASE IN STATE and MUNICIPAL REVENUES

Under Sections 4 and 5 of this legislation:

- The state would lose an estimated \$212 million in property tax revenues during construction and through the second full year of project operation.
- The Fairbanks North Star Borough and North Slope Borough would lose an estimated \$302 million in property tax revenues during construction and through the second year of production.
- Although the state and the municipalities would never receive this property tax revenue if the project is not built, there is no opportunity to determine whether the tax relief provided by this bill is needed to make the project economic.
- This bill does not provide a mechanism to provide funding to affected municipalities that experience additional costs because of the impact of the project on the community.
- The above estimates are based on a natural gas project carrying North Slope gas to Alberta, for distribution to markets in the Lower 48 states. The estimate of lost revenues would be different and would include additional municipalities if the project was an LNG line to tidewater at Valdez or Cook Inlet.
- The affected municipalities would face higher expenses during the influx of construction workers and the resulting demand for increased school, police, road and various other public services. Meeting those demands without the ability to tax the project itself would put a severe strain on local resources.
- One option for localities would be raise property taxes on all other property within their jurisdiction. The state's share of property taxes on the Trans-Alaska Oil Pipeline and other oil and gas facilities already in place is reduced dollar for dollar by property taxes paid to local communities. Therefore increased municipal property taxes in the affected municipalities would reduce the state's oil and gas property tax receipts.

Section 7 of this legislation would exempt the natural gas project from municipal sales and use taxes. The department is unable to estimate the fiscal impact of this provision on municipalities.