

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

3106 SCOMM 143: SENATE SPEC.COMM.ON NATURAL GAS DEV. 2005-2006

Further, oil production has been a vital resource in the development of the State and its municipalities. For many years, the State has relied heavily on the production of oil to foster its livelihood, to provide opportunities and employment for its citizens and to generate revenue to ensure future prosperity. In recent years, however, lower oil prices, reduced production and potential field depletion have greatly affected the State's ability to generate revenues and provide a secure future for its citizens. This Project will generate much-needed revenues for the State, provide employment for its citizens and generally provide the State with the financial resources to prosper in the next century.

The benefits of the Project to the State and its residents are clear. Nevertheless, the obstacles to building the pipeline have been staggering. For thirty years private interests have investigated ways to build a pipeline to transport the Gas from the North Slope to market, but the scope, cost and practical difficulties of building it have thus far been financially and practically infeasible. Thus, the Original Municipalities believe that only a public entity has the requisite power and resources to build the pipeline and credibly deliver the Gas for use by Alaska residents and other purchasers.

2. Description of the Project

The Project consists of the acquisition, creation and improvement of all facilities and infrastructure necessary or useful for the purchase, conditioning, transportation, storage and sale of the Gas. It will include the acquisition, construction, financing, installation and improvement of new and existing port facilities located at the Port of Valdez and any other necessary facility, including compression stations, pipelines, spur lines and plants for conditioning the Gas for transport by commercial carriers (such plants are technically referred to as LNG Facilities). The Authority will deliver a development plan, which requires approval by each Participating Municipality prior to the construction or acquisition of the Project.¹⁹

As part of the Project, the Authority will be responsible for acquiring the Gas and other related commodities, whether by purchase or other conveyance or by exercising its eminent domain power, as well as for acquiring all necessary permits, licenses and related rights necessary for the operation of the Project.

The Authority expects that the Project will be operated by a professional gasline operator pursuant to a management contract. The Authority expects and intends that any such contract will meet the requirements of *Revenue Procedure 97-13*.²⁰

3. Financing of the Project

To finance the Project, the Participating Municipalities may contribute or advance public funds, personnel, equipment or property to the Authority.²¹ Such advances may be subject to

¹⁹ Ordinances, § 15.

²⁰ Rev. Proc. 97-13, 1997-1 C.B. 632.

²¹ Ordinances, § 13.

repayment in accordance with terms agreed upon at the time of the advance. As of the date hereof, the Original Municipalities have contributed funds to the Authority and there is no expectation that any such funds will be repaid in the future.

Additionally, the Authority is authorized to issue bonds or any other form of indebtedness to raise funds to finance the Project.²² Debt issued by the Authority may consist of senior as well as junior or subordinated debt. To the extent that the Authority issues debt, the debt instruments will require all parties to treat such instruments as debt for tax purposes. Further, all debt will have a noncontingent interest rate and will be due upon a fixed maturity date. The interest on and principal of any debt issued by the Authority will be due and payable in all events and failure to pay will be an event of default. Other than Participating Municipalities to the extent of their advances, any creditor of the Authority will be unrelated to the Authority and will possess customary creditor's rights; no such creditor will receive management rights as a direct result of lending money to the Authority. Finally, the Authority will have cash flow projections that reflect that there will be sufficient revenues to pay all debt, including subordinated debt.

The principal and interest on all debt issued by the Authority as well as the repayment of any advances will be payable exclusively from the income and receipts of, or other money derived from, the Project. Neither the State nor any of the Participating Municipalities will be liable for the debts, liabilities or obligations of the Authority.

II. RULINGS REQUESTED

The Authority requests a ruling that:

The Authority is a political subdivision of the State, whose income is exempt from federal income tax.

III. STATEMENT OF LAW AND ANALYSIS

Under the doctrine of intergovernmental tax immunity, "income earned by a . . . political subdivision of a state is generally not taxable in the absence of specific statutory authorization for taxing such income."²³ This doctrine ensures that the federal government does not impose taxes that would unduly burden the state in the performance of its functions.²⁴

For purposes of determining whether an entity qualifies for tax exemption under the doctrine of intergovernmental immunity, a "political subdivision" is defined as "any division of any State or local governmental unit which . . . has been delegated the right to exercise part of

²² Ordinances, § 11.

²³ Rev. Rul. 87-2, 1987-1 C.B. 18 (citing Rev. Rul. 71-131, 1971-1 C.B. 28) (emphasis added); see also Rev. Rul. 71-132, 1971-1 C.B. 29; Priv. Ltr. Rul. 88-20-030 (Feb. 16, 1988).

²⁴ Priv. Ltr. Rul. 88-20-030 (Feb. 16, 1988) (citing Rev. Rul. 71-131, 1971-1 C.B. 28; Rev. Rul. 71-132, 1971-1 C.B. 29).

the sovereign power of the government.²⁵ In considering whether an entity is a political subdivision, a two-part analysis must be taken.

First, in order to be a political subdivision, the entity must be a division of a state or local government (*i.e.*, the entity have close ties with a state or local government).²⁶ This determination is generally based upon all of the facts and circumstances.²⁷ Of particular importance are (1) the extent to which there is governmental control of the entity and (2) whether the entity has a public purpose.²⁸ In the case at hand, the Authority is governmentally controlled as it is managed by a governing board that is appointed by the Original Municipalities, and all of the Authority's assets and net revenues inure to the benefit of the State and its municipalities. Also, the Authority was established for the public purpose of promoting the development of the State's valuable natural resources, which would otherwise lie dormant but for public involvement. Such resource development will provide an alternative, more efficient fuel source to the citizens of the State, provide additional employment within the State and raise revenue for the State and its municipalities.

Second, a political subdivision must have a grant of sovereign power by the state. The primary sovereign powers are: (1) the power to tax, (2) the power of eminent domain, and (3) the police power.²⁹ "It is not necessary that all three of these powers be delegated. However, possession of only an insubstantial amount of any or all sovereign powers is not sufficient."³⁰ In this case, the Authority has been delegated broad and substantial powers, including the power of eminent domain. Moreover, the Authority has been delegated the eminent domain power by the Participating Municipalities, as permitted by the Act, to the same extent that such power exists in such municipalities.

A. The Authority is a "Division" of the Participating Municipalities

To be considered a political subdivision, an entity must be a division of the state or local government. "All the facts and circumstances must be taken into consideration in determining whether an entity is a political subdivision, including the public purposes of the entity and its control by government."³¹ The more indicia of "close ties" between government and the entity, the more likely the entity is a political subdivision.³² The Authority is closely related to the State and local government: (1) the Authority's Board is appointed by the Original Municipalities; (2) the Authority's net revenues inure to the benefit of the State and its municipalities; (3) the

²⁵ Treas. Reg. § 1.103-1(b). In General Counsel Memorandum 36,994, the Internal Revenue Service concluded that the definition of "political subdivision" under Section 103 should be used to interpret other provisions of the Code involving political subdivisions. Gen. Couns. Mem. 36,994 (Feb. 3, 1977).

²⁶ See *Philadelphia Nat'l Bank v. United States*, 666 F.2d 834, 835 (3d Cir. 1981).

²⁷ Rev. Rul. 77-174, 1977-1 C.B. 414; Gen. Couns. Mem. 37,629 (July 31, 1978).

²⁸ Rev. Rul. 77-174, 1977-1 C.B. 414.

²⁹ *Estate of Shamburg*, 3 T.C. 131 (1944), *acq.*, 1945 C.B. 6, *aff'd*, 144 F.2d 998 (2d Cir. 1944).

³⁰ See, e.g., *Texas Learning Tech. Group v. Commissioner*, 958 F.2d 122, 124 (5th Cir. 1992) (citing 30 Op. Atty. Gen. 252); Rev. Rul. 77-164, 1977-1 C.B. 20.

³¹ Rev. Rul. 77-164, 1977-1 C.B. 20.

³² See *Philadelphia Nat'l Bank*, 666 F.2d at 835.

Authority's assets will be distributed to the Participating Municipalities upon dissolution; and (4) the Authority is fulfilling a public purpose.

1. The Authority is Government Controlled

Control by the government is an important factor in determining whether an entity is a political subdivision. Rulings by the Internal Revenue Service (the "Service") have pointed to two indicia of governmental control: (1) whether the governing board of the entity is controlled by government and (2) whether the entity's revenue and assets inure to a public entity.

a. The Authority is Controlled by a Government-Appointed Governing Board

Public control via a government-appointed board indicates that an entity is a political subdivision.³³ There are several instances where the courts and the Service have determined that an entity is a political subdivision where the governing body of the entity is appointed by government or elected by the public.³⁴

In *Revenue Ruling 83-131*,³⁵ for example, the Service ruled that electric and telephone membership corporations, which had eminent domain power, were not political subdivisions because they were "not controlled directly or indirectly by a state or local government."³⁶ Instead, "the business and affairs of the corporations [were] controlled by a board of directors that [was] independent of such authority."³⁷ Accordingly, the membership corporations did not have close enough ties with government to be political subdivisions.

By contrast, the Authority is managed by a Governing Board that is entirely governmentally appointed. Each Original Municipality appoints three members to the Board. Each member of the Board shall "serve at the pleasure of the governing body of the Original Municipality by whom such member was appointed."³⁸ Moreover, any member "may be terminated at any time by a majority vote of the governing body of such Original Municipality which appointed such member."³⁹

³³ See *id.*; Rev. Rul. 83-131, 1983-2 C.B. 184. Cf. Rev. Rul. 77-164, 1977-1 C.B. 20.

In *Philadelphia Nat'l Bank* the court specifically noted that the majority of the entity's board was made up of private individuals, who were elected by the entity's board. The state only appointed a minority of the board members. See *Philadelphia Nat'l Bank*, 666 F.2d at 838.

³⁴ See, e.g., *Commissioner v. Shamberg*, 144 F.2d at 998, 1000 (2d Cir. 1944); *Commissioner v. White*, 144 F.2d 1019, 1020 (2d Cir. 1944); Priv. Ltr. Rul. 84-05-007 (Oct. 26, 1983); Priv. Ltr. Rul. 88-09-038 (Dec. 3, 1987); Priv. Ltr. Rul. 93-27-072 (April 12, 1993).

³⁵ Rev. Rul. 83-131, 1983-2 C.B. 184.

³⁶ *Id.*

³⁷ *Id.*

³⁸ Ordinances, § 7.

³⁹ *Id.*

b. The Authority's Assets and Net Revenues Inure to the Benefit of the State and its Municipalities

Another strong indicator that an entity is a "division" of a State or local government is the fact that the entity's assets and net revenue inure to the public benefit. For instance, a hospital district possessing only the power to tax was a political subdivision since no private individual or organization would benefit from the dissolution of the entity; the revenue and assets were to inure solely to the public benefit.⁴⁰

Here, the Authority will distribute its revenue only to the State and its municipalities.⁴¹ Generally, net revenues will be distributed sixty percent to the State, thirty percent to all municipalities in Alaska and ten percent to the Original Municipalities.

Furthermore, if the Authority is dissolved, the Act and Ordinances mandate that the Authority's assets are to be distributed to all Participating Municipalities.⁴² The assets will be distributed to the Participating Municipalities "in proportion to the difference between their contributions to the authority and any outstanding debt or obligation of that municipality to the [A]uthority."⁴³ Under no circumstances will private persons or entities receive asset distributions from the dissolution of the Authority.

2. The Authority is Fulfilling a Public Purpose

Whether an entity is serving a public purpose is also important in the determination of whether the entity has close ties with, or is a division of, the state or local government. The courts and the Service have given the term "public purpose" a broad interpretation. Not only has it included such traditional public purposes as education⁴⁴ and transportation⁴⁵ but also county humane societies with the purpose of preventing cruelty to children and animals,⁴⁶ utilities,⁴⁷ conservation and preservation of natural resources,⁴⁸ community development,⁴⁹ and even off-track betting⁵⁰ and the operation of liquor stores.⁵¹ In fact, we did not find a single opinion or

⁴⁰ Priv. Ltr. Rul. 88-20-030 (Feb. 16, 1988). The district argued that it also had the power of eminent domain, but the Service concluded that the district's power was too insubstantial since its condemnation decisions were subject to state approval. *Id.*; see also Priv. Ltr. Rul. 88-09-038 (Dec. 3, 1987); Priv. Ltr. Rul. 93-27-072 (April 12, 1993).

⁴¹ Ordinances, § 17.

⁴² Ordinances, § 16; ALASKA STAT. § 29.35.610.

⁴³ ALASKA STAT. § 29.35.610.

⁴⁴ *Michigan v. United States*, 40 F.3d 817, 819-20 (6th Cir. 1994); *Texas Learning*, 958 F.2d at 122.

⁴⁵ *Shamberg*, 144 F.2d at 959-1002; *White*, 144 F.2d at 119-20; Gen. Couns. Mem. 37,637 (1978).

⁴⁶ Gen. Couns. Mem. 38,713 (May 5, 1981).

⁴⁷ Gen. Couns. Mem. 37,629 (July 31, 1978); Gen. Couns. Mem. 37,771 (Nov. 30, 1978).

⁴⁸ Rev. Rul. 68-444, 1968-2 C.B. 430; Rev. Rul. 59-37, 1959-1 C.B. 384; Gen. Couns. Mem. 33,808 (April 29, 1968).

⁴⁹ Rev. Rul. 77-164, 1977-1 C.B. 20; Gen. Couns. Mem. 33,556 (July 8, 1967).

⁵⁰ Rev. Rul. 78-138, 1978-1 C.B. 314.

⁵¹ Rev. Rul. 71-131, 1971-1 C.B. 28.

O'MELVENY & MYERS LLP

Assistant Chief Counsel, Financial Institutions & Products, November 19, 1999 - Page 12

ruling where a court or the Service found that an entity was not a political subdivision based on an insufficient public purpose.

The Authority serves many of the above-mentioned purposes. Its primary function involves an exercise of the transportation powers of municipalities within the State. The public functions furthered by the exercise of those powers include the provision of natural gas for the use by its citizens, the development and preservation of the natural resources of the State, the development of jobs and commerce within the State and the raising of revenue to serve the general needs of the State, its municipalities and its citizens. Accordingly, the Authority's public purpose supports a determination that it is a political subdivision.

B. The Authority is a Political Subdivision as it Possesses a Substantial Amount of the Sovereign Power of Eminent Domain

1. The Power of Eminent Domain Is Sufficient

To be classified as a political subdivision, an entity must be authorized to exercise part of the sovereign powers of the government.⁵² There are three primary sovereign powers—the power to tax, the power of eminent domain and the police power; an entity need not possess all such powers to be a political subdivision.⁵³ In fact, possession of only one or two of these powers is sufficient as long as such powers are not insubstantial.⁵⁴

The seminal case that established the requirements for political subdivision status, *Commissioner v. Estate of Shamberg*,⁵⁵ also involved a port authority. In *Shamberg*, the court held that the Port of New York Authority (the "Port of New York") was a political subdivision because it possessed more than an insubstantial amount of the sovereign powers.⁵⁶

In *Shamberg* the Port of New York was established pursuant to a compact between the State of New York and the State of New Jersey and was vested with (i) all of the powers

⁵² *Shamberg*, 144 F.2d at 1005.

⁵³ *Id.*

⁵⁴ *Texas Learning*, 958 F.2d at 124 (citing 30 Op. Atty. Gen. 252); Rev. Rul. 77-164, 1977-1 C.B. 20. Three generally acknowledged sovereign powers of states are the powers to tax, the power of eminent domain, and the police power. . . . It is not necessary that all three of these powers be delegated. However, possession of only an insubstantial amount of any or all sovereign powers is not sufficient. All of the facts and circumstances must be taken into consideration, including the public purposes of the entity and its control by a government.

Id. (citations omitted).

⁵⁵ 144 F.2d 998 (2d Cir. 1944). Although decided under the statutory predecessor to section 103, *Shamberg* is still consistently cited as authority in this area. See *Texas Learning*, 958 F.2d at 125; *Michigan v. United States*, 40 F.3d 817, 824 (6th Cir. 1994); *Philadelphia Nat'l Bank*, 666 F.2d at 837 ("There is surprisingly little decisional law on what constitutes a political subdivision within the meaning of § 103. The Supreme Court has never addressed the issue, and the leading—and almost only—cases on point were decided by the Court of Appeals for the Second Cir.); *Commissioner v. Estate of White*, 144 F.2d 1019 (2d Cir. 1944).

⁵⁶ *Shamberg*, 144 F.2d at 1004; see also Rev. Rul. 77-164, 1977-1 C.B. 20.

O'MELVENY & MYERS LLP

Assistant Chief Counsel, Financial Institutions & Products, November 19, 1999 - Page 13

necessary to acquire and construct its projects;⁵⁷ (ii) the power to make and enforce the rules and regulations it deemed convenient for the operation of the bridges and tunnels it operates and to maintain a uniformed police force and (iii) the power of eminent domain. The Port of New York could only exercise its police power with the consent of the State, and rules and regulations made by the port authority were effective only if the legislatures of both states concurred. Nevertheless, the court held that the Port of New York was a political subdivision since it was not necessary that the Port of New York exercise all the functions of the state; it was sufficient that the Port only exercise a portion of those functions.⁵⁸

In relying on *Shamberg*, both the courts and the Service have consistently held that entities that possess but one of the three primary sovereign powers (e.g., the power of eminent domain) are political subdivisions so long as that power is more than insubstantial.⁵⁹ The House Ways and Means Committee stated: "an entity is a political subdivision . . . if it has more than an insubstantial amount of *one or more of* . . . the power to tax, the power of eminent domain, and the police power."⁶⁰

2. The Authority Possesses a Substantial Amount of Eminent Domain Power

The determination whether an entity possesses more than an insubstantial amount of sovereign power turns primarily on the extent to which the entity's power is similar to that of other governmental units within the state. As outlined below, the evaluation turns on (1) the extent to which such power rests with the entity that purports to be a political subdivision, as opposed to some other governmental unit or entity, and (2) the extent to which the entity's

⁵⁷ Specifically, under the compact the Port of New York was granted with the power to purchase, construct, lease and/or operate the terminal; to make charges for the use thereof; to own, hold, lease and/or operate real or personal property; to borrow money and secure the same by bond or by mortgages; and to make rules and regulations relating to navigation and commerce. *Shamberg*, 144 F.2d at 999-1001.

⁵⁸ *Id.* at 1004.

⁵⁹ Rev. Rul. 61-181, 1961-2 C.B. 21; Rev. Rul. 77-143, 1977-1 C.B. 340; Priv. Ltr. Rul. 77-52-065 (Sept. 29, 1977); Priv. Ltr. Rul. 78-07-069 (Nov. 18, 1977); Priv. Ltr. Rul. 84-05-007 (Oct. 26, 1984); Priv. Ltr. Rul. 89-09-038 (Dec. 3, 1987); Priv. Ltr. Rul. 88-20-030 (Feb. 16, 1988); Priv. Ltr. Rul. 93-27-072 (April 12, 1993); Priv. Ltr. Rul. 97-25-038 (March 25, 1997); Priv. Ltr. Rul. 97-30-001 (Oct. 4, 1997).

The Service has maintained that this is a facts-and-circumstances decision. Accordingly, the Service has been reluctant to state categorically that only one sovereign power is necessary. Gen. Couns. Mem. 36,994 (Feb. 3, 1977). The Service has a two-fold concern. First, a political subdivision must have close ties with the state or local government; a private company serving some public functions is not a political subdivision, even if it has certain sovereign powers. See Gen. Couns. Mem. 37,629 (July 31, 1978); see also Rev. Rul. 83-131, 1983-2 C.B. 184 (holding that electric and telephone membership corporations were not political subdivisions because they were not controlled by government). Second, an entity must possess a sufficient quantity of a sovereign power; the powers must be more than insubstantial in their effect as well as in their amount. Gen. Couns. Mem. 36,994 (Feb. 3, 1977).

The Authority has close ties to the State and the Participating Municipalities. It is governed by the Participating Municipalities; its net revenues inure to the State and its municipalities; its assets will be distributed to the Participating Municipalities upon dissolution; and it serves an important public purpose. The Authority also has more than an insubstantial amount of the eminent domain power; indeed, the Authority's eminent domain power is substantial in its effect and its amount.

⁶⁰ Committee Report on P.L. 99-514 (Tax Reform Act of 1986) (emphasis added).

sovereign power is similar substantively and procedurally to that of other governmental units within the state, including that of the governmental unit or units that created the entity.

a. The Power of Eminent Domain Rests with the Authority

In *Revenue Ruling 78-138*,⁶¹ the Service ruled that the determination of whether an entity possesses more than an insubstantial amount of one of the primary sovereign powers turns on whether the entity possesses the sovereign power in its own right. In *Revenue Ruling 78-138*, a corporation was established to operate an off-track betting system, which was designed to raise revenue and curb illegal bookmaking. The corporation possessed certain regulatory powers and it had the power of eminent domain; however, state law restricted its condemnation power by requiring the corporation to obtain the approval of the local chief elected official where the property was located. The Service held that for purposes of determining whether an entity possesses more than an insubstantial amount of sovereign power the "critical inquiry is not whether the power is restricted, but *with whom the actual power rests*."⁶² Consequently, the Service ruled that the corporation was a political subdivision because it possessed substantial, albeit restricted, powers of eminent domain and regulation in its own right.⁶³

Likewise, in similar situations the Service has determined that an entity possessing only the power of eminent domain will constitute a political subdivision if the entity can "exercise the condemnation power in its own right and by itself, and thereafter hold the acquired property in its own title."⁶⁴

Where the entity does not possess the eminent domain power in its own right, the entity may not be a political subdivision, absent possession of more than an insubstantial amount of one of the other primary sovereign powers. For example, in *Philadelphia National Bank v. United States*,⁶⁵ the court held that Temple University, a state university, was not a political subdivision because the university was required to obtain approval from the state to erect new facilities:

When it wishes to erect additional facilities, the university must request the General State Authority to procure the property. The power to condemn selected property is vested in the Authority, and the fact that it has cooperated with the university by accepting and implementing its suggestions does not constitute a grant of sovereign power to Temple.⁶⁶

⁶¹ Rev. Rul. 78-138, 1978-1 C.B. 314.

⁶² *Id.* (emphasis added).

⁶³ *Id.* (emphasis added).

⁶⁴ Priv. Ltr. Rul. 84-05-007 (Oct. 26, 1983).

⁶⁵ 666 F.2d 834 (3d Cir. 1981).

⁶⁶ *Id.* at 840.

Although the state had cooperated with the university and had implemented the university's suggestions, the university was not a political subdivision because it did not possess a sovereign power in its own right.⁶⁷

The Alaska Gasline Port Authority is authorized to exercise the power of eminent domain and declaration of taking. The Authority does not need to seek the approval of any of the Participating Municipalities prior to exercising its eminent domain power. Section 6 of the Ordinances provides that:

The Authority is authorized, in its own name, to do all acts necessary or convenient for the exercise of said power for said purposes, including but not limited to . . . exercise the powers of eminent domain and declaration of taking within its physical boundaries . . . to acquire land or materials for authority purposes.⁶⁸

Moreover, the Authority is vested with eminent domain powers to the same extent that such powers exist in the Participating Municipalities.⁶⁹ Finally, upon the exercise of its power, the Authority will hold all property in its own name.⁷⁰ Thus, the Authority possesses full eminent domain power.

b. The Authority's Eminent Domain Power Is Identical Both Procedurally and Substantively to that of the Participating Municipalities

The scope of an entity's sovereign power and the procedures by which the entity must exercise that power has also been considered by the Service. For example, the Service has decided that health-care authorities, which had only eminent domain power,⁷¹ were political subdivisions because the entity "[had] the same power of eminent domain as [was] vested by law in any authorizing subdivision."⁷² Moreover, the Service has determined that a water district, possessing only the power of eminent domain, was a political subdivision because it could (1) commence condemnation actions in state court to enforce the right and (2) take possession of the property upon commencement of the proceedings, rather than after judgment.

⁶⁷ *Id.*

⁶⁸ Ordinances, § 6.

⁶⁹ ALASKA STAT. § 29.35.030.

⁷⁰ Section 6 of the Ordinances provides that: "The Authority shall have the power to acquire, by purchase, lease, contribution, condemnation, or otherwise, real property and personal property for the Project . . ."
Ordinances, § 6.

⁷¹ Priv. Ltr. Rul. 97-30-001 (Oct. 4, 1996). The eminent domain power of the health-care authorities was subject to a minor restriction: the authorities could not exercise their eminent domain power to provide "office facilities for the private practice of a health care professional." *Id.* Nevertheless, the Service determined that this power alone was sufficiently substantial to qualify the authorities as political subdivisions. *Id.*

⁷² *Id.*

In the present case, the Act and the Ordinances empower the Authority with full eminent domain power—the exact power that is vested in the Participating Municipalities and other municipalities within the state.⁷³ Moreover, the Authority is authorized by the Act and Ordinances to commence actions in its own name in Alaska superior court⁷⁴ and to take possession of the property upon commencement of the proceedings.⁷⁵

In sum, the Authority's broad eminent domain power is sufficient to qualify it as a political subdivision. First, the Authority can exercise condemnation power in its own right and by itself and can hold title to condemned property in its own name. Second, the Authority's power mirrors the eminent domain power of the Participating Municipalities. Third, the Authority can commence actions in state court to enforce its condemnation right and can take possession of the property upon commencement of the proceedings. Based on the Service's past positions, the such a grant of eminent domain power mandates that the Authority be treated as a political subdivision of the State.

C. Conclusion

For the reasons set forth above, we respectfully request that the Service issue a letter ruling that the Authority is a political subdivision of the State, whose income is exempt from federal income tax.

IV. TAXPAYER INFORMATION AND PROCEDURAL MATTERS

A. Names, Addresses, Telephone Numbers of All Interested Parties

Alaska Gasline Port Authority
c/o William M. Walker
550 West 7th Avenue
Suite 1850
Anchorage, Alaska 99501
(907) 278-7000

City of Valdez
c/o Dave Cobb, Mayor
P.O. Box 307
Valdez, Alaska 99686
(907) 835-4313

⁷³ The Act and Ordinances, each of which empower the Authority with eminent domain power, refer to Section 29.35.030 of the Alaska statutes, which is the source of eminent domain power for the Alaskan cities and boroughs. ALASKA STAT. § 29.35.030.

⁷⁴ ALASKA STAT. § 9.55.290.

⁷⁵ ALASKA STAT. § 9.55.380.

Fairbanks North Star Borough
c/o Hank Hove, Mayor
P.O. Box 71267
Fairbanks, Alaska 99707
(907) 459-1304

North Slope Borough
c/o George Ahmaogak, Mayor
P.O. Box 69
Barrow, Alaska 99723
(907) 852-2611

B. Taxpayer Identification Number

The Authority's Taxpayer Identification Number is 92-0169762.

C. Annual Accounting Period and Overall Method of Accounting

Not applicable.

D. Applicable District Office

The district having audit jurisdiction over the Authority is the Pacific Northwest District.

E. Identical or Similar Issues

To the best of the knowledge of the Authority and the Fairbanks North Star Borough, the North Slope Borough and the City of Valdez (the "Current Members") and their respective authorized representatives:

- a. Issues identical or similar to those discussed in this letter ruling request are not in any earlier return of the Authority, the Current Members or any taxpayer related to the Authority or the Current Members;
- b. The Service has not previously ruled on identical or similar issues for the Authority, the Current Members or any taxpayer related to the Authority or the Current Members;
- c. Neither of the Authority nor the Current Members or any taxpayer related to the Authority or the Current Members has submitted a request involving issues identical or similar to those raised in this letter ruling request and withdrawn it before a ruling was issued;
- d. Neither of the Authority nor the Current Members or any taxpayer related to the Authority or the Current Members or any predecessor of the

O'MELVENY & MYERS LLP

Assistant Chief Counsel, Financial Institutions & Products, November 19, 1999 - Page 18

Authority or the Current Members has previously submitted a request involving identical or similar issues that is currently pending with the Service; and

- e. Neither of the Authority nor the Current Members or any taxpayer related to the Authority, the Current Members or any predecessor of the is submitting to the Service another request involving identical or similar issues.

F. Certainty of the Law

The law in connection with the request is relatively certain and has been adequately addressed by relevant authorities. Beyond the authorities discussed in this request, the Authority, the Current Members and their authorized representatives are not aware of authorities contrary to the positions advocated therein.

G. Deletions Required by Section 6110(c) of the Code

The Authority desires to have certain information deleted from any documents made available for public inspection. A deletions statement is attached as **Exhibit H**.

H. Power of Attorney

An Internal Revenue Service Form 2848, Power of Attorney and Declaration of Representative, has been completed with respect to the Authority and said form is attached as **Exhibit I**.

I. Penalty of Perjury Declaration

The declaration required by Section 601.201(e)(1) of the Treasury Regulations is attached as **Exhibit J**.

J. Additional Information

If you have any questions or need further information in order for you to rule as requested, please contact Travis C. Gibbs at (213) 430-7402.

K. Request for a Conference

The Authority respectfully requests a conference at the National Office to discuss the issues involved in this letter ruling request.

L. Checklist

The checklist required by *Revenue Procedure 99-1* is attached as **Exhibit K**.

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O'MELVENY & MYERS LLP

Assistant Chief Counsel, Financial Institutions & Products, November 19, 1999 - Page 19

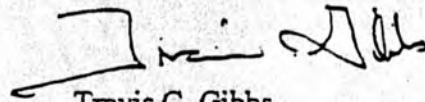
M. User Fee

Pursuant to Appendix A of *Revenue Procedure 99-1*, enclosed in a separate envelope is a check in the amount of \$5,000, payable to the Internal Revenue Service.

N. Facsimile Transmission

When a letter ruling is prepared, the Authority requests that an advance copy of the letter ruling be sent by facsimile transmission to Travis C. Gibbs; the fax number is (213) 430-6407. We agree to waive any disclosure violations resulting from the facsimile transmission.

Very truly yours,



Travis C. Gibbs
of O'MELVENY & MYERS LLP

TCG:mfm

LA3:889475.11

INDEX TO EXHIBITS

Exhibit A	Ordinance of Fairbanks North Star Borough
Exhibit B	Ordinance of North Slope Borough
Exhibit C	Ordinance of City of Valdez
Exhibit D	Municipal Port Authority Act
Exhibit E	Alaska Eminent Domain Statutes
Exhibit F	Map of the Project
Exhibit G	By-laws of the Alaska Gasline Port Authority
Exhibit H	Deletions Statement
Exhibit I	Power of Attorney and Declaration of Representative
Exhibit J	Declaration Under Penalties of Perjury
Exhibit K	<i>Revenue Procedure 99-1</i> Checklist

Alaska Gasline Port Authority

Presentation to Senate Special Committee on Natural Gas Development



Project Economics

August 3-4, 2006



Important Notice About Financial Projections

The purpose of this presentation is to provide background information and assist the recipients hereof in obtaining a general understanding of the Alaska Gasline Port Authority ("AGPA") and its project. This document is not intended to form a sole basis of any investment decision or other decision to participate in the AGPA project and should not be considered as a recommendation or invitation by AGPA to make such decision. Each recipient hereof must make (and will be deemed to have made) its own independent assessment and appraisal of AGPA and its project after making such investigation, as it deems necessary in order to determine its interest and independently (and at its own cost) to have formed its own opinions and views.

Although the information contained herein appears reasonable to AGPA on the basis of its present knowledge, neither AGPA nor any of its officers, directors, employees, or advisors accept liability or responsibility for the adequacy, accuracy or completeness of, nor make any representation or warranty, express or implied, with respect to the information contained in this document or on which this document is based or any other information or representations supplied or made in connection with this document. In addition, no representation, express or implied, is made that such information remains unchanged after receipt of this document.

This presentation includes certain estimates and projections of the anticipated future performance of the AGPA project. Such estimates and projections reflect various assumptions made by AGPA and its advisors, concerning anticipated results, which assumptions may or may not prove to be correct. The actual outcome may be affected by changes in economic and other circumstances that cannot be foreseen or have not been anticipated. The reliance that can be placed upon the projections and forecasts is a matter of commercial judgment. No representation is made by the AGPA or its advisors as to the accuracy of such estimates or projections or as to the reasonableness of any assumptions used. The financial projections contained herein have been prepared and set out for illustrative purposes only and should not be taken as a commitment as to future performance.



Overview

- Introduction of the Analysis
- Price Assumptions
- LNG Project Concept and Gas Volumes
- Cost Assumptions
- Netback Calculations
- Upstream Returns to the Producers
- PTU Case
- Comparison of State Revenues
- Conclusions / Questions



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Introduction of the Analysis



Project Component Terms

- Upstream
 - Lease production activities

- Midstream
 - Feeder lines
 - GCP
 - Alaska pipeline(s)
 - LNG Facility
 - Canadian pipeline(s)

- Downstream
 - LNG marine transportation
 - Regasification and takeaway pipelines to market
 - NGL extraction in Alberta



Project Component Terms (continued)

- AGPA project components: owned, built and financed by AGPA
 - Pipeline(s) from Prudhoe Bay to Valdez and possibly to Canadian Border
 - LNG Facility in Valdez
- Producer project components: owned, built and financed by Producers
 - GCP
 - Feeder pipelines
 - Upstream production activities
 - Canadian route components (if not provided by Third Parties)
- Third Party project components: provided by third parties
 - LNG marine transportation
 - Regasification and downstream takeaway pipelines to market
 - Canadian route components (if not provided by Producers)



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Price Assumptions

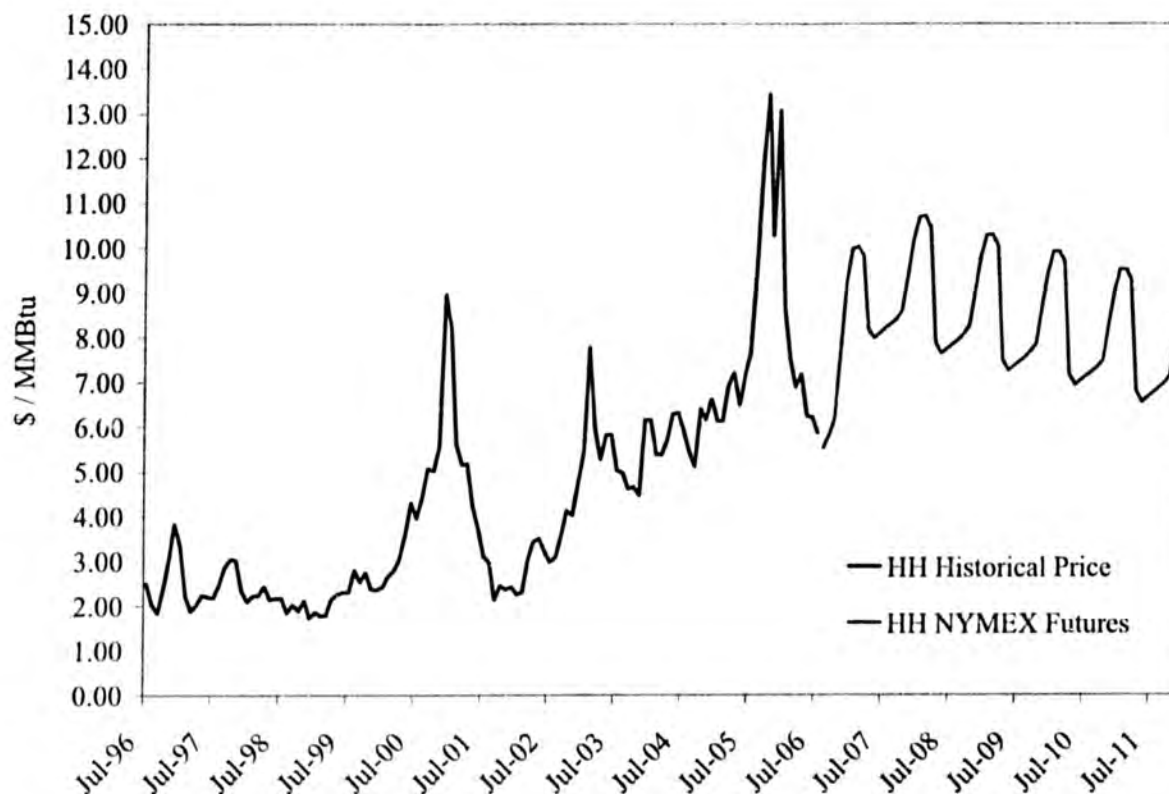


Gas Price Assumptions

- Henry Hub price:
 - considered the benchmark U.S. gas price
 - most forecasts for U.S. gas prices refer to Henry Hub pricing
 - used for the benchmark NYMEX physical and financial gas price futures contracts
- Regional gas prices are typically expressed as a differential above or below Henry Hub pricing (“basis”)

Henry Hub Price Assumption

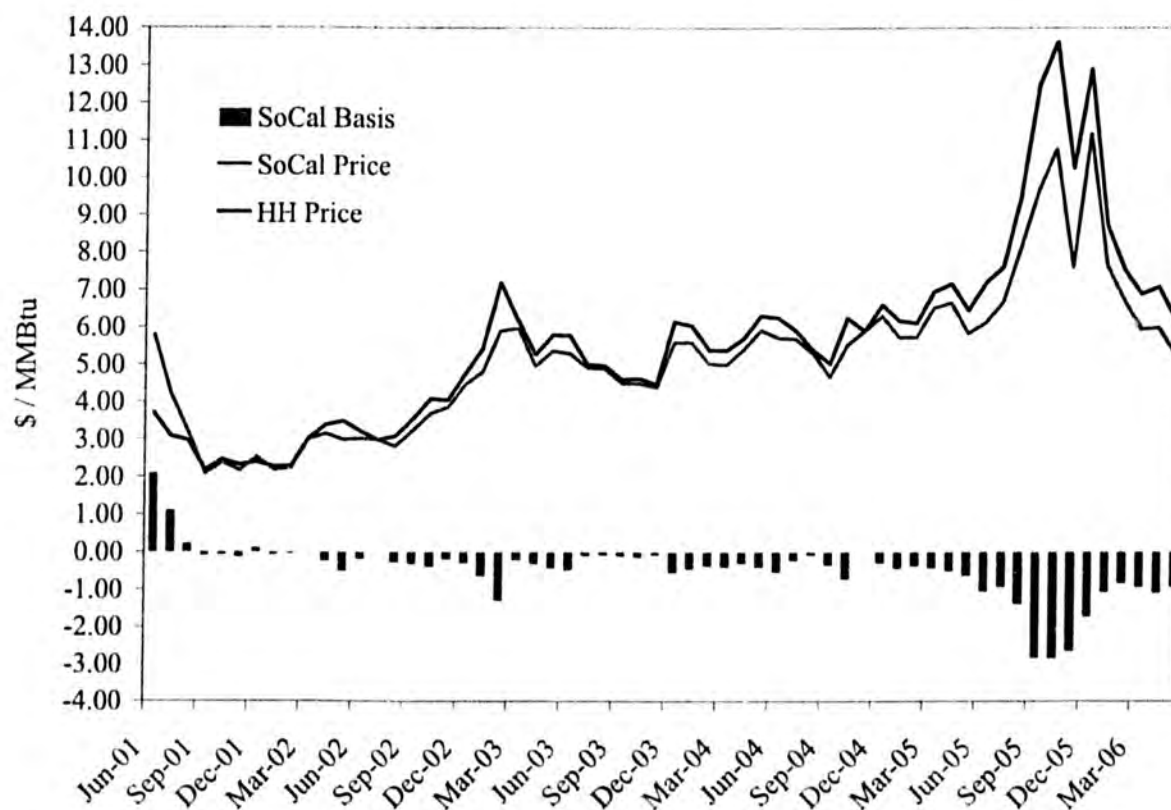
- Henry Hub historical 5-year average price: \$5.68 per MMBtu
- Current forward pricing on NYMEX: \$7.70 per MMBtu (average of distant 12 months)
- AGPA base case assumption: \$5.50 per MMBtu (constant 2005 dollars)



Source: Bloomberg, NYMEX

SoCal Gas Price Assumption

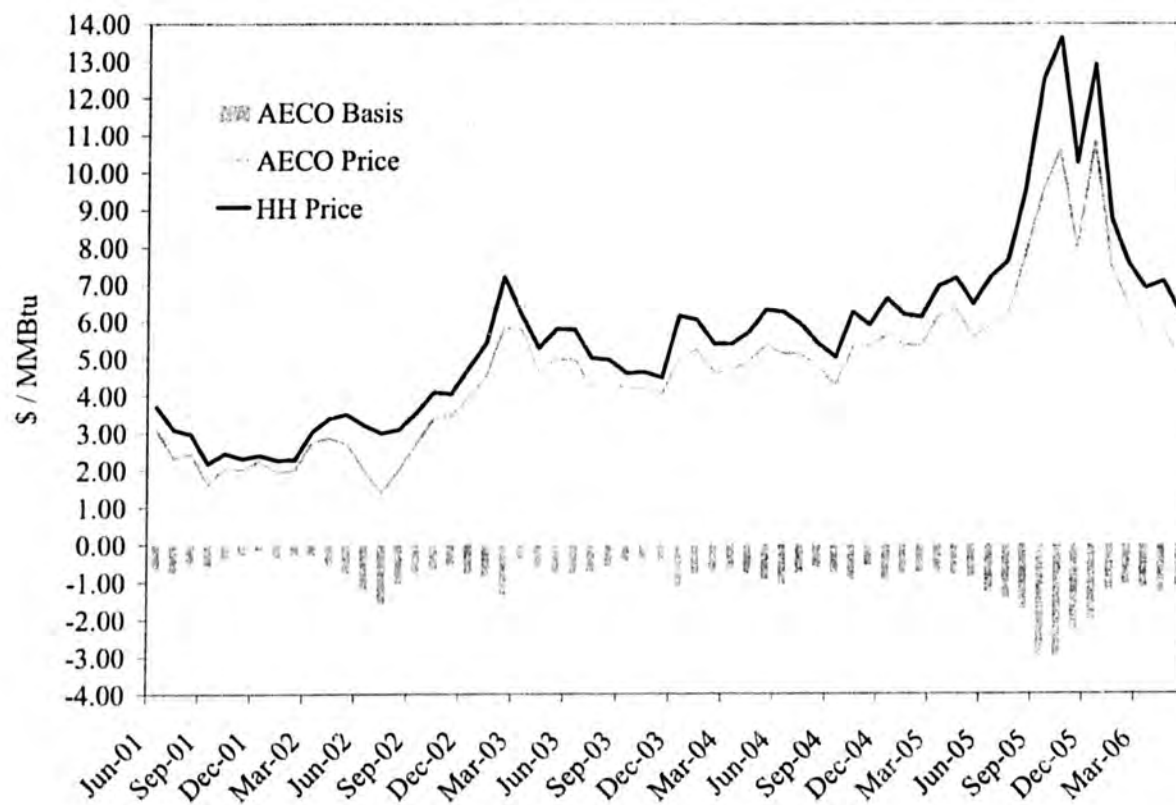
- 5-year average SoCal basis: \$(0.47) per MMBtu discount to HH
- After an increase to over \$(2.00)/MMBtu, SoCal basis has been narrowing and is expected to decrease further
- AGPA base case assumption: \$(0.47) per MMBtu discount (flat nominal terms)



Source: Bloomberg

Alberta Gas Price Assumption

- 5-year average AECO-C basis: \$(0.93) per MMBtu discount to HH
- AGPA base case assumption: \$(0.93) per MMBtu discount (flat nominal terms)

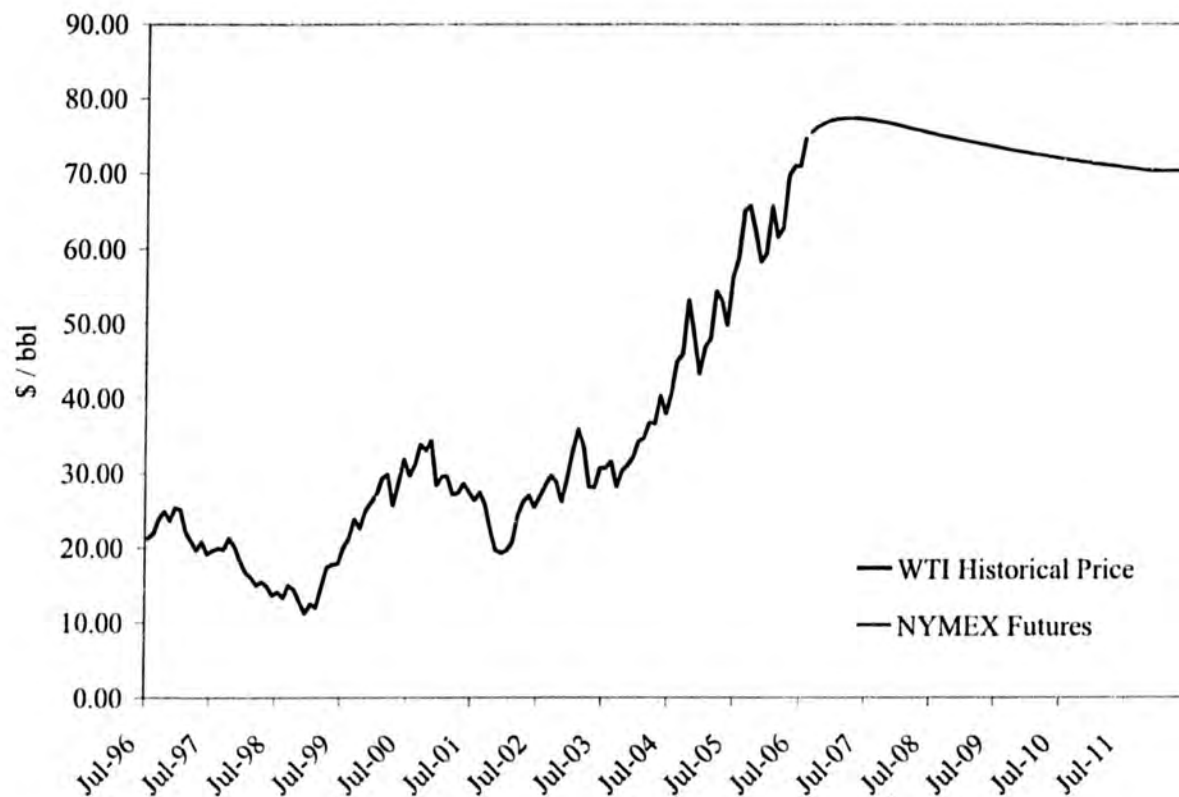


Source: Bloomberg

Crude Oil Prices

- WTI historical 5-year average price: \$40 per bbl
- Current forward pricing on NYMEX: ~ \$70 per bbl

- What is a reasonable WTI price assumption consistent with a certain Henry Hub gas price assumption?



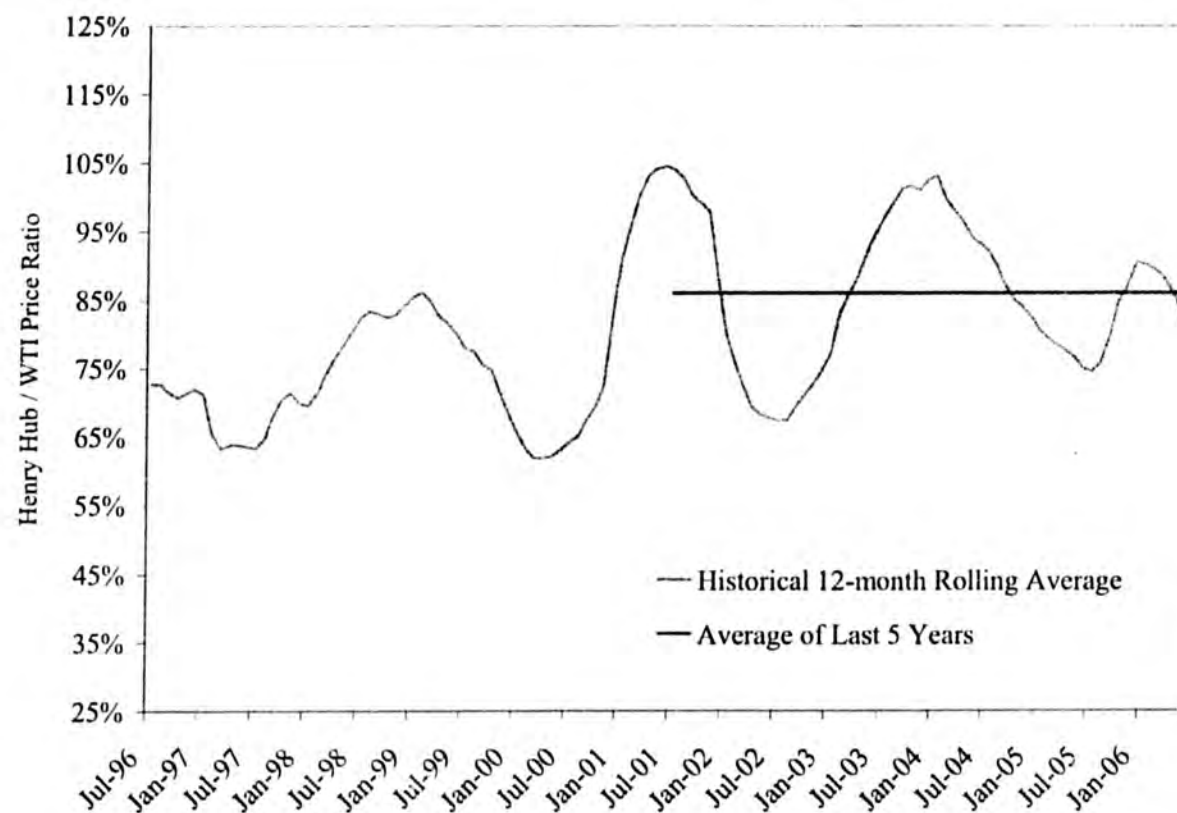
Source: Bloomberg, NYMEX

Crude Oil Prices (continued)

- Henry Hub prices and oil prices historically have not been closely correlated
- Henry Hub / WTI historical 5-year average price ratio: 86%

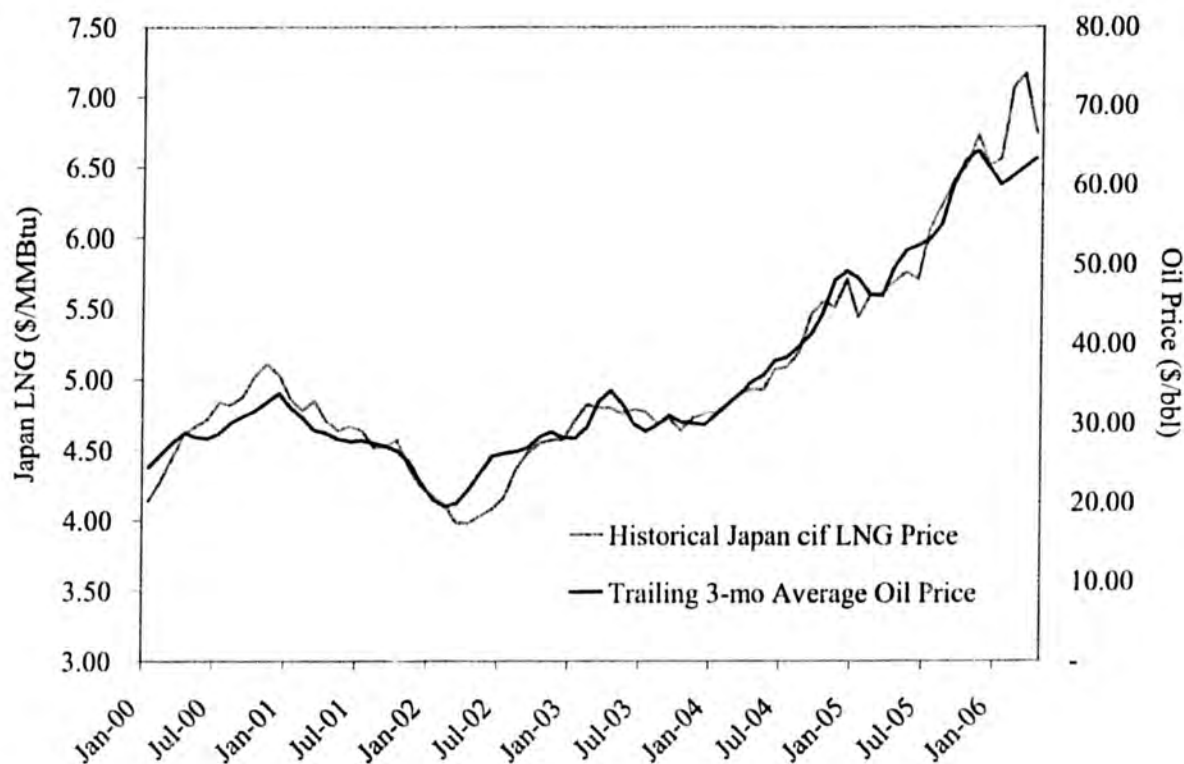
- A \$5.50/MMBtu Henry Hub assumption would be equivalent to a WTI assumption of \$37/bbl, assuming a 86% HH to WTI price ratio

- AGPA WTI base case assumption: \$36/bbl



Japan LNG Prices

- Japan LNG sales prices are typically expressed in contract formulas indexed to JCC (basket of crude oil imports to Japan)
- Japan LNG prices, therefore, are closely correlated with oil prices
- The AGPA model calculates Japan LNG prices on the basis of the assumed oil price and the historical price relationship



Source: Bloomberg

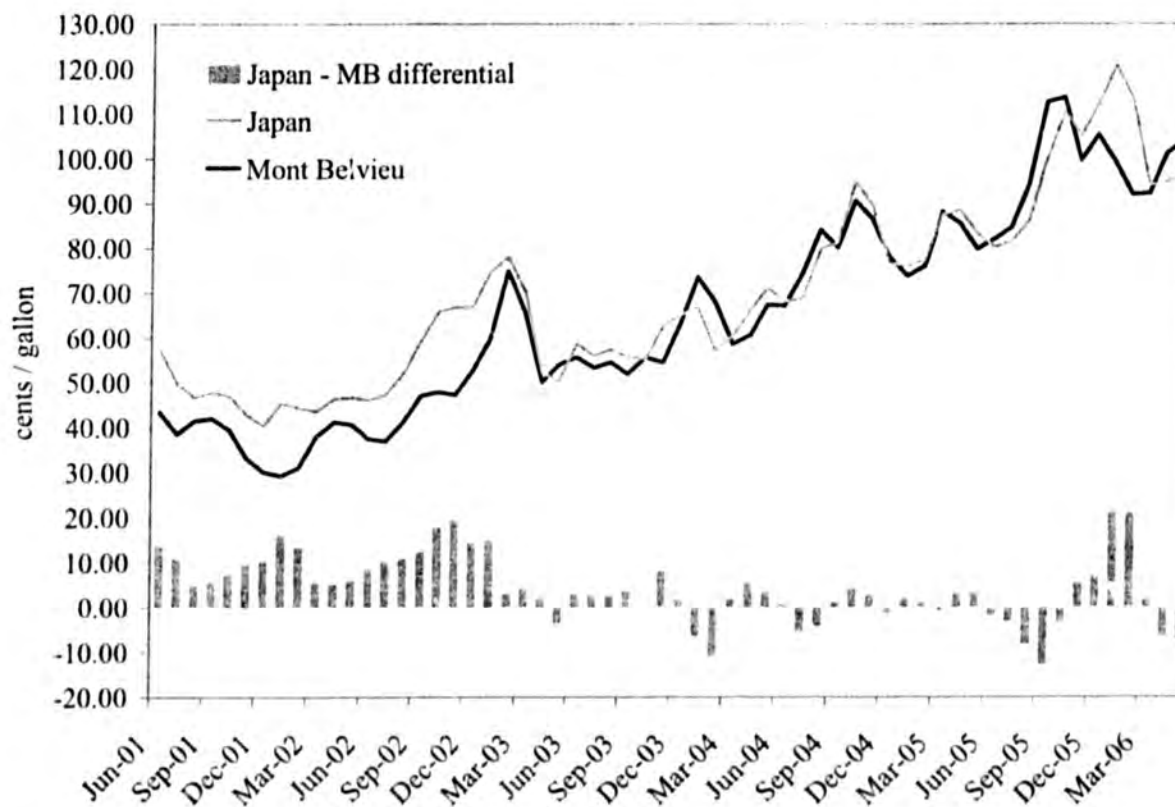


Propane Price Assumptions

- Mont Belvieu propane price:
 - benchmark U.S. Gulf Coast price
 - Mont Belvieu is the deepest propane market in the U.S.
 - used for the NYMEX propane futures contract
- MB propane prices have been historically correlated with both WTI and Henry Hub prices
- AGPA's financial model calculates Mont Belvieu propane prices on the basis of the assumed WTI and Henry Hub prices, using the historical price relationship
- Regional propane prices are assumed on the basis of historical premium/discount to Mont Belvieu

Propane Price Assumptions: Japan

- 5-year average Japan premium to MB: 4.4 cents/gallon
- AGPA assumption: 4.0 cents/gallon premium over MB

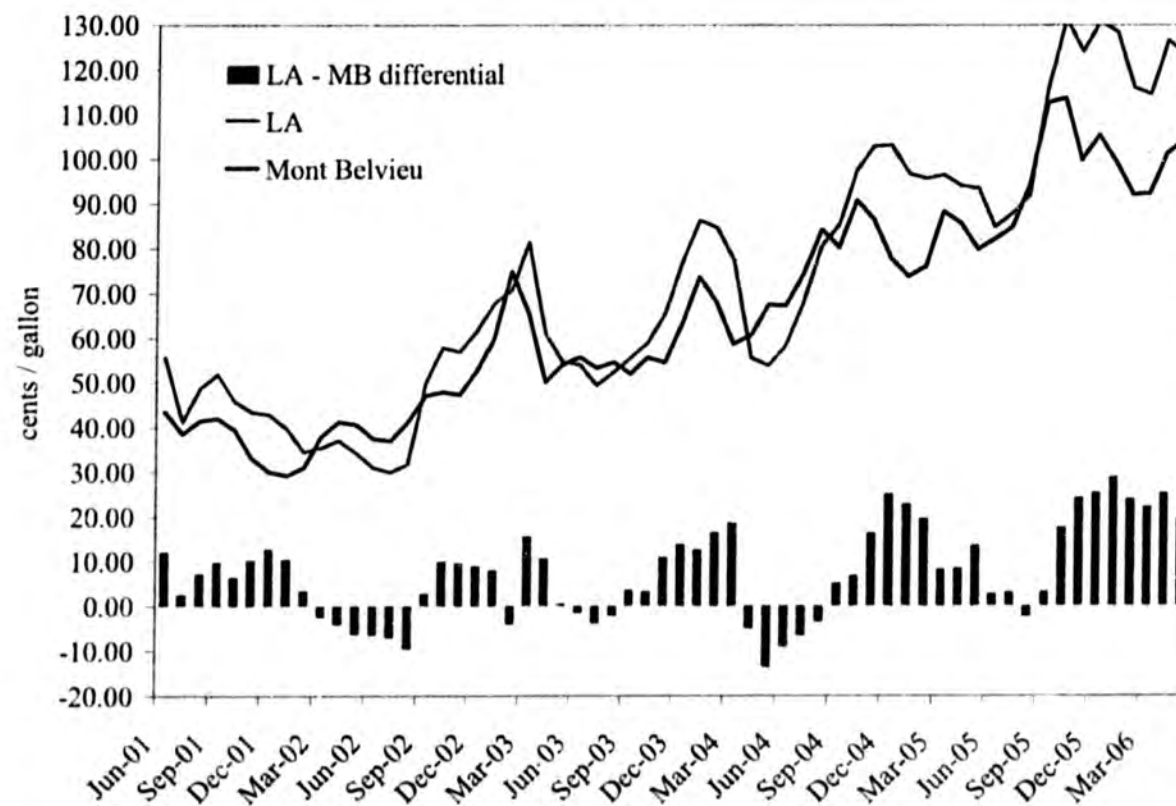


Source: Bloomberg



Propane Price Assumptions: LA

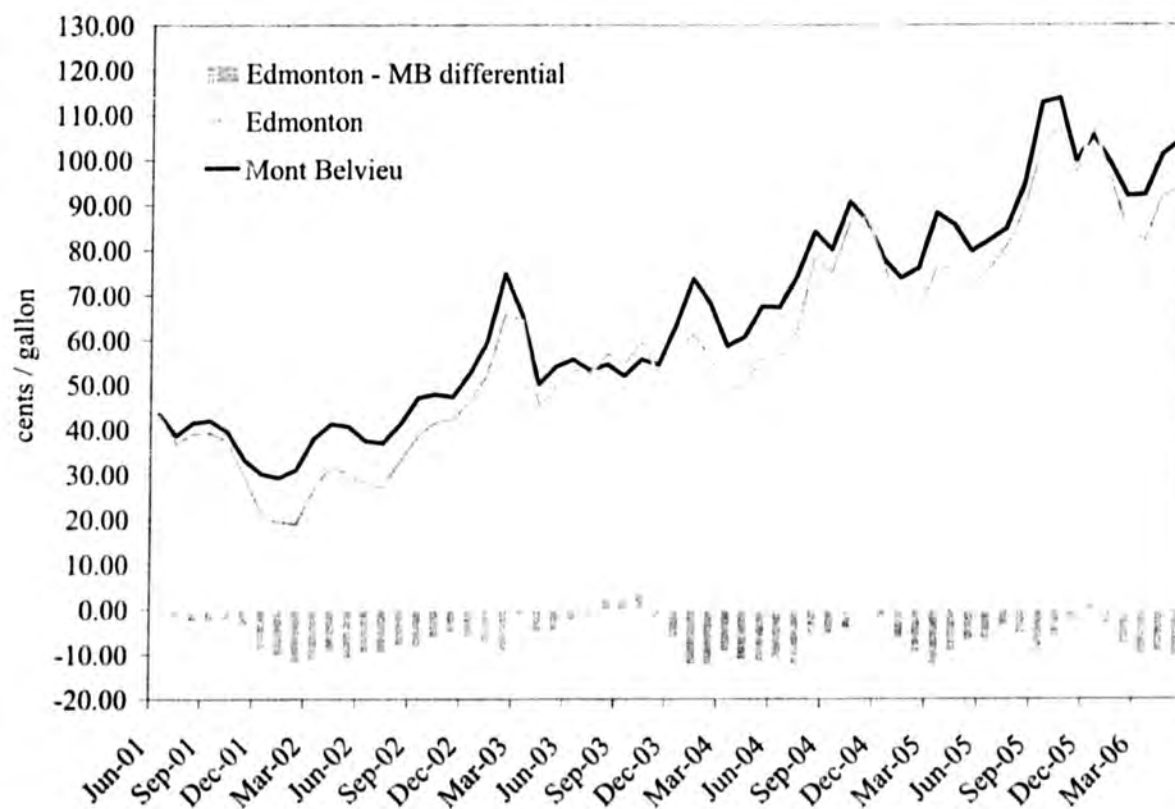
- 5-year average LA premium to MB: 7.6 cents/gallon (flat nominal terms)
- AGPA assumes most LPGs will go to East Asia, but there is opportunity for higher premium in LA market



Source: Bloomberg

Propane Price Assumptions: Alberta

- 5-year average Alberta discount to MB: (6.2) cents/gallon (flat nominal terms)
- AGPA assumption: (6.0) cents/gallon discount to MB



Source: Bloomberg, Duke Energy



Butane Prices

- Assumed on the basis of historical differential between butane and propane in respective markets (East Asia and Alberta)
- Japan butane – propane differential: 9 cents/gallon (flat nominal terms)
- Alberta butane – propane differential: 10 cents/gallon (flat nominal terms)



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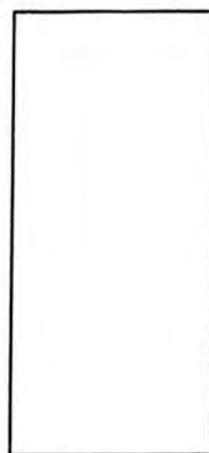
LNG Project Concept and Gas Volumes



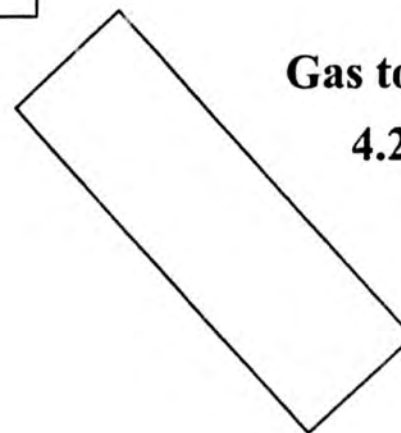
Highway Project Proposal

Year: 2016

4.3 Bcf/d



Pipeline from Prudhoe Bay



**Gas to Canada
4.2 Bcfd**

AGPA Proposal: Immediate Implementation

Year: 2012

1.2 Bcf/d

Pipeline from Prudhoe Bay



Alaska LNG

1.1 Bcfd





AGPA Proposal: Immediate Implementation (continued)

- The AGPA project can be implemented immediately
- Brings value to State and Producers during the period 2012 – 2016+ that would not be otherwise created
- The Highway Project can be implemented at a future date, when ready
- How will volumes be distributed if and when the Highway Project is ready to proceed?

AGPA Proposal: Y-Line Scenario A – Constrained Volume

Year: 2016

4.3 Bcf/d

No reason to limit total
volume to 4.3 Bcf/d

Pipeline from Prudhoe Bay

Reduction in volume
to Canada results in a
potential value
reduction due to loss
of economy of scale

**Alaska LNG
1.1 Bcfd**

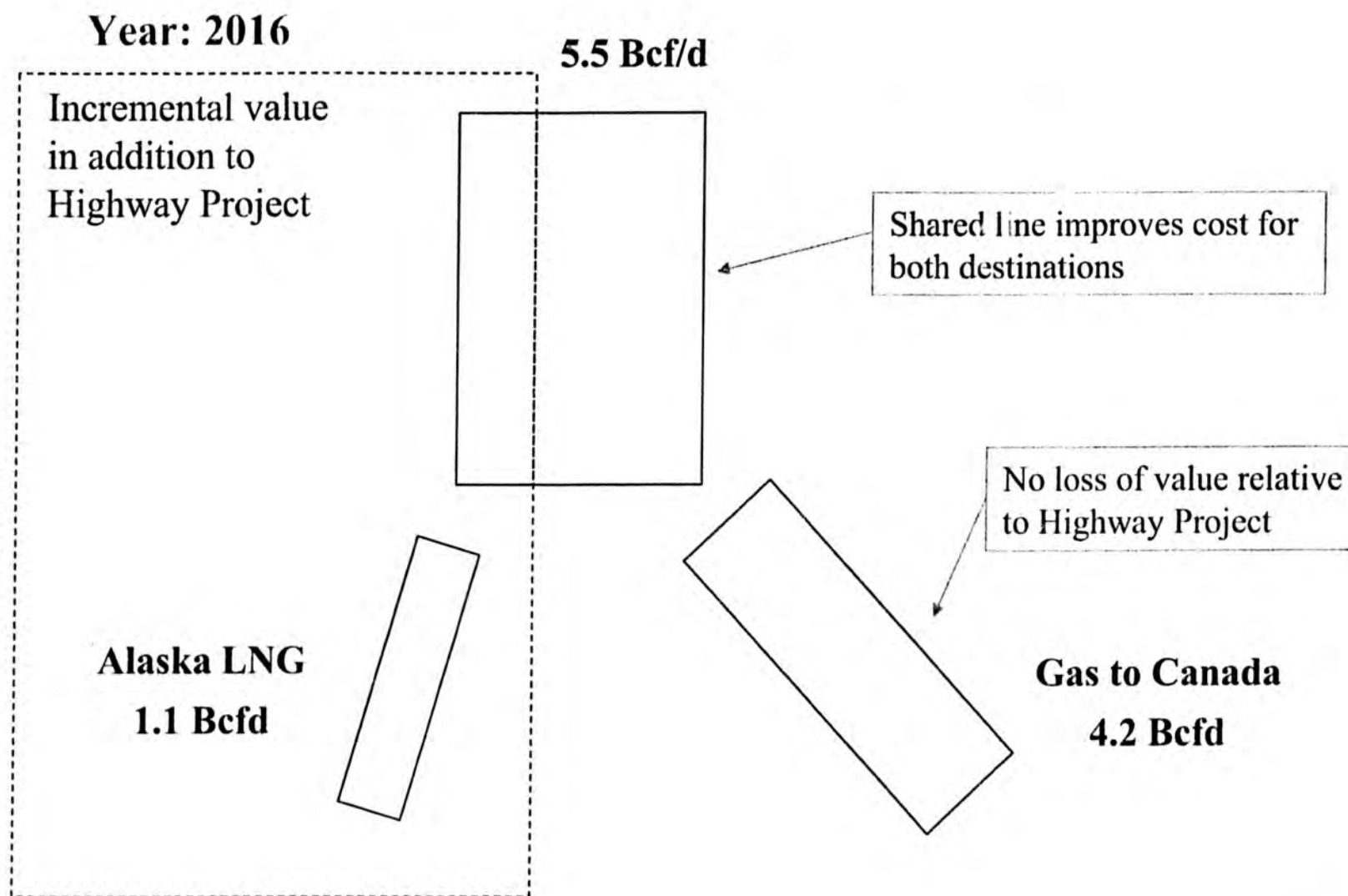
**Gas to Canada
3.1 Bcfd**



AGPA Proposal: Y-Line Scenario B – Incremental Volume

- It has been suggested that AGPA's Y-Line proposal is disadvantageous because the reduction of volume to Canada results in a loss of economies of scale, and hence, lower value for the gas
- This reasoning is premised on limiting total volume at the pipeline inlet to 4.3 Bcf/d (the same amount as under the Highway Project proposal)
- There is no reason to limit the total volume to 4.3 Bcf/d
 - LNG volumes could be in addition to the 4.3 Bcf/d to Canada
 - total volume at pipeline inlet in Prudhoe Bay: 5.5 Bcf/d
 - the Highway Project at 4.3 Bcf/d requires 49 Tcf over 30 years
 - a 5.5 Bcf/d Y-line project would require 62Tcf over 30 years
 - the known discovered resource on ANS is 35 Tcf
 - the Highway Project would require substantial new discoveries to proceed (both as a stand-alone project and part of a Y-line)
 - the stand-alone LNG project, however, can proceed immediately

AGPA Proposal: Y-Line Scenario B (continued)





Stand-Alone LNG Project Concept

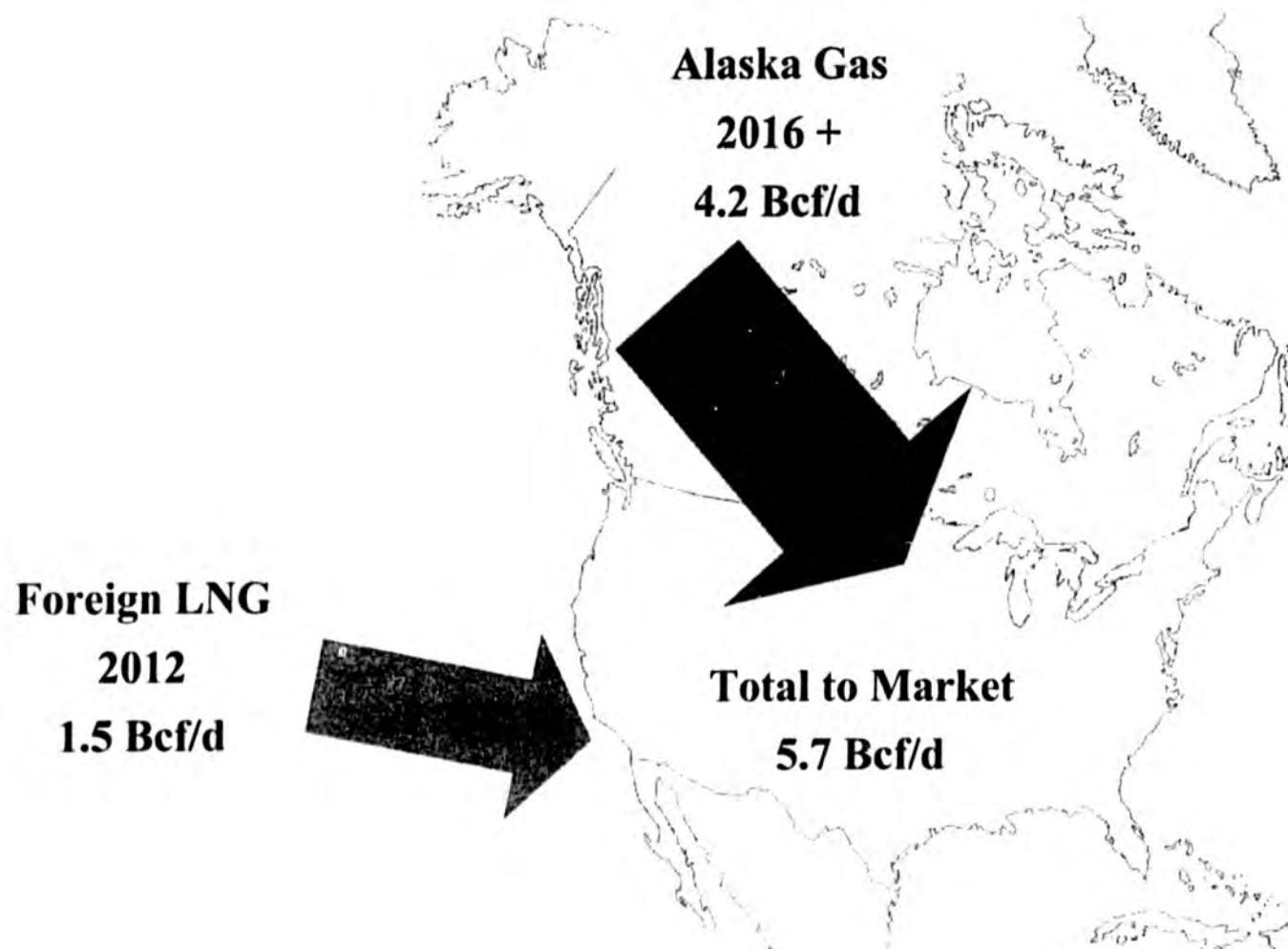
- The issue is whether the AGPA project is economic on a stand-alone basis, as there will be no guarantee in 2012 that the expansion volumes from the Highway Project will ever materialize
- The subsequent sections elaborate on the economics of the stand-alone LNG project
- The projections show robust economics, with both high returns for the Producer and revenues for the State that would be incremental to the revenues from a potential Highway Project to be implemented later



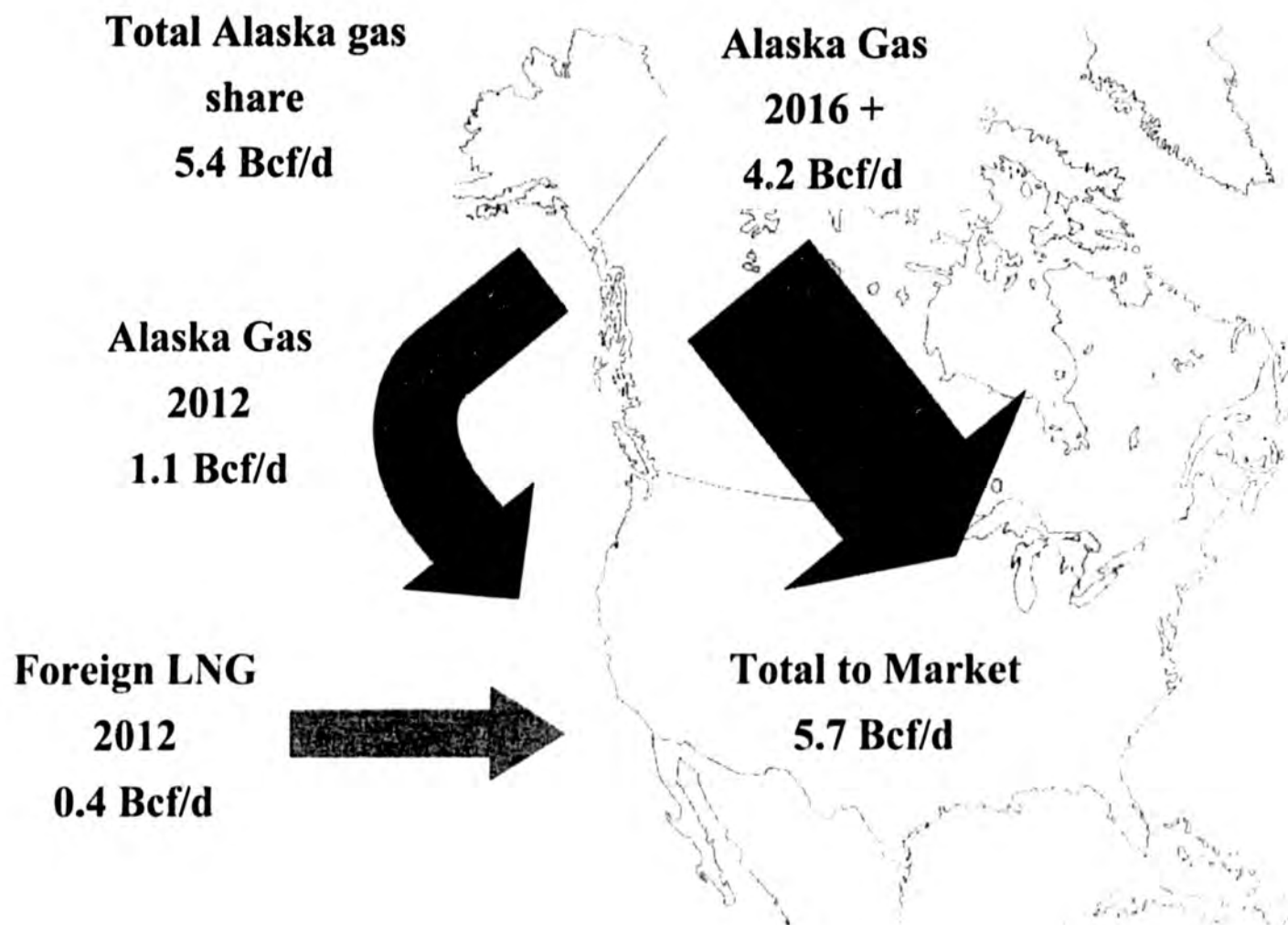
The Market Context

- Does a combined Y-Line of 5.5 Bcf/d deliver too much gas to market?
- The total gas to market is likely to be the same, but Alaska would capture a larger share, which would otherwise go to foreign LNG suppliers

Gas Flows to North America Under the Highway Proposal



Gas Flows to North America Under AGPA Proposal



Alaska's Risk: A Real Possibility?

**Foreign LNG
2012
1.5 Bcf/d**



**Total to Market
5.7 Bcf/d**

**Foreign LNG
2016 +
4.2 Bcf/d**





Additional Strategic Considerations

- Full commercialization of the Alaska gas resource requires a large scale project and additional exploration
- Independent explorers have expressed concern that they will be shut out of a potential Alaska gasline
- Without certainty as to whether pipeline capacity will be available, an explorer will not have an incentive to spend capital for exploration
- An AGPA line sized to accommodate future expansion and Y-line volumes will send a signal that there is free capacity and will spur exploration which will not occur otherwise



Additional Strategic Considerations (continued)

- The LNG project will make the implementation of the Highway Project more likely
- The Producers will have an incentive to participate in the value of the LNG Project and to take steps to fill the spare capacity of AGPA's pipeline
- The LNG project will give Alaska access to additional markets that would not be accessible to the Highway Project

Additional Markets for Alaska LNG

**LNG to
Japan/East Asia**

?

**LNG to West
Coast**

2012

1.1 Bcf/d

Foreign LNG

2012

0.4 Bcf/d

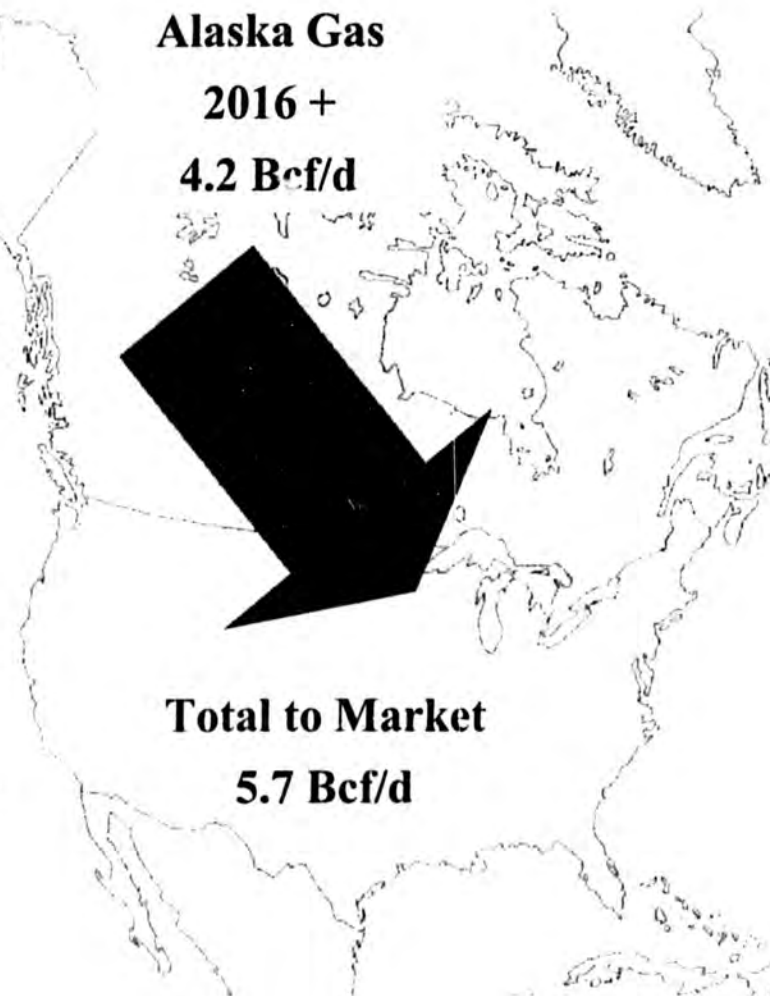
Alaska Gas

2016 +

4.2 Bcf/d

Total to Market

5.7 Bcf/d





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Cost Assumptions

Consistency of Capital Cost Assumptions

- Importance of consistency of capital cost numbers across project components
- Same components for different projects should have the same assumed costs in a comparison
- AGPA pipeline cost assumption in April 2005 (Sempra and AGPA proposal to State and Producers):
 - 3.0 Bcf/d, 48-inch diameter
 - \$8.4 billion EPC cost (2005 detailed cost update)
- FIF assumption (May 2006) for Alaska component of Highway line:
 - 4.3 Bcf/d, 52-inch
 - \$5.9 billion capex



Consistency of Capital Cost Assumptions (continued)

- Why are the capital costs estimates so different?
 - the mileage difference of Highway route vs. Valdez route of 8% clearly cannot alone explain the 42% higher cost of AGPA's *smaller* line
- Difference in methodology of estimate and cost inclusions
 - date of estimate
 - accuracy of estimate
 - contingencies included
- Some comparisons between the AGPA project and the proposed Highway Project (FIF, PFC) have failed to make an adjustment for consistency across capex numbers
- The following slides describe the appropriate adjustments that need to be made for a proper comparison of alternatives



Consistency of Capital Cost Assumptions (continued)

- AGPA's previously publicized capital cost figures include:
 - Contractor's contingencies ranging from 10% to 15%, depending on project component
 - Contractor's escalation allowance during construction period
 - Contractor's profit and risk premium
 - Owner's contingency in addition to Contractor's contingency
 - Owner's insurance cost during construction
- It appears that the above items have not been included in the capital cost estimates made public in the FIF
- A comparative analysis should use the same approach for both projects, as the risk mitigation and related cost premiums and contingencies associated with a given contracting strategy would be available to both projects



Consistency of Capital Cost Assumptions (continued)

- The magnitude of such consistency adjustments is significant:
- AGPA has previously used a \$2.1 billion estimate for the LNG Facility
- Stripping away the various risk premiums and allowances (both contractor's and owner's) that are not included in estimates for an alternative project reduces the capital cost assumption to \$1.5 billion

How Reliable are the Cost Estimates?

- AGPA's cost estimates are the result of extensive engineering work performed by Bechtel in 2000, with a detailed cost update study performed in 2005
- The technical details of Bechtel's work have been shared with the State's consultants
- There appears to be considerable uncertainty surrounding the publicized cost estimates for the proposed Highway project

Project Component	2001 Producer Estimate	2006 FIF Assumptions
GTP	\$2.6 billion	\$2.6 billion
Pipeline from Prudhoe Bay to Alberta	\$11.0 billion	\$11.6 billion

Source: Fiscal Interest Findings; Presentation titled "Alaska Producer Pipeline Presentation May 2002" and 2004 SGDA testimony by Producer group

AGPA Base Case Capital Cost Assumptions

- Midstream components (2005 dollars):
 - LNG Facility: \$1.5 billion
 - pipeline from PB to Valdez (initial 1.2 Bcf/d capacity): \$5.3 billion
 - expansion of PB-Delta Junction segment to accommodate incremental volume: \$0.9 billion
 - Delta Junction to Alberta pipeline: \$8.5 billion
 - GCP: based on the \$2.6 billion assumption in the FIF, adjusted for volume
 - all midstream components include a 10% capex contingency and a 5% owner's contingency
 - real 2005 numbers are escalated at 2.5% p.a.
- Upstream (PBU, PTU, other ANS fields and yet-to-find gas): \$8.4 billion



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Netback Results

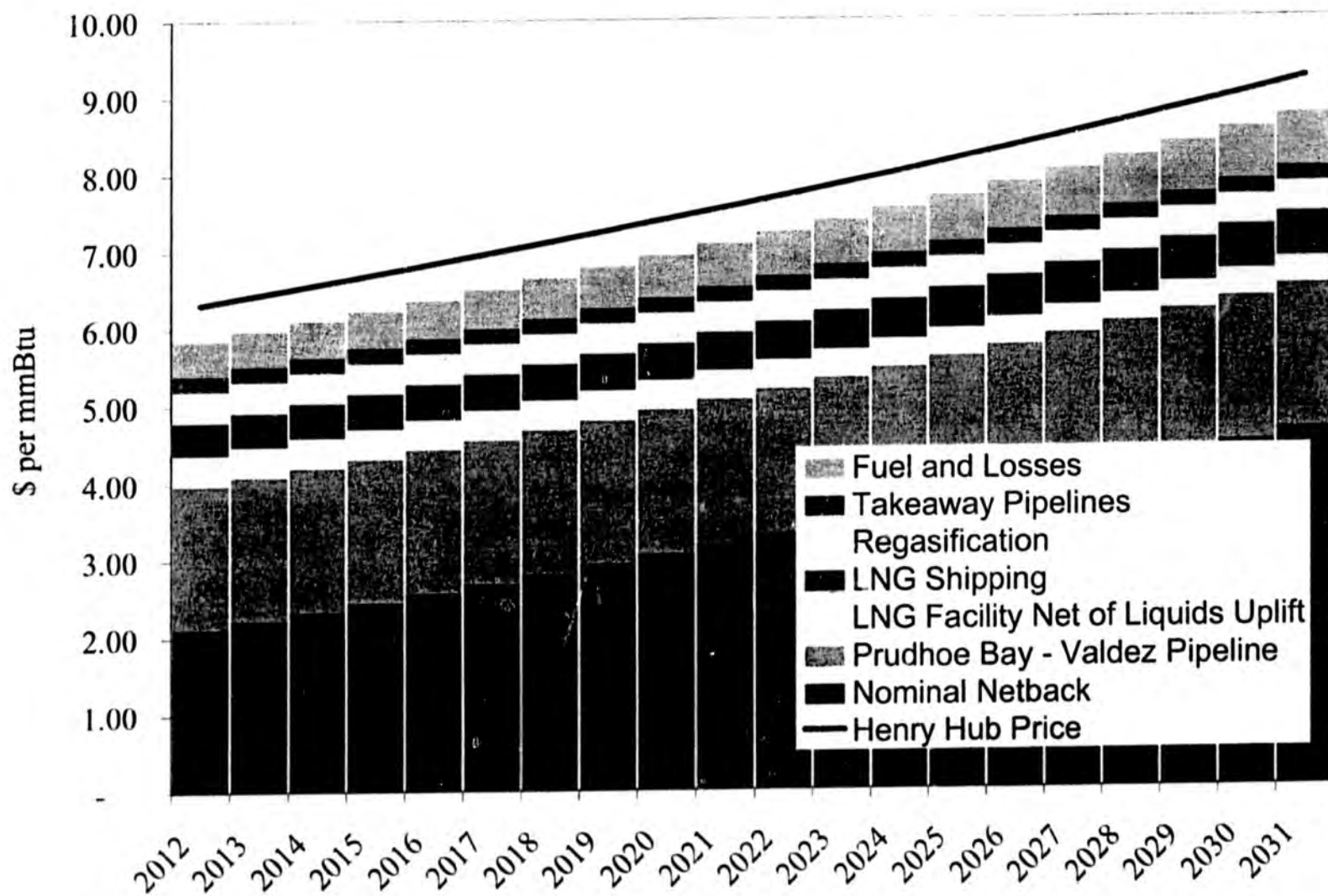
Netback Pricing

- Tariff Assumptions on midstream components
 - debt to equity ratio 80:20
 - interest on debt 5.50% (assumes Federal guarantee under ANGPA)
 - pipelines ROE 14%
 - LNG facility ROE 12%
- Combined pipeline and LNG facility tolls:
 - \$2.50 per mmBtu nominal terms in 2012
 - \$2.17 per mmBtu in real 2005 terms
- Downstream components plus total fuel consumption and losses:
 - \$1.50 per mmBtu nominal terms in 2012
 - \$1.30 per mmBtu in real 2005 terms

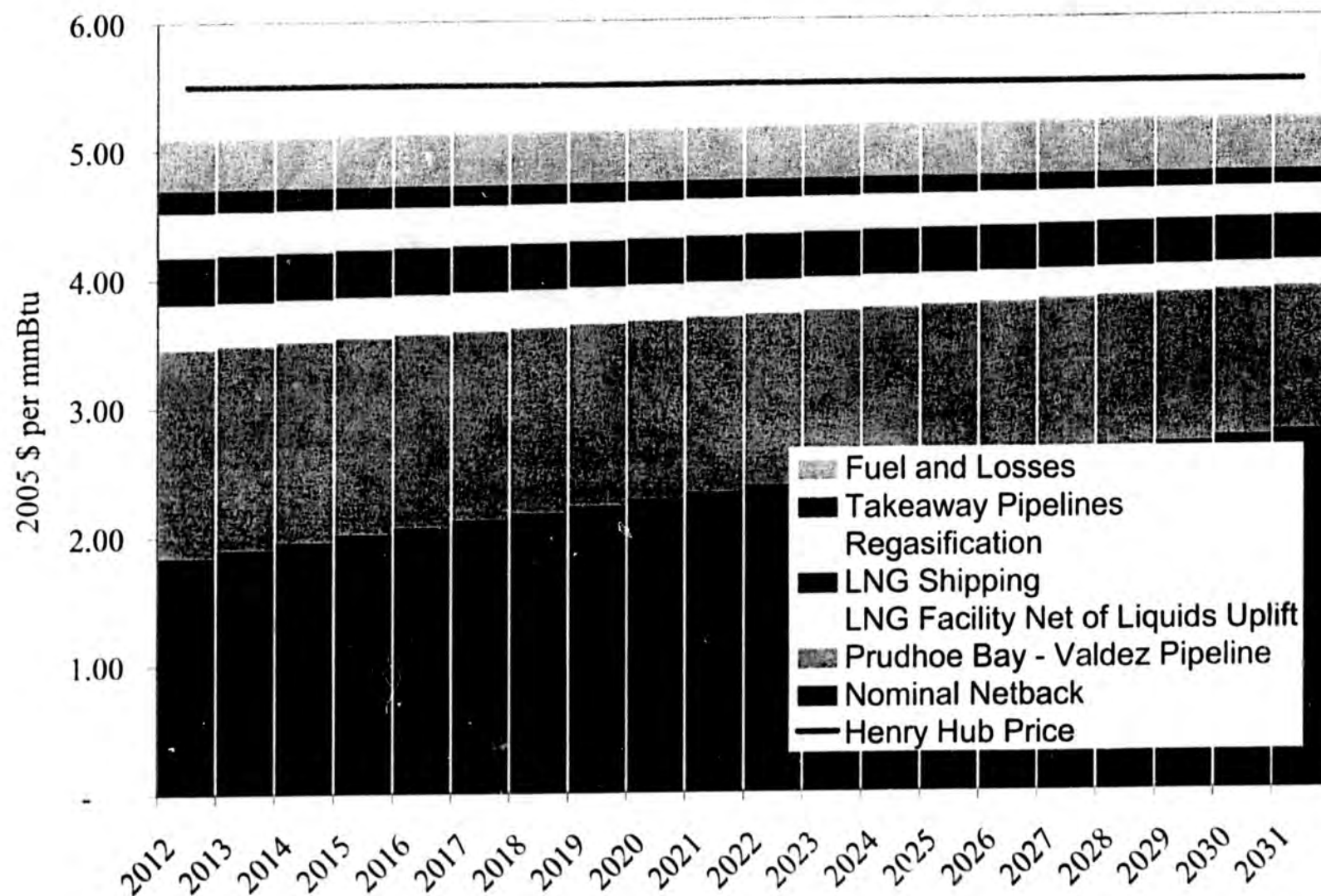
Netback Pricing (continued)

- Uplift from liquids extracted in Valdez:
 - \$0.23 per mmBtu nominal terms
 - \$0.20 per mmBtu in real 2005 terms
- Nominal netback prices at the pipeline inlet are in the range of \$2.11/mmBtu in 2012 to \$7.87/mmBtu in 2041
- Real at the pipeline inlet are in the range of \$1.84/mmBtu in 2012 to \$3.86/mmBtu in 2041
- Nominal prices at the point of production (net of GCP toll and shrinkage and feeder pipeline costs) are in the range of \$1.47/mcf to \$7.16/mcf

Nominal Netback at Pipeline Inlet



Real Netback at Pipeline Inlet (2005 \$)

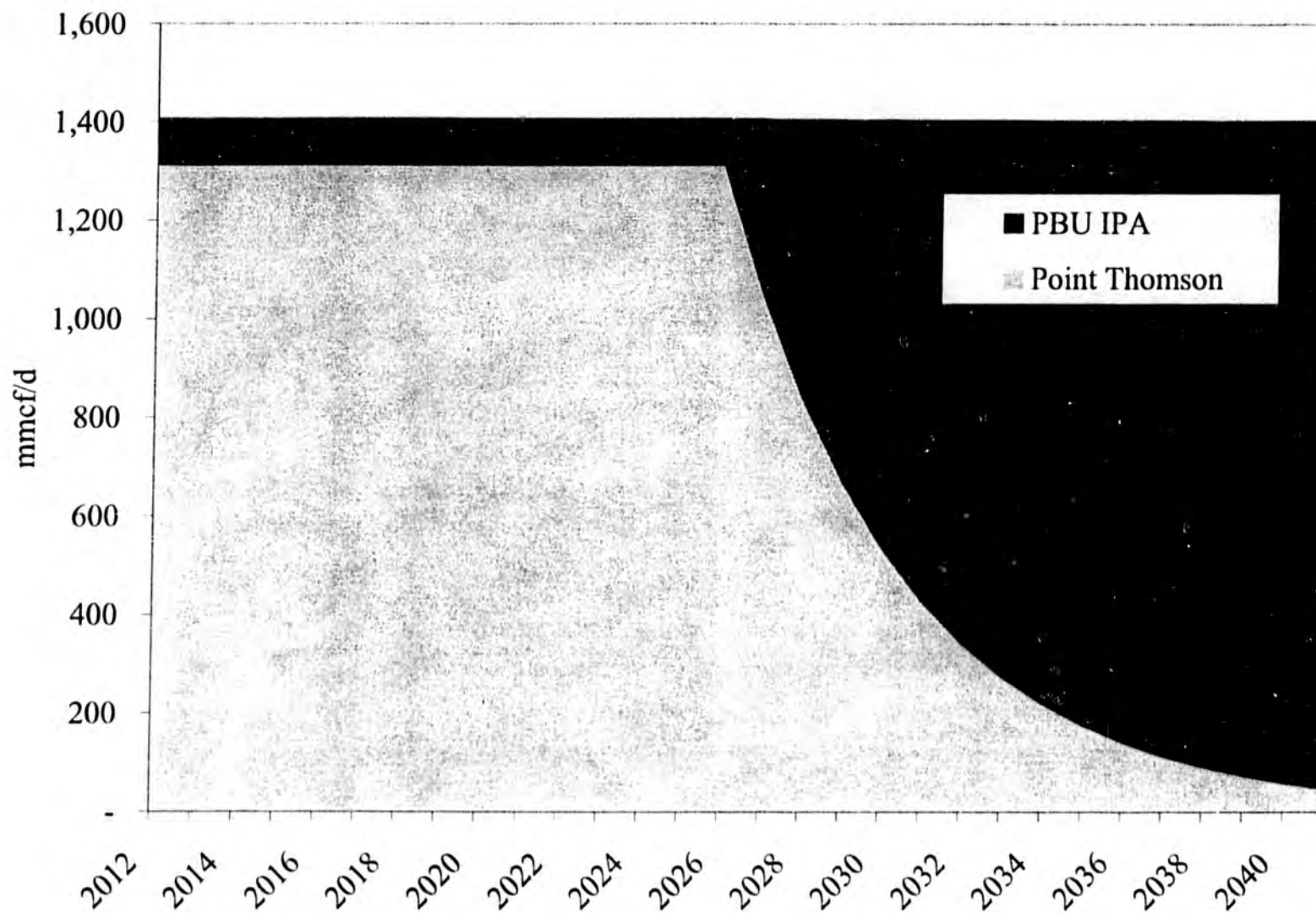




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Producer Results

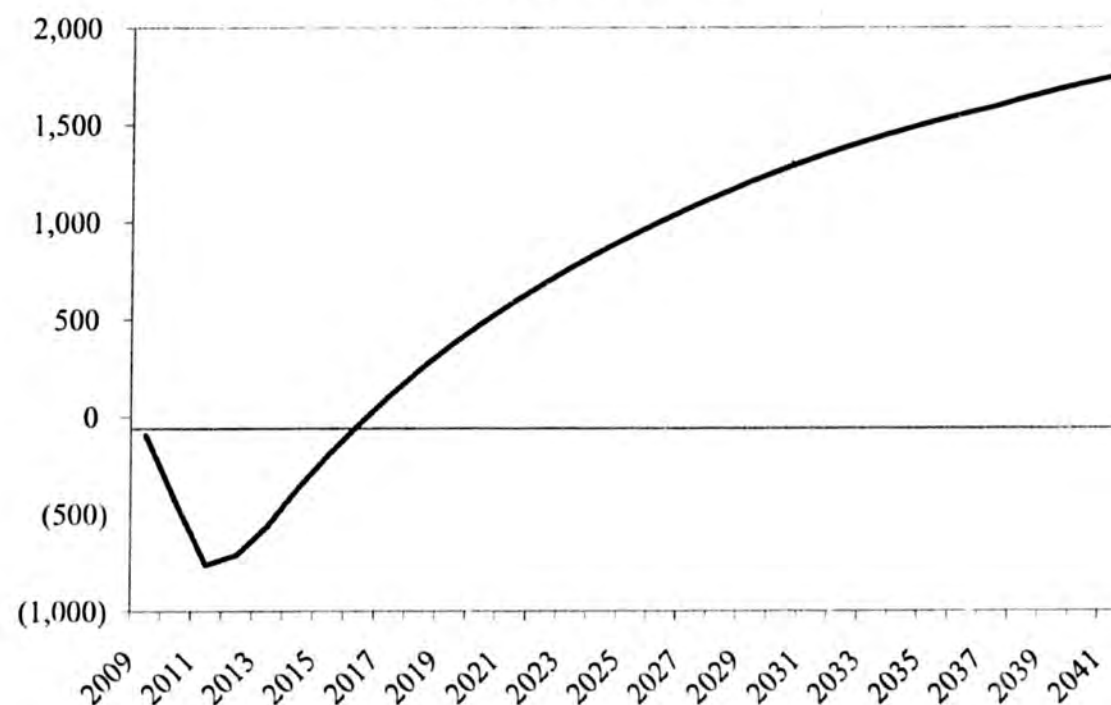
Assumed Upstream Production



Producer Returns

- Upstream Producer returns at the Base Case Henry Hub price of \$5.50/mmBtu
 - NPV @ 12% discount rate: \$1.7 billion
 - IRR: 27.4%

Producer Upstream NPV@12



- Discounted payback is achieved rapidly – within the first six years of operations

Sensitivity of Producer Returns

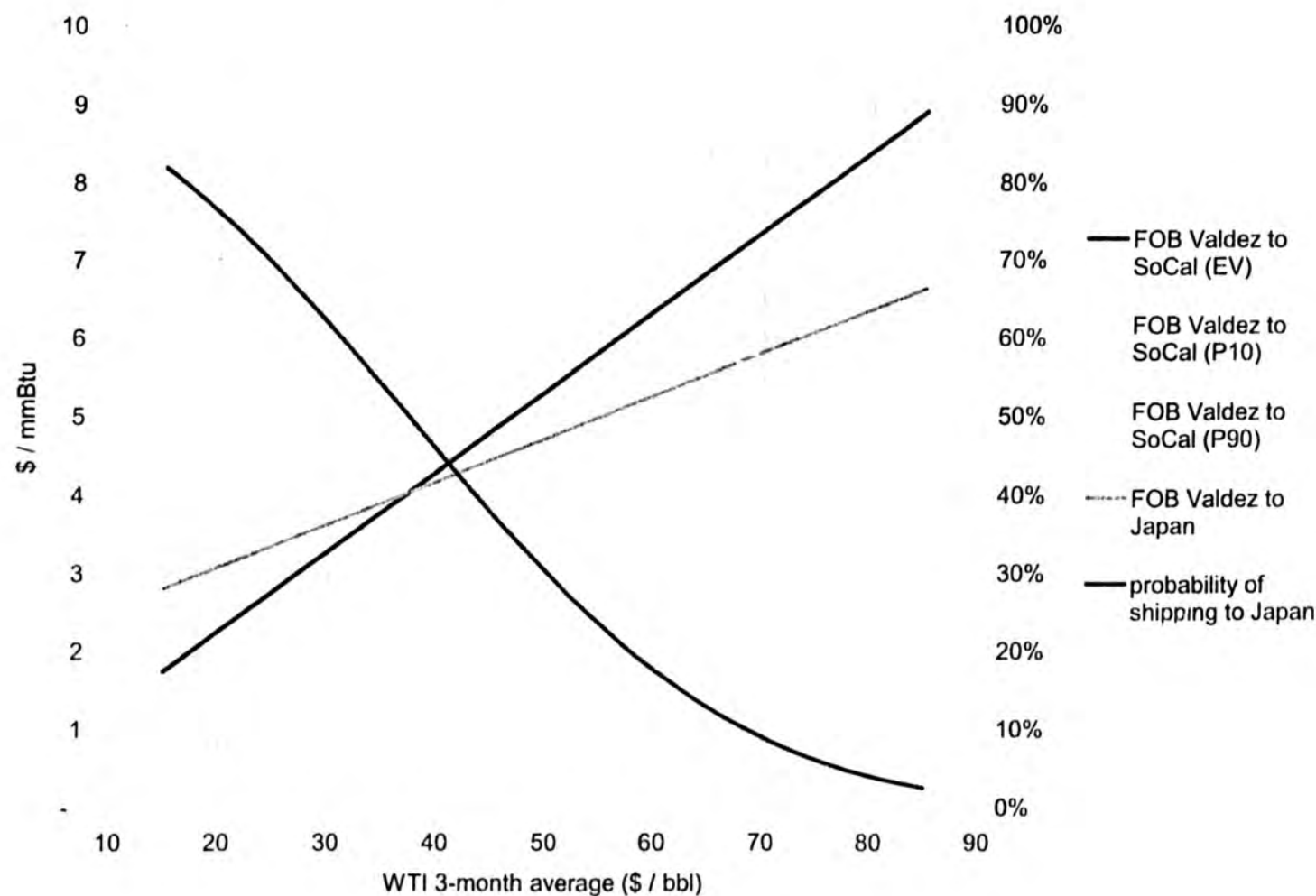
- Producer upstream returns at the high price scenario (\$7.70/mmBtu Henry Hub and \$70/bbl WTI):
 - NPV @ 12% discount rate: \$4.6 billion
 - IRR: 52.4%
- The breakeven Henry Hub price (at which the Producer IRR equals 12%) is \$4.30/mmBtu
- At the low prices scenario (stress case) (\$4.00/mmBtu Henry Hub and \$27/bbl WTI), the netback from Japan is significantly higher:
 - \$1.55/mmBtu at the pipeline inlet and \$0.95/mcf at the point of production in 2012 (nominal terms)
- The LNG project's option to divert production to higher value markets (e.g., Japan) has a significant value

Value of Diversion Option

- Japanese LNG c.i.f. prices are highly correlated with oil prices (R^2 of 0.96)
 - primarily due to contractual linkages to JCC
- US gas prices (including SoCal) are not highly correlated with oil prices, and by extension, Japanese LNG prices
- This low correlation gives increases the likelihood that prices in Japan will be high during periods of low U.S. prices, making it worthwhile to divert cargoes
- An analysis has been performed using both an algebraic approach and a Monte Carlo simulation to estimate the value of this option to divert cargoes to the high-prices market
- At AGPA's base case prices, the expected value of the diversion option is estimated to be \$0.49 per mmBtu of LNG produced



Value of Diversion Option (continued)



Value of Diversion Option (continued)

Example of diversion option value at a given oil price (\$26.84/bbl in this case)

