HOUSE FINANCE COMMITTEE
March 17, 2010
1:35 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:35 p.m.

MEMBERS PRESENT

Representative Mike Hawker, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Bill Thomas Jr., Vice-Chair
Representative Allan Austerman
Representative Mike Doogan
Representative Anna Fairclough
Representative Neal Foster
Representative Les Gara
Representative Reggie Joule

MEMBERS ABSENT

Representative Mike Kelly
Representative Woodie Salmon

ALSO PRESENT

Jan Levy, Staff, Representative Mike Hawker; Larry Persily, Staff, Representative Mike Hawker; Roger Marks, Consultant, House Finance Committee; Representative Peggy Wilson, Sponsor; Reid Harris, Staff, Representative Peggy Wilson; Steve Prysunka, Director, Alaska Crossings, Wrangell; Mark Galla, Owner/Operator, Alaska Peak & Seas, Wrangell.

PRESENT VIA TELECONFERENCE

Bob Pickett, Chairman, Regulatory Commission of Alaska; Stuart Goering, Assistant Attorney General, Commercial/Fair Business Section, Civil Division (Anchorage), Department of Law; Carol Rushmore, Economic Development Director, City & Borough of Wrangell; Timothy Rooney, Manager, City & Borough of Wrangell.

SUMMARY

HB 273 MUNICIPAL GENERAL GRANT LAND

HB 273 was HEARD and HELD in Committee for further consideration.

HB 280 NATURAL GAS

HB 280 was HEARD and HELD in Committee for further consideration.

#hb280
HOUSE BILL NO. 280

"An Act relating to natural gas; relating to a gas storage facility; relating to the Regulatory Commission of Alaska; relating to the participation by the attorney general in a matter involving the approval of a rate or a gas supply contract; relating to an income tax credit for a gas storage facility; relating to oil and gas production tax credits; relating to the powers and duties of the Alaska Oil and Gas Conservation Commission; relating to production tax credits for certain losses and expenditures, including exploration expenditures; relating to the powers and duties of the director of the division of lands and to lease fees for the storage of gas on state land; and providing for an effective date."

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REPRESENTATIVE MIKE HAWKER, SPONSOR, explained that the purpose of the bill was to address the shortage of fuel in Southcentral Alaskan communities. He introduced staff who had worked on the legislation.

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Co-Chair Hawker directed attention to the sectional analysis (copy on file). He emphasized the increasing difficulty of meeting the demand for fuel in Southcentral due to growing population in the area and the depletion of natural gas in the Cook Inlet basin. He reported that studies conducted by utilities, government, and industry have universally concluded that gas storage capacity is a

critical element in achieving energy security. He argued that the empty or nearly empty reservoirs left after extracting the original natural gas could be used as storage vessels for gas produced from new wells. The warehoused gas could then allow for flexibility in meeting demands during times of peak use.

Co-Chair Hawker anticipated that adding storage capacity to the supply chain would result in increased costs. He stated that HB 280 would enable the legislature to effectively provide consumer cost relief without cost to the state through an investment tax credit for the development of gas storage businesses when the stored gas is used for consumer utilities. He stressed that the tax credits in the provision would not apply to existing warehouses.

Co-Chair Stoltze noted that market forces do not supply the necessary incentive.

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Co-Chair Hawker called the legislation a market-driven solution, not a government-driven one; government would not provide a subsidy for the service but would facilitate lowering the cost to consumers through third-party developed storage.

Co-Chair Hawker continued that the bill resolves current regulatory uncertainty that has been impeding gas storage facility development. He reminded the committee that the Regulatory Commission of Alaska (RCA) had recently asked the legislature for clarification of its regulatory responsibilities related to gas storage facilities providing gas to Southcentral consumers; HB 280 establishes that the activity is regulated.

Co-Chair Hawker added that regulatory clarification related to the management of inventory was needed for potential owners of gas storage facilities. He defined “inventory” as the gas in the facility that would be cycled back to the market when needed. The legislation adopts a “last in and first out” inventory management structure. Production taxes were not paid on any original gas remaining in the reserve, but those molecules are indistinguishable from gas that has been put in for storage. To address this classic accounting challenge related to any kind of inventory, the bill does not tax gas pulled out until it exceeds the amount put in.

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Co-Chair Hawker pointed out that HB 280 explicitly mandates that investment tax credit utilized for the construction of a qualified gas facility be passed on to the consumer. In addition, the bill provides for gas deliverability requirements in Southcentral by making it as attractive as possible for the exploration and development industry to go after undiscovered gas in Cook Inlet.

Co-Chair Hawker described challenges getting companies to explore and develop potential reserves in the Cook Inlet basin. When Cook Inlet was first developed around 50 years ago, there were several large domes of natural gas that were relatively easy to locate and to exploit, allowing Southcentral access to inexpensive energy. Although there may still be a great deal of gas, it is located in smaller stratigraphic traps. In addition, most of the basin is under water, and large portions are under land that is not available for exploration and development.

Co-Chair Hawker maintained that the small traps are unattractive to large oil and gas exploration and development companies such as ExxonMobile, ConocoPhillips, and Chevron. He noted that the state must attract a new kind of explorers who are very reluctant to work in Alaska because of oil and gas taxes currently in place; HB 280 modifies some provisions to make existing credits or tax advantages more accessible with minimal enhancement to other credits.

Co-Chair Hawker detailed that HB 280 would eliminate the prohibition against utilization of credits. Current statute requires that the credits be amortized over two years; HB 280 allows amortization over one year. The bill also eliminates the penalty against existing Cook Inlet tax credits from earlier PPT/ACES [Petroleum Production Tax/Alaska Clear and Equitable Share] legislation. He noted that the Cook Inlet tax structure is based on the ELF [Economic Limit Factor] formula, which was meant to provide consumer cost relief. A company exploring in Cook Inlet is required to discount tax credits it owns, eliminating the benefit based on the differential between the ELF rate and the ACES rate. The result has been investment outside the Cook Inlet.

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Co-Chair Hawker concluded that HB 280 is about making gas available to consumers and relieving future cost increases related to gas storage. The bill would also impose regulation on the emerging gas storage industry for the benefit of consumers and provide potential operators with the assurances needed to move forward.

Co-Chair Stoltze noted energy challenges in Southcentral and concerns about a coming shortage. Co-Chair Hawker opined that the state has been fortunate so far to have sufficient production and the ability to divert excess production in times of less demand, but he anticipated the demand would exceed supply. He expected that the March 31, 2011 expiration of the federal export permit could eliminate the production buffer in Southcentral. He underlined that without the proposed storage, the average daily flow would not meet peak demands.

Vice-Chair Thomas queried the transferability of tax credits. Co-Chair Hawker replied that under current statute, the credits are not transferable; however, an individual entity has the ability to apply to the Department of Revenue for reimbursement if it cannot utilize all the credit.

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Representative Austerman questioned whether stored gas that is tapped when needed would fluctuate in price or be amortized across the year. Co-Chair Hawker replied that the RCA would regulate gas flowing to consumers through a storage facility. The commission might level prices throughout the year; alternatively, it could allow lower prices in the summer when demand is low and gas storage is "off-line" and require higher prices during peak winter demand.

Representative Fairclough referred to refunds collected through the Oil and Gas Tax Credit Fund and queried the balance of the fund. Co-Chair Hawker replied that the credit fund was originally established with $400 million and is recharged annually based on expected demands. The determination was made the previous year that the fund was overfunded and the legislature reappropriated $200 million out of the fund through the supplemental budget. The

governor requested $140 million be added to the fund in the current year's budget. He anticipated that $20 million to $25 million would be needed considering the $15 million credit limit per facility (for the one or two 10 billion cubic feet storage facilities needed for Cook Inlet).

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Representative Fairclough referenced ownership in Section 4 and asked what would happen if a company sold a facility. Co-Chair Hawker responded that there are two components to storage facility enhancements: Section 10 addresses an investment tax credit and Section 4 directs DNR to waive land lease fees for the first ten years for a qualified gas storage facility. In addition, an anti-churning provision stipulates that a facility in operation prior to the bill cannot receive credits, and if the storage facility is sold, credits cannot be obtained on the purchase.

JAN LEVY, STAFF, REPRESENTATIVE MIKE HAWKER, specified that the provision was in Section 10(g) on page 10 of HB 280.

Co-Chair Hawker pointed to Section 10(h) on page 10 and emphasized the importance of providing recapture provisions when providing investment tax credits in case a storage facility ceases commercial operations. He did not intend a business to get a credit in year one, go out of business in year two, and then pocket the credit. The recapture provision requires a ten-year step-down in order to fully vest in the tax credit.

Representative Fairclough turned to a Section 4 requirement that the credits be reflected in the fuel base rate. She asked how to ensure protection for rate payers once the credits are passed on to the owner of the gas.

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Co-Chair Hawker responded that the RCA would regulate the operations of gas storage facilities operated for consumer purposes.

Representative Fairclough asked about royalties and the relationship between the market price a utility would pay for gas and the price a consumer would pay. Co-Chair Hawker pointed out that a utility does not pay royalties; only the producer of the gas pays royalties when the gas is taken

from the ground during original production. He stressed that the storage facilities are only warehousing facilities.

Representative Fairclough remarked that the rate paid by a utility includes the tax. She was concerned that utilities would buy low, store the gas, and charge consumers more.

LARRY PERSILY, STAFF, REPRESENTATIVE MIKE HAWKER, explained that for third-party gas storage, the utility would buy gas during the year and pay the contract price to the producers. He emphasized that the price for the gas would not change when it comes back out of storage because utilities are not allowed to make a profit on the gas. The RCA would allow the utility to only recover what it paid for the gas plus the cost of storage.

Co-Chair Hawker added that the contracts are typically long-term upstream procurement contracts.

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Representative Gara queried the current tax structure in Cook Inlet. He wanted to know more about the additional tax incentives as well as the current production tax in Cook Inlet. He agreed that gas storage is needed and supported passage of some form of gas storage incentive in the current year. Regarding incentives to promote exploration in Cook Inlet, he believed that the tax rate was not too high, but that no one would spend the money to get the gas unless they knew they could sell it. He relayed concerns that the remaining gas resource is hard to explore for without a long-term buyer. He wondered why more tax credits on Cook Inlet gas was the answer.

Mr. Persily responded that the tax structure for gas produced in Cook Inlet and used in Alaska is hardwired under ELF at about $0.17 per thousand cubic feet.

Representative Gara asked for more information. Mr. Persily explained that the tax essentially comes in at $0.17 and cannot go above that number; he did not know whether it could go under. He noted that the tax rate would not be changed; the legislation deals with exploration credits.

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ROGER MARKS, CONSULTANT, HOUSE FINANCE COMMITTEE, detailed that Cook Inlet taxes were originally crafted under PPT and carried over into ACES and used the ELF structure that was in place when PPT came into effect April 1, 2006. For both oil and gas, the average ELF structure that was in place the prior twelve months is hardwired in through 2022; for any field that went into production after the PPT effective date, the average ELF rate for all other fields became the actual ELF structure for new fields.

Mr. Marks explained that the ELF structure was a product of two things: the nominal rate of 10 percent for gas and the ELF, which was a number that gave every gas well 10,000 mcf per well per day tax free. The ELF number (a fraction) times the 10 percent tax rate comes to $0.17/mcf for Cook Inlet.

Mr. Marks continued that oil works in a similar way; the ELF structure for oil was 300 barrels per well per day tax free coupled with a 15 percent gross rate. For oil, the ELF rate happened to be zero, so Cook Inlet oil pays no severance tax under the current production tax law.

Representative Gara queried the percentage tax rate charged on the gross on Cook Inlet gas currently. Mr. Persily responded that the number would depend on the price; if the price is $8 per thousand cubic feet, the tax rate would be 2 percent using the $0.17. The rate would fluctuate with the price the producers get under a particular contract.

Mr. Marks pointed out that the $0.17 is independent of the price; ELF reflected 10,000 mcf per well per day tax free regardless of the price.

Representative Gara asked the range of current gas prices to understand the relative value of the $0.17.

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Mr. Marks replied that a wide spectrum of contracts exist in Cook Inlet, including old contracts with low prices and others that reflect the current Henry Hub [natural gas spot] price based on a three-year rolling average. He added that the $0.17 tax rate applies whether the contract is currently receiving $1 or $8 for the gas.

Representative Gara queried the current Henry Hub price. Co-Chair Hawker replied that the price was currently $4.20 and has been shifting between $4.25 and $5 for the past several months.

Representative Gara surmised the benchmark would be a 3 percent gross tax. Mr. Persily replied that the number would be 4 percent.

Co-Chair Hawker commented that one of the things driving the market was that people who had gas to produce and sell were unable to get a long-term contract approved by the RCA. He reported that the commission had rejected a couple of viable long-term contracts with minimal explanation and that there had been conflict over the issue. He referred to a shift within the commission towards understanding that it has been part of the problem.

Co-Chair Hawker informed the committee that he had wanted to remove the RCA from regulating procurement contracts. He recognized that allowing the market to operate freely would not be consumer-friendly. He noted that language had been put into HB 280 providing specific guidance to the RCA; RCA had helped with the language and felt it would aid the agency in evaluating future long-term contracts. In Section 5, the commission is directed to consider the impact of long-term gas supply contracts on consumers. He stressed that the criteria was very different than in the past; the consequence of rejecting two major contracts has severely exacerbated problems with securing deliverability. Companies are no longer willing to enter into long-term contracts under the same terms.

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BOB PICKETT, CHAIRMAN, REGULATORY COMMISSION OF ALASKA (via teleconference), acknowledged that the commission had declined to approve a series of contracts in the past. He noted that HB 280 asks RCA to consider and articulate the reasons for declining contracts and the impact on consumers. The bill requires wrap-up and that other parties to the proceedings take into account the same considerations.

Representative Gara asked whether HB 280 would change RCA's analysis of rulings such as the denial of the ENSTAR contract the previous year. Mr. Pickett believed the

commission had considered the impact of declining the contracts and pointed out that the proceedings involved other parties. He emphasized that the commission makes decisions on the basis of developments in proceedings. He felt the world was significantly different than when the contracts were being considered. He underlined the seriousness of issues such as the lack of gas supply under contract for Southcentral utilities and deliverability issues. He believed HB 280 was a move in the appropriate direction, although he did not think it would correct all problems in Cook Inlet.

Representative Gara emphasized that he did not intend to criticize the RCA. He asked whether the proposed legislation would affect how the commission would rule on similar issues in the future. Mr. Pickett did not think future RCA rulings could be pre-judged. He emphasized that RCA does not regulate producers in Cook Inlet and cannot compel producers to enter into any kind of contract with any utility. The commission has to respond to the filings that the utilities make and the contracts that they present for review. He viewed the Cook Inlet market as small and disconnected.

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Representative Gara clarified that he wanted to know whether there was a provision in HB 280 that would affect how the commission would rule on future cases.

Co-Chair Hawker noted that Section 5 was the relevant section.

STUART GOERING, ASSISTANT ATTORNEY GENERAL, COMMERCIAL/FAIR BUSINESS SECTION, CIVIL DIVISION (ANCHORAGE), DEPARTMENT OF LAW (via teleconference), informed the committee that he was assigned to RCA. He explained that Section 5 would add a new provision to the basic authority of the commission, requiring it to look at specifically named factors when determining whether or not a contract should be considered just and reasonable and therefore approved. In particular, the provision points RCA and parties presenting evidence to the commission to considerations of whether or not a utility has alternatives to the contract presented, and if not, the impact the rejection of a contract would have on the reliability of the utility's service. The provision

would change the commission's behavior as well as require parties to bring relevant evidence to the commission.

Representative Gara queried the role of the Attorney General's Office related to consumer protection on RCA matters. Mr. Goering replied that there are two statutory roles for the department regarding utilities and pipeline regulation. He described his role as advisor to the RCA directly. The other role relates to the Regulatory Affairs & Public Advocacy (RAPA) section of the Department of Law; that function is filled by Daniel Patrick O'Tierney.

Mr. Persily directed attention to Section 20 of HB 280, which uses the same language as Section 5 and directs RAPA to consider the same issues when weighing in on the side of the public.

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Representative Gara asked the department's opinion on the section. Mr. Goering opined that language in both sections will be beneficial to the RCA in that it will cause the parties to bring additional relevant evidence into proceedings when the commission is considering whether or not to approve gas sales agreements and rates related to natural gas transactions. He emphasized that more evidence is always good and encouraged guidance from the legislature regarding the kinds of evidence that should be considered when making such an important public interest determination.

Mr. Persily informed the committee that he had worked with Mr. O'Tierney on the section.

Representative Gara requested input from Mr. O'Tierney.

Co-Chair Hawker suggested more explanation of the increased access to existing credits offered by the bill. Mr. Persily explained that the hope is that third-party gas storage would foster more of a market and therefore more production. He anticipated that the credits in the bill would remove the limitation so that someone investing in Cook Inlet exploration receives credit, can use the full credit for their state-wide tax return, and allows Cook Inlet explorers to recover their full tax credit in the first year rather than over two years.

Mr. Persily noted that currently in Cook Inlet a company can get a 30 or 40 percent credit on exploration depending on how far it is from the existing well; Section 16 puts the credit at 40 percent and applies it to all well-related lease expenditures in Cook Inlet, which includes delineation wells, service wells, and anything related to producing oil and gas.

Co-Chair Hawker added that after HB 280 had been introduced and identified impediments in the Cook Inlet, the administration brought forward a state-wide bill to adjust some of the oil and gas credits. He assured the committee that HB 280 does not apply beyond the Cook Inlet.

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Representative Gara requested analysis of estimated subsidies under HB 280. He wondered whether the $0.17 tax rate and 40 percent credit could result in paying people to produce Cook Inlet gas. Mr. Persily responded that the amount was unknown; to calculate how much tax credit a company could get he needed to know how much it would invest in the inlet during the next ten years. The fiscal effect would be a percentage of eligible expenses in future years; if no one spends, the state pays no credits. If a company finds gas, the state would come out ahead through its royalty and production tax. In addition, there would be the indirect benefit of more gas in Cook Inlet.

Mr. Persily responded to the second question regarding whether the state could end up paying someone to produce gas. He explained that the state would not end up paying a producer. However, a company could possibly invest so much in a single year that available tax credit for the year would exceed production tax liability; in that case the credit could be carried forward to a future year or essentially refunded by the state. He added that regardless of where a producer made the investment that earned the tax credit, the credit would be applied to the company's tax return for its total statewide production tax liability. [Under state law, production taxes are assessed on the value of a company's total statewide production, not individual wells or fields.]

Co-Chair Stoltze regarded the measure as a tax credit for constituents who are using natural gas. He believed the ultimate subsidy was for the consumers in Southcentral. Co-

Chair Hawker agreed that corporate entities do not pay taxes; consumers pay the taxes. The Cook Inlet is unique in that the majority of the gas produced there is for Alaskan consumption. The state needs a reasonable tax structure; considerations are different than for larger projects aimed at export.

Co-Chair Stoltze believed some would view the issue as a Southcentral subsidy. Co-Chair Hawker agreed the political argument could be raised. He asked members to be "statesmanlike" and emphasized the number of citizens affected. He stressed that nothing was being asked of the state treasury in the bill; the measure intends to incentivize third-party investment in Cook Inlet in order to provide greater development of resources.

Co-Chair Stoltze viewed the measure as a consumer credit.

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Representative Doogan questioned who would take advantage of the gas storage in the legislation. Co-Chair Hawker responded that the issue was inventory management; part of inventory management is who owns the inventory. He listed possible alternatives:

- A public utility constructs its own gas storage facility, acquires a lease, and develops the storage facility that is operated as part of the utility;
- A public utility acquires gas under long-term purchase contracts from a producer and further contracts with a third-party storage owner/operator; or
- A producer needs a warehouse for their own produced gas prior to meeting contractual delivery demands.

Co-Chair Hawker pointed out that the gas storage facility investment tax credits in HB 280 are not available to a producer developing storage capacity for their own gas. The credits are available to a public utility that will benefit the consumer.

Mr. Persily commented that Chevron and Marathon already have their own gas storage facilities; they put the gas in year-round and draw to meet contractual deliverability requirements for utilities. He noted that such proprietary storage would not get the incentives and would not be regulated by the RCA under HB 280. The incentives and

regulation apply to open-access storage for utilities that buy gas through contracts; the utilities pay for the storage fee as an unbundled price.

Representative Doogan questioned whether pricing and regulatory structure would be sufficient to assure that consumers would not be paying a premium for the gas when it comes out of the warehouse.

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Mr. Persily replied that a utility has to get the gas contracts approved by the RCA. He stressed that a company would only be able to charge the price they paid for the gas plus the cost of storage; HB 280 would regulate the cost of storage, while the utilities and gas supply contracts are already regulated. The RCA would determine whether the price was appropriate to pass on to the consumer. The utility could determine how to deal with the cost of storage service; for example, it could use a winter surcharge, or spread the cost over the whole year. He underlined that the utility cannot make a profit on the gas.

Representative Doogan asked whether he meant to say a utility cannot make "any additional profit on the gas." Mr. Persily replied that utilities are not allowed to make any profit on the gas. Co-Chair Hawker added that a long-term supply contract by the regulated utility would be done through the RCA.

Representative Doogan wanted further clarification regarding consumers paying too much for the storage after costs have been decided. Co-Chair Hawker replied that the regulations and pricing structure work to assure that a utility does not make a profit on gas. The utility makes its earnings on invested capital in the transportation system. He referred to an Institute of Social and Economic Research (ISER) study showing that from 1996 to 2007, consumer prices declined as utilities developed more efficient transportation systems, but commodity prices drove consumer prices up substantially.

Representative Doogan wanted people to have a clear idea of what is being asked and what is being offered.

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Co-Chair Hawker assured him that the receipt of any financial advantage is under RCA regulation.

Representative Gara queried the change in the tax credit from 30 percent to 40 percent. He questioned whether a larger tax credit would result in more production; he believed the lack of long-term contracts has deterred exploration in Cook Inlet, not tax rates. Co-Chair Hawker replied that they would have to agree to disagree on the point; some people believe industry can be motivated to produce through taxes, and others do not. He felt that the consumer benefited the most and new explorers/producers would be attracted when government takes less from the value of the resource.

Mr. Persily added that exploration in Cook Inlet is increasingly costly as well as risky; he argued that the state paying more in tax credits was cheaper than subsidizing fuel or paying towards a gas pipeline if there is not enough gas in Cook Inlet.

Co-Chair Hawker noted that the 40 percent credit is not new but makes the existing tiered 30/40 percent credit (crafted for the North Slope) more appropriate to Cook Inlet.

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Representative Gara wanted evidence that more tax credit would mean more gas. He did not think it was fair to say the people in Southcentral would suffer if more tax credits are not offered. He pointed out that there has not been enough exploration in Cook Inlet in spite of extensive tax relief granted in the last ten years through exemption from ACES and PPT, as well additional tax credits for Cook Inlet exploration. He questioned adding another form of tax relief before analyzing how the past ten years of tax credits have worked. Co-Chair Hawker replied that Cook Inlet has not been granted tax relief; exempting the basin by allowing retention of the existing tax structure had been determined to be in the best interest of the region’s consumers.

Co-Chair Stoltze added that people in Chugiak and Wasilla believed the state did not require as much.

Co-Chair Hawker stated that attracting capital is about being competitive. He believed the basin would be more attractive to investors through elimination of the Cook Inlet penalty and the 30/40 percent tier.

Representative Gara requested a history of Cook Inlet tax credits adopted in the past decade. Mr. Persily replied that he would get the information.

Representative Gara did not think the bill reflected discussion that production and exploration tax credits would benefit consumers. Co-Chair Hawker explained that the cost of the product to the utility is the basis of the rate making; the less government takes, the less the consumer will pay.

Representative Gara recalled a past argument made connected to an RCA application about charging market or Henry Hub rates without an adjustment for tax credits. He asked whether there would be an adjustment for tax credits. Mr. Persily replied that there is not a statutory, direct dollar-for-dollar requirement that tax dollars flow through; the tax rate is reflected in that the utilities pay the production tax under Cook Inlet supply contracts.

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Representative Doogan noted that one part of the bill is about gas storage and another is about incentivizing more exploration in Cook Inlet. He asked whether there was a reliable estimate of when the stored gas would not be enough to meet the demand. Mr. Persily believed that the utilities would need more gas around 2013 in order to meet the need.

Co-Chair Stoltze pointed out that there have already been some close calls. Co-Chair Hawker added that the situation could be exacerbated if the production buffer provided by the export facility is lost in March 2011. Co-Chair Stoltze emphasized the seriousness of the issue.

Co-Chair Hawker MOVED to ADOPT Amendment 1 (26-LS1185\C.1, Bullock, 3/10/10):

Page 7, following line 14:
Insert a new bill section to read:

"*Sec.7.AS 42.05.711 is amended by adding a new subsection to read:

(q) The service of natural gas storage furnished by operating a natural gas storage facility that is (1) part of a pipeline facility operated by a pipeline carrier, (2) part of a natural gas pipeline facility operated by a natural gas pipeline carrier, or (3) part of a North Slope natural gas pipeline facility operated by a North Slope natural gas pipeline carrier is exempt from this chapter. In this subsection, "natural gas pipeline carrier," "natural gas pipeline facility," "North Slope natural gas pipeline carrier," "North Slope natural gas pipeline facility," "pipeline carrier," and "pipeline facility" have the meanings given in AS 42.06.630."

Renumber the following bill sections accordingly.

Page 9, line 9:

Delete "for"

Co-Chair Stoltze OBJECTED for discussion.

Co-Chair Hawker explained that there is not law related to gas storage facilities and that a regulatory distinction needed to be made between storage facilities and gas storage in something such as a pipeline (called “packing”). He informed the committee that Amendment 1 clarifies that a gas storage facility that is part of a natural gas pipeline and already regulated under the RCA is not subject to regulation under HB 280, which intends to create storage facilities in order to meet consumer demands.

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Mr. Persily expanded that the language in the amendment was drafted by Mr. Goering, the Assistant Attorney General assigned to the RCA. Mr. Goering had felt clarification was needed for two sections of RCA regulation: AS 40.205 (utilities, under which gas storage would be regulated), and AS 40.206 (which regulates pipelines). Mr. Goering felt the bill referred to a storage facility that is part of a regulated natural gas pipeline under 40.206 and does not need to be regulated a second time under 40.205.

Co-Chair Stoltze queried the removal of the word “for” on page 9, line 9. Co-Chair Hawker replied that the language was preferred by the Department of Revenue.

Co-Chair Stoltze WITHDREW his OBJECTION. There being NO further OBJECTION, Amendment 1 was ADOPTED.

Co-Chair Hawker MOVED to ADOPT Amendment 2 (26-LS1185\C.3, Bullock, 3/16/10):

> Page 15, following line 9:
> Insert a new subsection to read:
> “(o) For the purposes of (m) and (n) of this section, a Cook Inlet well lease expenditure is a lease expenditure that is incurred in the Cook Inlet sedimentary basin that is directly related to a well. A lease expenditure is directly related to a well if
> (1) during exploration and development, the lease expenditure is characterized as an intangible drilling and development cost under 26 U.S.C. 263(c) (Internal Revenue Code) or 26 C.F.R. 1.612-4 regardless of any election made under those provisions;
> (2) during production, the lease expenditure is an expenditure that is directly related to the processes of operating a well and moving fluids to the assembly of valves, pipes, and fittings used to control the flow of oil and gas from the casinghead, but does not include the processes of gathering, separating, and processing well fluids downstream from that assembly;
> (3) it is an overhead expenditure authorized under AS 43.55.165(a)(2) for exploring for, developing, or producing, as applicable, the oil or gas deposits, or an expense for seismic work conducted within the boundaries of a production or exploration unit.”

Co-Chair Stoltze OBJECTED for discussion.

Co-Chair Hawker explained that the amendment provides a clear definition of Cook Inlet well lease expenses. He pointed to vagueness in current law that needs to be addressed. The amendment focuses on IRS rules for determining eligible well expenses.

Co-Chair Stoltze WITHDREW his OBJECTION. There being NO further OBJECTION, Amendment 2 was adopted.

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Co-Chair Hawker wanted to discuss an amendment that had not yet been drafted. He believed DNR would object to the amendment, and that he did not view the department as amenable to furthering the production of Cook Inlet gas. He explained that the undrafted amendment related to proprietary storage lease operations, particularly connected with gas storage.

Co-Chair Hawker listed three storage scenarios:

- A regulated public utility owns and operates storage;
- Open-access third-party storage is offered for a price; or
- An investor in Cook Inlet builds a warehouse for their own benefit, not available to the public on a third-party basis.

Co-Chair Hawker reminded the committee that HB 280 is crafted so that either open-access third-party storage or utility-owned storage gets the benefits of the incentives, but would be subject to regulation.

Co-Chair Hawker referred to a DNR decision to not permit proprietary storage; the department wanted open-access storage. He felt the decision was unfair and an over-application of regulatory authority. He also believed the position violates an important free-market principle: the state grants exploration/production leases to an entity and then tells the entity it cannot build the assets it believes are commercially reasonable, appropriate, and necessary to operate the business of developing the state's natural resources.

Co-Chair Hawker informed the committee that his proposed amendment would specifically allow third-party proprietary storage and say that DNR may not deny an application for a lease solely on the grounds that it would be used exclusively for the entity's own product. He believed the amendment would protect investors in Cook Inlet and at the same time not compromise what the bill is attempting to accomplish by creating incentives for open-access storage.

Co-Chair Stoltze wanted DNR to testify before the full committee. He thought the proposed amendment would raise policy questions.

3:08:11 PM

Representative Gara requested an analysis of HB 280 by both DNR and REV.

Co-Chair Stoltze reported that he had issued invitations. He wanted committee members to have the testimony needed.

HB 280 was HEARD and HELD in Committee for further consideration.

3:10:47 PM AT EASE
3:14:40 PM RECONVENED

#hb273
HOUSE BILL NO. 273

"An Act relating to general grant land entitlements for the City and Borough of Wrangell; and providing for an effective date."

3:14:48 PM

REPRESENTATIVE PEGGY WILSON, SPONSOR, explained that HB 273 would increase the land entitlement to the City and Borough of Wrangell, correcting a deficit in the borough formation process. She noted that the state grants state land to support the development of a new borough.

Representative Wilson detailed that Wrangell's original entitlement in 2008 was only 1,952 acres. Negotiations with the Department of Natural Resources (DNR) resulted in an agreement regarding acreage; however a new amendment was required to bring the total entitlement to 9,006 acres. The additional acreage would allow the City and Borough of Wrangell to select the Sunny Bay section of the Cleveland Peninsula. She emphasized that the land is important to provide for the needs of the borough and to address the economic, cultural, and resource-based goals of the residents. The parcel was not included originally because boundaries had not been set.

Representative Austerman asked whether the requested parcel was connected to the rest of the borough's land.

REID HARRIS, STAFF, REPRESENTATIVE PEGGY WILSON, replied that Wrangell is on an island, but the borough encompasses other pieces.

Representative Austerman queried the proximity of the proposed land to the existing borough. Mr. Harris replied that a boat was needed to access the parcel.

3:19:15 PM

STEVE PRYSUNKA, DIRECTOR, ALASKA CROSSINGS, WRANGELL, spoke to concerns regarding the legislation. He testified as representative of a large community-service organization in Wrangell that provides medical, dental, pharmaceutical, and therapeutic services to the surrounding areas. Alaska Crossings also runs the largest wilderness therapy program in Alaska. About 250 Alaskan young people travel to a floating facility off Deer Island, a renovated logging camp moored near the island.

Mr. Prysunka told the committee that the area under consideration on Cleveland Peninsula is important to Alaska Crossing's operation. The waters are protected and can be used by the kids. He was concerned about the potential for development in the area. He stressed that Alaska Crossings with 85 employees is the largest employer in the community and has been a significant financial contributor to the local economy. He noted that there are not other mooring options in the borough for the floating facility.

MARK GALLA, OWNER/OPERATOR, ALASKA PEAK & SEAS, WRANGELL, spoke in opposition to the legislation. He explained that he runs a guide/charter operation out of Wrangell. He was concerned about development in the land selection, such as logging or construction, which would severely limit his operations, especially brown bear hunting.

Mr. Galla emphasized that development of the area would displace him from the area; the parcel covers over 30 percent of the area he operates in and would result in a 30 percent negative impact to his business. He stated his support of Wrangell acquiring the piece of land to better serve the community.

3:25:19 PM

Vice-Chair Thomas noted that the borough would have jurisdiction over the area and could make land-use decisions, including to log. Mr. Galla understood, but hoped the borough would consider the interests of small businesses such as his.

CAROL RUSHMORE, ECONOMIC DEVELOPMENT DIRECTOR, CITY & BOROUGH OF WRANGELL (via teleconference), testified in support of the legislation. She strongly stressed the importance of the entitlement for long-term economic sustainability in the borough. She pointed out that the borough has been negotiating with DNR regarding the additional entitlement; agreement had been secured related to the 6,506 acreage amount. However, the Sunny Bay parcel on the Cleveland Peninsula never came up during negotiations because of inadequate information from DNR regarding the possibility of selecting the area.

Ms. Rushmore informed the committee that in 2005, when the University of Alaska land bill had come forward, Wrangell had lobbied successfully to have three other areas within the proposed borough set aside for possible selection. However, after the 2005 land bill passed, Meyers Chuck approached Wrangell about becoming part of the forming borough instead of the Ketchikan borough (which was going through an annexation process at the same time). In response, the borough boundary line was modified to include part of the Cleveland Peninsula. She emphasized the importance of Meyers Chuck to the borough and requested the additional acreage.

Vice-Chair Thomas noted that Amendment 1 would address the issue.

3:28:13 PM

TIMOTHY ROONEY, MANAGER, CITY & BOROUGH OF WRANGELL (via teleconference), stated that the borough is interested in the area for its economic potential and benefits. He reported that the borough is working closely with Alaska Crossings and local businesses on current and future potential use of the area, and noted that Meyers Chuck residents use it for recreation and subsistence.

Representative Wilson read a paragraph from the third page of a handout, "Section 14.40.365. University land grant" (copy on file):

> (o) Notwithstanding (a) of this section, the state land identified in this subsection and described in the document entitled “University of Alaska Land Grant List 2005,” dated January 12, 2005, may not be conveyed by the University of Alaska under this section if the land is included in a borough formed before July 1, 2009, that includes Wrangell or Petersburg. If a borough is not formed before July 1, 2009, land described in this subsection shall be conveyed to the University of Alaska on July 1, 2009. If a borough is formed before July 1, 2009, and the borough does not select land described in this subsection before January 1, 2013, the land not selected by the borough shall be conveyed to the University of Alaska on June 30, 2013.

Representative Wilson reminded the committee that Wrangell became a borough in 2008 and that the proposed portion of Cleveland Peninsula was not on the list only because the boundaries were unknown at the time. She noted that when the university land grant became law, it was decided that Wrangell would get first pick of the land.

Vice-Chair Thomas noted that the amendments would be further discussed at a future hearing.

Representative Fairclough asked whether DNR would be present to speak to the amendments.

3:32:33 PM

Vice-Chair Thomas CLOSED public testimony.

HB 273 was HEARD and HELD in Committee for further consideration.

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ADJOURNMENT

The meeting was adjourned at 3:34 PM.