EIGHTH CLAIM FOR RELIEF
Against BP – Breach of Contract

229. The Authority repeats and realleges all of the allegations in all the paragraphs above as if set forth fully herein.

230. As set forth above, BP entered into a contract – "Charter for Development of the Alaskan North Slope" – under which it agreed, among other things, to:

(a) negotiate in good faith to make North Slope gas available to third parties at a commercially reasonable fair market price or transportation charge in quantities sufficient to support a treatment and transmission project;

(b) make reasonable efforts to assist in obtaining approval for a qualified transportation project, such as the Authority's, from the other gas producers and field interest owners; and

(c) give fair consideration to any reasonable project to deliver gas to market, specifically including projects sponsored by the Authority, YPC, the State, and others

231. The Authority was an intended beneficiary of that contract. As a political subdivision of the State, the Authority's purpose is to benefit the State of Alaska and its citizens by the construction of an independently owned gas pipeline system to transport natural gas from Alaska's North Slope to market BP's continued refusal to negotiate with the Authority and others to sell gas constituted a breach of the contract, and frustrated the Authority from accomplishing its intended purpose. As a result of these breaches, the Authority, an intended beneficiary of the contract, has been injured in its business or property, including through the loss of future profits, by the loss of customers and potential customers, and by the prospective destruction of its business. The Authority has been injured and suffered damages in an amount

to be proven at trial and, without injunctive relief, the Authority will continue to suffer irreparable injury as a result of Defendants' unlawful conduct. The Authority has no adequate remedy at law.

VIII. PRAYER FOR RELIEF

WHEREFORE, Plaintiff requests that the Court:

A. Adjudge and decree that Defendants have violated Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2; and Section 7 of the Clayton Act, 15 U.S.C. § 18; that Defendants have violated the Alaska Unfair Trade Practice and Consumer Protection Act, AS 45.50.471 *et seq.*; that Defendants have tortiously interfered with the Authority's prospective economic advantage; and that BP's conduct constitutes breach of contract;

B. On the Authority's First through Sixth Claims, enter judgment against Defendants for treble the amount of the Authority's damages as proven at trial in accordance with Section 4 of the Clayton Act, 15 U.S.C. § 15, and the Alaska Unfair Trade Practice and Consumer Protection Act, AS 45.50.531;

C. On the Authority's Seventh and Eighth Claims, enter judgment against Defendants for the amount of the Authority's damages as proven at trial and, on the Authority's Sixth and Seventh Claims, for punitive damages;

D. Grant the Authority injunctive relief pursuant to 15 U.S.C. § 26, sufficient to restrain Defendants' continuing violations of 15 U.S.C. §§ 1 and 2;

E. Grant the Authority injunctive relief pursuant to 15 U.S.C. § 26, sufficient to restrain and prevent Defendants' violations of 15 U.S.C. § 18, including but not limited to injunctive relief requiring divestiture of some or all of the assets acquired, and/or imposing conditions on Defendants' use of some or all of the assets acquired;

F. Award the Authority its costs and expenses of litigation, including attorneys' fees and expert witness fees; and

G. Enter judgment against Defendants for such other and further relief as the Court deems just and proper.

DEMAND FOR JURY TRIAL

Plaintiff AGPA hereby demands trial by jury in this action on all issues so triable.

Dated: Monday, December 19, 2005

Respectfully submitted,

David Boies
Robert Silver
John F. Cove, Jr.
Kenneth F. Rossman IV
BOIES, SCHILLER & FLEXNER LLP

William M. Walker
WALKER & LEVESQUE, LLC

Charles E. Cole
LAW OFFICES OF CHARLES E. COLE

Counsel for Plaintiff Alaska Gasline Port Authority

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TransCanada
In business to deliver

July 13, 2006

VIA FAX: (907) 465-3889

Governor F H Murkowski
550 West 7th Avenue, Suite 1700
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TransCanada Corporation
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Calgary, Alberta T2P 5H1

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Hal Kvisle
President and CEO

Dear Governor Murkowski:

Re: Letter from Governor Frank H. Murkowski to the Honorable Ben Stevens, dated June 22, 2006 regarding a Pipeline to Transport Natural Gas from the Alaska North Slope to North American Markets (the "Project")

I am writing to provide comments on your June 22nd letter to Senator Ben Stevens, in which you encourage Senator Stevens to support the ratification of the agreement that your Administration has reached with the Alaska North Slope ("ANS") producers, regarding the construction of a gas pipeline and related facilities for the movement of ANS natural gas to market

TransCanada, its predecessors and the State of Alaska have enjoyed a constructive working relationship since the Project was first conceived some thirty years ago. TransCanada has worked particularly closely with your Administration in recent years, and we value the relationship we have developed with you and your Administration. We have also worked closely with many members of the Alaska State Legislature, and we value those relationships as well.

It is within the long term context of TransCanada's relationship with the State of Alaska that I wish to provide comments on three issues:

(i) The gas pipeline agreement you have reached with the ANS producers
(ii) Provisions regarding Canada, contained within that agreement
(iii) The viability of independent pipelines, as referenced in your June 22nd letter to Senator Ben Stevens

1 Gas Pipeline Agreement Between the State of Alaska and the ANS Producers

TransCanada recognizes the importance of the agreement you have reached with the ANS producers – it is difficult to see how a gas pipeline from the North Slope to North American markets could proceed expeditiously without the agreement and support of the ANS producers. As you will recall, TransCanada has consistently advised your Administration to be wary of independent pipeline proposals that would seek to develop a pipeline without the agreement and

support of the ANS producers. You will also recall that TransCanada declined to join various consortiums seeking to develop independent pipelines without ANS producer support.

TransCanada recognizes the technical, financial and regulatory challenges of building a single high volume gas transmission system from the North Slope to the Alberta Hub. While we are prepared to lead and manage the entire Project, we recognize that our unique expertise lies on the Canadian side of the border. We hold significant rights, extensive technical and environmental information and other assets within Alaska, which we are willing to convey to a producer-led Project that involves TransCanada on the Canadian side of the border. We remain willing to do that.

There is much debate around the specific terms of your agreement with the ANS producers. These are issues to be resolved between the State of Alaska and the ANS producers, and we do not wish to take a position on any specific covenants, except as noted under section 2 of this letter.

To the extent that your agreement with the ANS producers would lead to the expeditious construction of the Project, and provided that the matters addressed in section 2 are resolved, we are generally supportive of the gas pipeline agreement which you have reached with the ANS producers. We encourage the State of Alaska to resolve the outstanding issues, ratify the agreement and move forward.

2. Provisions Regarding Canada, contained within the Gas Pipeline Agreement

Notwithstanding our general support for the agreement you have reached with the ANS producers, TransCanada is concerned that specific provisions within that agreement will lead to difficulty in Canada. Specifically, we object to provisions that specify joint State-producer ownership within Canada, as well as provisions that commit the State to an NEB regulatory process within Canada. As you know, TransCanada holds valid property rights to build and own the Canadian section of the Project, and we have no option but to defend those rights on behalf of our Canadian shareholders. We have invested several billion dollars to pre-build and pre-engineer the Project within Canada, and we will take all necessary actions to protect investments that were reviewed, approved and implemented pursuant to Canada's Northern Pipeline Act.

Most recently, TransCanada has developed commercial proposals for the construction, ownership and operation of the Canadian section of the Project, and we continue to discuss those proposals with the ANS producers. We believe commercial negotiations will lead to a reasonable "win-win" outcome in Canada, if the determination of ownership of the Canadian section can be deferred until matters in Alaska are finalized. Alternatively, we are prepared to engage immediately to negotiate a commercial framework for the Canadian section, with the intention of including that framework in your agreement with the producers, prior to State ratification.

We respectfully ask that you consider amending your agreement with the ANS producers, to either defer determination of ownership in Canada or to reflect the key elements of a commercial agreement with TransCanada. Either approach would minimize the risk of delay within Canada

3. The Viability of Independent Pipelines

Your June 22nd letter to Senator Stevens states that neither an "All Alaska Gas Pipeline" nor "independent pipeline proposals" are "economically sound", or "based on the realities of the gas transmission business". The Letter concludes that neither are "viable alternatives" for the movement of ANS natural gas to market

TransCanada owns and operates the largest natural gas transmission facilities in North America, and has been a leader in the gas transmission business for over 50 years. We have an enviable track record, having developed successful pipeline projects in Canada, the United States and internationally. The independent pipeline commercial arrangement that TransCanada proposed and diligently negotiated with the State over many months is both realistic and economically sound. I would note that our proposal was developed at your Administration's request, as a competitive alternative, available at the State's election, to assist the State in unlocking its stranded natural gas reserves.

TransCanada has at all times recognized that our independent pipeline proposal could lead to delay and litigation if the ANS producers were unwilling to commit their gas to an independent project. At all times, we stressed the need to seek and obtain ANS producer support for our independent pipeline proposal – in that way, our proposal was different from those put forth by parties who would seek to build an independent pipeline without producer support. Our proposal was specifically designed to encourage the ANS producers to participate in the Project by offering them a commercially viable arrangement and an opportunity for ownership in the Alaska portion of the Project.

Our independent pipeline proposal was developed and presented to the State as a constructive alternative that remains available to the State in the event the current State-producer arrangement does not proceed. Our proposal does reflect the realities of the North American gas transmission business – I would note that the vast majority of North American gas moves to market through independent gas transmission systems. The shipping terms and risk sharing mechanisms contained in our proposal were innovative, competitive and economically sound. We continue to see our proposal as a realistic alternative in the event you are not able to reach closure on your current arrangement with the ANS producers.

In Conclusion

TransCanada looks forward to working with the State of Alaska and the ANS producers to move this important project forward. We look forward to discussing, negotiating and concluding a

commercial arrangement for the movement of Alaska gas from the Alaska border to the Alberta Hub, and on to Lower 48 markets. We would welcome your support for the early commencement of commercial negotiations

Governor Murkowski, I would again emphasize that TransCanada remains willing and able to devote its proven expertise, financial strength and proprietary Canadian rights to the development of an Alaska-Canada pipeline that will deliver enormous economic benefits for all Alaskans

Sincerely,

TRANSCANADA CORPORATION

Hal Kvisle
Chief Executive Officer

cc: Senator Ben Stevens
Alaska State Legislators
Mr J. Mulva, ConocoPhillips
Mr R Tillerson, ExxonMobil
Mr B Frank, BP Canada

TransCanada
In business to deliver

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June 8, 2006

Department of Revenue
Commissioner's Office
P.O Box 110430
Juneau, AK 99811-0430

Attention: William Corbus

Dear Mr. Corbus:

Re: Comments on the May 23, 2006 Draft Alaska Stranded Gas Development Act Contract between the State of Alaska and the Alaska North Slope Producers Submitted by TransCanada Corporation ("TransCanada")

TransCanada appreciates the opportunity (i) to provide comments on the draft Stranded Gas Development Act ("SGDA") contract (the "Gas Line Contract" or the "Contract") between the State of Alaska (the "State") and BP Exploration (Alaska) Inc., ConocoPhillips Alaska, Inc. and ExxonMobil Alaska Production Inc. (the "ANS Producers"), and (ii) to set forth its views on the most effective and expeditious way to place a pipeline for the delivery of Alaska North Slope gas, through Canada, to market (the "Alaska Highway Pipeline Project" or the "Project") into service.

TransCanada recognizes this important next step toward the eventual in-service date of the Project, the commencement of the flow of Alaska North Slope Gas to Alaska and North American markets, and the flow of important revenues to the citizens of Alaska. TransCanada is ready and eager to participate in the ultimate success of the Project by constructing and operating the Canadian segment of the Project, in accordance with valid and exclusive authorizations issued to it by the Canadian Government, and by contributing important assets to the Project, in both Canada and Alaska. If the legitimate interests of TransCanada are respected and accommodated and the important contributions of TransCanada welcomed, everyone will benefit. However, if TransCanada's interests are ignored, the Project will be threatened by protracted litigation and extensive delay that could and should be avoided.

TransCanada believes that the choice is simple for the State of Alaska – it should bring all parties with legitimate interests to the table – the State itself, the ANS Producers, producers of future gas reserves, and TransCanada – to meld the Alaska and Canadian portions of the Project into a single pipeline that is placed in service soon and brings benefits to all.

To that end, TransCanada offers the following comments:

I. TransCanada's Interest

TransCanada has a significant economic and legal interest in the Project:

1. TransCanada's wholly-owned subsidiary, Foothills Pipe Lines Ltd. ("Foothills") holds valid and exclusive certificates, issued under the *Northern Pipeline Act* (Canada) (the "NPA") for the construction and ownership of the Canadian portion of the Project;

2. A general partnership wholly-owned by TransCanada, the Alaskan Northwest Natural Gas Transportation Company ("ANNGTC"), holds the certificate issued by the United States Federal Regulatory Energy Commission under the Alaska Natural Gas Transportation Act ("ANGTA") and under the Natural Gas Act for the Alaska portion of the Project, which regime was enhanced and confirmed under the enabling legislation;

3. TransCanada holds key land and environmental permits in Alaska, including significant Corps of Engineers Clean Water Act wetlands permits, existing right of way over Federal lands along the route in Alaska, and a completed application for right of way over State lands along the route, that is pending, awaiting final decision by the State;

4. TransCanada's rights in Yukon pursuant to the NPA include the easement for the entire route in Yukon, which easement is recognized in the Umbrella Final Agreement amongst the Government of Canada, the Government of Yukon and the Council of Yukon First Nations, acting on behalf of the 14 First Nations of the Yukon;

5. TransCanada has invested 1.7 billion dollars[1] in the so-called "Pre-build Facilities" (the "Pre-build"), which were constructed pursuant to the NPA by Foothills in the early 1980's (and have been expanded pursuant to the NPA five times since, most recently in 1998) as the southern-most segments of the Alaska Highway Pipeline Project in order to allow for the delivery of much needed Canadian natural gas supplies to U.S. markets, pending the flow of Alaska gas;

6. TransCanada is North America's largest gas transmission company, owning approximately 30,000 miles of natural gas transmission infrastructure in Canada and the United States, including approximately two thirds of the take-away gas transmission capacity which is likely to be utilized to transport Alaskan gas from the Alberta hub to markets; and

7. TransCanada has world renowned expertise in the construction and safe, reliable operation of large diameter, cold weather pipe.

[1] All references in this Public Comment to dollars are referenced in Canadian dollars.

2. TransCanada's Facilitation of the Project

TransCanada has worked hard over several decades, and particularly since the gas commodity price has risen to a level that supports the Project, to ensure the readiness of those aspects of the Project within its control. To that end, it has (i) constructed and maintained its significant physical assets in the Project; (ii) increased its ownership in the Project both in Canada and in Alaska; (iii) continued to invest in maintaining the Project; (iv) resolved potential impediments to the Project in Canada; and (v) created and supported the development of momentum for the Project in Alaska, Washington, D.C. and in Canada. TransCanada and its subsidiaries have invested 1.7 billion dollars in the Prebuild in Canada, and an additional 0.4 billion dollars to develop the Project, including most recently, 8 million dollars spent on two Alaska initiatives—an application for the right of way easement over State lands along the route, and the development of a contract with the State of Alaska under the Stranded Gas Development Act.

TransCanada believes the Project is of critical importance to Alaska, Canada, and the Lower 48 States. Therefore, TransCanada made the difficult but strategic choice not to oppose the initiative of the ANS Producers to seek U.S. Federal enabling legislation (the "Alaska Natural Gas Pipeline Act" or "ANGPA"). This decision was made notwithstanding that another of TransCanada's wholly-owned subsidiaries, ANNGTC, already holds the certificate for the Alaska portion of the pipeline pursuant to the existing ANGTA law.

This was a deliberate choice made by TransCanada in the spirit of compromise. In that same spirit, TransCanada has publicly indicated to the ANS Producers and to others, including the State of Alaska, that it is prepared to forego its rights in Alaska and contribute its valuable assets to the Project, provided that its rights in the Canadian portion of the Project are respected and accommodated in a commercial resolution.

TransCanada has respected the rights of Alaskans to determine the manner in which they choose to develop the Project in Alaska. It has taken major steps in Alaska only by invitation of the State. Such steps have included TransCanada's application for right of way over State lands along the route of the Project in Alaska, and our application under the SGDA. Both of these steps were taken by TransCanada, and pursued vigorously and at some considerable expense, pursuant to a Memorandum of Understanding between the State of Alaska and TransCanada dated April 19, 2004 which is part of the public record. In the spirit of advancing the Project, without reducing the State's flexibility regarding the ultimate outcome, TransCanada agreed to convey any assets granted pursuant to those initiatives, to a third party (such as the ANS Producers or a project jointly pursued by the ANS Producers and the State) entitled to own and construct the Project in Alaska, if that third party would contractually agree to connect the natural gas transmission facilities within Alaska at the Alaska/Canada border with pipeline facilities to be constructed by TransCanada along the highway route in Canada. That offer remains on the table today.

The State's process for reviewing TransCanada's right of way lease application (including the public hearing process) was completed at the end of 2004. The application awaits only a final

decision by the State. Vigorous negotiations between the State and TransCanada to develop a contract under the Stranded Gas Development Act were substantially completed in principle in May of 2005, before the State chose to suspend such negotiations in order to focus its efforts on finalizing the Contract with the ANS Producers. Both of these initiatives have substantially assisted the State in its efforts to progress the Project.

3. *TransCanada's Comments on Ownership and Regulation of the Canadian Portion of the Project*

TransCanada does not choose at this time to comment on the majority of the provisions of the Gas Line Contract that Alaskans must evaluate. Our comments will be confined to the issues that directly affect TransCanada's interest in Canada -- ownership of the Project in Canada and regulation of the Canadian portion of the Project.

The manner in which the Gas Line Contract deals with ownership and regulation of the Canadian portion of the Project will have a significant impact on the success of the Contract in ensuring an early Project. To fully evaluate the Contract, Alaskans must understand; (i) the conflict between the proposed provisions of the Contract and existing law in Canada relating to the Canadian portion of the Alaska Highway Pipeline Project; (ii) the history and status of TransCanada's existing rights to own and construct the Canadian portion of the Project; (iii) our corporate obligation to defend our rights to the Canadian portion of the Project for the benefit of our shareholders; and (iv) the potential for impact on the Project, if those rights are disregarded in the final Gas Line Contract adopted by the State.

I <u>*Ownership*</u>

a. <u>*Contract Ownership Provisions*</u>

The Contract provides for ownership of what is defined in the Contract as the "Alaska to Alberta Project" on an 80/20 basis; 80% to be held in the aggregate by the ANS Producers and 20% to be held by the State. Ownership in the remainder of the Canadian portion of the Project – defined in the Contract as the "Alberta to Lower 48 Project" is provided for in the Contract as follows:

> "The State shall own, directly or indirectly through a State-owned entity, an interest in the Alberta to Lower 48 Project, if newly built or acquired by any Person in which Affiliates of all the Producers have an ownership interest, in a share commensurate with the expected throughput of State Gas, as estimated when that Project Entity is formed."

Ownership in the Alaska to Alberta Project is proposed in the Contract in the same manner as the ownership structure being proposed for the Alaska portion of the Project (the "Mainline", as defined in the Contract). It should be noted that there is no reason that the ownership structure in Canada and Alaska must be the same. In fact, since the Project's original conception, ownership of the Canadian and Alaskan portions of the Project have been different, with ownership in Alaska being held principally by American interests and ownership in Canada being held

principally by Canadian interests. This difference is a fundamental element of the Agreement between Canada and the United States on Principles applicable to a Northern Natural Gas Pipeline (the "Canada/US agreement" or the "Treaty") that allows for a pipeline to transit our natural gas producing nation in order to transport American gas to market.

b. Canadian Law

The aforementioned Contract provisions propose an ownership structure that is inconsistent with the rights conveyed by existing Canadian law to TransCanada's wholly-owned subsidiary, Foothills and the investments made in reliance on those rights. They ignore the fact that the Government of Canada has awarded to Foothills, the exclusive rights to build the Canadian segments of the Alaska Highway Pipeline Project. These rights were granted to Foothills after a lengthy, competitive regulatory proceeding before the National Energy Board (the "NEB" or the "National Energy Board"). (The full history of these rights is described Appendix "A"). Briefly:

- The decision of the NEB in favour of Foothills was enshrined by an Act of the Canadian Parliament in the *Northern Pipeline Act* (the "NPA" or the "Northern Pipeline Act"), which statute specifically names Foothills as the party entitled to own and construct the Canadian portion of the Project;
- The "Canada/US Agreement" was entered into between the Government of the United States and the Government of Canada specifically naming Foothills as the party entitled to own and construct the Canadian portion of the Project;
- The NPA remains in full force and effect in Canada and the Treaty remains in full force and effect in both the U.S. and Canada; and
- Neither the NEB's decision in favour of Foothills nor the NPA contains a "sunset" provision or termination date for the certificate granted to Foothills (as the National Energy Board would normally have done in awarding a certificate).

This is a unique regulatory, legislative and treaty structure, created because of the importance of Canadian ownership of the Canadian segment and the certainty required by the Project. There is no evidence that either the Canadian or the United States governments intend to change this regime in Canada. The Canadian Government has, in the past, reaffirmed the continued vitality and importance of the regime and the U.S. government has maintained that the ownership of the Canadian portion of the Project is a matter for Canadians to decide.

Reopening this structure would adversely affect the Project in two ways. First, the parties and the Governments of Canada and the U.S. would need to negotiate significant issues related to the Project between Canada and the U.S. afresh. Second, any such negotiations would be accompanied by TransCanada's defence of its existing rights, which rights TransCanada would rather use to further the Project. Delay to the Project would be the inevitable and unfortunate result.

c *The Project is Precisely the Project Originally Conceived*

The Project envisaged under the Contract, after much debate and study by the ANS Producers on route selection, is precisely the project that was first envisaged under both the NPA and the Treaty, that being, as defined under the NPA, a "pipeline for the transmission of natural gas from Alaska across Canada along the route set out in Annex I to the Agreement" (which route is the Alaska Highway route). Complications related to the delivery of natural gas from the Mackenzie Valley that existed at the time have now been resolved by a separate Mackenzie Valley pipeline, making the provisions of the NPA that allowed such gas to be addressed in the future, if required, unnecessary. The Foothills certificate, as issued under section 21 of the NPA, relates to precisely the facilities that are required today.

Foothills has already constructed what has now become known as the Pre-build of the Alaska Highway Pipeline Project, under its NPA certificates. These facilities have transported Alberta gas while awaiting the economic conditions under which Alaskan gas would flow. Since the Pre-build was constructed, the Northern Pipeline Agency has approved, and Foothills has constructed, five expansions to these facilities pursuant to the Northern Pipeline Act, the latest of which was awarded in 1998. These investments were made in reliance on the rights awarded to Foothills pursuant to the NEB decision, the NPA and the Canada/US Agreement.

d *The Passage of Time Has Not Undermined the Predicates of the NPA Approvals*

Economics confirm that connecting Alaskan gas to existing natural gas transmission facilities at Boundary Lake, on the British Columbia/Alberta border as contemplated under the NPA routing, creates the lowest pipeline transportation tolls to deliver Alaska gas through Alberta to North American markets. The existence of spare capacity on TransCanada's Alberta System is forecast to reduce to minimal levels the need for any new facilities to transport Alaska gas within the Province of Alberta and beyond. TransCanada, as the owner of the Alberta System, is uniquely positioned to make these lower costs and lower tariffs available to increase netbacks to the ANS Producers, and the State of Alaska as the owner and shipper of royalty gas.

Some parties have argued that the NPA authorized only a narrowly defined project and cannot be used to construct the Project or to make the adjustments necessary to allow the use of the Alberta System to reduce costs and tariffs. This view is simply not consistent with the statutory provisions of the NPA. The Project approved in the NPA did not dictate or freeze design, pipe size, operating pressure or gas volumes. Instead, the NPA is a flexible regime that calls for approval, upon rigorous review, of a design that meets current requirements and provides, as well, for the meeting of modern standards in all areas, including environmental and First Nations consultation. Discretion is specifically granted to the Designated Officer appointed from the NEB pursuant to the Act, to approve the specific plans for the pipeline as they are developed. The Canadian part of the Project would be developed and constructed by TransCanada pursuant to the NPA to meet all modern standards; in the same manner as all Phase I construction (the Prebuild and all five subsequent expansions) has met such modern standards.

e. *The Canadian Portion of the Project Should Be Built Pursuant to the NPA*

Whether the Alaskan portion of the pipeline is built under either the existing ANGTA regime, which remains valid and was affirmed under ANGPA, or constructed under the Natural Gas Act pursuant to ANGPA, TransCanada's rights to construct the Canadian portion of the Project along the Alaska highway route under the NPA remain valid with respect to the ownership and construction of the Canadian portion of the Project.

The fact that the Project has not yet been constructed is due to the fact that the Project has simply been suspended because, due to natural gas prices, the ANS Producers have taken the gas that was to have been transported on the Project as originally conceived and re-injected it for decades. It is in no way attributable to any fault or omission on the part of Foothills, or as some would suggest, to the age or applicability of the U.S. and Canadian approvals which Foothills holds for the Project. Those approvals, and the rights they provide Foothills, remain valid, intact, and in force.

In summary, the ownership of the Canadian portion of the Project has already been determined by the NEB in favour of Foothills and acted upon by the Northern Pipeline Agency in relation to the Prebuild segment of the Project as recently as 1998. The Contract should not be ratified unless and until ownership of the Canadian portion of the Project is resolved to the satisfaction of Foothills as the holder of the existing certificates in Canada. TransCanada has made clear that it stands ready to collaborate with Alaskan interests to move the Project forward.

II *NEB Jurisdiction under the Contract*

Article 8.2 of the Contract requires the State and the ANS Producers to "seek and support the exclusivity of ... NEB's jurisdiction as described in Article 8.1 in any agency or court proceeding" relating to the Canadian portion of the Project. No mention is made anywhere in the contract of the existing regulatory regime in Canada or of the Northern Pipeline Agency, which was created specifically and solely for this Project pursuant to the Northern Pipeline Act.

a. *Obligation to Seek "Exclusivity of NEB Jurisdiction"*

Article 8.2 of the Contract completely disregards the Canadian legislation that was specifically designed to establish both ownership and regulation of the Canadian portion of the Project. The covenant of the parties to seek the exclusive jurisdiction of the NEB for the Canadian portion of the Project either dismisses or ignores the fact that the NEB already has conducted and concluded a competitive proceeding for the right to own and construct the Project, which resulted in a decision in favour of Foothills, as described in Appendix "A". The provisions of the NPA enshrine the regulatory rights of Foothills statutorily, and grant to the Northern Pipeline Agency sole authority over the further development of the Project by Foothills, pursuant to an expeditious, single window regulatory regime. Any residual jurisdiction of the NEB for the initial Project, is confined to the regulation of tolls and tariffs for the pipeline, once the Project is in service, as specifically provided for under the NPA.

In addition, a covenant to seek regulatory approval for the Project in Canada from the NEB is inconsistent with the history of regulatory approvals granted by the Northern Pipeline Agency pursuant to the Northern Pipeline Act for the Pre-build and five expansions.

b *No Canadian Enabling Legislation*

It must be stressed that the Government of Canada has not chosen to enact any legislation in Canada that is parallel to the U.S. ANGPA, nor has it signalled that it has any intention to do so or to repeal the NPA. Enabling legislation was identified by the ANS Producers as a prerequisite for the development of the American portion of the Project. The ANS Producers may also seek similar special legislative and regulatory procedures in Canada.

There can be no assurances that Canada will enact legislation that undermines the NPA or creates a special regulatory structure for the Project. The last formal statement by the Canadian Government reaffirmed the NPA. Furthermore, TransCanada would vigorously oppose any such legislation in Canada and would pursue its legal remedies for compensation for its lost opportunity and other damages.

c *NEB Jurisdiction Does Not Provide Project Expedition*

The covenant of the proposed Contract that would bind the parties to seek the exclusivity of NEB jurisdiction would deny the Project proponents the unique benefits of the expedited, single window regulatory regime of the Northern Pipeline Agency, created under the Northern Pipeline Act, as well as the significant advantage of the existing determination under the NPA regime that the Project is in the public interest in Canada. In addition, it would deny the Project the benefits of the land rights and environmental permits held by Foothills for the Project including, significantly, right of way over Federal lands in Alaska (and potentially State lands, if the pending right of way is issued to Foothills), and the easement across Yukon, which has been acknowledged in the Umbrella Final Agreement by the Council of Yukon First Nations.

The benefits of the NPA are real and significant. Absent the benefits of the NPA, the Mackenzie Valley pipeline project regulatory process is anticipated to take up to 48 months in total, with 12 months of oral public hearings. Even if the NEB could be made applicable to the Project, it does not provide the same unique, expediting regulatory features that are available under the NPA and would have to adjudicate the fundamental issue of the public interest of the Project.

III *Alaskans Will Bear the Consequences of These Regulatory Impediments under the Contract*

The subject of work commitments is dealt with in Article 5 of the Contract. The ANS Producers are required to proceed with "due diligence", but they are relieved of any obligation to proceed by sub-sections (ii) and (iv) of Article 5.5(b) of the Contract, which state:

"(ii) Project planning and other Project development activities may be adversely impacted by Canadian regulatory processes or Canadian aboriginal issues. If the State seeks to terminate this Contract, and delays or other Project impacts are related to Canadian regulatory processes or Canadian aboriginal issues, the Tribunal shall be instructed that in determining whether the Participants have not acted by Diligence that other major pipeline projects have experienced delays in Canada"

"(iv) A Party is not required to enter into a commercial arrangement or settle a dispute with another Person. The failure to take such action may not be used as evidence to support termination of this Contract"

Thus, the State of Alaska will lose the benefit of the work commitments until regulatory issues are resolved in Canada. In sharp contrast, a project in which TransCanada owns the Canadian section can provide the State of Alaska with the benefits of the NPA structure and maintain the continuing obligation of the ANS Producers to pursue their work commitments with due diligence. The provisions of the Contract requiring the State and the ANS Producers to own 100% of the Canadian portion of the Project and obligating them to seek the exclusive jurisdiction of the NEB for the Project in Canada are certain to cause confrontation in Canada, unless changed to accommodate the rights of Foothills under existing certificates. Such confrontation can reasonably be anticipated to delay the Project. The provisions of Article 5 provide the State with no remedy if that delay occurs. The Project could be stalled indefinitely for the length of the term of the Contract without recourse by Alaskans.

4. TransCanada Must Defend its Rights in Canada

In reliance upon the rights that were bestowed upon Foothills pursuant to the NEB hearing, the Treaty and the NPA and in anticipation of the exercise by Foothills of its rights to complete the Project, TransCanada has invested billions of dollars in:

(i) existing Pre-build infrastructure, for which only half of TransCanada's investment has been recovered to date;

(ii) maintaining permits and existing land rights;

(iii) research and development costs for completion of the Project;

(iv) maintaining aboriginal relations along the route; and

(v) completing acquisitions which have provided TransCanada with a 100% per cent interest in Foothills.

The lost opportunity cost that would result if TransCanada was to be deprived of its right to complete the Project, is significantly higher.

It is not TransCanada's desire to reduce this issue to a legal adjudication of its rights in Canada. However, if the interests of TransCanada in the Canadian part of the Project are not

accommodated in a satisfactory manner through good faith commercial negotiation, TransCanada will be compelled, on behalf of its shareholders, to defend those interests, both in regulatory, judicial and other public forums. Litigation would embroil the Project in delay, which is not in the interests of any of the stakeholders. More importantly, it would have the effect of hardening the parties against the creation of the optimal commercial outcome.

5. TransCanada Remains Ready, Willing and Able to Expedite the Project by Constructing, Owning, and Operating the Canadian Segment of the Project

TransCanada continues to initiate, as it has for some number of years, the negotiation of a reasonable commercial resolution with the ANS Producers in the context of its NPA rights in Canada. We have proposed to add significant value to the Project, not only through the conveyance to the Project of certain substantial land rights and environmental permits (including those that are pending in the State of Alaska), but as well through commercial mechanisms for risk mitigation and sharing, appropriate to the relative risk and reward of pipeline investments. Those proposals are well known to the ANS Producers and the State of Alaska.

TransCanada has an enviable track record in bringing major projects in on time and on budget. The contributions that it can make to both the Alaskan and the Canadian sections of the Project will ensure that the Project is delivered faster, better and cheaper than any alternative that excludes TransCanada ,

It is time for the parties to come together to bring this important energy infrastructure project to fruition as soon as possible in a way that will provide the anticipated benefits to both Canada and the United States and to meet the growing demands in North America for gas supply. Alaskans should insist on amendments to the Contract or should set aside the Contract until the parties are finally brought together.

TransCanada looks forward to working with the State of Alaska, the ANS Producers and others to achieve, at long last, the agreements and cooperation needed to enable the Project to take its next steps.

Yours truly,

Dennis McConaghy
Executive Vice-President,
Pipeline Strategy and Development

Appendix "A"
Historical Background on TransCanada's Rights under the Northern Pipeline Act

a. ***The NEB Proceeding***

The principal objectives of the initial NEB process were to establish whether or not to permit the construction of a gas pipeline in the Western Arctic, and if so, to determine the Canadian routing for the Project, the successful Project proponent, and whether the Project met the NEB statutory standard of being in the "public convenience and necessity". A process to determine essentially the same issues for the American part of the pipeline was unfolding in the United States, where an additional option of an "all-American" route was considered. Without complementary findings on these critical issues on both sides of the border, the pipeline could not have proceeded to the next stage of international agreement.

The NEB found in favour of the Alaska Highway route, it found in favour of Foothills as the party entitled to hold the ownership and development rights for the Project and it resulted in a finding that the Project met the NEB's standard of public convenience and necessity. Shipping agreements had not yet been entered into for the Project, pending the establishment of the unique bilateral framework between Canada and the United States that was required to establish the benefits to Canada of a project that would transit its territory. Pending the commitment of natural gas volumes to the pipeline, it was not possible in the initial NEB proceeding to definitively finalize all matters such as those related to size and design. The framework for finalizing those matters later was therefore explicitly created under the NPA.

b ***The Canada/US Agreement and the Enactment of the NPA***

Following the NEB hearing, a bilateral agreement relating solely to the Project, was then entered into between the Governments of Canada and the United States which specifically recognized the rights of Foothills to own and construct the Project (the "Canada/US Agreement" or the "Treaty", which was made part of the NPA, as Schedule I of that Act). The specific recognition of Foothills' rights within the Canada/US Agreement is a significant fact. It would not have been necessary to enshrine an acknowledgement of Foothills' rights within the Treaty, if the selection of that particular Canadian entity for the Canadian portion of the Project had not been an important outcome for the Canadian negotiators of that Treaty. The Treaty "evergreens", allowing for termination after a period of 35 years, only in the event that one of the Governments provides at least one year's notice to the other of a desire to terminate.

It was not until the NEB hearing had been concluded, and the Treaty entered into, that the NPA was enacted. The NPA statutorily enshrined the selected routing, and the successful proponent, being Foothills. It also created the single window regulatory regime of the Northern Pipeline Agency that would apply to the approval of all matters required for the further development of the Project. The regulatory regime created pursuant to the Northern Pipeline Act was designed to be flexible enough to allow for a rigorous review of all such matters, including environmental matters, subject only to not revisiting the fundamental finding that the Project is in the public interest and will proceed. Further, there was no "sunset" or expiry date placed on the certificates granted to Foothills by either the NEB

(which would have been the norm) or under the NPA, doubtless in recognition of the fact that the commitment of natural gas volumes to the pipeline had not yet been made.

Subsequent to the completion of the NEB hearing, the execution of the Treaty and the enactment of the NPA, the parties that had competed in the hearing and lost did not choose to pursue any legal or regulatory remedy to challenge the result. Such parties recognized the finality of the outcome, not only as evidenced by the NEB decision, but as evidenced as well by the highly unusual enshrining of the rights of Foothills in both the Canada/US Agreement and the Act. Property rights had been bestowed, a unique regulatory regime had been created which would govern the development of the Project indefinitely, and the matter was closed.

c. *Complementary Applicability of Two Regulatory Regimes*

The two processes of the NEB and the Northern Pipeline Agency are integrally related for this unique Project. Separate jurisdiction of the two regulatory regimes over different aspects of the Project is recognized in the NPA framework, and the jurisdiction of the two regimes is complementary in design. The NEB presided over the original hearing of this matter. It will preside over the Project again in relation to matters related to the approval of tolls and tariffs, once the Project has been constructed and it will preside over any approvals of subsequent expansions. The Northern Pipeline Agency has jurisdiction over the development of the initial construction of the Project, which involves such unique bilateral aspects and requirements for expedition that it is codified statutorily separately from the standard NEB processes.

Administratively, the regimes of the NPA and the NEB are linked. The NPA provides that the designated officer appointed to administer the Northern Pipeline Agency will be a member of the National Energy Board. Subsection 5 of Section 12 of the NPA, provides for the secondment to the Northern Pipeline Agency, at the Minister's direction, of any officers and employees from any department or agency of the Government of Canada.

The drafters of the NPA framework created a unique regulatory regime that is practical, and at the same time, nothing less than visionary, for the Project.

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STATE OF ALASKA

SARAH PALIN, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

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The Honorable Ralph Samuels
House Majority Leader
Alaska Representative
State Capitol, Room 204
Juneau, AK 99801-1182

March 23, 2007

Dear Representative Samuels:

Attached to this letter are memoranda prepared by Greenberg Traurig prior to the introduction of AGIA.

As you'll recall, the January 17, 2007 agreement between the administration and legislature sets out the conditions under which written communication between the Administration and Greenberg prior to the AGIA's introduction are to be handled.

> "Prior to the introduction of the legislation, GT's work product provided to the Administration would not be disclosed to the legislature. After the legislation is introduced, GT's written communications to the Administration would be provided to the Legislature by the Administration (subject to any confidentiality requirements deemed appropriate by the administration) and GT would be free to advise the Committee regarding that legislation."

Consistent with that agreement, the legislature may release the documents attached to this memo as it desires, with the understanding that the administration and legislature are waiving their right to attorney/client privilege with respect to the attached material only.

Greenberg has also produced a number of documents relevant to AGIA since the bill's introduction. Because the administration and legislature have common interests and have both retained Greenberg for similar tasks related to AGIA, the administration will also provide access to written communications generated by Greenberg related to AGIA produced after AGIA's introduction. However, because these documents may raise issues of protected attorney/client communications, if the legislature desires the public release of any particular post-introduction documents, please contact me to discuss whether release is appropriate. The administration will, of course, endeavor to provide the widest dissemination of relevant analyses concerning AGIA consistent with protecting the attorney/client privilege.

As I described above, although the agreement only applies to documents prepared by Greenberg prior to the introduction of AGIA, the administration is prepared to provide documents produced by Greenberg after introduction, but in a manner that does not inadvertently waive privileges.

Please let me know if you have any questions or comments.

Sincerely,

Patrick S. Galvin
Commissioner

Enclosures: Alaska Correspondence

cc: Larry Ostrovsky, Assistant Attorney General, Department of Law, Alaska
Don Shepler, Attorney, Greenberg and Traurig

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ATTACHMENT

Attachment 1

Greenberg Traurig

Memorandum

TO: Larry Ostrovsky, Chief Assistant Attorney General

FROM: Phillip C. Gildan
Marvin A. Kirsner

DATE: February 7, 2007

RE: Alaska Gasline Incentive Act: Commerce Clause Issues

PRIVILEGED AND CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION AND ATTORNEY WORK PRODUCT

You have requested we review the potential impact of the United States Constitution Commerce Clause, U.S. Const. Art. § 8, cl. 3 (the "Commerce Clause"),on potential options to incentivize the construction of a natural gas pipeline that could be considered for inclusion in an Alaska Gasline Incentive Act ("AGIA").

Over the last thirty years most States have enacted various laws creating incentives for businesses to locate, remain, and expand in the State ("Business Incentives"). Most States have also enacted laws imposing State hire and State resource obligations ("Local Preferences") on government related or funded infrastructure projects. Each of these laws potentially have an impact on interstate commerce, with such potential implicating the Commerce Clause.

In general terms, the Commerce Clause authorizes Congress to regulate commerce among the States, and implicitly limits States from enacting laws that impede interstate commerce. Generally States may not levy discriminatory taxes on interstate economic activity, with taxes broadly to include not just tax levies, but tax exemptions or their equivalent. Despite this broad scope, a body of Federal case law has developed over the last 30 years that has permitted certain Business Incentives and Local Preferences, and has defined what is impermissible under the

Commerce Clause. The following sets forth a brief discussion of certain of the more recent Federal cases addressing these Commerce Clause standards and how they may inform the crafting of Business Incentives and Local Preferences for the AGIA.

I. *Cuno v. DaimlerChrysler, Inc.*, 386 F. 3d 738 (6th Circuit 2004)

The State of Ohio adopted an investment tax credit against the state's corporate franchise tax if a business bought machinery and equipment and installed it at a business location in Ohio. DaimlerChrysler sought to utilize the investment tax credit, together with a property tax exemption from the City of Toledo and two local school districts. Ohio taxpayers challenged the investment tax credit and the property tax exemption as violating the Commerce Clause because they had the effect of "coercing businesses already subject to the Ohio franchise tax to expand locally rather than out-of-state." *Id.* at 743. The Sixth Circuit Court of Appeals agreed as to the investment tax credit and disagreed as to the property tax exemption. The Court approved use of a property tax exemption because the favorable tax treatment was "related to the use or location of the property itself." *Id.*, at 746. Notably, in invalidating the investment tax credit, the Court compared the invalid tax credit with a direct state subsidy, suggesting that a direct subsidy from the state would not have violated the Commerce Clause because it doesn't regulate interstate commerce through the state's power to tax. While not an issue before the Court and thus not binding as case law precedent, there appears to be strong indication that if the issue of a direct subsidy were to come before the federal courts, that direct subsidies would likely be upheld as not violative of the Commerce Clause.

II. *DaimlerChrysler, Inc. v. Cuno*, 126 S. Ct. 1854 (2006)

DaimlerChrysler appealed the Sixth Circuit Court's opinion above (Cuno I) to the Supreme Court. The Supreme Court reversed the Sixth Circuit Court's decision on procedural standing grounds, without getting to the merits of the Commerce Clause challenge (Cuno II). While this decision restored the DaimlerChrysler tax credit, one could anticipate that the Sixth Circuit Court would again invalidate an incentive tax credit program under the Commerce Clause if a party with standing were to challenge it. The notable aspect of this decision is the elimination of a class of potential challengers to a business incentive tax credit program. The Supreme Court ruled that neither state nor local taxpayers had standing to challenge the Ohio investment tax credit. The implication from the Court's ruling was that only businesses directly impacted by the discriminatory tax credit (presumably business competitors who did not receive the reduced cost benefits of the tax credit) would have standing to raise the Commerce Clause challenge.

III. *New Energy Co. of Ind. v. Limbach*, 108 S. Ct. 1803 (1988)

In another Ohio business incentive program, Ohio had enacted a tax credit against the state motor vehicle fuel sales tax for each gallon of ethanol sold if the ethanol was produced in Ohio. This time an out-of-state ethanol competitor brought a Commerce Clause challenge, and accordingly the Court reached the merits of this claim. The Supreme Court agreed with the competitor that the incentive tax credit violated the Commerce Clause. It stated the standard for review as, "[t]his "negative" aspect of the Commerce Clause prohibits economic protectionism-that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors. . . .Thus, state statutes that clearly discriminate against interstate commerce are routinely struck down . . . unless the discrimination is demonstrably justified by a valid factor

unrelated to economic protectionism. . ." *Id.*, at 1807 (citations omitted). The Court further suggested that incentives utilizing the state's taxing power would have a difficult time passing muster, "[o]ur cases leave open the possibility that a State may validate a statute that discriminates against interstate commerce by showing that it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives. . . . This is perhaps just another way of saying that what may appear to be a "discriminatory" provision in the constitutionally prohibited sense-that is, a protectionist enactment-may on closer analysis not be so. However it be put, the standards for such justification are high." *Id.*, at 1810. Notable in this decision is the Court's discussion about subsidies versus tax credits: "[d]irect subsidization of domestic industry does not ordinarily run afoul of that prohibition [interference with interstate commerce]; discriminatory taxation of out-of-state manufacturers does." *Id.*

IV. *White v. Massachusetts Council of Construction Employers, Inc.*, 103 S. Ct. 1042 (1983)

This case involves a challenge to a Local Preferences law enacted by the Mayor of the City of Boston for all construction projects funded in whole or in part by city funds or funds the city had authority to administer under federal grant programs for urban development. While the Court rejected a Commerce Clause challenge related to those projects funded by city funds under a "market participant" exception, the notable aspect of the case was the Court's decision rejecting the Commerce Clause challenge for those federally funded projects the city was administering under the federal grant programs. Here the Court announced a different exception, stating, "[w]here state or local government action is specifically authorized by Congress, it is not subject to the Commerce Clause even if it interferes with interstate commerce." *Id.*, at 1047. Accordingly, if Congress

enacts a law that would allow or be compatible with local preferences (or arguably Business Incentives), then the State or local government enacting such a program would not be subject to a Commerce Clause challenge.

This aspect of the Court's decision may have implications to the potential incentive options under AGIA based upon the provisions of the Alaska Natural Gas Pipeline Act enacted by Congress ("ANGPA"). Arguably, ANGPA represents Congress's intent to incentivize the construction of the natural gas pipeline. Such intent, under the ***White*** decision, could be enough to justify most if not all Business Incentive options that could be envisioned for AGIA. Certainly, the more direct statements of Congressional intent in ANGPA regarding Local Preferences would appear to be sufficient to support most if not all Local Preferences options for inclusion in AGIA. As no case interpreting ANGPA has been brought to date, there remains the risk that a Court would not reach the same interpretation of the ***White*** decision as to a potential Commerce Clause challenge to potential incentive options eventually enacted under AGIA.

Conclusion

Based on the apparent current state of the case law as summarized above, it appears that a cash grant incentive program, properly crafted legislatively, would have the best likelihood of avoiding a potential Commerce Clause challenge. While we have found no decisions directly on point, the case law discussion regarding grant programs would appear to apply equally to a loan incentive program. Given the Congressional statements of intent in ANGPA to incentivize the development of a natural gas pipeline, good arguments exist under White to defend a properly crafted pipeline development/operations tax credit incentive program against a Commerce Clause challenge. However, while the Supreme Court in Cuno II has eliminated general tax-payer

Commerce Clause challenges to a tax credit incentive program, an Tax Credit incentive program enacted by the State could still face a Cuno I based Commerce Clause challenge from a competing pipeline company or other specially impacted business not able to benefit from the incentive program.

The foregoing conclusions reflect our best judgment on the Commerce Clause implications associated with Business Incentive and Local Preference program options. There can, however, be no guarantee that the courts or the appropriate authorities will agree with these conclusions if a challenge is brought, nor that any of the matters on which we relied will not change.

Attachment 2

Greenberg Traurig

Memorandum

TO: Larry Ostrovsky, Chief Assistant Attorney General

FROM: Phillip C. Gildan and Tim Wolfe

DATE: February 7, 2007

RE: Follow-up to U.S. Senator Ted Stevens Comments on Alaska Natural Gas Pipeline Project Development

---

On Monday, February 6, U.S. Senator Ted Stevens commented on the recently released FERC report that suggested the State's schedule for developing the Alaska Natural Gas Pipeline had "slipped considerably." He was quoted as stating, "I'm very concerned about it; it concerns me in that it lays out a problem that can't be solved here in Washington.." Senator Stevens has emphasized previously the Federal Government's continued strong support for the Natural Gas Pipeline project and the importance of the project National Security, and his continuing pledge to assist the State in its efforts to complete an agreement with all deliberate speed.

Towards that end, this memorandum sets forth a number of suggestions for Federal Government initiatives that could further enhance the economics and certainty of a Pipeline project, and work hand in hand with the incentive options proposed for the Alaska Gasline Inducement Act (AGIA).

Suggestion 1. Federal Authorization of Pipeline Project Finance as Tax-Exempt Bonds/Exempting Project Bonds from Private Activity Bonds State Cap

Under the current Federal Tax Code, debt financing for a Pipeline Project would not qualify for tax-exempt status on interest paid on the debt portion of a financing of a Pipeline Project (with the possible exception of a government-entity sponsored project) . If a Pipeline Project debt financing could be qualified for tax-exempt status, the cost of debt might be significantly reduced, thus improving the economics of the Project. For example, under an 80% debt to equity financing program, such reduction in interest payments, due to the difference in

interest rate between taxable and tax-exempt debt, could significantly reduce the overall cost the Project.

To authorize tax-exempt status on a Pipeline Project debt financing, possible suggested changes to the Federal Tax Code are set forth below. The first change (A) would include the project within the definition of exempt facility bonds. The second change (B) would remove the state private activity bonds volume cap from applying to the project. The third change (C) would exempt the project from restrictions on private activity bond issuance necessary given the multi-national/jurisdiction elements of the project.

A. Amend TITLE 26, Subtitle A, CHAPTER 1, Subchapter B, PART IV, Subpart A, Sec. 142 of the Federal Code to add natural gas pipeline projects to section 142(a) and a new section 142(n):

(a) General rule
For purposes of this part, the term "exempt facility bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide -

(16) Alaska natural gas pipeline projects.

(n) Natural Gas Pipeline Projects.- For purposes of subsection (a)(16), the term "Alaska natural gas pipeline project" means a qualified infrastructure project as defined in 15 U.S.C. 720n(g)(4), including facilities located outside of the governmental unit or the United States.

B. Amend TITLE 26, Subtitle A, CHAPTER 1, Subchapter B, PART IV, Subpart A, Sec. 146, to add an Alaska natural gas pipeline project as an exception to the private activity bond state volume cap.

g) Exception for certain bonds
Only for purposes of this section, the term "private activity bond" shall not include -

(3) any exempt facility bond issued as part of an issue described in paragraph (1), (2), (12), (13), (14), (15) or (16) of section 142(a)

C. Amend TITLE 26, Subtitle A, CHAPTER 1, Subchapter B, PART IV, Subpart A, Sec. 147(f) to add a new paragraph (5).

(5) Special Rule For Approval Of Alaska Natural Gas Pipeline Projects.- In the case of an Alaska natural gas pipeline project bonds issued for facilities located inside or outside the State issuing the bonds (or in which the governmental unit issuing the bonds is located) or outside of the United States, the State issuing the bonds (or in which the governmental unit issuing the bonds is located) shall be deemed to be the only governmental unit having jurisdiction over such facilities for purposes of this subsection.

Suggestion 2. Clarification and Enhancement of the Federal Loan Guarantee Program.

From the round-table discussions with the Administration and the Producers during last year's Legislative Special Sessions, it became apparent that certain important elements of the Federal Loan Guarantee program authorized under 15 U.S.C. 720n, remain uncertain, which uncertainty has diminished the potential utility and economic benefit of such program and could negatively impact structural elements of a proposed Pipeline Project. Elimination of this uncertainty and further clarification of the Loan Guarantee program benefits could enhance the project economics and provide greater flexibility regarding Pipeline Project structural elements. Possible suggested clarifications at the Federal level are set forth below:

A. Amend 15 U.S.C. 720n(f) to read as follows:

(f) Authorization of appropriations

There are authorized to be appropriated such sums as may be necessary to cover the cost of loan guarantees under this section, as defined by section 661a(5) of Title 21. Such sums shall remain available until expended. The Secretary shall not charge or pass-through the cost of loan guarantees under this section as a condition for issuing a Federal guarantee instrument.

B. Amend 15 U.S.C. 720n(b)(3) to read as follows:

(3) The Secretary shall not require as a condition of issuing a Federal guarantee instrument under this section any contractual commitment, guarantee or other form of credit support of the sponsors or project owners (other than equity or non-Federal guaranteed debt contribution commitments in amounts not more than the percentage of total capital costs of the project not covered by a Federal debt guarantee under this section), or any throughput, minimum volume, or other guarantee from prospective shippers greater than such guarantees as shall be required by the project owners.

Attachment 3

Greenberg Traurig

Memorandum

TO: Larry Ostrovsky, Chief Assistant Attorney General of the State of Alaska

FROM: Phillip C. Gildan
Marvin A. Kiraner

DATE: February 7, 2007

RE: Constitutional and Statutory Questions Raised As to Alaska Gasline Incentive Act: Can AGIA Propose to Provide Loans to Qualified Applicants? Can Loans be Provided Interest-Free? Can AGIA Propose to Provide Cash Payments to Qualified Applicants?

PRIVILEGED AND CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION AND ATTORNEY WORK PRODUCT

You have requested we review a number of questions arising out of the State of Alaska's ("State's") review of potential incentive options that could be available for inclusion in a Alaska Gasline Incentive Act ("AGIA"). The issues you have presented fall into two broad categories:

(1) whether, and under what circumstances, the State could provide loans (including interest-free loans) or direct cash payments as incentives ("Incentive Program") to applicants proposing to construct a pipeline(s) that would deliver natural gas from the Alaska North Slope to Lower 48 markets, in-State markets or overseas markets ("Pipeline Project"); and

(2) how such Incentive Program loans or direct cash payments would be treated for Federal Tax Purposes by the recipient of such loans or direct cash payments.

State Constitutional/Statutory Issues

A number of State Constitutional and Statutory provisions ("Laws") could impact the Incentive Program options listed in Issue 1 above. In summary, it appears that the Laws should not

present an impediment to utilization of loans or cash payments as part of an Incentive Program, provided appropriate legislation is enacted by the Legislature and approved by the Governor. A more detailed discussion of the impacts of the Laws is set forth below.

Constitutional Provisions

Article IX, § 6 of the Alaska Constitution provides: "No tax shall be levied, or *appropriation of public money made, or public property transferred, nor shall the public credit be used*, except for a public purpose" (emphasis added). This constitutional limitation applies as the use of interest free loans or direct cash payments to a private entity to incentivize the construction of a Pipeline Project would require the appropriation of public money (loan proceeds or cash payments), the transfer of public property (cash payments) and the use of public credit (loan proceeds). Accordingly, a public purpose for the use of loans and cash payments as part of an Incentive Program must be identified to overcome this constitutional barrier.

One such statement of public purpose for an Incentive Program that could potentially be utilized is set forth in Article XIII, § 2 of the Alaska Constitution which provides: "The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people." Presuming that the Alaska Legislature enacts appropriate and defensible preliminary findings concerning the public purpose of the Incentive Program, the public purpose requirement of the Alaska Constitution should be satisfied.

Statutory Provisions

While the provisions of Article IX, § 6 of the Alaska Constitution appear not to pose an insurmountable barrier to enactment of the Incentive Program, an existing Alaska statutory

provision could facially impose an additional barrier to the Incentive Program. AS 37.10.085 appears to raise a statutory limitation to the State providing loan proceeds or cash benefits to a private entity, notwithstanding a public purpose. It provides in pertinent part:

> (a) Except as provided in (c) or (d) of this section, *neither the state nor a political subdivision of the state may*
> (1) make a subscription to the capital stock of a corporation;
> *(2) lend its credit for the use of a corporation; or*
> *(3) borrow money for the use of a corporation.*
>
> . . .
>
> (d) This section does not apply to
> (1) the financial assistance program established under AS 37.17.500 - 37.17.690; or
> (2) investments of the assets of the public employees' retirement system established under AS 39.35 or the teachers' retirement system established under AS 14.25, to the extent the investments are made in the stocks, bonds, and other securities of
> (A) a corporation licensed under AS 10.13; or
> (B) a corporation attempting to become licensed under AS 10.13 if the corporation intends to use the proceeds to fulfill the tasks necessary to become licensed under AS 10.13.
> (emphasis added)

While the Incentive Program does not at this point deal with a subscription to the capital stock of a corporation, a broad interpretation of AS 37.10.085(a)(2) and (3) could implicate the Incentive Program. However, as can be seen from AS 37.10.085(d), the Legislature has previously created a number of exemptions to the prohibition AS 37.10.085(a), and presumably any proposed AGIA legislation could include an additional exemption for the Incentive Program. [Notably, AS 10.13, referenced in AS 37.10.085(d)(2), the Alaska BIDCO Act, establishes an existing loan and financial assistance program for private entities not unlike that proposed for consideration in the Incentive Program.]

Aside from AS 37.10.085, there does not appear to be any other overriding statutory provisions that would negatively impact the use of loan proceeds or cash payments as part of an

Incentive Program, except, perhaps, AS 43.82, the Alaska Stranded Gas Development Act. It is possible that the Legislative findings that would support the enactment of AGIA and the Incentive Program could be contradictory in whole or in part to the Legislative findings supporting AS 43.82. To avoid confusion and the potential for interpretive ambiguity, it may be prudent to synchronize the findings of the two Acts or perhaps repeal such provisions of AS 43.82 that are no longer applicable or would not be beneficial after enactment of AGIA.

Our initial review likewise did not uncover any obvious State statutory prohibitions against providing an "interest-free" loan option for the Incentive Program (although we have not reviewed State regulations which could potentially be pertinent to the issue). From a practical perspective, however, providing for repayment of an incentive loan without an accrual of interest, could alternatively be viewed as the State providing a "grant" to the private entity of the interest that would otherwise be due on a traditional loan (and as discussed below, it is possible that the Internal Revenue Service would so treat it for tax purposes). Seen from this perspective, the "grant" of interest should be treated like any other business development grant program that the State would put in place, provided again that sufficient Legislative findings and exemptions were enacted as above.

Another area that could raise a potential issue is the funding source for the Incentive Program, *i.e.*, where will the money come from to fund the program loans and cash payments (*e.g.*, dedicated tax revenues, general fund surpluses, bond proceeds, Alaska Permanent Fund, etc.). Depending on the source of the money, a number of other statutory provisions could be implicated. While examination of sources of funding is outside the scope of our current review, we would

recommend the State's bond counsel review these potential funding sources and any statutory limitations that may be attendant to the use of such sources.

Finally, with respect to Issue 1, as referenced above, the Alaska BIDCO Act, and the provisions of AS 37.17.500 - AS 37.17.690, may provide a useful template for crafting the administrative procedures attendant to an Incentive Program utilizing loans and cash payments.

Tax Treatment of AGIA Grants

We received a copy of the January 16, 2007, Black & Veatch Memorandum to Antony Scott from John Rohrbach re: Corporate Tax issues related to Alaska Gasline Inducement Act ("B&V Memorandum"). We were requested to comment on the B&V Memorandum regarding AGIA incentives received by companies proposing to construct a natural gas pipeline project ("Pipeline Entity"), and provide any additional insights on the issues the B&V Memorandum raised. A new development has occurred since the B& V Memorandum was prepared which requires additional discussion.

Many ventures that have received government grants have relied on Section 118 of the Internal Revenue Code to take the position that such government grants are not reportable as taxable income. As noted in the B&V Memorandum, Section 118 is the provision allowing tax-free contributions to the capital of the corporation. As also noted in the B& V Memorandum, the case law has allowed tax free treatment for many types of government grants in cases where the governmental entity giving the grant is not a shareholder of the corporation receiving the grant. Based on these cases, partnerships and limited liability companies which are pass-through entities for tax purposes, have also relied on Section 118 to avoid paying tax on governmental grants, even though they are not taxed as a corporation.

However, the IRS recently announced that it will disallow Section 118 treatment for receipt of non-shareholder contributions to partnerships, joint ventures and limited liability companies. The announcement, contained in LMSB-04-11 06-0 16 (dated December 28, 2006), states that Section 118 only applies to corporations, and therefore is not applicable to pass-through entities, such as

partnerships and limited liability companies. (See copy of LMSB-04-1106-016 attached as Appendix A.)

This means that the IRS would likely challenge Section 118 tax-free treatment on the receipt of government grants if a Pipeline Entity is structured not as a corporation, but as a partnership or limited liability company. [Note that the Pipeline Entities under Governor Murkowski's proposed Fiscal Contract were limited liability companies]. Because such entities are pass-through entities for tax purposes and have the benefit of a corporation's liability protection for its members, these entities have become an entity of choice in major infrastructure projects.

This new announcement from the IRS directed at non-corporate pass-through business entities, could be quite problematic for the potential Pipeline Entities that the State is seeking to target with AGIA incentives. Having to recognize an incentive grant as ordinary income for Federal tax purposes would undermine the potential value of a grant. Of course, from a practical perspective, any non-corporate entity accepting an incentive grant may likely have significant tax losses from early development expenses to potentially offset such income recognition, but the tax impact would become a factor in the business entity's Project economics analysis.

If, on the other hand, to deal with the IRS pronouncement, potential Pipeline Project joint venturers, (such as the major Alaskan oil companies, a group of independent pipeline companies, or a combination of the such entities and other financial partners (the "Investment Group")), form their entity as a corporation, then such corporation could receive a grant from the State that would be non-taxable as a contribution to capital by a non-shareholder under Section 118, as set out in the B& V Memorandum. However, in such a case, the Investment Group which would be the shareholders of the Pipeline Entity would not be able to file consolidated returns with the Pipeline

Entity, because to file a consolidated return, the filing company must own at least 80% of a subsidiary in order to file a consolidated return. If each member of the Investment Group owns a proportionate share of the stock of the Pipeline Entity, none would satisfy this 80% requirement for filing a consolidated return (which generally accounts for the use of limited liability companies for joint participation in major infrastructure projects). Thus, having to utilize a corporate entity to qualify for the Section 118 treatment would make a grant significantly less meaningful as an incentive.

Alternatively, it might be possible to structure a transaction where each member of the Investment Group forms its own wholly-owned pipeline subsidiary company. The state would award grants to each of the pipeline subsidiary companies. Since each of the pipeline subsidiary companies would be corporations, the benefits of Section 118 should be available to avoid payment of federal income taxes on the award of the grant. Each pipeline subsidiary company would, in turn, form a limited liability company, and contribute to the capital of the limited liability company its share of the state grant, plus other required capital contributions. The limited liability company, would then construct the gas pipeline. If this proposed structure is practical from a business prospective, then it would need further detailed review to have a reasonable certainty that this such structure would be accepted by the Internal Revenue Service. It is possible that the IRS might argue that the "Step Transaction Doctrine" would apply in such a case and treat the grant as a contribution directly from the State to the limited liability company, and disallow Section 118 treatment.

The IRS announcement could also be problematic for another set of potential participants in a Pipeline Project that the State may determine to target, private hedge funds. Private hedge funds

have recently been increasing their participation in major public infrastructure projects. Such private hedge funds are, for the most part, structured as either partnerships or limited liability companies that are pass-through entities and not treated as a corporation for tax purposes. Much of the economic benefit of an incentive program could be lost to such project participants if grants are treated as taxable income, absent utilization of a restructured program that would pass IRS muster, as discussed above.

Tax Ramifications From Interest Free Loans

If the Incentive Program is structured as an interest-free loan to the Pipeline Entity, then the federal income tax ramifications of below-market interest loans should be considered. These rules are found in Section 7872 of the Internal Revenue Code (the "Code"). This Code provision provides that certain types of loans (known as "7872 Loans") must provide a minimum yield. The minimum yield is known as the applicable federal rate or AFR. If a 7872 Loan does not provide for a yield at least equal to the AFR, interest will be deemed to have been paid by the borrower to the lender. In order to explain the fact that interest was not in fact paid, the Code deems a transaction[1] to have occurred with the interest essentially having been paid back from the lender to the borrower. The treatment of the deemed transaction back depends on the type of 7872 Loan. There is an exception from the application of the rules contained in Section 7872 for loans from a state, but only if the loan is a "type made available under a program of general application to the public."

Section 7872 Loans include compensation related loans.[1] A compensation related loan includes a loan between an independent contractor and the person on whose behalf the services are

[1] A corporation/shareholder loan is also subject to Section 7872. If the Pipeline Entity is structured as a corporation, there is a possibility that the IRS might try to classify the loan as a corporation/shareholder loan, even though the State might not technically be a shareholder. The IRS could conceivably make the argument that the nature of the State's interest in the Pipeline Entity could elevate the State to the position of a quasi-shareholder, if the final agreement gives

performed. Depending on the conditions to obtain a loan, it is possible that the IRS could take the position that an interest free loan to the Pipeline Entity is a compensation related loan. Even if the loan is not deemed a compensation related loan, there are two catch-all provisions that could cause the Section 7872 imputed interest rules to apply: (i) the tax avoidance loan rules and (ii) the significant effect rules.

A tax avoidance loan under Section 7872 is a below market interest loan where one of the principal purposes of the arrangement is the avoidance of any federal tax. A loan will be considered to have a principal purpose of tax avoidance where a principal motivation in structuring the transaction as a below market loan is to reduce the tax liability of the lender or borrower. If the Pipeline Entity is structured as a partnership or limited liability company, then the IRS could assert that the interest free loan is a tax avoidance loan. It is possible that the recent I.R.S. announcement indicating it will not allow Section 118 tax-free contribution to capital treatment for government grants to partnerships or LLC's is signaling an I.R.S. intent to crack down on tax-free treatment of all types of government grants. If this is the case, the I.R.S. might assert that an interest free loan to the Pipeline Entity as a tax avoidance loan.

A significant effect loan under Section 7872 is a loan arrangement that may have a "significant effect" on the tax liabilities of the parties involved. The IRS has been given the authority to publish regulations that would characterize an arrangement as a significant effect loan.

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the State some type of corporate oversight or equity rights. The State would need to carefully review the proposed structure of the relationship between the Pipeline Entity and the State once the structure has been determined, to analyze the risks of re-characterization as a corporation/shareholder loan. If the interest free loan is classified as a corporation/shareholder loan, then the deemed payment from the State to the Pipeline Entity would be characterized as a contribution by the State to the Pipeline Entity as a contribution to capital. This deemed contribution to capital should not be treated as taxable income as a contribution to capital as discussed in the B&V Memorandum, if structured properly. However, it would be necessary to carefully review the proposed Pipeline Entity and interest free loan structure in order to be certain of this result.

It is possible that the I.R.S. might publish regulations classifying interest free loans from government entities for economic development purposes as a "significant effect loan." In such a case, the proposed loan to the Pipeline Entity could become a 7872 Loan. It is far from clear how the deemed payment from the State to the Pipeline Entity would be characterized if the loan failed to be treated as a compensation related loan, but was treated as a significant effect or a tax avoidance loan.

If the loan is characterized as a compensation related loan (or one of the other types of loans subject to Section 7872), then the tax consequences to the owners of the Pipeline Entity would depend upon whether the loan is treated as a demand loan or a term loan. A loan with a definitive term will not be treated as a term loan if the benefits of the interest arrangements are (i) not transferable and (ii) conditioned on the future performance of substantial services by the borrower. If the loan is treated as demand loan under this rule, the foregone interest would be treated as a payment to the Pipeline Entity for services (or something else), followed by an interest payment to the State, in each year. These amounts will generally match but, as of the current time, there are substantial limitations on the ability of a corporation to deduct interest and the additional interest expense could have foreign tax credits consequences.

If the loan is treated as a term loan, the difference between the amount loaned and the present value of the obligation to repay the loan is treated as compensation (again, or something else) to the service provider in full in the year that the loan is made. This compensation would then offset by interest deductions over the duration of the term loan. Here, the owners of the Pipeline Entity would have a timing disadvantage: they would be required to include the full compensation element in income in the year that the loan was made and would have deductions in the future.

Again, there are substantial limitations on the ability of a corporation to deduct interest and the additional interest expense could have foreign tax credits consequences.

In the event an interest-free loan to the Pipeline Entity is classified as a Section 7872 Loan, resulting in the deemed receipt of interest by the State, this should not result in any taxable federal income to the State, because the State is exempt from federal income tax. The state, however, would have an information reporting obligation to report the deemed payment for services to the I.R.S.

Furthermore, beginning in 2011, state and local governments will be required to withhold three percent (3%) of all payments made to government contractors, pursuant to the Tax Increase Prevention and Reconciliation Act of 2005(Pub. L. No 109-222). This provision is codified in Section 3402(t) of the Code. See copy of Section 3402(t) reproduced as Appendix "B." If the loan is characterized as a demand loan, the imputed payment to the Pipeline Entity would not be treated as having been paid entirely in the year the loan was made. Thus, the withholding obligation (beginning in 2011) could have very negative tax consequences to the State, since the withholding obligation would be an out-of-pocket cash payment by the State (because there is no cash actually changing hands). It should also be noted that although these new withholding rules are not scheduled to go into effect until 2011, proposals are being floated in Congress to accelerate this date.

The details of the arrangement with the Pipeline Entity would need to be reviewed in detail in order to determine whether it might be subject to these rules. The impact to the Pipeline Entity cannot be ascertained until the details of the transaction are analyzed. Because there are many uncertainties regarding the federal tax consequences in connection with 7872 Loans to the Pipeline

Entity and to the State (such as a possible withholding obligation if the loan is classified as a compensation related 7872 Loan), the State should consider requesting a ruling from the I.R.S. once the structure of transaction has been finalized. Alternatively, the State could ask Congress to adopt legislation to exempt an interest free loan to the Pipeline Entity from the rules of Section 7872.

In the event an interest free loan from the State to the Pipeline Entity is characterized as a 7872 Loan, there is the possibility that another state (the "Taxing State") might seek to assert that Alaska is subject to the Taxing State's income or gross receipts tax in connection with any imputed interest that might be connected to the Pipeline Entity's activities in the Taxing State (there may also be similar Canada tax law implications, and accordingly you may wish to consider inquiring with Canada tax counsel regarding potential tax implications). For example, if the Pipeline Entity undertakes construction activities in a Taxing State, that Taxing State might argue that a portion of the imputed interest deemed to be received by Alaska should be allocated to the Pipeline Entity's activities in the Taxing State. Although a state government is immune from the payment of Federal income tax on its interest income, a state government that engages in business activities in another state might be required to pay income tax to such other state. This situation occurs in cases where a state pension fund engages in business activities in another state. In these cases, the state pension fund might be subject to taxation in a Taxing State. Likewise, a Taxing State could argue that interest income imputed to the State under Section 7872 could be allocated, in part, to the conduct of business in the Taxing State, if the Pipeline Entity has activities in the Taxing State. The actual details of the loan between to the Pipeline Entity would need to be reviewed in detail in order to

determine what, if any, state tax consequences such arrangement might create in another Taxing State.

One potential method to protect the State in such a situation would be for the Pipeline Entity to indemnify Alaska in connection with a claim by another Taxing State for any taxes due to such Taxing State. Alternatively, the State could ask the Taxing State for a tax ruling from the Taxing State. The ultimate solution to this risk would be to seek federal legislation that would prohibit a Taxing State from imposing a tax in connection with any matters arising from the Pipeline Project.

Tax Advice Disclosures:

This discussion only addresses United States tax issues, and does not address the tax ramifications of any other country, such as Canada. Canadian counsel should be engaged to determine the tax consequences of the transaction discussed in this memorandum.

To ensure compliance with requirements imposed by the IRS under Circular 230, we inform you that any us. federal tax advice contained in this communication (including any attachments), unless otherwise specifically stated, was not intended or written to be used, and cannot be used, for the purpose of (1) *avoiding penalties under the Internal Revenue Code or* (2) *promoting, marketing or recommending to another party any matters addressed herein.*

APPENDIX "A"

Date: Dec. 28, 2006

Full Text Published by [redacted]

INDUSTRY DIRECTOR DIRECTIVE ON SECTION 118 ABUSE

LMSB Control No. LMSB-04-1106-016
Impacted IRM 4.51.2

December 28, 2006

MEMORANDUM FOR
INDUSTRY DIRECTORS
DIRECTOR, FIELD SPECIALISTS
DIRECTOR, PREFILING AND TECHNICAL GUIDANCE
DIRECTOR, INTERNATONAL COMPLIANCE
STRATEGY AND POLICY

FROM:
Patricia C. Chaback
Industry Director
Communications, Technology and Media

SUBJECT:
Tier I Issue -- Section 118 Abuse Directive #1

This memorandum is intended to provide field direction on a Tier I issue relating to Section 118 abuse. While the core issue relates to whether or not income qualifies as a non-shareholder contribution to capital under I.R.C. § 118, this memorandum is intended to provide guidance relating to the applicability of this code section to payments received by partnerships.

Background/Strategic Importance:

Taxpayers operating in corporate and partnership form are using I.R.C. § 118 to exclude certain payments from gross income. The field should disregard I.R.C. § 118 arguments by a taxpayer operating in partnership form. I.R.C. § 118 is only applicable to corporations. I.R.C. § 118(a) provides that "[i]n the case of a corporation, gross income does not include any contribution to the capital of the taxpayer." Thus, taxpayers operating in partnership form cannot benefit from the use of I.R.C. § 118.

Issue Tracking:

UIL: 118-01-02 Non-shareholder Contributions

Planning and Examination Guidance:

Issue Identification: The issue can be identified via review of the Schedule M for income recorded on books but not included on Schedule K.

Planning and Examination Risk Analysis: The field should challenge all arguments by taxpayers operating in partnership form that I.R.C. § 118 allows them to exclude payments from gross income.

Audit Techniques: A generic Information Document Request should be issued asking the taxpayer for a list of all I.R.C. § 118 exclusions from income.

This Directive is not an official pronouncement of law or the position of the Service and can not be used, or cited, or relied upon as such.

cc: Commissioner, LMSB
Deputy Commissioner, LMSB
Division Counsel, LMSB
Commissioner, SBSE
Chief, Appeals
Director,
Performance, Quality and Audit Assistance

Tax Analysts Information

Code Section: Section 118 -- Contributions to Capital
Jurisdiction: United States
Subject Area: Corporate taxation
Partnership taxation
Institutional Author: Internal Revenue Service
Tax Analysts Document Number: Doc 2007-371 [PDF]
Tax Analysts Electronic Citation: 2007 TNT 4-32

APPENDIX "B"

Code Sec. 3402. Income tax collected at source.

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[1](t) Extension of withholding to certain payments made by government entities.

(1) General rule.
The Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies) making any payment to any person providing any property or services (including any payment made in connection with a government voucher or certificate program which functions as a payment for property or services) shall deduct and withhold from such payment a tax in an amount equal to 3 percent of such payment.

(2) Property and services subject to withholding.
Paragraph (1) shall not apply to any payment—

(A) except as provided in subparagraph (B), which is subject to withholding under any other provision of this chapter or chapter 3,

(B) which is subject to withholding under section 3406 and from which amounts are being withheld under such section,

(C) of interest,

(D) for real property,

(E) to any governmental entity subject to the requirements of paragraph (1), any tax-exempt entity, or any foreign government,

(F) made pursuant to a classified or confidential contract described in section 6050M(e)(3),

(G) made by a political subdivision of a State (or any instrumentality thereof) which makes less than $100,000,000 of such payments annually,

(H) which is in connection with a public assistance or public welfare program for which eligibility is determined by a needs or income test, and

(I) to any government employee not otherwise excludable with respect to their services as an employee.

(3) Coordination with other sections.
For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, payments to any person for property or services which are subject to withholding shall be treated as if such payments were wages paid by an employer to an employee.