

**ALASKA STATE LEGISLATURE**  
**HOUSE LABOR AND COMMERCE STANDING COMMITTEE**

February 8, 2010

3:21 p.m.

**MEMBERS PRESENT**

Representative Kurt Olson, Chair  
Representative Mark Neuman, Vice Chair  
Representative Mike Chenault  
Representative Bob Lynn  
Representative Tammie Wilson  
Representative Robert L. "Bob" Buch  
Representative Lindsey Holmes

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

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."

- HEARD & HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 280

SHORT TITLE: NATURAL GAS

SPONSOR(S): REPRESENTATIVE(S) HAWKER, CHENAULT

01/15/10	(H)	PREFILE RELEASED 1/15/10
01/19/10	(H)	READ THE FIRST TIME - REFERRALS
01/19/10	(H)	L&C, RES, FIN
02/08/10	(H)	L&C AT 3:15 PM BARNES 124

**WITNESS REGISTER**

REPRESENTATIVE MIKE HAWKER  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Presented HB 280 and answered questions as joint prime sponsor of HB 280.

LARRY PERSILY, Staff  
Representative Mike Hawker  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Testified and answered questions on behalf of Representative Mike Hawker on HB 280.

ROBERT PICKETT, Commissioner; Chairman  
Regulatory Commission of Alaska (RCA)  
Department of Commerce, Community, & Economic Development  
(DCCED)

Anchorage, Alaska

**POSITION STATEMENT:** Provided information and testified on HB 280.

**ACTION NARRATIVE**

**CHAIR KURT OLSON** called the House Labor and Commerce Standing Committee meeting to order at 3:21 p.m. Representatives Buch, Lynn, Wilson, and Olson were present at the call to order. Representatives Chenault, Neuman, and Holmes arrived as the meeting was in progress.

**HB 280-NATURAL GAS**

3:22:01 PM

CHAIR OLSON announced that the only order of business would be 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 LYNN moved to adopt the proposed committee substitute (CS) for HB 280, Version 26-LS1185\S, Bullock, 2/5/10, as the work draft.

REPRESENTATIVE BUCH objected for purpose of discussion.

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REPRESENTATIVE MIKE HAWKER, Alaska State Legislature, as a joint prime sponsor of HB 280, stated that due to declining productivity and the overall decline of natural gas production, not enough natural gas will be produced in Cook Inlet to meet the demand in Southcentral Alaska. This bill would allow for gas storage, and allow utilities to purchase gas during lower demand periods for use during peak use times. Secondly, the bill would address concerns about the tax incentive programs and may help facilitate oil and gas production. The bill will help to define specific terms such as facility and types of gas. He related that HB 280 was pre-filed this legislature but a number of important, technical changes were incorporated into a committee substitute. He noted that he has been working with the stakeholders in developing this bill.

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REPRESENTATIVE HAWKER asked members to consider adopting the proposed committee substitute, which incorporates a number of important technical changes. As a joint prime sponsor, he would like to commence the discussion of the bill.

REPRESENTATIVE BUCH asked to remove his objection.

There being no objection, Version S was before the committee.

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REPRESENTATIVE HAWKER stated that this bill would address the regional problem for primary source of heat and light for the Southcentral Region, which is the natural gas production from Cook Inlet. This basin was identified 50 years ago and while the rich fields are being depleted, there arguably remains ample

natural gas. However, gas has become more difficult to extract from the five major gas domes. The remaining gas will likely occur in small stratigraphic traps of gas, similar to small bubbles, instead of the massive reserves extracted in the first 50 years of development. As the community has grown, the level of consumption has increased at the same time that the productivity of the basin has declined. The increasing demand curve crosses the decreasing production curve and the community is then in a life-safety risk situation. While he offered his belief that this shortage is not a crisis, the legislature can facilitate a security plan for the region. He characterized the process as "getting out of the way of enterprise that has the capability to address our needs and solve our problems." He offered that an alternative viewpoint would be that government needs to step in and take control and try to fix it. He argued for the legislature to make a policy call and support the existing infrastructure, industries, and utilities and let the private sector address the problem.

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REPRESENTATIVE HAWKER identified the three areas the bill focuses on to help facilitate the development of additional natural gas sources to assure peak deliverability requirements. He noted the difference between peak deliverability and average deliverability of gas. Gas wells tend to produce at a fairly level state, but consumers have a lower demand in the middle of summer and a higher demand in winter due to lower temperatures. Thus, gas demand is very high in mid-February, he stated. In order to meet the peak demand, the producers must meet the peak deliverability requirement year round. Previously excess natural gas could be burned off, but that is no longer an acceptable method of handling excesses. In Alaska, in order to maximize the value of the resource, in the summer the state has provided gas to large anchor consumers such as the Agrium plant in the Kenai Peninsula. In the winter, gas has been diverted from commercial users to Alaskan consumers, and the demand has regulated the flow, with excesses used by non-residential non-community consumers. The state is currently approaching the point in which the ability to produce from the Cook Inlet will not meet the peak winter demand. Some energy solutions exist using a combination of conservation measures and alternative energy sources. However, he stated that alternative solutions take time and investment. He predicted that in another two winters the supply may not meet demand in Southcentral Alaska.

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REPRESENTATIVE HAWKER described the central element of this bill as a universally accepted mechanism by gas utilities, producers, and local government to increase amount of gas available on peak demand days through storage. Natural gas storage has been used in the Lower 48 for a hundred years, but significant gas storage has not been used in Alaska since it has not been needed until now. Realistically, to hold volumes of gas to meet peak demand will require underground gas storage, he stated. The industry technology has advanced to allow natural gas to be pumped from a new well into a depleted reservoir for storage. When natural gas is needed in the winter to meet peak demand, the natural gas can be pumped from storage, basically doubling the deliverability capacity. He stated that gas storage is universally accepted across the stakeholders involved. This bill provides a tax-credit incentive program for third parties to build and operate a storage facility to meet these deliverability requirements.

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REPRESENTATIVE HAWKER pointed out that he is providing details in his testimony primarily to provide a foundation for the new legislative members.

CHAIR OLSON agreed it was important to provide any new members with an overview.

REPRESENTATIVE HAWKER explained that this bill creates cost incentives and cost benefits to those interested in providing storage. One key point is that providing government support for the storage is important because the cost of storing natural gas is part of the supply chain of gas to the consumer. Thus, any benefit provided must be reflected in the rates ultimately charged to consumers purchasing gas moved through a storage facility. Therefore, any savings created for industry will be passed on as savings to the consumer due to the regulatory oversight on natural gas and pricing. He recapped that the state provides an incentive for industry to store gas, but it results in savings to consumers.

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REPRESENTATIVE HAWKER explained the second aspect of the bill relates to increasing access to existing tax incentives, and creating tax credit incentives for the development of gas by producers in Cook Inlet. Thirdly, an issue arose with the

Regulatory Commission of Alaska authority. The original bill intentionally contained limited language since a docket was open at the Regulatory Commission of Alaska (RCA) to consider whether it should regulate a proposed gas storage facility in Cook Inlet. He surmised that a potential project could be put on hold if the legislature was going to decide if it should regulate the business. The RCA recently came to the conclusion that its authority to regulate gas was unclear. Thus, the RCA requested the legislature provide guidance on the RCA's authority over regulating gas storage.

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REPRESENTATIVE HAWKER requested the committee consider the RCA's request for regulatory guidance. He indicated he will provide a recommendation on the level of guidance, and the specific language. He offered to discuss this conceptually.

REPRESENTATIVE HAWKER, in response to Chair Olson, suggested an amendment to HB 280 to address the specific guidance.

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REPRESENTATIVE HAWKER recapped that HB 280 provides incentives for gas storage facilities, additional incentives for exploration and development, and enlightened guidance from the legislature to the RCA on regulating these facilities. This is an urgent issue for Southcentral Alaska since its communities are at risk of not being served during the coldest winter months at some time in the next few years. Passing HB 280 will not solve all the problems but will give the stakeholders in the Cook Inlet incentives and represents a positive move towards energy security for consumers in Southcentral Alaska.

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CHAIR OLSON remarked that the state is losing its safety value, which has been its ability to reduce the amount of Liquefied Natural Gas (LNG) on tankers destined for Japan to provide additional gas to Southcentral Alaska.

REPRESENTATIVE HAWKER expanded on the LNG, describing the safety buffer that the state has enjoyed is the export of excess natural gas from Nikiski when it was not needed. He explained that what has kept natural gas inexpensive in Southcentral Alaska has been the export of excess natural gas. In March 2011, the export permit is up for renewal and industry is not

expressing any interest in renewing the permit, nor has he heard any interest by the administration in promoting the extension. He characterized the deadline as a "critical deadline."

REPRESENTATIVE NEUMAN asked whether two types of facilities were under consideration, including above ground storage and underground storage for gas..

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LARRY PERSILY, Staff, Representative Mike Hawker, Alaska State Legislature, stated that the gas storage could be an underground storage facility, a nearly depleted reservoir, an above ground tank, or a pipeline. He explained that a pipeline could be packed with a small amount of storage and that the bill does not provide any exclusion. He said the storage facility is defined as a tank, an above ground tank, a nearly depleted reservoir, or any other structure in the state.

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REPRESENTATIVE NEUMAN recalled losses when natural gas is injected underground. Thus, if a million cubic feet of natural gas is injected underground some gas is lost. He asked who would absorb the losses.

REPRESENTATIVE HAWKER responded that HB 280 addresses the technical nature of storage with a series of definitions. It is recognized that when natural gas is placed into an existing reservoir, some gas has not been developed or been assessed production taxes. It's a pressure vessel underground so gas is pumped in, but a base level of pressure is provided by "cushion gas," which acts as a spring at the bottom of the well. Cushion gas is comprised of native gas and non-native gas. Native gas would be comprised of the gas molecules that have never been produced, and depending on the specific facility, may provide enough gas to operate the facility. However, if it is necessary to pump gas into the reservoir to provide adequate pressurization, non-native gas is used. This bill operates on the concept that the last molecule pumped into a facility is the first molecule pumped out. Thus, production taxes are paid on volumetrics. Production taxes are not paid on native gas until an equal volume is removed from the facility. Thus, if gas is seeping out underground, that loss will be counted against the producer.

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REPRESENTATIVE HAWKER explained that storage facilities are big. In order to qualify for incentives, the facility must be large and it must be able to deliver gas at a rate sufficient to help alleviate the peak deliverability problems. Those parameters are contained in HB 280. Additionally, limits on the aggregate amount of credit are intended to reduce overspending on capital expenditures than is necessary. The arbiter will be the Alaska Oil and Gas Conservation Commission (AOGCC), which he characterized as the single most respected independent operating agency in existence in Alaska.

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REPRESENTATIVE HAWKER, in response to Representative Neuman, explained how the proposed tax credit would work. This is an investment tax credit, so when an owner or investor is building a storage facility, the company can receive a credit against the investment as an amount against its future state income tax obligations using a traditional investment tax credit model. The credit is not given on the molecules moving through the facility, but rather is given on the capacity of the facility. Thus, the goal is to provide an income tax credit of approximately 10 percent of the cost as a tax credit, which is based on judgment. One way to consider creating an investment tax credit is to spend money, send copies of the receipts, and obtain a ten percent of the qualified investment expenditures. However, the state has discovered that trying to define "qualified" has been difficult. The ACES regulations were just released, and the Governor has been considering asking for forgiveness regulations since it took so long to promulgate the regulations. Meanwhile, the industry has been operating for three years without any rules. The ACES law requires penalties, but the penalties are due to the state's inability to provide regulatory guidance, he said.

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REPRESENTATIVE HAWKER offered his belief that it is urgent to provide rules to any potential natural gas storage facility owners. He said he would hate to see the legislature compromise moving forward on storage capacity because the government cannot operate more efficiently. An easier way to calculate the tax credit exists. By using the volumetric approach, the state could provide a credit of \$1.50 per thousand cubic feet, the facility could get built, the AOGCC could certify the rate of the tax credit, which is easy to calculate and would amount to

approximately a 10 percent tax credit. He stated this process would avoid complications and someone investing more into the facility than necessary due to the structure of cash on cash investment tax credit. He restated that the tax credit concept is volumetric.

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REPRESENTATIVE NEUMAN asked whether the source of the injected gas matters.

REPRESENTATIVE HAWKER answered no.

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MR. PERSILY also answered no. He explained that the bill makes no distinction, so long as the natural gas is produced somewhere else and is then injected into the storage facility.

REPRESENTATIVE HAWKER added that it must be gas for deliverability through the utility system.

MR. PERSILY, in response to Representative Neuman, explained that the tax credit has to do with the size of the "hole in the ground" or the above ground tank. The AOGCC will certify how much produced gas from elsewhere can be injected into that storage facility. Once the AOGCC certifies the capacity, the tax credit would be based on the capacity of the facility to hold "working gas," gas that is produced somewhere else, non-native gas, delivered to the storage and owned by the utility. When the utility wants its natural gas back to meet the winter demand the gas would be delivered to the utility. Thus, the credit is based on the capacity of the "hole in the ground" or the reservoir storage tank to hold gas.

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REPRESENTATIVE LYNN stated that the committee certainly favors economic development. This seems sensible, but the "devil is probably in the details." He asked for any concerns.

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REPRESENTATIVE HAWKER related that during the development of HB 280, the conscious focus was to address the Southcentral Alaska's needs for natural gas, while working to provide least amount of political strife. He sincerely hoped this bill would

have minimal "push back" from any stakeholder. He offered his belief that this bill will have significant support. He expressed concern that controversial elements could be added to the bill. He related that the committee process is the appropriate process to determine the level of regulatory oversight for gas storage facilities and ameliorate any conflicts.

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REPRESENTATIVE LYNN applauded the sponsor's presentation. Besides the stakeholders and the legislature, he asked whether the general public or other interested parties are opposed to this bill.

REPRESENTATIVE HAWKER stated that he does not believe so. He stated that he is unaware of controversy. He stated that differing views on components may be present, but he is not aware of horrendous controversy. He recalled that the initial response by the MOA's Mayor's Energy Task Force was overwhelmingly positive for the conceptual view of the bill.

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MR. PERSILY added that the public will need to understand that natural gas storage is not free, that a cost will be assessed, and the utilities will roll those storage costs into the rates. Thus, the public will absorb the costs of natural gas storage or risk not having natural gas in the winter to provide heating fuel. He stated that TransCanada's subsidiary and the ENSTAR Natural Gas Company [ENSTAR] have been discussing gas storage, but the rates have not been established yet. The cost may be assessed as a winter surcharge or rolled into the rates, but costs will be assessed for guaranteed deliverability, he stated.

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REPRESENTATIVE BUCH referred to page 3, line 6, and asked for clarification between native and non-native gas.

REPRESENTATIVE HAWKER offered to present the sectional analysis for HB 280.

MR. PERSILY referred to the definitions on pages 2 and 3, and stated that "native gas" is natural gas that exists but has not yet been produced. "Cushion gas" is the amount of the natural gas needed to maintain pressure to allow removal of sufficient

volumes of natural gas. The "non-native gas" is the natural gas that is produced somewhere else and a utility purchases it, rents the reservoir, and injects the non-native gas, which is the working gas. He described a scenario in which an underground reservoir once held 10 billion cubic feet but has been produced down to 5 billion cubic feet of gas. The 5 billion cubic feet of native gas still remaining in the reservoir is injected with 5 billion cubic feet of non-native gas, which becomes the working gas, or the amount of natural gas above the level of base gas. He offered to explain the basics of the royalty gas charges without discussing the detailed structure. The tax and royalties are paid at the time the natural gas is produced and even if the gas is subsequently stored in the reservoir, the gas would not be assessed taxes and royalties a second time.

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MR. PERSILY presented the section-by-section analysis of HB 280. He stated that Section 2 describes the process in developing a gas storage facility (GSF), including presenting the engineering and hydrology to the AOGCC, which would certify it meets the minimum working storage capacity of 10 million cubic feet per day to be eligible for the tax credit incentives.

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MR. PERSILY stated that Section 3 requires the Director of the Division of Mining, Land and Water to give priority to and expedite "when reasonably possible" any applications, permits, right-of-way's and lease assignments needed for development and operation of a GSF.

REPRESENTATIVE HAWKER added that Section 3 is an emergency section.

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MR. PERSILY related that Section 4 directs the Department of Natural Resources (DNR) to waive any state land lease fees or rents for the first 10 years of a GSF's operation. The waiver of lease fees or rents would be public record. It requires any financial benefits of the 10 year exemption flows through to the utilities for their customers. Finally, Section 4 clarifies that any gas withdrawn is considered to be non-native gas and is not subject to royalty until all non-native working gas is withdrawn, or "last in, first out."

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REPRESENTATIVE NEUMAN recalled that Alaska's constitution provides a 12.5 percent royalty on resources that are developed.

MR. PERSILY explained that this provision does not waive it, but merely postpones it. He related a scenario in which 5 billion cubic feet of gas has never been produced, and non-native working gas - which was produced and taxed somewhere else - is injected into the GSF, that this provision would provide that for production tax and royalty purposes, the last molecules are the native gas molecules. Thus, this provision does not waive the royalties, but requires the non-native molecules to be removed prior to assessing taxes and royalties on the native gas.

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MR. PERSILY, in response to Representative Neuman, answered that once the natural gas has been produced and taxes and royalties have been assessed, that even though the gas may be stored, no additional taxes or royalties will be assessed.

REPRESENTATIVE HAWKER characterized this provision as an inventory management provision.

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MR. PERSILY continued. Section 5 would direct the Regulatory Commission of Alaska (RCA) to consider the impact on consumers in the event the commission would reject a utility's gas supply contract, which is similar to the EIS process in that one must consider all of the alternatives. Before the RCA denies a gas supply contract, it must consider the effect this will have on consumers. Secondly, the RCA must also recognize the value of a utility holding a diversified portfolio of gas supply contracts with different pricing mechanisms, in order to protect consumers from inadequate gas supplies and the risk of a single pricing mechanism. This means that not every contract must be the same.

REPRESENTATIVE HAWKER interjected that this bill was originally drafted prior to the RCA's request for clarification. The purpose of this section was to address concerns raised as a result of the RCA's denial of procurement contracts by utilities in Southcentral Alaska in recent years. Some people thought the RCA's denial of contracts was unreasonable and resulted in

compromising the gas deliverability capabilities. However, at the time, the RCA did not have any legislative guidance, he stated. This bill was structured to provide a skeletal framework to give the RCA guidance, without too many strictures, to evaluate the consequences of any contract denials.

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MR. PERSILY explained that Section 6 requires that a utility's cost of gas storage reflect the financial benefits of any tax credits or state lease exemptions provided in this bill. Section 7 specifies that the RCA has jurisdiction over gas storage services provided for gas that is owned by a regulated utility. The name of the taxpayers, the amount of the tax credits issued for storage facilities will be public record. Section 8 covers the actual credit, which is \$1.50 per 1,000 cubic feet of working gas storage capacity, and is only applied to GSF developed in Alaska during the period 2011 - 2015. He stated that since an urgency exists, it is important not to leave the credit "on the books" for 20 years, but to accomplish this sooner rather than later. The maximum credit is limited to \$30 million per GSF and allows the credit to be transferred or sold to another taxpayer, similar to how other oil and gas credits are currently handled.

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MR. PERSILY explained Section 9 sunsets a statute on January 1, 2011, which essentially means that the Petroleum Production Tax (PPT) and Alaska's Clear and Equitable Share (ACES) do not apply, so the rate that will be used is the Economic Limit Factor (ELF) rate, which is a maximum of \$.17 per thousand cubic feet for the production tax.

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REPRESENTATIVE HOLMES asked whether this section would allow tax to go below zero.

MR. PERSILY answered no. He explained that currently a producer might have \$2 million in tax credits, but because the tax in Cook Inlet is set so low, the company could only use \$250,000 in tax credits in Cook Inlet. If the Cook Inlet tax had been set at full value the producer could have used \$1 million against the tax liability. The difference between \$250,000 and \$1 million would be lost. This section would repeal that provision and allow the entire \$2 million in tax credits to be used

against the company's tax liability in Alaska, but the tax cannot drop below zero. In further response to Representative Holmes, he agreed the \$2 million in tax credits could be applied to the company's tax liability outside of Cook Inlet.

REPRESENTATIVE HAWKER affirmed that the provision reevaluates the PPT and ACES that would apply to a producer who has a GSF in Cook Inlet. The goal is to put the Cook Inlet on a par with the rest of the state in terms of exploration incentives.

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MR. PERSILY, in response to Representative Neuman, clarified that this section does not affect the amount of the tax, but eliminates the limitation on the use of tax credits. The tax would remain at a very low rate on gas that is produced in Cook Inlet or produced in Alaska and used in Alaska.

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MR. PERSILY explained that Section 10 clarifies the "last in - first out" accounting principle for determining the production tax on native gas. Gas withdrawn from a GSF is considered to be non-native gas until all the non-native gas is withdrawn, at which point the gas withdrawn is native gas. He explained the effect of Sections 11 - 13, such that currently the production tax credit must be spread over two years, but this provision allows producers to receive their full production tax credit in the first year. Section 14 provides a 40 percent credit for exploration expenses in Cook Inlet against production taxes, rather than the two-tiered 30 percent/40 percent credit in existing statute depending on how far the new well is from existing wells. Non-capital well-related lease expenditures in Cook Inlet also qualify for the credit.

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MR. PERSILY highlighted that Sections 15 - 16 allows the producer the option of selling the tax credit back to the state.

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REPRESENTATIVE HOLMES asked whether these credits function the same way, for use in Cook Inlet or elsewhere in the state.

MR. PERSILY answered yes, and if the producer does not have a tax liability, it can sell the tax credits to someone else or back to the state.

REPRESENTATIVE HAWKER recalled that in drafting this section, it was easier to create a parallel structure that mirrored the existing statute but was limited to Cook Inlet.

MR. PERSILY continued. Currently if a company has exploration credits that it wants to sell back to the state, the company must prove that it has spent an amount equal to that within two years of the work that obtained the credit. Thus, if a company has a \$10 million credit, the company must demonstrate that it has spent at least \$10 million in Alaska. Section 17 would eliminate the requirement for Cook Inlet. He related a scenario in which a company drills but hits a dry hole and decides not to continue. The goal of this provision is not to penalize explorers who are unsuccessful. Thus, if a producer spends the money exploring, but is unsuccessful, the credit could be sold back to the state.

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REPRESENTATIVE HAWKER clarified that the motivation behind the salability and transferability of the credits is due to the changing geology in Cook Inlet. He offered his belief that none of the major producers believe Cook Inlet is currently attractive nationally or internationally companies that produce or explore for gas. The large domes that were internationally competitive are now depleted. No one, including the AOGCC, has given any indication that Cook Inlet gas is interesting to large international companies, he restated. He then suggested that the future of exploration and development in Cook Inlet lies with the state's ability to attract well capitalized independent exploration and production companies who "make their business out of chasing those stratigraphic traps" - the small bubbles of gas trapped in the Cook Inlet basin. Most of the basin is underwater, which makes it difficult and expensive to access. Again, this bill is structured to create an environment to attract the well capitalized independent producer to the Cook Inlet basin.

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REPRESENTATIVE BUCH asked whether it is a common industry-wide practice to reward a company even if it fails.

REPRESENTATIVE HAWKER related that is the foundation of the structure of the PPT and ACES. He mentioned that capex [capital expenditure] credits do not require successful efforts. The limitations were put in place to make larger companies take a greater share of the risk penalty for their exploration decisions on the North Slope. The state standard also captures the independent. This bill would not eliminate, but would relax the standard for producers in the Cook Inlet.

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REPRESENTATIVE LYNN remarked that it is not exploring if you already know where something is located.

REPRESENTATIVE HAWKER agreed.

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MR. PERSILY stated that the last section, Section 18, directs the Office of Public Advocacy (OPA) in the Department of Law, when considering whether to participate in a utility rate case regarding a gas supply contract before the RCA, to consider the impact to consumers if the commission rejects a utility's gas supply contract, and to recognize the value of a utility holding a diversified portfolio of gas supply contracts with different pricing mechanisms in order to protect consumers from inadequate gas supplies and the risk of a single pricing mechanism.

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REPRESENTATIVE HAWKER concluded his remarks. He stated that numerous analysis and background information was available, but the bill packet was limited to several outstanding but brief analyses that resulted in the bill. He pointed out three articles that provide analysis and background information, including an article written by Rena Delbridge dated December 27, 2009, which appeared in the Alaska Dispatch, a second written by Tim Bradner dated June 12, 2009, which appeared in the Alaska Journal of Commerce, and the third article, which was prepared by the University of Alaska's Institute of Social and Economic Research (ISER) 2006, at a Southcentral Energy Forum, sponsored by the AOGCC. He related that these articles can provide a foundation on these issues.

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ROBERT PICKETT, Commissioner; Chairman, Regulatory Commission of Alaska (RCA), Department of Commerce, Community, & Economic Development (DCCED), prefaced his comments. He offered that he is not speaking for state government outside the Regulatory Commission of Alaska (RCA), which is an independent quasi-judicial agency. The RCA does not take an official position on a specific matter until the commission takes a vote. Thus, he cannot take an official position, but can discuss the issues. He related that Representative Hawker's remarks set the context for the natural gas situation in Cook Inlet. He acknowledged that while he previously had a general awareness of the issues he did not know the extent of the problems until he began working for the RCA.

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MR. PICKETT characterized the past five years of the history of Cook Inlet's natural gas as a dysfunctional one, in part due to actions by the RCA, the legislature, and the utilities. The public has not been brought along very well with the realities of Cook Inlet gas issues. The RCA strongly welcomes legislative clarity and direction on key issues. He said that HB 280 is a very good step and while it is not a "silver bullet," the bill represents a good start. The status quo is not acceptable. The RCA recognizes the critical nature of deliverability when ENSTAR experienced a deliverability crunch, that even though the temperatures were not that cold their systems reached a threshold. Since then the utilities approached the RCA on four separate occasions with contingency planning. Mayor Sullivan, Anchorage, has focused his attention on Anchorage's preparedness. And although the five largest Cook Inlet fields are declining, he said he thinks the solution for Cook Inlet gas problems will be Cook Inlet gas. Currently, gas prices are low; the contracts signed with the utilities were full deliverability contracts. These contracts will be unlikely to happen again. The bill addresses the portfolio of different contracts and future contracts will probably be a mix of provisions. Obviously the utilities will need some stable, long-term base-load contracts. But shorter-term contracts and very short-term contracts will also be necessary to obtain price signals on the value of gas to encourage smaller independent producers to participate in Cook Inlet.

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MR. PICKETT related that storage is acknowledged as one of the key legs by those familiar with Cook Inlet natural gas. ENSTAR,

after working with TransCanada's wholly-owned subsidiary, ANR Pipeline Company (ANR), requested assistance by petitioning the RCA on December 21, 2009, to obtain a declaratory judgment to clear up jurisdictional, regulatory issues. The RCA held several proceedings and a workshop in mid-December addressing the storage issue. The petition asked whether the RCA was regulating the project or would provide a Certificate of Public Convenience and Necessity (CPCN) in the matter or not. Thus, ENSTAR and ANR did not want their project to commence and discover the rules had changed midstream. The ENSTAR asked for a ruling by January 23rd, which RCA did not meet, noting the fairly aggressive schedule, including issuing orders on December 24th and December 31st. He related that as the filings were returned, a clear division ensued. The statutes, under AS 42.05, relating to utilities, or AS 42.06, the pipeline statute was unclear. He said:

We could not in good conscience make a definitive judgment saying - yes, this is going to be regulated or not - knowing full well when it comes to issues of interpretation of law, it's the courts that will ultimately decide it. If you have this much uncertainty and lack of clarity, what you're doing is getting intervenors down the road that may be opposed to storage, a gigantic hammer to come in and "muck up the works." And trust me. Having been through a couple of gas supply agreements, it's fairly easy to "muck up the works." And that absolutely is not what we need at this point.

[4:35:17 PM](#)

MR. PICKETT related that the RCA has not taken an "up or down" vote on whether third party independent storage should be regulated. The RCA believes that decision is appropriate for the legislature to make. The general consensus has been that it will be difficult for the RCA to insure that the public benefits from tax credits that flow through to the ratepayer if it is totally unregulated. Just to decide the baseline and how to apply credits, and what is a reasonable level. Initially, it was ENSTAR's clear understanding that it would make cost to service showing and have an open and transparent process. Independent storage will require long-term contracts, spanning from 15 to 20 years, with some key anchor utilities. The utilities will need a baseline commitment, with the assurance that they can recover their storage costs in their rates. The public will need to realize there is no "free lunch." In

essence what has been happening is the natural gas services are being unbundled and storage is one element. In closing, he offered his belief that it is absolutely critical for the legislature to weigh in and provide direction on AS 42.05 and AS 42.06, and clarity will be most helpful to the RCA.

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CHAIR OLSON stated that during the first 30 years of production in the Cook Inlet fields, most of the natural gas was produced by the same company that also purchased the gas, so the price was somewhat meaningless. He recalled that 80 to 85 percent of the gas went to the fertilizer plant, Agrium, Incorporated [Agrium]. He further recalled that most of the gas was sold by ENSTAR at prices similar to the Agrium prices. Perhaps the Beluga Hills field set a more accurate price but the rest was based on the Agrium Inc. urea plant. He did not think the RCA could be blamed for the pricing, adding that problems started happening when natural gas services were unbundled and no one could figure out how to value the gas.

MR. PICKETT agreed.

[4:38:18 PM](#)

REPRESENTATIVE BUCH stated that the price for Liquefied Natural Gas is known.

MR. PICKETT explained that the RCA is not privy to the contracts between Conoco Phillips Alaska Inc. and Marathon Oil Corporation with the Tokyo Utilities. He commented that the cost structure when the five fields were discovered were entirely different than today's costs. He reaffirmed his belief that the solution for the Cook Inlet gas problem is Cook Inlet gas. However, producers also need the assurance of a market for their gas. If the LNG plant ceases to export gas some people will think that more gas will be available for ratepayers, but what will likely happen is that producers have less incentive to explore for gas without the anchors. He agreed with the values and pricing.

[4:39:52 PM](#)

REPRESENTATIVE BUCH understood the value of having the LNG plant. He related that the RCA showed interest in protecting ratepayers, in particular, the residential ratepayers and viewed this bill as a starting point at looking at overall costs.

MR. PICKETT asked whether he was referring to gas storage facilities or gas prices in general.

REPRESENTATIVE BUCH clarified that his interest is in providing a reliable natural gas source for the Cook Inlet region. Since the producers also live in Anchorage, and are Alaska residents and communities members, they also are interested in reasonable costs to heat their homes. Additionally, for over 20 years, Southcentral Alaskans have had the cheapest gas in the country. He stated that when prices were dramatically adjusted, that consumers did not understand the increased costs.

MR. PICKETT agreed that the public does not understand because the RCA and others have not communicated well, that the RCA routinely receives calls from ratepayers who make all manner of accusations, as well as hearing complaints from producers. Thus, openness and transparency is critically important. He characterized the RCA's relationship with the public as a major trust issue. Any decisions that are not made in the open, no matter what the intention, will be subject to criticism. He prefers some level of regulation over gas storage to give the public some level of confidence since one component will be locked into their rates for the next twenty years.

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REPRESENTATIVE NEUMAN asked how the RCA would insure that the tax credit is passed on to consumers and whether any limit exists for the percentage rate of the utility's profit.

MR. PICKETT stated that the utility's rate is set through a ratemaking process, which is a well-established methodology. The rate base is the physical investment and allowable depreciation schedules and operating expenses. The RCA would review the capital structure of the company, the breakdown between the debt and equity ratio, typically the debt is significantly cheaper than the equity contribution. The return on equity for pipeline companies routinely ranges between 12 - 14 percent, while the return on equity for utilities would typically be less than that, depending on the size and type of the utility, and risk factors. Storage facilities would likely fall in the range similar to pipelines.

MR. PICKETT related his understanding that the intent of the proposed tax credit is to make sure the benefit flows through to the ratepayers. Thus, a baseline rate would need to be established for the storage services, keeping in mind that the

utilities own the gas. The utility would contract with the producer for fixed amounts of gas and would store a portion of the gas in the storage facility. Thus, a rate would be established per volume per unit of time. The utility would need to commit to a certain minimal level, since the project's sponsor needs to have assurance of sufficient business. He said he hoped that the storage project would allow for common carriage type of storage for smaller producers. However, with respect to the regulated ratepayers, if storage was unregulated it would be quite difficult, and if it is regulated, with some baseline to draw from the application of the credit itself is a mathematical calculation. He provided an example. He stated that he managed the low-income housing tax credit program for the state during his time at the Alaska Housing Finance Corporation (AHFC). Over a 15 year period, as credits were sold, the program initially offered a high discount, but once it was established, the discounts were reduced, and it received \$.95 to \$.96 on the dollar. He offered his belief that amount has dropped back more recently. Thus, clarity in the regulation will help define the net credit or provide guidelines on what should flow through to the ratepayers. It should not be difficult to figure out, he offered.

[4:47:06 PM](#)

REPRESENTATIVE NEUMAN asked in an instance in which a producer was selling native gas to a utility under these contracts, and non-native gas was being injected into the storage facility, whether the RCA would need to calculate the tax credits to the utility company or to the party that owns the gas storage facility (GSF).

MR. PICKETT responded that once the facility operates with a certain amount of native gas, depending on the reservoir, the project sponsor would need to provide an additional amount of gas to obtain the cushion gas that stays in place. This becomes part of the cost structure. The working gas is the gas that is pumped in and out of the GSF and is gas actually owned by utility. He related that the volume of the working gas and the length of time the working gas is "parked" will determine the storage cost.

REPRESENTATIVE NEUMAN related that he was trying to clarify the cushion gas since the company would not put in 100 and take out 100. He said he was interested in how the tax credit works.

[4:48:49 PM](#)

MR. PICKETT pointed out the necessity to distinguish between the project itself and what the utilities are "putting in and out."

REPRESENTATIVE T. WILSON remarked that the Interior does not currently have natural gas. She asked if the Interior obtained natural gas, whether additional legislation would be required.

MR. PICKETT agreed that this bill is focused on Cook Inlet and it would depend on companies like Doyon discovering natural gas.

[4:49:39 PM](#)

REPRESENTATIVE T. WILSON related that it does look like a GSF will be built on the North Slope.

MR. PICKETT asked for clarification if she is referring to FNG's project on the North Slope, explaining that it is a little different than the Cook Inlet issues.

[4:50:11 PM](#)

REPRESENTATIVE HAWKER clarified that the incentives available for GSF's would apply statewide as the bill was crafted to facilitate development of storage as appropriate to the Fairbanks region.

[4:51:25 PM](#)

[HB 280, Version S, was held over.]

#### **ADJOURNMENT**

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 4:51 p.m.