

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

February 17, 2005

5:05 p.m.

MEMBERS PRESENT

Representative Vic Kohring, Chair
Representative Nancy Dahlstrom
Representative Lesil McGuire
Representative Norman Rokeberg
Representative Ralph Samuels
Representative Berta Gardner
Representative Beth Kerttula

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE BILL NO. 71

"An Act relating to a credit for certain exploration expenses against oil and gas properties production taxes on oil and gas produced from a lease or property in the state; relating to the deadline for certain exploration expenditures used as credits against production tax on oil and gas produced from a lease or property in the Alaska Peninsula competitive oil and gas areawide lease sale area after July 1, 2004; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 71

SHORT TITLE: AK PENINSULA OIL & GAS LEASE SALE; TAXES

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/12/05	(H)	READ THE FIRST TIME - REFERRALS
01/12/05	(H)	W&M, O&G, RES, FIN
02/11/05	(H)	W&M AT 8:30 AM CAPITOL 106
02/11/05	(H)	Moved CSHB 71(O&G) Out of Committee
02/11/05	(H)	MINUTE(W&M)
02/14/05	(H)	W&M RPT CS(W&M) NT 3DP 1AM
02/14/05	(H)	DP: MOSES, GRUENBERG, WEYHRAUCH;
02/14/05	(H)	AM: WILSON

02/17/05

(H)

O&G AT 5:00 PM CAPITOL 124

WITNESS REGISTER

Jerry Burnett, Special Assistant
to the Commissioner of Revenue
Alaska Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Presented HB 71 to the committee and answered questions.

GARY ROGERS, Revenue Auditor
Tax Division
Alaska Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: Available to answer questions regarding exploration credit regulations.

PAT GALVIN, Petroleum Land Manager
Division of Oil and Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions regarding lease sales and tax credits.

JIM COWAN, Resource Evaluation
Division of Oil and Gas
Alaska Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions regarding exploration activities on the Alaska Peninsula.

ACTION NARRATIVE

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at [5:04:55 PM](#). Representatives Kohring, Dahlstrom, Samuels, Gardner, and Kerttula were present at the call to order. Representatives McGuire and Rokeberg arrived as the meeting was in progress.

HB 71 - AK PENINSULA OIL & GAS LEASE SALE; TAXES

[5:05:08 PM](#)

CHAIR KOHRING announced that the only order of business would be HOUSE BILL NO. 71, "An Act relating to a credit for certain exploration expenses against oil and gas properties production

taxes on oil and gas produced from a lease or property in the state; relating to the deadline for certain exploration expenditures used as credits against production tax on oil and gas produced from a lease or property in the Alaska Peninsula competitive oil and gas areawide lease sale area after July 1, 2004; and providing for an effective date."

5:05:30 PM

Jerry Burnett, Special Assistant to the Commissioner of Revenue, Alaska Department of Revenue, explained that HB 71 was introduced by the governor and is intended to encourage exploration and development of one of the largest undeveloped onshore oil and gas fields remaining in Alaska, outside of the North Slope. He commented that development of this field has the potential to bring stable, high paying, year-round jobs to an area which has traditionally relied on a seasonal commercial fishing economy. He said, "Gas from this field can provide an efficient, relatively low-cost energy source for heating and production of electricity to the Alaska Peninsula area. And oil and gas development can provide infrastructure [and] lower the cost of living in the area." He pointed out that the committee information packets contained letters of support from local governments and Native corporations who support the development of oil and gas resources in this area.

5:06:41 PM

MR. BURNETT stated that today the Alaska Department of Revenue issued its first oil and gas exploration tax credit certificate under the existing legislation for a well on the North Slope drilled by Kerr-McGee Oil and Gas Corp.

CHAIR KOHRING asked if this was the result of Senate Bill 185 from two years ago.

MR. BURNETT replied that it was.

CHAIR KOHRING asked:

Are they about to lose their tax credit availability on the Slope? Because this bill's germane to just Bristol Bay for providing a tax credit extension, if I understand. ... I ask that because I'm just wondering if we ought to expand the scope of this legislation and carry it outside of just Bristol Bay.

MR. BURNETT replied that at this point, the exploration tax credit is in effect for work done through 2007 statewide; the Bristol Bay extension was being done because the lease sale in the Bristol Bay area will not be done until the spring of 2006.

[5:08:54 PM](#)

MR. BURNETT mentioned that the [House Special Committee on Ways and Means] had a committee substitute for HB 71 in which there were technical drafting changes, but no substantive changes. Reviewing AS 43.44.025 on the Alaska Oil and Gas Exploration Tax Credits, he explained:

[Under] 43.55.025(a)(1) companies are qualified for 20 percent of exploration expenditures for a well three miles from an existing well, or 20 percent of exploration expenditures for a well 25 miles outside a unit, or both. So it's up to 40 percent of their exploration expenditures for a well that is [both] three miles from an existing well and 25 miles [outside a unit]. And they ... may qualify for up to 40 percent credit for their seismic expenditures not associated with a well. That credit can be taken against tax on production that's done after July 1, 2004. ... Current law, statewide between July 1, 2003 and July 1, 2007, you could take the credits. With the passage of HB 71 it would extend the credits on the Alaska Peninsula for the sale which is described in the bill for a time period between July 1, 2003 and July 1, 2010.

[5:11:04 PM](#)

MR. BURNETT explained which types of exploration expenditures qualify for the tax credits: seismic or geophysical exploration not connected to a well; and exploration wells, specifically the reasonably required costs for goods, services, and rentals to prepare and drill, and the costs associated with abandonment of dry holes within 18 months. He pointed out that overhead costs are not allowed to be used toward tax credits.

MR. BURNETT, in response to Representative Samuels, clarified that roads and airfields on site would count, but not "the expenditures back at the head office that are in support of this."

[5:12:40 PM](#)

GARY ROGERS, Revenue Auditor, Tax Division, Alaska Department of Revenue stated that he worked on the exploration credit regulations that were drafted as a result of Senate Bill 185 last year, and he is responsible for auditing the exploration tax credits.

CHAIR KOHRING commented that he hasn't heard industry ask for this bill, and he asked Mr. Burnett to explain why the bill should be passed and how time sensitive the bill is.

MR. BURNETT deferred to Mark Myers, the director of the Division of the Oil and Gas. [Mr. Myers was unable to attend the meeting.]

[5:14:49 PM](#)

PAT GALVIN, Petroleum Land Manager, Division of Oil and Gas, Department of Natural Resources, explained:

The legislation is needed to facilitate a successful initial lease sale for the Alaska Peninsula. The incentive credits [are] an opportunity that we see to encourage companies to look at this new lease sale that we're potentially going to offer in October. And what we recognize is that while we can go through the Best Interest Finding process and develop the environmental safeguards to hold the lease sales and have it be successful in the eyes of the local governments, we need industry to feel that there is an opportunity for them to go out and have it be successful for them economically. And the incentive credits were put in place to foster exploration throughout the state, and to have them present for the initial sale is something that we feel is really important to really foster a successful first sale.

[5:15:57 PM](#)

CHAIR KOHRING asked, "How much does the industry actually want this? ... Is this something that would spur them to actually start sinking wells?"

MR. GALVIN responded:

With any new lease sale, the companies are generally going to be somewhat reserved in their discussion of

their interest in the lease sale because, frankly, they don't want to give any sort of commercial advantage or indication of their interest in order to ... create a competitive situation where there may not be one if they were to keep quiet about their interests. So one of the reasons why we do areawide lease sales is because companies are, just by their nature, reluctant to provide [an] indication of a lot of interest in particular areas or particular tracts. And so with [a] new lease sale, we would not expect any particular company to come out and say, ... "With this incentive credit, we will bid on tracts."

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CHAIR KOHRING commented, "Well, if nothing else this can serve as a starting point; if it doesn't work we can readjust it next year."

MR. GALVIN replied:

At this point, we really don't know what kind of interest we're going to get with this sale. It's really going to be a matter of making it available and seeing who comes. And the incentive credits are just one thing to make the offer a bit more attractive to the companies that are looking at exploring an otherwise new area.

[5:17:56 PM](#)

REPRESENTATIVE GARDNER asked if the existing tax credits have created any new exploration.

MR. BURNETT reiterated that Kerr-McGee Oil and Gas Corporation has been issued the first tax credit. He said:

There are a number of other companies who are doing it. We can't speak about them without their permission, for the most part, so it's really difficult to publicly quantify ... and to quantify this ... program that's only been in place for a short period of time. It does appear to be working at this point.

CHAIR KOHRING commented that perhaps the legislature should extend the tax credits more comprehensively and not focus it only on Bristol Bay.

[5:19:24 PM](#)

REPRESENTATIVE ROKEBERG stated that he would like to know who has applied for exploration expenditure tax credits since they went into effect. He asked if the Kerr-McGee Oil and Gas Corporation was receiving production tax incentive credits for activities in the National Petroleum Reserve, Alaska (NPRA).

MR. BURNETT replied that he didn't know.

REPRESENTATIVE ROKEBERG responded that he would be very disturbed if that was the case, "given the fact that we hardly receive a dime from money expended on exploration in NPRA."

[5:20:33 PM](#)

MR. GALVIN pointed out that the Kerr-McGee wells are on state land; they're both offshore and onshore North Slope.

REPRESENTATIVE ROKEBERG asked, "Do these credits that are now currently existing apply to exploration in NPRA?"

MR. GALVIN responded affirmatively and said that the credits apply to exploration throughout the state. He stated that there are three wells in NPRA that have qualified for the tax credit.

[5:21:37 PM](#)

CHAIR KOHRING commented that he is concerned that the state is giving a tax credit and a financial break to companies that the state is not realizing a benefit from.

MR. GALVIN pointed out that the state does receive a benefit on NPRA; there is a royalty sharing. He said, "When the legislation was first passed, there were discussions with regard to limiting it to merely state lands, but the decision was made to make it statewide and not to distinguish between the land status."

[5:22:19 PM](#)

REPRESENTATIVE KERTTULA asked if the tax credits apply to federal leases.

MR. GALVIN replied affirmatively, that it applies whether it is a state, federal, or private lease. In response to Representative Rokeberg, he said, "When the legislation was first written, it was not made specific to state lands, which meant that it was applicable to all lands."

CHAIR KOHRING commented, "That one's a bit of a loophole, if you ask me."

[5:23:19 PM](#)

CHAIR KOHRING asked if there has been any environmental opposition to [HB 71].

MR. BURNETT responded, "We're not aware of any."

MR. GALVIN replied that [the Department of Natural Resources (DNR)] just released a preliminary Best Interest Finding two days ago for public comment. He said that DNR has been working closely with the local governments and Native organizations to ensure that it has addressed the concerns of the fishing industry as well as protected the sensitive habitats. While offshore acreage is available in the lease sale, he noted, no offshore drilling would be allowed; the offshore acreage would have to be explored and developed from onshore drilling facilities using directional drilling techniques.

[5:24:23 PM](#)

CHAIR KOHRING noted that there was a two mile boundary off the shoreline on the map he was viewing. He asked what this boundary represented, and if it meant that a company could drill offshore directionally, potentially as far out as two miles.

MR. GALVIN answered that the boundary on the map is the three-mile jurisdictional boundary of the state. He explained, "What it means is that, while that state submerged land is available to the lease sale, the only development that could take place ... would be drilled directionally from an onshore drilling facility."

CHAIR KOHRING asked what the potential is in Bristol Bay.

MR. GALVIN deferred to Jim Cowan.

[5:25:56 PM](#)

JIM COWAN, Resource Evaluation, Division of Oil and Gas, Alaska Department of Natural Resources commented, "We really don't have a good fix on this one. There has been no good resource assessment done ... on the offshore part of this basin. But it looks like it might be from 35 million to 200 million barrels of oil and ... several tcf of gas."

MR. COWAN, in response to Chair Kohring, stated:

There has been very little seismic work onshore; there's been a lot of seismic work adjacent to the state lands, offshore on the federal OCS [Outer Continental Shelf] acreage. ... There have however been about 13 wells drilled along that side of the peninsula dating back to as far as 1903, I believe, but the last one was drilled in 1985. ... They have oil and gas shows, almost all of them. ... We had a field party out there for almost a month, ... two sessions last summer with the Division of Oil and Gas, and the DGGG [Division of Geological and Geophysical Surveys] in Fairbanks. ... Lot of oil seeps. They came back ... pretty encouraged about the reservoir potential. ... There were field parties out there this summer from two major oil companies also.

CHAIR KOHRING commented, "With such limited information out there and little or no seismic work done, other than test wells, ... I'm kind of curious as to why there's such a concerted effort here to proceed. ... It seems like we're giving a lot of emphasis to Bristol Bay based on really nothing that we have so far."

[5:28:06 PM](#)

MR. COWAN replied that it's been dormant out there for about 20 years. He said, "There was some activity out there about 25 years ago, 20 years ago, but [due to the] moratorium, the concerns about the fishing and the environment, it's just been put aside until just most recently."

REPRESENTATIVE MCGUIRE commented:

Part of the reason there isn't any seismic data is just what was eluded to; this was a controversial issue 20 years ago. There was extensive seismic that was done and a lot of interest, and frankly the

stakeholders could not come to an agreement at that point in time. And so ... you had various Native groups, you had various fishing groups, and the oil and gas industry infighting, and at the end of the day, the moratorium went into effect, and so here we are now. I remember last year before this committee there was a lot of discussion about new seismic being done and frankly it's very expensive. But I think we all know from the information we've been able to gather that this is a phenomenal resource waiting to happen.

REPRESENTATIVE MCGUIRE continued:

Let me clarify something that I'm maybe misunderstanding here. This bill does not extend the three-year date to the NPRA areas, does it? Isn't this just expanding the production tax credit to 2010 of July 1 for those competitive oil and gas areawide ... leases that are on the Alaska Peninsula? I'm just concerned. I've heard a lot of referencing of NPRA and things like that, but I think we kind of need to stick back to what this bill is doing. We may have regrets about the way that the bill itself came together in years past, but this particular bill really is simply a recognition of the fact that many of the folks that are interested in this competitive oil and gas areawide lease sale ... may not have things in place by 2007. And so we're talking about expanding it out three years.

[5:30:27 PM](#)

MR. BURNETT replied that this was exactly the purpose of the bill: to allow a very specific area to have an extension because it has not been leased yet.

CHAIR KOHRING asked why there is a timeline at all.

MR. BURNETT responded that this was a policy decision.

REPRESENTATIVE GARDNER commented that a time limit is important because otherwise it's not an incentive.

[5:31:10 PM](#)

REPRESENTATIVE ROKEBERG stated that he would like to see a report on the initial bill's impact on exploration activity and investments, and on those credits that have been granted under this legislation. He said:

While I agree with Representative McGuire that we need to focus ... and I support the bill itself, I am most disturbed because we have this before us, that there was controversy about the language and I find it a little bit disturbing ... that the administration would interpret language ... without legislative input to apply to federal leases, particularly in consideration of the fact that we have limited revenues from those area. In other words, we're subsidizing; we're giving out more money than we even take in. ... I'm not going to support moving this bill until we get some answers on this and that can be clarified.

[5:32:53 PM](#)

CHAIR KOHRING declared:

I pledge we will follow up on that; we will get some information from DNR including a written report as to the effect of [Senate Bill 185] and so forth, and a clarification as to why they interpret the law to read that we can expand this to places like NPRA, which really wasn't our intent.

CHAIR KOHRING opened the meeting to public testimony. [No one wished to testify. HB 71 was held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at [5:34:08 PM](#).