

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

March 6, 2003

3:22 p.m.

MEMBERS PRESENT

Representative Vic Kohring, Chair
Representative Mike Chenault, Vice Chair
Representative Hugh Fate
Representative Lesil McGuire
Representative Norman Rokeberg
Representative Beth Kerttula

MEMBERS ABSENT

Representative Harry Crawford

OTHER LEGISLATORS PRESENT

Representative Jim Holm

COMMITTEE CALENDAR

HOUSE BILL NO. 61

"An Act establishing an exploration and development incentive tax credit for persons engaged in the exploration for and development of less than 150 barrels of oil or of gas for sale and delivery without reference to volume from a lease or property in the state; and providing for an effective date."

- MOVED CSHB 61(O&G) OUT OF COMMITTEE

PREVIOUS ACTION

BILL: HB 61

SHORT TITLE: OIL & GAS TAX CREDIT FOR EXPLORATION/DEV

SPONSOR(S): REPRESENTATIVE(S) CHENAULT

Jrn-Date	Jrn-Page		Action
01/24/03	0060	(H)	READ THE FIRST TIME - REFERRALS
01/24/03	0060	(H)	O&G, RES, FIN
01/24/03	0060	(H)	REFERRED TO OIL & GAS
02/04/03		(H)	O&G AT 3:15 PM CAPITOL 124
02/04/03		(H)	<Bill Hearing Canceled>
02/27/03		(H)	O&G AT 3:15 PM CAPITOL 124

02/27/03 (H) Heard & Held
MINUTE(O&G)
03/06/03 (H) O&G AT 3:15 PM CAPITOL 124

WITNESS REGISTER

KATHY ZABEL, Senior Tax Counsel
Marathon Oil Corporation
Houston, Texas

POSITION STATEMENT: Answered questions on HB 61, Version D.

JOHN A. BARNES, P.E., Alaska Business Unit Manager
Marathon Oil Company
Anchorage, Alaska

POSITION STATEMENT: Answered questions on HB 61, Version D.

CHUCK LOGSDON, Chief Petroleum Economist
Tax Division
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: Testified that Version D of HB 61 is a better bill; said the department had no position on it, but offered that the bill will provide a commercial incentive to look for gas and develop it in the Cook Inlet.

MARK MYERS, Director
Division of Oil & Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions on HB 61, Version D; pointed out an oversight later addressed by Amendment 3.

ACTION NARRATIVE

TAPE 03-13, SIDE A

Number 0001

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at 3:22 p.m. Representatives Kohring, Chenault, Rokeberg, Fate, and McGuire were present at the call to order; Representative Kerttula arrived shortly thereafter. Representative Holm also was in attendance.

HB 61-OIL & GAS TAX CREDIT FOR EXPLORATION/DEV

Number 0051

CHAIR KOHRING announced that the committee would hear HOUSE BILL NO. 61, "An Act establishing an exploration and development incentive tax credit for persons engaged in the exploration for and development of less than 150 barrels of oil or of gas for sale and delivery without reference to volume from a lease or property in the state; and providing for an effective date."

CHAIR KOHRING indicated the new proposed committee substitute (CS) addresses members' concerns expressed previously.

Number 0171

REPRESENTATIVE FATE moved to adopt the proposed CS, Version 23-LS0270\D, Chenoweth, 3/6/03, as a work draft. There being no objection, Version D was before the committee.

Number 0223

CHAIR KOHRING began explaining changes in Version D. On page 1, lines 9-10, he noted, the oil incentive has been eliminated.

REPRESENTATIVE CHENAULT, sponsor of HB 61, pointed out its removal from the title as well.

CHAIR KOHRING informed members that on page 1, line 15, and page 2, lines 1-2, the credit for qualified services has been reduced from 100 percent to 10 percent in order to address a member's concern. On page 2, lines 13-15, because of an issue brought up by the Department of Revenue, the amount of tax credit in a single year must not be greater than 50 percent of the taxpayer's total tax liability for that year, and is calculated prior to application of any other credits. On page 3, lines 13-16, as brought up by a committee member, Version D eliminates the "double-up" with other incentive programs; a taxpayer who elects to participate in this exploration and development program, as noted in the bill, isn't entitled to any other set of programs such as royalty reductions, but may forego this incentive and still use other programs.

Number 0461

CHAIR KOHRING continued with Version D. On page 3, lines 20-21, as requested by the Department of Natural Resources (DNR), it better defines what is meant by "new gas to market"; he said it has to do with new gas now being defined as gas reserves in a gas reservoir for which there has not yet been any commercial production. On page 3, lines 27-28, it tightens the definition

of "qualified capital investment" to address concerns of Representative Fate. Language has been added to clarify that this only deals with exploration and development expenses, rather than any expenses relating to ongoing production in the future. In addition, the provision is being eliminated that deals with property relating to oil exploration and development. Furthermore, "air strips" in the previous bill is being replaced with "helicopter pads", and aircraft and motor vehicles also are eliminated as far as any allowable expense.

CHAIR KOHRING continued with Version D. On page 4, lines 11-13, it tightens the definition of "qualified services" and clarifies the language, to address concerns of Representative Rokeberg. It adds language to clarify that "qualified services" expenditures must be directly attributed to "qualified capital investments." Furthermore, it adds language to clarify that ongoing operating expenses won't be available for the credit.

Number 0653

KATHY ZABEL, Senior Tax Counsel, Marathon Oil Corporation, [responding to a question from Representative Holm as to why page 2, line 22, of Version D says "on a form prescribed by the department", whereas line 24 of the original bill says "on a form prescribed and provided by the department"], explained that it was a change suggested by the Department of Revenue to clarify that the department normally would prescribe the forms, but wouldn't necessarily deliver them to the taxpayer.

MS. ZABEL, in response to questions from Representative Rokeberg, explained that there was an investment tax credit in the federal Internal Revenue Code, but that was changed considerably in 1986; now, the [federal] investment tax credit is limited to three different types of qualified property and is brought in under the general business credit. When it was in existence, the investment tax credit was basically a 10-percent credit on a very broad category of qualified property; the taxpayer could take that credit back three years and forward fifteen years. In response to further questions, she added that normally credits on both the state and federal level prescribe some "carry back" or "carry forward" period, or indicate that credits generated in a particular tax year must be used that tax year. It would be limited by the amount of taxable income, and most states have had some type of "ordering rule" with regard to how this had to be utilized in each of the tax years, requiring it to be carried back three years and then only forward if there were remaining credits, for instance.

Number 1143

REPRESENTATIVE ROKEBERG noted that [Version D] has a five-year period but no more than 50 percent.

MS. ZABEL responded that there is a limitation as to the carry-forward period, as well as a limitation as to taxable income in this particular bill.

REPRESENTATIVE ROKEBERG surmised that a taxpayer would want to maximize the "write-down" but would be limited by the "50 percent the first year" rule.

MS. ZABEL affirmed that.

REPRESENTATIVE ROKEBERG suggested that a taxpayer with profits the second year presumably would take the balance of the 50 percent the second year. He asked whether that is correct.

MS. ZABEL answered in the affirmative.

REPRESENTATIVE ROKEBERG asked whether a taxpayer could carry it forward if there were no net income the second year, for example.

MS. ZABEL replied, "Yes, in theory." She indicated that normally there is some type of preference by the Alaska Department of Revenue or the federal government as to how these credits are utilized in particular years.

Number 1218

REPRESENTATIVE ROKEBERG referred to Ms. Zabel's mention of the provision for carrying it back three years and forward fifteen years. He asked, "If you had the 10 percent and you had sufficient net income that year, you could actually take 100 percent of the credit that particular year?"

MS. ZABEL answered in the affirmative.

Number 1244

REPRESENTATIVE ROKEBERG conveyed concern about the qualified services on [page 4] of Version D. He suggested perhaps his concern could be ameliorated by testimony on the record interpreting the "directly applicable" language as it relates to

such things as "overhead burden and other soft-cost-type things that might be ... corporate overhead" for a discrete project that might qualify under this bill. He asked whether Ms. Zabel believed the language would prohibit that or allow it to occur.

MS. ZABEL responded, "It was our intention that normal lease operating expenses ... and things of that nature would not be included in this bill."

REPRESENTATIVE ROKEBERG suggested that an accountant for a particular company would try to find everything possible to qualify. Expressing concern, he asked, "Do we need a brighter line?"

MS. ZABEL answered that generally Alaska's corporate income tax system follows the federal system. The Internal Revenue Code prescribes what are considered capitalized items and lease-operating-expense items, as well as an intangible drilling cost or intangible personal property. She specified, "It would be our intention to ... be consistent with the parameters that are already in there in the Alaska income tax provisions, as well as the Internal Revenue Code provisions."

Number 1395

REPRESENTATIVE ROKEBERG asked whether general corporate operating expenses would or wouldn't be allowed to be incorporated into what he called the "soft-cost category" of qualified services.

MS. ZABEL replied, "No, that would not be our intention to include those type of overhead costs in the calculation of qualified services."

REPRESENTATIVE ROKEBERG still expressed concern that the statute could be read to allow it.

MS. ZABEL responded, "Certainly, we could provide whatever language would make the committee feel more comfortable that the statute itself was restricted to the type of cost that we intended to include here."

Number 1489

REPRESENTATIVE ROKEBERG asked about adopting language within the statute to mirror or cite the United States Code for these

issues, and whether that would be applicable and would help define the boundaries.

MS. ZABEL agreed it would be one way to handle the issue.

REPRESENTATIVE ROKEBERG asked whether Ms. Zabel believed that would cover "some of these other areas of soft costs" he was talking about.

MS. ZABEL said it possibly could, but suggested the need to look at it further.

REPRESENTATIVE ROKEBERG indicated he would draft an amendment to cover it when the time was appropriate. He asked that the committee and the sponsor track it, suggested that feedback could be obtained from the Department of Revenue, and indicated it could be addressed in the House Finance Committee.

Number 1570

REPRESENTATIVE FATE moved to adopt Amendment 1, on page 4, line 8, to delete "unrefined oil". He explained that unrefined oil had been removed everywhere else, but this had been missed.

CHAIR KOHRING noted that the deletion would be "or refined oil".

Number 1624

CHAIR KOHRING asked whether there was any objection to adopting Amendment 1. There being no objection, it was so ordered.

Number 1649

REPRESENTATIVE KERTTULA offered her reading that gas could be known to be in the reservoir, but that it couldn't have been commercially produced yet in order to qualify. She asked if that is right.

MS. ZABEL deferred to Mr. Barnes.

Number 1701

JOHN A. BARNES, P.E., Alaska Business Unit Manager, Marathon Oil Company, responded:

You're correct. There ... could be cases where it's known that gas may be in a reservoir but it's not yet

been commercially produced because of technological issues, development cost issues. It may have been a tighter reservoir, lower productivity, that under some price regimes were not producible, or it could be new gas that's found, or even, conceptually, a resource. But I believe your reading on that is correct.

Number 1736

REPRESENTATIVE KERTTULA returned to the intent behind the legislation. She said in terms of exploration and looking for new finds, she sees the reasoning; however, she expressed a little difficulty if known gas would have been "perfectly producible under any other regime." She asked whether that has happened elsewhere, and whether there is a way to make that kind of determination and cut it that fine.

MR. BARNES, noting that it was a good question, indicated within Cook Inlet there probably haven't been many cases that line up with that scenario, but acknowledged the possibility. He added, "Again, I think the intent was to ... look at commercial development." Mr. Barnes said there is risk in both exploration and development. For example, even under current technology, there could be cases when [a company isn't] capable of producing because it requires lower drilling costs and "better stimulation"; that is typically called a "resource." Referring to his testimony at the previous bill hearing, he reiterated that there are some "resource estimates" in Cook Inlet.

MR. BARNES recapped some of his testimony of the previous week, noting that reserves are typically categorized as "proven" if they are, under SEC [Securities and Exchange Commission] definitions, commercially producible at this time under current technological and economic conditions. "Probable" reserves are normally deemed as having less than a 50-percent probability of production under "current commercial cases." With regard to the Susitna basin and coal bed methane, he added, "That would be called a resource, that they know that there's a lot of coal there, they know that there's a lot of resource potentially with it, [but] can it be made producible?" The final category of reserves, "possible," is when there is an inkling that something may be there, which gets more into the "exploration side." Noting that there is a gray area, he remarked, "Oftentimes, people do call [it] an exploration well when you go into an area to drill for a resource that might have been seen on an earlier drilled well but it was never properly identified or captured,

so you're now going in, mobilizing a drilling rig, maybe perhaps acquiring the lease, seismic [data]."

Number 1927

REPRESENTATIVE KERTTULA said her concern was discrete. She expressed the need to define it so that there is no special credit for something a company probably would do anyway.

MR. BARNES replied:

I might suggest that a good test of the water would be market conditions. Again, in my last week's testimony, I described where reserves were going in the Cook Inlet, and, indeed, there is even a deliverability shortfall now. So I would suggest, I believe, that if there were known gas reserves in the inlet right now - or potentially in other basins that could easily be hooked up - market conditions would drive that. So that's, I believe, the intent of trying to say commercial development. If ... someone can make money at it today, ... I would believe they'd be trying to do it.

Number 2016

REPRESENTATIVE McGUIRE followed up on Representative Kerttula's concern. Noting that she supports this legislation, she provided an example: if the Division of Oil & Gas was negotiating already on a particular project, unbeknownst to the legislature, and this legislation passed and thereby gave away more than is needed to get that reserve developed, Representative McGuire said she would feel that the legislature wasn't upholding its constitutional mandate. Suggesting perhaps language could be added later, she agreed with the need to perhaps clarify that [this credit wouldn't apply] if negotiations were pending or if there were some concrete, substantial activity toward securing a deal. She indicated her belief that it is the legislature's job to try to gain the maximum benefit of these resources for the people of Alaska.

Number 2099

REPRESENTATIVE ROKEBERG agreed with some concerns expressed by Representative Kerttula, suggesting this demands a clearer statutory response to at least try to set those parameters and remove discretion from the decision making.

REPRESENTATIVE KERTTULA said she doesn't know what those [parameters] are.

REPRESENTATIVE ROKEBERG suggested the question is whether to draw a line there. He noted that the bill draws a line in that these expenditures - both the services and the capital investment - must be made [for a tax year beginning] after December 31, 2002. He pointed out that [the date] is another question: why not say 2003, for example? He also noted that Mr. Barnes had gotten his attention when he mentioned coal bed methane. He remarked:

That's kind of the problem here. If we know the reservoir gas is there, we may not know if it's commercially producible. And, as he's pointed out, it's market conditions. So what we need here is a bill that's going to be applicable ... for all those situations. So, what is our intention here? ... What if they found an "elephant" gas field? ... If they found an elephant gas field, that's exactly what this bill's all about, so we shouldn't feel bad about that, because the ... ITC is limited to their investment amount, not the long-term, provable reserves or protections or net profits going to flow from that.

That's the point here, because the relationship is between the ITC ... and what they've invested, not what's being produced or the profit. Don't forget that the state royalty and corporate taxes not offset by the ITC, and other sources of revenues we'd have, ... even ELF [economic limit factor] may apply to that particular production. So, therefore, ... we shouldn't delimit the applicability of the credit because you have a larger field.

Number 2252

REPRESENTATIVE ROKEBERG highlighted coal bed methane, for which he suggested this type of bill will encourage development. He explained, "We know it's there, but we don't know [whether] it's going to be economically producible. And you really don't know it until you get in there and spend the dollars to see if it works." Noting that capital investment would vary, he proposed that the credit would go up with the capital investment. He added, "So I would venture to say, philosophically, you should have ... the credit if you make the investments that produce the

gas." He acknowledged that [the bill] doesn't address whether the amount produced would be large or small, but emphasized that there is no credit for dry holes. He offered his understanding that there must be successful commercial production to apply for the credit.

Number 2306

REPRESENTATIVE KERTTULA said she agreed with the intent expressed by Representative Rokeberg, as well as the idea behind the bill. However, she again relayed her concern about the possibility - especially if prices rise - that the state could be allowing this [incentive for a reservoir that is already known to be there].

Number 2342

REPRESENTATIVE FATE offered that a gas field has exploration; development; and production, which won't occur without a market. Development may take several "collecting lines": is that production or development? If there is only one well, for example, with only one gathering line to a main transportation system, is that development or production? Representative Fate said that in discussing some of this to come up with a good bill, he'd tried to delineate exploration from development. Within development comes delineation of the field, he said, as well as ascertaining whether it will be "commercial," the market price, and so forth; once those are established, there is production - the stage at which it is transported and sold. He said it was quite clear to him: production is "out here somewhere and could not be taxed, because this is an incentive, and you don't incentivize production; you do incentivize ... exploration and development."

Number 2445

REPRESENTATIVE ROKEBERG suggested that was one reason for a trigger date [in the bill]. He said:

They couldn't be banking some gas, if you will, and then going back retrospectively and asking for an ITC based on an existing reservoir that, because of the high price of gas right now, they ... want to put some additional capital money in, then bring in the production. It's like gaming the system or cooking the books, if you will, to try to get ... a 10-percent discount on the capital investment you're going to

make - ... unless they really just found something here. And the only new thing you've brought on is Ninilchik, right, Mr. Barnes?

MR. BARNES said it was the only thing discovered lately.

REPRESENTATIVE ROKEBERG asked whether most of [the company's] money was spent before December 31, 2002.

MR. BARNES responded that it is ongoing, wells have been drilled, and it's in the middle of development.

REPRESENTATIVE ROKEBERG referred to Representative Fate's discussion of the line between [exploration and production]. He asked: What about additional wells drilled after production of a first well begins? Or will all wells be drilled before production begins? He also asked whether the economics would become a stronger driving force than the 10-percent ITC.

MR. BARNES remarked that incremental wells, once they're on production, wouldn't fall under this bill.

Number 2537

REPRESENTATIVE ROKEBERG asked Ms. Zabel if there is a way to draft a brighter line.

MS. ZABEL replied, "I guess it was our intention that ... the language was fairly clear with respect to that, that this really was only with respect to new investments. However, ... where we could ..." [The teleconference cut out at this point.]

REPRESENTATIVE ROKEBERG suggested different scenarios could be arrived at with regard to what is exploration, production, and development. He said the infrastructure clearly is allowable under the bill - rightfully so, because there must be infrastructure in place to have production. He mentioned coal bed methane and that if trying to increase field size, someone may punch in 30, 40, or 50 wells "to keep the deal going." Asking where to draw that line, he requested input from Mr. Barnes.

MR. BARNES responded that probably the clearest trigger would be when the initial production begins. He then suggested that the day when gas is first sold might be an appropriate trigger. He explained:

At that point in time you've shifted phases, and you might have, as you said, additional drilling ... in a fault block that's already under production, and then, by the definition of reservoir, it's not to qualify. If you step out into a riskier area, a new fault block, a new strata - it's not currently [being] produced - then ... I believe that you ... would incentivize that well, but not any facilities, because that's already on production. But I would think that a good trigger point, whether it was for a well or a facility, would be the day first gas goes through ... that tangible item. It would be ... the least controversial, I would think.

Number 2650

REPRESENTATIVE KERTTULA asked whether there is any other definition of "production" under this title in the statutes.

MR. BARNES replied, "I'm not certain. I know that's when we start ... paying taxes."

REPRESENTATIVE FATE offered his belief that a yardstick for oil is when the first molecule enters the pipeline going to market. Therefore, he suggested that production of gas should be when that first molecule - whether from one well or from collecting lines, for example - gets into the transportation system to go to market.

Number 2693

REPRESENTATIVE ROKEBERG proposed that it would be easier [to determine] with gas - which this bill applies to - than with oil because there wouldn't be "small little stripper gas wells."

MR. BARNES said he hoped not. Noting that he isn't an expert on it, he offered that coal bed methane operations involve moving significant volumes of water to dewater the coal; after a point, gas is being produced that goes through a sales meter and so forth; it is bound by lease terms, royalty, and severance tax. He suggested there is a fiduciary responsibility to monitor and account for that gas. Even though there is activity going on, it is known when gas has been sold, he indicated.

REPRESENTATIVE ROKEBERG referred to Evergreen [Resources]. Indicating the desire to make sure companies qualify and can

make a profit, he suggested making [the legislation] even looser for coal bed methane.

Number 2792

REPRESENTATIVE FATE pointed out that the [Alaska Oil & Gas Conservation Commission (AOGCC)] could determine where development ends and production begins. He suggested that would be simple, and offered his belief that one responsibility of AOGCC is to determine when that molecule goes through [the pipeline] that will go to market.

Number 2812

REPRESENTATIVE McGUIRE, following up on the testimony of Mr. Barnes, highlighted the importance of determining the intent. She posed a scenario in which there has been exploration on one well and production has begun. If a company wanted to "step out a little bit and see what's around," that would be exploration. She asked, "Are we going to count that as new exploration, even though there is production that has already ... come into play on a well within a certain region? ... Do we want to define it by proximity ... to the original, or do we care?" She asked to hear from the sponsor.

REPRESENTATIVE CHENAULT responded that it has been addressed somewhat in the definitions of gas reservoirs. He noted that the bill says [in subsection (h)(1)] "gas reserves in a gas reservoir for which there has not been commercial production". He offered his interpretation: if a company "stepped out into the reservoir during more [discovery], I guess there would be ... either an understanding there that ... if you have commercial production out of that reservoir, then that wouldn't apply to the tax credit [or] if you stepped outside of that reservoir or you went into ... another area, then, in turn, that could be conceived ... as new exploration, and it would fall in underneath this incentive program."

Number 2897

CHAIR KOHRING asked whether members wanted to amend the bill to provide that delineation, or leave it as is and have the AOGCC determine any needed clarification.

The committee took an at-ease from 4:09 p.m. to 4:11 p.m. [Tape ends 1.5 minutes early; no testimony is missing.]

TAPE 03-13, SIDE B

Number 2924

CHAIR KOHRING requested that Mr. Logsdon address the committee on this issue.

Number 2898

CHUCK LOGSDON, Chief Petroleum Economist, Tax Division, Department of Revenue, told members the proposed CS [Version D], in the department's view, is a better bill and will provide additional commercial incentive to industry to explore and develop the gas resource in Cook Inlet. Noting that the department didn't have a position on the bill, he said it is clear from the committee's discussion that members fairly well understand what the issues are. From the department's standpoint of determining a monetary effect, he pointed out, it is fairly complicated to determine an exact dollar amount, because the bill is broad-based and could cover any gas from an "elephant" field to coal bed methane. Fixing a price tag would be fairly difficult without knowing where the gas would be found, and what quantity and quality it would be.

Number 2836

MR. LOGSDON highlighted the importance of the price of natural gas: if the bill were put into law, there is a modest risk that if gas prices continued to rise, there would be an "accelerating, market-driven development" of new gas reserves, which would suggest that the credit wasn't needed. He added that now that [the bill] has a 10-percent credit for any [qualified capital investment or 10 percent of the annual cost incurred for qualified services], "we're looking at something that's a little more conventional from an income tax standpoint, as was also mentioned that the ITC in the federal tax for that is a little more conventional, and that although ... it's possible ... that there might be a better way of incentivizing, clearly this bill ... would increase commercial incentive to look for gas and develop it in the Cook Inlet."

Number 2766

REPRESENTATIVE ROKEBERG referred to page 3 of Version D [lines 18-22, subsection (h)(1)], which read in part:

(1) "qualified capital investment" means a cash expenditure or binding payment agreement, as described

in (b)(1) of this section, for real property or tangible personal property used in this state in the exploration and development of gas reserves in a gas reservoir for which there has not been commercial production if the reserves produce gas for sale and delivery;

REPRESENTATIVE ROKEBERG asked Mr. Logsdon whether additional language was needed to clarify the exact point of triggering the ITC or when it would cease.

MR. LOGSDON said he hadn't thought about whether there is a need for a more specific trigger. He offered some initial thoughts on it, however, as follows:

We know that there are areas where it's more likely to find gas than other areas right now. ... And as Mr. Barnes stated, gas ... reserves often are produced in a different way than oil reserves. I've been told that in some cases, because there is a deliverability requirement, you might find that you could have initial production from a reserve to meet your deliverability by drilling one well, and that ... as other ... reserves decline [and] you need the ... additional deliverability from that reserve, you may need to drill more wells. ... But that's just an example. So, to come up with a triggering mechanism that covers all cases, I think, you ... might find difficult.

Number 2658

CHAIR KOHRING pointed out that the committee hadn't received a revised fiscal note [for Version D from the Department of Revenue], but surmised that it would remain a zero fiscal note.

MR. LOGSDON affirmed that.

Number 2587

REPRESENTATIVE ROKEBERG began discussion of Conceptual Amendment 2. He asked Ms. Zabel for any recommendations about incorporating the U.S. tax code as a guideline in relation to qualified capital investments and qualified services.

MS. ZABEL responded, "It was our intention that the language that was included in there, 'directly applicable', would be

limiting enough." She expressed the need to think about it further.

REPRESENTATIVE ROKEBERG asked her to consider it.

Number 2540

REPRESENTATIVE ROKEBERG moved to adopt Conceptual Amendment 2, to amend subsection (h) beginning on page 3, line 17. He noted that this may apply both to [paragraph] (1) on line 18, "qualified capital investment", and to [paragraph] (2) on page 4, line 10, "qualified services". He explained:

The conceptual amendment would be to modify subsection (h) ... to reflect ... the United States Code as to the guidelines for the definitions and then implementations of an investment tax credit as it relates to this ... section.

REPRESENTATIVE ROKEBERG said the idea is to be "consistent in the Alaska application of what the definitions of those items would be, and not inconsistent with the U.S. tax code," to hopefully give the department some guidelines in terms of defining "stop-cost" and other issues. He suggested the bill could then be moved to the next committee of referral, and either that committee or the House Finance Committee could "verify that, to see how that works." He concluded by saying it is a conceptual amendment "to adopt the U.S. Code ... under investment tax credits to that section (h), as appropriate."

Number 2413

CHAIR KOHRING asked whether there was any objection to the adoption of Conceptual Amendment 2. There being no objection, it was so ordered.

Number 2395

REPRESENTATIVE KERTTULA, apologizing for her absence at the previous hearing, requested confirmation that there is no price trigger under the bill, no matter what the price of gas is. If there were a known field and the price were "hitting the ceiling," this [incentive] would still be allowed. She asked Mr. Myers whether she was reading that right.

Number 2359

MARK MYERS, Director, Division of Oil & Gas, Department of Natural Resources, answered, "Yes, you are. There is no sort of needs-based assessment or requirement here. It's simply a credit for the investment, regardless of price."

REPRESENTATIVE KERTTULA asked, when incentives are instituted, whether [the legislature] ever considers a ceiling if the price is high and [the incentive] isn't necessary to spur production.

MR. MYERS offered his belief that, with this type of incentive, it is sort of a gamble, a "chicken or egg," which is the reason for the difficulty in quantifying its worth and cost. [This bill] puts some protection in the form of sideboards so that pre-commercial production is clearly the limit of the expenditures. Also, by using a date of 2002, he indicated it assumes the intention of wanting to pay credits for things that have already been done for at least a year. He suggested that if the motivation is to incentivize future behavior rather than current behavior, the date might be an issue.

Number 2280

MR. MYERS began discussion of what would become Amendment 3. Noting that there is some protection against double dipping in conjunction with other incentives, he pointed out that subsection (g), page 3, line 13, says "tax" rather than "tax or royalty". With the bill written that way, there wouldn't be the ability to double dip on tax incentives, but would be the ability to get royalty [modification] plus this incentive. He offered his belief, based on previous committee discussion, that it was an oversight.

MR. MYERS concluded his response to Representative Kerttula by saying this is not necessarily needs-based, although it is a rational credit similar to federal credits. He said there certainly is a need for more exploration and development in Cook Inlet. He added, "I think you struggle with the concept of what are you incentivizing. This clearly is beyond just incentivizing exploration, but all those pre-production expenses as well. And it would work for established fields that have yet to [be] proven commercial, as well as undiscovered resources."

Number 2178

REPRESENTATIVE CHENAULT addressed the possible addition of "or royalty" in subsection (g). He said this question had arisen earlier, and that he didn't see any problem with putting

"royalty tax credit" in there also. He said it would be an "either/or," as an option.

Number 2134

REPRESENTATIVE FATE suggested asking Mr. Barnes as well. He said he himself didn't like the double dipping, and that, to his belief, the intent of [Marathon Oil Company] wasn't to do so. He suggested that adding "royalty" still allows an either/or, but not both [the incentive and another].

CHAIR KOHRING, responding to a pronouncement from the audience, stated, "Just for the record, they do concur with adding the verbiage in there."

Number 2102

REPRESENTATIVE FATE moved to adopt Amendment 3, adding "or royalty" [on page 3, line 13]. There being no objection, it was so ordered.

REPRESENTATIVE ROKEBERG asked whether the amendment should read "royalty credit or modification", for example.

MR. MYERS, in response to a request for his input, offered his belief that "royalty modification" would be more clear. He explained that in some cases there is a credit such as an economic incentive credit; in other cases, such as royalty reduction, there is a modification in the royalty rate.

Number 1985

REPRESENTATIVE KERTTULA requested an amendment to Amendment 3 so that it would read "or royalty modification". Thus subsection (g) would read:

A taxpayer who obtains a credit under this section may not claim a tax credit or royalty modification provided for under any other title. However, a taxpayer may, at the taxpayer's election, forgo a credit under this section in order to continue to qualify for a credit provided for in another title.

CHAIR KOHRING, hearing no objection to the amendment to Amendment 3, announced that [Amendment 3, as amended] was adopted.

Number 1973

REPRESENTATIVE KERTTULA began discussion of what she would offer later as Amendment 4. She expressed concern about the retroactivity on page 4, line 28, which says [AS 43.20.043, added by Section 1] is retroactive to January 1, 2003. She noted that this bill is meant to be an incentive and forward-looking.

MR. BARNES suggested it is a policy question.

The committee took an at-ease from 4:31 p.m. to 4:33 p.m.

Number 1884

REPRESENTATIVE KERTTULA noted that the law would become applicable January 1, 2003. She said the question goes to what would have happened in that period to which this [incentive] might apply.

MR. BARNES responded:

I think we've announced the discovery, and we are doing some work. ... This bill has been two or three years in the making, and each year you just start with the date. I think the policy issue for this committee or someone else [is] ... to pick a start date. ... Frankly, I care more about getting a bill in place than the start date. But, again, as written, it starts January 1, ... 2003.

Number 1839

REPRESENTATIVE ROKEBERG pointed out that this isn't new legislation. He suggested the need to use the December 31 date because of the tax year - assuming it's a calendar year, notwithstanding whatever fiscal year a company might use, consistent with the tax code. He suggested the other option is to have it not apply to anything that has occurred "this calendar year as a tax year." He suggested Marathon Oil Company needs to answer how much money it has spent this year for which it might benefit this particular calendar year.

MR. BARNES replied:

We're spending money this year. We spent some money last year. I hope to spend some money next year.

Again, the intent of the bill is to try to level that playing field so we can see capital investments ... by Marathon plus other companies. So, Marathon's position is that a start date's a policy question. We are doing some work. Some other parties are doing some work. I think ... our point all along has been that there's not sufficient activity in the inlet. So I don't know what a correct start date would be.

Number 1756

REPRESENTATIVE ROKEBERG alluded to page 2, lines 5-7, which read, "(1) cash expenditures or binding payment agreements entered into after December 31, 2002". He suggested it is clear that anything after that date would apply. He suggested that with the Ninilchik field, most of the money would have been spent before that date.

MR. BARNES responded:

We're in the middle of trying to get the field developed, so there will be ongoing expenditures. I'm not certain, depending on where you draw a line, how much is last year, this year to date, and next year. ... We could provide that. But, clearly, ... I care more about, "Pick a date, get an incentive going." But you are correct: we are doing work, and we are spending money.

REPRESENTATIVE ROKEBERG expressed concern about negative media coverage if there isn't full disclosure about whether the legislature is doing this specifically to help [Marathon Oil Company] on one project. He said he believed what Mr. Barnes was saying, that Mr. Barnes was more concerned about future public policy. He suggested that if the company would have spent tens of millions of dollars this year that would apply, for example, the legislature should know about that before making a final decision.

Number 1675

REPRESENTATIVE FATE, noting that this bill has been before the legislature at least two years, said this also refers back to when [Marathon Oil Company's] project started, because expenditures before that date wouldn't be applicable. He suggested that expenditures from some of the development work might be much greater than the expenditures from January 1,

2003. He agreed with Representative Rokeberg that, if that is the case, it should be publicized and [the legislature] should know it.

Number 1617

REPRESENTATIVE KERTTULA moved to adopt [Conceptual Amendment 4], to remove the retroactivity. She explained:

At this point, we don't know. And I think if the information comes forward and we feel confident when it goes to [the House Finance Committee], it could be added back in. But right now, at this time, I don't feel confident; I don't know what they are. I think it does throw the whole thing into question, because this is an incentive. It's not for things that have really already been on line, that we know are going to happen. It really is to get people out and to do new things. And I'd feel more comfortable if the retroactivity were out.

Number 1590

REPRESENTATIVE ROKEBERG objected for discussion purposes. He suggested it is a matter of faith with regard to whether to move this out of committee and let [Representatives Fate and Chenault, who co-chaired the House Resources Standing Committee] work on it. He said he agreed with Representative Kerttula's point, which is why he'd asked that information be brought forward. He said the question is whether to amend it out just because she isn't comfortable until the data can be seen. He said he didn't want the bill to sit [in committee] too much longer.

REPRESENTATIVE KERTTULA again expressed concern that if something is happening already, it isn't proper for that to receive an incentive.

Number 1539

REPRESENTATIVE FATE asked [Mr. Barnes] if he could come up with some figures before the bill goes to the House Resources Standing Committee. He said he had no objection to a retroactive date if it could be justified.

MR. BARNES replied:

My feeling would be, if there's a discussion there, I would suggest we just follow Representative Kerttula's suggestion ... and really just ... drop the retroactivity, because no matter how much money Marathon spent, ... we've spent a significant amount last year, we're spending a pretty good amount of money this year. ... I believe that it'd always be a question. And, frankly, I don't know that Marathon wants that question, "Was this done just for this project or that?" And, ... frankly, I'd rather just ... step away from it and get a bill going that does incentivize activity. And if that's ... really the critical issue, I think ... that would be the simplest thing. And, as I said before, I'd rather see Marathon and other companies out there doing work without having this question in front of us.

REPRESENTATIVE FATE responded that it's probably a good suggestion because of proprietary information that might be exposed, which Marathon Oil Company might not want exposed.

Number 1462

REPRESENTATIVE ROKEBERG said, "I think the cat's out of the bag. They have to expose it, one way or the other, and ... they owe it to the public." He surmised that Representatives Kerttula, Fate, and Chenault, who all currently served on the House Resources Standing Committee, would ensure that this is right after it moves along. He recommended leaving it alone and getting a promise from the sponsor and [Representative Fate] to take it up or offer another amendment [in the House Resources Standing Committee].

Number 1400

REPRESENTATIVE MCGUIRE remarked that what she was hearing from Mr. Barnes was that he'd rather see a good bill go forward that will do the right thing, without having distractions about the retroactivity that she believed would exist. She explained that people would assume this is some sort of gift being given by the legislature to special interests. She said:

I'd rather see it be cleaner. I think it's the right thing to do, to give incentives. I think we want to see these ... reservoirs developed. I think this bill is great. I applaud all the work of Marathon. And I think that's what I hear you saying. So I don't

understand why we're going to leave it in, when you hear the people who are wanting the bill [Mr. Barnes] ... say "out".

Number 1324

REPRESENTATIVE KERTTULA thanked Representative Rokeberg for pointing out the importance of obtaining the information. She said she would hope Marathon Oil Company would come forward and elaborate on that in [the House Resources Standing Committee]. She said it isn't just because of the long history of the bill; this will still be open to the challenge of rising market prices and whether [the incentive] is really necessary. She expressed appreciation for the openness.

Number 1266

REPRESENTATIVE ROKEBERG maintained his objection, saying that he lives in the Cook Inlet area, which needs gas.

CHAIR KOHRING concurred with Representative Rokeberg, suggesting that the more that is put in the bill, the more there will be incentives to develop gas. He specified the desire to keep the January 1 [2003] start date. He said he also wondered about the issue of proprietary information. Noting that the intent of the legislation is to encourage [exploration and development], he said he thinks [this amendment] takes a little away from that.

Number 1220

MR. BARNES told members:

Just another observation that I would throw out regarding Representative Kerttula's comment on price: I think the goal of an incentive is to mitigate price increases. If prices do go up, you're correct. I would say that that would be one stimulus, but that would probably be a measure of lack of incentive, because it reflects market conditions, it reflects supply-demand, which says that, ... obviously, the supply is down relative to the demand. So, ... indeed, that would be a driver. My thought, my suggestion might be that that would be a measure that we were too late, perhaps, in considering the incentive.

And the other thing I would offer up, though, is: the intent of this bill was to draw capital into the Cook Inlet. So it's not only Cook Inlet gas prices that we will watch, it's other investment opportunities that companies have. If gas prices increase in the Cook Inlet to ... a level that we don't like, but that's less than perhaps Lower 48 prices are, then capital will, nonetheless, go to the Lower 48 until prices rise in the Cook Inlet again to that same level. So it's not only Cook Inlet supply-demand directly, it's also that relative balance between investment opportunities that corporations have.

REPRESENTATIVE KERTTULA said that was a good point.

Number 1105

A roll call vote was taken. Representatives Kerttula and McGuire voted in favor of Conceptual Amendment 4. Representatives Chenault, Rokeberg, Fate, and Kohring voted against it. Therefore, Conceptual Amendment 4 failed by a vote of 2-4.

REPRESENTATIVE ROKEBERG surmised that the bill's sponsor and [Representative Fate] would follow up on the concern expressed by Representative Kerttula. He said he'd certainly change his position [on the retroactivity] if it turned out there was an unwarranted amount. He again suggested the need to see the figures from this company, if it would provide them. He then asked Representative Chenault where the 68th parallel is.

Number 0971

REPRESENTATIVE CHENAULT said it is about at the Brooks Range. As the sponsor and current co-chair of the House Resources Standing Committee, he announced the intention of working to answer these questions and to talk with representatives from Marathon Oil Company, in order to answer the questions so that everyone is happy with the bill.

REPRESENTATIVE FATE echoed those comments. Going to a map on the wall, he pointed out the 68th parallel, noting that it basically runs to the Brooks Range. He said there is coal bed methane at Red Dog [Mine] above the 68th parallel, to his understanding; however, most gas above the 68th parallel is conventional gas.

REPRESENTATIVE ROKEBERG suggested perhaps finding a way to get the line above the Red Dog [Mine].

Number 0814

REPRESENTATIVE McGUIRE moved to report CSHB 61, Version 23-LS0270\D, Chenoweth, 3/6/03, as amended, out of committee with individual recommendations and the forthcoming fiscal note. There being no objection, CSHB 61(O&G) was reported from the House Special Committee on Oil and Gas.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 4:51 p.m.