

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2648 SCOMM 118: HOUSE SPECIAL COMMITTEE OIL & GAS, 1999-2000

Through 1999 the TAPS owners had collected \$1.535 billion — more than 98% of the total DR&R requirement. That averages about \$0.12 per barrel in nominal dollars (\$0.20 per barrel in today's inflation-adjusted dollars). But a statement of cash collected for DR&R obscures what Paul Harvey might call the rest of the story. Subsequent analysis revealed three salient characteristics of these calculations that appear to run directly counter to standard rate-making practices, and to common sense:

- The DR&R collection schedule is accelerated, or "front-loaded;"
- The amounts to be collected for DR&R are cast in concrete; and
- the funds are not escrowed or placed in a special reserve account).¹⁵

Taken together, these characteristics of the DR&R created a windfall of enormous proportions to the TAPS owners. A closer look at each is therefore warranted.¹⁶

- Accelerated recovery of DR&R. Payments to reimburse the Owners for future DR&R outlays are collected under TSM on a steeply accelerated or "front-loaded" schedule. The reason for collecting DR&R in advance of actual outlays is to match those costs with barrels shipped during the existence of the pipeline; that makes good sense. But the decision to accelerate those advance collections is a different matter altogether. There are clear public policy reasons for allowing a pipeline owner to recoup capital investment on an accelerated depreciation schedule — for example, to make capital available more rapidly for further development. Indeed, front-loaded recovery of *prior* expenditures is one of the primary bases for the 1985 settlement. But allowing accelerated collections in advance for *future* cash outlays is a gift to the pipeline owners that, on its face, simply does not make sense.

2011. As to how these figures are derived, Exhibit E of the settlement is silent. (*Settlement Agreement between the State of Alaska and ARCO Pipe Line Co.*, June 28, 1985, p. 14 and Exhibit E.)

¹⁵ See: *Prefiled Testimony of Rudolph L. Bertschi* (Alaska Public Utilities Commission Docket No. P-86-2), December 17, 1986, pp. 63-70. For additional discussion, see also: Antony Gordon Scott, *The Trans-Alaska Pipeline System: The Consequences and Causes of Regulatory Failure* (Master of Science Thesis, University of Wisconsin - Madison, 1996), pp. 59-68.

¹⁶ The following discussion, which follows Bertschi and parallels Scott, is taken from Richard A. Fineberg, *Overcollection and Failure to Escrow TAPS DR&R Funds: Imputed Present and Future After-Tax Value to TAPS Owners of Excess DR&R Collections Under TSM* (prepared for the Alaska Conservation Alliance, June 24, 1999). See also: Richard A. Fineberg, *Hidden Billions: The TAPS DR&R Provision* (prepared for Stan Stephens, August 1992).

- Terms cast in concrete. Unlike the settlement methodology as a whole — which consists of formulae for determining the maximum amount the TAPS Owners may collect each year for each element of the tariff — the DR&R numbers are stated in hard dollars. In 1985 it was virtually impossible to estimate the correct amounts to pre-collect for DR&R. Even if the year of pipeline shutdown could have been known with certainty, three other estimating factors necessary to calculating the correct pre-collection of DR&R through the tariff were uncertain or unknown at that time: Specifically, the annual amounts listed in the Settlement Agreement were based on assumptions regarding (1) the return the Owners would realize from the pre-collected funds during the years between collection and expenditure and (2) the rate of inflation during those years. Since the DR&R collections constituted income until the funds were expended, the pre-collected funds would be taxable; the DR&R collections were therefore "grossed up" by (3) the estimated income tax. Finally, (4) nobody knew in 1985 (and nobody knows today) when TAPS will actually be dismantled. Under normal utility rate-making principles, elements that are difficult to forecast are typically recalculated periodically; not so with TAPS DR&R. The almost inevitable errors in each of these 1985 estimates has caused DR&R over-collections of enormous proportions.

- Collections not escrowed. TSM might have required that TAPS DR&R collections be held in escrow, or even placed in a special internal account. In a subsequent North Slope pipeline tariff proceeding, a FERC Administrative Law Judge ruled that because the amount necessary for DR&R was so difficult to estimate, DR&R funds should be placed in escrow to ensure refunds to the rate-payers (shippers) in the event of over-collection.¹⁷ Another policy problem results from the failure to escrow DR&R collections. At some point in the future, as TAPS shutdown nears, the North Slope producers may claim that the need to expend funds for DR&R will deprive them of capital that might otherwise be invested in efforts to extend production. Under these circumstances, the State may be forced to choose between requiring DR&R funds be used for the purpose for which they were collected or continuing North Slope production.

¹⁷ Paul J. Fitzgerald, Presiding Administrative Law Judge, "Initial Decision (October 26, 1988)," in: Kuparuk Transportation Co., Docket Nos. IS85-9-000 and OR85-1-000, pp. 77-83. (That decision was rendered moot in 1991 by a settlement between the state and the Kuparuk pipeline owners.)

Together, these attributes of TAPS treatment of DR&R created an enormous financial gift to the owners of TAPS. Last year I estimated that if TAPS shuts down in 2011, industry's tax-paid profit from DR&R collections — over and above the costs of DR&R itself — is likely to be somewhere between \$12.5 to \$16.0 billion, with earlier estimates ranging from approximately \$4.3 to \$20.5 billion (all estimates in 1999 dollars). The spreadsheet showing the facts and assumptions that produce an after-tax windfall to the TAPS owners of \$16.0 billion is attached as Exhibit D. If TAPS operates past 2011 and the earnings of the owners exceed inflation, gains to the TAPS owners will be even greater; few expect the line to shut down in 2011 and average earnings of the TAPS owners beat inflation in each of the first 21 years of pipeline operations.¹⁸ The imputed value of those collections at the end of 1999 was approximately \$5.0 billion to \$5.5 billion.¹⁹ Were dismantling required today, adjusting the settlement estimate in current (year 2000) dollars, the operation would cost approximately \$2.5 billion.²⁰

Although TSM was discussed at some length in 1985, the public debate ensued after the Administration and ARCO announced the settlement they had worked out in extended negotiations. I cannot recall any significant public discussion of DR&R during those after-the-fact settlement discussions, despite its magnitude, DR&R somehow fell between the cracks.²¹ It was one year after the settlement was adopted that the Alaska Public Utilities Commission's staff expert witness revealed that the DR&R

¹⁸ See: *Overcollection and Failure to Escrow*, Table 4 (attached here as Exhibit E).

¹⁹ The lower estimate values DR&R collections at 1% below the rate of the weighted average return on all TAPS owner equity during this period; the higher estimate assumes that DR&R earnings equalled TAPS owner return to equity. See: *Overcollection and Failure to Escrow*, Tables 4 and 5.

²⁰ See Exhibit D. (Estimate derived by multiplying the settlement estimate of \$872.1 million in 1977 dollars [column G] by inflation factor [column E].)

²¹ One reason DR&R was overlooked during the TAPS settlement controversy may be that the provision was portrayed as revenue-neutral by the Department of Law and the U.S. Dept. of Justice. The 111-page explanatory statement the State of Alaska and the U.S. Department of Justice submitted to FERC with the settlement discusses DR&R in one paragraph that states:

The schedule for the DR&R Allowance is found in Exhibit E of the Agreement. See Section II-4. As with the depreciation schedule described below, the DR&R schedule was accelerated in order to further Protestant's [State's] objective of ensuring a declining tariff profile. The annual amounts were calculated so that when they are accumulated at a rate equal to the after-tax yield on Moody's Aa bonds, the balance will be sufficient to meet the expected costs of dismantling, removal and restoration of TAPS, stipulated for purposes of the TSM [TAPS Settlement Methodology for tariff calculation] at \$872 million in 1977 dollars. (Explanatory Statement, pp. 30-31; emphasis added.)

provision constituted what he termed a hidden or off-book windfall to the TAPS owners.²²

With this background in mind, we are now ready to look at what happened to the income tax portion of the DR&R component of the TAPS tariff.

III. Income Tax Payments on TAPS DR&R

Public disclosure of this scam came about in January in a challenge to TAPS tariffs before the new Regulatory Commission of Alaska brought by the Tesoro Petroleum Co. One issue Tesoro raised was the manner in which the tariff treats DR&R. The new commission found itself facing a barrage of confusing claims and counter-claims about TAPS tariffs. The RCA therefore requested all parties to file legal briefs on various aspects of the DR&R question, including its tax treatment.²³ In preparing its response to a question regarding the appropriate tax treatment of the DR&R funds, the Department of Law apparently discovered that although the 1985 TAPS Settlement Agreement increased DR&R collections to pay federal income tax, the TAPS owners then "took federal tax deductions for TAPS DR&R in advance of incurring the actual expense."²⁴

According to the Department of Law's brief, the 1985 settlement agreement "assumes that since DR&R funds are treated as taxable income... (and) that the TAPS carriers cannot take a deduction for DR&R expenses until such expenses are actually incurred." According to the Department of Law's brief, the TAPS owners had explained to FERC that the TAPS Owners "pay taxes on the DR&R collections on a current basis, but the deductions will not be available until far in the future." However, the brief continued, the State recently learned "that the TAPS Carriers have taken current-year deductions for TAPS DR&R expenses, despite the fact that such expenses have yet to be incurred." The State's brief included excerpts

²² *Prefiled Testimony of Rudolph L. Bertschi.*

²³ "Order of Administrative Law Judge Documenting Procedural Schedule," Regulatory Commission of Alaska, Docket No. P-97-7, Order No. 40, Sept. 22, 1999.

²⁴ The Department of Law advised the RCA that "(t)he State is currently evaluating the ramifications of this, and is not able to submit a complete answer to the Commission's question at this time." ("State of Alaska's Brief on DR&R Legal Issues," Regulatory Commission of Alaska, Docket No. P-97-7, Jan. 26, 2000, pp. 3, 21.)

of a public petition Exxon filed in U.S. Tax Court in 1990 that stated in part:

In a July 20, 1988 Closing Agreement under section 7121 of the Code, the Commissioner and the TAPS participants, including Exxon Pipeline, agreed to the proper section 162 deduction for TAPS dismantlement and restoration costs. Although Exxon Pipeline's ownership interest during 1980, 1981, and 1982 was 20.3378 percent, the Commission used a 20 percent ownership interest in determining the . . . deduction.²⁵

It was a remarkable revelation. The IRS ruling eliminated the need for the income tax surcharge on tariff collections for DR&R. But the terms of the 1985 settlement welded the DR&R amounts into the tariff. Unlike most of the other elements in the tariff (including income taxes on the profits built into the tariff), the DR&R provision was immutable; the tariff collection for income taxes on money collected in advance to pay for future dismantling apparently remained in the tariff, even though there was no tax to be paid. I'm not a lawyer, but it seems to me that when you collect money for one purpose and then divert it to your own pocket, that's ill-gotten gains and tantamount to fraud.

What has happened in the ten weeks since the Department of Law disclosed the problem? Earlier this week an attorney in the department told me that the department is still trying to obtain documents to determine what actually happened to both the State and the Federal income tax payments on TAPS DR&R. Because the department does not yet have the full story, he said, it would be premature to quantify the consequences at this time.²⁶

You asked me to attempt to quantify the effects on state receipts. For a number of reasons — not the least of which is the veil of taxpayer confidentiality which screens the detail of these activities from view — this is difficult to do. Let me tell you what I have been able to figure out from the public record.²⁷ In the interest of making sure we lay out the best

²⁵ *Ibid.*, pp. 19-20.

²⁶ Michael Barnhill, Assistant Attorney General, April 10, 2000 (telephone message in response to query).

²⁷ The TAPS Carriers have attempted to classify as "confidential" the 1988 closing agreement from which the Department of Law quoted in its Jan. 26 brief. (Vinson & Elkins, LLP, "Petition to Classify Records as Confidential," Regulatory Commission of Alaska, Docket No. P-97-7, Jan. 14, 2000.) The Department of Law subsequently opposed this motion. Earlier this week, in response to various confidentiality issues in its tariff proceedings, the RCA issued an order on confidentiality. I do not know

information possible, I hope the Department of Law will clarify if I have misunderstood or mis-stated the limited and still unfolding information on the public record.

The TAPS Owners and the State of Alaska (Department of Law) have advised the RCA that the amounts collected to pay income tax on DR&R collections through August 1999 is approximately \$765 million — \$663 million for Federal income tax and \$102 million for State income tax.²⁸

Let's take with State income tax first. It should be a simple matter, but it's not. To deal with State income tax, the first thing we would need to know is: Does the State collect corporate petroleum income taxes on TAPS DR&R collections, or do we follow the IRS on this matter? If the Department of Law knows the answer to this question, I have not found it in the public record. It strikes me that the Department of Law could obtain the answer to this question without infringing on taxpayer confidentiality question simply ask the Department of Revenue what the TAPS Owners have paid in corporate Petroleum income taxes on TAPS DR&R. Since these would be aggregate numbers involving, at present, seven different corporate taxpayers, I should think the Department of Revenue should have no problem of taxpayer confidentiality in responding to this question on the public record.

As you know, BP recently paid \$416 million to settle State corporate income tax disputes. I do not know whether this amount includes payments for TAPS, whether those amounts were already paid in full, or whether a deduction was granted.²⁹ While the Department of Revenue may not be able to answer these questions publicly due to taxpayer confidentiality, I know of nothing that would prohibit BP from providing you with the answer to these questions.

the effects of this order on the ability of the public to delve further into this issue; my testimony today, in any event, is based only on materials filed publicly to date.)

²⁸ "State of Alaska's Response to Commission's Request for Joint A Stipulation of Facts," Regulatory Commission of Alaska, Docket No. P-97-7, Oct. 25, 1999, pp. 3-5; "TAPS Carriers' Revised Statement of Facts," Docket No. P-97-7, Nov. 12, 1999, pp. 2-4.

²⁹ If the \$416 million included amounts for failure to pay income tax on income for TAPS DR&R, another question might be asked: To induce better corporate behavior and avoid the recurrence of similar problems, was a penalty sought and/or collected?

Since I don't know the answer to these basic questions about State income tax collections, I'm going to have to leave out the \$102 million and deal with the fiscal effect on State revenue of the \$663 million the TAPS Owners have collected through the years for the assumed purpose of paying Federal income taxes on the revenue they received for the future dismantling of TAPS. As you know, it is a general rule of thumb that every time the price of oil goes up (or transportation costs go down), the State of Alaska gains or loses approximately \$0.25 of that amount. Multiply 663 by 0.25) and you get 160.75 put a dollar sign in front a million behind it, and you get \$160,750,000. Adjusted to current- year dollars using the inflation factors in Exhibit D, that amount would exceed \$250 million in losses to the State resulting from the industry's sleight-of-hand. To that amount must be added State income tax losses, if any, plus interest due on back taxes (if any).

IV. Policy Implications: Why is this strange story only now coming to light?

The Department of Law is responsible for the management of TAPS tariff issues at the Federal Energy Regulatory Commission (FERC). I am aware of few other instances in State government in which the Department of Law makes and executes policy. Typically, the Department is representing a client agency. In the interest of full disclosure, I would be remiss if I did not tell you that in various commentaries over the last year I have noted that many of the people who formulated State oil and gas revenue administration and collection policies are responsible for implementing those policies today. I have also noted that the external counsel who assisted the Department of Law in negotiating the 1985 TAPS settlement has continued to represent the State of Alaska in pipeline tariff matters at FERC during the 15 years since the TAPS settlement.³⁰ With this background in mind, let's review the indicators that might have prompted a more timely and aggressive look at this problem prior to the year 2000:

- 1985 — The Department of Law, on behalf of the State of Alaska, entered into the TAPS tariff agreement with its unusual DR&R provision.

³⁰ See, for example: Richard A. Fineberg, "Troubling questions pester ARCO-BP merger, Anchorage Daily News (Forum), Oct. 7, 1999, p. B-10.

- 1986 — The Alaska Public Utilities Commission staff expert witness pointed out that the DR&R provision conferred extraordinary hidden profit to the industry — in part because taxes were pre-collected at an assumed rate of 46%, but the Federal corporate income tax rate was subsequently lowered significantly.
- 1988 — The TAPS Owners secured a deduction that apparently exempted DR&R income from Federal income tax.
- 1990 — I prepared and published a report for the Alaska State Legislature on problems associated with petroleum litigation settlements. The report included a lengthy case study on the 1985 TAPS settlement.³¹
- 1990 — Exxon disclosed its deduction publicly when it sought to increase the deduction granted in the 1988 closing agreement from 20% to 20.336%.
- 1992 — I re-calculated the gains to the TAPS Owners from DR&R in a privately funded report whose results were reported in the press.
- 1993: A Legislative Research Report raised the question of whether TAPS payments should be audited;
- 1996 — In an economic analysis of the 1985 TAPS tariff settlement, a University of Wisconsin Master's Thesis confirmed that TAPS DR&R collections were excessive; that study also identified income tax collections as one of the contributing causes.
- 1998 — The fact that the TAPS Owners received ~~an~~ ^{deduction} DR&R income was discussed several times in open court during a U.S. Tax Court proceeding in Washington, D.C.

I will conclude this strange story by quoting from the introduction to my 1990 report to the Alaska State Legislature on the 1985 TAPS settlement:

This review of the documentary record of materials provided to the Governor, to the Legislature and to the public before and after the 1985 settlement of the Trans-Alaska Pipeline System (TAPS) rate case reveals twenty examples of omission, misinformation, needlessly obscure and delayed presentations

³¹ Richard A. Fineberg, *The 1985 TAPS Settlement: A Case Study in the Effects of Confidentiality on Information Available to Decision Makers in Oil and Gas Revenue Disputes (Supplemental Report)*, prepared for the Alaska State Legislature, February 5, 1990.

that may have hampered policy makers making and reviewing key policy decisions concerning what has been called the largest and most complicated litigation in the history of the United States. . . . While specifics of current cases and their management cannot be discussed in detail due to the restraints of taxpayer confidentiality and the need to preserve attorney-client privilege matters affecting litigating strategy, it is not unreasonable to assume that the potential for similar problems exists at this time in the State's management of tax, royalty and pipeline disputes with the oil companies that operate on Alaska's North Slope.³²

While I commend the Department of Law for its bringing the current problem to light, the problem itself, the delay in discovery and the difficulties encountered in assessing the problem lead me to believe the conclusions I drew in my report to the Legislature a decade ago are still valid today.

³² *Ibid.*, pp. 3-4.

04/20/2000 10:12
From the desk of


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To: Lori Backes
House Oil & Gas Committee

Date: April 18, 2000

Fax #: 907 / 465-2070

No. of Sheets (including this sheet): 2

Re: Corrections and Additions to My Written Testimony 4/13
Regarding: Federal Income Tax Payments on the Dismantling
Element of the Trans-Alaska Pipeline System (TAPS) Tariff

In order to provide you the clearest possible written record on this subject, here are corrections to typographical errors in the written Testimony I presented to the House Oil & Gas Committee April 13. These changes do not affect the assessment of fiscal effects I presented; nor do these corrections affect my conclusions regarding the roots of this problem.

Page 8, line 8 — "Exhibit D" should read: "Exhibit E."

Page 8, fn. 20 — "See Exhibit D" should read: "See Exhibit E."

Page 9, fn. 24 — "State of Alaska's Brief on DR&R Legal Issues" should be dated Jan. 10, 2000 (not Jan. 26).

Page 9, Part III., par. 2, line 3 — Delete the word "(and)."

Page 11, par. 3, line 8 — Delete the word "question."

Page 12, line 9 — the phrase "0.25) and you get 160.75" should begin with an open parenthesis and end with a semi-colon. The corrected phrase should read: "Multiply 663 by (0.25) and you get 160.75; put. . . ."

Page 15, Exhibit E. — The final exhibit to this testimony is Table 4 of my June 24, 1999 report (not "Table 3").

These are all the corrections of which I am aware. You may wish to note them on the copies of my testimony you retain on file. Alternatively, I can re-submit the testimony with the corrections listed above.

Additionally, the following information may add support to my conclusion that an alert administration should have identified and remedied this problem long ago:

Page 13, 1993 — The Legislative Research report is: *Distribution of Income from Alaska Oil and Gas Operations and the Role of State Tax Policy*, September 1993 (Legislative Research Agency Report 93.001, September 1993). (The report discusses tariff administration with particular reference to questions relating to audits and income tax provisions at pp. 25-28.)

Page 13, 1996 — In 1996, I asked BP to explain entries on its FERC Form 6 indicating tax deferral for TAPS DR&R; copies of the inquiry were provided to the Department of Revenue. (The department looked into the question and subsequently reported informally that the items in question referred to the accounting for tax treatment of TAPS tariff DR&R collections.)

Thanks to you and the Chairman for your follow-through on this issue; I hope the information I have provided from the public record will assist you in resolving the problem; if I can provide additional assistance or insight, please let me know.

List of Exhibits

Exhibit A. "State of Alaska's Response to Commission's Request for Joint A Stipulation of Facts," Regulatory Commission of Alaska, Docket No. P-97-7, Oct. 25, 1999; "TAPS Carriers' Revised Statement of Facts," Docket No. P-97-7, Nov. 12, 1999.

Exhibit B. "How TAPS Tariffs Affect Owner and Non-Owner Shippers (Base Case)," from Richard A. Fineberg, *The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope*, Oilwatch Alaska, October 23, 1997, Table 1.1.

Exhibit C. "Effects of Non-Cost-Based Tariff Increases on State, Owner Shipper and Non-Owner Shipper," from Richard A. Fineberg, *The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope*, Oilwatch Alaska, October 23, 1997, Table 1.2.

Exhibit D. "Imputed Value of TAPS Dismantling Funds (DR&R) Collected Under TSM" (1985 Assumptions), Richard A. Fineberg, *Overcollection and Failure to Escrow TAPS DR&R Funds: Imputed Present and Future After-Tax Value to TAPS Owners of Excess DR&R Collections Under TSM* (prepared for the Alaska Conservation Alliance, June 24, 1999), Table 3.

Exhibit E. "Imputed Value of TAPS Dismantling Funds (DR&R) Collected Under TSM" (1985 Assumptions), Richard A. Fineberg, *Overcollection and Failure to Escrow TAPS DR&R Funds: Imputed Present and Future After-Tax Value to TAPS Owners of Excess DR&R Collections Under TSM* (prepared for the Alaska Conservation Alliance, June 24, 1999), Table 3.

STATE OF ALASKA
BEFORE THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Nanette Thompson, Chairperson
Patricia DeMarco
James Strandberg

In the Matter of the Petition of TESORO ALASKA
PETROLEUM COMPANY for an Investigation into
the Amounts Collected by AMERADA HESS
PIPELINE CORPORATION; ARCO
TRANSPORTATION ALASKA, INC.; BP
PIPELINES (ALASKA) INC.; EXXON PIPELINE
COMPANY; MOBIL ALASKA PIPELINE
COMPANY; PHILLIPS ALASKA PIPELINE
CORPORATION; and UNOCAL PIPELINE
COMPANY for Dismantling, Removal and Restoration
of the Trans Alaska Pipeline System

P-97-7

STATE OF ALASKA'S RESPONSE TO COMMISSION'S REQUEST FOR JOINT
STIPULATION OF FACTS

On September 10, 1999, and September 22, 1999, the Commission ordered
the parties to attempt to stipulate to three factual issues. The parties have been unable to so
stipulate for the reasons set forth in the Public Advocacy Staff's motion for clarification, filed
October 19, 1999.

The State of Alaska neither joins in nor opposes the Public Advocacy Staff's
motion for clarification. The State does not need clarification of the Commission's orders,
but to the extent that other parties need such clarification, the State has no opposition to any
party seeking such clarification.

10/25/99

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1
2
3 In interest of furthering the progress of this docket, the State submits this
4 response to the Commission's questions:¹
5

6 1) The amount of DR&R funds that have been collected through August 31,
7 1999:

8 The amount of DR&R funds collected from TAPS shippers pursuant to the
9 1985 Interstate TAPS Settlement Agreement and the 1986 Intrastate TAPS Settlement
10 Agreement is as follows:
11

12 Year	DR&R Collection
13 1977	\$ 23,536,000
14 1978	95,967,000
15 1979	113,142,000
16 1980	127,182,000
17 1981	120,225,000
18 1982	121,148,000
19 1983	115,745,000
20 1984	110,377,000
21 1985	104,048,000
22 1986	97,766,000
23 1987	95,023,000
24 1988	85,401,000
25 1989	73,214,000
26 1990	60,717,000
1991	50,254,000
1992	40,334,000

23 ¹ The Commission requested that the stipulation separately state total, interstate and
24 intrastate amounts of DR&R, earnings and taxes. Order P-97-7(40) at n.1. The State is presently
25 unable to make any precise allocations based on interstate and intrastate tariff collections. The
26 State does not have sufficient information to allow it to make such calculations. In general, the
State believes that intrastate DR&R collections have historically accounted for approximately 5
to 10 percent of the total DR&R collections.

1993	31,188,000
1994	24,386,000
1995	19,288,000
1996	13,802,000
1997	8,405,000
1998	3,893,000
1999	<u>2,418,667</u> (as of 8/31/99; - \$3,628,000 x (8/12))
Total	\$ 1,537,459,667

The above schedule of DR&R allowances ("DR&R Allowance Schedule") is one component of the TAPS Settlement Methodology as outlined in the 1985 and 1986 TAPS Settlement Agreements. See Testimony of Dr. Thomas Horst, Exhibit TOH-2 (8/1/86) (attached hereto as Exhibit A). As such, the State of Alaska supports the continued use of the DR&R Allowance Schedule as part of the TAPS Settlement Agreements, subject to the State's right of renegotiation which matures on January 1, 2007. See TAPS Settlement Agreements, Section I-8. The DR&R Allowance Schedule will permit the following collections from September 1, 1999 through 2011:

Year	DR&R Collection
1999	\$ 1,209,333 (= \$3,628,000 x (4/12))
2000	3,650,000
2001	3,451,000
2002	3,229,000
2003	2,853,000
2004	2,610,000
2005	2,411,000
2006	2,234,000
2007	1,924,000
2008	1,659,000
2009	1,283,000
2010	951,000
2011	<u>796,000</u>
Total	\$ 28,260,333

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(a) For 1977 through 2015, the applicable State tax rate was assumed to be 9.4 percent. From 1978 to 1981, however, the State did not tax the principal amount of the DR&R collections.

(b) For 1977 and 1978, the applicable federal tax rate was 48 percent. For 1979 through 2015, the applicable federal tax rate was assumed to be 46 percent. For 1977 through 2015, the State taxes attributable to DR&R were assumed to be deductible for federal tax purposes.

See Exhibit A, Testimony of Dr. Thomas Horst.

Accordingly, under the DR&R Allowance Schedule the TAPS Carriers are assumed to have received an allowance for taxes for DR&R collections as follows:

Year	DR&R Collection	State Tax	Federal Tax
1977 S	23,536,000	S 2,212,384.00 ¹	10,235,335.68 ²
1978	95,967,000	0.00 ³	46,064,160.00 ⁴
1979	113,142,000	0.00	52,045,320.00 ⁴
1980	127,182,000	0.00	58,503,720.00
1981	120,225,000	0.00	55,303,500.00
1982	121,148,000	11,387,912.00	50,489,640.48 ⁷
1983	115,745,000	10,880,030.00	48,237,886.20
1984	110,377,000	10,375,438.00	46,000,718.52
1985	104,048,000	9,780,512.00	43,363,044.48
1986	97,766,000	9,190,004.00	40,744,958.16

¹ DR&R Collection x .094.

² DR&R Collection x (1-.094) x .48.

³ No State tax on DR&R collections, 1978-1981.

⁴ DR&R Collection x .48.

⁵ DR&R Collection x .46.

⁷ DR&R Collection x (1-.094) x .46.

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DRR
 COLLECTION

STATE
 TAX

FEDERAL
 TAX

1987	95,023,000	8,932,162.00	39,601,785.48
1988	85,401,000	8,027,694.00	35,591,720.76
1989	73,214,000	6,882,116.00	30,512,666.64
1990	60,717,000	5,707,398.00	25,304,416.92
1991	50,254,000	4,723,876.00	20,943,857.04
1992	40,334,000	3,791,396.00	16,809,597.84
1993	31,188,000	2,931,672.00	12,997,910.88
1994	24,386,000	2,292,284.00	10,163,109.36
1995	19,288,000	1,813,072.00	8,038,466.88
1996	13,802,000	1,297,388.00	5,752,121.52
1997	8,405,000	790,070.00	3,502,867.80
1998	3,893,000	365,942.00	1,622,446.68
1999*	<u>2,418,667</u>	<u>227,324.70</u>	<u>1,008,005.66</u>
Total	\$ 1,537,459,667	\$ 101,608,704.70	\$ 662,837,254.98

Grand Tax Total: 5764,445,959.68

DATED: October 25, 1999

BRUCE M. BOTEIHO
 ATTORNEY GENERAL

By: Michael A. Bernhill
 Michael A. Bernhill
 Assistant Attorney General
 Alaska Bar No. 9311063

* As of 8/31/99.

State of Alaska's Response to Commission's Request for
 Joint Stipulation of Facts, P-97-7
 Page 6

The undersigned hereby certifies that on the 25th day
 of October, 1999, the attached documents
 were mailed to the attorneys of record - Attorney
Gregory M. Bernhill attache list

VERIFICATION

Michael A. Barnhill, being duly sworn, states:

(1) That he is an attorney for the State of Alaska, Department of Law, in Juneau, Alaska, and that he prepared the attached State of Alaska's Response to Commission's Request for Joint Stipulation of Facts.

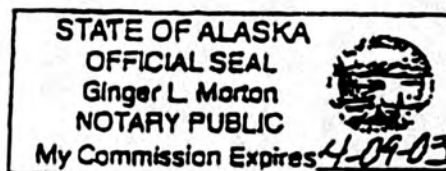
(2) That he declares under oath that he has read the foregoing document and believes all the statements made in the document are true.

DATED: October 25, 1999

Michael A. Barnhill
Michael A. Barnhill

SUBSCRIBED and SWORD TO before me this 25th day of October, 1999.

Ginger L. Morton
Notary Public, State of Alaska
My commission expires: 4-09-03



ATTORNEY GENERAL, STATE OF ALASKA
DIMOND COURTHOUSE
P.O. BOX 110300, JUNEAU, ALASKA 99811
PHONE: 485-3600

RECEIVED

Ex. A (7)

NOV 15 1998

Department of Law
Office of Attorney General
3rd Judicial District
Anchorage, Alaska

STATE OF ALASKA

BEFORE THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

G. Nanette Thompson, Chair
Bernie Smith
Patricia M. DeMarco
Will Abbott
James S. Strandberg

In the Matter of the Petition of TESORO ALASKA)
PETROLEUM COMPANY for an Investigation into)
the amounts Collected by AMERADA HESS)
PIPELINE CORPORATION; ARCO)
TRANSPORTATION ALASKA, INC.; BP)
PIPELINES (ALASKA) INC.; EXXON PIPELINE)
COMPANY; MOBIL ALASKA PIPELINE)
COMPANY; PHILLIPS ALASKA PIPELINE)
CORPORATION; and UNOCAL PIPELINE)
COMPANY for Dismantling, Removal and)
Restoration of the Trans Alaska Pipeline System)

P-97-7

TAPS CARRIERS' REVISED STATEMENT OF FACTS

Pursuant to Orders P-97-7(41) and P-97-7(44) the TAPS Carriers¹ submit the following statement of facts. Under and according to the TAPS Settlement Methodology ("TSM") established by the TAPS Settlement Agreement² the following facts are established as of August 31, 1999³:

¹The TAPS Carriers are Amerada Hess Pipeline Corporation; ARCO Transportation Alaska, Inc., BP Pipelines (Alaska) Inc., Exxon Pipeline Company, Mobil Alaska Pipeline Company, Phillips Alaska Pipeline Corporation and Unocal Pipeline Company.

²The Interstate Settlement Agreement dated June 28, 1985 and the Intrastate Settlement Agreement dated April 7, 1986.

³In the Prepared Direct Testimony of Thomas O. Horst on Behalf of the State of Alaska submitted to the Alaska Public Utilities Commission in Docket No. P-86-2, Dr. Horst explained how the DR&R allowance in the TAPS Settlement Agreement was derived, *id.* at 11-13, and attached Exhibit TOH-2 to show the calculation of the DR&R allowance by year. Because these pages of Dr. Horst's testimony and Exhibit TOH-2 are the basis for all facts stated herein, they are attached as Exhibit A. All amounts set forth below are rounded to the nearest thousand dollars.

UNOPPOSED
Guess & Rudd
PC

510 L STREET
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ANCHORAGE, ALASKA 99501
TELEPHONE (907) 793-2200
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1. The amount of DR&R funds that has been collected is:

interstate	1,501,771,000
intrastate	<u>35,689,000</u>
total/gross	\$ 1,537,460,000 ⁴
less taxes on collections	<u>764,443,000⁵</u>
total/net	\$ 773,017,000

2. The earnings that have accrued on the amounts collected for DR&R are:

interstate	2,047,508,000
intrastate	<u>101,419,000</u>
total/gross	\$ 2,148,927,000 ⁶
less taxes on earnings	<u>1,097,608,000⁵</u>
total/net	\$ 1,051,319,000

3. The taxes that have been collected from shippers on account of DR&R are:

	Federal Tax	State Tax	Total
interstate	647,821,000	98,527,000	746,348,000
intrastate	<u>15,016,000</u>	<u>3,079,000</u>	<u>18,095,000</u>
total	<u>\$ 662,837,000⁷</u>	<u>\$ 101,606,000⁷</u>	<u>\$ 764,443,000⁷</u>

⁴Derived from Exhibit TOH-2, column 7, entitled "DR&R Allowance."⁵ See item 3 of this statement regarding taxes.⁶ Derived from Exhibit TOH-2, column 9, entitled "Imputed Interest." Exhibit TOH-2 contains no earnings accrual identified as such. However, Imputed Interest, to which the parties to the TAPS Settlement Agreement stipulated as one of the assumptions required for the actuarial calculation for deriving column 7, "DR&R Allowance," displays the amount those parties stipulated as earnings on DR&R amounts.

The interstate and intrastate amounts set forth above are approximations, principally because the TAPS Carriers have been unable to locate data on volumes shipped to Valdez in 1977-79 and 1982 that were then shipped to Nikiski. For purposes of providing the estimated amounts, it was assumed that the 1980 volumes of Nikiski deliveries were representative of the years 1977-79. This likely overestimates the Nikiski volumes for those years because in the early 1980s Nikiski volumes were increasing from one year to the next. Missing Nikiski volumes for 1982 were estimated by interpolation using 1981 and 1983 data.

Apart from TSM there can be no specification of the amounts shown above. The TAPS Carriers and the State of Alaska have agreed to each of the elements of TSM, including all issues regarding DR&R, only in the context of the TAPS Settlement Agreement, a comprehensive agreement governing all aspects of the TAPS Carriers' maximum rates. They have not agreed to be bound by individual elements of the TAPS Settlement Agreement unless that agreement is approved as a whole. There is today no regulatory decision resolving any of the issues covered by the TAPS Settlement Agreement. Thus if the Commission does not approve the TAPS Settlement Agreement, all issues resolved by that agreement, including items 1 - 3 above and all other issues regarding the

⁷ Derived from Exhibit TOH-2, column 11, entitled "State Tax," and column 13, entitled "Federal Tax." The difference between these figures and those in columns 11 and 13 of Exhibit TOH-2 is that the Exhibit TOH-2 figures include both taxes that have been collected from shippers on account of DR&R and taxes on the Imputed Interest on the DR&R funds collected. Taxes on Imputed Interest total \$1,097,608,000. State Tax and Federal Tax, like Imputed Interest, display amounts to which the parties to the TAPS Settlement Agreement stipulated as assumptions required for the actuarial calculation for deriving column 7, "DR&R Allowance." Among those assumptions are tax benefits of \$3,469,120,000 in the form of refunds of Federal Tax in the years 2011 - 2015 arising from DR&R expenditures. In the actuarial calculation, these tax benefits are added to the DR&R accumulation. The effect of this treatment is that State Tax and Federal Tax provide a net benefit to shippers over the life of the actuarial calculation.

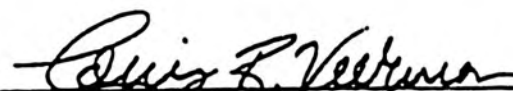
appropriate treatment of DR&R, would have to be litigated and decided before rates, including amounts recovered for DR&R, could be set.

Dated at Anchorage, Alaska this 12th day of November, 1999.

Respectfully submitted,

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By: 
Louis R. Veerman
Alaska Bar No. 7610141

ATTORNEYS FOR THE TAPS CARRIERS

J:\S2\US\pleading\05revisedstmt.doc

CERTIFICATE OF SERVICE

This is to certify that on the 12th day of November, 1999,
a true and correct copy of the foregoing was faxed and mailed to the
persons identified on the following service list.

GUESS & RUDD P.C.



Table 1.1

How TAPS Tariffs Affect Owner and Non-Owner Shippers (Base Case)

(Simplified, Hypothetical Example)

		(\$ per barrel)	
Major ANS Cost and Profit Elements		Non-Owner Shipper	Owner Shipper
1	Refinery Price	\$20.00	\$20.00
2	TAPS Tariff (includes \$0.63 Carrier profit) <i>(Per 1985 TAPS Settlement)</i>	(\$2.50)	(\$2.50)
3	Tanker <i>(Estimated)</i>	(\$1.50)	(\$1.50)
4	Alaska Severance Tax & Royalty Base <i>Line 1 - (Line 2 + 3)</i>	\$16.00	\$16.00
5	Royalty <i>Line 4 * .125</i>	(\$2.00)	(\$2.00)
6	Severance <i>(Line 4 - Line 5) * .15</i>	(\$2.10)	(\$2.10)
7	Producer's Gross Revenue <i>Line 4 - (Line 5 + 6)</i>	\$11.90	\$11.90
8	Operating Expense (Lifting) <i>(Estimated)</i>	(\$2.00)	(\$2.00)
9	Capital Expenditure <i>(Estimated)</i>	(\$4.00)	(\$4.00)
10	Pre-Tax Profit <i>Line 7 - (Line 8 + 9)</i>	\$5.90	\$5.90
11	State Income Tax <i>Line 10 * .094</i>	(\$0.55)	(\$0.55)
12	Federal Income Tax <i>(Line 10 - Line 11) * .35</i>	(\$1.87)	(\$1.87)
13	Producer's After-Tax Production Profit <i>Line 10 - (Line 11 + 12)</i>	\$3.47	\$3.47
13a	TAPS Profit (Owner-Shipper only) <i>(From Line 2)</i>	—	<u>\$0.63</u>
14	Total Upstream Profit (Excluding Tanker) <i>(Line 13 + 13a)</i>	\$3.47	\$4.10

TAPS Owner-Shipper retains \$0.63 profit from tariff; Non-Owner Shipper pays entire tariff out-of-pocket
--

EXHIBIT C

Table 1.2

Effects of Non-Cost-Based Tariff Increases on State, Owner Shipper and Non-Owner Shipper

How Non-Cost-Based Tariff Increase Increases Owner-Shipper Profit, Reduces State Revenues and Non-Owner Shipper Profits (Simplified, Hypothetical Example)

		(\$ per barrel)	
<u>Major ANS Cost, Profit Elements</u>	<u>How Calculated...</u>	<u>Non-Owner Shipper</u>	<u>Owner Shipper</u>
1 Refinery Price		\$20.00	\$20.00
2 TAPS Tariff (includes \$0.63 Carrier profit)	(Per 1985 TAPS Settlement)	(\$3.50)	(\$3.50)
3 Tanker	(Estimated)	(\$1.50)	(\$1.50)
4 Alaska Severance Tax & Royalty Base	Line 1 - (Line 2 + 3)	\$15.00	\$15.00
5 Royalty	Line 4 * .125	(\$1.88)	(\$1.88)
6 Severance	(Line 4 - Line 5) * .15	(\$1.97)	(\$1.97)
7 Producer's Gross Revenue	Line 4 - (Line 5 + 6)	\$11.16	\$11.16
8 Operating Expense (Lifting)	(Estimated)	(\$2.00)	(\$2.00)
9 Capital Expenditure	(Estimated)	(\$4.00)	(\$4.00)
10 Pre-Tax Profit	Line 7 - (Line 8 + 9)	\$5.16	\$5.16
11 State Income Tax	Line 10 * .094	(\$0.48)	(\$0.48)
12 Federal Income Tax	(Line 10 - Line 11) * .35	(\$1.64)	(\$1.64)
13 Producer's After-Tax Production Profit	Line 10 - (Line 11 + 12)	\$3.04	\$3.04
13a TAPS Profits (Owner-Shipper only)	(Line 2)		\$0.63
13b Retained tariff excess (Owner-Shipper only)	(\$1.00 - (\$1.00 * .35))	—	\$0.65
14 Total Upstream Profit (Excluding Tanker)	(Line 13 + 13a + 13b)	\$3.04	\$4.32

Compare to Base Case (Table 1.1). Increased tariff (retained by owner-shipper if not cost-based) lowers State taxes and royalties, decreases Non-Owner-Shipper's ANS after-tax profit, increases Owner-Shipper's ANS after-tax profit.

Imputed Value of TAPS Dismantling Funds (DR-R) Collected under TSM

Table L. TAPS Settlement Methodology (TSM) Scenario - 1983 Assumptions

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)	(N)	(O)	(P)	(Q)	(R)	(S)
Calendar Year	Nominal Fed Tax Rate (%)	Nominal State Tax Rate (%)	Inflation Factor (Decimal)	ONP Deflator (Index)	Stipulated Expenditure Fraction (%)	Estimated Expenditure (\$MM)	Projected Throughput (1000 bbl/d)	TSM Adjusted Throughput (1000 bbl/d)	Adjusted Throughput (1000 bbl/d)	Depreciation Factor (Decimal)	DR&R Allowance (\$MM)	Alaska's As Corp Bond Yield (%)	Imputed Interest (\$MM)	State Taxable Income (\$MM)	State Tax (\$MM)	Fed Taxable Income (\$MM)	Fed Tax (\$MM)	After-Tax Balance (\$MM)
											1.795350							
1977	48.0%	9.4%		100		872.1	97,094	1.00	97,094	0.015	23,536			23,536	2,212	21,323	10,235	11,088
1978	48.0%	9.4%					395,995	1.00	395,995	0.061	95,968	8.90%	0.987	0.987	0.093	96,852	46,494	61,456
1979	46.0%	9.4%					466,759	1.00	466,759	0.072	113,143	9.94%	6,109	6,109	0.574	118,677	54,591	125,542
1980	46.0%	9.4%					552,294	0.95	524,679	0.081	127,181	12.50%	15,693	15,693	1,475	141,400	65,044	201,898
1981	46.0%	11.0%					551,085	0.90	495,977	0.077	120,225	14.75%	29,780	29,780	3,276	146,729	67,495	281,132
1982	46.0%	9.4%					587,985	0.85	499,787	0.077	121,149	14.42%	40,539	161,688	15,199	146,489	67,385	360,236
1983	46.0%	9.4%					595,869	0.80	477,495	0.074	115,745	12.43%	44,777	160,522	15,089	145,433	66,899	438,770
1984	46.0%	9.4%		232.4			677,135	0.75	455,351	0.070	118,377	13.51%	59,278	169,655	15,948	153,708	70,705	521,772
1985	46.0%	9.4%	1.05	244.0			611,200	0.70	429,240	0.066	104,048	12.00%	62,613	166,061	15,666	150,995	69,457	603,309
1986	46.0%	9.4%	1.06	258.7			620,500	0.65	401,325	0.062	97,766	12.00%	72,397	170,163	15,995	154,168	70,917	686,560
1987	46.0%	9.4%	1.06	274.2			653,350	0.60	392,010	0.061	95,023	12.00%	82,387	177,411	16,677	160,734	73,928	773,356
1988	46.0%	9.4%	1.06	290.6			649,575	0.55	352,316	0.055	85,402	12.00%	92,803	178,204	16,751	161,453	74,268	890,541
1989	46.0%	9.4%	1.06	308.1			661,075	0.50	302,038	0.047	73,314	12.00%	103,265	176,479	16,589	159,890	73,549	946,081
1990	46.0%	9.4%	1.06	326.6			556,625	0.45	250,481	0.039	66,717	12.00%	113,626	174,343	16,388	157,954	72,659	1,032,177
1991	46.0%	9.4%	1.06	346.1			518,300	0.40	207,320	0.032	50,254	12.00%	123,861	174,116	16,367	157,749	72,564	1,117,361
1992	46.0%	9.4%	1.06	366.9			475,412	0.35	166,394	0.026	40,334	12.00%	134,083	174,417	16,395	158,022	72,690	1,202,693
1993	46.0%	9.4%	1.06	388.9			428,875	0.30	128,663	0.020	31,188	12.00%	144,323	175,511	16,498	159,013	73,146	1,288,560
1994	46.0%	9.4%	1.06	412.3			402,412	0.25	100,603	0.016	24,306	12.00%	154,627	179,013	16,827	162,186	74,606	1,376,140
1995	46.0%	9.4%	1.06	437.0			397,850	0.20	79,570	0.012	19,288	12.00%	165,137	184,425	17,336	167,089	76,061	1,466,368
1996	46.0%	9.4%	1.06	463.2			379,600	0.15	56,940	0.009	13,802	12.00%	175,964	189,766	17,838	171,928	78,087	1,559,210
1997	46.0%	9.4%	1.06	491.0			346,750	0.10	34,675	0.005	8,405	12.00%	187,105	195,510	18,378	177,132	81,481	1,654,861
1998	46.0%	9.4%	1.06	520.5			321,200	0.05	16,070	0.002	3,893	12.00%	198,583	202,476	19,033	183,444	84,384	1,753,921
1999	46.0%	9.4%	1.06	551.7			299,300	0.05	14,965	0.002	3,628	12.00%	210,470	214,098	20,125	193,973	89,227	1,858,666
2000	46.0%	9.4%	1.06	584.8			301,125	0.05	15,056	0.002	3,650	12.00%	223,040	226,690	21,309	205,381	94,475	1,969,572
2001	46.0%	9.4%	1.06	619.9			284,700	0.05	14,215	0.002	3,451	12.00%	236,349	239,799	22,541	217,258	99,939	2,086,891
2002	46.0%	9.4%	1.06	657.1			266,450	0.05	13,322	0.002	3,239	12.00%	250,427	253,656	23,844	229,813	105,714	2,210,990
2003	46.0%	9.4%	1.06	696.5			235,425	0.05	11,771	0.002	2,853	12.00%	265,319	268,172	25,208	242,964	111,763	2,342,190
2004	46.0%	9.4%	1.06	738.3			215,350	0.05	10,767	0.002	2,610	12.00%	281,063	283,673	26,665	257,008	118,224	2,480,975
2005	46.0%	9.4%	1.06	782.6			198,925	0.05	9,946	0.002	2,411	12.00%	297,717	300,128	28,212	271,916	125,081	2,627,809
2006	46.0%	9.4%	1.06	829.6			181,325	0.05	9,216	0.001	2,234	12.00%	315,337	317,571	29,852	287,719	132,351	2,783,178
2007	46.0%	9.4%	1.06	879.3			158,775	0.05	7,939	0.001	1,924	12.00%	333,981	335,906	31,575	304,331	139,992	2,947,516
2008	46.0%	9.4%	1.06	932.1			136,875	0.05	6,844	0.001	1,659	12.00%	353,702	355,361	33,494	321,957	148,100	3,121,373
2009	46.0%	9.4%	1.06	988.0			105,850	0.05	5,292	0.001	1,283	12.00%	374,565	375,848	35,330	340,518	156,638	3,305,253
2010	46.0%	9.4%	1.06	1047.3	2.5%	162,982	78,475	0.05	3,924	0.001	0,931	12.00%	396,630	397,581	37,373	359,207	167,724	3,411,755
2011	46.0%	9.4%	1.06	1110.1	5.0%	345,522	65,700	0.05	3,285	0.001	0,796	12.00%	409,411	410,207	38,559	370,852	179,361	3,525,862
2012	46.0%	9.4%	1.06	1176.7	50.0%	3,662,536						12.00%	411,103	411,103	0.000	(3,251,433)	(1,495,639)	1,670,089
2013	46.0%	9.4%	1.06	1247.4	30.0%	2,329,173						12.00%	200,411	200,411	0.000	(2,128,962)	(979,323)	530,449
2014	46.0%	9.4%	1.06	1322.2	10.0%	823,045						12.00%	62,454	62,454	0.000	(760,591)	(349,872)	109,730
2015	46.0%	9.4%	1.06	1401.5	2.5%	218,107						12.00%	13,168	13,168	0.000	(204,939)	(94,272)	0.938

13,345,125

6,459,246

Estimated Surplus (1999 AIAI \$) => -0.349

Annual DR&R collections presented by Exhibit E of the TAPS Settlement Agreement appear in bold face in Column (L), imputed annual balances in Column (S)

Source: Train worksheet provided by Rudolph L. Bertels, 6/1/98. See also "The filed testimony of Rudolph L. Bertels," Staff Expert Witness, in AFPC Docket No. P-86-2, Dec. 17, 1986, at pp. 63-70 and Exhibits B, D, E, F, G, H, I, J, K, L, M, N, O, P, Q, R, S, T, U, V, W, X, Y, Z, AA, AB, AC, AD, AE, AF, AG, AH, AI, AJ, AK, AL, AM, AN, AO, AP, AQ, AR, AS, AT, AU, AV, AW, AX, AY, AZ, BA, BB, BC, BD, BE, BF, BG, BH, BI, BJ, BK, BL, BM, BN, BO, BP, BQ, BR, BS, BT, BU, BV, BW, BX, BY, BZ, CA, CB, CC, CD, CE, CF, CG, CH, CI, CJ, CK, CL, CM, CN, CO, CP, CQ, CR, CS, CT, CU, CV, CW, CX, CY, CZ, DA, DB, DC, DD, DE, DF, DG, DH, DI, DJ, DK, DL, DM, DN, DO, DP, DQ, DR, DS, DT, DU, DV, DW, DX, DY, DZ, EA, EB, EC, ED, EE, EF, EG, EH, EI, EJ, EK, EL, EM, EN, EO, EP, EQ, ER, ES, ET, EU, EV, EW, EX, EY, EZ, FA, FB, FC, FD, FE, FF, FG, FH, FI, FJ, FK, FL, FM, FN, FO, FP, FQ, FR, FS, FT, FU, FV, FW, FX, FY, FZ, GA, GB, GC, GD, GE, GF, GG, GH, GI, GJ, GK, GL, GM, GN, GO, GP, GQ, GR, GS, GT, GU, GV, GW, GX, GY, GZ, HA, HB, HC, HD, HE, HF, HG, HH, HI, HJ, HK, HL, HM, HN, HO, HP, HQ, HR, HS, HT, HU, HV, HW, HX, HY, HZ, IA, IB, IC, ID, IE, IF, IG, IH, II, IJ, IK, IL, IM, IN, IO, IP, IQ, IR, IS, IT, IU, IV, IW, IX, IY, IZ, JA, JB, JC, JD, JE, JF, JG, JH, JI, JJ, JK, JL, JM, JN, JO, JP, JQ, JR, JS, JT, JU, JV, JW, JX, JY, JZ, KA, KB, KC, KD, KE, KF, KG, KH, KI, KJ, KK, KL, KM, KN, KO, KP, KQ, KR, KS, KT, KU, KV, KW, KX, KY, KZ, LA, LB, LC, LD, LE, LF, LG, LH, LI, LJ, LK, LL, LM, LN, LO, LP, LQ, LR, LS, LT, LU, LV, LW, LX, LY, LZ, MA, MB, MC, MD, ME, MF, MG, MH, MI, MJ, MK, ML, MM, MN, MO, MP, MQ, MR, MS, MT, MU, MV, MW, MX, MY, MZ, NA, NB, NC, ND, NE, NF, NG, NH, NI, NJ, NK, NL, NM, NN, NO, NP, NQ, NR, NS, NT, NU, NV, NW, NX, NY, NZ, OA, OB, OC, OD, OE, OF, OG, OH, OI, OJ, OK, OL, OM, ON, OO, OP, OQ, OR, OS, OT, OU, OV, OW, OX, OY, OZ, PA, PB, PC, PD, PE, PF, PG, PH, PI, PJ, PK, PL, PM, PN, PO, PP, PQ, PR, PS, PT, PU, PV, PW, PX, PY, PZ, QA, QB, QC, QD, QE, QF, QG, QH, QI, QJ, QK, QL, QM, QN, QO, QP, QQ, QR, QS, QT, QU, QV, QW, QX, QY, QZ, RA, RB, RC, RD, RE, RF, RG, RH, RI, RJ, RK, RL, RM, RN, RO, RP, RQ, RR, RS, RT, RU, RV, RW, RX, RY, RZ, SA, SB, SC, SD, SE, SF, SG, SH, SI, SJ, SK, SL, SM, SN, SO, SP, SQ, SR, SS, ST, SU, SV, SW, SX, SY, SZ, TA, TB, TC, TD, TE, TF, TG, TH, TI, TJ, TK, TL, TM, TN, TO, TP, TQ, TR, TS, TT, TU, TV, TW, TX, TY, TZ, UA, UB, UC, UD, UE, UF, UG, UH, UI, UJ, UK, UL, UM, UN, UO, UP, UQ, UR, US, UT, UU, UV, UW, UX, UY, UZ, VA, VB, VC, VD, VE, VF, VG, VH, VI, VJ, VK, VL, VM, VN, VO, VP, VQ, VR, VS, VT, VU, VV, VW, VX, VY, VZ, WA, WB, WC, WD, WE, WF, WG, WH, WI, WJ, WK, WL, WM, WN, WO, WP, WQ, WR, WS, WT, WU, WV, WW, WX, WY, WZ, XA, XB, XC, XD, XE, XF, XG, XH, XI, XJ, XK, XL, XM, XN, XO, XP, XQ, XR, XS, XT, XU, XV, XW, XX, XY, XZ, YA, YB, YC, YD, YE, YF, YG, YH, YI, YJ, YK, YL, YM, YN, YO, YP, YQ, YR, YS, YT, YU, YV, YW, YX, YY, YZ, ZA, ZB, ZC, ZD, ZE, ZF, ZG, ZH, ZI, ZJ, ZK, ZL, ZM, ZN, ZO, ZP, ZQ, ZR, ZS, ZT, ZU, ZV, ZW, ZX, ZY, ZZ.

(The continuing worksheet, see Anthony O. Scott, "The Train Alaska Pipeline System: Consequences and Causes of Regulatory Failure," Univ. of Wisconsin-Madison's Thesis, 1996, Table A1.2, p. 294.)

Figure 1. EXPLANATION OF THE ENTRIES IN TABLE 1
(TAPS SETTLEMENT METHODOLOGY FOR DETERMINING DR&R COLLECTIONS)

<u>Column</u>	<u>Explanation</u>
(A)	Calendar Years (stipulated life of TAPS; not an estimate of the pipeline's economic life)
(B)	Nominal federal income tax rates (the nominal rates were reduced by the Tax Reform Act of 1986 and are, in any event, not a true statement of taxes paid)
(C)	Nominal State income tax rates
(D)	Assumed for purposes of settlement
(E)	Calculated as a function of column (D)
(F)	Percentage figures indicate amount of DR&R work assumed to be performed in a particular year.
(G)	$= \$872.1 \times (\text{current year Col. [e]}) \times (\text{current year Col. [f]})$
(H)	Estimates stipulated for settlement
(I)	Arbitrary weighting factor to accelerate front-end-load
(J)	$= (\text{current year Col. [H]}) \times (\text{current year Col. [I]})$
(K)	$= (\text{current year Col. [J]}) \times (\text{current year Col. [J]}) / (\text{sum of Col. [J]})$
(L)	$= (\$1,795.350) \times (872.1) \times (\text{current year Col. [K]})$. (Note: (\$1,795.350 is a factor, found by trial and error, that makes the final sum (Col. [S] for 2015) approach zero.)
(M)	1978-84 from Moody's; 1985-2015 = approximate average of 1978-84.
(N)	$= (\text{current year Column [M]}) \times (\text{prior year Column [S]})$
(O)	$= (\text{current year Column [L]}) + (\text{current year Column [N]})$
(P)	$= (\text{current year Column [O]}) \times (\text{current year Column [C]})$
(Q)	$= (\text{current year Column [L]}) + (\text{current year Column [N]})$ $- (\text{current year Column [P]})$
(R)	$= (\text{current year Column [Q]}) \times (\text{current year Column [B]})$
(S)	$= (\text{current year Column [L]}) + (\text{current year Column [N]})$ $- (\text{current year Column [P]}) - (\text{current year Column [Q]})$ $+ (\text{prior year Column [S]}) - (\text{current year Column [G]})$

From: Letter from Rudolph L. Bertschi to Richard Fineberg, June 1, 1988.

Imputed Value of TAPS Dismantling Funds (DR-R) Collected under TSAI

Table 4. Estimated Value to TAPS Owners of Actual DR&R Collections — Update to 1985 Assumptions with Moderate Inflation, Future Corporate Earnings reduced by 1% (Base Case Scenario)

Cal (A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)	(N)	(O)	(P)	(Q)	(R)	(S)	
Calendar Year	Fed Tax Rate (%)	State Tax Rate (%)	Inflation (CPI) Use Forecast	Compound Inflation Factor	Stipulated Expenditure Fraction (%)	Estimated Expenditure (M\$)	Projected Throughput (1000 M\$)	TSM Adjust. ment Factors (decimal)	Adjusted Throughput (1000 M\$)	Depreciation Factor (Decimal)	DR&R Allowance (M\$)	Est. Parent Co. Pre-Tax Ret. on Equity (%)	Imputed Interest (M\$)	State Taxable Income (M\$)	State Tax (M\$)	Fed Taxable Income (M\$)	Fed Tax (M\$)	After-Tax Balance (M\$)	
1..... Revised Estimates 1												1,795,350	1..... Revised Estimates 1						
1977	48.0%	9.4%		1.000		872.1	97,094	1.00	97,094	0.015	23,536			23,536	2,212	21,323	10,235	11,088	
1978	48.0%	9.4%	1.076	1.076			395,905	1.00	395,905	0.061	95,968	27.48%	3,047	3,047	0,286	98,728	47,389	62,427	
1979	46.0%	9.4%	1.113	1.118			466,759	1.00	466,759	0.072	113,143	52.85%	32,991	32,991	3,101	143,033	65,795	139,664	
1980	46.0%	9.4%	1.135	1.159			552,294	0.95	524,679	0.081	127,183	47.30%	66,064	66,064	6,210	187,036	86,037	240,664	
1981	46.0%	11.0%	1.103	1.49.9			551,085	0.90	495,977	0.077	120,225	33.94%	81,681	81,681	8,985	192,921	88,744	344,842	
1982	46.0%	9.4%	1.052	1.59.2			587,985	0.85	499,787	0.077	121,149	23.76%	81,930	203,078	19,089	183,989	84,635	444,196	
1983	46.0%	9.4%	1.032	1.64.3			596,869	0.80	477,475	0.074	115,745	24.23%	107,607	223,352	20,995	202,357	93,084	553,468	
1984	46.0%	9.4%	1.023	1.71.4			607,135	0.75	455,351	0.070	110,377	28.91%	160,019	270,396	25,417	244,979	112,690	685,757	
1985	46.0%	9.4%	1.016	1.77.6			613,200	0.70	429,240	0.066	104,048	26.07%	178,743	282,791	26,582	256,209	117,856	824,110	
1986	46.0%	9.4%	1.019	1.80.9			620,591	0.65	401,325	0.062	97,766	21.44%	176,694	274,460	25,799	248,661	114,384	938,387	
1987	40.0%	9.4%	1.016	1.87.4			653,350	0.60	392,010	0.061	95,023	25.07%	240,306	335,329	31,521	303,808	121,523	1,140,671	
1988	34.0%	9.4%	1.041	1.95.1			640,575	0.55	352,316	0.055	85,402	25.07%	285,964	371,366	34,908	336,458	114,396	1,362,733	
1989	34.0%	9.4%	1.048	2.04.5			661,075	0.50	302,018	0.047	73,214	29.55%	402,664	475,878	44,733	431,145	146,970	1,647,290	
1990	34.0%	9.4%	1.054	2.15.5			566,625	0.45	291,481	0.039	60,717	27.37%	450,895	511,612	48,092	463,520	157,997	1,953,213	
1991	34.0%	9.4%	1.042	2.24.6			518,300	0.40	207,320	0.032	50,254	13.21%	258,034	308,259	28,976	279,282	94,956	2,137,539	
1992	35.0%	9.4%	1.030	2.31.3			475,412	0.35	166,394	0.026	40,334	7.61%	162,632	202,966	19,079	183,887	64,361	2,257,066	
1993	35.0%	9.4%	1.030	2.38.3			428,875	0.30	128,663	0.020	31,188	13.25%	299,151	330,339	31,052	299,287	104,750	2,451,603	
1994	35.0%	9.4%	1.026	2.44.5			402,412	0.25	100,601	0.016	24,386	23.14%	567,304	591,691	55,619	536,072	187,625	2,800,049	
1995	35.0%	9.4%	1.028	2.51.3			397,850	0.20	79,570	0.012	19,288	22.15%	620,539	699,827	60,144	579,683	202,889	3,176,843	
1996	35.0%	9.4%	1.030	2.58.8			379,600	0.15	56,940	0.009	13,802	32.07%	1,018,814	1,032,616	97,066	935,550	327,443	3,784,951	
1997	35.0%	9.4%	1.023	2.64.8			346,750	0.10	34,675	0.005	8,405	31.64%	1,197,468	1,205,873	113,352	1,092,521	382,382	4,495,089	
1998	35.0%	9.4%	1.016	2.69.0			321,200	0.05	16,060	0.002	3,893	14.97%	672,915	676,888	63,620	613,188	214,616	4,893,661	
1999	35.0%	9.4%	1.018	2.73.7			297,300	0.05	14,965	0.002	3,628	17.54%	858,348	861,976	81,026	780,950	273,333	5,401,279	
2000	35.0%	9.4%	1.030	2.82.0			301,125	0.05	15,056	0.002	3,650	17.71%	956,567	960,216	90,260	879,956	304,485	5,966,750	
2001	35.0%	9.4%	1.030	2.90.4			284,700	0.05	14,235	0.002	3,451	17.88%	1,066,855	1,070,306	100,609	969,697	339,394	6,597,053	
2002	35.0%	9.4%	1.030	2.99.1			266,450	0.05	13,322	0.002	3,229	18.05%	1,190,768	1,193,997	112,236	1,081,762	378,617	7,300,198	
2003	35.0%	9.4%	1.030	3.08.1			235,425	0.05	11,771	0.002	2,853	18.22%	1,330,096	1,332,949	125,297	1,207,652	422,678	8,085,172	
2004	35.0%	9.4%	1.030	3.17.3			215,350	0.05	10,767	0.002	2,610	18.31%	1,480,395	1,483,005	139,402	1,343,603	470,261	8,958,514	
2005	35.0%	9.4%	1.030	3.26.9			198,925	0.05	9,946	0.002	2,411	18.31%	1,640,304	1,642,715	154,415	1,488,300	520,905	9,923,909	
2006	35.0%	9.4%	1.030	3.36.7			184,325	0.05	9,216	0.001	2,234	18.31%	1,817,434	1,819,668	171,049	1,648,619	577,017	10,997,511	
2007	35.0%	9.4%	1.030	3.46.8			158,775	0.05	7,939	0.001	1,924	18.31%	2,013,644	2,015,569	189,463	1,826,105	639,137	12,184,480	
2008	35.0%	9.4%	1.030	3.57.2			136,875	0.05	6,844	0.001	1,659	18.31%	2,230,978	2,232,637	209,868	2,022,769	707,969	13,499,280	
2009	35.0%	9.4%	1.030	3.67.9			105,850	0.05	5,292	0.001	1,283	18.31%	2,471,718	2,473,001	232,462	2,240,539	784,189	14,955,630	
2010	35.0%	9.4%	1.030	3.78.9	2.5%	82,614	78,475	0.05	3,924	0.001	0,951	18.31%	2,738,376	2,739,327	257,497	2,399,216	839,726	16,515,120	
2011	35.0%	9.4%	1.030	3.90.3	5.0%	170,185	65,700	0.05	3,285	0.001	0,796	18.31%	3,023,919	3,024,715	284,323	2,570,207	899,572	18,185,755	
2012	35.0%	9.4%	1.030	4.02.0	50.0%	1,752,901						18.31%	3,329,812	3,329,812	0,000	1,576,910	551,919	19,210,747	
2013	35.0%	9.4%	1.030	4.14.1	30.0%	1,083,293						18.31%	3,517,488	3,517,488	0,000	2,434,195	851,968	20,792,973	
2014	35.0%	9.4%	1.030	4.26.5	10.0%	371,931						18.31%	3,807,193	3,807,193	0,000	3,435,263	1,202,342	23,025,894	
2015	35.0%	9.4%	1.030	4.39.3	2.5%	95,772						18.31%	4,216,041	4,216,041	0,000	4,120,269	1,442,094	24,784,069	
13,345,125										6,459,246		Estimated Surplus (1999 M\$) =>							16,017,926

Source: TAPS Settlement Methodology DR&R calculations (Table 1), modified as follows:

Cal (B), (C): Federal corporate income tax rates reduced subsequent to 1985 settlement, worksheet assumes owners pay all income taxes at maximum rates

Cal (D): 1977-1998 = U.S. CPI U, 1999 = Alaska Dept. of Revenue Fall 1998 revenue forecast, 2000 - 2015 inflation estimated at 3% p/a

Cal (M): 1977 - 97 = Return to Common Equity adjusted to pre-tax level (S&P Compustat), 98 = weighted average of ARCO, BP and Eastern shareholder ROE (from co. annual reports), 1999 - 2015 = (annual weighted avg. of 1977-1998) + inflation less 1%

SCOMM

118:20

DNR Analysis of HB 58

"An Act relating to certain audits regarding oil and gas royalty and net profits..."

HB 58 bill will transfer the authority to audit royalty revenues from the Department of Revenue ("DOR") to the Department of Natural Resources ("DNR"). This legislation will create administrative efficiencies and provide DNR with the tools to successfully pursue the state's interests in its relationship with the oil industry.

Background

Most of state government petroleum revenues come from two sources: production taxes levied by DOR and royalty payments administered by DNR.¹ The calculation of production tax and royalty payments involves very similar arithmetic. In both cases, a percentage of oil and gas production is multiplied by a "netback" value. The netback value is the difference of the price of the oil or gas at the market destination minus marine transportation costs and pipeline tariffs.

DNR and DOR used to conduct audits of their respective revenues independently. In 1980 the legislature consolidated auditing functions under DOR. The legislature felt then that a single audit authority made sense because most of the oil and gas production that was subject to royalty payments was also subject to production taxes. Given the similarity in the calculation of production taxes and royalty payments a single audit was all that was thought was needed.

Since 1980, circumstances have changed and it now makes sense now for the audit authority for royalty to be transferred back to DNR. The impact of the economic limit factor (ELF) means that more oil and gas production is exempt from taxes while royalty payments are still required. For example, oil producers in the Cook Inlet pay no production taxes because of the ELF but they still must pay royalties. The netback calculations required by each department also have become more dissimilar over time. Production taxes are imposed on the oil and gas producer by statute and regulations and each taxpayer calculates the netback value for taxes following identical rules. DNR calculates the netback value on the basis of leases and royalty settlement agreements that have evolved over time and are different for each lessee.

Efficiency

The state will benefit from the specialization of a DNR in-house audit staff and by the elimination of duplication between the departments.

- **Specialization.** Auditors within DNR participate in the development of royalty valuation methods used in the leases and royalty settlements and are familiar with the logic and history of each lessee's unique requirements. HB 58 will grant DNR better access to audit information and DNR will be able to more efficiently guide audits while they are underway to investigate issues important to the department.²

¹ "Royalty payments" in this context refers to both royalty payments and net profit share payments. It is the audit of these revenue streams that are the subject of HB 58.

² DOR recognizes the value of specialization and usually assigns the same staff to work on royalty auditor when possible. However, DOR's auditors do not work exclusively on DNR royalty audits.

- **Reduced Duplication:** DNR currently requests a royalty audit after DOR has completed the production tax audit. DOR will start a new audit separate from the original tax audit and includes tax audit information only when possible under the law. In addition to DOR staff assigned to the audit are DNR staff who must be involved in the process as much possible. DNR needs to be familiar with the information acquired in the audit and DNR needs to provide direction and oversight while the audit is conducted. When the audit is completed and delivered to DNR, DOR must keep its own records as well as transmitting copies to DNR. If DNR conducted its own audits, fewer audit staff will be required and there will be no need for inter-department reporting. The paperwork burden for each department will be reduced.

Because the potential for overlapping responsibilities between the departments has decreased over time, a single audit of both taxes and royalty payments is not really possible. HB 58 should not create an additional burden on the taxpayer. In fact, in no other state are the tax and royalty audit functions shared by departments.

What does HB 58 do?

The data provided from these audits are invaluable to DNR when evaluating whether or not its royalty settlement agreements are achieving the correct royalty netback value. As the DNR crafts new valuation methods and sets new lease terms, the audits will reveal what issues need to be considered. It makes sense that DNR acquire audit information first-hand rather than via summary reports and worksheets provided by DOR.

The language in Sections 1, 2, 3, and 5 of HB 58 cleaves the royalty audit role from DOR and transfers the audit authority to DNR. When the legislature granted to DOR the sole authority to audit royalty payments, DOR already had in AS 43 a toolbox to conduct audits. The original AS 38.05.036 was fairly straightforward. HB 58 provides DNR with not only the authority conduct royalty audits but also provides DNR with some tools it will need to conduct audits. These sections also retain for each department the existing authority to acquire data from the other in order to successfully conduct its own audits.

Section 1 also adds a provision to explicitly provide DNR the authority to audit exploration incentive credits awarded under AS 41.09. This remedies an oversight in the original statute where neither DOR nor DNR had such authority.

Parts of Section 4 were added after discussions with industry. Under current law, information collected in a DOR audit is held confidential under threat of criminal penalty. The penalties of divulging information given to DNR and considered confidential under current AS 38.05.035 are not so explicit. Section 4 imposes the same criminal penalty protection on royalty audits conducted by DNR. Section 6 provides reciprocal protection when DOR acquires DNR royalty audit data.

Section 4 also extends subpoena powers to DNR. When DOR performs an audit, whether for production tax or royalty, it has the authority under AS 43 to subpoena books and records. HB

58 does not expand the state's power it only transfers existing subpoena powers to DNR. Without this change, the power of the state to audit royalty payments will be diminished. As a practical matter, subpoena powers are rarely exercised.

Fiscal Impact

As noted in the Fiscal Note that accompanies HB 58, three staff are transferred from DOR to DNR at no additional cost to the state. With improved efficiencies, more royalty audits can be completed in the course of a year and the backlog of audits eliminated.

HB 58 achieves an important and simple goal. In the performance of its duties to maximize the value of the state's oil and gas royalty revenues, DNR should conduct its own audits.

TONY KNOWLES
GOVERNOR

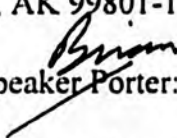


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January 20, 1999

The Honorable Brian Porter
Speaker of the House
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182


Dear Speaker Porter:

In the interest of improving efficiency within our state government, as well as between government and industry, I am transmitting this bill to transfer oil and gas royalty audit functions from the Department of Revenue (DOR) to the Department of Natural Resources (DNR). It makes sense to put the audit duties in the same department that administers, enforces, and is therefore most knowledgeable with, the oil and gas leasing program.

Ironically, the audit functions used to rest with DNR, but were switched to DOR in 1980 based on a legislative audit report. The recommendation stated cost savings would be achieved by having one staff of auditors review both tax and royalty compliance information.

Since 1980, however, the state has entered into royalty settlements with the major North Slope producers and has made changes to its tax regulations. As a result, there is no longer as much overlap between royalty and tax audits. In addition, separating DNR's duty to administer and enforce oil and gas contracts, agreements, and leases from the department's ability to conduct audits leading to possible enforcement actions, has resulted in inefficiencies and other problems.

The bill specifically authorizes DNR to audit reports and costs relating to exploration incentive credits and oil and gas licenses. It also grants DNR audit powers commensurate to those of DOR currently, including the right to subpoena information for audit purposes. The two departments would be allowed to exchange confidential information obtained in the course of their respective audits; a breach of confidentiality by any agency employee would be a felony offense.

This bill takes a sensible step in how the state does business with the oil and gas industry.

Sincerely,

Tony Knowles
Governor

FISCAL NOTE

Bill Version: HB 58

(H) Publish Date: 1/22/99

**STATE OF ALASKA
1999 LEGISLATIVE SESSION**

Revision Date:

Dept Affected: Natural Resources

Title: An Act relating to certain audits regarding oil
and gas royalty and net profits and to audits regarding costs...

BRU: Oil & Gas Development

Component: Oil & Gas Development

Sponsor: House and Senate Rules Committees

Requestor: Governor

Component Serial No.

#439

Expenditures/Revenues

(Thousands of Dollars)

OPERATING EXPENDITURES	FY00	FY01	FY02	FY03	FY04	FY05
PERSONAL SERVICES	230.9	230.9	230.9	230.9	230.9	230.9
TRAVEL	2.5	2.5	2.5	2.5	2.5	2.5
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	233.4	233.4	233.4	233.4	233.4	233.4

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
-----------------------------	------------	------------	------------	------------	------------	------------

CHANGE IN REVENUES (fund code)	0.0	0.0	0.0	0.0	0.0	0.0
---------------------------------------	------------	------------	------------	------------	------------	------------

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	233.4	233.4	233.4	233.4	233.4	233.4
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	233.4	233.4	233.4	233.4	233.4	233.4

Estimate of any current year (FY99) cost: \$ none

POSITIONS

FULL-TIME	3	3	3	3	3	3
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS:

(Attach a separate page if necessary)

Transfer from the Department of Revenue funds for two Revenue Auditor positions and one clerical position. The Revenue Auditor positions being transferred are filled and perform royalty audits. The departments agree that efficiencies will result in the timeliness of audits with the consolidation of this function in DNR. In the past, many of the tasks required to complete these royalty audits were duplicative of tasks performed in DNR. This fiscal note shows the transfer of the funds and positions from Dept. of Revenue to the Dept. of Natural Resources.

Prepared by: Ken Boyd, Director

Division: Oil & Gas

Approved by Commissioner:

Agency: Natural Resources

Phone: 269-8800

Date: 26-Oct-98

Date:

10-26-98

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FISCAL NOTE

Bill Version: HB 58

(H) Publish Date: 1/22/99

**STATE OF ALASKA
1999 LEGISLATIVE SESSION**

Revision Date/Time (Note if correction)

Title Oil & Gas Audits/Incentive CreditDept. Affected Revenue

BRU

Revenue Operations

Component

Oil & Gas Audit Division

Sponsor RulesRequester Governor

Component Serial No. _____

Expenditures/Revenues

(Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Personal Services	(230.9)	(230.9)	(230.9)	(230.9)	(230.9)	(230.9)
Travel	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

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

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)

Estimate of any current year (FY99) cost: _____

POSITIONS

Full-time	-3	-3	-3	-3	-3	-3
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill transfers from DOR to DNR the responsibilities and authority for auditing reports and payments relating to revenue under oil and gas contracts, agreements and leases. This function is performed by two DOR auditor positions and one clerk position that would be transferred from DOR to DNR.

Prepared by John F. Pilkinton, DirectorPhone 907-343-9225Division Oil & Gas AuditDate/Time Oct. 30, 1998Approved by
Commissioner Wilson L. CondonDate Oct. 30, 1998Agency Department of Revenue**PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE**

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July 20, 1999

OUR FILE NUMBER
600,000-12

City of Valdez
North Slope Borough
Fairbanks North Star Borough
Municipality of Anchorage

WRITER'S DIRECT DIAL
213-430-7403

WRITER'S E-MAIL ADDRESS
lgibbs@omm.com

**Re: Alaska Gasline Port Authority - Federal Taxation
of Income and Tax Exempt Financing Eligibility**

Ladies and Gentlemen:

This letter summarizes our advice to you regarding (i) whether income received by the Alaska Gasline Port Authority (the "Authority") should be excluded from gross income of the Authority and thereby exempt from federal income tax under the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) the extent to which the costs of the Project (defined below) should qualify for financing with tax-exempt obligations pursuant to Section 103 of the Code.

Federal Taxation of Authority's Income.

We have advised you that any income received by the Authority from the sale of natural gas should not be subjected to federal income tax under either of two theories:

1. First, income received by the Authority should not be subject to federal income tax because the Authority should be treated as a political subdivision of the State of Alaska (the "State").
2. Alternatively, in the event that the Authority is not a political subdivision of the State, income received by the Authority should be excluded from gross income of the Authority under Section 115 of the Code because the Authority should be viewed as performing an essential governmental function and all of its income should accrue to parties that are themselves political subdivisions.

In providing the above advice, we have, with your express consent, relied upon the accuracy and completeness of the following facts and assumptions:

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City of Valdez, July 20, 1999 - Page 2

a. The Authority will be established pursuant to the Municipal Port Authority Act, §§ 29.35.600 *et seq.* of the Alaska Statutes (the "Act") and the ordinances (the "Ordinances") passed or to be passed by City of Valdez, the Fairbanks North Star Borough, the North Slope Borough and the Municipality of Anchorage (the "Original Municipalities") as a body corporate and politic and an instrumentality for purposes of building and operating the facilities and infrastructure necessary to realize, for the benefit of the State, the Original Municipalities and other municipalities with the State, the economic potential of significant natural gas reserves located in that portion of the State known as the North Slope (the "Project"). The Original Municipalities and other municipalities believe that the realization of the economic value of the Project is vital to the continued economic health of the State, municipalities within the State and their respective citizens.

b. As provided under the Act, all members of the Port Authority will at all times be municipalities of the State.

c. The Authority has the power of eminent domain within its physical boundaries to acquire land or materials for Authority purposes. The Original Municipalities believe that utilization by the Authority of its eminent domain power will be or could be essential to completion of the Project.

d. All income, after payment of expenses, including any debt service, derived by the Authority will be divided among the State, the Original Municipalities and other municipalities within the State in accordance with the Ordinances for deposit in their respective general funds and used to pay the costs of government services. No portion of the income derived by the Authority will inure to the benefit of any private entity or individual, other than incidentally.

e. Upon dissolution, all of the assets of the Authority will be distributed to all the Original Municipalities and any other municipalities that have joined the Authority in proportion to their respective investments in the Authority at the time of dissolution, in accordance with the Act.

f. The members of the governing board of the Authority will all be appointed by the Original Municipalities.

Eligibility of the Project for Tax-Exempt Financing

We have advised you that the extent to which the costs of the Project may be financed with tax-exempt obligations depends primarily upon the form and content of the contractual arrangements between the Authority and the purchasers of the gas. For example, take-or-pay contracts will generally make those costs ineligible for tax-exempt financing. On the other hand, tax-exempt financing may be available if those contracts

O'MELVENY & MYERS LLP

City of Valdez, July 20, 1999 - Page 3

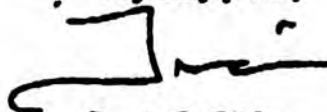
are in the nature of requirements contracts. We have also advised that it is important that the Authority pay fair market value to the current owners of the natural gas in order that those owners not be considered as deriving a special economic benefit from the Project. The analysis relating to the availability of tax-exempt financing will be further refined as additional relevant facts are developed.

We have further advised that certain of the costs of the Project may be eligible for tax-exempt financing notwithstanding the issues mentioned in the previous paragraph. First, we understand that a portion of the costs of the Project will be allocable to gas that will ultimately be sold to municipalities or municipally owned utilities for consumption with the State. Subject to a review of the basis on which that gas will be sold to the ultimate consumers, the costs properly allocable to such gas should be financeable on a tax-exempt basis.

Second, though tax-exempt bonds are generally not permitted where the financed facilities will be "used" by or will confer a benefit on private sector entities (unlike that benefit derived by the public at large), certain enumerated types of facilities, including "docks and wharves," may be financed on a tax-exempt basis notwithstanding such private sector "use" or receipt of benefits. We are currently making a preliminary assessment of whether any portion of the Project would qualify as "docks and wharves".

The advice presented in this letter is based on (i) our interpretation of the case law, provisions of the Code, Treasury regulations and administrative rulings and decisions of the Internal Revenue Service now in effect, all of which are subject to change subsequent to the date of this letter, and (ii) our review of the Act and Ordinances and the assumption that the Authority will at all times operate in accordance with the Act and the Ordinances. A detailed discussion of all of the relevant tax issues involved in determining whether the income of the Authority should be excluded from gross income and the availability of tax-exempt financing is contained in privileged memoranda provided to you separately and the advice provided herein is based on and subject to the discussion in such memoranda. Further, you should be aware that the advice of counsel is not binding on a court or the Internal Revenue Service.

Very truly yours,



Travis C. Gibbs
of O'MELVENY & MYERS LLP

TCG:mfn
LAJ:201313

**Alaska North Slope LNG Project
Statement for the House Special Committee on Oil and Gas
Concerning HB-170
(April 29, 1999)**

The sponsor group is pleased to continue the partnership with the state that was established over the past several years to advance gas commercialization. This partnership has manifested itself in a series of events by the State supporting gas commercialization. First was the original Memoranda of Understanding with the administration which documented the project bases to that point. Next, HJR-54, HR-1 were two legislative resolutions that both demonstrated general support and laid the ground work for later statutory modifications. In 1997, HB-250 called for a study and the development of proposed fiscal legislation. Last session, the state's efforts to provide state fiscal modifications culminated in HB-393, the Stranded Gas Development Act. These events represent a determined effort on the part of many in the legislature, administration and our sponsor group to commercialize North Slope gas. Further, through its individual companies, the sponsor group has long been working to bring a project to fruition.

It is understood that legislators are currently focused on the BP-Amoco/ARCO merger and want to know of any impact that it may have, if approved, on the sponsor group. Federal regulations restrict direct comments on the merger. But, fortunately, the answer to concerns about the sponsor group viability lies with the sponsor group itself. First, as stated in the past, the commercial structure that the sponsors are envisioning is for the sponsors to invest in the facilities, buy gas on the North Slope and sell LNG in the market place. Therefore, while the viability of the sponsor group is enhanced by participation from a gas owner, it does not depend upon investment by any North Slope gas owner. Second, the goal of the sponsor group is to develop a project that is economically attractive for investment. The chances for developing a project, which is acceptable to the market in terms of scale, scope and structure, are actually improved by the participation of a diverse group such as ours. The sponsor group includes North Slope gas owners, a world class pipeline company, a major Japanese trading company, a current Alaskan LNG project owner and a holder of major permits.

This group has wide ranging, major project experience. So, even though there are no assured outcomes, the sponsor group intends to continue on its current course, which we think gives the Alaska North Slope LNG project its best chances for success.

To reinforcement this commitment and focus, a letter was provided to the committee signed by each of the five sponsors demonstrating our alignment with and determination to develop a Market Viable Project concept and development plan.

To set the scene for our comments on HB-170, the sponsor group testified before the committee on February 22, 1999 concerning its work program. The essence of that testimony is that the sponsor group is executing a comprehensive plan to develop a market viable Alaska North Slope LNG Project. The vision is to achieve economic viability through cost reductions, federal and state fiscal modifications, and general risk reductions. The vision also includes finding a project size that can gain a foothold in the competitive Far East gas markets. Pipeline routings to Valdez and Cook Inlet and 5 LNG plant sites are currently being considered.

The sponsor group was formed with the objective to create an equity investment opportunity for the sponsors. That is, the plan is to own the facilities and make a profit on that investment. Federal tax modifications and state fiscal modifications as set forth in the Stranded Gas Development Act (HB-393) are seen as a way to cooperatively make this project economically competitive. Focusing on the state side, it is unclear how the concept for realizing a project under HB-170 correlates to the concept which was reflected in last year's HB-393. We hope that this matter will be made clearer as the bill is discussed.

Section 5 seems to be a critical part of HB-170. This section calls for a feasibility report on a project based upon state ownership/financing to forestall federal income taxes. It would appear that this report will require two studies: one on taxes and one on financing.

Addressing taxes, the state should conclusively deal with the question as to whether state ownership will exempt the enterprise from federal taxes. This question needs to be answered with

certainty for a project of this size to advance. It would appear that a comprehensive legal study by legal experts is needed in this regard. It might be particularly helpful to identify similar activities by other states as a way of benchmarking the idea of Alaskan ownership. This could also give the state insight as to mechanics of eliminating federal tax exposure.

Focusing next on the financial perspective, a thorough study of the state ownership concept will likely require significant expenditures by the state. For example, we would expect the study to cost substantially more than the nominal \$75,000 required for the Pedro Van Muers study in 1996. For the sake of discussion, we have visualized that the study will be conducted by an experienced banking institution with significant expertise in this area. Obviously, the selection of this institution should be done very carefully so that reliable recommendations can be achieved.

It is imperative that the assumptions for the financial study be carefully considered, especially relative to the financial community and the market place. For example, assumptions about pricing, rampup and project risks will significantly impact any economic conclusions and perceived financial risk. Also, the economic goal should be to become competitive over a range of economic conditions with the best greenfield LNG projects serving the East Asian market.

The financial study should examine a range of project configurations that dovetail with the sponsor group work. Naturally, what has previously been called the reference case, which is sized at 14 million tpy, will be included. But serious consideration should be given to the smaller cases being developed by the sponsor group.

Because of this, a critical input into the fiscal study will be the technical description for the cases. If the state financial study dovetails with the sponsor group work, we expect that this case information will be available for state consideration perhaps by fall of this year. Naturally, we will want to develop mutually acceptable arrangements for sharing information.

One of the most important aspects of the financial study should be testing the market feasibility of each case. One critical issue is whether the market has the capability to absorb the LNG at the rates estimated for each case. For example, our investigations to date have suggested that a 14 million ton per year case may be too large for an initial project. Project size needs to be continuously tested in the marketplace. In addition, investigations should be conducted as to whether the market would view state ownership/financing to forestall federal income taxes as favorable overall.

The financial study should address risk management; that is what will happen if events do not unfold as expected? For example, how would the state handle substantial cost overruns if they were to occur during construction? In addition, how will the state deal with a major drop in world energy prices and hence project revenues?

This is just a first cut at the major aspects for the tax and financial studies that should be considered in the state feasibility report. In some cases these issues are alluded to in HB-170 and in some cases the bill seems to be silent on them. Since this is a complex topic, the sponsor group would certainly offer ongoing assistance in refining these general comments. In this way, the state feasibility study can be dovetailed into the sponsor group's substantial work program.

There was a point that the sponsor group made in the February 22 testimony that bears repeating: commercial regulation will be an important sponsor group initiative starting later this year. Commercial Regulation is needed to establish a method by which export volumes will not be prorated and that cost allocations for instate gas will be fair. There is still a need for this, and the sponsor group looks forward to consideration of this by the state in due course. In addition, the sponsor group is working towards the development and submittal of an application under the Stranded Gas Development Act during our Stage 1 activities.

Finally, HB-170 seems to involve public policy issues that need to be addressed by the state prior to implementing the "Alaska Gas Corporation". It is assumed that these issues will be addressed as the bill is developed and no comments on them have been developed on them by the sponsors at this time.

To summarize, the sponsor group is fully aligned and committed to developing a market viable Alaska North Slope LNG Project as an investment opportunity. The group is proceeding as visualized in the Stranded Gas Development Act, but it has not ruled out other methods to achieving federal tax modifications. The group also stands ready to make arrangements to provide the information needed for the comprehensive feasibility studies called for by HB-170.

LEGAL SERVICES

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STATE OF ALASKA

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Mail Stop 3101

130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

MEMORANDUM

April 6, 1999

SUBJECT: Re North Slope gas: Would a requirement of sale of North Slope gas reserves compel commitment of the gas to transportation in a trans-Alaska gas pipeline? (Work Order No. 21-LS0349)

TO: Representative Jim Whitaker

FROM: Jack Chenoweth
Assistant Revisor of Statutes

Question considered: You have asked whether the production of North Slope gas in commercial quantities requires the lessees to commit the gas to a proposed trans-Alaska gas pipeline.

Response: I know of no legal requirement that, in order to meet an obligation to market North Slope gas, now requires a lessee to commit its production to transportation using the projected trans-Alaska gas pipeline. However, language in a state lease requiring that a lessee "exercise reasonable diligence in drilling, producing, and operating wells on the leased area" fairly requires that, if production and delivery of the gas become economically viable, the lessee must produce and market the gas or face the risk of a claim for breach of the implied duty to market, or, in the alternative, termination of the lease. At the same time, production and delivery of North Slope natural gas by pipeline becomes economically viable only if the gas is committed for sale in one or more markets outside Alaska, necessitating its transshipment out of the state.

There is a very close and very direct relationship between the eventuality of construction of the pipeline project and a commitment on the part of the lessees to commit to providing product to it for a protracted period. It is the commitment of the gas under a contract of sale and its in-state transportation for eventual out-of-state delivery that is the basis for the eventual financing of the construction of both the means of transportation of the gas--the pipeline--and the corresponding obligation to produce and market it. Thus, the logistics of delivering the product to its place of sale may compel the North Slope lessees to commit production, or a very substantial portion of it, to that transportation facility.

In summary, the obligation to market and the opportunity to develop and deliver Alaska's substantial natural gas reserves to domestic and international markets are opposite sides of the same coin. The production and delivery of North Slope natural gas becomes possible

Representative Jim Whitaker
April 6, 1999
Page 2

only if the lessees commit the product under long-term contracts sufficient to determine pipeline capacity and to meet construction costs.

JBC:jdr:pl
99-186.jdr

LEGAL SERVICES

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STATE OF ALASKA

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Mail Stop 3101

130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

MEMORANDUM

March 22, 1999

SUBJECT: Exemption of the income or earnings of the proposed Alaska Gas Corporation from federal income taxation (Work Order No. 21-LS0694\A)

TO: Representative Jim Whitaker

FROM: Jack Chenoweth
Assistant Revisor of Statutes

QUESTION PRESENTED: You have inquired as to whether the proposed Alaska Gas Corporation, to be established by law as a public corporation, may be structured so that the earnings or income from its activities will not be subject to taxation under the federal income tax, 26 U.S.C.¹

SHORT ANSWER: The Internal Revenue Code provides that income derived from a public utility or from the exercise of any essential government function is exempt from federal income taxation if the income accrues to a state or a political subdivision of a state. I am of the view that the activities contemplated by the proposed Alaska Gas Corporation would not

¹ Your transmittal memo noted that income of the Alaska Permanent Fund Corporation, Alaska Railroad Corporation, and Alaska Housing Finance Corporation is not subject to federal tax.

The income of the Railroad Corporation enjoys an explicit exemption from federal income taxation under 45 U.S.C. 1207(a)(6)(A). I assume that the Internal Revenue Service views the Alaska Housing Finance Corporation as simply a device (in the form of a corporation) that performs a function, improvement of housing opportunity, that constitutes an essential government function, not unlike that performed in all other states, and refrains from asserting that the corporation's net income may be subject to taxation.

More problematical is the IRS's treatment of the income earned by the Alaska Permanent Fund. However, so long as the Permanent Fund Corporation undertakes to do what the state itself would otherwise perform directly for itself, investment of "surplus" revenue, with the earnings accruing generally to the state, the IRS should continue to avoid asserting that the corporation's income is subject to tax.

As to these each of these three, if their activities begin to involve them in substantial "private" activities or in activities that do not constitute essential functions of government, the exclusion from federal income taxation of at least part of the earnings of the respective corporation may be lost.

qualify the corporation as a public utility.² Thus, the requirements of the test really must concentrate on meeting the remaining two standards: the exemption from taxation applies

-- if the activity involves an essential government function; and

-- if the corporation's income accrues to the state.

To the extent the Alaska Gas Corporation acts to manage state assets, its activities arguably should qualify the corporation as something that performs an essential government function, leaving its earnings exempt from taxation under the Internal Revenue Code. However, exclusion of the income from federal income taxation is not entirely free from doubt. There are various reasons the Internal Revenue Service might decide that the earnings or income of the corporation may be taxed.

In addition, due to the so-called "accrual" requirement, the drafting of the legislation must ensure that the corporation's activities meet the minimum requirements that attach to this state's having a claim on some portion of the corporation's income.

If both requirements cannot be met, exclusion of income from taxation would be foregone. It may be necessary for the state to ask the Congress for a specific tax exemption (as has been previously provided for the Alaska Railroad Corporation).

DISCUSSION: The Internal Revenue Code, 26 U.S.C., provides for the levy and collection of taxes on individuals, corporations, and others. States, political subdivisions of states, and some of their instrumentalities have been treated by the Internal Revenue Service as not subject to the tax provisions of the Code. Income earned by states and political subdivisions has escaped federal income taxation. However, when states and political subdivisions establish wholly-owned corporations (and similar entities) to conduct or engage in public activities, unless there is a specific provision maintaining the corporation's tax-exempt status, the corporation's earnings *may* be subject to federal income taxation.

The principal Code provision applicable to the income earned by states and their political subdivisions is 26 U.S.C. 115(1), the relevant portion of which reads:

Gross income does not include --

(1) income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

....;

Courts have applied 26 U.S.C. 115(1) to determine the tax status of entities other than states and their political subdivisions. *City of Bethel v. United States*, 594 F.2d 1301 (9th Cir. 1979), *cert. denied*, 444 U.S. 980, 62 L.Ed.2d 407 (1979) (Ninth Circuit applied 26 U.S.C.

² The proposed Alaska Gas Corporation may not qualify as a public utility because its services would not be held out to be generally available to all or a substantial portion of the public, but rather are intended to aid *the state* in the marketing of its resources.

115(1) to evaluate asserted exemption from taxation of income of liquor store corporation that was wholly-owned by the city).

In taking the measure of whether the income of a public corporation is or is not tax exempt, the Internal Revenue Service concerns itself, first, with whether or not the income earned follows from "the exercise of [an] essential governmental function" and, second, whether the income generated by the entity engaged in the activity accrues to the state. Both parts of the test must be met if, under the application of 26 U.S.C. 115(1), the income is to escape federal income taxation.

I

There are cases on each side that consider whether the performance of a particular service qualifies as an "essential governmental function." For example, operation of the Port of New York Authority by the states of New York and New Jersey, designed to construct and operate transportation facilities on behalf of the two states, qualifies as an "essential government function" under an early New Jersey state court opinion.³ On the other hand, for purposes of determining federal tax liability, a public university's operation of a commercial television station does not qualify.⁴ The significant distinguishing characteristic may well be whether the particular service qualifies because of a duty imposed under the state's own constitution or, in the absence of a constitutional obligation, because it is either a function or duty arising in conjunction with the administration of government (e.g. investment of surplus revenues, a principal responsibility of the Alaska Permanent Fund Corporation) or with the exercise of a sovereign power of the state affecting the public. What does seem clear is that, in order to avoid a claim that the service does not qualify as an "essential government function," the service provided may not yield any more than an incidental benefit to one or more private parties, on the theory that a service does not qualify as an "essential government function" if it is done for the particular benefit of less than substantially all of the public.

II

26 U.S.C. 115(1) allows an exemption only if the corporation's income actually "accrues" to the state--that is, so long as it is received or transferred to the state.⁵ It is not enough that, in this instance, the state have the control of the corporation.⁶ The test appears to be whether

³ Miller v. Port of New York Authority, 15 A.2d 262, 266 (N.J. 1939).

⁴ Iowa State University of Science and Technology v. United States, 500 F.2d 508 (Ct. Cl., 1974).

⁵ Under the earlier-cited City of Bethel decision, the Ninth Circuit disallowed tax exempt treatment of the income of the city-owned liquor store's because the arrangement between the city and the corporation did not require a distribution of profits to the municipality.

⁶ Bear Gulch Water Co. v. Commissioner of Internal Revenue, 116 F.2d 975 (9th Cir. 1941), cert. denied 314 U.S. 652, 62 S.Ct. 99 (1941) (a corporation's retained earnings do not (continued...))

Representative Jim Whitaker
March 22, 1999
Page 4

or not the state has reserved to itself a right or enforceable claim to the corporation's net income. So, for example, in the City of Bethel decision, cited earlier, the Ninth Circuit noted that the city could have met the requirement by requiring the liquor store corporation's trustees to distribute the corporation's profit under a clause of the articles of incorporation: "The balance, if any, of all money received by the corporation from the operations of its liquor store, after the payment in full of all debts and obligations of the corporation of whatever kind or nature, shall be distributed exclusively to the [c]ity . . . for use in promotion of the general welfare of the [c]ity and its inhabitants." 594 F.2d at 1303, n. 6. The court declared that "[i]f the income had been transferred to Bethel coffers and the expended to finance [the city liquor store's] operations, a different result might follow Instead, the income was retained [by the city liquor store corporation] . . . [and] Bethel's financial records [did not] reflect any right to receive [the] income"

I can only suggest that, as it considers the proposed Alaska Gas Corporation, the legislature give careful consideration to each of the following points:

-- the legislation should try to avoid situations involving a commitment or involvement of the corporation's earnings in activities giving anything more than incidental benefit to one or more private parties, for providing that kind of treatment might come to be viewed and treated by the Internal Revenue Service as unrelated business income not excludable from taxation under the "essential governmental function" language of 26 U.S.C. 115(1);

-- the legislation should include some means that, as the Ninth Circuit related in City of Bethel, requires a distribution of net income (after provision for payments of debts and for reserves for obligations) to the state for deposit into the state treasury.

If compliance with one or both of these proves detrimental to achieving the stated purposes of the legislation, you may want to ask Congress to provide an express tax exemption.

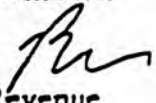
If this memo prompts questions, please contact me.

JBC:glc
99-119.glc

"(...continued)

accrue to a government entity for purposes of sec. 115(a) even though the corporation's stock is wholly owned by the government entity).

To: Representative Whitaker

From: Roger Marks 
Department of Revenue

Date: March 3, 1999

Re: North Slope Gas

At the request of Representative Whitaker, we examined the possibility of state ownership of the North Slope natural gas pipeline project. This would entail the following:

- Purchase of gas from the Prudhoe Bay working interest owners for 50 cents per thousand cubic feet (mcf) in Year 1999 dollars, increasing at 3 percent per year. This amount could represent either a firm 50 cents, or a firm spread between the market price of gas in the Far East and the wellhead purchase price.
- Tax-free financing of 100% of the capital and operating costs of the conditioning plant, pipeline, LNG terminal, and ships, at 6% interest, with payment beginning in the first year of LNG delivery over 30 years. Whether such financing is probable needs to be further confirmed.
- No state or federal taxes.
- State sale of the gas in the Far East.

The State's revenues would be the sale price of the gas. The State's expenses would be the purchase price of the gas and the debt service, including the principal and interest on the capital and operating costs.

The pipeline project was modeled similarly to the modeling procedure we used in the 1997 Report to the Governor. Essentially, 2 billion cubic feet per day (14 million tons per year) is sold after a 5-year ramp-up, starting in 2007. The total project cost is \$12 billion in 1999 dollars with a price of gas in the Far East of \$3.50 per million btu (mmbtu) in 1999 dollars.

We have modeled the total net cash flow to the State after expenses, at three different prices of LNG in the Far East: a \$3.50/mmbtu base case, a low case of \$2.50/mmbtu, and a high case \$4.50/mmbtu.

LNG prices in the Far East are structured to follow oil prices, except that there are ceilings and floors at high and low prices. This is called an "S-curve." A price of \$3.50 represents ANS oil at about \$17/bbl. A price of \$2.50 represents current conditions, about \$10/bbl ANS. A price of \$4.50 would represent ANS at about \$22/bbl.

The following table shows the net cash flow to the State at selected years and gas prices, with a 50-cent purchase price. By way of comparison, a project where the North Slope producers own the entire project coupled with the current fiscal system, notwithstanding the sub-market returns generated to the project sponsors, would yield about \$300 million to the State and local municipalities in the peak year.

**Net Cash Flow to State
North Slope Gas
(\$millions)**

Year	\$2.50	\$3.50	\$4.50
2007	\$51	\$209	\$367
2010	\$224	\$914	\$1,604
2015	\$389	\$1,589	\$2,789
2020	\$451	\$1,842	\$3,233
2025	\$523	\$2,135	\$3,748
2030	\$606	\$2,476	\$4,345
2035	\$702	\$2,870	\$5,037

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CS FOR HOUSE BILL NO. 170()
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FIRST LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): HOUSE SPECIAL COMMITTEE ON OIL AND GAS

A BILL

FOR AN ACT ENTITLED

1 "An Act establishing the Alaska Gas Corporation, a public corporation, and
2 providing for its structure, management, responsibilities, and operation."

3 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 * Section 1. FINDINGS AND INTENT. (a) The legislature finds that

5 (1) art. VIII, sec. 1, Constitution of the State of Alaska, provides that it is the
6 policy of the state to encourage the settlement of its land and the development of its resources
7 by making them available for maximum use consistent with the public interest;

8 (2) art. VIII, sec. 2, Constitution of the State of Alaska, requires the legislature
9 to provide for the utilization, development, and conservation of all natural resources belonging
10 to the state, including land and waters, for the maximum benefit of its people;

11 (3) the production of oil and gas from state land is an important source of
12 revenue to the state and job opportunities for all the people of the state;

13 (4) natural gas located on the North Slope is a valuable resource to the state
14 that has not been produced for sale in the market place;

1 (5) the amount of natural gas located on the North Slope is substantial and, if
2 sold, will generate significant revenue to the state and opportunities and benefits to its people
3 for many years into the future;

4 (6) maximum benefit to the people of the State of Alaska by the sale of North
5 Slope natural gas may be realized only through public ownership of a corporate entity that
6 provides the essential government function of use of this natural resource by accruing to the
7 state all net income;

8 (7) state revenue allocated to the state's municipalities is declining and a
9 natural gas pipeline project will significantly increase revenue sharing with municipalities; and

10 (8) failure to produce and sell the natural gas resource located in the state for
11 the maximum benefit of its people is in direct conflict with the provisions of the Constitution
12 of the State of Alaska.

13 (b) The intent of this Act is to

14 (1) provide the people of the state the maximum benefit possible through
15 extraction of natural resources as required by the Constitution of the State of Alaska;

16 (2) foster and promote the long-term economic growth and development of the
17 state;

18 (3) recognize that the production, ownership, and sale of natural gas is in the
19 long-term and maximum best interest of the citizens of the state;

20 (4) establish a means by which the state can bring North Slope natural gas
21 resources to market;

22 (5) create a public corporation with the powers, duties, and functions necessary
23 to facilitate the acquisition and sale of North Slope natural gas;

24 (6) require the corporation to contract with private sector entities for the
25 following services and functions in order to bring natural gas from the North Slope to market:

26 (A) the acquisition of North Slope natural gas;

27 (B) the conditioning of North Slope natural gas as required for
28 shipment through the Trans Alaska Gas Pipeline System;

29 (C) the design and construction of the Trans Alaska Gas Pipeline
30 System;

31 (D) the operation and maintenance of the Trans Alaska Gas Pipeline

1 System;

2 (E) the design and construction of a tidewater liquefaction facility;

3 (F) the operation and maintenance of a tidewater liquefaction facility;

4 (G) the operation of a sea transportation system; and

5 (H) the access and acquisition of natural gas market share sufficient to
6 ensure the long-term feasibility of the project; and

7 (7) provide for allocation to all municipalities of 25 percent of the profit
8 generated by the Alaska Gas Corporation from the operation of the pipeline and other
9 activities of the corporation.

10 * Sec. 2. AS 41 is amended by adding a new chapter to read:

11 **Chapter 41. Alaska Gas Corporation.**

12 **Article 1. Establishment of the Corporation.**

13 **Sec. 41.41.010. Establishment of the corporation.** (a) There is established
14 the Alaska Gas Corporation, the purpose of which is to provide one or more of the
15 following public services and functions in order to bring natural gas from the North
16 Slope to market:

17 (1) the acquisition of North Slope natural gas;

18 (2) the conditioning of North Slope natural gas as required for shipment
19 through the Trans Alaska Gas Pipeline System;

20 (3) the design and construction of the Trans Alaska Gas Pipeline
21 System;

22 (4) the operation and maintenance of the Trans Alaska Gas Pipeline
23 System;

24 (5) the design and construction of a tidewater liquefaction facility for
25 natural gas;

26 (6) the operation and maintenance of a tidewater liquefaction facility
27 for natural gas;

28 (7) the operation of a sea transportation system for natural gas; and

29 (8) the access and acquisition of natural gas market share sufficient to
30 ensure the long-term feasibility of the Trans Alaska Gas Pipeline System project.

31 (b) The corporation is a public corporation and an instrumentality of the state

1 within the Department of Revenue.

2 (c) The corporation has a legal existence independent of and separate from the
3 state.

4 (d) The acquisition of natural gas from the North Slope and the other activities
5 set out in (a) of this section undertaken by the Alaska Gas Corporation are essential
6 governmental functions of the state.

7 (e) The corporation may not be terminated as long as it has bonds, notes, or
8 other obligations outstanding.

9 **Sec. 41.41.020. Corporation governing body.** (a) The corporation shall be
10 governed by a board of directors consisting of the following seven members:

11 (1) the commissioner of natural resources;

12 (2) the commissioner of revenue; and

13 (3) five members appointed by the governor from the public, who may
14 not hold another state or federal office, position, or employment, either elective or
15 appointive, except as a member of the armed forces of either the United States or this
16 state.

17 (b) Of the five public members of the board,

18 (1) two members must have recognized competence and wide
19 experience in finance and business management;

20 (2) two members must have recognized competence and wide
21 experience in gas industry-related endeavors; and

22 (3) one member must have recognized competence and wide experience
23 in Alaska environmental issues.

24 (c) The board shall annually elect a chair, and may elect other officers, from
25 among its members.

26 **Sec. 41.41.030. Term of office.** The public members of the board shall be
27 appointed for terms of four years, and they may be reappointed. The terms of the
28 public members shall be staggered so that the terms of no more than two public
29 members expire each year.

30 **Sec. 41.41.040. Removal and vacancies.** (a) The governor may remove a
31 member of the board from office. A removal by the governor must be in writing and

1 must state the reason for the removal. A member who is removed by the governor
2 may not participate in board business and may not be counted for purposes of
3 establishing a quorum after the member receives written notice of removal from the
4 governor. A member who is removed by the governor is not entitled to honoraria, per
5 diem, or travel expenses authorized under AS 44.41.060 for work performed after the
6 member receives the written notice of renewal.

7 (b) The governor shall promptly fill a vacancy on the board by appointment.
8 An appointee to a vacancy shall hold office for the balance of the term for which the
9 appointee's predecessor on the board was appointed.

10 (c) A vacancy on the board does not impair the authority of a quorum of the
11 board to exercise all the powers and perform all the duties of the board.

12 **Sec. 41.41.050. Quorum and voting.** Four members of the board constitute
13 a quorum for the transaction of business and the exercise of the powers and duties of
14 the board. Action may be taken only upon the affirmative vote of a majority of the
15 full membership of the board.

16 **Sec. 41.41.060. Compensation of board members; per diem and travel**
17 **expenses.** (a) Public members of the board receive an honorarium of \$400 for each
18 day spent at a meeting of the board or at a meeting of a subcommittee of the board
19 or at a public meeting as a representative of the board.

20 (b) Members of the board are entitled to per diem and travel expenses
21 authorized for boards and commissions under AS 39.20.180.

22 **Sec. 41.41.070. General powers.** In addition to the exercise of other powers
23 authorized by law, the corporation may

- 24 (1) adopt a seal;
25 (2) adopt bylaws governing the business of the corporation;
26 (3) sue and be sued;
27 (4) appoint trustees and agents of the corporation and prescribe their
28 powers and duties;
29 (5) make contracts and execute instruments necessary or convenient in
30 the exercise of its powers and duties;
31 (6) maintain an office at any location in the state;

1 (7) acquire by purchase, lease, bequest, devise, gift, exchange, the
2 satisfaction of debts, the foreclosure of mortgages, or otherwise, personal property,
3 rights, rights-of-way, franchises, easements, and other interests in land, and acquire by
4 appropriation water rights that are located in the state, taking title to the property in
5 the name of the corporation;

6 (8) hold, maintain, use, operate, improve, lease, exchange, donate,
7 convey, alienate, encumber, or otherwise grant a security interest in, or authorize use
8 or dispose of, land or personal property, subject to other provisions of this chapter;

9 (9) contract with and accept transfers, gifts, grants, or loans of funds
10 or property from the United States and the state or its political subdivisions, subject
11 to other provisions of federal or state law or municipal ordinances;

12 (10) undertake and provide for the management, operation,
13 maintenance, use, and control of all the property of the corporation;

14 (11) recommend to the legislature and the governor any tax, financing,
15 or financial arrangement the corporation considers appropriate for expansion or
16 extension and operation of the corporation;

17 (12) enter into contracts, leases, and other agreements with other
18 businesses or persons concerning the services, activities, operations, property, and
19 facilities of the corporation, including services specified in AS 41.41.010;

20 (13) enter into agreements with a state agency or other instrumentality
21 of the state; and

22 (14) do all things necessary or desirable to carry out the powers and
23 duties of the corporation granted or necessarily implied in the chapter or other laws
24 of the state or the laws or regulations of the federal government.

25 **Sec. 41.41.080. Corporation staff.** (a) The board may employ and determine
26 the salary of an executive director.

27 (b) The executive director may, with the approval of the board, select and
28 employ additional staff as necessary.

29 (c) An employee of the corporation, including the executive director, may not
30 be a member of the board. The executive director and the other employees of the
31 board are in the exempt service under AS 39.25.110.

(d) In addition to its employees, the corporation may contract for and engage the services of bond counsel, consultants, experts, and financial advisors the corporation considers necessary for the purpose of developing information, furnishing advice, or conducting studies, investigations, hearings, or other proceedings.

Sec. 41.41.090. Legal counsel. (a) The attorney general

(1) is the legal counsel for the corporation;

(2) shall advise the corporation in legal matters; and

(3) shall represent the corporation in legal actions.

(b) Notwithstanding (a) of this section, the board of directors may, at its own discretion, seek and obtain the services of independent legal counsel.

Sec. 41.41.100. Conflicts of interest. (a) Members of the board and the executive director of the corporation are subject to the provisions of AS 39.50.

(b) If a member of the board or an employee of the corporation acquires, owns, or controls an interest, direct or indirect, in an entity or project in which assets of the corporation are invested, the member shall immediately disclose the interest to the board. The disclosure is a matter of public record and shall be included in the minutes of the board meeting next following the disclosure.

Sec. 41.41.110. Corporation budget. (a) The revenue earned by corporate operations must be identified as the source of the operating budget of the corporation in the state's operating budget under AS 37.07 (Executive Budget Act).

(b) Earnings of the corporation in excess of bond debt payments and future operating needs shall accrue and be transferred to the state general fund once each year, not later than January 15, after the first full year of operation.

Sec. 41.41.120. Audits. The Legislative Budget and Audit Committee may provide for an annual post audit and annual operational and performance evaluations of the corporation's operations and budget.

Sec. 41.41.130. Reports and publications. (a) By September 30 of each year, the board shall publish a report of the corporation for distribution to the governor and the public. The board shall notify the legislature that the report is available.

(b) The report must include financial statements audited by independent outside auditors and a statement of the amount of money received by the corporation

1 from its operations during the period covered.

2 **Sec. 41.41.140. Tax exemption.** (a) The corporation and its operations and
3 the earnings on them are exempt from all taxes and assessments in the state.

4 (b) All bond and security instruments issued by the corporation, their transfer,
5 and their income are exempt from all taxes and assessments in the state.

6 **Sec. 41.41.150. Political activities.** The resources of the corporation may not
7 be used to finance or influence political activities.

8 **Sec. 41.41.160. Public access to information.** (a) Information in the
9 possession of the corporation is a public record, except that information that discloses
10 the particulars of the business or affairs of a private enterprise or investor is
11 confidential and is not a public record for purposes of AS 09.25.110 - 09.25.140.
12 Confidential information may be disclosed only for the purposes of an official law
13 enforcement investigation or when its production is required in a court proceeding.

14 (b) The restrictions of (a) of this section do not prohibit the publication of
15 statistics presented in a manner that prevents the identification of particular reports,
16 items, persons, or enterprises.

17 **Article 2. Bonds and Notes.**

18 **Sec. 41.41.200. Bonds and notes of the corporation.** (a) The corporation,
19 by resolution, may issue revenue bonds and bond anticipation notes in order to provide
20 funds to carry out the purposes set out in AS 41.41.010(a).

21 (b) The principal and interest on the revenue bonds or notes authorized and
22 issued under (a) of this section are payable from corporation funds. Bond anticipation
23 notes may be payable from the proceeds of the sale of bonds or from the proceeds of
24 the sale of other bond anticipation notes or, in the event bond or bond anticipation note
25 proceeds are not available, the notes may be paid from other funds or assets of the
26 corporation.

27 (c) Bonds or notes may be additionally secured by a pledge of a grant or
28 contribution from the federal government, or a corporation, association, institution, or
29 person, or a pledge of money, income, or revenues of the corporation from any source.

30 (d) Bonds or bond anticipation notes of the corporation may be issued in one
31 or more series and shall be dated, bear interest at the rate or rates per year or within

1 the maximum rate, be in the denomination, be registered, carry the conversion or
2 registration provisions, have the rank or priority, be executed in the manner and form,
3 be payable at the times, from the sources, and in the medium of payment and place
4 or places within or outside the state, be subject to authentication by a trustee or fiscal
5 agent, and be subject to the terms of redemption with or without premium, as the
6 resolution of the corporation may provide. Bond anticipation notes shall mature at the
7 time or times that are determined by the corporation. Bonds shall mature at a time not
8 exceeding a number of years from their date that is determined by the corporation.
9 Before the preparation of definitive bonds or bond anticipation notes, the corporation
10 may issue interim receipts or temporary bonds or bond anticipation notes,
11 exchangeable for bonds or bond anticipation notes when these definitive bonds or bond
12 anticipation notes have been executed and are available for delivery.

13 (e) Bonds or bond anticipation notes may be sold in the manner and on the
14 terms the corporation determines.

15 (f) If an officer whose signature or a facsimile of whose signature appears on
16 a bond or note ceases to be an officer before the delivery of the bond or note, the
17 signature or facsimile is valid the same as if the officer had remained in office until
18 delivery.

19 **Sec. 41.41.210. Covenants.** (a) In a resolution of the corporation authorizing
20 or relating to the issuance of bonds or bond anticipation notes, the corporation has
21 power by provisions in the resolution that will constitute covenants of the corporation
22 and contracts with the holders of the bonds or bond anticipation notes to

23 (1) pledge to a payment or purpose all or a part of its revenues to
24 which its right then exists or may thereafter come into existence, and the money
25 derived from the revenues, and the proceeds of bonds or notes;

26 (2) covenant as to the use and disposition of payments of principal or
27 interest received by the corporation on loans or other investments held by the
28 corporation;

29 (3) covenant as to establishment of reserves or sinking funds and the
30 making of provision for and the regulation and disposition of the reserves or sinking
31 funds;

1 (4) covenant with respect to or against limitations on a right to sell or
2 otherwise dispose of property of any kind;

3 (5) covenant as to bonds and notes to be issued, and their limitations,
4 terms, and conditions, and as to the custody, application, and disposition of the
5 proceeds of the bonds and notes;

6 (6) covenant as to the issuance of additional bonds or notes, or as to
7 limitations on the issuance of additional bonds or notes and the incurring of other
8 debts;

9 (7) covenant as to the payment of the principal of or interest on the
10 bonds or notes, as to the sources and methods of the payment, as to the rank or
11 priority of the bonds or notes with respect to a lien or security, or as to the
12 acceleration of the maturity of the bonds or notes;

13 (8) provide for the replacement of lost, stolen, destroyed, or mutilated
14 bonds or notes;

15 (9) covenant as to the redemption of bonds or notes and privileges of
16 their exchange for other bonds or notes of the corporation;

17 (10) covenant to create or authorize the creation of special funds of
18 money to be held in pledge or otherwise for operating expenses, payment or
19 redemption of bonds or notes, reserves, or other purposes;

20 (11) establish the procedure, if any, by which the terms of a contract
21 or covenant with or for the benefit of the holders of bonds or notes may be amended
22 or abrogated, the amount of bonds or notes the holders of which must consent to
23 amendment or abrogation, and the manner in which the consent may be given;

24 (12) covenant as to the custody of property or investments, their
25 safekeeping and insurance, and the use and disposition of insurance money;

26 (13) agree with a corporate trustee that may be a trust company or bank
27 having the powers of a trust company within or outside the state as to the pledging or
28 assigning of revenue or funds to which or in which the corporation has rights or an
29 interest; the agreement may further provide for other rights and remedies exercisable
30 by the trustee as may be proper for the protection of the holders of a bond or note of
31 the corporation and not otherwise in violation of law and may provide for the

1 restriction of the rights of an individual holder of bonds or notes of the corporation;
2 (14) appoint and provide for the duties and obligations of a paying
3 agent or paying agents or other fiduciaries as the resolution may provide within or
4 outside the state;

5 (15) limit the rights of the holders of a bond or note to enforce a
6 pledge or covenant securing the bonds or notes;

7 (16) make covenants other than and in addition to the covenants
8 expressly authorized in this section of like or different character, and to make
9 covenants to do or refrain from doing acts and things as may be necessary or
10 convenient and desirable in order to better secure bonds or notes or that, in the
11 absolute discretion of the corporation, will tend to make bonds or notes more
12 marketable, notwithstanding that the covenants, acts, or things may not be enumerated
13 in this section.

14 **Sec. 41.41.220. Limitations of issuance of bonds.** (a) The corporation may
15 not issue bonds in an amount that exceeds the amount of bonds authorized to be issued
16 by the legislature.

17 (b) This section does not apply to the issuance by the corporation of refunding
18 bonds or to the issuance by the corporation of bonds the proceeds of which are
19 intended to be used to refinance the loans held by the corporation.

20 **Sec. 41.41.230. Independent financial advisor.** In negotiating the private sale
21 of bonds or bond anticipation notes to an underwriter, the corporation may, at its
22 discretion, retain a financial advisor. A financial advisor retained under this section
23 must be independent from the underwriter.

24 **Sec. 41.41.240. Validity of pledge.** (a) The pledge of assets or revenue of
25 the corporation to the payment of the principal or interest on an obligation of the
26 corporation is valid and binding from the time the pledge is made, and the assets or
27 revenue are immediately subject to the lien of the pledge without physical delivery or
28 further act. The lien of a pledge is valid and binding against all parties having claims
29 in tort, contract, or otherwise against the corporation, irrespective of whether those
30 parties have notice of the lien of the pledge.

31 (b) This section does not prohibit the corporation from selling assets subject

1 to a pledge, except that a sale may be restricted by the trust agreement or resolution
2 providing for the issuance of the obligations.

3 Sec. 41.41.250. **Capital reserve funds.** (a) For the purpose of securing one
4 or more issues of its obligations, the corporation may establish one or more special
5 funds, called "capital reserve funds," and shall pay into those capital reserve funds (1)
6 money appropriated and made available by the state for the purpose of those funds, (2)
7 proceeds of the sale of its obligations, to the extent provided in the resolution or
8 resolutions of the corporation authorizing their issuance, and (3) other money that may
9 be made available to the corporation for the purposes of those funds from another
10 source. All money held in a capital reserve fund, except as provided in this section,
11 shall be used as required solely for the payment of the principal of obligations or of
12 the sinking fund payments with respect to those obligations; the purchase or
13 redemption of obligations; the payment of interest on obligations; or the payment of
14 a redemption premium required to be paid when those obligations are redeemed before
15 maturity. However, money in a fund may not be withdrawn from that fund at any
16 time in an amount that would reduce the amount of that fund to less than the capital
17 reserve requirement set out in (b) of this section, except for the purpose of making,
18 with respect to those obligations, payment, when due, of principal, interest, redemption
19 premiums, and the sinking fund payments for the payment of which other money of
20 the corporation is not available. Income or interest earned by, or increment to, a
21 capital reserve fund due to the investment of the fund or other amounts in it may be
22 transferred by the corporation to other funds or accounts of the corporation to the
23 extent that the transfer does not reduce the amount of the capital reserve fund below
24 the capital reserve fund requirement.

25 (b) If the corporation decides to issue obligations secured by a capital reserve
26 fund, the obligations may not be issued if the amount in the capital reserve fund is less
27 than a percent, not exceeding 10 percent of the principal amount of all of those
28 obligations secured by that capital reserve fund then to be issued and then outstanding
29 in accordance with their terms, as may be established by resolution of the corporation,
30 called the "capital reserve fund requirement," unless the corporation, at the time of
31 issuance of the obligations, deposits in the capital reserve fund from the proceeds of

1 the obligations to be issued or from other sources an amount that, together with the
2 amount then in the fund, will not be less than the capital reserve fund requirement.

3 (c) In computing the amount of a capital reserve fund for the purpose of this
4 section, securities in which all or a portion of the funds are invested shall be valued
5 at par or, if purchased at less than par, at amortized costs as the term is defined by
6 resolution of the corporation authorizing the issue of the obligations or by some other
7 reasonable method established by the corporation by resolution. Valuation on a
8 particular date must include the amount of interest earned or accrued to that date.

9 (d) To assure the continued operation and solvency of the corporation for the
10 carrying out of its corporate purposes, provision is made in (a) of this section for the
11 accumulation in capital reserve funds of an amount equal to their capital reserve fund
12 requirement.

13 (e) The chair of the corporation shall annually, no later than January 2, make
14 and deliver to the governor and chairs of the house and senate finance committees a
15 certificate stating the sum, if any, required to restore a capital reserve fund to the
16 capital reserve fund requirement. The legislature may appropriate that sum, and all
17 sums appropriated during the current fiscal year by the legislature for the restoration
18 shall be deposited by the corporation in the appropriate capital reserve fund.

19 (f) Nothing in this section creates a debt or liability of the state.

20 **Sec. 41.41.260. Remedies.** A holder of obligations issued under the provisions
21 of this chapter, and a trustee under a trust agreement or resolution authorizing the
22 issuance of the obligations, except as restricted by a trust agreement or resolution,
23 either at law or in equity, may enforce all rights granted hereunder or under the trust
24 agreement or resolution, or under another contract executed by the corporation under
25 this chapter, and may enforce and compel the performance of all duties required by
26 this chapter or by the trust agreement or resolution to be performed by the corporation
27 or by an officer of it.

28 **Sec. 41.41.270. Negotiable instruments.** All obligations are negotiable
29 instruments under the laws of this state, subject only to applicable provisions for
30 registration.

31 **Sec. 41.41.280. Obligations eligible for investment.** Obligations issued under

1 the provisions of this chapter are securities in which all public officers and public
2 bodies of the state and its political subdivisions, all insurance companies, trust
3 companies, banking associations, investment companies, executors, administrators,
4 trustees, and other fiduciaries may properly and legally invest funds, including capital
5 in their control or belonging to them. These obligations may be deposited with a state
6 or municipal officer of an agency or political subdivision of the state for a purpose for
7 which the deposit of bonds, notes, or obligations of the state is authorized by law.

8 **Sec. 41.41.290. Refunding bonds.** (a) The corporation may provide for the
9 issuance of refunding bonds for the purpose of refunding an obligation then
10 outstanding that have been issued under the provisions of this chapter, including the
11 payment of redemption premium on them and interest accrued or to accrue to the date
12 of redemption of the obligations. The issuance of the bonds, the maturities and other
13 details of them, the rights of the holders of them, and the rights, duties, and obligations
14 of the corporation in respect of them are governed by the provisions of this chapter
15 that relate to the issuance of obligations insofar as those provisions may be
16 appropriate.

17 (b) Refunding bonds may be sold or exchanged for outstanding bonds issued
18 under this chapter, and, if sold, the proceeds may be applied, in addition to another
19 authorized purpose, to the purchase, redemption, or payment of the outstanding
20 obligations. Pending the application of the proceeds of refunding bonds, with any
21 other available funds, to the payment of the principal, accrued interest, and redemption
22 premium on the obligations being refunded, and, if so provided or permitted in the
23 resolution authorizing the issuance of the refunding bonds or in the trust agreement
24 securing them, to the payment of any interest on the refunding bonds and expenses in
25 connection with the refunding, the proceeds may be invested in direct obligations of,
26 or obligations the principal of and the interest on which are unconditionally guaranteed
27 by, the United States that mature or that will be subject to redemption, at the option
28 of the holders of them, not later than the respective dates when the proceeds, together
29 with the interest accruing on them, will be required for the purposes intended.

30 **Sec. 41.41.300. Credit of state not pledged.** (a) Obligations issued under
31 the provisions of this chapter do not constitute a debt, liability, or obligation of the

1 state or of a political subdivision of the state or a pledge of the faith and credit of the
2 state or of a political subdivision of the state but are payable solely from the revenue
3 or assets of the corporation. Each obligation issued under this chapter must contain
4 on its face a statement that the corporation is not obligated to pay it or the interest on
5 it except from the revenue or assets of the corporation and that neither the faith and
6 credit nor the taxing power of the state or of a political subdivision of the state is
7 pledged to the payment of the principal of or the interest on the obligation.

8 (b) Expenses incurred by the corporation in carrying out the provisions of this
9 chapter are payable from funds provided under this chapter, and liability may not be
10 incurred by the corporation in excess of these funds.

11 **Sec. 41.41.310. Officers not liable.** A member or other officer of the
12 corporation is not subject to personal liability or accountability by reason of having
13 executed or issued an obligation.

14 **Article 3. Property of the Corporation.**

15 **Sec. 41.41.350. Property of the corporation.** The corporation may acquire,
16 by purchase, lease, or gift, upon terms that it considers proper, land, structures, real
17 or personal property rights, rights-of-way, franchises, easements, and other interests in
18 land it considers necessary or convenient for the financing of the project or a part of
19 the project.

20 **Article 4. General Provisions.**

21 **Sec. 41.41.900. Tax exemption.** (a) The exercise of the powers granted by
22 this chapter will be in all respects for the benefit of the people of the state, for their
23 well-being and prosperity, and for the improvement of their social and economic
24 conditions. The corporation is not required to pay a tax or assessment on property
25 owned by the corporation under the provisions of this chapter or on the income from
26 it.

27 (b) All obligations issued under this chapter are declared to be issued by a
28 body corporate and public of the state and for an essential public and governmental
29 purpose, and the obligations, and the interest and income on and from the obligations,
30 and all fees, charges, funds, revenues, income, and other money pledged or available
31 to pay or secure the payment of the obligations, or interest on the obligations, are

1 exempt from state taxation except for transfer, inheritance, and estate taxes.

2 **Sec. 41.41.990. Definitions.** In this chapter,

3 (1) "board" means the board of directors of the Alaska Gas
4 Corporation;

5 (2) "corporation" means the Alaska Gas Corporation;

6 (3) "obligations" means bonds, notes, or other obligations issued to
7 evidence borrowings of the corporation;

8 (4) "project" means the gas transmission pipeline, together with all
9 related property and facilities, to extend from the Prudhoe Bay area on the North Slope
10 of Alaska to tidewater at a point on Prince William Sound and includes planning,
11 design, and construction of the pipeline and facilities as described in
12 AS 41.41.010(a)(1) - (6).

13 * **Sec. 3.** AS 39.25.110(11) is amended by adding a new subparagraph to read:

14 (G) Alaska Gas Corporation;

15 * **Sec. 4.** AS 39.50.200(b) is amended by adding a new paragraph to read:

16 (56) the board of directors and executive director of the Alaska Gas
17 Corporation (AS 41.41.020).

18 * **Sec. 5. DEVELOPMENT OF PROJECT PLAN.** (a) The House Special Committee on
19 Oil and Gas of the Twenty-First Alaska State Legislature shall submit a report to the governor,
20 the speaker of the house, and the president of the senate no later than the first day of the First
21 Regular Session of the Twenty-Second Alaska State Legislature based on conclusions drawn
22 by qualified engineering, consulting, and other entities considered appropriate as to whether
23 the construction and operation of a natural gas transmission pipeline project, as defined in
24 AS 41.41.990, added by sec. 2 of this Act, using a public corporation is feasible.

25 (b) The feasibility study must be a general description of the requirements and current
26 status of the requirements set out in (a) of this section with respect to gas supply, engineering,
27 technical, financial, regulatory, and market access matters relating to the project. In addition,
28 the plan must include the following specific items and findings and recommendations on each
29 item:

30 (1) the proposed methods and procedures by which the project will be
31 financed, including the amounts and times of issuance of bonds by the corporation;

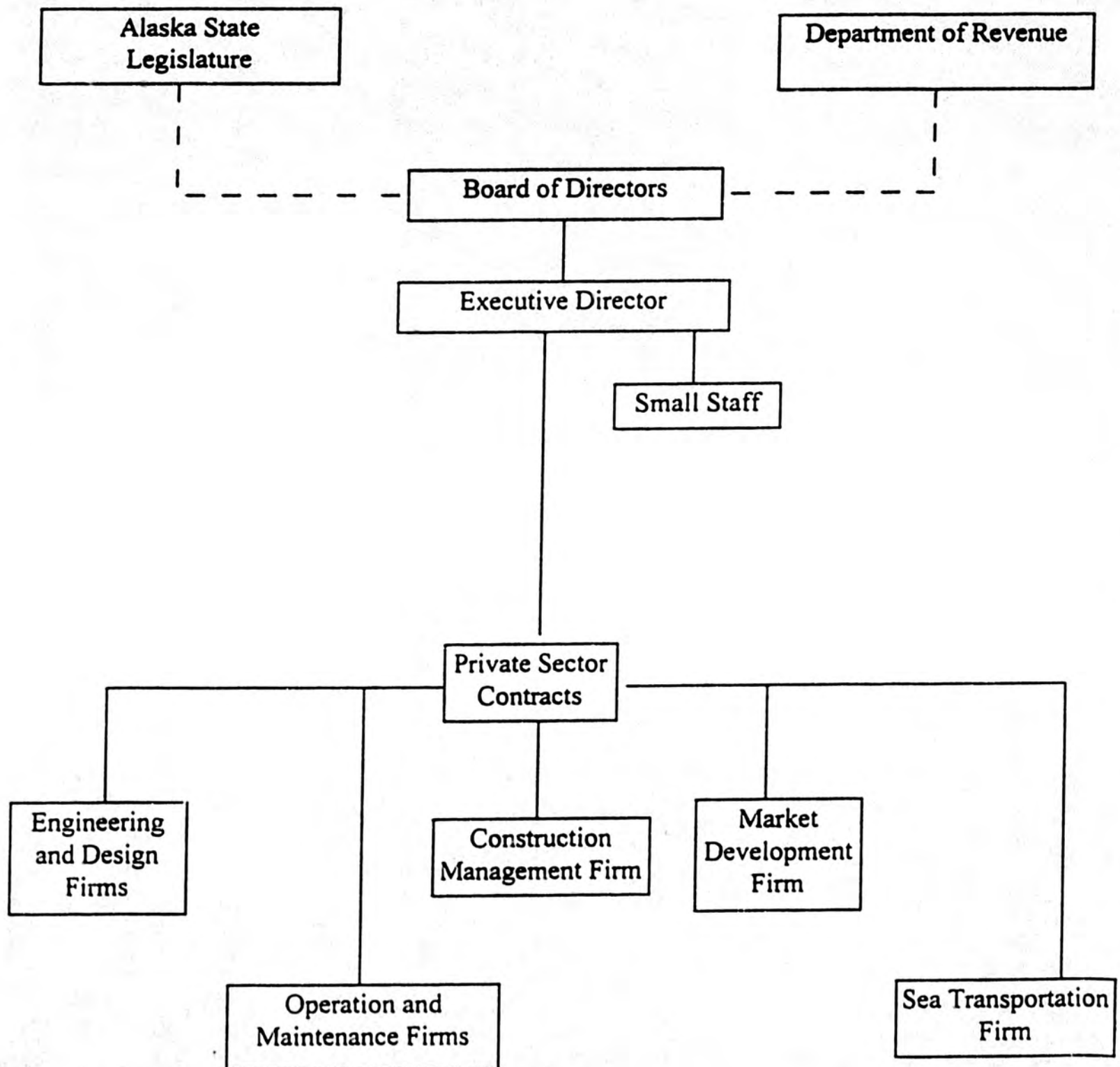
- 1 (2) the method of securing the bonds;
2 (3) projected debt service requirements of the bonds;
3 (4) projected revenues, for the period of time during which reasonable
4 projections can be made, that will be available to the corporation to meet debt service
5 requirement;
6 (5) documentation that contractors have undertaken
7 (A) to use their best efforts to advertise for, recruit, and employ
8 qualified residents of the state;
9 (B) to subcontract with existing licensed Alaska firms within the state
10 and, in subcontracting with those firms, to encourage the contractors to employ and,
11 when necessary, train existing state residents;
12 (C) to enter into contracts with Alaska-licensed vendors, contractors,
13 and suppliers for the provision of supplies and services; and
14 (D) to conduct quarterly audits of the performance of the contractors
15 under (A) - (C) of this paragraph and to report the results of these audits to the
16 legislature and other interested state officials in a timely manner;
17 (6) the estimated number of Alaska workers who will be employed under the
18 provisions of (5) of this subsection, the estimated total number of workers to be employed on
19 the project during construction, the estimated dollar volume of contracts that will be let to
20 Alaska contractors or firms under the provisions of (5) of this subsection, and the estimated
21 total dollar volume of contracts that will be let for the project during construction; and
22 (7) documentation that the necessary documents and exhibits have been filed
23 before the appropriate federal regulatory agencies.

24 * Sec. 6. INITIAL APPOINTMENTS OF MEMBERS OF ALASKA GAS
25 CORPORATION BOARD OF DIRECTORS. Of the public members first appointed under
26 AS 41.41.020(a)(3) and (b), enacted by sec. 2 of this Act,

- 27 (1) two members shall be appointed to a four-year term;
28 (2) one member shall be appointed to a three-year term;
29 (3) one member shall be appointed to a two-year term; and
30 (4) one member shall be appointed to a one-year term.

Draft

Alaska Gas Corporation Organizational Chart



Alaska State Legislature

House of Representatives



Official Business

State Capitol
Juneau, AK. 99801-1182

Representative Jim Whitaker

*State Capitol, Room 13
(907) 465-3004*

January 19, 1999

David Lawrence, Alaska North Slope LNG Project, Chairman
C/o Arco Alaska, Inc.
PO Box 100360
Anchorage, AK 99510-0360

Dear Mr. Lawrence:

As you are aware, the 1999 legislative session is now underway. As chairman of the Oil and Gas Committee, I have scheduled a few informational and organizational meetings during the month of February. These briefings will allow the committee members to discuss legislation passed by the committee last session, determine progress made in the interim and receive answers to questions they may have concerning the oil and gas industries. Please allow this letter to serve as an invitation for you to address the Oil and Gas Committee on Tuesday, February 23, 1999 at 10am in Room 17. Specifically, I am requesting an update from the Sponsor Group regarding the status of the Alaska North Slope LNG Project. Please contact Shannon Grynkeiwich, Oil and Gas Committee Aide, at 465-2283 to confirm your attendance. I look forward to working with you and your staff during the session as we address important oil and gas issues facing the state of Alaska.

Sincerely,

A handwritten signature in black ink, appearing to read "M. Whitaker", with a long horizontal flourish extending to the right.

Representative Jim Whitaker
Oil & Gas Committee, Chairman

Cc: George Findling, Arco Alaska
Arne Holhjem, Phillips Petroleum Co.
Terry Cameron, Foothills Pipe Line Co.
Makato Ito, Marubeni Corporation
Jeff Lowenfels, Yukon-Pacific

JW:sjg

Alaska State Legislature

House of Representatives



Official Business

State Capitol
Juneau, AK. 99801-1182

Representative Jim Whitaker

*State Capitol, Room 13
(907) 465-3004*

January 26, 1999

Jeff Lowenfels
Yukon-Pacific Corp.
1049 W. 5th Avenue
Anchorage, AK 99501

Dear Mr. Lowenfels:

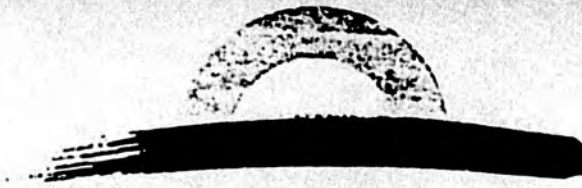
As Chairman of the Special Committee on Oil and Gas, I am interested in reviewing information pertaining to the Trans-Alaska Gas System. I would like to request any materials you may have concerning permits you hold for this project, as well as timelines or engineering work which would indicate the earliest possible completion date. Thank you very much for your time and attention to this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim Whitaker".

Representative Jim Whitaker
Oil and Gas Committee Chairman

JW:sjg



ALASKA NORTH SLOPE LNG PROJECT

700 G Street, PO Box 100360, Anchorage, AK 99510-0360, Phone: (907) 265-6876, Fax: (907) 265-6838

February 8, 1999

Representative Whitaker
Alaska State Legislature
State Capitol, Room 13
Juneau, AK 99801-1182

Dear Representative Whitaker:

Thank you for your letter of January 19th inviting the Alaska North Slope LNG Project to address the House Oil and Gas Committee. I am delighted to accept your invitation on behalf of the Project and we look forward to briefing the committee on February 23rd starting at 10am in Room 17.

For your information the briefing will be given by the Project's two managers, namely Mr. John Miller, Engineering Manager and Mr. Steve Alleman, Commercial Manager.

For logistical details, please continue to work with Mr. George Findling. (907-263-4174)

Yours sincerely,

David M. Lawrence
Chairman

cc: Sponsor Board Representatives

ARCO Alaska, Inc.
Post Office Box 100360
Anchorage Alaska 99510-0360
Telephone 907 276 1215



David M. Lawrence
Gas Commercialization and Marketing Manager
Prudhoe Bay Field

February 18, 1999

Representative Jim Whitaker
Alaska State Legislature
State Capitol (MS3100)
Juneau, AK 99801-1182

Dear Representative Whitaker:

This letter is to further respond to the question raised at the February 4, 1999 House Oil and Gas Hearing about ARCO's overall gas commercialization plans. The question posed to us was whether ARCO's interest in the Tangguh project in Irian Jaya, Indonesia is detracting from our efforts on the Alaska North Slope LNG project. Our answer is unequivocally no. ARCO was instrumental in forming the Sponsor Group to progress the ANS LNG project and we are fully committed to funding our 37% share of the \$20 million Stage 1 program. ARCO has eight people dedicated, full time to North Slope gas commercialization as well as others in part time support. No other ANS gas owner can match the human and financial resources we have dedicated to progressing the Alaskan LNG project.

Clearly, ARCO would like both the Tangguh and North Slope projects to succeed. They are part of our long term vision to be a major, LNG player in the East Asian market in the next century. Tangguh is widely seen as one of the most attractive new LNG projects, and it was highly ranked in a 1997 study by the State's consultant, Pedro Van Miers. ARCO has long been planning for Tangguh's early entry into the market. It is hoped that this, in turn, will give ARCO more credibility in competing for market share for the Alaskan LNG project for the expected demand growth in the 2007+ time period.

At this time, the task is to make the Alaskan project economically competitive with the best expansion and greenfield LNG projects worldwide, as well as other energy forms such as coal, nuclear, etc. This is no small matter, considering that other LNG projects do not have the burden of an 800 mile gas pipeline. But ARCO has been leading the development of the Alaska North Slope LNG project through an innovative and comprehensive technical and commercial program with our sponsor team: ARCO, Hothills Pipelines, Marubeni, Phillips and CSX/YPC.

We have a long journey ahead of us to realize an LNG project in Alaska. But, despite the current historically low oil prices and the very difficult economic conditions in the market, we remain committed to moving our program forward together with the sponsors.

Sincerely,

David M. Lawrence
Manager, Gas Commercialization & Marketing

cc: Members of the House Special Committee on Oil & Gas

Alaska State Legislature

Representative Jim Whitaker

House Special Committee on Oil and Gas, Chairman

House Resources Committee

House Health, Education, and Social Services
Committee

House State Affairs Committee

House Special Committee on Fisheries



House of Representatives
District 31

Session:

State Capitol, Room 13
Juneau, Alaska 99801-1182
Phone: (907) 465-3004
Fax: (907) 465-2070

Interim:

119 N. Cushman St. Suite 213
Fairbanks, Alaska 99701
Phone: (907) 452-1088
Fax: (907) 452-1146

February 24, 1999

Mr. Jeff Lowenfels, President
Yukon Pacific Corporation
1049 W. 5th Avenue
Anchorage, AK 99501

Dear Mr. Lowenfels:

Testimony before the Alaska State Legislature's Oil and Gas Committee given by John Miller on behalf of the Alaska North Slope LNG Project Sponsor Group is in direct conflict with the Yukon Pacific TAGS permits white paper. Your white paper was provided to my office in response to my correspondence dated January 26, 1999. The white paper indicated that, "YPC has constructed a portfolio of twelve permits which represent a very significant portion of the efforts necessary to permit a North Slope Natural gas export project." Mr. Miller's testimony indicated otherwise.

I am not going to beat around the bush; either the white paper is incorrect and/or misstated, or Mr. Miller has misinterpreted its meaning and importance. This conflict puts the Oil and Gas Committee in a position wherein all testimony and/or correspondence from the Sponsor Group and its members is suspect. If the credibility of the Sponsor Group and its members before the Oil and Gas Committee is to be re-established, it is necessary that this issue be clarified.

Please respond at your earliest convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim Whitaker", written over a horizontal line.

Jim Whitaker
Oil and Gas Committee, Chairman

JW:sjg



**YUKON
PACIFIC
CORPORATION**
TRANS-ALASKA GAS SYSTEM

March 4, 1999

The Honorable Jim Whitaker
House of Representatives
State of Alaska
State Capitol
Room 13
Juneau, AK 99801

Dear Representative Whitaker:

We appreciate and share the concern expressed in your letter of February 24, 1999. Mr. Miller's responses to questions regarding "permitting" a world-scale Alaska LNG export project — a critical and complex area "pioneered" by Yukon Pacific Corporation over many years and at great expense — were uninformed and unfortunate. Even so, we sympathize with and understand how these kinds of offhand comments are sometimes made during the course of public testimony, particularly during such a free-ranging exchange of questions and views as occurred after Mr. Miller's and Mr. Alleman's formal testimony. Except for the troubling replies to permitting issues, we thought the balance of the presentation provided by those representing the Sponsor Group was otherwise excellent, informative and helpful.

We have reviewed the language contained in our TAGS Permits White Paper and stand by it. We are also fully prepared to present testimony to your committee if necessary (although we hope it is not) to elaborate on the issues raised in the White Paper, and to answer all questions as forthrightly and candidly as possible.

As a member of the Sponsor Group we are aware of the need to allow sufficient time for other members of the group to become familiar and comfortable with the significance and relevance of our many years of work. In the meantime, however, we had hoped to avoid the very discord that has now occurred. Nevertheless, we sincerely believe that once all of the other Sponsor Group members have had time to evaluate the importance and implications of the major permits we have diligently secured over the past 12 years, they will come to the common view that if a North Slope-sourced LNG export project is to proceed on *any kind of meaningful and predictable schedule* it will do so because the very permits described in our White Paper (and, taken together, *only those* permits) provide that opportunity.

Sincerely,

Wayne F. Lewis
Vice President

Alaska State Legislature

Representative Jim Whitaker

House Special Committee on Oil and Gas, Chairman
House Resources Committee
House Health, Education, and Social Services
Committee
House State Affairs Committee
House Special Committee on Fisheries



House of Representatives
District 31

Session:
State Capitol, Room 13
Juneau, Alaska 99801-1182
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119 N. Cushman St. Suite 213
Fairbanks, Alaska 99701
Phone: (907) 452-1088
Fax: (907) 452-1146

March 30, 1999

Mr. David Lawrence
ANS LNG Project, Chairman
P.O. Box 100360
Anchorage, AK 99510-0360

Dear Mr. Lawrence:

On Tuesday, March 16, 1999, I met with four members of the ANS LNG Sponsor Group. It was a cordial meeting. Our discussion focussed on two issues:

- 1) The sponsor group presentation before the House Oil and Gas Committee of February 23, 1999, and
- 2) Pending legislation regarding the creation of the Alaska Gas Corporation.

Discussion point number one was simply an assessment of the sponsor group presentation. We agreed that the presentation was an opportunity for an open and frank discussion. We further agreed that while terse, the exchanges involved no animus, and were generally fruitful.

Discussion point two was initiated by me in an effort to provide the sponsor group with the best and most timely information possible regarding an issue which may directly effect the effort of the sponsor group. I also wanted to provide the sponsor group the earliest opportunity to participate and to take advantage of the inherent additional opportunities provided by this approach to commercialization of North Slope gas. The meeting ended with me asking the question: "may I characterize this meeting as having been an open and positive discussion?" Steve Allemen readily agreed to that being a fair characterization.

The purpose of this letter is to inform you personally of the discussions of the meeting of March 16, 1999, and to again reiterate my offer to the sponsor group to participate with the State as we bring this project to fruition.

I'm not going to waste time playing with semantics. The legislature has a constitutional imperative under Article VIII, sections 1 and 2 to utilize the State's resources for the maximum benefit to its people. Additionally, the legislature is faced with a budget imperative of significant proportion. North Slope gas provides an avenue to successfully meet the requirements of both imperatives. The Alaska State Legislature has no choice; we must and will bring this commodity to market. Again, I invite the sponsor group to participate and hopefully benefit from this endeavor. Please respond at your earliest convenience

Sincerely,

A handwritten signature in black ink, appearing to read "J. Whitaker", with a stylized flourish extending to the right.

Jim Whitaker
Oil and Gas Committee, Chairman

Cc:
Mr. Arne Holhjem, Phillips Petroleum Company
Mr. Terry Cameron, Foothills Pipe Line Co.
Mr. Makato Ito, Marubeni Corporation
Mr. Jeff Lowenfels, CSX Corporation

JW:rpc

Alaska State Legislature

House of Representatives



Official Business

State Capitol
Juneau, AK. 99801-1182

March 31, 1999

Mr. David Lawrence
ANS LNG Project
PO Box 100360
Anchorage, AK 99510-0360

Dear Mr. Lawrence:

Enclosed for your review is House Bill 170, relating to the formation of the Alaska Gas Corporation. The legislation contains the following provisions:

- Establishes the Alaska Gas Corporation;
- Specifies that the responsibility of the corporation is to bring North Slope natural gas to market;
- Requires the Alaska Gas Corporation to contract with private businesses for construction and maintenance of a natural gas pipeline, gas conditioning facility, liquification facility, and liquid natural gas sea transportation system; and
- Requires a report to be presented to the legislature by January 2001, concerning gas supply, engineering, technical, financial, regulatory, and market access matters relating to the feasibility of this project.

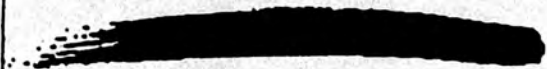
I welcome your comments on the proposed legislation and look forward to working with you as we continue to develop the means necessary to secure a natural gasline project for the State of Alaska. If you have any questions, please do not hesitate to contact my office.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim Whitaker".

Jim Whitaker
Oil and Gas Committee, Chairman

Enclosure
JW:sjg



ALASKA NORTH SLOPE LNG PROJECT

700 G Street, PO Box 190340, Anchorage, AK 99510-0340, Phone: (907) 263-6676, Fax: (907) 263-6831

April 9, 1999

Representative Jim Whitaker
Alaska State Legislature
House of Representatives District 31
State Capitol, Room 13
Juneau, AK 99801

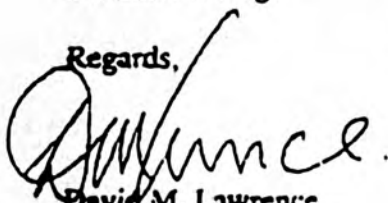
Dear Representative Whitaker:

Thank you for your letter of March 30, 1999. I am responding on behalf of the ANS LNG Project members.

We have read your letter with interest and also read the proposed legislation you are considering regarding "the Alaska Gas Corporation". Needless to say both of these documents have raised a great many questions within our group. We are currently reviewing HB 170 and hope to be in a position shortly to respond with our thoughts.

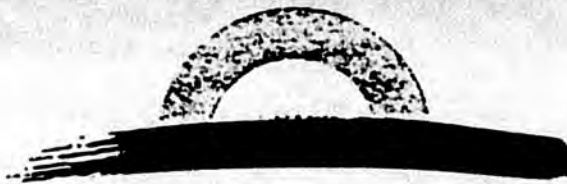
With this in mind, we would like to invite you to meet with us in our Project Office here in Anchorage to update you on our work and to discuss HB 170. I shall ask a representative from the Team to work with your staff to set up a mutually acceptable time for this meeting.

Regards,



David M. Lawrence
Chairman

cc: Sponsor Board



ALASKA NORTH SLOPE LNG PROJECT

700 G Street, PO Box 100360, Anchorage, AK 99510-0360, Phone: (907) 265-6876, Fax: (907) 265-6838

April 20, 1999

Representative Jim Whitaker
Alaska State Legislature
House of Representatives District 31
State Capitol, Room 13
Juneau, AK 99801

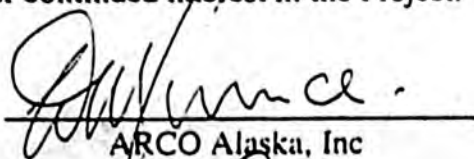
Dear Representative Whitaker:

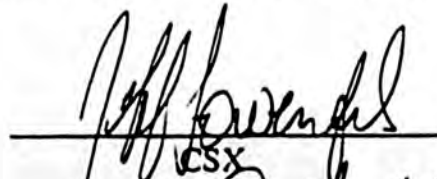
The Alaska North Slope LNG Project Sponsor Board is writing in response to your letter of March 30, 1999, which references the presentation made by our group to the House Special Oil and Gas Committee on February 23, 1999.

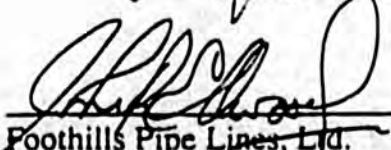
Firstly, the Board would like to reiterate that the primary objective of the ANS LNG Project Team is to establish the most cost effective and viable project possible that is acceptable to the market, recognizing that the market will ultimately determine the scale and timing of any project.

Secondly, with that objective in mind, we wish to assure the Committee that the five sponsor companies are fully aligned in all respects in the direction of our work. Most importantly all our companies agree that we shall need to be creative and innovative in all aspects of our work to first establish a viable project. Our reviews of the market have shown that our reference plan for a large project of 14 mmtpa capacity could be very difficult for the market to accept in a reasonable time frame. Our work programs are therefore evolving to also investigate the so called "MVP" (Market Viable Project) which is designed to define the smallest project that can gain a foothold in the competitive Far East gas markets. We wish to emphasize that our investigations are not being driven by any particular pipeline route, plant site or project scope, nor by previous work by any of the Project members companies. If any prior work is determined to lead to the best solution then it will be used, otherwise entirely new options will be investigated.

It is very important for the credibility of Alaska's gas commercialization efforts that all Project Team members and the State of Alaska speak with one voice. It is the intent of the Project to proceed in this manner and to continue to work with the State as we move forward. Thank you for your continued interest in the Project.


ARCO Alaska, Inc


CSX


Foothills Pipe Lines, Ltd.


Marubeni Corporation


Phillips Petroleum

Alaska State Legislature

Representative Jim Whitaker

House Special Committee on Oil and Gas, Chairman

House Resources Committee

House Health, Education, and Social Services
Committee

House State Affairs Committee

House Special Committee on Fisheries



House of Representatives
District 31

April 28, 1999

Session:

State Capitol, Room 13

Juneau, Alaska 99801-1132

Phone: (907) 465-3004

Fax: (907) 465-2070

Interim:

119 N. Cushman St. Suite 213

Fairbanks, Alaska 99701

Phone: (907) 452-1088

Fax: (907) 452-1146

Mr. David Lawrence
ANS LNG Project, Chairman
700 G Street
PO Box 100360
Anchorage, AK 99510-0360

Dear Mr. Lawrence:

The time has come to provide you with my straight forward assessment of the Alaska North Slope LNG Project Sponsor Group, and the role it is playing in relation to the state's effort to commercialize North Slope gas.

Your group's efforts appear to be in response to HB 393, enacted by the Twentieth Alaska State Legislature. However, your group has not yet taken definitive steps pertinent to HB 393, therefore, it appears to be at a preliminary stage of feasibility development. I sincerely wish you luck as you proceed and offer my assistance as you pursue this endeavor. However, it must be further noted that I remain very concerned and somewhat skeptical in light of the fact that certain sponsors do possess competing gas properties around the world. It must, therefore, be assumed that market entry decisions will be made which will best serve the needs and interests of the individual sponsors and not the State of Alaska.

The state has an obligation to pursue all options available, and to that end, two courses of action are being pursued independently of your group:

1. Other interested parties have been contacted with regard to North Slope gas opportunities in the hope that an additional sponsor group or groups will participate in the commercialization of North Slope gas; and
2. House Bill 170 has been introduced which, as you know, pertains to the formation of the Alaska Gas Corporation; a wholly owned state entity.

I must also take exception to the last paragraph of your letter dated April 20, 1999. The State of Alaska should and must speak for itself until it is in its best interest to do otherwise. It is my opinion that we are not at that point in time or circumstance.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim Whitaker", with a long horizontal stroke extending to the right.

Jim Whitaker
Oil and Gas Committee, Chairman

Cc: Oil and Gas Committee Members
Arne Holhjem, Phillips Petroleum Company
Terry Cameron, Foothills Pipe Line Company
Makato Ito, Marubeni Corporation
Jeff Lowenfels, Yukon Pacific
Jim Eason, ANS LNG Sponsor Group

JW:sjs