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## Governor Bill Walker STATE OF ALASKA

October 19, 2015

Dear Members of the 29<sup>th</sup> Alaska State Legislature,

I have called the Legislature to a special session to consider legislation relating to the subject of the State of Alaska's (State) efforts to advance the current liquefied natural gas (LNG) process to commercialize our vast natural gas resources. We are at a critical juncture in the Alaska liquefied natural gas project process (Alaska LNG), in which the partners – BP, ConocoPhillips, ExxonMobil, TransCanada and the Alaska Gasline Development Corporation (AGDC) – are working together to advance the technical work. However the process we are currently working under has failed to produce any project-enabling agreements on the timeline that Alaskans requested and the State's partners indicated was possible. Unfortunately, instead of presenting project-enabling agreements to you in this special session, as was the goal of all of the parties involved, I must instead ask you for measures necessary to advance the process with assurances it will not see similar delay in the future or actual process failure caused by the reluctance of one or more parties to move forward. Our goal is to move from the gasline process established in Ch. 14 SLA 2014, into actual gasline project construction. We cannot afford to add yet one more example to Alaska's long history of failed gasline processes.

The three items for consideration in this special session are: (1) passage of legislation lifting the tax holiday on real property leased from the State containing threshold volumes of gas in order to ensure that producers are incentivized to commit their gas to Alaska LNG, or to make gas available for purchase if Alaska LNG does not proceed with all current project participants on previously established timelines; (2) an appropriation to pay TransCanada its development costs and terminate its participation in Alaska LNG, so that AGDC can take over TransCanada's current equity position in the gas treatment plant (GTP) and pipeline; and (3) appropriations for the State to make cash calls on the GTP and pipeline components of Alaska LNG to continue pre-front end engineering and design (FEED) work necessary to reach a FEED decision, and for the other State agencies involved in Alaska LNG to fund the work to continue efforts to negotiate and reach final agreements necessary to reach a FEED decision.

The first item is a lifting of a long standing property tax holiday on property leased for gas production but that has not been put into production. The property tax is not designed to be punitive. Built into this legislation are several exemptions. Should the taxpayer qualify for any one of the exemptions, the property tax would not apply. The bill would correct problems with how we have structured taxation of natural gas by removing the incentive for leaseholders to delay production of our gas resources. Property taxation in Alaska is primarily local, and statutorily includes the value of all real property including land and improvements (with limited exemptions). If land is leased from the State or federal governments, then the tax is based on the reversionary value of the lease. There is also a 20 mill statewide property tax on oil and gas property, with a

credit against the statewide tax for local taxes paid on the same property. However, in oil and gas property taxes at the statewide and local level, the State allows producers to exclude the value of the land (i.e. the oil and gas lease itself). This is because Alaska made the policy decision decades ago to forgo a property tax on the value of oil and gas leases and instead to levy a production tax. Exempting the value of the lease interest from property taxes in favor of a production tax is a rational tax policy when the mineral interests in those leases are produced. But in the case of North Slope natural gas, this exemption from property taxes has resulted in a tax holiday that eliminates the incentive that a property tax normally creates to put gas leases into production. The gas reserves property tax ensures gas leases are taxed in parity with other real property interests in Alaska. Why should other landowners in Alaska pay property taxes on the value of their land, but gas leases be exempted in favor of production taxes if, in fact, there is no production?

Thus, the heart of the property tax is to ensure taxes are paid on the value of the gas lease if there is no commitment by the leaseholder to put the land into production and pay production taxes in the alternative. With that idea in mind, the proposed property tax allows a continued exemption from taxation if gas is committed to the Alaska LNG project or to another gas commercialization project in the event that one or more project participants leaves or makes the internal corporate decision to delay or exit Alaska LNG. It is designed to continue exemptions for producers who proceed on schedule to the sanction of Alaska LNG or are willing to commit gas to a commercialization project, who sell their gas to third-party customers or agree to ship their gas on a project, or who agree to offer their gas to potential buyers on reasonable commercial terms. Producers who meet one of these exemptions would continue to be exempt from property taxation. A producer would only be subject to the tax in the event that it was unwilling to commit its gas to a project. Without the proposed property tax, Alaskans have no assurance that its producer partners will commit to the next phases of Alaska LNG and will have no recourse if the State's Alaska LNG producer partners delay or decline to support the Alaska LNG project, or to another gas commercialization project.

Given the long history of failed gasline commercialization efforts to date, and the demonstrated reluctance of certain Alaska LNG partners to advance the process on a timeline acceptable to Alaska's needs, it is imprudent to continue this process without removing the property tax holiday on leases holding threshold volumes of gas on the North Slope, where those companies choose not to make the gas in those leases available for a gasline project.

The second item, an appropriation to fund the replacement of TransCanada with AGDC as the holder of the State's equity interest in the GTP and pipeline, is necessary to ensure greater State control of those project components and to provide the State with lower transportation costs over the life of Alaska LNG. TransCanada has been a valuable partner, and I appreciate its efforts and contributions in progressing the pre-FEED work on the project. However, at this point the State through AGDC should take a direct investment in the entire project to lower annual gas transportation costs after the project begins operations. While this will mean that the State must make the project pre-FEED, FEED, and construction payments that TransCanada would have otherwise made, the State is better off in the long term. We have begun to provide and will continue to make presentations to the Legislature with details on the cost savings and other benefits of replacing TransCanada. The appropriations bill will provide the funds needed to acquire

TransCanada's ownership interest in the project by reimbursing it for development costs, which the State is obligated to pay under the Precedent Agreement with TransCanada.

The third item is an appropriation to fund the State's costs of continuing in Alaska LNG through pre-FEED, including agency costs and the additional monthly cash calls that AGDC will be required to make as the State's direct project participant in all three segments of the project. These appropriations are necessary to fund the State's participation in the pre-FEED work up to a FEED decision, if we are to continue with the Alaska LNG framework.

We look forward to working with all of you in the upcoming special session. While some of our partners in Alaska LNG are advancing up to eight other LNG projects around the world, all bound for the same Asian markets that are presently available for North Slope gas, Alaska has but one potential natural gas project. Therefore, it is imperative that we not only have a seat at the table in the Alaska LNG process but that we have taken steps to incentivize our partners to choose to commit the gas within their leases to an Alaska LNG project.

Thank you for your commitment to Alaska's future. I look forward to the upcoming special session.

Sincerely,

A handwritten signature in blue ink, appearing to read "Bill Walker", is written over a light blue horizontal line.

Bill Walker  
Governor