STATE CAPITOL
P.O. Box 110001
Juneau, AK 99811-0001
907-465-3500
fax: 907-465-3532

550 West Seventh Avenue, Suite 1700
Anchorage, AK 99501
907-269-7450
fax 907-269-7461
www.Gov.Alaska.Gov
Governor@Alaska.Gov

Governor Sean Parnell
STATE OF ALASKA

January 23, 2014

The Honorable Charlie Huggins
President of the Senate
Alaska State Legislature
State Capitol, Room 111
Juneau, AK 99801-1182

Dear President Huggins,

Alaska has significant gas resources on the North Slope. Current known reserves are nearly 35 trillion cubic feet (TCF), and US Geological Survey estimates of technically recoverable conventional gas resources are more than 240 TCF. Bringing this gas to market has been the focus of many efforts over the last 30 years, but to be successful, requires a coordinated and collaborative effort of many parties.

The recent alignment by parties around a path forward on a large-scale LNG project, and the Alaska Gasline Development Corporation's (AGDC) preparation for an open season in 2015 for an in-state pipeline, create an opportunity for that coordinated and collaborative effort. With parties working together on Alaska's terms, and in Alaskans' interests, it is time to move forward with legislation to advance a natural gas project that would provide natural gas for Alaskans and markets beyond. Therefore, under the authority of Article III, Section 18 of the Alaska Constitution, I am transmitting a bill designed to achieve the long-sought State goal of commercial production of North Slope natural gas for the benefit of all Alaskans.

The bill will expand the purposes of AGDC to allow it, through a separate subsidiary, to advance a large-diameter natural gas pipeline project by carrying the State's equity interest in the project's infrastructure, including treatment and liquefaction facilities. The bill would also authorize the Commissioner of Natural Resources to negotiate modifications of existing oil and gas leases to better manage Alaska's interests in its North Slope natural gas resources. Finally, the bill would amend the levy of tax on gas under Alaska's oil and gas production tax, providing the clarity of terms any North Slope natural gas project needs to proceed.

First, commercialization of North Slope natural gas should occur with both in-state needs and export potential in mind. Therefore, the bill would provide authority to pursue an equity position in a large-diameter natural gas pipeline project that could include treatment and liquefaction facilities, but would not impede the mission of AGDC to continue to advance the Alaska Stand Alone Pipeline (ASAP) in-state gasline project.

As to the provisions of the bill relating to the Department of Natural Resources, the bill would provide the needed authority for the Commissioner of Natural Resources to enter into short-term commercial agreements related to the North Slope natural gas project. In addition, the bill would allow the Commissioner of the Department of Natural Resources to negotiate terms, subject to legislative approval, for project services related to a natural gas project. To facilitate negotiations and continuing development activities, confidentiality of information would be maintained, but any contract to be presented to the Legislature for authorization would not be confidential.

Current State oil and gas leases contain terms – such as provisions that allow the State to switch between taking royalty oil and gas in-kind or in-value – which may hinder the ability of lessees to enter into long-term contracts for sales of natural gas produced on the North Slope. The bill would allow the Commissioner of Natural Resources to modify certain lease terms on property that commits gas to a natural gas project in order to facilitate commercialization. After a natural gas project sponsor has demonstrated sufficient project commitments, the Commissioner may modify existing leases that commit gas to a natural gas project, with the concurrence of the lessees. Gas committed from these leases, whether through royalty or the production tax, would be subject to the current standards for sale, exchange, or disposal of gas taken in-kind by the State as its royalty share.

Other provisions of the bill relate to the oil and gas production tax, specifically to the tax levy on gas. The current tax structure, which imposes a net tax on the annual production tax value of oil and gas, is retained until 2022 when the tax limitations expire for Cook Inlet oil and gas produced anywhere in the state but used in-state. The bill proposes changes to the tax system to facilitate natural gas development and provide gas for in-state sale and export. For gas produced after 2021, the tax levy on gas would be 10.5 percent of annual gross value at the point of production. The oil tax levy would remain at 35 percent of net annual production tax value. Most importantly, for leases that have been modified as described above, the bill would allow a producer to pay, for gas from modified leases only, its production tax with gas instead of with money equal to 10.5 percent of the taxable gas production from the modified leases. The Commissioner of Revenue will continue to direct revenue received from the sale of gas to the General Fund.

In order to pay the production tax in-kind, the producer must make an irrevocable election under regulations adopted by the Department of Revenue. Disputes over any tax deficiency, and interest or penalties on a deficiency, would be accounted for as if the tax was levied in money. Furthermore, gas flared, released, or allowed to escape upstream of the point of production, or gas used on a lease or property would not be subject to an in-kind election.

The bill would make changes to provisions in current law to facilitate the new gross tax levy on gas. The name of a producer and the volumes of gas subject to the election to pay tax as gas would be public information. The alternate minimum tax on North Slope oil and gas would apply only to oil after 2021. The bill accounts for how producers make estimated monthly installment payments of tax due after 2021 and clarifies that credits may be taken only against the tax levy in money, not against the levy in-kind.

Development of natural gas projects of this scope is a new chapter in State resource development that will be enhanced by the State's equity participation in either project. Given the momentum on developing North Slope gas, we must act now to assure that our laws provide the appropriate agencies with authorities and tools to allow the State to advance projects on Alaska's terms and in Alaskans interests.

I urge your prompt and favorable action on this measure.

Sincerely,

Sean Parnell
Governor

Enclosure