

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS**

January 18, 2006

9:10 a.m.

**MEMBERS PRESENT**

Representative Bruce Weyhrauch, Chair  
Representative Norman Rokeberg  
Representative Paul Seaton  
Representative Max Gruenberg  
Representative Carl Moses

**MEMBERS ABSENT**

Representative Ralph Samuels  
Representative Peggy Wilson

**OTHER LEGISLATORS PRESENT**

Representative Harry Crawford  
Representative Kurt Olson

**COMMITTEE CALENDAR**

HOUSE BILL NO. 223

"An Act levying a tax on certain known resources of natural gas, conditionally repealing the levy of that tax, and authorizing a credit for payments of that tax against amounts due under the oil and gas properties production (severance) tax if requirements relating to the sale and delivery of the natural gas are met; and providing for an effective date."

- HEARD AND HELD

PERS/TRS Funding Shortfall Issues

- HEARD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 223

SHORT TITLE: NATURAL GAS PIPELINE INCENTIVE/ GAS TAX

SPONSOR(S): REPRESENTATIVE(S) CROFT

03/17/05 (H) READ THE FIRST TIME - REFERRALS  
03/17/05 (H) W&M, O&G, RES

04/25/05 (H) W&M AT 8:30 AM CAPITOL 106  
04/25/05 (H) Heard & Held  
04/25/05 (H) MINUTE(W&M)  
01/11/06 (H) W&M AT 9:00 AM CAPITOL 106  
01/11/06 (H) Heard & Held  
01/11/06 (H) MINUTE(W&M)  
01/18/06 (H) W&M AT 9:00 AM CAPITOL 106

#### **WITNESS REGISTER**

MARK MYERS

Anchorage, Alaska

POSITION STATEMENT: On behalf of Representative Croft, provided information on the economic issues pertaining to HB 223.

REPRESENTATIVE ERIC CROFT

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as the sponsor of HB 223.

#### **ACTION NARRATIVE**

**CHAIR BRUCE WEYHRAUCH** called the House Special Committee on Ways and Means meeting to order at [9:10:55 AM](#). Representatives Weyhrauch, Seaton, and Gruenberg were present at the call to order. Representatives Rokeberg and Moses arrived as the meeting was in progress. Representatives Crawford and Olson were also in attendance.

#### HB 223-NATURAL GAS PIPELINE INCENTIVE/ GAS TAX

[9:11:05 AM](#)

CHAIR WEYHRAUCH announced that the first order of business would be continuing testimony on HOUSE BILL NO. 223, "An Act levying a tax on certain known resources of natural gas, conditionally repealing the levy of that tax, and authorizing a credit for payments of that tax against amounts due under the oil and gas properties production (severance) tax if requirements relating to the sale and delivery of the natural gas are met; and providing for an effective date."

[9:11:46 AM](#)

MARK MYERS, former Director of the Division of Oil and Gas, Department of Natural Resources (DNR), summarized his presentation given at the previous meeting during which he

addressed the economics of the gas pipeline project as analyzed in a report by Econ One Research, Inc. He noted that prices north of \$3.00/million British thermal units (mmbtu) are "very robust" and the [gas pipeline] project is actually net-positive at prices below \$3.00/mmbtu.

MR. MYERS explained that today's prices, around \$9.00/mmbtu, and future prices, which are expected to be greater than \$5.00/mmbtu, show the project as being very economic. Furthermore, he noted that the Econ One findings showing a \$4.00, \$5.00, and \$6.00 price-deck with varying returns, all indicate the project as very robust. Even with high-cost overruns on the project, Mr. Myers concluded that it's still lucrative with investment returns very typical of those expected for a petroleum company investment.

[9:14:40 AM](#)

REPRESENTATIVE SEATON remarked that [the committee] is looking at HB 223 as an incentive tax and wonders why it doesn't make any reference to interest being accumulated and paid back. Furthermore, he noted, the bill doesn't address any loss after commitment and prior to shipment of gas. He questioned whether more language is needed to address an incentive. However, he indicated that he does not believe the intent is to have people "using this as just a bank" where money is deposited, earns interest and no loss is incurred if done within a required timeframe.

MR. MYERS recommended asking the sponsors for clarification on the intent of HB 223 regarding incentives and the design of the tax. He opined that the design is not to be punitive but rather to provide a jumpstart to the project. According to his interpretation of the bill, should the project move forward on a timely basis, then the companies would recover all the tax lost.

[9:16:49 AM](#)

REPRESENTATIVE SEATON asked Mr. Myers if he believes a deposit of money with the state, and then receiving that money back, is enough of an incentive to help stimulate the development of a gas pipeline.

MR. MYERS replied that this depends on how the legislature perceives the project. He indicated his belief that HB 223 shows [the legislature's] intent to "cut a middle-ground" and not be too punitive. Additionally, he said, that when looking

at a reserves tax, it's important not to discourage future exploration. He relayed his belief that the bill is structured in such a way as to not affect future exploration.

[9:19:00 AM](#)

REPRESENTATIVE SEATON referred to page 2, lines [10-16], proposed AS 43.58.220(c)(1)-(2)(B):

(c) Gas is not taxable gas under this chapter if the gas is

(1) not subject to a state-approved oil and gas unit; or

(2) subject to a state oil and gas lease, but that lease

(A) has not been in existence throughout the 10 years immediately preceding the tax year;

(B) was not in a state-approved oil and gas unit as of January 1, 2002, and January 1 of the tax year; or

REPRESENTATIVE SEATON sought confirmation on his interpretation of this section by asking whether those [gas reserves] which haven't been unitized are then not taxable. He further asked how common it is for [Alaska] to have large gas reserves that are not unitized.

[9:19:51 AM](#)

MR. MYERS replied that generally unitization does not occur until a lease is at the very end of its primary term, which would typically be closer to 10 years from the initial issuance of the lease. In those cases, he explained, unitization occurs under one of two conditions: either "companies want to keep the leases and they want to have a firm commitment for exploration," or, more typically, "they're ready to develop a field in order to hold the leases, in order to produce the property in common." Mr. Myers stated that according to his understanding of the intent of HB 223, companies in the primary term of a lease and still in an exploration stage would not be subject to a tax unless they choose to unitize early in the primary term of the lease. Mr. Myers concluded his testimony by expressing his belief that HB 223 is designed to encourage exploration.

[9:21:13 AM](#)

CHAIR WEYHRAUCH, upon ascertaining there were no further questions to ask of those present at the meeting - representing ConocoPhillips Alaska, Inc., Department of Revenue or the Office of Management & Budget - requested the sponsor of HB 223, Representative Croft, come forward to testify.

9:21:47 AM

REPRESENTATIVE ERIC CROFT, Alaska State Legislature, first pointed out that when working with Walter Hickel in drafting HB 223, the former governor wanted Representative Croft to increase the incentive [to develop the gas]. He then addressed the questions posed earlier by Representative Seaton offering his explanation of the language on page 2, lines [10-18] of HB 223, which lists the gas not taxable under this chapter. Excluded from this [exemption], he explained, are units of older, established fields, "particularly Prudhoe Bay and Point Thompson," with leases over 10 years old. No future finds, he said, are affected by this bill. "This is an incentive for companies that have been sitting on gas for decades to develop it, and we specifically crafted it so that it would not affect any future exploration," he opined.

REPRESENTATIVE CROFT next addressed the structure of the credit as written in HB 223 on page 6, lines 7-25, proposed AS 43.55.027(d)-(f), which addresses credits that may not be allowed. He explained that only 50 percent of the [producer's] severance tax owed each month can be written off at the end of every year until December 31, 2030, when this credit can no longer be applied.

REPRESENTATIVE CROFT said that since HB 223 does not include provisions for giving credit for interest, it is to the oil company's advantage to have the gas pipeline project completed as promptly as possible in order to have more years of applying the 50 percent credit to taxes before the credit option expires. He gave an example of how a company, in completing the gas pipeline project in the next 6 to 7 years, would be able to get all the money back on taxes paid by having 17 years to apply the 50 percent credit until the December 31, 2030 deadline. "That is about the breakeven point," he explained, as every year [the companies] delay the project, the less time they have to apply the credit.

REPRESENTATIVE CROFT related that Mr. Hickel was adamant that the amount of the tax be raised from \$.02/1,000 cubic feet (mcf)

to \$.03/mcf as the original tax Representative Croft introduced raised approximately \$650 million a year.

[9:26:59 AM](#)

REPRESENTATIVE SEATON asked where it's specifically stated that interest will not accrue on the money that's deposited.

[9:27:24 AM](#)

REPRESENTATIVE CROFT explained that during early drafting of HB 223, the matter of interest was included in the credit section but then removed. He stated that by not including language for earning credit for interest means [oil companies] can expect a dollar-for-dollar credit with no interest. Representative Croft mentioned the possibility of the [committee] changing the bill to include language on interest credit.

[9:28:12 AM](#)

REPRESENTATIVE GRUENBERG opined that it would be "much safer" to specifically state "no interest" in the bill. He then asked if there was any value to a petroleum company having a non-producing lease with the possible exception of it being able to deny that lease to a competitor or perhaps to increase the credit-worthiness of the company.

REPRESENTATIVE CROFT presented three reasons to explain why companies might want to reserve the gas even though "it's perfectly economic to produce": companies' stock prices are based on their reserve and Wall Street wants to see adequate reserves to ensure those higher stock prices; companies having more reserves in other countries might be getting tremendous pressure to develop there versus very little pressure from [Alaska]; and larger companies may see delaying development of a project as a competitive ploy to "hurt certain smaller players."

REPRESENTATIVE GRUENBERG asked if there was any way to quantify the value of interest [in the project] for the purpose of establishing the rate of the tax.

[9:32:53 AM](#)

REPRESENTATIVE CROFT said the tax could be based on what it would take to change the minds of "Exxon or British Petroleum" in building a gas pipeline, or by reviewing the revenues the State of Alaska may lose by delaying the project. He opined

that it's harder to quantify the advantages for companies in having [gas] reserves than it is to quantify the actual value of what [Alaska] would lose, which might be in the \$4 to \$5 billion range.

[9:34:19 AM](#)

REPRESENTATIVE GRUENBERG asked if Representative Croft was "aware of any economists or any economic model that has been developed to actually, directly quantify those kinds of things."

REPRESENTATIVE CROFT said there is good, economic modeling that shows how much the state would make from this project; however, he said he has not seen modeling that shows benefits for [Exxon] to delay in building a gas pipeline. He indicated his belief that the revenues, however, would be substantial.

[9:35:39 AM](#)

REPRESENTATIVE CROFT, in answering questions put forth by Chair Weyhrauch, confirmed that the tax only applies to the resource, ends when the resource starts flowing through the pipeline, and essentially only applies to the Prudhoe Bay and Point Thompson fields.

CHAIR WEYHRAUCH asked why a company willing to build a gas pipeline when others are not, would be subjected to a tax.

[9:36:23 AM](#)

REPRESENTATIVE CROFT replied that this differential impact on the major leaseholders is addressed when the credit starts. He explained that after much discussion with those more knowledgeable on oil and gas leasing, it was determined that the [gas reserve] tax would end "only on something that was irrefutable" to avoid possible litigation. He listed some of the specific requirements addressed in the bill such as delivery by a [pipeline or combination of pipelines] having a [minimum delivery capacity] of 2 billion cubic feet (bcf) of gas per day, and one that is route-neutral, whether "Canadian or All-Alaska," and ownership neutral, whether independent, producer-owned, or Alaska-owned.

REPRESENTATIVE CROFT then referred to the language on page 5, Section 2 of the bill where it explains that the credit starts when an [oil company] makes an irrevocable agreement to sell the gas or agrees to ship it in an open season. The tax itself ends

when the pipeline is built," he noted. He said, "So, in that situation, the leaseholder that has done what we'd like, starts to receive the credit from that date and the other players do not."

[9:38:54 AM](#)

REPRESENTATIVE SEATON posed a scenario in which only one owner of a three-owner field was committed to shipping or selling the gas. In that case, would the tax then accrue on all of the gas, he said, "and is not part of the credit until they make this binding agreement to either sell or ship, and therefore, if the other two [owners] do not make that binding agreement, their tax is there but no credit would be applied to that until such date as they agree to sell or ship."

[9:39:29 AM](#)

REPRESENTATIVE CROFT said that was correct.

[9:39:34 AM](#)

REPRESENTATIVE ROKEBERG asked whether a company agreeing to ship necessitates having a pipeline and wouldn't having an open season mean having a project.

REPRESENTATIVE CROFT said it means a project proposal on an open shipment or [oil companies] could agree to sell.

REPRESENTATIVE ROKEBERG posed a situation in which ConocoPhillips Alaska, Inc. finalized the transaction of selling the gas, and asked whether that would be an example of what Representative Croft's "driving at here?"

REPRESENTATIVE CROFT replied that this addresses some of the difficulties with the negotiation in which Governor Murkowski is currently involved. He opined that if [Governor Murkowski] concludes an option agreement wherein ConocoPhillips Alaska, Inc. could take the fiscal terms whenever it wished, it would not be a project; however, a specific agreement to ship under these terms, would be. He said that this identifies one of the great risks of the entire process, which is obtaining agreement on fiscal terms and not on a project.

[9:41:16 AM](#)

REPRESENTATIVE ROKEBERG sought clarification on whether a company, with the intent to ship gas, would not receive credit and have to pay the tax if particular terms of an agreement are not acceptable to it.

REPRESENTATIVE CROFT responded that it depends on the agreed terms.

REPRESENTATIVE ROKEBERG then asked what if there's not a gas pipeline, in spite of a company's willingness to have one, because the company cannot afford to do it on its own.

REPRESENTATIVE CROFT maintained that the incentive remains until the pipeline is built.

REPRESENTATIVE ROKEBERG requested clarification on whether "paying the tax" is the "incentive" to which Representative Croft refers.

REPRESENTATIVE CROFT reiterated that the intent of the bill is "You don't let up pressure until the line is done." Any other benchmark, he said, falls short of what is required.

REPRESENTATIVE ROKEBERG asked if a willing party entering into an agreement would still have the incentive of paying a tax.

REPRESENTATIVE CROFT replied, "They're going to put that earnest money down and get it back, and those that never did, aren't going to get it back." He then agreed with the comment made by Representative Rokeberg that interest would still be paid [while completing the project].

[9:43:34 AM](#)

CHAIR WEYHRAUCH asked if this was related to a question posed earlier by Representative Seaton regarding "whether they should get that money back with some interest if they developed the gas."

[9:43:45 AM](#)

REPRESENTATIVE SEATON expressed his belief that the current structure of the bill does not lay out in firm enough detail the sponsor's statement that it does not accrue interest. If accruing interest is not the intent, he opined that this should be stated in the bill to avoid being subject to litigation.

REPRESENTATIVE SEATON again sought confirmation from the sponsor regarding his understanding that a company only has to agree to sell [the gas] to start the credit and is not required to build the pipeline.

[9:45:09 AM](#)

REPRESENTATIVE CROFT expressed his belief that once the first agreement to sell is made, all the competitive pressures Representative Gruenberg referred to earlier "come to bear the other way." He explained that if ConocoPhillips Alaska, Inc. can agree to sell, and a small yet viable project is started without ExxonMobil Corporation's participation, then a whole new competitive structure results. "I wanted to put as much pressure as I could to get that first big agreement to sell," he said.

[9:46:28 AM](#)

REPRESENTATIVE SEATON asked if it is legally possible for only some of the owners of a field to sell their gas without all of the owners of that field agreeing to do so.

[9:47:24 AM](#)

REPRESENTATIVE CROFT related his understanding that it is legally possible; however, "the relationships in the different fields, the different agreements, as well as the other ways they cooperate in this state on the Trans-Alaska Pipeline system and others, make it practically difficult to separate themselves."

[9:48:07 AM](#)

REPRESENTATIVE ROKEBERG, referring to a question asked earlier by Representative Seaton, said he didn't see how a bullet line could satisfy the requirement of having a minimum delivery capacity of 2 bcf of gas per day as most bullet lines only have half the capacity or less. He asked then if it was correct to say "a bullet line from the North Slope to Cook Inlet would not qualify and that gas would still be subject to the penalty of [the] tax."

[9:48:56 AM](#)

REPRESENTATIVE CROFT explained that the intent was to set to a low, viable project level which would encompass the All-Alaska route or the Canadian route and maintain enough gas sufficient

for [Alaska] needs as well as maintain the production level currently in Kenai. He said Representative Rokeberg was correct in saying [the project] would not do those very small bullet lines of 300 or 400 mcf per day.

[9:50:10 AM](#)

REPRESENTATIVE ROKEBERG expressed concern that there may be missed opportunities in the years ahead considering the demand for fuel in the rest of the state, which might eventually entail repealing [HB 223].

REPRESENTATIVE CROFT expressed his belief that if the gas pipeline project is unsuccessful this time, HB 223 should be kept in place.

[9:51:24 AM](#)

REPRESENTATIVE ROKEBERG posed a situation in which the gas pipeline project is adopted by the legislature or by initiative, and asked whether the tax would still go into effect by January 2007, in spite of any agreement or any movement forward on the project.

REPRESENTATIVE CROFT expressed his hope that an agreement, with a binding commitment to ship, is signed.

[9:52:55 AM](#)

REPRESENTATIVE GRUENBERG relayed that sometimes companies that own pipelines and have the capacity to ship, will turn them off. He asked if there is anything in [the bill] that reinstates the tax should this occur. In hearing the sponsor's reply that there is nothing in the bill addressing this, Representative Gruenberg suggested it be seriously considered since [Representative Croft] would be "up against the best minds in the world who will do anything they can to get out of this tax."

[9:54:04 AM](#)

CHAIR WEYHRAUCH asked if paying a fee every day that the pipeline is not developed is essentially a disincentive to holding leases in gas. He questioned, "Why pay a tax on an uncertain future?"

REPRESENTATIVE CROFT maintained that [the bill] is an incentive to build the gas pipeline, has no effect on future exploration,

and if companies decide to turn over leases, there are hundreds of companies that would take them. Referencing contracts which were signed years ago and in which these companies agreed to develop, he expressed his belief they have the contractual duty to develop. He said that although the [government] can not nationalize in the United States, it can insist on its contractual rights and use taxing powers as constitutionally allowed.

[9:55:15 AM](#)

CHAIR WEYHRAUCH, having ascertained there was no further testimony on HB 223, closed public participation with the exception of the sponsor, Representative Croft.

[HB 223 was held over.]

PERS/TRS Funding Shortfall Issues

[9:55:28 AM](#)

CHAIR WEYHRAUCH announced that the final order of business would be to address the funding shortfall issues of the Public Employees' Retirement System/Teachers' Retirement System (PERS/TRS). Having ascertained there was no one present who wished to testify on the PERS/TRS issue, he announced the next meeting would address the two new bills dealing with the unfunded liability of the PERS/TRS.

[9:56:26 AM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:56 a.m.