

6HOUSE FINANCE COMMITTEE
March 31, 2010
9:06 a.m.

[9:06:49 AM](#)

CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 9:06 a.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
Representative Mike Kelly
Representative Woodie Salmon

MEMBERS ABSENT

None

ALSO PRESENT

Tom Wright, Staff, Speaker Chenault; Mary Siroky, Special Assistant, Department of Transportation; Tom Wright, Staff, Speaker Mike Chenault; Carri Lockhart, Production Manager, Marathon Oil Company; Marcia Davis, Deputy Commissioner, Department of Revenue

PRESENT VIA TELECONFERENCE

None

SUMMARY

HB 7 ROBERT E. BUSH VETERANS' MEMORIAL BRIDGE

CS HB 7 (TRA) was REPORTED out of Committee with a "do pass" recommendation and the previously published fiscal note: FN1 (DOT)

HB 229

GAS EXPLORATION\DEVELOPMENT TAX CREDIT

CS HB 229 (RES) was HEARD and HELD in Committee for further consideration.

[9:07:00 AM](#)

#hb7

HOUSE BILL NO. 7

"An Act naming the bridge over the Kasilof River on the Sterling Highway the Robert E. Bush, Jr., Veterans' Memorial Bridge."

[9:07:28 AM](#)

TOM WRIGHT, STAFF, SPEAKER CHENAULT, explained that the Uncle of Robert E. Bush, Jr. requested the bridge be named for Robert E. Bush, Jr. Robert Bush passed away on July 12, 2007, after serving in the US Army during Operation Desert Storm. When he returned home upon his discharge, he was diagnosed with Type 1 Diabetes, which eventually claimed his life. His children drove the Kasilof River Bridge daily, and naming the bridge in his honor would remind his family and the public of his contribution to the community and country. He stated that there are petitions from members of the community of Kasilof signed in favor of the bridge naming.

[9:08:40 AM](#)

Representative Kelly asked if anyone in Kasilof was opposed to the bridge naming. Mr. Wright responded that there were some who opposed the name change, but there was no official testimony in opposition.

Co-Chair Stoltze closed public testimony.

[9:09:55 AM](#)

MARY SIROKY, SPECIAL ASSISTANT, DEPARTMENT OF TRANSPORTATION explained the fiscal note for the street signs and installation. The signs would be brown, in

compliance with historic and recreation sign custom, and noted they will be on both sides of the street.

Co-Chair Stoltze asked if this would be consistent with other memorial signs. Ms. Siroky indicated yes.

[9:11:26 AM](#)

Vice-Chair Thomas MOVED to Report CS HB 7 (TRA) out of Committee with individual recommendations and the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

CS HB 7 (TRA) was REPORTED out of Committee with a "do pass" recommendation and the previously published fiscal note: FN1 (DOT)

[9:12:10 AM](#)

#hb229

HOUSE BILL NO. 229

"An Act amending and extending the exploration and development incentive tax credit under the Alaska Net Income Tax Act for operators and working interest owners directly engaged in the exploration for and development of gas for delivery and sale from a lease or property in the state; providing for an effective date by amending the effective date for sec. 2, ch. 61, SLA 2003; and providing for an effective date."

[9:12:24 AM](#)

TOM WRIGHT, STAFF, SPEAKER MIKE CHENAULT, presented an overview of the HB 229. He explained that the bill would amend and extend the exploration and development incentive tax that was originally enacted in 2003. The tax credit would continue to apply under the Alaska Net Income Tax Act for operators and working interest owners, who are directly engaged in the exploration for and development of natural gas in the Cool Inlet, to more strongly encourage companies to invest additional capital in new gas reserves. The legislation would make the following changes to current law: it would increase the amount of credit from 10 percent to 25 percent of the amount of qualified capital investment and qualified services spending; it would remove the 50 percent limitation on the amount of credits in a single year, which would increase the time value of money for the

credit; it would remove the successful efforts requirement that disallows the credit for wells that are drilled with all the same cost, but end up being non-productive; it would clarify that credits can be taken in a current tax return, a timely filed tax return, or a timely tax return filed for the year immediately following the year the qualified tax investment was made; it would clarify that credits can be applied to a gas reserve, regardless of whether or not there was previous gas production in the area; it would clarify that credits apply to North Slope gas that has been brought into South-central Alaska; and it extends the sunset date of the investment tax credit from January 1, 2013 to January 1 2020. The bill makes no changes to definitions of qualified capital investments or qualified services. The annual natural gas production and supply in the Cook Inlet was in decline, but demand was increasing. He remarked that the original investment tax credit was only a modest success; he stressed expanding the tax credit to allow for much greater success in development. He hoped the changes outlined in the bill would achieve that goal. He pointed out that under Alaska Statute (AS) 4320-043, which was the original bill that was passed in 2003, there was no allowance for double tax credits, or "double dipping."

[9:15:56 AM](#)

Representative Gara wondered why someone would choose the 10 percent credit in the bill, over a 20 percent credit written in current legislation. Mr. Wright deferred to Carri Lockhart.

Representative Fairclough remarked that one bill requires a disclosure of all geological and technical information, and the other bill does not.

[9:17:19 AM](#)

Representative Gara remarked that explorers and developers wait for supply contracts to expire, so a new market opens up. He wondered how that scenario would relate to the need for tax credits. Mr. Wright deferred to Carri Lockhart.

Vice-Chair Thomas referred to current legislation regarding an in state gas pipeline, and wondered if that might have an impact on the proposed tax credit sunset date of January 1, 2020. Mr. Wright explained that the hope for HB 229

would be a stop-gap measure, because gas line production was still unsure. He remarked that there were not many well defined fields in the Cook Inlet, so it is expensive to drill and explore the broad areas for the gas pockets.

[9:21:05 AM](#)

CARRI LOCKHART, PRODUCTION MANAGER, MARATHON OIL COMPANY, stated that the focus of Marathon Oil Company's Alaska Operation is natural gas production operations, limited to the Cook Inlet. In 2009, natural gas sales from Alaska averaged about 87 million cubic feet a day. It sold to local utilities: En-Star Electric, Chugach Electric, Tesoro, and the Department of Defense. It also provided natural gas to the Conoco Philips Marathon LNG plant. Marathon had been in business for Alaska for over 55 years, and she stressed that the company is committed to South-central Alaska's natural gas needs through current contractual commitments. She remarked that tax incentives are imperative, because of the long-term decline in natural gas reserves and deliverability. She remarked that it is unlikely that Cook Inlet reserve additions would replace annual production on an ongoing long-term basis. As such, natural gas reserves and deliverability were at risk for continued decline at Cook Inlet, which could result in exposure to unmet utility needs. There is a history of oversupply of natural gas from the Cook Inlet, which kept the price of gas below the lower 48 indexed prices. As of late, the regulatory processes and deterioration in market availability have added to project uncertainty. She pointed to key issues to ensure the reliability of natural gas in South-central Alaska: storage; market access and certainty; and economic projects. She believed HB 229 would impact economic projects. She noted that Marathon projects in Alaska compete globally for finite funding, and stated that HB 229 would level the playing field between Alaska projects and other investment opportunities. Marathon believed that HB 229 is one part of the equation to enhance Cook Inlet exploration and development activities. She reiterated that in order to qualify for the investment tax credit, the producer must make capital investments, which would add value back to the state.

[9:26:40 AM](#)

Representative Austerman queried the impact of the tax incentive in decisions Marathon might make in new

explorations. Ms. Lockhart replied that a 25 percent tax credit on expenditures does have an impact on overall expenditures, but was unsure if it would be influential enough for projects to compete at the corporate level.

Representative Austerman Ms. Lockhart responded that there was a portfolio of projects that Marathon assesses from a risk management perspective. She noted that those portfolios change, depending on wells that are drilled in advance. Some wells have continuing projects, based on the success of the well; some projects get eliminated, if the wells fail. Whether a project materializes in the near future is based on market availability. Marathon is attempting to secure new contracts. If those contracts are not secured the tax incentive may not matter, because there would be no market for the gas.

[9:30:10 AM](#)

In response to a question by Representative Kelly, Ms. Lockhart stated that the amount of regulations on the marketing side is a challenge for producers. She remarked that there are not many service providers in Alaska, so competition for service is high; therefore services often come from the lower 48.

[9:32:54 AM](#)

Representative Gara illuminated that there was not a current over-supply issue, and wondered if that was a benefit to Marathon. Ms. Lockhart stated that if supply and demand market functions in Alaska were the same as those in the lower 48, then it would likely benefit Marathon. Furthermore, the regulations in Alaska restrict the benefits. If producers do not have a return on their investment, they will choose not to invest, and the decline will continue.

In response to a question by Representative Gara, Ms. Lockhart stated there are many factors that gauge the marketability of gas. She pointed to complex technologies, risks, and deterioration of reservoirs. There was a higher cost for resource recovery, because there was not as much gas as there used to be.

[9:35:42 AM](#)

Representative Gara asked how long the contracts will last for the Cook Inlet. Ms. Lockhart responded that she was unsure, but stated that she had seen a study revealing a gap starting in the next two years highlighting utility needs.

Representative Gara wondered if utilities wait for their contracts to expire, before they ask for more exploring. Ms. Lockhart replied that utilities are proactive in seeking new supply contracts, at the same time producers are proactive in securing outlets.

[9:37:38 AM](#)

Co-Chair Hawker asked if utilities in South-central Alaska were frustrated by the regulatory commission. Ms. Lockhart responded that there had been three contracts before the regulatory commission; two of which were long term contracts, and were denied. She remarked that these denials had created uncertainty in Marathon's business. Because contracts have been denied, Marathon has cut back its investment in Cook Inlet.

In response to a question by Representative Gara, Ms. Lockhart declared that Marathon would be drilling, if the contracts were not denied by the regulatory commission.

Representative Gara wondered if Marathon was confident they would find a gas supply, even though gas resources are unsure. Ms. Lockhart replied that Marathon would have made a commitment investment to be sure the needs of the utilities were met.

[9:40:29 AM](#)

Co-Chair Hawker queried the success rate of current drilling operations. Ms. Lockhart stated that was never a 100 percent success rate. Some levels of hydro carbon are encountered in most cases, but economic expectations are most often not met. Expectations are based on the reservoir and risks related to the drilling projects.

Co-chair Hawker asserted that there is risk in drilling. Ms. Lockhart agreed, and explained that as exploration of reservoirs encroach the borders, the wells become higher risk.

[9:42:21 AM](#)

Representative Fairclough reported that she was involved in the Regulatory Commission of Alaska (RCA) rulings, when the two contracts were denied, as well as discussions with utilities. In those meetings, it was acknowledged that gas supply in 2012 would be greatly depleted. The Regulatory Commission of Alaska believed the investment required to meet the gas requirement was too high for the consumers in Anchorage. Because of that observation, she believed the denial was based on cost to the consumer. She specifically asked for an explanation of the complexities of geological and technical data that was released under production tax.

[9:44:37 AM](#)

Ms. Lockhart replied that under the current production tax incentives, geological data must be disclosed. The data is equated to a trade secret of a company. It is collected over years, and it is analyzed and interpreted in order to determine an assessment. After a certain period of time, that data is released for public viewing. Marathon has a problem with giving the public access to their private trade secrets. There are two sets of data: geophysical and well-log data. Current statute requires well-log data be released to the public domain after 24 months, and geophysical data is released after 10 years. She remarked that 10 years is a very short period of time.

[9:46:59 AM](#)

Representative Austerman wondered if doing away with Regulatory Commission of Alaska, rather than passing the bill might result in more drilling. Ms. Lockhart chose to treat the inquiry as rhetorical.

Representative Fairclough stated that while she was in Regulatory Commission of Alaska discussions, she did not see the data the Regulatory Commission of Alaska used to make its final decision. Ms. Lockhart stated that over past 18 months, there had been extensive dialogues. She pointed out that are many different roles to fix the problem: Regulatory Commission of Alaska, utilities, producers, and the state. The common goal is to meet the demand and reliability. She remarked that the Regulatory Commission of Alaska has approved projects, and they carefully consider strategic implications on tactical decisions. She said that

HB 229 would further progress development, but it is not the sole answer to the fuel shortage.

[9:50:26 AM](#)

Representative Gara asked if the denied contracts would have met En-star's five and ten year demand. Ms. Lockhart believed that the five year contract would have fulfilled unmet needs through 2016, but could not reply regarding the 10 year contract.

Representative Gara wondered how one commits to a five year gas supply contract, when the gas is not already available. Ms. Lockhart stated that it is a risked business. Various factors go into determining portfolios. Production profiles constantly change, and are considered when determining contract commitments.

Representative Gara wondered what happens if the gas that is promised is not recovered. Ms. Lockhart replied that the producer can purchase gas from other companies or keep drilling.

[9:53:18 AM](#)

Representative Fairclough shared that in her experience with the Regulatory Commission of Alaska the utilities typically do not request contracts from only one producer. Utilities normally submit multiple contracts with various producers, to ensure availability of the resource. She mentioned that the Regulatory Commission of Alaska recently faced an issue pertaining to the high cost of gas for the consumer, and that the Regulatory Commission of Alaska did not approve the contracts because of the cost.

[9:54:48 AM](#)

Representative Gara thought it would be in the best interest of his constituents and Alaska to receive the geophysical data if Marathon was to receive a tax credit. That way, sustainability knowledge is maintained. He asserted that the legislature's purpose is not to protect the interest of the industry, but for the protection of the gas supply for consumers. Ms. Lockhart replied that the state is benefited from the additional resource and reserve production. She restated that the release of the geophysical and well-log data is problematic for the producer.

[9:58:43 AM](#)

Representative Doogan wondered how the corporate income tax credit would be used by the producer. MARCIA DAVIS, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, stated that the 25 percent credit is based on the capital expenditures and services. Once that volume is determined, the 25 percent is used to offset up to 100 percent the corporate income tax, until the credit expires.

Representative Doogan asked how the tax credit is applied pertaining strictly to drilling attempts. Ms. Davis replied that if the producer avails themselves of the 25 percent corporate income tax credit, they would not be able to use the same expenditures under a production or exploration tax credit.

[10:02:48 AM](#)

Representative Doogan wondered if one might be eligible for future credits, once the 25 percent corporate income tax credit is used. Ms. Davis replied that one particular well may have many different tax credits applied to it, because different kinds of expenditures will be used through the life of the well.

[10:05:04 AM](#)

Representative Austerman referred to the current 10 percent tax credit currently written in law. He queried the money that had been used against the 10 percent tax credit, and requested an extrapolation against the proposed increase to the 25 percent tax credit. Ms. Davis replied that the only way to do a history of who has utilized the 10 percent tax credit, tedious physical examinations of corporate income tax returns and calculations would be required.

Representative Austerman would like to know the dollar value to previous tax credit bills, not limited to gas related tax credit bills. He emphasized the importance of obtaining that information, in order to determine the fiscal impact on the state. Co-Chair Stoltze agreed.

Representative Austerman assumed the Department of Revenue (DOR) was tracking all of the tax credit information. Ms. Davis reiterated that DOR was not tracking the tax credits, because they did not have the capabilities to manually

examine and calculate every corporate income tax return. She remarked that DOR is at a disadvantage when supporting the legislature, because they are without that information. She asserted that Representative Austerman's request for calculations and data were reasonable, but DOR was without that resource.

[10:08:13 AM](#)

Co-Chair Hawker remarked that approximately \$3 million dollars was appropriated three years prior, for the purpose of accumulating the requested data. He wondered why that money had not been used. Ms. Davis responded that the \$3 million was used to upgrade motor fuel, excise tax, and corporate income tax. The \$3 million would not be inadequate to provide a system requested by Representative Austerman.

Co-Chair Hawker pointed out that when HB 61 passed in the 2003 Legislature, DOR affirmed that they would provide a complete report in 2009 on the effect of the tax credit under HB 61. He asked if that report was completed. Ms. Davis affirmed that the report was completed, and agreed to provide the report at a later time.

Representative Austerman wondered if DOR looks at every piece of legislation pertaining to corporate income tax. Ms. Davis replied that there were many current bills that affect either production or corporate income tax, and DOR carefully examines the data, as is feasible with man power.

Representative Austerman stressed providing DOR with more money and capabilities to extrapolate data related to the production and corporate income tax.

[10:10:42 AM](#)

Co-Chair Hawker argued that the legislature faces decisions based on revenue generation and decisions based on the public good. He emphasized that half the population is in need of natural gas, and that a balance should be made when determining what money can be used towards a greater good.

Representative Austerman agreed that he was not arguing health and safety issues, and understood that gas is needed. He just wanted to be given accurate information, so he understood the fiscal impact of his decisions.

Representative Gara asked if DOR had an estimate of how much money had been received for corporate income tax from Cook Inlet over the two years prior. Ms. Davis agreed to provide that information. She furthered that that the information would only be rough estimate, because corporate income tax is done on a proportionate basis of global income based on a factor analysis.

Co-Chair Hawker queried how the state apportions world-wide income. Ms. Davis replied that corporate income tax from oil and gas is a ratio of the corporate global income. The return is a fraction of the Alaska payroll, a fraction of Alaska properties against total property, and other incorporating factors. Once that ratio is determined, it is multiplied by the total income to determine Alaska's share of the income.

[10:13:58 AM](#)

Representative Gara wondered if the credits can be combined with other deductions or royalty modifications. Ms. Davis replied the production tax is determined by applying the tax rate against the net income. The costs are lease expenditures in subtracting costs out of the proceeds, to determine the production tax value. The tax rate is then applied against the tax value. Therefore, the lease expenditures are used in deriving the tax value, which determines the oil and gas production tax under Alaska's Clear and Equitable Share (ACES).

In response to a question by Representative Gara, Ms. Davis stated that tax payers in Cook Inlet pay the Economic Limit Factor (ELF) rate, rather than the calculated rate under the production tax.

Representative Gara wondered if there were any other expenditures derived from the royalty. Ms. Davis replied royalty relief negotiations would occur before new costs are incurred. Production costs would not impact the royalty costs.

In response to a question by Representative Gara, Ms. Davis believed that royalty relief can occur anywhere in the state.

[10:17:49 AM](#)

Representative Joule asked how the tax credit would impact the work force. Ms. Davis responded that any time there is a credit, money is spent. The credit was formulated, in order to encourage production and spending. The target of the bill is Cook Inlet gas development, and the state is essentially giving the producers a discount on the production costs. The state would lose a bit of its corporate income tax due to the 25 percent tax credit, but the 75 percent of the cost incurred by the company, is used to presumably hire employees and continue to operate and produce oil.

[10:21:28 AM](#)

Co-Chair Hawker wondered if a tax payer avails themselves of the investment tax credit under HB229, they would be prohibited from receiving royalty modifications provided under any other title. Ms. Davis affirmed that is correct.

Co-Chair Hawker surmised that anyone who avails themselves of investment tax credit against the corporate income tax under HB229 would be prohibited from claiming any other tax credit or royalty modification under any other statute. Ms. Davis replied that is correct.

CSHB 229 (RES) was HEARD and HELD in Committee for further consideration.

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ADJOURNMENT

The meeting was adjourned at 10:24 AM