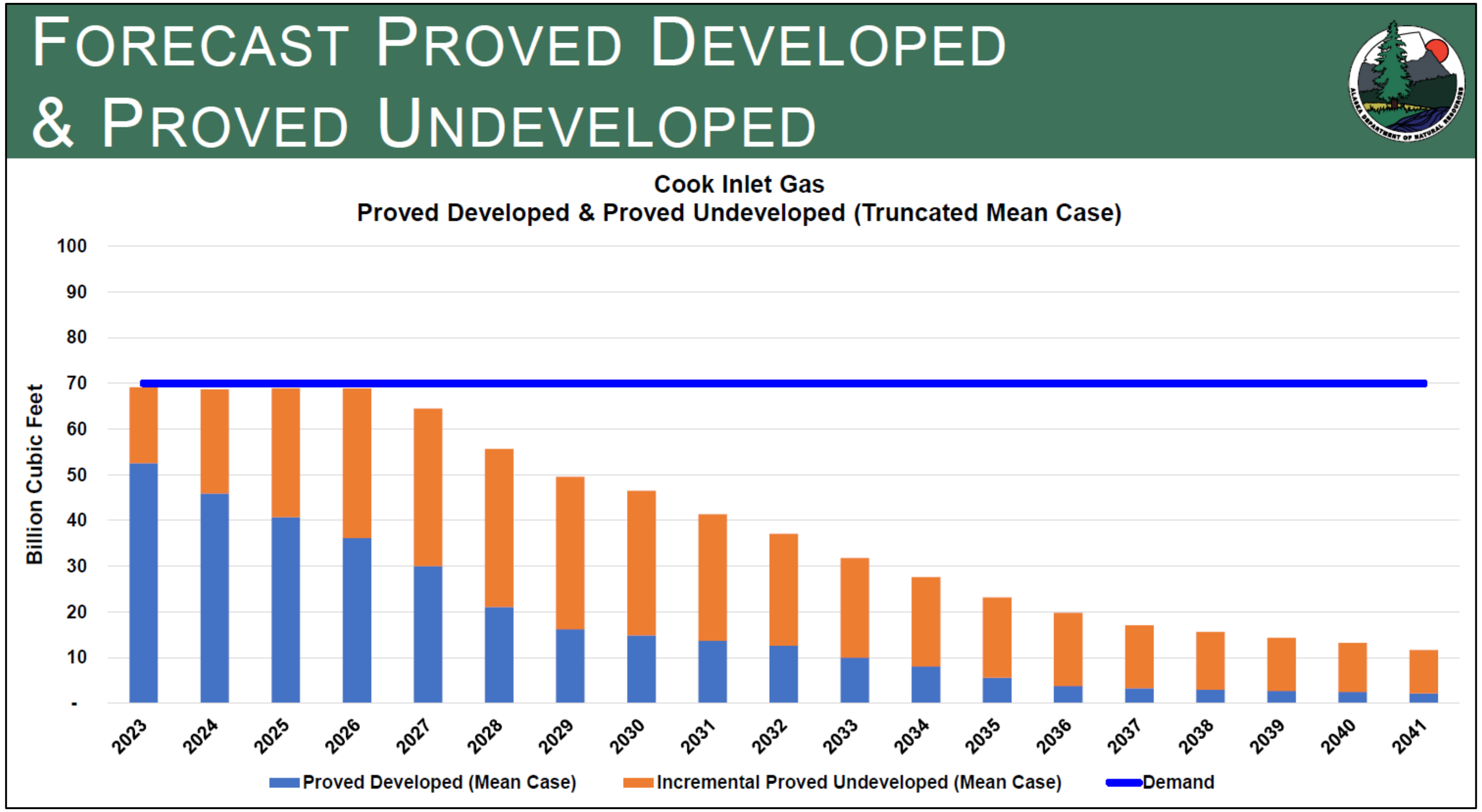
HB 393 – Cook Inlet/Middle Earth Gas Royalties

HOUSE RESOURCES COMMITTEE BILL

OFFICE OF REP. TOM MCKAY

Cook Inlet Production Shortage

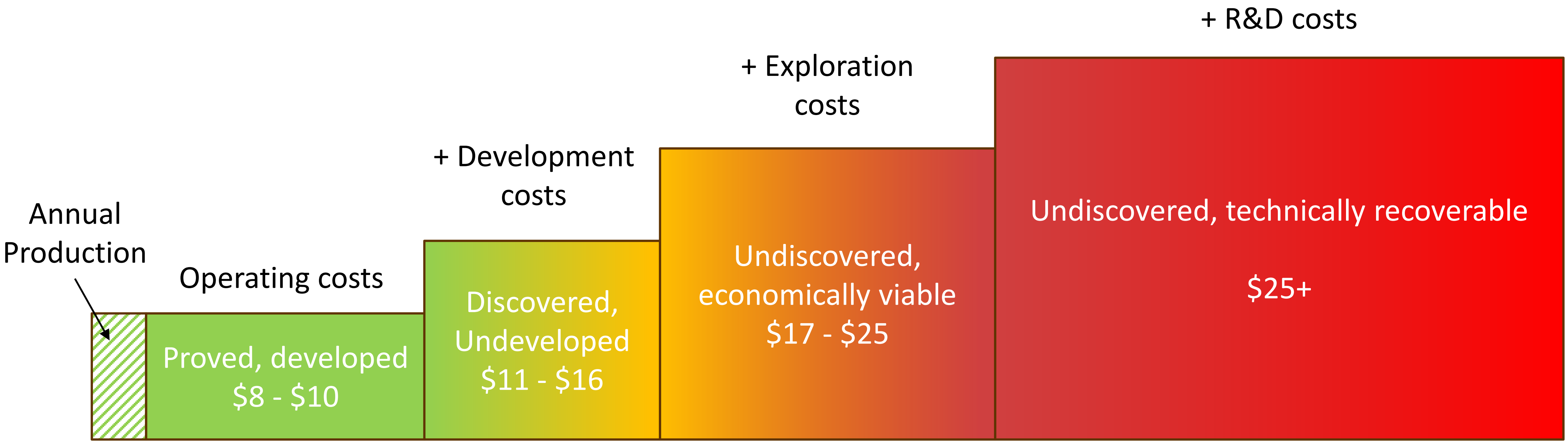


- State is facing a looming and increasing shortage of Cook Inlet natural gas production
- Legislature has tools at its disposal via legislation to address Cook Inlet gas production
- No “silver-bullet” solution

Poll Results: What do Alaskans Want?

- High level of support (59%) for state incentives to private companies and utilities to identify and pursue projects to ensure energy deliverability
- Same support (59%) for creating financial incentives for oil and gas companies to find and produce more Cook Inlet gas
- Significant opposition to importing natural gas (72%) with 44% having "strong" opposition
  - Most common reason for opposition: *"there is plenty of gas, we're a resources state, we just need to get the gas" (46%)*
  - *"Importing gas is more expensive"* only cited by 18% of respondents
- If residents were convinced imports are the cheapest option could be a sizeable shift in support, up to 60%
- 87% of residents support the construction of a natural gas pipeline for in-state use and export; evenly divided on the idea of reducing the PFD to help fund a gas line (49% support/49% oppose)

Market Dynamics



Considerations for Energy Policy

- Short Term vs. Long Term

- Risk vs. Cost – State needs to decide what level of risk is acceptable
  - Higher-Cost energy = Lower Risk Options
  - **Lower-Cost Energy = Higher Risk Options**

- How policies interact

Oil & Gas Revenue by Type and Geographic Area, FY 2020 - FY 2023

Prepared by Economic Research Group, January 29, 2024

State Oil & Gas Revenue by Source and Region ($ million)	FY 2020	FY 2021	FY 2022	FY 2023
North Slope				
Royalties (including bonuses, rents, and interest)	$ 965.9	$ 1,036.2	$ 1,770.2	$ 1,676.6
Production Tax (including surcharge)	$ 284.4	$ 388.4	$ 1,806.0	$ 1,494.3
Property Tax	$ 107.3	$ 103.8	$ 106.9	$ 112.5
Corporate Income Tax	$ 1.0	$ (23.2)	$ 284.9	$ 305.0
Subtotal North Slope	**$ 1,358.6**	**$ 1,505.2**	**$ 3,968.1**	**$ 3,588.4**
Non-North Slope (including Cook Inlet)				
Royalties (including bonuses, rents, and interest)	$ 49.7	$ 46.1	$ 53.8	$ 59.7
Production Tax (including surcharge)	$ 0.7	$ 0.6	$ 3.4	$ 4.3
Property Tax	$ 15.6	$ 15.4	$ 15.5	$ 16.3
Corporate Income Tax	$ (1.2)	$ 3.8	$ 12.6	$ 7.4
Subtotal Non-North Slope	**$ 64.8**	**$ 65.9**	**$ 85.2**	**$ 87.7**
STATEWIDE TOTAL				
Royalties (including bonuses, rents, and interest)	$ 1,015.6	$ 1,082.3	$ 1,824.0	$ 1,736.3
Production Tax (including surcharge)	$ 285.1	$ 389.0	$ 1,809.4	$ 1,498.7
Property Tax	$ 122.9	$ 119.2	$ 122.4	$ 128.8
Corporate Income Tax	$ (0.2)	$ (19.4)	$ 297.5	$ 312.4
Statewide Total	**$ 1,423.4**	**$ 1,571.1**	**$ 4,053.3**	**$ 3,676.2**

Source:

Fall 2023 Revenue Sources Book and supporting documentation, Tax Revenue Management System, Tax Accounting Group, Department of Natural Resources, and Economic Research Group modeling.

The Case for Aggressive Royalty Reduction

- Cook Inlet represents a small share of the states oil and gas revenues
- Energy prices likely to double or triple in the next 15 years if mass LNG imports are the solution
- An increase of this magnitude would result in rate payers paying 100’s of millions to billions more in energy costs ***every year.***

Royalty Structure Modifications

- Market has spoken: Cook Inlet under current royalty structure is not ideal for investment

- Time Value of Money

- **What does the state want to incentivize?**
  - **Royalty and tax decreases on producing wells → Extend the life of existing wells**
  - **Royalty and tax decreases on new wells → Increase the number of wells drilled**

HB 393 Overview

- Changes royalty structure for Cook Inlet:
  - 0% for gas produced from new wells drilled starting in FY25
  - 5% for oil produced from new wells drilled starting FY25
  - 5% on oil and gas produced from wells drilled prior to FY25

- Capital expenditures associated with development of oil or gas can be deducted from royalty burden; Excludes North Slope

- Requires commissioner to enter into lease negotiations to comply with these terms

Sectional Analysis

Sec. 1 Amends AS 38.05.180(f) to allow an exception for the new subsection (mm). Changes royalty structure for Cook Inlet leases to 0% on gas and 5% on oil for wells drilled after July 1st, 2024, and 5% on oil and gas for wells drilled prior to July 1st, 2024.

Sec. 2 Adds a new subsection (mm) to AS 38.05.180, stating that for leases issued for property in the state excluding land north of 68 degrees North latitude, the royalty share reserved to the state may not exceed zero if the lessee is recovering costs associated with development of oil or gas produced from a well drilled on or after July 1, 2024.

Sec. 3 Adds uncodified law regarding transition to comply with the changes in royalty rates which requires the commissioner of natural resources to enter into lease negotiations with a lessee holding a lease issued before the effective date of this Act in the Cook Inlet sedimentary basin to modify the lease to meet the royalty rates required by AS 38.05.180(f)(7) and (mm).

Sec. 4 Provides for an effective date of July 1, 2024.