

HB

16

HFIN

FILE

HOUSE COMMITTEE REPORT

(11)

Date Referred to Committee: March 3, 2003

FURTHER REFERRALS:

Date of Committee Action: 3/17/03

The FINANCE Committee considered:

HB 16

HOUSE BILL NO. 16

STRANDED GAS DEVELOPMENT ACT AMENDMENTS

"An Act amending the standards applicable to determining whether, for purposes of the Alaska Stranded Gas Development Act, a proposed new investment constitutes a qualified project, and repealing the deadline for applications relating to the development of contracts for payments in lieu of taxes and for royalty adjustments that may be submitted for consideration under that Act; and providing for an effective date."

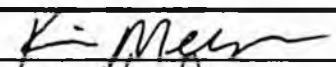
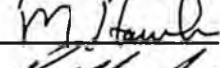

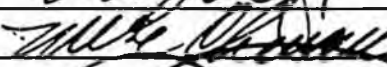

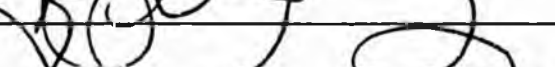
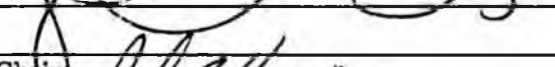
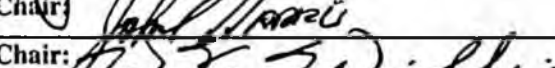
Recommends it be replaced with HCS or CS for HB 16 (FIN)
 For Senate Bills with new title: Technical Title New Title: HCR _____ Same Title New Title

- attach amendments
- add new referral to _____ Committee
- Letter of Intent _____ Committee

List of Abbrev for Depts.:
 ADM
 CED
 COR
 CRT
 EED
 DEC
 DFG
 GOV
 HSS
 LEG
 LAW
 LWF
 MVA
 DNR
 DPS
 REV
 DOT
 UA

| <u>NEW FISCAL NOTES</u> | | | | |
|-----------------------------------|------|--------|--------|------|
| *Assigned by Chief Clerk's Office | | | | |
| List by Dept(s): | *FN# | Fiscal | Indet. | Zero |
| REV | | ✓ | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

| <u>PREVIOUS FISCAL NOTES</u> | | | | |
|------------------------------|-----|--------|--------|------|
| List by Dept(s): | FN# | Fiscal | Indet. | Zero |
| CED | 1 | | | ✓ |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

| <u>Signing with recommendations</u> | Printed Last Name | DP | DNP | NR | AM |
|--|-------------------|----|-----|----|----|
|  | Mary Hawker | ✓ | | | |
|  | Hawker | ✓ | | | |
|  | Staltee | | | ✓ | |
|  | CROFT | | | ✓ | |
|  | Chenault | ✓ | | | |
|  | FOSTER | X | | | |
|  | Harris | ✓ | | | |
| Chair:  | Williams | ✓ | | | |

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: CS HB16 (RES)
() Publish Date: _____

Revision Date/Time (Note if correction): March 10, 2003 Dept. Affected: Revenue
Title: Stranded Gas BRU: Administration and Support
Development Act Amendments Component: Commissioner's Office
Sponsor: Representatives Fate and Whitaker
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 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 |
|------------------------|--------------|--------------|------------|------------|------------|------------|
| Personal Services | 89.5 | 89.5 | | | | |
| Travel | 25.0 | 25.0 | | | | |
| Contractual | 750.0 | 750.0 | | | | |
| Supplies | 2.0 | 2.0 | | | | |
| Equipment | 5.0 | 1.0 | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| TOTAL OPERATING | 871.5 | 867.5 | 0.0 | 0.0 | 0.0 | 0.0 |

| | | | | | | |
|-----------------------------|--|--|--|--|--|--|
| CAPITAL EXPENDITURES | | | | | | |
|-----------------------------|--|--|--|--|--|--|

| | | | | | | |
|-------------------------------|--|--|--|--|--|--|
| CHANGE IN REVENUES () | | | | | | |
|-------------------------------|--|--|--|--|--|--|

FUND SOURCE (Thousands of Dollars)

| | | | | | | |
|--------------------------------------|--------------|--------------|------------|------------|------------|------------|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | 121.5 | 117.5 | | | | |
| 1005 GF/Program Receipts | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| 1108 Statutorily Designated Receipts | 750.0 | 750.0 | | | | |
| TOTAL | 871.5 | 867.5 | 0.0 | 0.0 | 0.0 | 0.0 |

Estimate of any current year (FY2003) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

| | | | | | | |
|-----------|---|---|--|--|--|--|
| Full-time | 1 | 1 | | | | |
| Part-time | | | | | | |
| Temporary | | | | | | |

ANALYSIS: (Attach a separate page if necessary)

See attached analysis.

Prepared by: Larry Persily, Deputy Commissioner Phone 465-5469
Division: Department of Revenue Date/Time 3/10/03 4:32 PM
Approved by: Larry Persily, Deputy Commissioner Date 3/10/2003
Agency: Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 16 (RES)

ANALYSIS CONTINUATION

The intent of the Stranded Gas Development Act, AS 43.82, is to provide a mechanism for achieving the fiscal certainty that potential project sponsors say they need before proceeding with the large investment needed to bring Alaska North Slope natural gas to market. The Act allows the state to negotiate a contract for payments in lieu of taxes with a project sponsor. This contract could cover all state and municipal taxes on a project, including state corporate income taxes, production taxes, state and municipal property taxes, and any special municipal assessments. The Act also allows for negotiation of gas valuation methods for use in determining state royalties.

This bill, CS HB16 (RES), would amend the 1998 Stranded Gas Development Act to:

- Expand the Act to include a natural gas pipeline to serve mid-America and gas-to-liquid (GTL) projects as eligible projects under the law. The existing statute limits the application of the Act to only liquefied natural gas projects. This change would allow sponsors of either an LNG project and/or a natural gas pipeline to mid-America and/or a GTL project to apply to the state under the provisions of the Act to negotiate a contract for payments in lieu of taxes.
- Replace the June 30, 2001 deadline in statute for applications with a new deadline of March 31, 2005.
- Impose a \$1.5 million limit on the reimburseable expenses the state may require the project applicant(s) to repay the state for independent contractors used in evaluating the application or in the development of the contract terms. The Act allows the state to obtain reimbursement from the project applicant(s) for these expenses, and this bill would impose a \$1.5 million on the reimbursement. The Act also is amended to require that the expenses be "reasonable and nonredundant."
- It is the intent of this legislation, and the administration, that the \$1.5 million limit would be shared between all state agencies involved with the project application. The Department of Revenue, under the Act, is the lead agency in this effort, and would share the reimburseable agreement funding with the Department of Law and Department of Natural Resources.

OPERATING EXPENSES

The Act allows the Department of Revenue under AS 43.82.240 to recover from a project applicant the costs of contracting with an independent consultant to assist the state in evaluating applications submitted under the Act and in developing contract terms. Those statutorily designated program receipts are shown above as the authority to receive and expend those funds.

The Act does not allow the state to seek reimbursement from a project applicant for any other costs. The Department of Revenue would hire a project manager for the estimated two years of contract development, negotiations and approval, and the personnel services, travel and equipment expenses for that position and other commissioner's office expenses are shown as General Fund money.

The above costs are essentially the same as the Legislature approved for the Department of Revenue in passing the 1998 Stranded Gas Act.

The Stranded Gas Development Act

The Stranded Gas Development Act, AS 43.82, was passed into law by the Alaska Legislature in 1998. During the session it was House Bill 393. The application deadline for a project application under the Act was June 30, 2001. There were no applications by that date. Legislative action is required to reopen the option for a gas project developer. Such a reopener failed to win legislative approval last session, and has been introduced again this year as HB 16, sponsored by Representatives Fate and Whitaker.

The Act's genesis was in HB 250, which in 1997 established a North Slope Gas Commercialization Team in the administration to research and recommend changes to state law to encourage commercialization of North Slope gas. The team issued a report to the Governor in February 1998. The team's conclusions were that the project faced considerable risk, namely construction cost risk and gas price risk, and the state's fiscal system exacerbated those risks. Three of the risks of particular concern were fiscal uncertainty, the state's regressive tax system, and the front-end aspects of the fiscal system. We will discuss these in turn.

Given the high cost of the project, coupled with the volatility of gas prices, the project is financially risky. Given that the project is marginal under the current fiscal system, there is concern among potential project sponsors that if a project is started, the state could later modify the fiscal terms after the project had been built, changing its overall attractiveness to investors after they had invested. This is the fiscal uncertainty risk.

Second, there are two significant elements of the state's fiscal system that make it regressive. Regressivity means that the state's take in terms of share of the profits is high at low prices and low at high prices. Regressive systems exacerbate the risk of low prices to the project developers. First, the property tax is based on cost of the asset. The higher the cost, the higher the tax. Second, the basis of value for the severance tax and royalty is at the wellhead and does not consider capital and operating costs. Thus when capital and operating costs are high, and prices are low, the state's take is a high percentage of the low profits. (Regressive systems also reduce what the state's take could be at high prices, which means the state loses out on a greater slice of revenues during high prices and high profits.)

Third, the property tax makes for a front-end loaded system. The property tax is payable when construction begins, which could be several years before revenues start accruing. On a time value of money basis, this diminishes the rate of return on the project and exacerbates the risk of not recovering the investment.

Page 4 of 5
House Bill 16
Department of Revenue

After the team issued its report to the Governor, it worked with the major Prudhoe Bay producers to develop legislation to deal with these risks. The producers at the time had been studying commercializing gas through an LNG project to tidewater. The result was HB 393.

The law provided a mechanism for converting the state's fiscal system from a statutory basis to a contractual basis. This would provide for greater fiscal certainty. The fiscal system would be negotiated between the administration and the project sponsors and approved by the Legislature. And per the Act the contract terms could provide for a more progressive (less regressive) system.

The process for developing the contract was as follows: A sponsor would submit a project plan and application to the administration for contract negotiation. The project had to produce 500 billion cubic feet within 20 years and be an LNG export project. (The original bill called for any project. It was changed to only LNG during the legislative process.)

The sponsor group would negotiate fiscal terms with the state. Payments to the state would be made in-lieu of taxes. Fiscal terms would be customized to the specific project structure. The term of the contract could not exceed 35 years.

The Revenue Commissioner would be the main agent for negotiating and implementing the contract. However, the Natural Resources Commissioner is also responsible for reviewing the project plan for acceptability, and for negotiating any changes in royalty issues. The only royalty provisions subject to negotiation under the Act are the gas valuation method and the timing of royalty in-kind and royalty in-value notices.

The law allowed the commissioner of Revenue to use independent contractors to assist in the evaluation of any project application, and to condition the contract on an agreement with the project applicant that it would fully reimburse the state for the cost of the contractors retained for the state's analysis. The fiscal note for the legislation authorized the Department of Revenue to collect and expend those application fees to cover its contractor costs. The Legislature in 1998 also approved General Fund money for the Department of Revenue to hire a full-time project coordinator for two years to help manage the application review and negotiations. That position was never filled because there was no project application.

(Note: It is the intent this year of CSHB16(Resources) that the Department of Revenue would share those reimbursable agreement funds with the Department of Law and Department of Natural Resources as necessary for those agencies to fulfill their work assignments in this effort.)

Page 5 of 5
House Bill 16
Department of Revenue

In addition to replacing state oil and gas production taxes and corporate income taxes with a contract for payments, the Act also allowed the Revenue commissioner to include municipal sales taxes, municipal special assessments, state and municipal property taxes and any other state or municipal taxes in the negotiations. The intent was to wrap up as much as possible into the contract for payments in lieu of taxes.

Once a contract was developed, preliminary findings would be submitted to the governor. If the governor chose to proceed the preliminary findings would be given to the Legislature and the public. There would be a 30-day public review period.

After the review, the commissioner of Revenue would modify the contractual terms as appropriate and if acceptable to the sponsors. The final contract would be submitted to the governor. The governor would transmit the contract to the legislature with a request for authorization to execute the contract. Finally, the legislature would vote on it.

There was great concern by local municipalities that a contract could compromise the property tax revenues they might receive, especially given the concerns about the property tax discussed above. Accordingly, the Act requires that a portion of the payments due under the contract is paid to affected municipalities. Also, the law created a municipal advisory group to participate in developing contract terms.

The law also has provisions intended to help make gas available to communities, to promote local hire, and to deal with confidential information provided by the sponsors.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: CSHB 16(O&G)
 (H) Publish Date: 2/28/03

Revision Date/Time (Note if correction): _____ Dept. Affected: DCED
 Title Stranded Oil & Gas Development Act BRU Regulatory Commission of Alaska (399)
Amendments Component Regulatory Commission of Alaska
 Sponsor Representative Fate
 Requester House Oil & Gas Component No. 2417

Expenditures/Revenues (Thousands of Dollars)

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

| OPERATING EXPENDITURES | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 |
|------------------------|------------|------------|------------|------------|------------|------------|
| Personal Services | | | | | | |
| Travel | | | | | | |
| Contractual | | | | | | |
| Supplies | | | | | | |
| Equipment | | | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| TOTAL OPERATING | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

| | | | | | | |
|-----------------------------|--|--|--|--|--|--|
| CAPITAL EXPENDITURES | | | | | | |
|-----------------------------|--|--|--|--|--|--|

| | | | | | | |
|-------------------------------|--|--|--|--|--|--|
| CHANGE IN REVENUES () | | | | | | |
|-------------------------------|--|--|--|--|--|--|

FUND SOURCE (Thousands of Dollars)

| | | | | | | |
|--|------------|------------|------------|------------|------------|------------|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | | | | | | |
| 1005 GF/Program Receipts | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| Other (Specify Type-Do not abbreviate) | | | | | | |
| TOTAL | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

Estimate of any current year (FY2003) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

| | | | | | | |
|-----------|--|--|--|--|--|--|
| Full-time | | | | | | |
| Part-time | | | | | | |
| Temporary | | | | | | |

ANALYSIS: (Attach a separate page if necessary)

This bill has no fiscal impact on this agency.

Prepared by: G. Nanette Thompson, Chair Phone 907-276-6222
 Division Regulatory Commission of Alaska Date/Time 2/5/03 6:00 PM
 Approved by: Edgar Blatchford, Commissioner Date 2/5/2003
 Agency Department of Community & Economic Development

*amended **

23-LS0101.Q.2

Chenoweth

3/10/03

passed 7-1

AMENDMENT |

OFFERED IN THE HOUSE
TO: CSHB 16(RES)

BY REPRESENTATIVE HARRIS

1 Page 1, line 8, following "terms;":

2 Insert "providing a statement of intent for the Act relating to use of project labor
3 agreements;"

4

5 Page 1, following line 9:

6 Insert a new bill section to read:

7 "§ Section 1. LEGISLATIVE INTENT. It is the intent of the legislature that, in awarding
8 contracts under the Alaska Stranded Gas Development Act, a qualified sponsor or qualified
9 sponsor group and contractors of the qualified sponsor or qualified sponsor group may
/ 10 develop and enter into a project labor agreement with appropriate collective bargaining
11 organizations for each project for which a contract is entered into."

12

13 Page 1, line 10:

14 Delete "Section 1."

15 Insert "Sec. 2."

16

17 Renumber the following bill sections accordingly.

passed N/O #3

23-LS0101\Q.6
Chenoweth
3/14/03

AMENDMENT

OFFERED IN THE HOUSE

TO: CSHB 16(RES)

1 Page 1, line 8, following "terms;":

2 Insert "providing a statement of intent for the Act relating to reopening of
3 contracts;"

4

5 Page 1, following line 9:

6 Insert a new bill section to read:

7 "* Section 1. The uncodified law of the State of Alaska is amended by adding a new
8 section to read:

9 LEGISLATIVE INTENT. It is the intent of the legislature that each contract for
10 payments in lieu of taxes and for royalty adjustments entered into under the Alaska Stranded
11 Gas Development Act contain a provision by which the contract may be reopened by any
12 party to the contract. The subject matter of the reopening may be dealt with through the use
13 of arbitration proceedings agreed on by the parties."

14

15 Page 1, line 10:

16 Delete "Section 1"

17 Insert "Sec. 2"

18

19 Renumber the following bill sections accordingly.

20

21 Page 2, line 29:

22 Delete "15"

23 Insert "10"

24

- 1 Page 2, line 31:
- 2 Delete "25"
- 3 Insert "15 [25]"

AMENDMENT 4

W/D
3/17/03

OFFERED IN THE HOUSE FINANCE COMMITTEE
BY REPRESENTATIVE CROFT

TO: CS HB 16 (RES)

Page 3, line 7, insert:

"Sec. 4. AS 43.82.210 is amended to read:

AS 43.82.210. Contract Terms Relating to Payment in Lieu of One or More Taxes.

(a) If the commissioner approves an application and proposed project plan under AS 43.82.140, the commissioner may develop proposed terms for inclusion in a contract under AS 43.82.020 for periodic payment in lieu of one or more of the following taxes that otherwise would be imposed by the state or a municipality on the qualified sponsor or member of a qualified sponsor group as a consequence of participating in an approved qualified project:

(1) oil and gas production taxes and oil surcharges under AS 43.55;
(2) oil and gas exploration, production, and pipeline transportation property taxes under AS 43.56;

(3) [Repealed, Sec. 6 ch 34 SLA 1999].

(4) Alaska net income tax under AS 43.20;

(5) municipal sales and use tax under AS 29.45.650 - 29.45.710;

(6) municipal property tax under AS 29.45.010 - 29.45.250 or 29.45.550 - 29.45.600;

(7) municipal special assessments under AS 29.46;

(8) a comparable tax or levy imposed by the state or a municipality after June 18, 1998;

(9) other state or municipal taxes or categories of taxes identified by the commissioner.

(b) If the commissioner chooses to develop proposed terms under (a) of this section, the commissioner shall, if practicable and consistent with the long-term fiscal interests of the state, develop the terms in a manner that attempts to balance the following principles:

(1) the terms should, in conjunction with other factors such as cost reduction of the project, cost overrun risk reduction of the project, increased fiscal certainty, and successful marketing, improve the competitiveness of the approved qualified project in relation to other development efforts aimed at supplying the same market;

(2) the terms should accommodate the interests of the state, affected municipalities, and the project sponsors under a wide range of economic conditions, potential project structures, and marketing arrangements;

(3) the state's and affected municipalities' combined share of the economic rent of the approved qualified project under the contract should be relatively progressive; that is, the state's and affected municipalities' combined annual share of the economic rent of the approved qualified project generally should not increase when there are decreases in project profitability, or decrease when there are increases in project profitability;

(4) the state's and affected municipalities' combined share of the economic rent of the approved qualified project under the contract should be relatively lower in the earlier years than in the later years of the approved qualified project;

- (5) the terms should allow the project sponsors to retain a share of the economic rent of the approved qualified project that is sufficient to compensate the sponsors for risks under a range of economic circumstances;
- (6) the terms should provide the state and affected municipalities with a significant share of the economic rent of the approved qualified project, when discounted to present value, under favorable price and cost conditions;
- (7) the method for calculating the periodic payment in lieu of certain taxes under the contract should be clear and unambiguous; and
- (8) while cost calculations for the approved qualified project under the contract should be based on amounts that closely approximate actual costs, agreed-upon formulas reflecting reasonable economic assumptions should be used if possible to promote administrative certainty and efficiency.
- (c) Except as provided in (b) of this section, the commissioner's discretion under this section in developing proposed terms for a contract under AS 43.82.020 is not limited to consideration of the economic rent of the approved qualified project.

(d) Nothing in this chapter shall be construed to permit the state to suspend or contract away the power of taxation.

Renumber accordingly.

The amendment is designed to increase certainty by forestalling any argument or court challenges based on the claim that there is some hidden escape hatch to the sovereignty provision of the Alaska Constitution. If the supporters of this legislation believe it really requires a constitutional amendment, then they should go that route, rather than creating all sorts of uncertainty for future legislatures.

Revised

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: CS HB16 (RES)
() Publish Date:

Revision Date/Time (Note if correction): March 10, 2003
Title: Stranded Gas Development Act Amendments
Dept. Affected: Revenue
BRU: Administration and Support
Component: Commissioner's Office
Sponsor: Representatives Fate and Whitaker
Requester: House Oil and Gas Committee
Component No.: 123

Expenditures/Revenues (Thousands of Dollars)

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

Table with 7 columns: OPERATING EXPENDITURES, FY 2004, FY 2005, FY 2006, FY 2007, FY 2008, FY 2009. Rows include Personal Services, Travel, Contractual, Supplies, Equipment, Land & Structures, Grants & Claims, Miscellaneous, and TOTAL OPERATING.

CAPITAL EXPENDITURES table with 7 columns.

CHANGE IN REVENUES () table with 7 columns.

FUND SOURCE (Thousands of Dollars)

Table with 7 columns: FUND SOURCE, FY 2004, FY 2005, FY 2006, FY 2007, FY 2008, FY 2009. Rows include 1002 Federal Receipts, 1003 GF Match, 1004 GF, 1005 GF/Program Receipts, 1037 GF/Mental Health, 1108 Statutorily Designated Receipts, and TOTAL.

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: []

POSITIONS

Table with 7 columns: POSITIONS, FY 2004, FY 2005, FY 2006, FY 2007, FY 2008, FY 2009. Rows include Full-time, Part-time, and Temporary.

ANALYSIS: (Attach a separate page if necessary)

See attached analysis.

Prepared by: Larry Persily, Deputy Commissioner
Division: Department of Revenue
Approved by: Larry Persily, Deputy Commissioner
Agency: Department of Revenue
Phone: 465-5469
Date/Time: 3/10/03 4:32 PM
Date: 3/10/2003

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 16 (RES)

ANALYSIS CONTINUATION

The intent of the Stranded Gas Development Act, AS 43.82, is to provide a mechanism for achieving the fiscal certainty that potential project sponsors say they need before proceeding with the large investment needed to bring Alaska North Slope natural gas to market. The Act allows the state to negotiate a contract for payments in lieu of taxes with a project sponsor. This contract could cover all state and municipal taxes on a project, including state corporate income taxes, production taxes, state and municipal property taxes, and any special municipal assessments. The Act also allows for negotiation of gas valuation methods for use in determining state royalties.

This bill, CS HB16 (RES), would amend the 1998 Stranded Gas Development Act to:

- Expand the Act to include a natural gas pipeline to serve mid-America and gas-to-liquid (GTL) projects as eligible projects under the law. The existing statute limits the application of the Act to only liquefied natural gas projects. This change would allow sponsors of either an LNG project and/or a natural gas pipeline to mid-America and/or a GTL project to apply to the state under the provisions of the Act to negotiate a contract for payments in lieu of taxes.
- Replace the June 30, 2001 deadline in statute for applications with a new deadline of March 31, 2005.
- Impose a \$1.5 million limit on the reimburseable expenses the state may require the project applicant(s) to repay the state for independent contractors used in evaluating the application or in the development of the contract terms. The Act allows the state to obtain reimbursement from the project applicant(s) for these expenses, and this bill would impose a \$1.5 million on the reimbursement. The Act also is amended to require that the expenses be "reasonable and nonredundant."
- It is the intent of this legislation, and the administration, that the \$1.5 million limit would be shared between all state agencies involved with the project application. The Department of Revenue, under the Act, is the lead agency in this effort, and would share the reimburseable agreement funding with the Department of Law and Department of Natural Resources.

OPERATING EXPENSES

The Act allows the Department of Revenue under AS 43.82.240 to recover from a project applicant the costs of contracting with an independent consultant to assist the state in evaluating applications submitted under the Act and in developing contract terms. Those statutorily designated program receipts are shown above as the authority to receive and expend those funds.

The Act does not allow the state to seek reimbursement from a project applicant for any other costs. The Department of Revenue would hire a project manager for the estimated two years of contract development, negotiations and approval, and the personnel services, travel and equipment expenses for that position and other commissioner's office expenses are shown as General Fund money.

The above costs are essentially the same as the Legislature approved for the Department of Revenue in passing the 1998 Stranded Gas Act.

The Stranded Gas Development Act

The Stranded Gas Development Act, AS 43.82, was passed into law by the Alaska Legislature in 1998. During the session it was House Bill 393. The application deadline for a project application under the Act was June 30, 2001. There were no applications by that date. Legislative action is required to reopen the option for a gas project developer. Such a reopener failed to win legislative approval last session, and has been introduced again this year as HB 16, sponsored by Representatives Fate and Whitaker.

The Act's genesis was in HB 250, which in 1997 established a North Slope Gas Commercialization Team in the administration to research and recommend changes to state law to encourage commercialization of North Slope gas. The team issued a report to the Governor in February 1998. The team's conclusions were that the project faced considerable risk, namely construction cost risk and gas price risk, and the state's fiscal system exacerbated those risks. Three of the risks of particular concern were fiscal uncertainty, the state's regressive tax system, and the front-end aspects of the fiscal system. We will discuss these in turn.

Given the high cost of the project, coupled with the volatility of gas prices, the project is financially risky. Given that the project is marginal under the current fiscal system, there is concern among potential project sponsors that if a project is started, the state could later modify the fiscal terms after the project had been built, changing its overall attractiveness to investors after they had invested. This is the fiscal uncertainty risk.

Second, there are two significant elements of the state's fiscal system that make it regressive. Regressivity means that the state's take in terms of share of the profits is high at low prices and low at high prices. Regressive systems exacerbate the risk of low prices to the project developers. First, the property tax is based on cost of the asset. The higher the cost, the higher the tax. Second, the basis of value for the severance tax and royalty is at the wellhead and does not consider capital and operating costs. Thus when capital and operating costs are high, and prices are low, the state's take is a high percentage of the low profits. (Regressive systems also reduce what the state's take could be at high prices, which means the state loses out on a greater slice of revenues during high prices and high profits.)

Third, the property tax makes for a front-end loaded system. The property tax is payable when construction begins, which could be several years before revenues start accruing. On a time value of money basis, this diminishes the rate of return on the project and exacerbates the risk of not recovering the investment.

Page 4 of 5
House Bill 16
Department of Revenue

After the team issued its report to the Governor, it worked with the major Prudhoe Bay producers to develop legislation to deal with these risks. The producers at the time had been studying commercializing gas through an LNG project to tidewater. The result was HB 393.

The law provided a mechanism for converting the state's fiscal system from a statutory basis to a contractual basis. This would provide for greater fiscal certainty. The fiscal system would be negotiated between the administration and the project sponsors and approved by the Legislature. And per the Act the contract terms could provide for a more progressive (less regressive) system.

The process for developing the contract was as follows: A sponsor would submit a project plan and application to the administration for contract negotiation. The project had to produce 500 billion cubic feet within 20 years and be an LNG export project. (The original bill called for any project. It was changed to only LNG during the legislative process.)

The sponsor group would negotiate fiscal terms with the state. Payments to the state would be made in-lieu of taxes. Fiscal terms would be customized to the specific project structure. The term of the contract could not exceed 35 years.

The Revenue Commissioner would be the main agent for negotiating and implementing the contract. However, the Natural Resources Commissioner is also responsible for reviewing the project plan for acceptability, and for negotiating any changes in royalty issues. The only royalty provisions subject to negotiation under the Act are the gas valuation method and the timing of royalty in-kind and royalty in-value notices.

The law allowed the commissioner of Revenue to use independent contractors to assist in the evaluation of any project application, and to condition the contract on an agreement with the project applicant that it would fully reimburse the state for the cost of the contractors retained for the state's analysis. The fiscal note for the legislation authorized the Department of Revenue to collect and expend those application fees to cover its contractor costs. The Legislature in 1998 also approved General Fund money for the Department of Revenue to hire a full-time project coordinator for two years to help manage the application review and negotiations. That position was never filled because there was no project application.

(Note: It is the intent this year of CSHB16(Resources) that the Department of Revenue would share those reimbursable agreement funds with the Department of Law and Department of Natural Resources as necessary for those agencies to fulfill their work assignments in this effort.)

Page 5 of 5
House Bill 16
Department of Revenue

In addition to replacing state oil and gas production taxes and corporate income taxes with a contract for payments, the Act also allowed the Revenue commissioner to include municipal sales taxes, municipal special assessments, state and municipal property taxes and any other state or municipal taxes in the negotiations. The intent was to wrap up as much as possible into the contract for payments in lieu of taxes.

Once a contract was developed, preliminary findings would be submitted to the governor. If the governor chose to proceed the preliminary findings would be given to the Legislature and the public. There would be a 30-day public review period.

After the review, the commissioner of Revenue would modify the contractual terms as appropriate and if acceptable to the sponsors. The final contract would be submitted to the governor. The governor would transmit the contract to the legislature with a request for authorization to execute the contract. Finally, the legislature would vote on it.

There was great concern by local municipalities that a contract could compromise the property tax revenues they might receive, especially given the concerns about the property tax discussed above. Accordingly, the Act requires that a portion of the payments due under the contract is paid to affected municipalities. Also, the law created a municipal advisory group to participate in developing contract terms.

The law also has provisions intended to help make gas available to communities, to promote local hire, and to deal with confidential information provided by the sponsors.



*Re: Testimony Before House Finance Committee, March 17, 2003
In Support of HB 16*

Dear Representative Williams and Representative Harris:

For the record, my name is Ken Thompson. I am the past President of ARCO Alaska, Inc. Currently I am the President and CEO of a new Alaska company called Pacific Star Energy LLC.

This letter is written in support of HB 16 being reviewed by the House Finance Committee. The timing is right to support this bill that will grant the Administration authority to negotiate fiscal terms with North Slope gas project sponsors so that a project can be expedited. It is my opinion that within the next 10 years, Alaska's natural gas will be needed in the Lower 48 where natural gas supply is declining more steeply than forecast and demand is continuing to climb.

Pacific Star Energy is a consortium of various Alaska companies across the State that are interested in having an equity investment ownership in any North Slope natural gas project. In the Alaska oil industry, not one Alaska company owns a sizeable equity ownership in North Slope oil production nor in the TAPS oil pipeline. Rather, in the oil industry, Alaska companies play the important role of service and support. However, when the North Slope natural gas industry evolves, several Alaska companies desire an equity ownership stake in the gas pipeline and ancillary natural gas businesses within the State. Pacific Star Energy has been formed to pool together these interested companies under one "umbrella" company that is financially strong and capable to own an equity interest in the gas pipeline.

If Pacific Star Energy has cash flow from a natural gas pipeline project, we will then play a vital role in building natural gas infrastructure within the State. Pacific Star Energy is interested in constructing "hub" distribution centers in Alaska, natural gas processing facilities for distribution of natural gas liquids such as propane and butane to interior communities, and interested in constructing spur pipelines to Fairbanks, Anchorage, and potentially Valdez.

To date, several companies have either approved or are obtaining final approval for initial investment in Pacific Star Energy. Five Alaska companies – Arctic Slope Regional Corporation; Cook Inlet Region, Inc.; Koniag, Inc.; Pacific Rim Leadership Development; and Jim Jansen of Lynden, Inc. – have approved startup funding for this new consortium company. Several other companies in February and March have expressed interest in investing and plan to review investment in this consortium company with their Board of Directors in April: Ahtna, Inc.; Chugach Alaska; Doyon Ltd.; Nana, Inc.; Sealaska Corporation; and Enstar Natural Gas. We are hopeful some if not all of these companies approve investment in Pacific Star Energy. Discussions are also planned with 5-10 other Alaska companies and institutions to continue building a financially strong and broad coalition of Alaska companies to invest in the North Slope natural gas project.

Pacific Star Energy will be working cooperatively with the major producers over the next years to show that our consortium of Alaska companies can participate alongside them and add positive value to any North Slope natural gas project. Pacific Star Energy can provide assistance in: 1) obtaining pipeline permitting across Native and other lands, 2) assist in government relationships, 3) foster investments in in-state natural gas use and value added processing, 4) assist in transportation arrangements of gas owned by smaller producers and the State in-kind royalty gas, and 5) keep more profits within the State to help the State economy.

Our coalition of Alaska companies – Pacific Star Energy – supports approval of HB 16.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____

Bill Version: HB 16

() Publish Date: _____

Revision Date/Time (Note if correction):
Title Stranded Gas Development Act Amend.

Dept. Affected: Natural Resources

BRU Oil and Gas Development

Component Oil and Gas Development

Sponsor Fate
Requester House Oil and Gas

Component No. 439

Expenditures/Revenues (Thousands of Dollars)

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

| OPERATING EXPENDITURES | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 |
|------------------------|--------------|--------------|------------|------------|------------|------------|
| Personal Services | | | | | | |
| Travel | 10.0 | 10.0 | | | | |
| Contractual | 289.0 | 289.0 | | | | |
| Supplies | 1.0 | 1.0 | | | | |
| Equipment | | | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| TOTAL OPERATING | 300.0 | 300.0 | 0.0 | 0.0 | 0.0 | 0.0 |

| | | | | | | |
|-----------------------------|--|--|--|--|--|--|
| CAPITAL EXPENDITURES | | | | | | |
|-----------------------------|--|--|--|--|--|--|

| | | | | | | |
|-------------------------------|--|--|--|--|--|--|
| CHANGE IN REVENUES () | | | | | | |
|-------------------------------|--|--|--|--|--|--|

FUND SOURCE (Thousands of Dollars)

| | | | | | | |
|---|--------------|--------------|------------|------------|------------|------------|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | 300.0 | 300.0 | | | | |
| 1005 GF/Program Receipts | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| Other (Specify Type--Do not abbreviate) | | | | | | |
| TOTAL | 300.0 | 300.0 | 0.0 | 0.0 | 0.0 | 0.0 |

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

| | | | | | | |
|-----------|--|--|--|--|--|--|
| Full-time | | | | | | |
| Part-time | | | | | | |
| Temporary | | | | | | |

ANALYSIS: (Attach a separate page if necessary)

This bill would authorize the executive branch to negotiate a contract with sponsors of proposed projects to develop stranded gas in Alaska. The payments required by the contract would replace some or all of the state royalties and taxes and municipal taxes that would otherwise pertain to major economic activity engendered by the project.

Given the extended time frame to develop and market the large volumes of stranded gas, revenue impacts expected as a result of the bill are outside the time horizon of this fiscal note.

Under AS 43.82.220, the state is responsible for evaluating and negotiating contract terms relating to royalties.

Prepared by: Mark D. Myers

Phone 269-8800

Division: Oil and Gas

Date/Time 2/5/03 11:12 AM

Approved by: Tom Irwin

Date 2/5/2003

Agency: Natural Resources

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. HB 16 _____

ANALYSIS CONTINUATION

Pursuant to these responsibilities, DNR is requesting a total of \$600,000 over a two-year period.

The line item breakdown for the two years is as follows:

Contractual:

\$550,000 is to fund contractual services and advice from experts in technical, fiscal, regulatory, contract negotiation, legal, and financial areas. These technical, evaluative, and negotiation services would be required to assist the state in substantive and complex contract development and negotiation, potentially with multiple sponsors. The state does not have all of this expertise in-house. \$75,000 of these costs will be incurred in preparation for the application process regardless of whether there are applicants.

As per the proposed bill, contract applications are not time-limited. Expenditures for contractual services, therefore, may be necessary any time. Furthermore, one North Slope producer has estimated that contract development and negotiations will take two years. Since there is no way of knowing now specifically when expenditures would be required, it may be beneficial to treat this \$550,000 as a continuing appropriation.

The proposed legislation allows reimbursement of the state by the applicant for the expenses of independent contractors used to assist in the evaluation of an application. Consequently, some or all of these expenditures may be recouped.

\$28.0 is for miscellaneous contractual expenditures such as purchase of technical reports and conference participation.

Other:

\$20.0 to fund the travel for negotiations, and \$2.0 for miscellaneous supplies.

discussed
failed

AMENDMENT 2

OFFERED IN THE HOUSE
TO: CSHB 16(RES)

BY REPRESENTATIVE WHITAKER

1 Page 1, line 4, following "group":

2 Insert "and whether a project plan submitted may be approved as a
3 qualified project plan"

4
5 Page 3, following line 1:

6 Insert a new bill section to read:

7 "* Sec. 3. AS 43.82.130 is amended to read:

8 Sec. 43.82.130. **Qualified project plan.** A proposed project plan submitted
9 under AS 43.82.120 may be approved as a qualified project plan under AS 43.82.140
10 if the proposed project plan

11 (1) reflects a proposal for diligent development of the project on the
12 part of the applicant;

13 (2) does not materially conflict with the obligations of a lessee to the
14 state under a lease or under a pool, unit, or other agreement with the state; [AND]

15 (3) describes satisfactory methods and terms for making gas available
16 to meet the reasonably foreseeable demand in this state for gas within the economic
17 proximity of the project during the term of the proposed contract; and

18 (4) does not unreasonably exclude from participation in the
19 project any person that, in the judgment of the commissioner, is capable of
20 participating and willing to participate in the project substantially on the terms
21 set out in the project plan as submitted; in evaluating an application for
22 compliance with this paragraph, the commissioner may ^{negotiate with} ~~require~~ a qualified
23 sponsor or qualified sponsor group to amend and resubmit a proposed project
24 plan to include one or more other interested persons."

- 1
- 2 Renumber the following bill sections accordingly.

withdrawn
AMENDMENT 4

OFFERED IN THE HOUSE FINANCE COMMITTEE
BY REPRESENTATIVE CROFT

TO: CS HB 16 (RES)

Page 3, line 7, insert:

"Sec. 4. AS 43.82.210 is amended to read:

AS 43.82.210. **Contract Terms Relating to Payment in Lieu of One or More Taxes.**

(a) If the commissioner approves an application and proposed project plan under AS 43.82.140, the commissioner may develop proposed terms for inclusion in a contract under AS 43.82.020 for periodic payment in lieu of one or more of the following taxes that otherwise would be imposed by the state or a municipality on the qualified sponsor or member of a qualified sponsor group as a consequence of participating in an approved qualified project:

- (1) oil and gas production taxes and oil surcharges under AS 43.55;
 - (2) oil and gas exploration, production, and pipeline transportation property taxes under AS 43.56;
 - (3) [Repealed, Sec. 6 ch 34 SLA 1999].
 - (4) Alaska net income tax under AS 43.20;
 - (5) municipal sales and use tax under AS 29.45.650 - 29.45.710;
 - (6) municipal property tax under AS 29.45.010 - 29.45.250 or 29.45.550 - 29.45.600;
 - (7) municipal special assessments under AS 29.46;
 - (8) a comparable tax or levy imposed by the state or a municipality after June 18, 1998;
 - (9) other state or municipal taxes or categories of taxes identified by the commissioner.
- (b) If the commissioner chooses to develop proposed terms under (a) of this section, the commissioner shall, if practicable and consistent with the long-term fiscal interests of the state, develop the terms in a manner that attempts to balance the following principles:
- (1) the terms should, in conjunction with other factors such as cost reduction of the project, cost overrun risk reduction of the project, increased fiscal certainty, and successful marketing, improve the competitiveness of the approved qualified project in relation to other development efforts aimed at supplying the same market;
 - (2) the terms should accommodate the interests of the state, affected municipalities, and the project sponsors under a wide range of economic conditions, potential project structures, and marketing arrangements;
 - (3) the state's and affected municipalities' combined share of the economic rent of the approved qualified project under the contract should be relatively progressive; that is, the state's and affected municipalities' combined annual share of the economic rent of the approved qualified project generally should not increase when there are decreases in project profitability, or decrease when there are increases in project profitability;
 - (4) the state's and affected municipalities' combined share of the economic rent of the approved qualified project under the contract should be relatively lower in the earlier years than in the later years of the approved qualified project;

- (5) the terms should allow the project sponsors to retain a share of the economic rent of the approved qualified project that is sufficient to compensate the sponsors for risks under a range of economic circumstances;
- (6) the terms should provide the state and affected municipalities with a significant share of the economic rent of the approved qualified project, when discounted to present value, under favorable price and cost conditions;
- (7) the method for calculating the periodic payment in lieu of certain taxes under the contract should be clear and unambiguous; and
- (8) while cost calculations for the approved qualified project under the contract should be based on amounts that closely approximate actual costs, agreed-upon formulas reflecting reasonable economic assumptions should be used if possible to promote administrative certainty and efficiency.
- (c) Except as provided in (b) of this section, the commissioner's discretion under this section in developing proposed terms for a contract under AS 43.82.020 is not limited to consideration of the economic rent of the approved qualified project.

(d) Nothing in this chapter shall be construed to permit the state to suspend or contract away the power of taxation.

Renumber accordingly.

The amendment is designed to increase certainty by forestalling any argument or court challenges based on the claim that there is some hidden escape hatch to the sovereignty provision of the Alaska Constitution. If the supporters of this legislation believe it really requires a constitutional amendment, then they should go that route, rather than creating all sorts of uncertainty for future legislatures.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: CS HB16 (RES)
 () Publish Date: _____

Revision Date/Time (Note if correction): March 10, 2003 Dept. Affected: Revenue
 Title Stranded Gas BRU Administration and Support
Development Act Amendments Component Commissioner's Office
 Sponsor Representatives Fate and Whitaker
 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 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 |
|------------------------|--------------|--------------|------------|------------|------------|------------|
| Personal Services | 89.5 | 89.5 | | | | |
| Travel | 25.0 | 25.0 | | | | |
| Contractual | 750.0 | 750.0 | | | | |
| Supplies | 2.0 | 2.0 | | | | |
| Equipment | 5.0 | 1.0 | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| TOTAL OPERATING | 871.5 | 867.5 | 0.0 | 0.0 | 0.0 | 0.0 |

| | | | | | | |
|-----------------------------|--|--|--|--|--|--|
| CAPITAL EXPENDITURES | | | | | | |
|-----------------------------|--|--|--|--|--|--|

| | | | | | | |
|-------------------------------|--|--|--|--|--|--|
| CHANGE IN REVENUES () | | | | | | |
|-------------------------------|--|--|--|--|--|--|

FUND SOURCE (Thousands of Dollars)

| | | | | | | |
|--------------------------------------|--------------|--------------|------------|------------|------------|------------|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | 121.5 | 117.5 | | | | |
| 1005 GF/Program Receipts | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| 1108 Statutorily Designated Receipts | 750.0 | 750.0 | | | | |
| TOTAL | 871.5 | 867.5 | 0.0 | 0.0 | 0.0 | 0.0 |

Estimate of any current year (FY2003) cost: 0.0
 Check this box (X) if funding for this bill is included in the Govern.

POSITIONS

| | | | | |
|-----------|---|---|--|--|
| Full-time | 1 | 1 | | |
| Part-time | | | | |
| Temporary | | | | |

ANALYSIS: (Attach a separate page if necessary)

See attached analysis.

*A don't #2 Palled
 1000 #1
 (DNE to 200)*
*PPFN 1
 good*
*New
 Rev HB 16*

Prepared by: Larry Persily, Deputy Commissioner Phone 465-5469
 Division: Department of Revenue Date/Time 3/10/03 4:32 PM
 Approved by: Larry Persily, Deputy Commissioner Date 3/10/2003
 Agency: Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 16 (RES)

ANALYSIS CONTINUATION

The intent of the Stranded Gas Development Act, AS 43.82, is to provide a mechanism for achieving the fiscal certainty that potential project sponsors say they need before proceeding with the large investment needed to bring Alaska North Slope natural gas to market. The Act allows the state to negotiate a contract for payments in lieu of taxes with a project sponsor. This contract could cover all state and municipal taxes on a project, including state corporate income taxes, production taxes, state and municipal property taxes, and any special municipal assessments. The Act also allows for negotiation of gas valuation methods for use in determining state royalties.

This bill, CS HB16 (RES), would amend the 1998 Stranded Gas Development Act to:

- Expand the Act to include a natural gas pipeline to serve mid-America and gas-to-liquid (GTL) projects as eligible projects under the law. The existing statute limits the application of the Act to only liquefied natural gas projects. This change would allow sponsors of either an LNG project and/or a natural gas pipeline to mid-America and/or a GTL project to apply to the state under the provisions of the Act to negotiate a contract for payments in lieu of taxes.
- Replace the June 30, 2001 deadline in statute for applications with a new deadline of March 31, 2005.
- Impose a \$1.5 million limit on the reimburseable expenses the state may require the project applicant(s) to repay the state for independent contractors used in evaluating the application or in the development of the contract terms. The Act allows the state to obtain reimbursement from the project applicant(s) for these expenses, and this bill would impose a \$1.5 million on the reimbursement. The Act also is amended to require that the expenses be "reasonable and nonredundant."
- It is the intent of this legislation, and the administration, that the \$1.5 million limit would be shared between all state agencies involved with the project application. The Department of Revenue, under the Act, is the lead agency in this effort, and would share the reimburseable agreement funding with the Department of Law and Department of Natural Resources.

OPERATING EXPENSES

The Act allows the Department of Revenue under AS 43.82.240 to recover from a project applicant the costs of contracting with an independent consultant to assist the state in evaluating applications submitted under the Act and in developing contract terms. Those statutorily designated program receipts are shown above as the authority to receive and expend those funds.

The Act does not allow the state to seek reimbursement from a project applicant for any other costs. The Department of Revenue would hire a project manager for the estimated two years of contract development, negotiations and approval, and the personnel services, travel and equipment expenses for that position and other commissioner's office expenses are shown as General Fund money.

The above costs are essentially the same as the Legislature approved for the Department of Revenue in passing the 1998 Stranded Gas Act.

The Stranded Gas Development Act

The Stranded Gas Development Act, AS 43.82, was passed into law by the Alaska Legislature in 1998. During the session it was House Bill 393. The application deadline for a project application under the Act was June 30, 2001. There were no applications by that date. Legislative action is required to reopen the option for a gas project developer. Such a reopener failed to win legislative approval last session, and has been introduced again this year as HB 16, sponsored by Representatives Fate and Whitaker.

The Act's genesis was in HB 250, which in 1997 established a North Slope Gas Commercialization Team in the administration to research and recommend changes to state law to encourage commercialization of North Slope gas. The team issued a report to the Governor in February 1998. The team's conclusions were that the project faced considerable risk, namely construction cost risk and gas price risk, and the state's fiscal system exacerbated those risks. Three of the risks of particular concern were fiscal uncertainty, the state's regressive tax system, and the front-end aspects of the fiscal system. We will discuss these in turn.

Given the high cost of the project, coupled with the volatility of gas prices, the project is financially risky. Given that the project is marginal under the current fiscal system, there is concern among potential project sponsors that if a project is started, the state could later modify the fiscal terms after the project had been built, changing its overall attractiveness to investors after they had invested. This is the fiscal uncertainty risk.

Second, there are two significant elements of the state's fiscal system that make it regressive. Regressivity means that the state's take in terms of share of the profits is high at low prices and low at high prices. Regressive systems exacerbate the risk of low prices to the project developers. First, the property tax is based on cost of the asset. The higher the cost, the higher the tax. Second, the basis of value for the severance tax and royalty is at the wellhead and does not consider capital and operating costs. Thus when capital and operating costs are high, and prices are low, the state's take is a high percentage of the low profits. (Regressive systems also reduce what the state's take could be at high prices, which means the state loses out on a greater slice of revenues during high prices and high profits.)

Third, the property tax makes for a front-end loaded system. The property tax is payable when construction begins, which could be several years before revenues start accruing. On a time value of money basis, this diminishes the rate of return on the project and exacerbates the risk of not recovering the investment.

Page 4 of 5
House Bill 16
Department of Revenue

After the team issued its report to the Governor, it worked with the major Prudhoe Bay producers to develop legislation to deal with these risks. The producers at the time had been studying commercializing gas through an LNG project to tidewater. The result was HB 393.

The law provided a mechanism for converting the state's fiscal system from a statutory basis to a contractual basis. This would provide for greater fiscal certainty. The fiscal system would be negotiated between the administration and the project sponsors and approved by the Legislature. And per the Act the contract terms could provide for a more progressive (less regressive) system.

The process for developing the contract was as follows: A sponsor would submit a project plan and application to the administration for contract negotiation. The project had to produce 500 billion cubic feet within 20 years and be an LNG export project. (The original bill called for any project. It was changed to only LNG during the legislative process.)

The sponsor group would negotiate fiscal terms with the state. Payments to the state would be made in-lieu of taxes. Fiscal terms would be customized to the specific project structure. The term of the contract could not exceed 35 years.

The Revenue Commissioner would be the main agent for negotiating and implementing the contract. However, the Natural Resources Commissioner is also responsible for reviewing the project plan for acceptability, and for negotiating any changes in royalty issues. The only royalty provisions subject to negotiation under the Act are the gas valuation method and the timing of royalty in-kind and royalty in-value notices.

The law allowed the commissioner of Revenue to use independent contractors to assist in the evaluation of any project application, and to condition the contract on an agreement with the project applicant that it would fully reimburse the state for the cost of the contractors retained for the state's analysis. The fiscal note for the legislation authorized the Department of Revenue to collect and expend those application fees to cover its contractor costs. The Legislature in 1998 also approved General Fund money for the Department of Revenue to hire a full-time project coordinator for two years to help manage the application review and negotiations. That position was never filled because there was no project application.

(Note: It is the intent this year of CSHB16(Resources) that the Department of Revenue would share those reimbursable agreement funds with the Department of Law and Department of Natural Resources as necessary for those agencies to fulfill their work assignments in this effort.)

Page 5 of 5
House Bill 16
Department of Revenue

In addition to replacing state oil and gas production taxes and corporate income taxes with a contract for payments, the Act also allowed the Revenue commissioner to include municipal sales taxes, municipal special assessments, state and municipal property taxes and any other state or municipal taxes in the negotiations. The intent was to wrap up as much as possible into the contract for payments in lieu of taxes.

Once a contract was developed, preliminary findings would be submitted to the governor. If the governor chose to proceed the preliminary findings would be given to the Legislature and the public. There would be a 30-day public review period.

After the review, the commissioner of Revenue would modify the contractual terms as appropriate and if acceptable to the sponsors. The final contract would be submitted to the governor. The governor would transmit the contract to the legislature with a request for authorization to execute the contract. Finally, the legislature would vote on it.

There was great concern by local municipalities that a contract could compromise the property tax revenues they might receive, especially given the concerns about the property tax discussed above. Accordingly, the Act requires that a portion of the payments due under the contract is paid to affected municipalities. Also, the law created a municipal advisory group to participate in developing contract terms.

The law also has provisions intended to help make gas available to communities, to promote local hire, and to deal with confidential information provided by the sponsors.

Chapter 43.82. ALASKA STRANDED GAS DEVELOPMENT ACT

Sec. 43.82.010. Purpose.

The purpose of this chapter is to

(1) encourage new investment to develop the state's stranded gas resources by authorizing establishment of fiscal terms related to that new investment without significantly altering tax and royalty methodologies and rates on existing oil and gas infrastructure and production;

(2) allow the fiscal terms applicable to a qualified sponsor or the members of a qualified sponsor group, with respect to a qualified project, to be tailored to the particular economic conditions of the project and to establish those fiscal terms in advance with as much certainty as the Constitution of the State of Alaska allows; and

(3) maximize the benefit to the people of the state of the development of the state's stranded gas resources.

Sec. 43.82.020. Contracts for payments in lieu of other taxes and for royalty adjustments.

The commissioner may, under this chapter, negotiate terms for inclusion in a proposed contract with a qualified sponsor or qualified sponsor group providing for

(1) periodic payment in lieu of one or more taxes that otherwise would be imposed by the state or a municipality on the qualified sponsor or members of the qualified sponsor group as a consequence of the sponsor's or group's participation in an approved qualified project under this chapter; and

(2) certain adjustments regarding royalty under AS 43.82.220 .

Sec. 43.82.100. Qualified project.

Based on information available to the commissioner, the commissioner may determine that a proposal for new investment is a qualified project under this chapter only if the project

(1) is a project for the export of liquefied natural gas;

(2) would produce at least 500,000,000,000 cubic feet of stranded gas within 20 years from the commencement of commercial operations; and

(3) is capable, subject to applicable commercial regulation and technical and economic considerations, of making gas available to meet the reasonably foreseeable demand in this state for gas within the economic proximity of the project.

Sec. 43.82.110. Qualified sponsor or qualified sponsor group.

The commissioner may determine that a person or group is a qualified sponsor or qualified sponsor group if the person or a member of the group

(1) intends to own an equity interest in a qualified project, intends to commit gas that it owns to a qualified project, or holds the permits that the department determines are essential to construct and operate a qualified project; and

(2) meets one or more of the following criteria:

(A) owns a working interest in at least 10 percent of the stranded gas proposed to be developed by a qualified project;

(B) has the right to purchase at least 10 percent of the stranded gas proposed to be developed by a qualified project;

(C) has the right to acquire, control, or market at least 10 percent of the stranded gas proposed to be developed by a qualified project;

(D) has a net worth equal to at least 33 percent of the estimated cost of constructing a qualified project;

(E) has an unused line of credit equal to at least 25 percent of the estimated cost of constructing a qualified project.

Sec. 43.82.120. Applications.

(a) A qualified sponsor or qualified sponsor group may submit to the department an application for development of a contract under AS 43.82.020 evidencing that the requirements of AS 43.82.100 and 43.82.110 are met. The application must be submitted in the manner and form and contain the information required by the department.

(b) Along with an application submitted under (a) of this section, an applicant shall submit a proposed project plan for a qualified project that contains the following information based on the information known to the applicant at the time of application:

(1) a description of the work accomplished as of the date of the application to further the project;

(2) a schedule of proposed development activity leading to the projected commencement of commercial operations of the project;

(3) a description of the development activity proposed to be accomplished under the proposed project plan;

(4) a description of each lease or property that the applicant believes to contain the stranded gas that would be developed if the project was built;

(5) a description of the methods and terms under which the applicant is prepared to make gas available to meet the reasonably foreseeable demand in this state for gas within the economic proximity of the project during the term of the proposed contract, including proposed pipeline transportation and expansion rules if pipeline transportation is a part of the proposed project;

(6) a detailed description of options to mitigate the increased demand for public services and other negative effects caused by the project;

(7) a detailed description of options for the safe management and operation of the project once it is constructed;

(8) other information that the commissioner of revenue, in consultation with the commissioner of natural resources, considers necessary to make a determination that

(A) the work accomplished as of the date of application, the schedule of proposed development activity, and the development activity proposed to be accomplished under the proposed project plan reflect a proposal for diligent development on the part of the applicant;

(B) the proposed project plan does not materially conflict with the obligations of a lessee to the state under a lease or under a pool, unit, or other agreement with the state; and

(C) the proposed project plan describes satisfactory methods and terms for accommodating reasonably foreseeable demand for gas in this state within the economic proximity of the project during the term of the proposed contract.

(c) The requirements of (b) of this section do not diminish the obligations of a qualified sponsor or member of a qualified sponsor group to the state or restrict the authority of the commissioner of revenue or the commissioner of natural resources under any other law or agreement relating to a plan of development for a lease, pool, or unit.

Sec. 43.82.130. Qualified project plan.

A proposed project plan submitted under AS 43.82.120 may be approved as a qualified project plan under AS 43.82.140 if the proposed project plan

(1) reflects a proposal for diligent development of the project on the part of the applicant;

(2) does not materially conflict with the obligations of a lessee to the state under a lease or under a pool, unit, or other agreement with the state; and

(3) describes satisfactory methods and terms for making gas available to meet the reasonably foreseeable demand in this state for gas within the economic proximity of the project during the term of the proposed contract.

Sec. 43.82.140. Review of applications and determination of qualifications.

(a) The commissioner shall review an application submitted under AS 43.82.120 to determine whether the provisions of AS 43.82.100 concerning a qualified project and AS 43.82.110 concerning a qualified sponsor or qualified sponsor group have been met. The commissioner may approve an application only if those provisions have been met.

(b) If the commissioner approves an application under (a) of this section, the commissioner and the commissioner of natural resources shall review the proposed project plan submitted with the application to determine whether the provisions of AS 43.82.130 have been met. The

commissioner may approve the proposed project plan as a qualified project plan only if the commissioner of natural resources concurs in the approval.

(c) The commissioner shall send to the applicant written notice of and the reasons for the determinations made under (a) and (b) of this section.

Sec. 43.82.150. Actions challenging determinations on applications.

(a) Only an applicant under AS 43.82.120 who is aggrieved by a determination of the commissioner of revenue or the commissioner of natural resources under AS 43.82.140 may seek judicial review of the determination.

(b) The only grounds for judicial review of a determination made under AS 43.82.140 are

(1) failure to follow the qualification and application procedures set out in AS 43.82.100 - 43.82.180; or

(2) abuse of discretion that is so capricious, arbitrary, or confiscatory as to constitute a denial of due process.

Sec. 43.82.160. Multiple applications for similar or competing qualified projects.

Nothing in this chapter prohibits different qualified sponsors or different qualified sponsor groups from submitting applications under AS 43.82.120 relating to similar or competing qualified projects or prohibits the commissioner of revenue or the commissioner of natural resources from reviewing and approving applications and proposed project plans under AS 43.82.140 relating to similar or competing qualified projects.

Sec. 43.82.170. Application deadline.

The commissioner of revenue or the commissioner of natural resources may not act on an application for a contract submitted under AS 43.82.120 unless the application is received by the Department of Revenue no later than June 30, 2001.

Sec. 43.82.180. Withdrawal of applications.

Subject to the terms of a reimbursement agreement under AS 43.82.240 or other agreement with the Department of Revenue, the Department of Natural Resources, the commissioner of revenue, or the commissioner of natural resources affecting the withdrawal of an application, a qualified sponsor or qualified sponsor group may withdraw an application submitted under AS 43.82.120 at any time before the date that the commissioner of revenue submits a contract to the governor under AS 43.82.430 without further obligation under this chapter.

Sec. 43.82.200. Contract development.

If the commissioner approves an application and proposed project plan under AS 43.82.140, the commissioner may develop a contract that may include

(1) terms concerning periodic payment in lieu of one or more taxes as provided in AS 43.82.210 ;

(2) terms developed under AS 43.82.220 relating to

(A) timing and notice of the state's right to take royalty in kind or in value; and

(B) royalty value;

(3) terms regarding the hiring of Alaska residents and contracting with Alaska businesses under AS 43.82.230 ;

(4) terms regarding periodic payment to, or an equity or other interest in a project for, municipalities under AS 43.82.500 ;

(5) terms regarding arbitration or alternative dispute resolution procedures;

(6) terms and conditions for administrative termination of a contract under AS 43.82.445 ; and

(7) other terms or conditions that are

(A) necessary to further the purposes of this chapter; or

(B) in the best interests of the state.

Sec. 43.82.210. Contract terms relating to payment in lieu of one or more taxes.

(a) If the commissioner approves an application and proposed project plan under AS 43.82.140 , the commissioner may develop proposed terms for inclusion in a contract under AS 43.82.020 for periodic payment in lieu of one or more of the following taxes that otherwise would be imposed by the state or a municipality on the qualified sponsor or member of a qualified sponsor group as a consequence of participating in an approved qualified project:

(1) oil and gas production taxes and oil surcharges under AS 43.55;

(2) oil and gas exploration, production, and pipeline transportation property taxes under AS 43.56;

(3) [Repealed, Sec. 6 ch 34 SLA 1999].

(4) Alaska net income tax under AS 43.20;

(5) municipal sales and use tax under AS 29.45.650 - 29.45.710;

(6) municipal property tax under AS 29.45.010 - 29.45.250 or 29.45.550 - 29.45.600;

(7) municipal special assessments under AS 29.46;

(8) a comparable tax or levy imposed by the state or a municipality after June 18, 1998;

(9) other state or municipal taxes or categories of taxes identified by the commissioner.

(b) If the commissioner chooses to develop proposed terms under (a) of this section, the commissioner shall, if practicable and consistent with the long-term fiscal interests of the state, develop the terms in a manner that attempts to balance the following principles:

(1) the terms should, in conjunction with other factors such as cost reduction of the project, cost overrun risk reduction of the project, increased fiscal certainty, and successful marketing, improve the competitiveness of the approved qualified project in relation to other development efforts aimed at supplying the same market;

(2) the terms should accommodate the interests of the state, affected municipalities, and the project sponsors under a wide range of economic conditions, potential project structures, and marketing arrangements;

(3) the state's and affected municipalities' combined share of the economic rent of the approved qualified project under the contract should be relatively progressive; that is, the state's and affected municipalities' combined annual share of the economic rent of the approved qualified project generally should not increase when there are decreases in project profitability, or decrease when there are increases in project profitability;

(4) the state's and affected municipalities' combined share of the economic rent of the approved qualified project under the contract should be relatively lower in the earlier years than in the later years of the approved qualified project;

(5) the terms should allow the project sponsors to retain a share of the economic rent of the approved qualified project that is sufficient to compensate the sponsors for risks under a range of economic circumstances;

(6) the terms should provide the state and affected municipalities with a significant share of the economic rent of the approved qualified project, when discounted to present value, under favorable price and cost conditions;

(7) the method for calculating the periodic payment in lieu of certain taxes under the contract should be clear and unambiguous; and

(8) while cost calculations for the approved qualified project under the contract should be based on amounts that closely approximate actual costs, agreed-upon formulas reflecting reasonable economic assumptions should be used if possible to promote administrative certainty and efficiency.

(c) Except as provided in (b) of this section, the commissioner's discretion under this section in developing proposed terms for a contract under AS 43.82.020 is not limited to consideration of the economic rent of the approved qualified project.

Sec. 43.82.220. Contract terms relating to royalty.

(a) Notwithstanding any contrary provisions of AS 38, the commissioner of natural resources, with the concurrence of the commissioner of revenue and the affected parties holding a state lease or unit agreement, may develop proposed terms for inclusion in a contract under AS 43.82.020 that modify the timing and notice provisions of the applicable oil and gas leases and unit agreements pertaining to the state's rights to receive its royalty on gas in kind or in value if

(1) the viability of the approved qualified project depends on long-term gas purchase and sale agreements;

(2) certainty over time regarding the quantity of royalty gas that the state may be taking in kind is needed to secure the long-term purchase and sale agreements;

(3) the specified period of the state's commitment to take its royalty share in value or in kind does not exceed the term of the purchase and sale agreements; and

(4) the modification does not impair the ability of the approved qualified project or the state to meet the reasonably foreseeable demand in this state for gas within economic proximity of the project during the term of the contract developed under AS 43.82.020 .

(b) Notwithstanding any contrary provisions of AS 38, the commissioner of natural resources, with the concurrence of the commissioner of revenue and the affected parties holding a state lease or unit agreement, may develop proposed terms for inclusion in a contract under AS 43.82.020 that establish a valuation method for the state's royalty share of the gas production from an approved qualified project.

(c) The commissioner of revenue shall include any proposed terms relating to royalty developed in accordance with this section in the proposed contract under AS 43.82.400 .

(d) Nothing in this chapter permits modification of the state's rights that relate to timing, notice, and rights to receive oil royalty in kind or in value under oil and gas leases or unit agreements.

Sec. 43.82.230. Contract terms relating to hiring of Alaska residents and contracting with Alaska businesses.

(a) The commissioner shall include in a contract under AS 43.82.020 a term requiring the qualified sponsor or qualified sponsor group and contractors of the qualified sponsor or qualified sponsor group to comply with all valid federal, state, and municipal laws relating to hiring Alaska residents and contracting with Alaska businesses to work in the state on the approved qualified project and not to discriminate against Alaska residents or Alaska businesses. Within the constraints of law, the commissioner shall also include in a contract under AS 43.82.020 a term that requires the qualified sponsor or qualified sponsor group and contractors of the qualified sponsor or qualified sponsor group to employ Alaska residents and to contract with Alaska businesses to work in the state on the approved qualified project to the extent the residents and businesses are available, competitively priced, and qualified.

(b) The commissioner shall include in a contract under AS 43.82.020 a term requiring the qualified sponsor or qualified sponsor group and contractors of the qualified sponsor or qualified sponsor group to

(1) advertise for available positions in newspapers in the location where the work is to be performed and in other publications distributed throughout the state, including in rural areas; and

(2) use Alaska job service organizations located throughout the state and not just in the location where the work is to be performed in order to notify Alaskans of work opportunities on the approved qualified project.

(c) Subject to the voluntary agreement of the qualified sponsor, the commissioner may include a term in the contract providing for incentives to encourage training and hiring of Alaska residents.

(d) This section does not create or abridge individual rights and does not create a private right of action for any person.

(e) For purposes of this section,

(1) "Alaska business" means a firm or contractor that

(A) has held an Alaska business license for the preceding 12 months;

(B) maintains, and has maintained for the preceding 12 months, a place of business in the state that competently and professionally deals in supplies, services, or construction of the nature required for the approved qualified project; and

(C) is

(i) a sole proprietorship and the proprietor is an Alaska resident;

(ii) a partnership and more than 50 percent of the partnership interest is held by Alaska residents;

(iii) a limited liability company and more than 50 percent of the membership interest is held by Alaska residents;

(iv) a corporation that has been incorporated in the state or is authorized to do business in the state; or

(v) a joint venture and a majority of the venturers qualify as Alaska businesses under this paragraph;

(2) "Alaska job service organizations" means those offices maintained by the state and recommended by the Department of Labor and Workforce Development whose functions are to aid the unemployed or underemployed in finding employment;

(3) "Alaska resident" means a natural person who

(A) receives a permanent fund dividend under AS 43.23; or

(B) is registered to vote under AS 15 and qualifies for a resident fishing, hunting, or trapping license under AS 16;

(4) "available," as applied to an Alaska resident or Alaska business, means that the resident or business is available for employment at the time required and is located anywhere in the state, not just in the area of the state where the work is to be performed;

(5) "qualified," as applied to an Alaska resident or Alaska business, means that the resident or business possesses the requisite education, training, skills, certification, or experience to perform the work necessary for a particular position or to perform a particular service.

Sec. 43.82.240. Use of an independent contractor.

(a) The commissioner may use an independent contractor to assist in the evaluation of an application or in the development of contract terms under AS 43.82.200 . The commissioner may condition the development of a contract under AS 43.82.020 on an agreement by the applicant to reimburse the state for the expenses of an independent contractor under this section.

(b) An independent contractor selected under this section must sign an agreement regarding confidentiality and disclosures consistent with the determinations made under AS 43.82.310 before the contractor may review information that is determined confidential under AS 43.82.310

(c) Selection of an independent contractor under this section is not subject to AS 36.30 (State Procurement Code).

Sec. 43.82.250. Term of contract; effective date.

The term of a contract developed under AS 43.82.020 may be for no longer than is necessary to develop the stranded gas that is subject to the contract; however, the term of the contract may not exceed 35 years from the commencement of commercial operations of the approved qualified project.

Sec. 43.82.260. Change of parties to an application or a contract; assignment of interests.

(a) A qualified sponsor or member of a qualified sponsor group may assign an interest in or add or withdraw a party to an application under AS 43.82.120 only if the commissioner has

(1) made a finding that the assignment, addition, or withdrawal is consistent with the requirements of AS 43.82.110 ; and

(2) given prior written approval for the assignment, addition, or withdrawal.

(b) A contract developed under this chapter may provide for the assignment to or withdrawal of a qualified sponsor or member of a qualified sponsor group.

(c) Upon being added to an application under this section, a party becomes a qualified sponsor or a member of a qualified sponsor group, as appropriate, for the relevant project.

(d) The commissioner may not unreasonably withhold approval under (a) of this section, but may condition the approval in any way reasonably necessary to protect the fiscal interests of the state and to further the purposes of this chapter.

(e) For purposes of this section, an assignment includes a transfer of stock or a partnership interest in a manner that changes control of a qualified sponsor or member of a qualified sponsor group.

Sec. 43.82.270. Project plans and work commitments.

A contract under AS 43.82.020 must include the qualified project plan approved under AS 43.82.140 and provisions for updating the plan at reasonable intervals until the commencement of commercial operations of the approved qualified project. The commissioner of revenue, in consultation with the commissioner of natural resources, may, as a term in a contract under AS 43.82.020, include work commitments or other obligations in the contract to be accomplished before the commencement of commercial operations of the approved qualified project.

Sec. 43.82.300. Requests for information.

The commissioner of revenue or the commissioner of natural resources may request from an applicant information that the respective commissioner determines is necessary to perform the respective commissioner's responsibilities under AS 43.82.140. If the application is approved under AS 43.82.140, the respective commissioner shall require the successful applicant to provide financial, technical, and market information regarding the qualified project that the respective commissioner determines is necessary for the purpose of developing contract terms for the qualified project under AS 43.82.200. If requested information is not provided, the commissioner of revenue may not continue to review the application under AS 43.82.140 or develop the contract under AS 43.82.200 - 43.82.270, as applicable.

Sec. 43.82.310. Disclosure of information; confidentiality.

(a) An applicant may request confidential treatment of information that the applicant provides under AS 43.82.300 by clearly identifying the information and the reasons supporting the request for confidential treatment. The commissioner of revenue or the commissioner of natural resources, as appropriate, shall keep the information confidential until the commissioner determines whether the requirements of (b) of this section are met. If the commissioner of revenue or the commissioner of natural resources has not made a determination under (b) of this section within 14 days after receiving a request for confidential treatment, the request is considered denied. If the appropriate commissioner determines that the information does not meet the requirements of (b) of this section or if the commissioner fails to make a determination within 14 days, the commissioner shall return the information and any copies of it at the request of the applicant. If the commissioner of revenue or the commissioner of natural resources, as appropriate, returns information under this subsection, the commissioner shall cease review of the application or cease contract development under AS 43.82.200 - 43.82.270, as appropriate, unless the commissioner determines that the returned information is unnecessary to make a determination on the application or to develop contract terms under AS 43.82.200 - 43.82.270.

(b) If requested by the applicant, information provided to the commissioner of revenue or the commissioner of natural resources under AS 43.82.300 shall be kept confidential if the

commissioner receiving the information determines, upon an adequate showing by the applicant, that the information

(1) is a trade secret or other proprietary research, development, or commercial information that the applicant treats as confidential;

(2) affects the applicant's competitive position; and

(3) has commercial value that may be significantly diminished by public disclosure or that public disclosure is not in the long-term fiscal interests of the state.

(c) Information determined to be confidential under (b) of this section is confidential under that subsection only so long as is necessary to protect the competitive position of the applicant, to prevent the significant diminution of the commercial value of the information, or to protect the long-term fiscal interests of the state. The commissioner of revenue or the commissioner of natural resources, as appropriate, may not release information that the commissioner has previously determined to be confidential under (b) of this section without providing the applicant notice and an opportunity to be heard.

(d) Notwithstanding the limitation in (c) of this section, the Department of Revenue and the Department of Natural Resources may provide to one another, to the Department of Law, to the legislature, and to the Office of the Governor any information provided under AS 43.82.300 relevant to the implementation of this chapter or to the enforcement of state or federal laws. Information that is exchanged under this subsection that was determined to be confidential under (b) of this section remains confidential except as provided in (c) of this section. The portions of the records and files of the Department of Revenue, the Department of Natural Resources, the Department of Law, the legislature, and the Office of the Governor that reflect, incorporate, or analyze information that is determined to be confidential under (b) of this section are not public records except as provided in (c) of this section.

(e) Notwithstanding the limitation in (c) of this section, information that is determined to be confidential under (b) of this section shall be disclosed on request by the commissioner of revenue, the commissioner of natural resources, or the attorney general to a legislator; to the legislative auditor; and, as directed by the chair or vice-chair of the Legislative Budget and Audit Committee, to the director of legislative finance, to the permanent employees of those divisions who are responsible for evaluating a contract under AS 43.82.020, and to agents or contractors of the legislative auditor or the director of legislative finance who are engaged to evaluate a contract under AS 43.82.020. Information that is determined to be confidential under (b) of this section may also be disclosed by the commissioner of revenue or the commissioner of natural resources to an independent contractor under AS 43.82.240 or to a municipal advisory group established under AS 43.82.510. Before confidential information is disclosed under this subsection, the person receiving the information must sign an appropriate confidentiality agreement.

(f) If the commissioner of revenue chooses to develop a contract under AS 43.82.020, the portions of the records and files of the Department of Revenue, the Department of Natural Resources, the Department of Law, and a municipal advisory group established under AS 43.82.510 that reflect, incorporate, or analyze information that is relevant to the development of the position or strategy of the commissioner of revenue, the commissioner of natural resources,

or the attorney general with respect to a particular provision that may be incorporated into the contract are not public records until the commissioner of revenue gives public notice under AS 43.82.410 of the commissioner's preliminary findings and determination under AS 43.82.400 . Nothing in this subsection

(1) makes a record or file of the Department of Revenue, the Department of Natural Resources, or the Department of Law a public record that otherwise would not be a public record under AS 40.25.100 - 40.25.220;

(2) affects the confidentiality provisions of (a) - (e) of this section; or

(3) abridges a privilege recognized under the laws of this state, whether at common law or by statute or by court rule.

Sec. 43.82.400. Preliminary findings and determination regarding the contract.

(a) If the commissioner develops a proposed contract under AS 43.82.200 - 43.82.270, the commissioner shall

(1) make preliminary findings and a determination that the proposed contract terms are in the long-term fiscal interests of the state and further the purposes of this chapter; and

(2) prepare a proposed contract that includes those terms and shall submit the contract to the governor.

(b) To make the preliminary findings and determination required by (a)(1) of this section, the commissioner shall compare the projected public revenue anticipated from the approved qualified project with the estimated operating and capital costs of the additional state and municipal services anticipated to arise from the construction and operation of the approved qualified project. The commissioner shall address the reasonably foreseeable effects of the proposed contract on the public revenue.

(c) In conjunction with the making of preliminary findings and determination required by (a)(1) of this section, the commissioner shall describe the principal factors, including the projected price of gas, projected production rate or volume of gas, and projected recovery, development, construction, and operating costs, upon which the determination made under (a)(1) of this section is based. If the commissioner has previously submitted a proposed contract to the governor, the commissioner shall describe any material differences between the terms of the currently proposed contract and the previously proposed contract.

Sec. 43.82.410. Notice and comment regarding the contract.

The commissioner shall

(1) give reasonable public notice of the preliminary findings and determination made under AS 43.82.400 ;

(2) make copies of the proposed contract, the commissioner's preliminary findings and determination, and, to the extent the information is not required to be kept confidential under AS

43.82.310 , the supporting financial, technical, and market data, including the work papers, analyses, and recommendations of any independent contractors used under AS 43.82.240 available to the public and to

(A) the presiding officer of each house of the legislature;

(B) the chairs of the finance and resources committees of the legislature; and

(C) the chairs of the special committees on oil and gas, if any, of the legislature;

(3) offer to appear before the Legislative Budget and Audit Committee to provide the committee a review of the commissioner's preliminary findings and determination, the proposed contract, and the supporting financial, technical, and market data; if the Legislative Budget and Audit Committee accepts the commissioner's offer, the committee shall give notice of the committee's meeting to the public and all members of the legislature; if the financial, technical, and market data that is to be provided must be kept confidential under AS 43.82.310 , the commissioner may not release the confidential information during a public portion of a committee meeting; and

(4) establish a period of at least 30 days for the public and members of the legislature to comment on the proposed contract and the preliminary findings and determination made under AS 43.82.400 .

Sec. 43.82.420. Coordination of public and legislative review.

To the extent practicable, the commissioner shall coordinate the public comment opportunity provided under AS 43.82.410 (4) with a review by the Legislative Budget and Audit Committee under AS 43.82.410 (3).

Sec. 43.82.430. Final findings, determination, and proposed amendments; execution of the contract.

(a) Within 30 days after the close of the public comment period under AS 43.82.410 (4), the commissioner of revenue shall

(1) prepare a summary of the public comments received in response to the proposed contract and the preliminary findings and determination;

(2) after consultation with the commissioner of natural resources, if appropriate, and with the pertinent municipal advisory group established under AS 43.82.510, prepare a list of proposed amendments, if any, to the proposed contract that the commissioner of revenue determines are necessary to respond to public comments;

(3) make final findings and a determination as to whether the proposed contract and any proposed amendments prepared under (2) of this subsection meet the requirements and purposes of this chapter.

(b) After considering the material described in (a) of this section and securing the agreement of the other parties to the proposed contract regarding any proposed amendments prepared under

(a) of this section, if the commissioner determines that the contract is in the long-term fiscal interests of the state, the commissioner shall submit the contract to the governor.

(c) The commissioner's final findings and determination under (a) of this section are final agency decisions under this chapter.

Sec. 43.82.435. Legislative authorization.

The governor may transmit a contract developed under this chapter to the legislature together with a request for authorization to execute the contract. A contract developed under this chapter is not binding upon or enforceable against the state or other parties to the contract unless the governor is authorized to execute the contract by law. The state and the other parties to the contract may execute the contract within 60 days after the effective date of the law authorizing the contract.

Sec. 43.82.440. Judicial review.

A person may not bring an action challenging the constitutionality of a law authorizing a contract enacted under AS 43.82.435 or the enforceability of a contract executed under a law authorizing a contract enacted under AS 43.82.435 unless the action is commenced within 120 days after the date that the contract was executed by the state and the other parties to the contract.

Sec. 43.82.445. Administrative termination of a contract.

(a) The commissioner shall include terms in a contract developed under AS 43.82.020 that provide for administrative termination of a party's rights under the procedures and conditions set out in this section if the party has

(1) ceased to meet the requirements of AS 43.82.110 as a qualified sponsor or qualified sponsor group;

(2) intentionally or fraudulently misrepresented, in whole or in part, material facts or circumstances upon which the contract was made;

(3) failed to comply with a condition or material term of the contract or a provision of this chapter; or

(4) failed to comply with the approved qualified project plan or any updated project plan.

(b) Before administrative termination of a contract under this section, the commissioner shall give notice to the parties of the commissioner's intent to terminate the contract and an opportunity to be heard. The commissioner may also provide the parties an opportunity to cure any deficiency that is the basis for the termination if the commissioner determines that curing the deficiency is appropriate under the circumstances.

(c) Notwithstanding (a) and (b) of this section, the commissioner may not administratively terminate a contract after the party has committed full project funding except as provided in (e) of this section.

(d) A party to a contract who is affected by the commissioner's action to terminate under (a) of this section may file an appeal with the superior court under the Alaska Rules of Appellate Procedure.

(e) The commissioner may provide terms and conditions in a contract developed under AS 43.82.020 upon which a party's rights under the contract may be administratively terminated after the party commits full project funding.

Sec. 43.82.500. Obligation to share payments with municipalities.

If the commissioner develops a contract under AS 43.82.020 that includes terms that exempt a party to the contract, and the property, gas, products, and activities associated with the approved qualified project that is subject to the contract, from a municipal tax or assessment in accordance with AS 29.45.810 or AS 29.46.010 (b), or AS 43.82.200 and 43.82.210, the commissioner shall include a term in the contract that the party pay a portion of the periodic payments due under the contract to the revenue-affected municipality.

Sec. 43.82.505. Payments to economically affected municipalities.

If the commissioner executes a contract under AS 43.82.020 that will produce one or more economically affected municipalities, the commissioner shall include a term in the contract that provides for a portion of the periodic payments to the economically affected municipalities under the principles in AS 43.82.520 .

Sec. 43.82.510. Municipal advisory group.

(a) If the commissioner approves an application and proposed project plan under AS 43.82.140 and decides to develop a contract under AS 43.82.020 and 43.82.200, the commissioner shall notify each revenue-affected municipality and economically affected municipality.

(b) The mayor of a municipality notified by the commissioner under (a) of this section may appoint one representative to a municipal advisory group in relation to the application.

(c) Each municipal advisory group serves until a final action is taken on the application for which the group was appointed.

(d) Each municipal advisory group shall elect a chair.

Sec. 43.82.520. Duties of the commissioner of revenue in relation to municipal participation.

(a) The commissioner shall meet with each municipal advisory group periodically to report on the development of the contract provisions that affect the municipalities.

(b) In developing a contract under AS 43.82.200 - 43.82.270, the commissioner shall ensure that each revenue-affected municipality and economically affected municipality receives a fair and reasonable share of the payments provided under AS 43.82.210 in accordance with the following principles:

(1) the share of the payments to revenue-affected municipalities should be given priority over payments to economically affected municipalities with due regard to the anticipated size of the tax base that the contract would exempt from municipal taxation by revenue-affected municipalities;

(2) the share of the payments to municipalities should be determined with due regard to the anticipated economic and social burdens that would be imposed on the municipality by construction and operation of the project;

(3) the respective shares of the total payments to the state and to municipalities should be fixed in a manner to ensure that their respective interests are aligned;

(4) to the extent practicable, the periodic amounts paid to each of the municipalities should be stable and predictable; and

(5) to the extent practicable, the provisions for sharing payments with municipalities should be consistent with the principles established in AS 43.82.210 (b).

(c) In establishing the municipal shares under (b) of this section, the commissioner shall consult with the pertinent municipal advisory group.

Sec. 43.82.600. Governing law.

If a provision of this chapter conflicts with another provision of state or municipal law, the provision of this chapter governs.

Sec. 43.82.610. Regulations.

The commissioner of revenue, the commissioner of natural resources, and the commissioner of labor and workforce development may adopt regulations to carry out their respective duties under this chapter.

Sec. 43.82.620. Procedures for collection of amounts due; security.

(a) The commissioner may adopt procedures for the collection of amounts due the state under a contract developed under AS 43.82.020 , including the collection of interest and penalties.

(b) The commissioner may require a party to a contract developed under AS 43.82.020 to provide security sufficient to guarantee amounts due under the contract.

Sec. 43.82.630. Reports and audits.

The commissioner may require periodic reports from and may at reasonable intervals conduct audits and inspect the books of a party that has entered into a contract developed under AS 43.82.020 to ensure compliance with the provisions of this chapter and the regulations adopted under this chapter and of the terms of the contract.

Sec. 43.82.640. Annual report of the commissioner of labor and workforce development.

On an annual basis, the commissioner of labor and workforce development shall prepare and present to the legislature a comprehensive report on each party to a contract with the state developed under AS 43.82.020 , and its contractors, regarding the state residency of the employees working in this state on the approved qualified project that is subject to the contract. The commissioner of labor and workforce development shall use state data bases, including data from the quarterly reports by a party to the contract developed under AS 43.82.020 and its contractors for unemployment insurance purposes, to determine state residency of employees regarding compliance with AS 43.82.230 .

Sec. 43.82.900. Definitions.

In this chapter, unless the context requires otherwise,

(1) "affected municipality" means an economically affected municipality or a revenue-affected municipality;

(2) "commencement of commercial operations" means the start of regular deliveries of marketable products from an approved qualified project;

(3) "cubic foot of gas" means the quantity of gas contained in a volume of one cubic foot at a standard temperature of 60 degrees Fahrenheit and a standard absolute pressure of 14.65 pounds per square inch;

(4) "economically affected municipality" means a municipality the commissioner of revenue determines will be reasonably required to provide additional public services under the terms proposed in an application approved under AS 43.82.140 (a); the commissioner may consider historical data from construction of the Trans Alaska Pipeline System, and information submitted by a municipality in making the determination;

(5) "economic proximity" means the distance within which a person may be willing to design, construct, and operate a gas line to provide service to a local consumer;

(6) "economic rent" means the estimated total gross revenue less estimated total costs for a qualified project over the term of a contract under AS 43.82.020 , measured in undiscounted nominal dollars; for purposes of this paragraph, total costs do not include a rate of return on capital, financing costs, or any payments to governments;

(7) "full project funding" means full approval by a party to a contract under AS 43.82.020 for the expenditure of the capital necessary for construction and operation of the approved qualified project that is subject to the contract;

(8) "gas" has the meaning given in AS 43.55.900 ;

(9) "group" means two or more persons;

(10) "lease or property" has the meaning given in AS 43.55.900 ;

(11) "periodic payment" means payment made in lieu of one or more other taxes under a contract under AS 43.82.020 ;

(12) "revenue-affected municipality" means a municipality that the commissioner of revenue reliably expects will be restricted from imposing a tax, or a portion of a tax, as a result of implementation of a contract developed under this chapter;

(13) "stranded gas" means gas that is not being marketed due to prevailing costs or price conditions as determined by an economic analysis by the commissioner for a particular project.

Sec. 43.82.990. Short title.

This chapter may be cited as the Alaska Stranded Gas Development Act.

ALASKA STATE LEGISLATURE

House of Representatives

Representative Hugh (Bud) Fate

State Capitol, Room 128
Juneau, AK 99801
Phone: (907) 465-4976
Fax: (907) 465-3883
Toll Free: (866) 465-4976



Chair Resources
Member:
Military & Veterans Affairs
Oil & Gas
Transportation

Sponsor Statement

CS for House Bill 16

"An Act amending the standards applicable to determining whether, for purposes of the Alaska Stranded Gas Development Act, a proposed new investment constitutes a qualified project, and repealing the deadlines for applications relating to the development of contracts for payments in lieu of taxes and for royalty adjustments that may be submitted for consideration under that Act; and providing for an effective date."

House Bill 16 is cleanup language for the qualification and application procedures the Commissioners of Natural Resources, Revenue, or Labor and Workforce Development may use when considering a project involving natural gas. The changes update the language in order to allow continued interest in the development of the resource. By expanding the areas of potential gas exploration and development that fall under the Act.

Presently, statute only allows for natural gas projects if the product is to be exported in a liquefied form. HB 16 resolves this limitation, by expanding gas development and transportation in any form. With a lowering of the bar in capitol net assets, it expands the potential for a number of companies including those in Alaska, to become a part of the pipeline project.

When the Alaska Stranded Gas Development Act was passed, the language included an application deadline of June 30, 2001. HB 16 extends that deadline so the state and producers can resume contract negotiations with a clear understanding that the goal is the development of Alaska's natural gas for both foreign and domestic markets.

Overview of CSHB16(Resources)
Presentation to the House Finance Committee
Roger Marks
Alaska Department of Revenue
March 10, 2003

Good afternoon, Mr. Chairman and members of the committee. My name is Roger Marks. I am a petroleum economist with the Tax Division of the Department of Revenue. I worked on the original Stranded Gas Act in 1998 and am familiar with its history, intent, and mechanics. I would like to provide a very brief overview of the Act at AS 43.82. A more detailed synopsis is with the fiscal note.

The Act originated in HB 250 in 1997 which established a North Slope Gas Commercialization team in the Administration to research and recommend changes to state law to encourage commercialization of North Slope gas. The team concluded that the project faced considerable risk, namely gas price risk and cost overrun risk, and that the state's fiscal system actually exacerbated those risks. Two of the risks of particular concern were fiscal uncertainty and the state's regressive tax system.

(A brief comment on the price risk: The cost of the project is very large: \$20 billion. That is a lot of money to any corporation, even ones the size of Exxon, BP or ConocoPhillips. If this project is built and something goes wrong, such as low prices, the sponsors face very large losses. And even if these are relatively low-probability events, the project may not be built if a company cannot tolerate a loss of that size. That is why the risk-reduction mechanism proposed in Congress, which is currently in place for non-conventional gas in the Lower 48, may be a very necessary linchpin in making this project a reality.)

By fiscal uncertainty we mean the threat of changes in fiscal provisions after a project is built, that may change the project's viability after it is too late to do anything about it. A project may be feasible under one tax system. If it is built under the assumption that the tax system in place will stay in place, but the tax system changes, the changes could cause heavy financial losses.

Second, there are two significant elements of the state's fiscal system that make it regressive. By regressive we mean that the state's take is a high percentage of income at low prices, and a low percentage at high prices. First, the property tax is based on cost. The higher the cost the higher the tax. This is a double whammy to an investor who incurs a cost overrun. Moreover, the property tax is payable when construction begins, years before revenues start accruing. On a time value of money basis this diminishes the rate of return, and increases the risk of not recovering the investment.

The second regressive elements are the severance tax and royalty. They are based on the value at the point where the gas comes out of the ground, and ignore upstream costs such as capital and operating costs. Thus when costs are high and prices are low, the state's take is a high percentage of low income. Again, this intensifies the danger of low prices.

I might add that a regressive system also limits the state's take at high prices. Fixing that could be very important to the state for securing more revenue when prices are high, without threatening the viability of the project.

The Stranded Gas Act was the result of trying to fix these shortcomings. The law provided a mechanism for converting the state's fiscal system from a statutory basis to a contractual basis. This would provide for greater fiscal certainty. The fiscal system would be negotiated between the state and the project sponsors, and approved by the legislature, after a public review period. Payments to the state would be made in-lieu of taxes. And per the Act the contract terms would provide for a more progressive (less regressive) system.

Most of the provisions subject to negotiation are the tax provisions. Given that the royalty represents the state's ownership share, there was not interest in making the royalty rate subject to change. The only royalty provisions subject to negotiation would be the gas valuation method, and the timing of royalty in-kind and in-value notices.

The Commissioner of Revenue would be the primary agent for negotiating and implementing the contract. However, the Commissioner of Natural Resources is also responsible for reviewing the project plan for acceptability, and for negotiating any changes in those royalty issues.

There was concern by municipalities that a contract could compromise their property tax revenues. Accordingly, the Act created a municipal advisory group to participate in developing contract terms, and the Act requires that a fair and reasonable share of the payments due under the contract be paid to affected municipalities with regard to the size of the tax base that may be exempted, and the economic and social burdens imposed by construction and operation.

The Act also has provisions for sponsors to help make gas available to communities, to promote local hire, to deal with confidential information provided by the sponsors, and to reimburse the state for contractors it may use to assist in the negotiation process.

Finally, there were some questions raised as to whether this would surrender or contract away the power to tax, which is forbidden by our constitution. It was the administration's judgment that this would not preclude future legislatures from imposing other taxes, but this contract would represent a solemn pledge, a moral commitment by the state, and a message to future legislatures that once it agrees to the terms it will not change them.

legislation at the end of last week and hasn't had time to address some other issues. However, AOGCC holds the position with respect to all oil and gas drilling in the state that the commission's regulations should be directly tied to the risk that it's trying to manage, she related. There shouldn't be a requirement that doesn't directly relate to what AOGCC is trying to accomplish. Therefore, the approach in [HB 69] mirrors what AOGCC generally attempts to do. However, she acknowledged that AOGCC's regulations have historically been aimed at conventional oil and gas drilling. "To the extent that we're aware of the problems that have been raised or pointed out to us, we think that this accomplishes that," she added.

Number 2822

REPRESENTATIVE FATE suggested putting the staff issue to rest. He turned attention to AS 31.05.023(a), "The commission shall employ such staff as it considers necessary to carry out its responsibilities" and decisions as may be delegated. He said that takes care of it.

CHAIR KOHRING closed the public hearing.

Number 2767

REPRESENTATIVE FATE moved to report HB 69 out of committee with individual recommendations and the accompanying zero fiscal note(s). There being no objection, HB 69 was reported from the House Special Committee on Oil and Gas.

DRAFT

HB 16-STRANDED GAS DEVELOPMENT ACT AMENDMENTS

DRAFT

CHAIR KOHRING announced that the final order of business would be HOUSE BILL NO. 16, "An Act amending the standards applicable to determining whether, for purposes of the Alaska Stranded Gas Development Act, a proposed new investment constitutes a qualified project, and repealing the deadline for applications relating to the development of contracts for payments in lieu of taxes and for royalty adjustments that may be submitted for consideration under that Act; and providing for an effective date."

Number 2728

REPRESENTATIVE McGUIRE moved to adopt Version 23-LS0101\H, Chenoweth, 2/6/03, as the work draft. There being no objection, Version H was before the committee.

Number 2711

REPRESENTATIVE FATE, sponsor of HB 16, explained that the bill is a reauthorization of the Alaska Stranded Gas Development Act ("the Act") with amendments. The purpose of the Act is to allow negotiations between producers and the State of Alaska. The legislation proposes new language for what is a qualified project. It allows all forms of natural gas through the pipeline, including gas-to-liquids (GTLs), liquefied natural gas (LNG), and natural gas; the Act, by contrast, allowed just LNG, to his recollection. It isn't route-specific, he noted, since a lot of bills and resolutions from the previous legislature dealt with that subject. Most important, he said, it repeals the

deadline for application. He told members that even though the previous version allowed for other investors, the bill specifies that Alaskan businesses or corporations can "go into this pipeline with equity up to 10 percent" [of the estimated cost of constructing a qualified project], and it allows generically for the market to be either domestic or foreign.

Number 2580

REPRESENTATIVE ROKEBERG recalled working on the Alaska Stranded Gas Development Act several years ago in the House Special Committee on Oil and Gas, and that one bone of contention was what type of product it would cover and the prohibition of GTLs by the Act. Alluding to Section 2 of Version H, he asked Representative Fate about his intention on contract development with regard to Alaska-based businesses, as well as the rationale behind having equity not exceed 10 percent.

REPRESENTATIVE FATE responded that the provision for Alaskan business interests is to encourage Alaskan businesses with the capability and which can become qualified to enter into this. Nothing would prevent a corporation that can qualify from participating, he said, whether it is a Native corporation, a combination of Native corporations, or a combination of Alaska-based banks. With regard to the 10 percent, he said it is not just a negotiating tool, but is simply because he surmises that the producers don't want to exclude anyone but don't want to dilute their ownership to the extent that it becomes unprofitable and inhibits construction of a pipeline.

Number 2445

REPRESENTATIVE ROKEBERG acknowledged the need to hear from witnesses, but said he interpreted that [limit of 10 percent] as restricting the pipe size and companies' ability to participate. He offered his understanding that nothing in the [Act] restricts any Alaska-based company from participating; therefore, the [new] language is redundant and just says such a company couldn't have more than 10 percent of the equity. He asked whether that was Representative Fate's intention.

REPRESENTATIVE FATE answered, "It was the intent to encourage, ... so that there's not too big of ... participation you might see by somebody of the Alaskan -- unless, of course, they can -- you're right: maybe they can come in with more than 10 percent. Maybe they can take all the risk."

REPRESENTATIVE ROKEBERG asked whether, then, [BP Exploration (Alaska) Inc.], an Alaska-based company, could only invest 10 percent.

REPRESENTATIVE FATE agreed with Representative Rokeberg's observation about redundancy, but said he wanted to make it clear that Alaskan businesses can invest in this if they qualify.

Number 2355

CHAIR KOHRING pointed out that part of the Act, AS 43.82.110, stipulates the conditions under any group can be considered a candidate for potential ownership in the gas pipeline. He said he, too, wondered about adding that 10 percent provision.

REPRESENTATIVE FATE again acknowledged the redundancy and said the provision is to encourage Alaskans to participate.

Number 2299

CHAIR KOHRING referred to the fact that [the existing language of the Act set forth in Section 2 of Version H] says the commissioner may develop a contract that includes [various terms, including the new terms of paragraph (5) that discuss Alaska-based corporations or businesses and the 10 percent provision]. He expressed concern that it seems to give the commissioner authority to make those decisions when the owners of the pipeline may not concur with the commissioner's decision.

REPRESENTATIVE FATE responded that at one time he'd planned to take it out, but had decided to leave it in, because it might be a stimulus to help propel the pipeline forward, and because it gives a clear point to start from for negotiating with regard to either an Alaska-based business or even the financiers of the pipeline. "And we've labored long and hard with the staff and other people from the industry to discuss this," he remarked. He concluded, "We'll wait and see at the end of the day ... what we will do with that 10 percent."

Number 2203

REPRESENTATIVE KERTTULA noted that the original Act was to encourage development of North Slope gas and to add a timeline for development. With Version H, however, it appears to be "all gas, anywhere at any time." She questioned whether that broadness is intended, with no expiration date and no sidebars on where [the gas] goes or where it's from.

REPRESENTATIVE FATE agreed that it is broad and leaves the route and types of natural gas open-ended, which he said is intended to stimulate development of the gas pipeline in a more rapid fashion.

Number 2028

REPRESENTATIVE KERTTULA questioned the incentive if there is no expiration date. She expressed concern about when this would have to occur and what the incentive really would be. She observed that the royalty [may be included in the contract in the Act, Section 2 of Version H] and suggested that may be the only incentive.

Number 2008

REPRESENTATIVE ROKEBERG referred to subparagraph (C) on page 2 [Section 1 of Version H], noting that it mentions "any other technology", which Representative Fate had said may apply to GTLs. Representative Rokeberg recalled the argument in 1998 [when the Act was passed] that it should be restricted because it is a disincentive to build a gas line. He said the bill really opens up that debate, which may be the proper one to have again because of technological changes and other considerations. He requested testimony from witnesses about that.

Number 1928

REPRESENTATIVE CRAWFORD referred to Representative Kerttula's question and said it seems [Version H] is worded so that it could apply to even a very small project, rather than relating to just a gas pipeline from the North Slope. He asked whether that is the intent.

[Representative Fate responded by saying the intent is "to latitude 64 North." He later corrected his statement because the original version of HB 16, not Version H, referred to "the area of the state lying north of 64 degrees North latitude".]

Number 1809

ROGER MARKS, Petroleum Economist, Economic Research Section, Tax Division, Department of Revenue, noted that he'd worked on the Act in 1998 and therefore had some familiarity with its history, intent, and mechanics. He pointed out that the department had provided a three-page overview [in addition to the analysis] as part of its fiscal note [for HB 16].

REPRESENTATIVE ROKEBERG observed that [the fiscal note] is about half a million dollars.

Number 1693

REPRESENTATIVE KERTTULA asked Mr. Marks whether the department had looked at possible loss to the state in terms of royalties. She also asked that he discuss the original intent of the Act.

MR. MARKS, who was participating via teleconference, said he hadn't heard the first question and so began addressing the history. He explained that in 1997 the legislature passed HB 250, which established a North Slope gas commercialization team in the administration to research and recommend changes to the state law to encourage commercialization of North Slope gas; under HB 250, the administration was supposed to issue a report to the governor by February of 1998. That team did the research and concluded that the North Slope gas commercialization project faced considerable risks. Because of the size of the project needed to make the gas commercial, there were big cost risks and gas-price risks to the sponsors.

MR. MARKS told members that, in addition, "we" concluded that the state's fiscal system actually exacerbated those risks because of three general characteristics. The first was uncertainty: a very high-cost project with marginal economics could be feasible under a certain fiscal system and built under that system, but that system could be changed by statute, which would suddenly make the project not feasible after it was built.

MR. MARKS explained the second risk, the so-called regressive tax system for production tax and royalties. When profits are high, [the state] gets a small share of the profits; when profits are low, it gets a large share. That exacerbates the low-price risk to sponsors, he said, because making large payments to the state when prices are low could increase the possibility of losing money or not recovering their investment.

MR. MARKS discussed the third risk. The property tax is payable once construction starts, which could be years before revenue is generated. On a "time value of money" [basis], it lowers the sponsors' rate of return and increases the probability that they won't be able to recover their investment.

Number 1452

MR. MARKS told members that after the team issued its report to the governor, it worked with the major Prudhoe Bay producers to develop legislation to deal with those risks. The result was HB 393, which ultimately became the Alaska Stranded Gas Development Act, AS 43.82. In general, the law provided a

mechanism for converting the state's fiscal system from a statutory basis to a contractual basis, which provides for greater fiscal certainty. The fiscal system would be negotiated between the administration and the project sponsors; possibly as part of the terms of the negotiation, a less regressive fiscal system could be put in place. Mr. Marks noted another problem with a regressive system: at high prices, the state probably gets less money than it could.

Number 1362

MR. MARKS discussed the general mechanics of the process. A sponsor would submit a project plan and application to the administration; if acceptable under the terms of the Act, the administration would then begin negotiating the fiscal terms with the sponsor. Noting that under the Act all tax provisions in the current statutes would be on the table, Mr. Marks explained that because the royalty represents the state's ownership interests, it was the judgment of the administration that the state should keep the one-eighth - which is 12.5 percent - royalty rate for Prudhoe Bay gas, but that some royalty provisions could be negotiated, namely, the timing for taking royalty-in-kind (RIK) or royalty-in-value (RIV)] gas and the provisions for establishing the valuation method for the royalty.

MR. MARKS explained that once a contract was negotiated, preliminary findings would be submitted to the governor; if the governor chose to proceed, those findings would be given to the legislature and the public for a 30-day review period. After that, the commissioner of revenue would modify the contractual terms as appropriate, and if acceptable to the sponsor; a final contract would be submitted to the governor; the governor would transmit the contract to the legislature with the request for authorization to execute the contract; and the legislature would vote on it.

MR. MARKS addressed other provisions. Calling the property tax the bread and butter for municipalities, he explained that municipalities were concerned about their interests' not being represented in a negotiation. As part of the Act, therefore, a municipal advisory group was set up to participate in developing the contract terms. In addition, there are provisions in the Act for making gas available to communities; for local hire; and for dealing with confidential information provided by the sponsors.

Number 1208

MR. MARKS also pointed out that there was a question of the constitutionality of the Act as a whole, and whether this switching to a contract [basis] by one legislature is binding a future legislature. Noting that Article IX [Section 1] of the state constitution says that the power of taxation shall never be surrendered, suspended, or contracted away, Mr. Marks reported that it was the Department of Law's judgment that [the Act] was constitutional because it was simply putting fiscal terms into a contractual form. Certainly, he said, a future legislature would be able to add tax terms after the contract was in place, but the contract itself would be "a solemn pledge or a moral commitment by the state that once it agrees to this contract, it would not change it." Likening it to "a message to the future from one legislature to another," Mr. Marks said it was the administration's position that it wasn't airtight but was "a strong moral message."

Number 1101

MR. MARKS informed the committee that the Department of Revenue generally supports HB 16. He added that possibly the administration would submit some amendments, although he wasn't aware of what they would be.

Number 1070

MR. MARKS, in response to a question from Representative Rokeberg, said he'd only had [Version H] for about one-half hour and hadn't had time to study it.

REPRESENTATIVE ROKEBERG referred to [Section 1], the proposed amendments to AS 43.82.100 under the heading "Qualified project." He asked whether the new language in subparagraphs (A), (B), and (C) would affect the department's fiscal note.

MR. MARKS said he didn't believe so.

Number 1023

REPRESENTATIVE KERTTULA offered her understanding that part of the intent with the Act was to "try to get the gas going." She asked Mr. Marks whether the lack of an expiration date [in the bill] could actually result in some discouragement, and whether he'd ever looked at the economic picture in terms of whether having an expiration date would provide motivation.

MR. MARKS said [the department] hadn't looked at that question.

Number 0955

REPRESENTATIVE KERTTULA referred to the regressive nature of the tax. She asked Mr. Marks whether [the department] has looked at shifting that tax so that when the return is high, the tax is high, and when the return is low, the state would "shift around."

MR. MARKS said that is exactly what was envisioned to be shifted to. He added, "That's what we call a progressive system, ... which, again, reduces the risk of low prices to the sponsors and gives the state the opportunity to make more money when prices are high."

Number 0917

REPRESENTATIVE KERTTULA asked whether that is what it is envisioned that the commissioner would negotiate for in the contract.

MR. MARKS noted that eight principles to strive for in the Act are listed in existing AS 43.82.210(b). Calling it a blend, he said some of those "sort of counter each other," but that one principle - which is one direction negotiation would take - is that all things being equal, a progressive system is better than a regressive one.

Number 0793

JOE MARUSHACK, Vice President, Alaska North Slope Gas Commercialization, ConocoPhillips Alaska, testified that his company is working hard to commercialize Alaska North Slope (ANS) gas through development of a gas pipeline from Alaska

through Canada to the Lower 48. Urging passage of HB 16, he said it is needed so that ConocoPhillips Alaska and others may initiate formal discussions with the state, leading to a fiscal agreement on commercialization for ANS gas.

MR. MARUSHACK reported that ConocoPhillips Alaska has pursued a clear strategy to commercialize ANS gas for more than a year and a half, including federal enabling legislation to provide a more timely and certain U.S. permitting and regulatory framework; federal fiscal legislation that would mitigate the risk of unexpectedly low gas prices; and state fiscal legislation like HB 16 that provides a mechanism for his company, the state, and others to address issues regarding how the gas will be valued, how it will be taxed, how local impacts will be addressed, and how development costs will be treated.

MR. MARUSHACK said that since at least 1973, Alaskans and companies they work for have labored to overcome significant challenges in bringing Alaskan gas to the market. He cited challenges of the natural environment such as terrain, climate, elevation changes, and seasonal construction limits; technical challenges that have required use of new materials and equipment specifically constructed for this project; and the nature of this commodity, with price uncertainty and volatility being at odds with the huge investment and long-term fiscal commitments required. On the other hand, he said, Alaskans have a huge opportunity for additional jobs in construction and operation of the pipeline, and the state treasury has the prospect of a significant new revenue stream, funds for additional services. Suggesting the state's communities have an opportunity to share in the creation of new wealth, he told members:

The project can become a reality, and the time to move forward together is now. Passage of HB 16 is the first step that the Alaskan government could take towards addressing necessary legislation to move the gas pipeline project forward. However, I ask caution regarding any new amendments or modifications that may have unintended consequences and cause further delays. We need a clean bill that opens up the stranded gas Act process, not one that adds challenges. In closing, ConocoPhillips asks that you pass this legislation.

MR. MARUSHACK requested clarification as to whether the committee was addressing HB 16 or [Version H], but said he was prepared to discuss either.

CHAIR KOHRING clarified that before the committee was Version H.

Number 0531

REPRESENTATIVE CHENAULT asked Mr. Marushack for his thoughts on Version H and whether it helps or hinders the project.

MR. MARUSHACK answered that he hadn't studied it in great detail, having received it a few minutes before the hearing, but that it appears to generally work - and provide what his company needs it for - by removing the [application deadline] date and opening up the Act so it addresses a natural gas pipeline. However, he expressed concern that Section 2 may be somewhat contrary to commercial negotiations. He said it seems the state shouldn't dictate who the parties holding an equity interest in a commercial contract would be. The (indisc.) and the Act already contemplate that any company can participate if it

brings value to the table. He added:

Any party that brings value to the table is a party that the companies can probably work with and negotiate with. I also wouldn't see that it makes sense ... for anybody who can create value to be limited to 1 percent, 10 percent, 50 percent. But those are commercial negotiations. ... We've had some discussions with certain individuals like this, and we always give the same message: If there's true value there, we'll probably going to be able to ... bring that to the table. If there's really not true value there, we hate to see activities that would make the negotiations - and have unintended consequences - delay this project ... even further.

Number 0381

REPRESENTATIVE McGUIRE asked whether there is any harm in keeping [Section 2] in there, though.

MR. MARUSHACK acknowledged that his interpretation may be wrong, but said it appears that individuals may be looking for a commercial advantage through the legislative process. "And we don't think that's helpful at all," he remarked. He indicated, however, that if it lowers the cost and creates a more viable project, then it creates incremental value and is "a negotiation that generally leads to success."

Number 0325

REPRESENTATIVE ROKEBERG asked whether ConocoPhillips is an Alaska-based company.

MR. MARUSHACK answered that Phillips Petroleum Company [which merged with Conoco Inc. in 2002] was a Delaware corporation with "branches, if you will," in various areas including Alaska. "Whether that constitutes an Alaskan company per se, I don't know for sure," he added. "I consider myself to be an Alaskan, but hopefully ... I would not have my ownership interest limited one way or another if I wanted to do this project."

REPRESENTATIVE ROKEBERG remarked that one corporate predecessor of ConocoPhillips was ARCO Alaska, Inc., which at least should have had an Alaskan business license. Deeming Mr. Marushack to be an expert on it, Representative Rokeberg then asked whether he believes it would be helpful or necessary for the bill to include a provision "allowed by special Act of Congress allowing the Alaska railroad to issue IDB [Industrial Development Bonds]," which he suggested may be applicable to this project.

MR. MARUSHACK answered that for the bonding potential which he believed Representative Rokeberg was talking about, if it went through an Internal Revenue Service (IRS) test and truly passed all the requirements so that people lending money to the project could see that it actually would have a tax-exempt-bond basis, then it absolutely would provide incremental value. To the extent that the strength of the federal government is behind the financing - which he said he understands that the bonds may be able to do - the interest rate could be reduced; that would reduce the tariff, raise the wellhead value, and increase royalties. Mr. Marushack pointed out that he couldn't say whether that particular mechanism would pass an IRS test, and emphasized the need to get an IRS ruling that would allow the people lending money to this [project] to have enough assurance

that they would lend under those sorts of terms.

Number 0050

REPRESENTATIVE ROKEBERG indicated there possibly could be 200 basis points as a reduced interest rate. He suggested that a IRS ruling may provide further protection, particularly if related specifically to the project by including it in the Act.

TAPE 03-4, SIDE A

Number 0001

MR. MARUSHACK related [his company's] analysis that it would be perhaps more like 100 basis points. Regardless, he said, if the interest rate really were reduced, it would create incremental value. He also offered the belief that financing doesn't make a bad project good; rather, it is used to make a good project better and actually get it off the ground. "So we would look at this ... on an unfinanced basis to begin with, assuming you had full equity interest in this, and then, if that passed all the tests, so you ... thought you could actually sell that to the financial community, then you'd do that and hopefully make a more economic project at that point in time," he concluded.

REPRESENTATIVE ROKEBERG suggested that this is known to be a good project, but just needs to pencil out.

Number 0121

REPRESENTATIVE FATE asked, if there were a "mix and match" of financial ratings on this project, how the investment bankers would look at it.

MR. MARUSHACK replied:

This happens all the time, and it depends on ... how you want to structure this - whether it's project financed, whether it's financed by the absolute balance sheet of the companies. I don't think we're at a point yet where we know the answer to that, ... and we don't even know who would own this pipeline yet.

Currently, ... or at least last year, we were working with BP and ExxonMobil Corporation, ConocoPhillips; those companies have very strong balance sheets and could get relatively good financing rates. But how that would all blend together, I think, is one of the things that needs to be worked out, which is actually something that I think needs to happen in HB 16.

I believe that one of the real advantages to ... your bill is that it's going to allow people from the state and people from the producers to sit around ... the table for a long period of time and talk about issues just like this: What does financing do to this project? Can you get financing? What if the state needs something that is in conflict with what the financial people think they need to see?

There's a myriad of issues, which is why I think this bill is important to get passed right now, because I don't actually see us getting through this real quickly. I hope we do, but I think it's going to be very complicated and take a lot of work from the state

and the producers, and a lot of sharing of information, probably bringing in experts. It's just a very complicated project. There's nothing like it on earth.

Number 0276

REPRESENTATIVE CRAWFORD asked, since this bill apparently opens it up to any project at any time, whether Mr. Marushack sees that as keeping it a clean bill or whether it adds hurdles.

MR. MARUSHACK replied:

Clearly, ConocoPhillips is focused on a Lower 48 pipeline. We've put a lot of time and effort into that. And if this bill passes, we are going to come forward and ask to qualify, and want to negotiate on a Lower 48 pipeline using ANS gas ... as the product for that. But we have no problem with opening this up to other opportunities For instance, ... I'm not sure this works for Evergreen [Resources], but I hope Evergreen is tremendously successful, and if there's other opportunities out there, I think that's a good thing.

I don't know if this is where you're heading or not: there's clearly a problem we face in Washington [D.C.] with the concept of competing projects - a lot of confusion about ... what does Alaska really want, do they really want a Lower 48 pipeline, do they want something else. And ... my message is always, "I think this is about the only project that works right now, and we should absolutely focus on that." But ... I'm not recommending that we limit utilization of this to a Lower 48 pipeline right now. I don't think that's necessary.

Number 0452

KEN KONRAD, Senior Vice President, BP Exploration (Alaska) Inc., noting that he is the company's vice president for gas, offered the following testimony:

Significant time, effort, and money has been dedicated to develop a viable gas pipeline project to commercialize Alaska's enormous gas resource. Through 2002 and continuing into this year, BP has undertaken further technology-and-design optimization work on the project in an effort to reduce the cost of this \$20-billion project. We're working closely with state, federal, and Canadian agency staff around advanced materials and design, and are inviting them to witness key tests BP will be undertaking this year to validate much of the work we've done. Results to date are very encouraging. However, technical work alone will not be sufficient to make an Alaska gas pipeline a reality.

Before a project can advance to the next stage, three key government actions are needed: a clear and predictable regulatory process with the Canadian government and First Nations, a clear and predictable state fiscal framework around gas in Alaska, and the passage of important U.S. federal legislation. While success is needed on all three fronts, the one thing

Alaska itself can do to advance an Alaska gas pipeline is to sit down and work with industry to develop a fiscal framework for gas that provides confidence that the rules of the game won't change later. Achieving this mutually agreed framework will also send a powerful signal to Washington, D.C., that Alaska is indeed ready to see ... a gas pipeline project advance.

Number 0602

MR. KONRAD continued:

We're very encouraged that our new governor has already spoken to his desire to advance the development of a predictable fiscal framework for gas, and are similarly encouraged that the new legislature appears ready to support advancing this important agenda. ... Reauthorizing the stranded gas Act via House Bill 16 is a good idea. We supported the original stranded gas Act when it was debated and continue to do so. House Bill 16 can provide a framework that supports negotiation toward a clear and predictable fiscal regime in Alaska, and as such, will help support forward progress on gas commercialization.

But we don't necessarily need to wait on passage of this bill to begin engaging on the topic. Dialog with a small, experienced, informed, and empowered negotiating team made up of representatives of the state and the producers can commence anytime. Under any circumstance, any agreements worked with the state will require legislative review and approval.

We do believe that if HB 16 advances, it's important that the bill retains its focus and simplicity as it moves through the legislative process. Otherwise, there's potential failure in the event the bill becomes overburdened with extraneous provisions.

Number 0717

MR. KONRAD informed members that he'd just received Version H one-half hour earlier and hadn't had a chance to review it. He said it appears to be "reasonably clean," although he said he'd want to look at the ownership provision more closely to make sure it doesn't inadvertently restrict his company's ability to retain an interest in the project.

MR. KONRAD reiterated that the one thing the state can do to help move a gas line forward is to take tangible steps towards achieving fiscal certainty. "That, combined with U.S. federal legislation and continued regulatory progress in Canada, will allow Alaska to realize the extraordinary opportunities for jobs, revenue, and economic stability, as the gas pipeline can offer for decades and decades to come," he told members. He concluded by saying that "BP stands ready to work productively with the state towards a clear and predictable fiscal regime."

Number 0809

REPRESENTATIVE ROKEBERG inquired about the political situation with regard to "the First Nations issue" in Canada as well as the current position in Ottawa on granting permits and going

forward on this project.

MR. KONRAD replied that [his company] continues to have a number of "fairly productive" conversations with both the First Nations people and the Canadian regulators, who "have tabled a concept that we believe can work ... to come up with ... a simple, single regulatory process." He said there is still a little ways to go in terms of actually formalizing that. Mr. Konrad told members that he believes things are encouraging, although clearly the big focus right now in Canada is ensuring tangible progress on the Mackenzie Valley project. He expressed support for that, offering his belief that the two projects are complementary and will sequence naturally, and said the North American market can "certainly use all the gas it can get." He added, "Every indication is that they will be supportive of our project once we get some of these other key government actions in place."

Number 0931

REPRESENTATIVE ROKEBERG asked whether the [Canadian] federal government is actually "in the way" and whether his company is actually able to negotiate with them now.

MR. KONRAD answered that he doesn't think they're standing in the way at all. He said a number of ideas have been tabled, but in general there is concurrence. He added, "However, like everyone else, they have finite resources; they're focused right now on the Mackenzie Valley project. But we certainly have expectations ... that during this year we'll have had tangible ... and complete progress in the regulatory arena."

REPRESENTATIVE ROKEBERG offered his understanding that many sellers of gas in the [Lower 48] fear that when this "bubble of gas" from the Mackenzie River area and Alaska hits the market it will cause the market to be depressed, and that therefore those sellers are lobbying in Washington [D.C.] against incentives to build a line. He asked whether that is one of the biggest problems [the producers] are dealing with.

MR. KONRAD responded that, clearly, a number of parties are saying a number of things, and that it is far from simple. He said that in Canada, however, "things feel ... pretty good," and that the group there is almost ready to file permits; that project simply is ahead of the Alaskan project. He indicated his company continues to tell people in Canada, Washington [D.C.], and Alaska that clearly in the 2010-plus timeframe the market will be able to easily accommodate these volumes of gas. A question on a national policy issue is whether the preference is to have gas from Alaska, import LNG, or burn oil in power-generation plants. He said it isn't a matter of too much gas coming into the market.

Number 1127

REPRESENTATIVE KERTTULA asked Mr. Myers to describe what Version H possibly could apply to, particularly with regard to any other technology or area.

Number 1170

MARK MYERS, Director, Division of Oil & Gas, Department of Natural Resources, answered:

I believe it would qualify for, certainly, any gas-to-

liquids projects, basically any statewide project that could produce the volume qualifications of 500 bcf over the 20-year period. It could potentially apply, ... I believe, to natural gas liquids shipped down, say, ... a conventional oil pipeline like we do now on the Slope. So, basically, it would be slopewide and certainly would apply to LNG as well as conventional gas. It is conceivable in some basins, like the Nenana basin, there may be sufficiency of gas, assuming there was a way to export it beyond the Fairbanks market, to apply - and possibly for coal bed methane, [although] that would be a large quantity of coal bed methane gas to produce ... over a 20-year period. So, certainly, it's broad and flexible.

Number 1232

REPRESENTATIVE KERTTULA asked if there is a real need for incentives for all possible projects, no matter when or where.

MR. MARKS offered the judgment that given the size of all these projects, they are risky. Fiscal uncertainty adds to the other financial risks, he said, and these projects are marginal or "on the line" now, so any risk reduction is good and will help these projects.

REPRESENTATIVE KERTTULA asked, "How far down would you reduce that risk?"

MR. MARKS answered that he believes fiscal [uncertainty] is a risk that can be reduced, and that he wouldn't characterize it as "going down" because the state wouldn't necessarily come out behind as a result of simply nailing down its fiscal system. He continued:

In addition, this Act provides the opportunities to improve the fiscal system so that, indeed, under certain conditions, especially those of high prices, the state can ... come out much, much better than what it would do ... under the current fiscal system. So I don't believe the state ... is giving up anything by going into this process and, indeed, could ... come out far, far better than what it is now.

Number 1373

REPRESENTATIVE KERTTULA expressed a "lawyer's comment or concern" about opening this up. She asked how difficult it would be to rewrite the statute so that instead of relying on a contract, the provision Mr. Marks was talking about - in terms of making it a progressive rather than regressive tax scheme - would be put in statute; that way, all parties would know what they are getting.

MR. MARKS answered that the statutes could certainly be changed to make a more progressive system, which would reduce the risks associated with a regressive or "front-end-loaded" tax system. However, the issue of fiscal uncertainty would remain. In further response, he explained that the state could establish a statutory fiscal regime and yet a sponsor would question whether to spend \$20 billion without knowing what the tax rate would be, which may make the project uneconomical. Once the project is built, one can't "unbuild it," he pointed out, and so just having it be subject to changes in the [state's] fiscal system adds to the uncertainty and fiscal risk.

Number 1483

CHAIR KOHRING announced that HB 16 would be held over at the request of the sponsor, as well as to deal with questions about Section 2 of Version H and to have discussions with other groups. He expressed support for the concept of the bill and an intent to move it forward soon. [HB 16 was held over.]

DRAFT

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 5:16 p.m.

DRAFT

Bill Root: Display Bill Root



TO REPORT PROBLEMS WITH BASIS INQUIRY

LIVE KTOO STREAMS

[Return to Basis Main Menu \(23 Legislature\)](#)

[Return to Legislature Home Page](#)

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: HB 16
() Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
Title Stranded Gas BRU Administration and Support
Development Act Amendments Component Commissioner's Office
Sponsor Representatives Fate and Whitaker
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 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 |
|------------------------|--------------|--------------|------------|------------|------------|------------|
| Personal Services | 89.5 | 89.5 | | | | |
| Travel | 25.0 | 25.0 | | | | |
| Contractual | 150.0 | 200.0 | | | | |
| Supplies | 2.0 | 2.0 | | | | |
| Equipment | 5.0 | 1.0 | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| TOTAL OPERATING | 271.5 | 317.5 | 0.0 | 0.0 | 0.0 | 0.0 |

| | | | | | | |
|-----------------------------|--|--|--|--|--|--|
| CAPITAL EXPENDITURES | | | | | | |
|-----------------------------|--|--|--|--|--|--|

| | | | | | | |
|-------------------------------|--|--|--|--|--|--|
| CHANGE IN REVENUES () | | | | | | |
|-------------------------------|--|--|--|--|--|--|

FUND SOURCE (Thousands of Dollars)

| | | | | | | |
|--------------------------------------|--------------|--------------|------------|------------|------------|------------|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | 121.5 | 117.5 | | | | |
| 1005 GF/Program Receipts | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| 1108 Statutorily Designated Receipts | 150.0 | 200.0 | | | | |
| TOTAL | 271.5 | 317.5 | 0.0 | 0.0 | 0.0 | 0.0 |

Estimate of any current year (FY2003) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

| | | | | | | |
|-----------|---|---|--|--|--|--|
| Full-time | 1 | 1 | | | | |
| Part-time | | | | | | |
| Temporary | | | | | | |

ANALYSIS: (Attach a separate page if necessary)

See attached analysis.

Prepared by: Larry Persily, Deputy Commissioner Phone 465-5469
Division: Department of Revenue Date/Time 2/5/03 2:59 PM
Approved by: Larry Persily, Deputy Commissioner Date 2/5/2003
Agency: Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. HB 16

ANALYSIS CONTINUATION

BILL DISCUSSION

The intent of the Stranded Gas Development Act, AS 43.82, is to provide a mechanism for achieving the fiscal certainty that potential project sponsors say they need before proceeding with the large investment needed to bring Alaska North Slope natural gas to market. The Act allows the state to negotiate a contract for payments in lieu of taxes with a project sponsor. This contract could cover all state and municipal taxes and royalties on a project, including state corporate income taxes, production taxes, royalties, state and municipal property taxes, and any special municipal assessments.

This bill (House Bill 16) would amend the 1998 Stranded Gas Development Act to:

- Expand the Act to include a natural gas pipeline to serve mid-America as an eligible project under the law. The existing statute limits the application of the Act to only liquefied natural gas projects. This change would allow sponsors of either an LNG project and/or a natural gas pipeline to mid-America to apply to the state under the provisions of the Act to negotiate a contract for payments in lieu of taxes. This amendment also would limit eligible applicants under the Act to only a natural gas pipeline to mid-America that would parallel the Trans-Alaska Pipeline System and the Alaska Highway, thereby eliminating from inclusion in the Act the so-called "over-the-top" route.
- Eliminate the June 30, 2001 deadline in existing statute for project applications. This legislation does not introduce a new deadline, but rather simply eliminates any deadline in statute.
- Add a requirement that only those projects producing gas from north 64 degrees north latitude (roughly Delta Junction) would qualify for the provisions of the Act.

OPERATING EXPENSES

The Act allows the Department of Revenue under AS 43.82.240 to recover from a project applicant the costs of contracting with an independent consultant to assist the state in evaluating applications submitted under the Act and in developing contract terms. Those statutorily designated program receipts are shown above.

The Act does not allow the state to seek reimbursement from a project applicant for any other costs. The department would hire a project manager for the estimated two years of contract development, negotiations and approval, and the personnel services, travel and equipment expenses for that position and other commissioner's office expenses are shown in the fiscal note as General Fund money.

The above costs are essentially the same as the Legislature approved for the Department of Revenue in passing the 1998 Stranded Gas Act.

The Stranded Gas Development Act

The Stranded Gas Development Act, AS 43.82, was passed into law by the Alaska Legislature in 1998. During the session it was House Bill 393. The application deadline for a project application under the Act was June 30, 2001. There were no applications by that date. Legislative action is required to reopen the option for a gas project developer. Such a reopener failed to win legislative approval last session, and has been introduced again this year as HB 16, sponsored by Representatives Fate and Whitaker.

The Act's genesis was in HB 250, which in 1997 established a North Slope Gas Commercialization Team in the administration to research and recommend changes to state law to encourage commercialization of North Slope gas. The team issued a report to the Governor in February 1998. The team's conclusions were that the project faced considerable risk, namely construction cost risk and gas price risk, and the state's fiscal system exacerbated those risks. Three of the risks of particular concern were fiscal uncertainty, the state's regressive tax system, and the front-end aspects of the fiscal system. We will discuss these in turn.

Given the high cost of the project, coupled with the volatility of gas prices, the project is financially risky. Given that the project is marginal under the current fiscal system, there is concern among potential project sponsors that if a project is started, the state could later modify the fiscal terms after the project had been built, changing its overall attractiveness to investors after they had invested. This is the fiscal uncertainty risk.

Second, there are two significant elements of the state's fiscal system that make it regressive. Regressivity means that the state's take in terms of share of the profits is high at low prices and low at high prices. Regressive systems exacerbate the risk of low prices to the project developers. First, the property tax is based on cost of the asset. The higher the cost, the higher the tax. Second, the basis of value for the severance tax and royalty is at the wellhead and does not consider capital and operating costs. Thus when capital and operating costs are high, and prices are low, the state's take is a high percentage of the low profits. (Regressive systems also reduce what the state's take could be at high prices, which means the state loses out on a greater slice of revenues during high prices and high profits.)

Third, the property tax makes for a front-end loaded system. The property tax is payable when construction begins, which could be several years before revenues start accruing. On a time value of money basis, this diminishes the rate of return on the project and exacerbates the risk of not recovering the investment.

Page 4 of 5
House Bill 16
Department of Revenue

After the team issued its report to the Governor, it worked with the major Prudhoe Bay producers to develop legislation to deal with these risks. The producers at the time had been studying commercializing gas through an LNG project to tidewater. The result was HB 393.

The law provided a mechanism for converting the state's fiscal system from a statutory basis to a contractual basis. This would provide for greater fiscal certainty. The fiscal system would be negotiated between the administration and the project sponsors and approved by the Legislature. And per the Act the contract terms could provide for a more progressive (less regressive) system.

The process for developing the contract was as follows: A sponsor would submit a project plan and application to the administration for contract negotiation. The project had to produce 500 billion cubic feet within 20 years and be an LNG export project. (The original bill called for any project. It was changed to only LNG during the legislative process.)

The sponsor group would negotiate fiscal terms with the state. Payments to the state would be made in-lieu of taxes. Fiscal terms would be customized to the specific project structure. The term of the contract could not exceed 35 years.

The commissioner of Revenue would be the primary agent for negotiating and implementing the contract. However, the commissioner of Natural Resources is also responsible for reviewing the project plan for acceptability, and for negotiating changes in royalty terms, if any.

The law allowed the commissioner of Revenue to use independent contractors to assist in the evaluation of any project application, and to condition the contract on an agreement with the project applicant that it would fully reimburse the state for the cost of the contractors retained for the state's analysis. The fiscal note for the legislation authorized the Department of Revenue to collect and expend those application fees to cover its contractor costs. The Legislature also approved General Fund money for the Department of Revenue to hire a full-time project coordinator for two years to help manage the application review and negotiations. That position was never filled because there was no project application.

In addition to replacing state oil and gas production taxes and corporate income taxes with a contract for payments, the Act also allowed the Revenue commissioner to include municipal sales taxes, municipal special assessments, state and municipal property taxes and any other state or municipal taxes in the negotiations. The intent was to wrap up as much as possible into the contract for payments in lieu of taxes.

Page 5 of 5
House Bill 16
Department of Revenue

Once a contract was developed, preliminary findings would be submitted to the governor. If the governor chose to proceed the preliminary findings would be given to the Legislature and the public. There would be a 30-day public review period.

After the review, the commissioner of Revenue would modify the contractual terms as appropriate and if acceptable to the sponsors. The final contract would be submitted to the governor. The governor would transmit the contract to the legislature with a request for authorization to execute the contract. Finally, the legislature would vote on it.

There was great concern by local municipalities that a contract could compromise the property tax revenues they might receive, especially given the concerns about the property tax discussed above. Accordingly, the Act requires that a portion of the payments due under the contract is paid to affected municipalities. Also, the law created a municipal advisory group to participate in developing contract terms.

The law also has provisions intended to help make gas available to communities, to promote local hire, and to deal with confidential information provided by the sponsors.