

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**May 13, 2003**  
**4:41 PM**

**TAPES**

SFC-03 # 92, Side A  
SFC 03 # 92, Side B  
SFC 03 # 93, Side A

**CALL TO ORDER**

Co-Chair Gary Wilken convened the meeting at approximately 4:41 PM.

**PRESENT**

Senator Gary Wilken, Co-Chair  
Senator Con Bunde, Vice Chair  
Senator Robin Taylor  
Senator Donny Olson  
Senator Lyman Hoffman  
Senator Ben Stevens

**Also Attending:** SENATOR THOMAS WAGONER; BILL CORBUS, Commissioner, Department of Revenue; TRACI CARPENTER, Staff to Senator Lyda Green; JOHN MACKINNON, Deputy Commissioner of Highways & Public Facilities, Department of Transportation and Public Facilities; KATHLEEN STRASBAUGH, Assistant Attorney General, Governmental Affairs Section, Civil Division (Juneau), Department of Law; MARY JACKSON, Staff to Senator Thomas Wagoner; MARK MYERS, Director, Division of Oil & Gas, Department of Natural Resources; DAN DICKINSON, Department of Revenue; STEVE PORTER, Deputy Commissioner, Department of Revenue

**Attending via Teleconference:** From offnet sites: DOUG SHULTZ, Vice President, XTO ENERGY; KEVIN TABLER, Land and Government Affairs Manager, Unocal Oil

**SUMMARY INFORMATION**

SB 213-KNIK ARM BRIDGE AND TOLL AUTHORITY

The Committee heard from the Department of Transportation and Public Facilities and the Department of Law. Three amendments were adopted, and the bill reported from Committee.

SB 117-ELIMINATING LONGEVITY BONUS PROGRAM

A committee substitute was adopted, and the bill reported from Committee.

SB 185-ROYALTY REDUCTION ON CERTAIN OIL

The Committee heard testimony from the sponsor, the Department of Revenue, the Department of Natural Resources, and the public. A committee substitute was adopted, and the bill was held in Committee.

SB 100-APPROP: CAPITAL PROJECTS

One amendment was withdrawn from consideration, and the bill reported from Committee

#sb213

SENATE BILL NO. 213

"An Act establishing the Knik Arm Bridge and Toll Authority and relating to that authority; and providing for an effective date."

This was the second hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken stated that this legislation would establish an independent authority to build and operate a toll bridge over the Knik Arm. He clarified that SB 213, 23-GS1149\A, is the version before the Committee, and he reminded the Committee that previous questions on the bill included the composition of the Bridge Authority's members.

Amendment #4: This amendment provides for the appointment of two additional members to the Knik Arm Bridge Authority. In addition, the amendment provides for staggered member terms and defines initial term timelines.

Co-Chair Wilken moved to adopt Amendment #4 on behalf of its sponsor, Co-chair Green. He noted that Amendment #4 is similar to Amendment #1, sponsored by Senator Hoffman, that has yet to be offered for adoption.

TRACI CARPENTER, Staff to Senator Lyda Green, explained that Amendment #4 would add two members to the Bridge Authority; one to

represent the Matanuska Susitna Borough and the other to represent the Municipality of Anchorage. Additionally, she noted that the amendment clarifies the initial length of Board service for the three public members who are specified to serve five-year staggered terms.

Ms. Carpenter noted that Amendment #4 differs from Amendment #1 in that Amendment #4 does not address the Board vacancy appointment process.

Senator Taylor questioned the need to define the areas the two members would represent, as he attested, individuals from other regions could be assets to the Board.

Senator B. Stevens asked the Department of Transportation and Public Facilities' position on the amendment.

JOHN MACKINNON, Deputy Commissioner of Highways & Public Facilities, Department of Transportation and Public Facilities, commented that the amendment is acceptable to the Department.

Senator Olson asked whether the amendment would affect the fiscal note.

Mr. MacKinnon responded that the fiscal note should be increased approximately \$14,400 to provide stipend funds for the two additional members.

Co-Chair Wilken shared that Co-Chair Green is concerned about the amount of the fiscal note, and that she is negotiating with the Department to reduce it. He surmised that the final fiscal note would be "significantly less" than the original \$523,700 fiscal note.

There being no objection, Amendment #4 was ADOPTED.

Amendment #3: This amendment deletes subsection (f) of Sec. 44.90.221 of the bill, on page 8, lines 16 - 20 that reads as follows.

(f) The chair of the board shall annually, not later than January 2, deliver to the governor and the legislature a certificate stating the sum, if any, required to restore any capital reserve fund to the capital reserve fund requirement. Money appropriated during that fiscal year for capital reserve fund restoration shall be deposited by the authority in the proper capital reserve fund.

On behalf of Co-chair Green, Co-Chair Wilken moved for the adoption of Amendment #3. He then objected for sake of explanation.

Ms. Carpenter informed the Committee that the Department of Law recommends that Section (f) be deleted from the bill as it might negatively impact the State's bond rating.

KATHLEEN STRASBAUGH, Assistant Attorney General, Governmental Affairs Section, Civil Division (Juneau), Department of Law, explained that subsection (f) would create "a moral obligation on the part of the State to back the bonds of this agency." She stated that this action is inconsistent with other sections of the bill that are designed "to assure the financial independence" of the Board. She voiced that the Treasury Division of the Department strongly recommends that the section, whose inclusion is "an oversight" be deleted.

Co-Chair Wilken removed his objection.

There being no further objection, Amendment #3 was ADOPTED.

Senator Hoffman asked whether the Knik Arm Authority would be subject to the requirements of the Executive Budget Act.

Ms. Strasbaugh explained that the Executive Budget Act requires that, with the exception of debt retirement funds, any funds generated from the State must be reported. She noted that the information in question is located on page five line nine of the committee substitute that reads as follows.

(2) comply with the provisions of AS 37.07 (Executive Budget Act), except that AS 37.07 does not apply to the activities of the authority that relate to the authority's borrowing of money as provided in this chapter, including the issuing of its obligations or evidence of that borrowing and the repayment of the debt obligation.

Ms. Strasbaugh continued that this section does not relieve the Authority from certain reporting requirements as outlined in other sections of the bill.

Senator Taylor asked about provisions that provide immunity to the Authority.

Ms. Strasbaugh responded that provisions that relieve Board members from personal liability are included in Sec. 44.90.241 on page nine, lines 17 - 19 that reads as follows.

Sec 44.90.241. Nonliability on bonds. (a) Neither the members of the board nor a person executing the bonds of the authority is liable personally on the bonds or is subject to personal liability or accountability by reason of issuance of the bonds.

Senator Taylor voiced support for these provisions.

Amendment #2: This amendment inserts new subsections into Section 44.90.031 of the bill on page 2, line 13, following the word "citizen" to read as follows.

(4) one nonvoting member who is a member of the state house of representatives appointed by the speaker of the house and who serves at the pleasure of the speaker of the house; the speaker of the house shall consider the appointment of a legislator elected from a house district that lies entirely or partially within the Municipality of Anchorage or the Matanuska-Susitna Borough for appointment under this paragraph; and

(5) one nonvoting member who is a member of the state senate appointed by the president of the senate and who serves at the pleasure of the president of the senate; the president of the senate shall consider the appointment of a legislator elected from a house district that lies entirely or partially within the Municipality of Anchorage or the Matanuska-Susitna Borough for appointment under this paragraph

In addition, Amendment #2 contains conforming language and inserts the word "voting" in language on page 2, lines 22, 23, 26 when referring to members of the board.

Senator Hoffman moved for the adoption of Amendment #2.

Co-Chair Wilken objected for discussion.

Senator Hoffman stated that Amendment #2 specifies that a member of the House of Representatives and the Senate would be non-voting members on the Board. He stated that in addition to providing an opportunity for other regions of the State to be represented on the Board, the inclusion of Legislators would allow the Legislature to be "better informed" regarding the Authority.

Amendment #1: This amendment inserts a new subsection into Sec. 44.90.031 on page 2, line 13 of the bill that reads as follows.

(4) one public member, appointed by the governor from a list of 5 names submitted by the mayor of the

Municipality of Anchorage, who is a state resident, resident of the Municipality of Anchorage, and United States citizen;

(5) one public, appointed by the governor from a list of 5 names submitted by the mayor of the Matanuska-Susitna Borough, who is a state resident, resident of the Matanuska-Susitna Borough, and United States citizen;

Additionally the amendment inserts new language to subsection (c) of Sec. 44.90.031 on page 2, line 18, following "appointment" to read as follows.

(c) If a vacancy occurs in the public member seat on the board, the governor shall make an appointment to fill the vacancy in the same manner as the previous appointment to that seat, effective immediately, for the unexpired portion of that member's term.

Furthermore, in addition to technical changes, the amendment inserts a new bill section on page 12, following line 30 to read as follows.

Sec. 4. The uncodified law of the State of Alaska is amended by adding a new section to read:

APPOINTMENT OF THE INITIAL PUBLIC MEMBERS OF THE KNIK ARM BRIDGE AND TOLL AUTHORITY. Notwithstanding AS 39.05.055 and AS 44.90.031(b), added by sec. 1 of this Act, the governor shall appoint the initial public members of the board of directors of the Knik Arm Bridge and Toll Authority to terms as follows:

- (1) one public member to a term of five years;
- (2) one public member to a term of three years;  
and
- (3) one public member to a term of one year.

Senator Hoffman informed the Committee that he would not be offering Amendment #1 for consideration because of its similarity to Amendment #4.

Senator Bunde shared that there is a "parallel experience" with Legislative representation on a Postsecondary Education Commission. He noted that, "there is an on-going legal discussion as to whether" this representation is appropriate because of Legislative funding authority. Nonetheless, he voiced support for the concept.

Mr. MacKinnon stated that the reporting concern might be addressed by language on page five, lines one through eight, that requires the Authority to submit various reports to the Legislature and the Governor on an annual basis.

Co-Chair Wilken asked the Department's position regarding Legislative representation on the Board.

Mr. MacKinnon responded that the Department does not support the amendment.

Senator Bunde commented that Legislative representation on the Board might be beneficial in that it could provide the Board with immediate Legislative reaction to a situation before rather than after an event occurred.

Co-Chair Wilken removed his objection.

Without further objection, Amendment #2 was ADOPTED.

Senator Taylor moved to report the bill, as amended, from Committee with individual recommendations and accompanying fiscal note; however, he objected to state that while "this might be the most expeditious way to get that bridge built," the citizens of the area would be burdened with its administrative expense. He stated that were the Department of Transportation and Public Facilities rather than a bridge authority to build the bridge, the users would not have a burden. He noted his repeated efforts to instill toll roads and a Road Toll Authority in addition to a Marine Toll Authority to replace the current Marine Advisory Board.

Senator Taylor voiced support for building the Knik Arm Bridge, as he expressed that the citizens of the area, who might be required to pay approximately twenty dollars to transit the Bridge, would then be able to understand how the citizens of Southeast Alaska are affected by having to pay for transportation on the Marine Highway System.

Senator Taylor removed his objection.

Senator Bunde objected to the motion. He stated that, in consideration of the State's fiscal dilemma, all expenses should be questioned. He asked whether the State expenses associated with this legislation would be factored into the operating expenses of the bridge and into the toll amount charged for bridge transit.

Co-chair Wilken clarified that the question is whether State funds and other expenses that establish the Authority would be reimbursed via the toll system.

Mr. MacKinnon voiced the expectation that they would.

Senator Bunde repeated Mr. MacKinnon's comment, for the record,

that the State would be reimbursed. He removed his objection.

Senator Olson asked whether the toll amount has been established.

Mr. MacKinnon responded that the amount is unknown as the project is in the conceptual stage.

Without further objection, CS SB 213(FIN) was REPORTED from Committee with previous fiscal note #1 in the amount of \$523,700 from the Department of Transportation and Public Facilities.

#sb117

SENATE BILL NO. 117

"An Act eliminating the longevity bonus program and making related conforming changes; and providing for an effective date."

This was the third hearing for this bill in the Senate Finance Committee.

Senator Taylor moved to adopt CS SB 117, 23-GS1100\B, as the working document.

Senator Hoffman objected for explanation.

Senator Taylor explained that the committee substitute would provide for a five-year phase out of the longevity bonus program with the program being eliminated from State statute at the conclusion of that time. He communicated that he is furthering this proposal, not because he avidly supports it, but because it is an acceptable solution to the Pioneers of Alaska and AARP whose "wisdom" in the matter he acknowledges.

Co-Chair Wilken stated that the committee substitute's fiscal note would be forthcoming.

Senator Hoffman removed his objection, although he opined that the legislation does not reflect the wishes of "the masses" of the State's senior citizen population.

Without further objection, Version "B" was ADOPTED as the working document.

Senator Taylor moved to report the bill from Committee with individual recommendations and forthcoming fiscal note.

Senator Hoffman and Senator Olson objected.

Senator Hoffman reiterated that this legislation does not represent the desire of the majority of the State's seniors.

Senator Olson argued that the process has not provided sufficient time for public input. He noted that the elders in his Legislative District do not support the proposal.

A roll call was taken on the motion.

IN FAVOR: Senator B. Stevens, Senator Taylor, Senator Bunde and Co-chair Wilken

OPPOSED: Senator Olson and Senator Hoffman

ABSENT: Co-chair Green

The motion PASSED (4-2-1)

CS SB 117(FIN) was REPORTED from Committee with a forthcoming fiscal note.

#sb185

CS FOR SENATE BILL NO. 185(RES)

"An Act providing for a reduction of royalty on certain oil produced from Cook Inlet submerged land."

This was the first hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken informed the Committee that this bill would reduce royalty rates on oil production from offshore oil platforms on submerged lands in Cook Inlet based in a specified daily production rate. He moved for CS SB 185, 23-LS0926\Q, to be adopted as the working document.

Senator Hoffman and Senator Taylor objected for further explanation of the committee substitute.

SENATOR THOMAS WAGONER, the bill's sponsor, stated that the original intent of the bill was to revise State statutes pertaining to royalties on certain Cook Inlet oil fields nearing the end of their production capacity. He declared that a reduction in royalty expenses would make a field more economical to operate and allow producers to maximize production and continue employment opportunities.

Senator Wagoner stated that this increase in oil production "would be more than would have originally been realized, and subsequently, more royalty revenue even at the reduced rate." He continued that encouraging production in these "marginal fields will extend their life by a minimum of eighteen to twenty four months."

Senator Wagoner continued that, in addition, the original bill proposed new field exploration tax credits in order to create new jobs and revenue for the State.

MARY JACKSON, Staff to Senator Wagoner, explained that the committee substitute expands the original bill by inserting new language in Section 1 that would grant the Alaska Oil and Gas Conservation Commission the authority to incorporate the new provisions of the bill into statute. Furthermore, she stated that a new subsection pertaining to "midrange producers" was inserted into Section 2.

Ms. Jackson detailed the entirety of Section 2 as follows: Subsection (6)(A) identifies the rigs that would be eligible under the 1,200 barrel per day jurisdiction and Subsection (6)(B) identifies the royalty percentages for those identified rigs; Subsection (6)(C) inserts a new "midrange" production level pertaining to rigs that produce in the 975 barrels per day range and Subsection (6)(D) specifies the royalty rate for the midrange rigs; Subsection (6)(E) identifies rigs producing less than 750 barrels per day with Subsection (6)(F) specifying the royalty range for those rigs; and Subsection (6)(G) pertains to rigs in the West McArthur River field with Subsection (6)(H) specifying royalty ranges for that field. She stated that Subsection (6)(I) defines the criteria for determining the daily barrel production of a platform or field.

Ms. Jackson continued that Section 3 of the committee substitute outlines the new tax credit provisions.

Senator Hoffman removed his objection.

Without further objection, committee substitute Version "Q" was ADOPTED as the working document.

Senator Hoffman asked how the fiscal notes would be impacted by the committee substitute.

Ms. Jackson informed the Committee that the Section 3 tax credit provisions are addressed in the Department of Revenue fiscal note dated May 11, 2003 and that the new section pertaining to the

midrange oil producers is addressed in the Department of Natural Resources fiscal note, dated May 9, 2003.

Senator Bunde asked whether the proposed tax credits would only be applied upon discovery of a viable oil field.

Senator Wagoner responded that the tax credits are more applicable to exploration than discovery. He continued that the purpose of the language is to entice companies "to invest more money in Alaska and drill more wells" so that the possibility of both discovery and production could be "substantially" increased.

Senator Bunde summarized therefore that the answer to his question is no.

Senator Wagoner concurred.

BILL CORBUS, Commissioner, Department of Revenue, commented that, "the exploration tax credit which would be applied to the severance tax ... is one ingredient of the Governor's long-range plan." He shared that the Alaska oil pipeline is currently operating at 50-percent of capacity and the goal of incentives such as the proposed tax credit is to enable the pipeline to operate at full capacity. He noted that the State currently offers minimal incentives to companies to explore, and he expressed that Governor Murkowski "strongly urges that this legislation be adopted."

Senator Olson asked the regions of the State that would be affected by this legislation, specifically whether it would affect North Slope producers.

Commissioner Corbus affirmed that the provision would be applicable statewide.

Senator Taylor observed that the bill originally addressed oil production in the Cook Inlet region; however, he continued, the committee substitute expands it to a statewide scenario. He asked for further information regarding Section 3(c) which provides a 20-percent tax credit for a hole drilled more than three miles away from an existing hole, and Section 3(d) which provides an additional 20-percent credit were the hole drilled at least 25 miles from an existing hole. He contended that recently a major new reservoir was discovered but was "set idle" in anticipation of this legislation being enacted. Furthermore, he declared that advances in technology allow for such technique as "slant drilling," which enables holes to be drilled to a reservoir from distances that would allow companies to unfairly "take advantage" of the tax credits.

MARK MYERS, Director, Division of Oil and Gas, Department of Natural Resources, assured that exploration drilling within an area of "an existing unit" would not qualify for the tax credits as the bill contains restrictions that specifically address this issue. Additionally, he clarified that wells that are currently planned for exploration and development would not qualify. He stated that it has been determined "that three miles from a bottom well location" is "a reasonable distance" as it would likely drill "into a separate accumulation." He stated that there might be an occasion where a new well might drill into a substantial adjoining accumulation, but "it is unlikely." In responding to Senator Taylor's comment about a recent major discovery, he stated that he is unaware of any "capped off major discoveries" at this time.

Senator Taylor asked whether provisions exist that would prevent an entity from "capping off" a major find and drilling into it from three-miles distance in order to qualify for these "significant" tax credits.

Mr. Myers responded that the distance requirements could be increased or that the "language could be crafted" to further address this scenario.

Senator Taylor expressed "some sensitivity for the position that the oil industry" alleges regarding the high cost of exploration in the State as he avowed that the State has worked to address these industry concerns for years. Furthermore, he voiced that because the State's current fiscal crisis mandates that such things as the Longevity Bonus Program be eliminated, various taxes and user fees be instituted, and a Statewide sales tax be considered, he finds it difficult to support further benefits to the industry. He stated that granting tax credits to the oil industry appears to be contrary to attempts to increase the revenue that the State requires.

Commissioner Corbus qualified that the potential impact on revenue to the State would not occur until FY 05. He asserted that "oil is our future," and that he considers this legislation to be "an investment." He asserted that the State must offer this incentive in order to secure "a long-term stream of oil."

Senator B. Stevens asked for further information regarding language in Section 3(g) that specifies that the production tax credit certificate could be transferred, conveyed or sold to another entity.

Commissioner Corbus confirmed that the production tax credit could

be sold provided that the purchasing entity has a severance tax obligation within the State.

Senator B. Stevens asked whether there are limits on the tax credit amounts that could be accumulated.

DAN DICKINSON, Director, Tax Division, Department of Revenue, stated that the amount of tax credit that a producer could utilize toward their tax liability is "the face value of the certificate."

Senator B. Stevens asked whether limits have been established regarding the "discounted value" of the tax credit certificate that could be sold to a qualifying entity.

Mr. Dickinson responded that no limits are specified as, he asserted, were discounts disallowed, there "would be no reason" for another entity to purchase the certificate.

Mr. Dickinson exemplified a scenario wherein a producer might spend five million dollars conducting the practice of what is referred to in the industry as "shooting seismic on spec." He conveyed that it is common industry practice to sell that five million dollar tax credit at a discounted price to another producer. He avowed that a purchasing entity would not be willing to pay \$5 million for the tax credit certificate.

SFC 03 # 92, Side B 05:29 PM

Mr. Dickinson continued that, regardless of the amount the purchaser pays for the tax credit certificate, the credit value would be five million dollars, which is the face value of the certificate. He clarified that no limits are placed on the number of certificates that an entity could accumulate.

Mr. Dickinson informed the Committee that the three largest producers in the State currently pay approximately \$20 to \$30 million a month in taxes. He stressed that were this legislation adopted and credits accumulating "at that level, we would have a very very vibrant" program.

Co-Chair Wilken provided Committee members with a handout [copy on file] that contains information regarding the "Cost of Exploration," dated May 12, 2003 and charts depicting the exploration goals and expectations of this incentive program. He stated that the handout might provide Members with additional explanatory information.

Senator Taylor asked whether entities that conduct seismic fieldwork regularly contract to sell that information as a normal course of business.

Mr. Dickinson stated that is correct.

Senator Taylor argued therefore, that those entities are being paid to conduct seismic research, and, in addition, receive a tax credit from the State that they could then discount and sell to another company. He continued that the purchasing company could then use the certificate, at full face value, against that company's tax liability with the State.

Senator Taylor continued that the initial contractor gets paid for the seismic work and, in addition, receives a discounted amount for selling their tax credit certificate. He concluded that the purchaser of the certificate would then be able to apply the full face value of that tax credit certificate toward their tax liability with the State.

Senator Taylor inquired as to whether the full face value of the certificate is based on actual dollar costs of conducting the seismic work or a percentage of the production number.

Mr. Dickinson explained that the price paid for the seismic information "is a negotiated figure." He stated that, "it is highly unlikely" that the buyer of the tax credit certificate is the same entity that purchased the original seismic information. He asserted that it is a small market and that there are not many purchasers; therefore, he attested, the interested parties are knowledgeable about the tax credit. He stated that the price would be affected by that knowledge.

Senator Taylor asked the number of steps involved in this scenario; specifically whether one or two agreements would be involved.

Mr. Dickinson informed that the situation could involve one or two parties. Furthermore, he commented that the situation could apply to another group of "independents who don't yet have production."

Senator Taylor asked for further information regarding the value assigned to the certificate.

Mr. Dickinson affirmed that the certificate is based on the actual cost of conducting the research. He clarified that the only limitation currently in the legislation is specified in Section 3(i)(1) which reads as follows.

(1) the amount of credit that may be applied against the production tax for each tax month may not exceed the total production tax liability of the taxpayer applying the credit for the same month.

Mr. Dickinson continued that the tax liability could be carried forward to the following months.

Senator Taylor opined, therefore, that the tax liability credits could be carried forth infinitely as no statute of limitations exists.

Mr. Dickinson replied that none exists; however, he noted that there is a four-year limit in which the qualifying work could occur.

Senator Taylor asked whether the legislation has a termination date.

Mr. Dickinson identified information in Section 3(a), which indicates that credits against the tax due are subject to oil and gas produced on or after July 1, 2004, and Section 3(b) which states that exploration expenditure must be incurred for work performed on or after July 1, 2003 and before July 1, 2007. He stated that this four-year window would prompt "this work to be done," and were it done, the State "would underwrite up to forty percent of it."

Senator B. Stevens asked why the oil and gas exploration tax credits for dry well expenditures differs from that allowed for a successful well.

Mr. Dickinson noted that these are "very different" situations.

Senator B. Stevens observed that the expenditures that could be applied to the credit for a successful well are "more expansive" in their incorporation of associated, allowable expenses.

Mr. Myers stated that there "is a different element of risk" associated with the expense of developing a successful well hole. He continued that expenses such as roads, leasing permits, and helicopter pads would be necessary as opposed to only the exploration expenses associated with a dry well.

Mr. Myers stated that the exploration credits are "deliberately" limited "on the exploration side not to include testing or development costs or ... delineation costs to try to minimize the

fiscal impact, yet encourage exploration."

Mr. Myers stated that as exploration is conducted further away from existing infrastructure, "you need to find a substantial discovery or series of discoveries to make it economical." He avowed that this legislation would assist in "pushing" those endeavors forward.

Mr. Dickinson interjected that philosophical differences occur in discussions regarding offering a broad-based project a ten percent credit and a narrower based project a larger credit.

Senator Hoffman inquired regarding the reason for offering an exploration tax credit of up to a 40 percent.

Commissioner Corbus responded that this proposal is a test program, which the Department would evaluate "at the end of year four."

Senator Taylor asked the Department whether this legislation would "encourage independents and wildcat" developers.

Mr. Dickinson voiced the belief that this program would entice those types of developers. He commented that this program would provide the Department with information regarding what incentives are required to encourage a variety of entities to conduct exploration in the State.

Mr. Dickinson referred Committee members to the aforementioned handout titled "Cost of Exploration." He noted that Alaska is at the "very bottom" of the table depicting the level of financial assistance that developers receive from the State as compared to other governmental entities.

Senator Taylor noted that another obstacle to encouraging independents to operate in the State is the inability to access the Trans Alaska Pipeline with their product. As a result of this access problem, he stated that even though these entities might have a successful find, they are forced to sell that find to one of the larger companies.

Mr. Dickinson commented that, while this concern is "clearly one of several aspects" of the industry, the focus of this legislation is to encourage the performance of exploratory work by the industry.

Mr. Myers shared that he has professionally worked in numerous exploration projects, and, as a result, he believes that there are multiple ways that a credit like this would work: first, it would provide companies that are not exploring their large tracts of exploration acreage the ability "to farm out an interest in their

properties in which case this credit would be of value in bringing other companies" to share the value of the credit. This, he asserted, would enable such things as drilling costs and other expenses to be more manageable. Secondly, he contended, the large number of small independents operating on the North Slope and "who are literally cash constrained" would benefit, as this legislation would assist them in getting their projects operational.

Mr. Myers shared that, in addition to the access issue facing some developers, the availability of rigs and ice making equipment; the cost of transportation of the crude oil; and "maneuvering through the environmental permitting process" are other areas of concern. However, he stressed that receiving up to a 40-percent tax credit as specified in this legislation would be important in addressing the cost restraints placed upon a company.

Senator Taylor noted that the legislation requires an actual ownership interest in the well rather than a partnership relationship, in order to qualify for the credit.

Mr. Dickinson clarified that the "earlier exploration incentive credit" did require an ownership interest; however, this committee substitute does not. However, he continued that "typically," it would be expected that the ownership company would be present in the activity. He stated that, "if they have an over-riding royalty interest or some other interest in there that is not a clear working interest they would qualify for this credit."

Senator Taylor voiced the understanding that in order "to get the credit...you had to have an actual ownership in that well."

Mr. Dickinson confirmed "to take the credit, because it's a severance tax, yes, you have to have that interest." He clarified that were an independent to own the credit, "they would have to sell it to someone who could actually take it."

Senator Taylor voiced concern that due to the limited market of entities with ownership interests, the discounts on the price of the tax credit certificate "would get pretty stiff."

Mr. Myers attested that the Department's experience pertaining to the sale of incentive credits indicates that they "have traded fairly well," with the trades being approximately ninety cents on the dollar. He professed that while it is a discounted value, "it does have real value" and that there is a market for the certificates.

DOUG SHULTZ, Vice President of Operations, XTO Energy, testified

from an offnet site and informed the Committee that he oversees the Alaska Operations for the company. He stated that he is available to answer questions pertaining to the midrange language section of the bill.

Senator Hoffman stated that being provided with additional "snapshot" information regarding developmental costs and credits would be helpful.

Mr. Dickinson responded that a table of this nature could be generated and provided to the Committee.

Mr. Dickinson theorized that were another Alpine Oil Field discovered, it would generate approximately one billion dollars of revenue for the State. He voiced that this program should be gauged by the rate of return on the investment rather than how much the State would lose by offering tax incentives. He stated that "the problem lies in the hope" that another large oil field like Alpine would be discovered, as opposed to finding large quantities of oil generated from numerous smaller pools. He stated that the smaller pool scenario would not generate the same high rate of return as a large pool. He stated that by proposing this exploration incentive program, the State is attempting to increase the rate of success of finding another large field by increasing the amount of exploration being conducted.

Senator Hoffman calculated that were this incentive program implemented, the State would move from the bottom of the aforementioned Cost of Exploration table depicting government incentive programs to approximately the middle.

Mr. Dickinson agreed that this tax credit incentive program would make the State "just average."

Senator Hoffman stated that Alaska's incentives would therefore be comparable to those offered in the Gulf of Mexico and the United Kingdom, but substantially below the incentive program offered by Canada.

Mr. Dickinson agreed that this would be a good reference; however, he noted that the chart is based on theoretical rates. He continued that there might be a two or three cent variation.

Senator Hoffman asked whether the level of production would affect the credit amount being provided.

Mr. Dickinson confirmed that the credit level is based on the actual amount of oil being produced.

Senator Hoffman asked whether a higher potential of discovery in an area would correspondingly be assigned a larger incentive.

Mr. Dickinson communicated that, "in the final analysis, the geology is what is going to matter." He continued that regardless of the level of incentive, an area with minimal chance of return would not be explored. He continued that areas such as Prudhoe Bay did not require an incentive because it was believed that the probability of a successful find was high.

Senator Hoffman asked for additional information regarding the incentives provided by Russia and China as these countries' credits stipulate that the incentives offered would be "less depending on level of production."

Mr. Dickinson responded that this language is included in the chart because in some countries "there is not a single rule for everything." He noted that in Kazakhstan, for example, incentives are determined by production sharing agreements some of which might be high and some that might be low. He stressed that, "the ability to take the credit ties back to the ability to produce."

Senator B. Stevens asked for an explanation of "an exploration unit" as specified in Section 3(b)(4) which reads as follows.

(4) may not be incurred for an exploration well or seismic exploration that is included in a plan of exploration or a plan of development for any unit in the state at the time the expense is incurred.

Senator B. Stevens additionally asked whether the credit applies to expenses associated with the purchase of a lease that establishes a new unit.

Mr. Dickinson responded that lease acquisition costs are not included in the credit calculation.

Mr. Myers responded to Senator Stevens' question by explaining that this credit "is designed to stimulate activity that would not occur otherwise." He continued that, "a unit is an aggregate of leases put together for common exploration or development." He recounted that the State forms an agreement with the lessees who are obligated to perform certain activities in order to extend a lease beyond the primary term. He stated that these "reasonable" conditions and activities could include such things as specifying that a certain number of wells must be driven as well as a commitment to shoot seismic. He stated that a typical unit term

might be three to five years, and were the conditions unmet, the State could cancel the lease and reissue it to another entity.

Mr. Myers clarified that the costs associated with upholding the extension conditions do not qualify for the exploration credit incentive, as they are recognized as a requirement of the lease extension. He continued that additional exploration work could occur and he asserted, that this is, in fact, the goal of the exploration credit program. He continued that once a unit is established and exploration occurring, the next step, upon discovery of a field, would be the development of the infrastructure to enable production to begin. He noted that rather than shooting separate seismic surveys, some companies shoot seismic surveys both inside and outside of the perimeter of a unit for economic reasons and that credits could be issued for the seismic work conducted outside of the unit.

Senator B. Stevens summarized, therefore, that a unit does not need to exist to qualify for a tax credit.

Mr. Myers agreed and furthered that allowance of the exploration credit for seismic surveys conducted outside of a unit could lead to the development of new units for production as, he conveyed, the natural evolution after something is discovered is to form a unit for development. He stated that, while a typical lease term for a unit is seven to ten years, a lease could be extended for up to thirty years.

Senator B. Stevens commented that the credits should be referred to as unit exploration credits rather than oil exploration credits.

Senator Taylor noted that the Department of Revenue fiscal note explanation specifies that were the State successful in doubling the amount of exploration that is currently being conducted, the credit program would cost the State \$100 million in revenue in the next fiscal year.

Mr. Dickinson responded that, based on estimates, that amount "would be the ceiling." He stated that while this figure might be a little high, the possibility "is in that order of magnitude."

Senator Taylor voiced that it is difficult to support legislation that might result in a revenue reduction of \$100 million when the State's current revenue and expense projections might result in a \$400 million draw on the Constitutional Budget Reserve (CBR). He pointed out that the fiscal note additionally states that there is little likelihood that the State would garner offsetting revenues as a result of this legislation until the year 2007. He stated that

this is a "major" concept and that the Committee should not make a quick decision on it.

Co-Chair Wilken agreed; however, he stated that this discussion is providing information that would assist the Committee in understanding "this big legislation."

STEVE PORTER, Deputy Commissioner, Department of Revenue, stated that "the amount of drilling it would statistically take" to cost the State \$100 million in revenue would need to be "substantial." He continued that the fiscal note's "high numbers" are conservatively presented to reflect the range that might be possible. Additionally, he noted that to incur this level, most of the drilling must occur outside of the 25-mile zone as compared with current practice whereby the majority of the wells being drilled this year are located within the three to 25-mile zone with only one well being drilled outside of the 25-mile zone.

KEVIN TABLER, Land and Government Affairs Manager, Unocal Oil, testified via teleconference from offnet site to stress that the discussion not lose, "the importance of the primary purpose of the bill" which is "the royalty reduction aspect in the Cook Inlet," He opined that this "would be a wonderful thing to have." He voiced concern that the focus is now exploration on the North Slope when, he attested, the focus should be on furthering exploration on a statewide basis.

Mr. Tabler commented on language in Section 3(c)(2) which reads as follows.

- c) To be eligible for a 20 percent production tax credit, exploration expenditures must
  - (1) qualify under (b) of this section; and
  - (2) be for an exploration well that is located and drilled in such a manner that neither the bore hole nor any part of the bore hole is at any time located less than three miles away from any part of a bore hole of a preexisting suspended, completed, or abandoned oil or gas well.

Mr. Tabler stated that while he understands the intent of this language, he voiced the concern that were a three-mile arc drawn around every bore hole in Cook Inlet that has been drilled, there would be no place for a new exploratory well. He stated that this negates the incentive to drill in the area.

Mr. Tabler voiced that in addition to the density concern, there is an issue regarding the depth component. He exemplified that were a company to drill a 15,000 foot or 19,000 foot test well from an

existing platform, this, in essence could meet the three-mile criteria. Therefore, he suggested that language be changed to specify, "certified" rather than pre-existing oil or gas well and, in addition, insertion of the language "producing from a formation or certified capable to produce from the same formation in the exploration well." He reemphasized that the discussion "should not lose sight of the royalty component" of the bill.

Mr. Myers voiced that "the focus should be on what you are trying to incentiveize." He stated that exploration for deeper wells and step-out wells is occurring in existing fields, and that true wildcat exploration is occurring in areas that are removed from existing infrastructure and that have more uncertainty and less mapping accumulations. He stated that all of this could be characterized as exploration, but he attested, the goal is to focus "on what you wish to incentiveize." He stated that the three-mile limit would promote wildcat exploration that involves more risk and expense. He reemphasized that this type of development is the intent of the credit program.

Co-Chair Wilken echoed Senator Taylor's comments that "this is significant legislation." He noted that the bill would be held in Committee, and he continued, that upon completion of testimony, further technical changes could be entertained. He noted that a new committee substitute would be forthcoming.

Senator Taylor voiced concern that as "the pool of participants and producers has diminished," the State might be "being manipulated" by corporations that leverage exploration in one area against another, specifically playing the State's budget deficit situation in their favor. He stated that these corporate decisions might influence legislation that could provide the industry with additional incentives. He voiced concern that this might be a factor behind this legislation.

Commissioner Corbus stressed that, while the aforementioned chart comparing Alaska's incentives against other countries might have been some influence, Governor Murkowski and the Administration presented the exploration credit legislation.

Mr. Porter assured the Committee that this legislation was initiated by the Governor rather than by the industry. He communicated that the oil industry currently "has a substantial amount of production" in the State; however, he continued that the benefits of that asset could be taken and invested either in Alaska or in another area of the world. He stated that an oil company could decide to invest 20-cents or 65-cents of that dollar in the State or elsewhere. He stated that the industry would invest in an

area where "they would get the most bang for their buck," and he contended, the intent of this legislation is to draw some of that dollar back to the State.

At Co-chair Wilken's request, Mr. Porter shared with the Committee his professional experience, which includes twenty-one years in the oil and gas industry and incorporated such things as community relations and negotiations, specifically dealing with issues pertaining to the North Slope.

Mr. Myers further explained that the bill specifies that seismic data that would be collected would have "clear value" as it would be "released after ten years." He noted that this information would "help everyone across the board." Furthermore, he clarified that the exploration tax credits would be available to both independents as well as producers although, he specified that the independents would be required to sell the credits at a discount in order to receive that benefit.

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Mr. Myers continued that while the legislation might not address all the issues, it does further exploration efforts.

Senator Taylor shared that he has consistently supported measures that could assist independent operators as, he attested, having a multitude of entities operating in the State "was the only way that we as a State could find out what the value of our resource really was." He noted that 30-percent of the Lower 48's oil is produced either by wildcats or independents, and he stressed that he would like to see those percentages in Alaska. He voiced support for this type of legislation in addition to legislation that "would reduce environmental costs to enable the State to be more competitive with the rest of the oil producing world." Yet, he continued, he is disappointed that this legislation is being presented late in the Legislation session as it deters the ability "to have a greater opportunity to explore it;" however, he voiced "faith" in the information being provided.

Senator B. Stevens asked the source of the "Cost of Exploration" comparison chart information that has been provided to the Committee.

Mr. Dickinson replied that a private consultant renown for producing annual summaries pertaining to world fiscal regimes, supplied the information to the State.

Senator B. Stevens clarified that the consultant was hired by the State.

Mr. Dickinson clarified that the individual was hired by the State; however, he noted that the information was not compiled at the direction of the State, as this information is commutated from information the consultant compiles on an on-going basis.

Co-Chair Wilken asked whether this legislation differentiates between royalties and severance taxes for production on private land as compared to those in place on State or federal land.

Mr. Dickinson stated that work conducted on private land is treated in the same manner as State or federal land. He stated that property and income taxes occur regardless of the ownership status of the land; however, he reminded that royalties apply only to production on State land and that royalties on production on federal land are negotiated with the federal government. He specified that a severance tax is applicable to all oil and gas produced in the State based on the size of the accumulation. Therefore, he noted that while every pool on the North Slope pays the State, the rates vary. Nonetheless, he concluded, "more oil in the pipeline" is the focus of this legislation, and he stressed that the royalty and severance taxes could be addressed once that occurs.

Co-Chair Wilken ordered the bill HELD in Committee.

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#sb100

SENATE BILL NO. 100

"An Act making capital appropriations and reappropriations; capitalizing a fund; making appropriations under art. IX, sec. 17(c), Constitution of the State of Alaska, from the constitutional budget reserve fund; and providing for an effective date."

This was the fifteenth hearing for this bill in the Senate Finance Committee.

Amendment #17: This amendment adds a new "Ketchikan Gateway Borough - Ketchikan Shipyard (ED 1)" component and \$1,500,000 Alaska Industrial Development and Export Authority (AIDEA) Corporate Receipts appropriation to the Grants to Municipalities (AS

37.05.315) Budget Request Unit (BRU) on page 3, lines 21 and 22. Accompanying explanatory language reads as follows.

This funding will match an additional \$7.5 million currently available (\$5.0 million of federal receipts, \$2.5 million in local Borough funding, and \$1.0 million in general funds previously appropriated.)

Senator Taylor moved to withdraw Amendment #17 from consideration as he explained that a funding source has not been identified to support the amendment.

There being no objection, Amendment #17 was WITHDRAWN from consideration.

Senator Taylor moved to report the bill, as amended, from Committee with attached fiscal notes and individual recommendations.

Co-Chair Wilken objected to request that his staff in conjunction with the Division of Legislative Finance and Legislative Legal Services be authorized "to make appropriate technical changes while drafting the committee substitute in order to conform to amendments that have been adopted."

Senator Taylor offered a friendly amendment to his motion to authorize Co-Chair Wilken's staff to make technical changes.

There being no objection, CS SB 100, 23-GS1003\Q, as amended, was REPORTED from Committee.

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**ADJOURNMENT**

Co-Chair Gary Wilken adjourned the meeting at 06:25 PM