May 29, 1998

The Honorable Tony Knowles
Governor
State of Alaska
P.O. Box 110001
Juneau, Alaska 99801-0001

Re: SCS CSHB 393(FIN) -- Alaska Stranded Gas Development Act
A.G. file no: 883-98-0083

Dear Governor Knowles:

At the request of your legislative director, Pat Pourchot, we have reviewed SCS CSHB 393(FIN), the Alaska Stranded Gas Development Act, which would authorize the commissioner of revenue to develop new fiscal terms for projects that develop stranded natural gas resources in the state.

The bill is identical in most important respects to the bill introduced at the request of the governor. The bill is largely the product of the North Slope Gas Commercialization Team, which was established last year by House Bill 250. The team, which consisted of the attorney general, the commissioner of revenue, and the commissioner of natural resources, was charged with recommending terms for a contract that would improve the economic feasibility and competitiveness of a North Slope gas project. The team also was asked to recommend legislative provisions necessary or appropriate to implement such a contract. The purpose of the team•s efforts and of the bill is to enable the state to create a fiscal regime appropriately tailored to the development of some or all of the approximately 35 trillion cubic feet of gas on the North Slope. Today that gas is stranded there because of the prohibitive cost of getting it to market.

Sections 1 through 9 of the bill would authorize the commissioner of revenue to develop the terms of a fiscal contract with sponsors of projects to develop known gas reserves that currently cannot be marketed economically. Unlike the governor•s proposal, the bill is limited to liquefied natural gas (•LNG•) projects. In a letter of intent adopted by the Senate, Senator Kelly explains that while the state has studied the economics of a North Slope LNG project, no comparable study has been made of the next most likely alternative, a gas-to-liquids (GTL) project. The letter of intent suggests that the state should continue to explore any method of commercializing its stranded gas resources, and that an economic analysis of GTL may support amending the Stranded Gas

Development Act to include it. The North Slope Gas Commercialization Team•s Report to the Governor of December 15, 1997, in fact identifies an LNG project as the •most promising• alternative for commercializing North Slope gas and focuses its economic analysis exclusively upon it, although the fiscal principles in the Report which are incorporated in the bill, could be applied more broadly.

The payments required by the contract would replace some or all of the state and local taxes that would otherwise apply to qualified sponsors as a consequence of their participation in a qualified project. Those taxes might include: (1) the state and local ad valorem property taxes that would be imposed on the project facilities; (2) the production or severance tax that would be imposed on the gas produced and marketed by the project; and (3) the state corporate income tax obligation arising as a consequence of the construction and operation of the project. In addition, the commissioner of natural resources may develop terms, which the commissioner of revenue may include in a contract, addressing timing and notice of the state•s right to take its royalty gas in kind, as well as a method for valuing the state•s royalty share of gas. In effect, the bill would permit the commissioner of revenue to develop terms that would replace the state•s current fiscal regime --which, if applied to a North Slope gas project today, would be relatively regressive and front-end loaded -- with a regime that is more progressive and back-end loaded, in an effort to lower the risk of the project and boost the rate of return that investors could expect.

The principal difference between this bill and the version introduced at the governor•s request is that the former, though empowering the commissioner of revenue to negotiate fiscal terms, does not authorize the commissioner to actually execute the contract. Instead, sec. 3 of the bill adds AS 43.82.435, which provides that the •governor may transmit a contract developed under this chapter to the legislature together with a request for authorization to execute the contract.• The section further provides that the contract is not binding unless the governor is authorized to execute the contract by a subsequent enactment. In the view of legislative counsel, this aspect of the bill may reflect an encroachment by the legislature upon the powers properly reserved to the executive branch under the Alaska Constitution. However, legislative counsel also recognized that the executive is free as a matter of comity to acquiesce in what amounts to the legislature•s request for more active oversight. In fact, the governor, in the transmittal letter accompanying his proposed legislation, encouraged the legislature to review the contract and approve it before it became effective. The governor made this request because of the importance of North Slope gas development to the state.

We agree with legislative counsel that the governor may acquiesce in the approach adopted by the legislature. We also note that it is far from clear that the legislature•s approach would, in fact, violate the separation of powers doctrine. The legislature arguably has not usurped an executive function, but rather has divided its delegation of authority into two steps, rather than the traditional one. It should be noted, moreover, that both the negotiation of the contract and its submission to the legislature are discretionary. Finally, it is relevant that the contract that is to be provided to the legislature involves the state•s fiscal regime, a subject substantially within the purview of the legislative branch under art. IX of the Alaska Constitution. Since the contractual payments in lieu of taxes authorized by this bill could be characterized as, in essence, a new tax, the legislature may well be required to levy the new tax by law. Viewed in this light, the legislature•s approach might not only be permissible, but necessary, under the constitution.

There are a number of other important issues raised by this legislation. First, art. IX, sec. 1 of the Alaska Constitution provides that •[t]he power of taxation shall never be surrendered.• The bill raises the •surrender of the taxing power• question because it contemplates development of a long-term contract that reflects the fiscal terms applicable to the sponsors of a stranded gas project. The legislation itself, however, is not unconstitutional under art. IX, because it does not purport to bind future legislatures. Instead, it merely authorizes the commissioners of revenue and natural resources to develop appropriate contract terms. Authorization to execute the contract will not be delegated to the executive branch until the legislature has had an opportunity to review the contract and ascertain whether its terms are in the public interest. Even if that authorization is given, the legislature may expressly provide that the contract•s fiscal terms are binding only so long as no future legislature decides to exercise the taxing power in a different way. In other words, the •surrender of the taxing power• issue may never arise. A concrete analysis of the issue must be left to the day the legislature decides whether, and if so under what terms, it will allow execution of a contract at all.

The second issue is the bill•s provision in sec. 3, adding AS 43.82.500 - 43.82.520, for municipal participation and revenue sharing. Like the former Industrial Incentive Act (AS 43.25, repealed in 1986), the bill recognizes that changes in the state•s tax regime will be ineffective to encourage development unless municipal tax changes are also included. Unlike the former Act, the bill includes provisions to ensure that affected municipalities receive a •fair and reasonable• share of the payments from a project that affects them. The bill also creates a municipal advisory group to assist the commissioner in developing the contract terms that may affect municipalities.

Third, the bill recognizes that the commissioners of revenue and natural resources may have to review confidential company data in order to develop fiscal terms that best advance the state•s interests. The people of the state, however, have a right to know the basis for administrative decisions affecting their welfare. The bill strikes a balance between, on the one hand, the state•s interest in encouraging competition and the right of companies to keep proprietary information from their competitors and, on the other hand, the public•s right to review their elected and appointed officials• decisions. The bill does this by limiting confidential treatment to proprietary information that, if revealed, would both affect a company•s competitive position and significantly diminish the value of the information. In addition, information loses its confidential status as soon as confidentiality is no longer necessary to protect the company•s competitive position or the information•s value.

Finally, an important goal of this legislation is to facilitate the hiring of Alaskans in all phases of the construction and operation of a stranded gas project. The bill adds AS 43.82.230, which requires employers participating in a project to advertise locally for available positions and use Alaska job service organizations located throughout the state. Most significantly, the commissioner is directed, •[w]ithin the constraints of law,• to include a provision in a contract requiring sponsors to employ qualified Alaska residents and Alaskan-owned businesses. The commissioner of labor will prepare and present to the legislature an annual report compiled from state data bases, particularly quarterly unemployment insurance reports, regarding the residency of employees working in the state on the project. We see no constitutional problem with these aspects of the bill, because the bill expressly provides that the Alaska hire provisions in the contract must be consistent with •the constraints of law.•

Finally, we note that although the bill is unique in many respects, the legislature has passed comparable measures to encourage industrial development in the past. For example, the liquefied gas plant, gas pipeline, and related facilities on the Kenai Peninsula benefitted directly from the Alaska Industrial Incentive Act, former AS 43.25. Without the tax advantages provided by the Act at that time, the Kenai LNG facility might never have been built. Today, that facility is a significant source of jobs and property tax revenues in the Cook Inlet area.

We see no legal problems presented by this bill.

Sincerely,

Bruce M. Botelho
Attorney General

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