

**ALASKA STATE LEGISLATURE**  
**SENATE RESOURCES STANDING COMMITTEE**

February 8, 2010

3:33 p.m.

**MEMBERS PRESENT**

Senator Lesil McGuire, Co-Chair  
Senator Bill Wielechowski, Co-Chair  
Senator Charlie Huggins, Vice Chair  
Senator Hollis French  
Senator Bert Stedman  
Senator Gary Stevens  
Senator Thomas Wagoner

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

SENATE BILL NO. 195

"An Act relating to the repeal of the establishment of the Goldstream Public Use Area."

MOVED SB 195 OUT OF COMMITTEE

SENATE BILL NO. 208

"An Act requiring the Department of Natural Resources to evaluate current incentives and recommend additional incentives that would increase gas exploration, development, and production in the Cook Inlet sedimentary basin; and requiring the Department of Natural Resources to evaluate the means by which the department may explore for, purchase, and sell natural gas from newly proved gas reserves in the Cook Inlet sedimentary basin."

HEARD AND HELD

SENATE BILL NO. 228

"An Act providing for an industrial incentive investment tax credit and including a gas- to-liquids facility as an eligible investment; and providing for a production tax limit on gas used as a raw material for producing liquids or petrochemicals from gas in the state."

HEARD AND HELD

SENATE BILL NO. 203

"An Act relating to a tax credit for a facility to store Cook Inlet gas for sale and delivery in the state; relating to an exemption from the oil and gas exploration, production, and pipeline transportation property tax for a facility that stores Cook Inlet gas for sale and delivery in the state; and providing for an effective date."

HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SB 195

SHORT TITLE: MAKE GOLDSTREAM PUBLIC USE AREA PERMANENT

SPONSOR(s): SENATOR(s) THOMAS

01/19/10	(S)	PREFILE RELEASED 1/8/10
01/19/10	(S)	READ THE FIRST TIME - REFERRALS
01/19/10	(S)	RES
02/03/10	(S)	RES AT 3:30 PM BUTROVICH 205
02/03/10	(S)	Heard & Held
02/03/10	(S)	MINUTE(RES)
02/08/10	(S)	RES AT 3:30 PM BUTROVICH 205

BILL: SB 208

SHORT TITLE: DNR STUDY ON NATURAL GAS

SPONSOR(s): SENATOR(s) WIELECHOWSKI

01/19/10	(S)	PREFILE RELEASED 1/8/10
01/19/10	(S)	READ THE FIRST TIME - REFERRALS
01/19/10	(S)	RES, FIN
02/08/10	(S)	RES AT 3:30 PM BUTROVICH 205

BILL: SB 228

SHORT TITLE: TAX INCENTIVES FOR GAS-TO-LIQUID

SPONSOR(s): SENATOR(s) MCGUIRE

01/19/10	(S)	READ THE FIRST TIME - REFERRALS
01/19/10	(S)	RES, FIN
02/08/10	(S)	RES AT 3:30 PM BUTROVICH 205

BILL: SB 203

SHORT TITLE: COOK INLET GAS STORAGE FACILITIES

SPONSOR(s): SENATOR(s) FRENCH, WIELECHOWSKI

01/19/10	(S)	PREFILE RELEASED 1/8/10
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01/19/10 (S) READ THE FIRST TIME - REFERRALS  
01/19/10 (S) RES, FIN  
02/08/10 (S) RES AT 3:30 PM BUTROVICH 205

**WITNESS REGISTER**

SENATOR JOE THOMAS  
Alaska State Legislature  
Juneau, AK

**POSITION STATEMENT:** Sponsor of SB 195.

MICHELLE SYDEMAN  
Staff to Senator Wielechowski  
Alaska State Legislature  
Juneau, AK

**POSITION STATEMENT:** Commented on SB 208 for the sponsor.

KEVIN BANKS, Director  
Division of Oil and Gas  
Department of Natural Resources (DNR)

**POSITION STATEMENT:** Available to answer questions on SB 208.

JOHN IVERSON, Director  
Tax Division  
Department of Revenue (DOR)

**POSITION STATEMENT:** Commented on SB 208.

JERRY MCCUTCHEON, representing himself  
Anchorage, AK

**POSITION STATEMENT:** Commented on SB 208.

MIKE PAWLOWSKI  
Staff to Senator McGuire  
Alaska State Legislature  
Juneau, AK

**POSITION STATEMENT:** Presented the CS to SB 228 for the sponsor.

RICHARD PETERSON, President  
Alaska Natural Gas-to-Liquids

**POSITION STATEMENT:** Supported SB 228.

JIM DODSON, President  
Fairbanks Economic Development Corporation

**POSITION STATEMENT:**

SENATOR FRENCH  
Alaska State Legislature

Juneau, AK

**POSITION STATEMENT:** Sponsor of SB 203.

JOHN IVERSON, Director

Tax Division

Department of Revenue (DOR)

**POSITION STATEMENT:** Commented on SB 203.

JIM GREELEY, State Petroleum Property Assessor

Department of Revenue (DOR)

**POSITION STATEMENT:** Answered questions about SB 203.

JOHANNA BALES, Deputy Director

Tax Division

Department of Revenue (DOR)

**POSITION STATEMENT:** Answered questions about SB 203.

BRADLEY EVANS, CEO

Chugach Electric Association

**POSITION STATEMENT:** Didn't think SB 203 was needed at this time.

#### **ACTION NARRATIVE**

[3:33:18 PM](#)

**CO-CHAIR WIELECHOWSKI** called the Senate Resources Standing Committee meeting to order at 3:33 p.m. Present at the call to order were Senators Stedman, French, Wagoner, McGuire, and Wielechowski. Senator Stevens arrived shortly after the meeting started.

#### **SB 195-MAKE GOLDSTREAM PUBLIC USE AREA PERMANENT**

[3:34:19 PM](#)

**CO-CHAIR WIELECHOWSKI** announced SB 195 to be up for consideration. He noted that the committee heard no opposition to it last week.

**SENATOR JOE THOMAS**, sponsor of SB 195, commented that he didn't want people to think that he had overstated the situation in saying that the Goldstream Public Use Area is the Central Park of the Goldstream Valley. There are no facilities that anyone needs to maintain and it gets passively managed by the Department of Natural Resources (DNR). All the work that gets done, like grooming the trails, is on a volunteer basis and no money gets spent on it.

SENATOR WIELECHOWSKI said the bill has had nothing but unanimous support.

SENATOR WAGONER moved to report SB 195 from committee with individual recommendations and attached fiscal note(s). There were no objections and it was so ordered.

### SB 208-DNR STUDY ON NATURAL GAS

[3:36:40 PM](#)

CO-CHAIR WIELECHOWSKI announced SB 208 to be up for consideration.

MICHELLE SYDEMAN, staff to Senator Wielechowski, sponsor of SB 208, explained that many share a growing concern over the dwindling reserves of natural gas in Cook Inlet. Last year the committee heard testimony on this topic from Kevin Banks, Director, Division of Oil and Gas, and Bob Swenson, Director, Division of Geological and Geophysical Survey, both with the DNR. They were all shown a chart that is in their packets today that is known as "The Waterfall Chart," which depicts declining production from Cook Inlet wells. Unless there is additional exploration and identification of new reserves by 2012 the possibility exists of homes and businesses in Southcentral Alaska not having sufficient gas.

She said that earlier this year the DNR completed a new assessment of known possible and probable reserves in Cook Inlet. The review concluded that if sufficient investing in the Inlet were made, supplies could last a great deal longer, certainly into the next decade. This would be especially good for the local economy since gas produced locally would not be subject to expensive tariffs or other transportation costs.

MS. SYDEMAN said the challenge still remains of deciding what actions the state should take if any at all to encourage more natural gas exploration and production in the Inlet.

[3:37:34 PM](#)

SENATOR HUGGINS joined the committee.

[3:37:43 PM](#)

MS. SYDEMAN remembered the June 4 meeting in Anchorage when producers from Cook Inlet were asked what could be done to help them feel more comfortable investing there. So, she said, this bill examines which incentives are most likely to work and which

would simply transfer precious state dollars from the state treasury to companies that otherwise might have sufficient incentive to invest in the Inlet if proper market conditions exist. It asks if the state can take steps other than lowering tax rates or increasing credits that might have a greater effect on private sector behavior. This question is particularly compelling in light of the very modest tax rates and generous tax credits the producers in the Inlet already enjoy, and the fact that the Legislature has gone to lengths to encourage more gas production in the Inlet. It asks to what extent those incentives are working, because that is not exactly known now.

Before the state leaps to offer additional incentives, Ms. Sydeman stated, this bill seeks to answer questions like what other jurisdictions are doing to promote more investment. If the small size of the market in Alaska is an impediment to new exploration and production, which they all heard last June, are can the state take steps to enhance the market to ensure that producers see a return on their investment in a reasonable time frame? Could it commit to buying proven reserves upfront so investors don't have to wait years to realize their investment, for instance?

MS. SYDEMAN said last week they heard testimony that the state already reimburses companies for roughly 45-65 percent of their exploration costs. Given this fact, how can the state partner more effectively with industry to ensure that the needs of Alaskans for a long-term, affordable and reliable source of gas are met? Would it be worthwhile to consider establishment of a state entity like ANGDA to partner with the private sector to explore in areas where a critical need for gas exists? She said this bill calls for a speedy analysis of these questions before new incentives are enacted. It asks Department of Natural Resources (DNR) and the Department of Revenue (DOR) to assess the effectiveness of existing incentives, propose new incentives they believe will be useful and then look more broadly at what other strategies the state might employ to make sure Alaskans don't tumble down the cliff depicted in the waterfall chart. Most importantly, it calls for this work to be done expeditiously - by November 1 of this year, so the legislature can act swiftly next year once the foundation for more informed decisions has been laid.

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KEVIN BANKS, Director, Division of Oil and Gas, Department of Natural Resources (DNR), said he was available to answer questions on SB 208.

SENATOR WAGONER said he wanted Mr. Banks to talk about how important the market is versus the incentive to explore. He thought they had already incentivized gas exploration in Cook Inlet as much as possible some years ago.

[3:42:45 PM](#)

MR. BANKS responded that was a good point and that the waterfall chart is as much a function of decline in demand in the marketplace as it is a decline in production. The real challenge in the Cook Inlet market is that it has essentially three large sellers of gas and three or so consumers of gas in the form of the electric utilities and the local distribution company, EnStar. As a consequence, the marketplace has few players. So he likes to say, "The market is free, but it's not necessarily competitive."

[3:44:10 PM](#)

Furthermore, he remarked, it's challenged because the contracting arrangements among all of the parties don't always come due at the same time. So, one contract will expire and it may be the only time that buyers and sellers are interacting in the marketplace until another contract is negotiated. There are very few indicators of what the market price is or should be, and it's difficult to know what market incentives exist to encourage new production in the kind of "surplus production" that the Inlet has enjoyed for so long - the lack of which is creating some anxiety about future supplies.

[3:44:59 PM](#)

SENATOR STEDMAN asked if he has seen any changes since the PPT was passed and if they need to review that work.

MR. BANKS answered that at the moment, the tax rate that applies to gas in the Cook Inlet is only about \$17.07/mcf, and as prices for gas change in time, that number will remain the same under the current tax regime. Tax credits can be used in Cook Inlet, but he didn't know how the credits and tax rate interact with each other; DNR might better respond to that. It was his impression that the tax and royalty provisions that apply in the Cook Inlet exert kind of a light touch on production there.

Several fields have only a 5-percent royalty as result of legislation that was done 10 years ago. He mentioned that Armstrong is developing the North Fork Unit - one of those 5-percent royalty fields. So in a sense, a lot of the stimulus in terms of tax and royalty incentives is already in place. Then to

follow on from Senator Wagoner's point, it would behoove legislators to try to get a better understanding of how the market interacts, so they might considering doing something to expand it.

CO-CHAIR WIELECHOWSKI said this is one of the first things he looked into when elected over three years ago and they still don't have an answer. Some of the lowest tax and royalty rates in the nation are in Cook Inlet; so that looks like the incentives that are in place are not working and his thought is to step back and get some experts to evaluate how exploration can be spurred.

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SENATOR WAGONER said no one will explore and drill for gas without a market or a place to put it. Right now there is no place to put it; the only outlet is the LNG plant. Has any producer other than ConocoPhillips or Marathon put any gas into the LNG plant?

MR. BANKS said he didn't know.

[3:49:48 PM](#)

JOHN IVERSON, Director, Tax Division, Department of Revenue (DOR), said that exploration in Cook Inlet is very heavily incentivized from a tax credit perspective.

SENATOR HUGGINS stated that it appears that this area is a victim of a lack of effort and the subject gets just probed whenever it comes up. He has listened to the department talk about all the gas there and he has seen the charts and all we have to do is go get it. The two jack-up rigs the Murkowski administration talked about "just went away." Right now the state has an in-state gas coordinator that is supposed to be working on things like this. Enstar and ANGDA have been working on it, the Railbelt consolidation is going on, and then there's the RCA that no matter what solution they come up with, they tend to be able "to just screw it up" because long term contracts can't be used. He asked Mr. Banks if he was "Mr. Cook Inlet," programmatically, what three things would he do in Cook Inlet?

[3:53:19 PM](#)

MR. BANKS answered that he looks at the problem from different perspectives. Number one, the size of the market is pretty small; number two, the Cook Inlet region has enjoyed relatively low gas prices because it had a surplus of productive capability

- people looking for oil found large gas fields. It was actually cheaper to just drill another producing well than to do anything else. If we want to go back to the time where we had this kind of surplus productive capacity, then that tends to mean there are different kinds of problems to solve. First of all, the market must be bigger. It has to have some kind of support either in exports or some other kind of demand. The issue, then, is if gas can be found for prices that are attractive for those kinds of projects.

[3:55:21 PM](#)

MR. BANKS said he is convinced that Cook Inlet has a fair amount of gas in the ground, and the trigger to get it to market is not just a matter of price, although that is important. A place to put it is also needed; and this requires increasing costly investments.

He said the he would look for ways to expand the market, ways to export, and create situations within the market today that will solve some of the more critical problems. For instance, the supply on an annual basis as indicated in the supply studies is part of the problem, but gas supply is also needed in the winter when it's cold and consumption rates are high. Storage will be needed for that. They also need to make sure that the infrastructure for supplying gas to homes will not break down - so reliability is another factor. Also some kind of mechanism should be considered so that a lessee or a producer doesn't have to strand his supply of gas in order to give the state peace of mind knowing that it has a sufficient supply of gas - whatever that means.

[3:56:46 PM](#)

SENATOR HUGGINS said effort are going on right now to work LNG imports and he characterizes that as - okay we can't solve our problems, so we'll buy somebody else's product and invest in their jobs. He hangs his head when he thinks about it. He asked Mr. Banks if he was aware of those efforts.

MR. BANKS answered no.

SENATOR HUGGINS remarked, "Call the Railbelt Consolidation guys, because they're doing it."

MR. BANKS asked if he was referring to the integrated resource development plan.

SENATOR HUGGINS said that is part of it.

CO-CHAIR WIELECHOWSKI agreed with him and said that all these groups have been studying these problems for years, but no comprehensive plan has been developed for it.

[3:58:22 PM](#)

SENATOR STEDMAN asked Mr. Banks to clarify what he means by expanding and "unstranding" the Cook Inlet area.

MR. BANKS replied that he means if the goal is to be where we used to be with excess gas supply, the only way to have that is to have a larger market. But the industrial LNG market was created to take up excess supply. When consumers needed the gas, there was an opportunity to direct production into the local market. To the extent that the reserves on the graph are "stranded" it means that people are not drilling for these kinds of supplies of gas because they know that unless they can enter into some kind of agreement with a local utility, there is no point in drilling today. So, a producer will wait until it has a supply contract with certain supply requirements that must be met and then make the drilling commitments to satisfy those requirements. It seemed to him that a broader market with more players would create conditions for more production.

[4:00:27 PM](#)

SENATOR STEDMAN asked what part the long term pricing contracts play into this and how do they incentivize producers to drill if they aren't able to get a long term contract to make it worth their while to go drill.

MR. BANKS replied that he was hitting on all the issues that surround the problems with getting more production out of the Cook Inlet, and he didn't disagree with anything he said. Even the possibility of LNG exports from Cook Inlet in the future, a new industrial use, or the reestablishment of Agrium's plant will truly depend on the price of gas. How the marketplace with so few players gets to that price is a real challenge. He said he shares everyone's frustration that he has heard here today about how the market itself doesn't seem to be taking care of what residents' expectations are for that region - that new supplies will be produced there. So, something else needs to be examined as a possibility. A structure like ANGDA should be explored and that is what that kind of study is doing.

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SENATOR WAGONER suggested the he discuss the Armstrong re-drilling on the North Fork of the Anchor River and talk about

the history of that gas field where oil was explored in the early '70s, but gas was found. The wells were capped, because there was no market or transportation for it.

MR. BANKS explained that North Fork and several other fields that are now under way in the last several years are an example of fields that had been discovered very early on in the search for oil, but because of the lack of transportation and the technology that existed in those days the gas wasn't produced. Now Armstrong is bringing in different technologies that weren't even available when the gas was discovered and they have a commitment to sell 10 bcf to Enstar. Presumably the price will be satisfactory to Armstrong to encourage their development, and those are a bit higher than what the weighted average cost of gas is today in the Cook Inlet.

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SENATOR HUGGINS recalled that the state has one lease for gas storage.

MR. BANKS answered that three gas storage facilities exist now in the Cook Inlet - one is on federal land at Swanson River and two are on state land.

SENATOR HUGGINS said one is proposed by ANR, a subsidiary of TransCanada, and it appears that it has been put in limbo by the Regulatory Commission of Alaska (RCA) and their connotation that there potentially has to be legislation before it will go forward.

MR. BANKS said he wouldn't say that judging by the level of activities his division is entering into and that the department is involved with in terms of permitting the project and developing the storage lease. It is correct that the RCA ruled that it regarded its jurisdiction as muddled over the question of whether or not they would regulate storage there, but he wasn't sure to what extent that is going to hold up a project that still has an 18-month timeframe before production goes into it.

4:07:31 PM

SENATOR HUGGINS said if modifications have to happen legislatively, would he be correct in assuming the administration would bring forward some legislation. Does there have to be a fix?

MR. BANKS replied that he didn't know what the administration is planning on doing on that issue, but he knew some discussions were going on in the other body with the chairman of the RCA now.

SENATOR HUGGINS said he is supportive of his efforts to get some things done. Lawmakers need some answers, because they can't just "dilly dally on the sidelines" while people end up without any gas.

CO-CHAIR MCGUIRE asked what kind of outreach his division does or how it interfaces with potential commercial consumers in the Cook Inlet. For instance, she said, Alberta has an active portion of its department looking for those industrial anchors that will be a part of developing these basins and trying to match them up with potential explorers.

[4:09:05 PM](#)

MR. BANKS replied that the department doesn't have a specific outreach to that kind of consumer, but it does spend a lot of time with the potential producers and potential new producers. It was an attempt of theirs in licensing the LNG plant where exports are now occurring to encourage the operators of the plant to offer the services of the LNG plant to other suppliers as part of an RFP that they were to publish just prior to the export license period to begin. They did that without much success. When the opportunity arises the department steps up, but it doesn't do that kind of advertising and promoting that she is thinking about.

[4:11:04 PM](#)

CO-CHAIR MCGUIRE asked who is leading the charge in developing Cook Inlet, and said perhaps the administration is the better branch of government to do this. She remembered last year that no one was interested in gas storage in the Interim and then she started hearing rumors that TransCanada had been in conversations with the department and is on the fast track to a storage facility. How is the department participating in those negotiations?

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MR. BANKS thanked her for the encouragement to develop new markets for the state's gas. He said that he went to China in December and met with petrochemical companies along with Harold Heinze and some legislators as part of his "ongoing duties as assigned" in trying to find potential gas markets in general. With respect to the TransCanada project, they are thought of as

the applicant for the AGIA pipeline, but their subsidiary, ANR, has a lot of storage capacity in facilities in the Midwest, particularly in Michigan. So becoming a potential sponsor of a storage facility whose role it is only to provide the warehousing of the gas and pumping it out when it is needed hasn't been done yet in the state of Alaska. ANR came to the department about six months ago and they are working through a process to gain the appropriate permits and the land they will need for the surface operations, and the DNR is helping them prepare the lease agreements that will make it possible for them to operate a storage facility on the state's mineral estate. That company and the current lessee have agreements; some of those discussions are ongoing and confidential so he couldn't say too much. He related that the department has had other sporadic conversations with other sponsors in the Cook Inlet region; he has gotten the sense that the sponsors have gone back to do some more homework and he full expects them back as time goes on. He said, "There are more than just the TransCanada ANR proposal that may come to fore here in the next couple of years."

CO-CHAIR MCGUIRE said a second example occurred to her - the first one being AGIA - of when the government decides to really fast track and put together a series of permits, advice, authority, and bring suppliers together. She would like to see Alaskan companies coming forward and maybe the department could come up with a process to get more information out to them about the opportunities.

SENATOR STEDMAN went to page 3, line 1, that said, "identify, evaluate and recommend additional incentives that may be enacted by the legislature for increasing exploration and development of gas" and suggested softening it to "that may be enacted by the legislature" because they are really trying to come up with a solution.

He went to a similar item on line 4 says, "determine the cost, feasibility, and a proposed organizational structure for a new state entity". He said some are a little gun shy about continually creating new state entities; Cook Inlet already has too many entities running around. This issue has been going on for several years and it seemed more like a long-term price issue to him.

[4:19:08 PM](#)

MR. BANKS said on that last point, their supply study had an observation that bringing in the new resources will cost more

than in the past and that the right kind of price signal will have to be available to producers to do it. He agreed that an "organizational structure" might be a "long reach" and that they should look at all possibilities. However, he thought this bill intended to look for a more active role by the state to achieve some new supply.

SENATOR STEDMAN said he still thought that until the long-term price issue is solved, they can do everything including paying an explorer directly to explore and even that wouldn't solve the problem. He said lowering the tax rate in Cook Inlet three years ago didn't produce the results they were hoping for then and he did not want to create another state bureaucracy that would not lead to a solution.

CO-CHAIR WIELECHOWSKI said Cook Inlet has some of the lowest taxes in the country and very low royalty rates, but it's not getting exploration. If the producers who have the leases are not willing to develop the leases they have, he said, let's do it ourselves.

[4:22:55 PM](#)

SENATOR WAGONER said if they really want the "free market" to work, they should have a five year sunset and keep RCA from having oversight on gas contracts. Basically that gas has one major user, Enstar, and with the RCA controlling the market, they won't see much exploration in Cook Inlet other than what can be put under contract. Taking RCA out of the picture would stimulate some exploration and production.

CO-CHAIR MCGUIRE said she and Senator Wielechowski diverged philosophically on this particular method of solving the problem, but they don't diverge on the need for it. That sense of frustration is pretty unanimous, but the need in Cook Inlet is "dire." She thought in a state that depends so much on this resource someone should be tasked with bringing people to the table to chat with other folks - like the tourism and fisheries industries do.

SENATOR STEDMAN said he supported the concept of the bill, but they need to look back at what incentives they have already done in Cook Inlet over the last decade - reducing taxes, increasing credits, and ring-fencing Cook Inlet - that were supposed to address this issue.

CO-CHAIR WIELECHOWSKI said that is a good point and he also thought they should look at what has been done in the past and not repeat themselves on something that isn't working.

[4:29:31 PM](#)

JERRY MCCUTCHEON, representing himself, Anchorage, Alaska, said this is a Kevin Banks problem. They don't need to encourage further Cook Inlet gas production with tax breaks or whatever; they need to enforce the leases in Alaska's constitution.

[4:31:12 PM](#)

CO-CHAIR WIELECHOWSKI announced a recess.

[4:31:17 PM](#)

CO-CHAIR WIELECHOWSKI called the meeting back to order at 4:31. He closed public testimony and announced that SB 208 would be set aside for further work.

#### **SB 228-TAX INCENTIVES FOR GAS-TO-LIQUID**

[4:31:49 PM](#)

CO-CHAIR WIELECHOWSKI announced SB 228 to be up for consideration.

MIKE PAWLOWSKI, staff to Senator McGuire, sponsor of SB 228, explained that he would give a brief introduction of the bill and then address the committee substitute (CS) that members have in their packets. He said the basic premise behind SB 228 is to look at the end market for gas and to look at what other jurisdictions have done to build an industrial base around their supply and to use it to create a valued-added liquid through the Fischer-Tropsch process. SB 228 started off with a reauthorization of an old industrial incentive tax credit that existed in statute for petrochemical oil and gas facilities that expired in 1999. The sponsor updated and reauthorized it in sections 1-6 of the original bill. The second part of the bill, was written with the understanding that these plants might be the downstream facility and that the upstream might be the producer selling to the facility.

[4:33:33 PM](#)

MR. PAWLOWSKI said the definition of gas used in-state for heat and power in the ACES bill was expanded in SB 228 to include gas used for raw materials for producing liquids or petrochemicals. This was the beginning of the bill and the idea was to incentivize both the downstream and the upstream.

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He explained that after talking to the Department of Revenue and Legislative Legal, the sponsor discovered several problems in the approach. The first one was that the original intent was to incentivize any Fischer-Tropsch process - looking at coal-to-liquids, biomass-to-liquids, and gas-to-liquids. But either coal or biomass has to first be synthesized into a gas and then turned into a liquid and the definition of gas-to-liquids in the original version of the bill wasn't broad enough to include the whole world of possibilities for this type of development in Alaska. So CSSB 228 (), version 26-LS1324\S, changes the definition on page 1, lines 10-11 to say a facility that produces liquids from gas, coal or biomass - thus including the world of Fischer-Tropsch fuels.

MR. PAWLOWSKI said secondly the original industrial incentive tax credit couldn't be reauthorized because the provisions it referenced in federal law had changed. So, an entirely separate industrial incentive was designed within the CS. Sections 1-6 became section 1 that simply says if you make this investment you get a descending capital credit against your corporate income taxes up to the first billion dollars. He said that technical issues still need to be corrected to limit that credit; for one thing multiple entities could claim credit on the same investment, which is not the sponsor's intent.

[4:36:10 PM](#)

So, language on page 2, lines 24-28, has the important credit limits to protect the state's downside, he said. The first provision is that the tax credit can never be more than 60 percent of the tax liability in a year. This assures that the state is accruing some revenue and that it is just foregoing revenue when the facilities are getting built. The second part on line 28 says that the credits cannot be carried forward past 2025.

[4:37:24 PM](#)

RICHARD PETERSON, President, Alaska Natural Gas-to-Liquids, said he had been looking at this particular concept in Alaska since 1997. He said he didn't care who built the gas-to-liquids plant, but the idea is to put the mechanism in place for anybody to compete for that type of project. In this respect they wholeheartedly support this bill. Through the years of their looking at gas-to-liquids in Alaska, the one thing that seemed to be apparent is that Alaska isn't interested in the Fischer-Tropsch process. This bill is the first sign of support for Fischer-Tropsch.

[4:39:53 PM](#)

SENATOR WAGONER asked if he is here to promote some other company to do the Fischer-Tropsch process.

MR. PETERSON responded that he hopes to be the successful party to do it and he has been working on it with Sasol and Shell, the two leaders in Fischer-Tropsch technology and the only two major companies in the world that actually have operating Fischer-Tropsch plants. However, he said, Exxon has the ability to do this and if they want to take advantage of the energy credits, that's great.

He said the whole purpose in 1997 was to introduce Fischer-Tropsch technology to the US to help it reduce its dependence on imported energy. Most of his time has been spent putting federal legislation in effect that would help this process.

MR. PETERSON said he also has a more personal reason. His son is a career Marine who came back in April from his sixth tour in Iraq, and he didn't want him to have to go back. But that won't happen unless the US as a nation creates a national energy policy to reduce its dependence on imported energy - "and that's what Fischer-Tropsch can do." It can do it across natural gas, coal, and biomass including garbage.

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SENATOR WAGONER asked how Alaska can compete in a worldwide market when Shell can buy its gas for \$0.50/mcf at tidewater for their 140,000-barrel/day plant that is being built in Qatar.

MR. PETERSON replied that is why he worked to enact federal legislation that would provide energy credits and lower excise tax rates on domestic Fischer-Tropsch fuels sold in the US. These energy credits when combined will amount to about \$700 million/year towards a plant in Alaska, or in Montana or in any other state in the US. That translates into about \$4/mmBtu. The federal legislation makes them competitive; the sole purpose of enacting it is so that the plant is competitive around the world.

MR. PETERSON also stated that when Senator Stevens enacted the energy credits for Fischer-Tropsch fuels made from coal and biomass, every coal-rich state in the United State "beat a path" to South Africa and to Shell, every state except Alaska, and he wants to make sure that Alaska leads this type of technology in the US.

CO-CHAIR WIELECHOWSKI asked Mr. Peterson if he still thought Alaska could be competitive at \$24/barrel for oil - with the federal tax credits.

MR. PETERSON replied yes - in theory - assuming a plant can get built for \$5 billion and a lot of other assumptions. The combined credits amount to \$34/barrel. So that makes these projects competitive at \$55-60/barrel. This means in theory that even at \$28-30/barrel, they can be price competitive. From a pure marketing point of view he hoped the numbers stayed up around \$60-70/barrel.

SENATOR WAGONER asked what size plant could get built for \$700 million.

MR. PETERSON answered a 70,000 barrel/day plant.

SENATOR WAGONER asked the difference between the Fischer-Tropsch process and the Bixby-something process in Virginia.

MR. PETERSON said he didn't know, but Fischer-Tropsch is a generic name from the two German scientists who commercialized the process in the 1930s.

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SENATOR WAGONER said he mentioned that everyone but Alaska went to South Africa to look at that plant and he asked how many of those are building those plants now.

MR. PETERSON answered that at least 8 or 10 of those states passed legislation enabling price support tax credits, loan guarantees, municipal bond funding, et cetera. All of them are moving forward, including Alaska that did a \$2 million pre-feasibility study for an 80,000 barrel/day coal-to-liquids plant in Cook Inlet. The numbers worked, but the big issue was the cost of sequestering CO<sup>2</sup> and how "cap and trade" would affect it.

CO-CHAIR MCGUIRE said the idea behind this credit is much like her geothermal production tax credit from last year that later grew to include hydro, solar, wind, biomass, carbon capture and sequestration, but from that Alaska has invited the world in to talk about geothermal prospects. This bill is another attempt at incentivizing these projects that might otherwise be marginal.

She said that she and Senator Wielechowski came back from South Africa trying to get Fischer-Tropsch facilities built in Alaska.

She said Alaska is unique with respect to this technology because it has all three of the natural resources that are needed as the feed stock in spades; we have the quantities of gas that would be needed as well, but they are stranded. The main thing is to make sure we're not double and triple dipping in on the tax credits. She also believed that developing Alaska's resources was very important because of the war we are fighting "largely over crude oil."

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SENATOR STEDMAN added that a fundamental concern a lot of people have is that Alaska doesn't get a major export line out of the state into Alberta, or LNG export with vast stores of gas just sitting everywhere, or that we end up with an export line to Alberta with no base jobs in Alaska except for a couple of hundred compressor station operators. He didn't know if income tax was the right thing to incentivize.

He also said that he wanted the committee to get educated on the possible impacts this technology could have on the state in case the big pipeline didn't go through and also in the event that we do get a pipeline that something could be created in the state that would generate some jobs.

CO-CHAIR WIELECHOWSKI remarked that this plant could be a big job creator and could potentially be a huge anchor for a bullet line or spur line into Southcentral. It has tremendous potential.

SENATOR WAGONER asked if he had been looking at a coal plant for gasification earlier and asked what kind of study he did in terms of sequestering CO<sup>2</sup>.

MR. PETERSON said they did a very preliminary study looking at existing wells in Cook Inlet with the idea of using CO<sup>2</sup> for enhanced oil recovery. That was a good idea five years ago, but as time goes on those wells in the existing oil fields are getting to the point where it might not make any economic sense to do that. So, they primarily looked at storing gas in the depleted oil and gas fields as a pure cost to the project of about \$50-75 million/year, but it could be more like \$500 million/year with cap and trade.

He said the two best Alaska places to sequester CO<sup>2</sup> were Prudhoe Bay and Cook Inlet. Every other place in the country would have an issue with where to put it. Both Sasol and Shell in 1995 said they would not consider locating a coal-to-liquids or gas-to-

liquids program in the US unless there was a viable place to put CO<sup>2</sup>.

CO-CHAIR WIELECHOWSKI said they heard that in South Africa, too, where the plant is located next to an oil field where the CO<sup>2</sup> could be injected right into the ground.

SENATOR HUGGINS said the Pentagon wanted to get into a cooperative effort with the state of Alaska to produce a blended jet fuel a while ago and asked where that was and how confident he felt they could pull it off.

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MR. PETERSON replied if they can build a GTL/CTL plant in Alaska they can easily meet that criterion.

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SENATOR WAGONER said he was not sure CO<sup>2</sup> injection would work in the Cook Inlet because the fields have been water flooding for so long.

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JIM DODSON, President, Fairbanks Economic Development Corporation, said they have done an extensive feasibility study on a coal/biomass/natural gas-to-liquids facility in Interior Alaska. He noted copies of "The Hatch Report," a 2005-DOE report on enhanced oil recovery using CO<sup>2</sup>, and Dr. Paul Metz's paper on the value of using CO<sup>2</sup> for enhanced oil recovery on the North Slope and said the issue to Alaskans is the possibility of turning relatively low-valued natural resources including biomass, coal and natural gas into high-value product synthetic fuel - produced in Alaska by Alaskans. He said the size of the plant is enormous as is the \$5-6 billion to build it.

MR. DODSON said that Dr. Metz's paper states that sequestering CO<sup>2</sup> on the North Slope could potentially return Alaska an additional \$100 billion from existing oil fields.

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CO-CHAIR WIELECHOWSKI announced that SB 228 would be set aside for future discussion.

#### **SB 203-COOK INLET GAS STORAGE FACILITIES**

CO-CHAIR WIELECHOWSKI announced SB 203 to be up for consideration.

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SENATOR FRENCH, sponsor of SB 203, said it is targeted at solving a specific problem in Cook Inlet by creating an emergency store house of natural gas for times of shortage during peak demand winter months when the current gas deliverability doesn't keep up with demand. Should there be a valve or compressor problem, brown outs might be seen in Anchorage and across the Anchorage Bowl.

About a week ago the Regulatory Commission of Alaska (RCA) took up the question of whether such a facility would be regulated by itself, Senator French said. It was brought by a company known as Sing's Cook Inlet Natural Gas storage, a subsidiary of TransCanada. Sing's asked for a declaratory judgment that they not be regulated by the RCA, who came back saying that their statutes did not provide explicit authority to regulate natural gas nor did they definitively set natural gas storage outside of their jurisdiction. They were puzzled and said either the Supreme Court would have to decide or the Legislature would have to act. So, this bill has a provision that says, yes, those facilities will be covered by the RCA just like practically every other well or production facility is in the Southcentral Basin.

He pointed out that on page 8 of the Order the commissioners wrote that all interested persons agreed that storage in the Cook Inlet area is a serious or even critical need even though they didn't agree, 50/50, on the RCA's jurisdiction. They also agreed that the time available to meet that need through construction of a storage facility is short. The bill essentially works with a tax credit much as the one they just looked at, but at 20 percent against capital expenditures which is smaller.

SENATOR FRENCH said he thought it was important to do something although there wasn't any point in extending a 20-percent tax credit to a company that is ready to push on through to the goal line, but he is concerned that ideas like this get half way down the field and then suddenly the industry loses interest and wanders off.

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SENATOR WAGONER commented why give someone a tax credit when they are already going forward with their project and they haven't asked for one, yet. He wanted to know how the 20 percent tax credit was different from the 20 mil levy on industrial

capital improvements and how that would affect the city and borough's ability to get revenue.

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JIM GREELEY, State Petroleum Property Assessor, Department of Revenue (DOR), explained that the bill has two incentive provisions, one for corporate income tax and one for property tax. The property tax incentive exempts state property tax by defining gas storage property as not taxable. Therefore, he suspects the local jurisdiction, in the case of the Kenai Peninsula Borough, would still be able to tax locally up to the 1.4 percent; and the difference between the 1.4 percent and the 2 percent state levy would be the incentive.

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JOHANNA BALES, Deputy Director, Tax Division, Department of Revenue (DOR), explained that the provision exempts the gas storage facility from the oil and gas property tax, but the tax credit itself in this bill is against the corporate income tax. There is no effect on the state's property tax and no effect on the borough's tax either.

SENATOR WAGONER asked to have that clarified in writing.

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SENATOR STEDMAN said just in general, creating an incentive when it's not clear that one is needed in all cases needs to be looked at.

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BRADLEY EVANS, CEO, Chugach Electric Association, said the association is heavily dependent on Cook Inlet natural gas to fuel its thermal power plants; about 90 percent of the kilowatt hours are produced from gas. They have approximately the same usage level as Enstar. Through their own analysis and contract negotiations they have concluded that storage is needed in Cook Inlet for security of deliverability and reservoir enhancement - where gas could be "parked" in the low usage months of the summer to keep the wells at or above their minimum producing level. He said they had been working with Enstar, Municipal Light and Power, and Sing's for the gas storage facility and they intend on executing a contract for that.

MR. EVANS said however, they need to get timely approval of storage contracts. Delays in the regulatory process can discourage people from doing business. He explained that as a utility they need to ensure that they will be able to recover

their costs; that also needs to be addressed in the regulatory environment. And if they do contract for volume of storage, they need certainty that it will be there for the long-term.

He said the timeline for Sing's project is critical because they may have winter deliverability problems as soon as 2012. They are on record with the RCA saying that they think the gas storage facility should be regulated under AS 42.05. Chugach Electric doesn't like the disruption of the regulatory process, but they like the protection that it provides.

CO-CHAIR WIELECHOWSKI asked if he thought this incentive package was needed or will they go ahead without it.

MR. EVANS replied that putting this facility into service is relatively expensive, and maybe the subsidy should flow through to the consumer rather than into the corporate end of the arrangement. "It doesn't seem to make sense at this point." He also said he would like to revisit that if it becomes apparent that an incentive is the only way it will happen.

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SENATOR WAGONER said when he talked about Enstar being the customer he meant for residential uses, but he also said "and other industrial users." He asked if it was true that three different places are being looked at for storage in Cook Inlet - one of them being Cannery Loop.

MR. EVANS said he didn't know for sure, but very probably. The problem is with the size of the facility and the risk of going it alone. He has joined forces with Enstar and Municipal Light and Power to share the risks, but they are all on a parallel track to evaluate other places because it is a prudent thing to do.

SENATOR WAGONER asked if one was Cannery Loop.

MR. EVAN answered no.

SENATOR WAGONER asked which storage facility he was talking about.

MR. EVANS said he was bound by confidentiality agreements from discussing that.

CO-CHAIR WIELECHOWSKI noted there were a lot of raised eyebrows in the room. Finding no further comments, he closed public testimony and adjourned at 5:21 p.m.