

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

March 31, 2010

3:32 p.m.

**MEMBERS PRESENT**

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

**MEMBERS ABSENT**

Senator Lesil McGuire, Co-Chair

**COMMITTEE CALENDAR**

SENATE BILL NO. 255

"An Act relating to sharing records regarding fish purchased by fish processors with certain federal agencies, to requirements to obtain and maintain a fisheries business license, and to payment of industry fees required of fish processors; and providing for an effective date."

- MOVED SB 255 OUT OF COMMITTEE

HOUSE BILL NO. 162

"An Act establishing the Southeast State Forest and relating to the Southeast State Forest; and providing for an effective date."

- MOVED SCS HB 162(RES) OUT OF COMMITTEE

OVERVIEW BY DNR AND DOR ON COOK INLET INCENTIVES

- HEARD

SENATE BILL NO. 309

"An Act amending and extending the exploration and development incentive tax credit under the Alaska Net Income Tax Act for operators and working interest owners directly engaged in the exploration for and development of gas from a lease or property in the state; providing for an effective date by amending the

effective date for sec. 2, ch. 61, SLA 2003; and providing for an effective date."

- HEARD AND HELD

SENATE BILL NO. 290

"An Act providing a credit against the tax on the production of oil and gas for drilling certain exploration wells in the Cook Inlet sedimentary basin."

- HEARD AND HELD

COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 280(FIN) AM

"An Act 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 a gas storage facility on state land; and providing for an effective date."

- HEARD AND HELD

#### **PREVIOUS COMMITTEE ACTION**

BILL: SB 255

SHORT TITLE: FISH PROCESSOR FEES, LICENSES, RECORDS

SPONSOR(S): SENATOR(S) OLSON

02/03/10	(S)	READ THE FIRST TIME - REFERRALS
02/03/10	(S)	RES, FIN
03/29/10	(S)	RES AT 3:30 PM BUTROVICH 205
03/29/10	(S)	Heard & Held
03/29/10	(S)	MINUTE(RES)

BILL: HB 162

SHORT TITLE: SOUTHEAST STATE FOREST

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

03/02/09	(H)	READ THE FIRST TIME - REFERRALS
03/02/09	(H)	RES, FIN

04/08/09 (H) RES AT 1:00 PM BARNES 124  
 04/08/09 (H) Moved Out of Committee  
 04/08/09 (H) MINUTE(RES)  
 04/10/09 (H) RES RPT 7DP 1AM  
 04/10/09 (H) DP: OLSON, EDGMON, TUCK, SEATON,  
 WILSON, JOHNSON, NEUMAN  
 04/10/09 (H) AM: KAWASAKI  
 04/13/09 (H) FIN RPT 5DP 5NR  
 04/13/09 (H) DP: THOMAS, FOSTER, AUSTERMAN,  
 FAIRCLOUGH, JOULE  
 04/13/09 (H) NR: GARA, CRAWFORD, KELLY, SALMON,  
 STOLTZE  
 04/13/09 (H) FIN AT 8:30 AM HOUSE FINANCE 519  
 04/13/09 (H) Moved Out of Committee  
 04/13/09 (H) MINUTE(FIN)  
 04/15/09 (H) TRANSMITTED TO (S)  
 04/15/09 (H) VERSION: HB 162  
 04/16/09 (S) READ THE FIRST TIME - REFERRALS  
 04/16/09 (S) RES  
 01/20/10 (S) FIN REFERRAL ADDED AFTER RES  
 03/29/10 (S) RES AT 3:30 PM BUTROVICH 205  
 03/29/10 (S) Heard & Held  
 03/29/10 (S) MINUTE(RES)

BILL: SB 309

SHORT TITLE: GAS EXPLORATION\DEVELOPMENT TAX CREDIT  
 SPONSOR(S): RULES BY REQUEST

03/25/10 (S) READ THE FIRST TIME - REFERRALS  
 03/25/10 (S) RES, FIN  
 03/31/10 (S) RES AT 3:30 PM BUTROVICH 205

BILL: SB 290

SHORT TITLE: TAX CREDIT TO DRILL WELLS IN COOK INLET  
 SPONSOR(S): WAGONER

02/22/10 (S) READ THE FIRST TIME - REFERRALS  
 02/22/10 (S) RES, FIN  
 03/31/10 (S) RES AT 3:30 PM BUTROVICH 205

BILL: HB 280

SHORT TITLE: NATURAL GAS: STORAGE/ TAX CREDITS  
 SPONSOR(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  
 02/08/10 (H) Heard & Held  
 02/08/10 (H) MINUTE(L&C)  
 02/15/10 (H) L&C AT 3:15 PM BARNES 124  
 02/15/10 (H) Moved CSHB 280(L&C) Out of Committee  
 02/15/10 (H) MINUTE(L&C)  
 02/17/10 (H) L&C RPT CS(L&C) NT 4DP 2NR 1AM  
 02/17/10 (H) DP: LYNN, NEUMAN, CHENAULT, OLSON  
 02/17/10 (H) NR: HOLMES, T.WILSON  
 02/17/10 (H) AM: BUCH  
 02/19/10 (H) RES AT 1:00 PM BARNES 124  
 02/19/10 (H) -- MEETING CANCELED --  
 02/26/10 (H) FIN AT 1:30 PM HOUSE FINANCE 519  
 02/26/10 (H) <Bill Hearing Canceled>  
 03/12/10 (H) RES AT 1:00 PM BARNES 124  
 03/12/10 (H) Heard & Held  
 03/12/10 (H) MINUTE(RES)  
 03/15/10 (H) RES AT 1:00 PM BARNES 124  
 03/15/10 (H) Moved CSHB 280(RES) Out of Committee  
 03/15/10 (H) MINUTE(RES)  
 03/17/10 (H) RES RPT CS(RES) NT 5DP  
 03/17/10 (H) DP: EDGMON, OLSON, P.WILSON, SEATON,  
 JOHNSON  
 03/17/10 (H) FIN AT 9:00 AM HOUSE FINANCE 519  
 03/17/10 (H) <Bill Hearing Postponed to 1:30 pm  
 Today>  
 03/17/10 (H) FIN AT 1:30 PM HOUSE FINANCE 519  
 03/17/10 (H) Heard & Held  
 03/17/10 (H) MINUTE(FIN)  
 03/18/10 (H) FIN AT 9:00 AM HOUSE FINANCE 519  
 03/18/10 (H) Heard & Held  
 03/18/10 (H) MINUTE(FIN)  
 03/18/10 (H) FIN AT 1:30 PM HOUSE FINANCE 519  
 03/18/10 (H) Moved CSHB 280(FIN) Out of Committee  
 03/18/10 (H) MINUTE(FIN)  
 03/22/10 (H) FIN RPT CS(FIN) NT 9DP 1AM  
 03/22/10 (H) DP: AUSTERMAN, FAIRCLOUGH, KELLY,  
 N.FOSTER, DOOGAN, THOMAS, JOULE,  
 STOLTZE  
 03/22/10 (H) HAWKER  
 03/22/10 (H) AM: GARA  
 03/24/10 (H) TRANSMITTED TO (S)  
 03/24/10 (H) VERSION: CSHB 280(FIN) AM  
 03/25/10 (S) READ THE FIRST TIME - REFERRALS  
 03/25/10 (S) RES, FIN  
 03/31/10 (S) RES AT 3:30 PM BUTROVICH 205

**WITNESS REGISTER**

SENATOR OLSON  
Alaska State Legislature  
Juneau, AK  
**POSITION STATEMENT:** Sponsor of SB 255.

CHRIS MAISCH, State Forester  
Department of Natural Resources (DNR)  
Juneau, AK  
**POSITION STATEMENT:** Supported HB 162.

KEVIN BANKS, Director  
Division of Oil and Gas  
Department of Natural Resources (DNR)  
Juneau, AK  
**POSITION STATEMENT:** Presented overview of Cook Inlet oil and gas incentives from DNR perspective, and commented on SB 309 and SB 290.

MARCIA DAVIS, Deputy Commissioner  
Department of Revenue (DOR)  
Juneau, AK  
**POSITION STATEMENT:** Presented overview of Cook Inlet oil and gas incentives from DOR perspective, and commented on SB 309 and SB 290.

MIKE PAWLOWSKI  
Aide to Senator McGuire  
Alaska State Legislature  
Juneau, AK  
**POSITION STATEMENT:** Commented on SB 309 for the sponsor.

KAREY LOCKHART, Production Manager  
Alaska Operations  
Marathon Oil Corporation  
**POSITION STATEMENT:** Supported SB 309.

MARK LAND, Executive Vice President, Land and Administration  
Renaissance Alaska, LLC, &  
Vice President, Land and Business Development  
Buccaneer Energy Limited Alaska  
**POSITION STATEMENT:** Commented on SB 309.

STACY SHUBERT, Director  
Intergovernmental Affairs  
Mayor Sullivan's Office

Anchorage, AK

**POSITION STATEMENT:** Supported SB 309 at the request of Mayor Sullivan.

MARY JACKSON

Staff to Senator Wagoner  
Alaska State Legislature  
Juneau, AK

**POSITION STATEMENT:** Commented on SB 290 for the sponsor.

REPRESENTATIVE MIKE HAWKER

Alaska State Legislature  
Juneau, AK

**POSITION STATEMENT:** Sponsor of HB 280.

#### **ACTION NARRATIVE**

[3:32:30 PM](#)

**CO-CHAIR WIELECHOWSKI** called the Senate Resources Standing Committee meeting to order at 3:32 p.m. Present at the call to order were Senators Wagoner, French, Huggins, Stevens, and Wielechowski.

#### **SB 255-FISH PROCESSOR FEES, LICENSES, RECORDS**

[3:33:47 PM](#)

**CO-CHAIR WIELECHOWSKI** announced SB 255 to be up for consideration. He said this bill would enable fisheries that have elected to pursue and permit buyback program to do so. The purpose is to stabilize the fleet and ensure the long term economic stability of the fishery. This bill creates the legal mechanisms to ensure the proper accounting of all the transactions involved in this process.

[3:34:12 PM](#)

**SENATOR OLSON**, sponsor of SB 255, said this bill strengthens the viability of the fisheries even though it is fairly simple.

**CO-CHAIR WIELECHOWSKI** noted a letter of intent that would accompany the bill with six signatures. He explained that it is the result of an agreement between the seiners and the processors that the permit buyback program will not remove more permits than necessary for the health and viability of the fishery and sets the number of permits at 260.

SENATOR FRENCH moved to report SB 255 from committee with individual recommendations, attached fiscal note(s), and letter of intent. There were no objections and it was so ordered.

### **HB 162-SOUTHEAST STATE FOREST**

[3:36:16 PM](#)

CO-CHAIR WIELECHOWSKI announced HB 162 to be up for consideration. It would establish a new Southeast State Forest on about 25,000 acres of state lands presently used for timber harvest. The establishment of a forest will enable the Division of Forestry to manage these lands for a long term supply of timber for local processors. Lands in the forest would also continue to be open for multiple uses. He said they heard resounding public support for this bill on Monday.

He said there were two small conceptual amendments to change the date on page 6, line 9, from July 1, 2009 to July 1, 2010 and the second would be to make the same change to line 11. He said the change was previously made, but to the wrong version of the bill.

[3:37:37 PM](#)

CHRIS MAISCH, State Forester, Department of Natural Resources (DNR) agreed that those two changes needed to be made.

SENATOR HUGGINS remembered the when they did the University lands bill and suddenly a lot of communities came out and said they had never heard of it before. Would they hear from communities that they were surprise by this or have concerns that they weren't able to voice.

MR. MAISCH replied no; they spent a lot of time in Southeast Alaska and this bill had wide support.

CO-CHAIR WIELECHOWSKI moved conceptual Amendment 1. There were no objections and it was adopted.

SENATOR STEDMAN joined the committee.

[3:39:31 PM](#)

SENATOR FRENCH moved to report HB 162 as amended from committee with individual recommendations and attached fiscal note(s). There being no objection, SCS HB 162(RES) moved from the Senate Resources Standing Committee.

### **Overview by DNR and DOR on Cook Inlet incentives**

3:41:22 PM

CO-CHAIR WIELECHOWSKI announced the overview of Cook Inlet incentives by the Department of Natural Resources (DNR) and Department of Revenue (DOR).

3:41:30 PM

KEVIN BANKS, Director, Division of Oil and Gas, Department of Natural Resources (DNR), introduced himself. He said he would speak to incentives particularly related to royalties (managed by the DNR) and Marcia Davis would speak about tax credits. He said AS 38.05.180(j) provides three kinds of opportunities for lessees to reduce their royalties under certain circumstances. This statute was passed in 1995 with a lot of controversy, but several things are very important and valuable.

Basically, Mr. Banks explained, if you have an existing field that is nearing the field's end, it is possible under AS 38.05.180(j) to reduce the royalty to 3 percent - if it can be established that the life of the field can be extended by doing so. He explained they view "end of field life" as being at the point where the revenues coming for sale of the oil and gas off of the lease exceed the operating costs. It will happen to every field and if they can reduce the royalty at that point, there is a chance that the life of the lease could be extended by as much as 18 to 24 months.

It also provides for a reduction in royalty should a field shut down for a period of time. A situation like that was at Milne Point in the mid-80s when the prices collapsed. Conoco (not the ConocoPhillips of today) at the time was one of the four oil companies on the North Slope and had to bring the field to shut in; then they subsequently restarted it and applied for royalty relief. Under the circumstances that followed the royalty wasn't granted but that was the situation. More importantly, in 1995 AS 38.05.180(j) was changed to offer royalty relief before production begins. This is unique in that now we are saying that if there can be a showing that a royalty relief under these terms can affect the economics of a project so that it moves it into the success pile instead of the failure pile, you can move forward with it and get a royalty relief down to 5 percent. The lessee has to meet some requirements in order for him to permit it, however, because they are talking about a prospective situation.

The lessee has to provide the department with sufficient information about the reservoir, the resource itself and the

kinds of costs it expects. The department evaluates it against a price forecast and some measure of risk and uncertainty for developing the field. A certain amount of delineation of the prospect has to be done, and that involves a fairly thorough look on the part of the department to determine that the state's best interests are served. He said he looks for royalty relief credit to be both effective and efficient. It should be effective in so far as it will alter the behavior of the lessee so that their economics have improved so much that they will move ahead and develop. And it's efficient in so far as it grants no more royalty relief than is needed to achieve the change in behavior.

MR. BANKS said the statute also says that this relief must be tied to some kind of price or some other measure of economic success so that if prices rise, the department can condition the royalty relief on the improved economics that higher prices might cause.

[3:48:19 PM](#)

MR. BANKS stepped down to the discovery royalty and said for many of the leases on state land, which are probably all in production or have long since expired, it is possible to get discovery royalty of 5 percent for the first 10 years of production (for pre-1969 leases). A few of those may still have that opportunity. Cook Inlet also has a discovery royalty provision for the first 10 years of production. Finally, in 1998/99, a law passed that identified six pools that had been discovered earlier, which if someone could bring them into production, the first 25 million barrels of oil or the first 35 bcf gas are subject to a 5 percent royalty for the first 10 years of production by 2004. The fields that were subject to that were Nicolai Creek, Redoubt Shoals, West Foreland, North Fork, and Sterchikof, which were not in production at that point. Right now Nicolai Creek is in production, North Fork is under development right now by Armstrong, and Redoubt Shoals is one of the properties that was involved in the bankruptcy of Pacific Energies and is now owned by Cook Inlet Energy.

MR. BANKS said the department also has a managing and exploration licensing program, although that is not a normal incentive. After tomorrow they will offer a period in which applicants for exploration licensing can come to the DNR with suggestions to acquire land in areas outside of the Cook Inlet and North Slope with nothing more than the size of a work commitment and acquire limited rights to exploration, which upon completion of some work commitments that may be offered by the

applicant that license converts to a conventional oil and gas lease. It is an incentive in one regard in that competitive bidding is not necessarily involved (unless there are challenges for the same piece of property). But no bonus bidding is involved, so the cash that would normally go to the state in the form of a bonus bid goes into the ground in the form of some exploration program.

[3:51:49 PM](#)

MARCIA DAVIS, Deputy Commissioner, Department of Revenue (DOR), explained that the exploration tax credit is 40-50 percent of drilling costs. Drilling costs under the Alaska's statutes are a collection of both operating and capital costs.

CO-CHAIR WIELECHOWSKI asked if the exploration incentive credit (EIC) and exploration tax credit (ETC) credits are cumulative.

MS. DAVIS answered that each credit has a description of when it can be used and she would have to look at that. She thought the EIC is exclusive. The EIC also covers seismic, but only costs that are outside of an existing unit. Likewise for the exploration drilling costs - all of those are parted; either you're outside of 25 miles in which case you get 40 percent; if you're three miles outside a unit or three miles away from a well and less than 25 miles away from existing units then you get the 30 percent credit. None of these credits are available if the drilling is happening within existing unit boundaries.

[3:53:41 PM](#)

SENATOR FRENCH said in his chart under "North Slope" it says "30 percent of drill costs if greater than 25 miles and preapproved" and asked if "preapproved" is the qualifier.

MS. DAVIS answered "exactly." You have to meet one and two in order to get the 40 percent.

SENATOR FRENCH asked what the situation is between three miles and 25.

MS. DAVIS answered you're still at 30 percent because you're greater than three miles; if it's less than three, you get nothing. She explained that there are several types of production tax credits; the first one is the qualified capital expenses credit (AS 43.55.023) - essentially 20 percent of things that are known as qualified capital expenditures, defined in that section as essentially the intangible drilling costs. The trick about the qualified capital expenditure credit is that

you can use half in the current year and half in the following year.

[3:55:33 PM](#)

She explained that the loss carry forward credit (AS 43.55.023) is essentially if a producer has capital expenditures and can't fully deduct them (in other words, you have earned less than you expended that year), they are allowed to use 25 percent and use that in the following year as a net operating loss credit.

SENATOR FRENCH asked what happens to the other 75 percent.

MS. DAVIS answered it goes away.

SENATOR FRENCH asked that they are transferable in the sense that you can push them forward, but you can't sell them.

MS. DAVIS answered yes. Your net operating loss is essentially that you take 25 percent of the capital expenses that you had. If that equates to the full loss that you had, that's what you've got. But you can't claim a loss for more than what was 25 percent of your capital expenditures in that year.

[3:56:47 PM](#)

MS. DAVIS said the third credit is known as the "small producer credit" or "frontier basing credit." She said people sometimes miss two of the credits in one section. The first one in AS 43.55.025(a) is a \$6 million credit that is given to someone who produces less than 50,000 barrels per year from non-North Slope/non-Cook Inlet properties. The second small producer credit is up to \$12 million for a producer that has less than 100,000 barrels average per day. So a producer that has 50,000 barrels or less per year will get the full \$12 million; between 50,000 and 100,000 it gets proportionately drawn down.

Finally, the other benefit under the production tax is the economic limit factor (ELF), the reduced tax for Cook Inlet-related properties. The net effect of that is that the maximum tax on gas coming out of the Cook Inlet region is 17 cents/mcf (by formula) and the maximum tax on oil per barrel is zero dollars.

[3:58:29 PM](#)

SENATOR FRENCH asked if any of the credits can be combined.

MS. DAVIS answered that the same expenditure can either be used either as an exploration tax credit or as a qualified capital expenditure credit; it can't be both.

SENATOR FRENCH asked which can be sold either to the state or to another producer.

MS. DAVIS replied the exploration tax credit, the capital credit under AS 43.55.023(a)(b) and AS 43.55.025 and the net operating loss can be cashed out, but not the small producer credits.

SENATOR FRENCH asked if those are the only ones that are transferable or sellable on the market.

MS. DAVIS added that those are only cashable by taxpayers who have an average of 50,000 barrels or less of production per day.

CO-CHAIR WIELECHOWSKI said he wanted to understand the difference between the EIC and ETC better.

MR. BANKS interrupted to explain that an EIC is a DNR-offered credit that becomes a term of the lease before the lease sale. Generally speaking it's some proportion of the well cost - some amount of money per foot or some percentage of the total cost up to 50 percent. It makes the lease more attractive.

CO-CHAIR WIELECHOWSKI asked if the first "default" would be the ETC which anyone would be eligible for and if the state wanted to incentivize a lease more it could be raised from 30 percent to 50 percent.

MR. BANKS replied that he wasn't sure that the EIC under AS 38.05 is additive to the ETC.

MS. DAVIS said she did not see any exclusions in AS 43.55.025, which means that it is additive.

[4:02:05 PM](#)

CO-CHAIR WIELECHOWSKI asked if someone could get an 80 percent tax credit.

MR. BANKS answered if he offered leases with that 50 percent credit, yes.

CO-CHAIR WIELECHOWSKI asked Mr. Banks if the royalty modification is similar to the EIC in that it is something he

would offer to potential lessees or would a producer ask him for royalty relief for a marginal field.

MR. BANKS answered that it works in the later case. It is not a provision of the lease; it is a provision in AS 38.05.180(j) that allows a lessee to ask for royalty relief prospectively.

CO-CHAIR WIELECHOWSKI asked how many leases in Cook Inlet have royalty modifications.

MR. BANKS answered there are none in Cook Inlet; the only two places that have a form of royalty modification (AS 38.05.180(j)) are the leases in Oooguruk on the North Slope and in the Nikiachuk Unit, and he explained that Nikiachuk was evaluated after the PPT had passed; so they accounted for the economic effects of that in their evaluation.

SENATOR FRENCH said the basic argument they would be confronted with from a producer is the that the economics of a field are challenged for whatever reason, and he asked if there was any limit on the reasons they can present - like being too far from existing infrastructure, having a difficult formation to produce, or heavy oil.

MR. BANKS replied that it all gets boiled down to how much it costs to develop the field. Distance would matter if infrastructure was needed. Most of those issues would be captured in the cost of development.

SENATOR FRENCH asked if anything prevents a producer from making the argument that taxes on a field are so high that the royalty needs to be lowered so the field could stay in production.

MR. BANKS answered no; that is a plausible argument and it would be incorporated in his evaluation, as would how the progressivity would work. In the evaluations the department has done so far, however, moving the royalty rate from the average of 12.5 percent down to 5 percent often doesn't make a very big difference in the economics of a project, because the royalties are paid basically after production begins and after a great deal of the money has been spent.

SENATOR FRENCH recapped that it's hard to make the argument that a 7 percent reduction in royalty would make a big difference in the economics of a field.

MR. BANKS said that is correct, and he reminded him that the department evaluates these prospects before production begins and before a major investment occurs. His point is if you are offering royalty relief it will typically occur after all the big money has been spent.

SENATOR FRENCH asked if a royalty reduction can be brought on with any lease the state oversees.

MR. BANKS responded that the prospective reduction is only provided to those fields that are not in production.

CO-CHAIR WIELECHOWSKI asked what factors he looks at to determine a royalty reduction.

MR. BANKS answered they try to place the economics of the project into what a prudent operator would do to move a project forward - perhaps the net present value of a project at some discount rate, the internal rate of return, capital efficiency, and some risk measurement. They would consider what would happen if the project would become wildly successful.

[4:09:23 PM](#)

MS. DAVIS interrupted to clarify an earlier answer she gave when asked if this is the only tax incentive. It is the only incentive for production tax, but another tax provision should be on the chart - the corporation income tax credit known as the gas exploration and development tax credit under AS 43.20.043. That provision provides for gas exploration expenditures that are non-North Slope gas; under current law, 10 percent of those expenditures become a credit against the corporate income tax. If you use that credit it is in lieu of the EIC or any of the production tax credits, although some of the language is problematic.

She also wanted to go back and answer the question about which credits are in lieu of other credits. The only provision under the production tax regime (five potential benefits) that has to be exclusive is the capital credit under AS 43.55.023(a). But if a new player who is under that 50,000 barrel threshold could do an exploration well that would qualify for the exploration tax credit. If they don't have a lot of production, they will likely have a lot of expenses and not much income; so they will generate a net operating loss credit. They will also conceivably qualify for the small producer credit (\$12 million) and depending on where they are located (not the North Slope or Cook Inlet) they could also get the \$6 million. If you are an

incumbent producer with over 100,000 barrels then you are essentially looking at the capital credit or the exploration tax as an alternative for the same expenditures if you have net operating losses.

CO-CHAIR WIELECHOWSKI asked what they thought the legislature needed to do to get existing companies to continue to explore and to get new entrants to come in.

MR. BANKS answered that the AS 38.05.180(j) incentive takes a very hard look at the kinds of economics that can be anticipated for a particular project, but it is not automatic. Sometimes the state just can't offer enough relief to make a difference. In the last several weeks the concern has been raised by many that relief isn't automatic. At least, a credit involves some kind of assurance that the tax payer will be spending money in order to get money, and the state is protected to a certain extent. But of course they don't look at a lot of these credits with the kind of eye that a AS 38.05.180(j) application would have to have.

CO-CHAIR WIELECHOWSKI asked how Alaska's credits compare to other countries and states - for Cook Inlet in particular.

MR. BANKS said he couldn't answer that, but no other state has the kind of credits the Alaska DNR has. The federal government offered royalty incentives for OCS in the Gulf of Mexico, but that became quite controversial as prices rose.

SENATOR HUGGINS asked where the standard deduction would fit on their chart.

MS. DAVIS answered that the standard deduction is a means of calculating what the lease expenditures are and is part of the tax calculation for arriving at what the production tax value is. So they didn't add that as an incentive.

SENATOR HUGGINS asked what the net effect is of the standard deduction.

MS. DAVIS answered that the effect is that you essentially take the 2006 level of lease expenditures for the two large fields, Prudhoe Bay and Kuparuk, and lock those in as the lease expenditure level that would be allowed for three years - with it being escalated by roughly 2 percent.

[4:16:26 PM](#)

SENATOR HUGGINS asked if the proximity piece of the exploration tax credits for the North Slope had been about right or do they require an adjustment.

MS. DAVIS answered in terms of the distance piece, their experience is that wells were drilled, but the taxpayer has chosen to use the credits that are available in some instance under the capital expense credits because they can be immediately cashable or returnable.

SENATOR HUGGINS asked what the most effective category for exploration in 2010 is for new investment.

MS. DAVIS answered that the last full tax returns they looked at were from 2008 and 91 percent of the credits that were applied for and used against tax liabilities were the AS 43.55.023 credits, and approximately 6 percent were in the exploration tax credit regime. The vast bulk of credits the state is issuing are in the capital credits category. She clarified that her statistics do not include companies that are currently incurring costs that have no production. She would expect those companies would be more heavily tilted toward the exploration credits.

[4:18:49 PM](#)

CO-CHAIR WIELECHOWSKI asked for their initial reactions to President Obama's decision to expand drilling allowable areas in Cook Inlet.

MR. BANKS said he was still trying to figure it out exactly what it was that he did. It appears that there will be progress on the existing leases in the Chukchi and Beaufort Seas. That is a good thing, but he remains concerned that there may be some kind of moratorium on future lease sales until studies are completed. The opportunity to add to your prospect with some expected timing as a lessee begins to explore its own existing prospects is fairly important, and it's unfortunate that there may actually be a delay.

CO-CHAIR WIELECHOWSKI asked them to let the committee know when he has performed some initial analysis.

MR. BANKS pointed out that a line drawn from Anchor Point across the Cook Inlet is about where the OCS begins heading south. So there could very well be an impact starting there.

CO-CHAIR WIELECHOWSKI thanked them for their comments.

**SB 309-GAS EXPLORATION\DEVELOPMENT TAX CREDIT**

[4:20:46 PM](#)

CO-CHAIR WIELECHOWSKI announced SB 309 to be up for consideration.

[4:20:53 PM](#)

MIKE PAWLOWSKI, Staff to Senator McGuire, clarified that the legislation was offered at the request of the Senate Energy Committee and Senator McGuire. He started off on the incentive sheet they were just working off of. SB 309 deals with the area under the exploration tax credit in AS 43.20.043, which is a tax credit that specific to below the 68th parallel. It cannot be taken in conjunction with other credits or royalty modifications. So, it's specific to exploration within the Cook Inlet or south of the 68th parallel and is not stackable with the other credits.

He explained that SB 309 makes substantive changes to the existing credit on page 3, line 25, that gets towards the NDR Cook Inlet study and the recent Petro Technical Resources assessment that the utilities prepared. He explained that one of the principles underlying SB 309 is that the best place to look for gas is probably within a gas field. In that the old exploration incentive tax credit had to be on land that had not been under production or had not been explored for, this actually frees it up so that wells that are drilled within an existing field can qualify for this incentive as well. The incentive is further modified on page 2, lines 6-18, where new language was added that increases the credit from 10 percent to 25 percent. This credit is against corporate income tax and is not against production taxes.

MR. PAWLOWSKI said the third substantive change is on page 3, lines 10-20. He explained that originally this credit was only applicable against 50 percent of taxpayer's corporate income tax obligation and SB 309 removes that 50 percent cap and allows the credit to be claimed against the total tax liability.

Finally, he said, Sections 7 and 8 extend the sunset. This particular exploration incentive tax credit is set to expire in 2013 and the bill extends it to 2020 with a transitional sunset to 2024 for any carry-forward credit against a future tax obligation.

[4:24:40 PM](#)

SENATOR HUGGINS asked what makes him think these incentives will have an effect.

MR. PAWLOWSKI answered that the issue in Cook Inlet is related to the production tax, which isn't very big. On the other hand, corporations that are operating in Cook Inlet might have substantial corporate income tax; so designing this tax credit to apply against that tax exclusively provides a tool that might work for a corporation that might not want to use one of the other credits. Further, allowing development of an existing field rather than looking outside of the existing fields really is what gets to the heart of the bill because that is where gas is likely to be found in the near term.

CO-CHAIR WIELECHOWSKI asked why he needs six lines on page 2, lines 13-18 rather than just changing the 10 to a 25.

MR. PAWLOWSKI answered that the language has to be mirrored from lines 4-9 in transitioning from the original 10 percent credit to 25 percent credit.

CO-CHAIR WIELECHOWSKI asked what Section 2 does.

MS. DAVIS, Deputy Commissioner, Department of Revenue (DOR), explained that Section 2 is simply trying to accommodate the split in the two different tax years, pre-2010 and post-2010 era. One of the things that is sort of hidden is you've got the split of the credit being for capital investment - taxpayer's qualified capital investment and qualified services, both of which are defined at the back of this tax section.

[4:29:37 PM](#)

CO-CHAIR WIELECHOWSKI asked why "reserves" is changed to "wells" on line 29.

MS. DAVIS answered that this happened before she became associated with the bill, but one of the attempts was made that relates to an effort to change the credit from one that is success oriented to one that gave a credit for the action of drilling the well and doing the exploration regardless of whether they ended up with a successful commercial producing gas well. They are moving away from reserves to simply the well being drilled.

MR. PAWLOWSKI said his understanding is that clerically reserves are produced, but it is a well that actually produces gas. The

language was trying to get towards that concept, as well as get away from the success concept.

MS. DAVIS said she understood that Legislative Legal was trying to remove "per" from wherever they see it. That was the line 7 change and then line 8 removes the 50 percent cap of the income tax liability. So, now this credit can draw down the income tax liability entirely.

CO-CHAIR WIELECHOWSKI asked if a producer produces in Cook Inlet and also has exploration on the North Slope, is there is a way of writing off these taxes on North Slope production.

MS. DAVIS answered yes; under the corporate income tax they do not look at different parts of the state; it's all combined.

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MS. DAVIS said deleting the language in Section 4 simplifies the concept that a taxpayer is not entitled to a credit for capital expenditures or qualified services made for activities related to gas on the North Slope. The original draft specifically excluded gas from the North Slope going to Valdez, which seemed to suggest that gas from the North Slope going to Canada was okay. It became more problematic to fix it than to eliminate it.

CO-CHAIR WIELECHOWSKI asked if this whole bill only applies to south of 68 degrees.

MS. DAVIS answered that is correct.

CO-CHAIR WIELECHOWSKI asked if that includes Gubik.

MR. BANKS answered that Gubik is significantly north of the 68th parallel.

CO-CHAIR WIELECHOWSKI asked if any significant development or exploration going on south of 68 degrees.

MR. BANKS answered that he knew of proposals for exploration activities in the Yukon region.

MS. DAVIS went to section 5 that adds language that deals with a failure leg. It adds "if the exploration and development activity touch on gas reserves regardless of whether there has been commercial production in the area" - in other words they can go back into a previously explored area - "or whether the exploration and development activity results in the production

of a well, gas or well not capable of commercial production" - meaning that they could end up having a mediocre well and it could still be covered. Because of the use of the phrase "gas reserve" throughout, from the administration's stand point, they will probably have to lean heavily on DNR, because she is left with the impression that if a rank wildcat-type gas exploration well has no indication of gas reserves and they drill a dry hole, the bill and the original statute is written such that they are not accessing or touching gas reserves. So, in that one instance this bill would not seem to apply.

[4:35:43 PM](#)

She said that section 5 also defines what is considered to be the qualified capital investment. There is concern about including "topping plant" in the list of properties breakdown within (c). That was cleaned up because that is a crude oil process for refining and it simply doesn't belong in a gas bill.

Concern was also expressed about processing units and whether that included an LNG plant. Technically from an engineering standpoint it would, and so the House cleaned that up by re-referencing that as gas processing and gas treatment plants (both downstream and upstream gas processing that would be normal things), but excluding LNG or other manufacturing plants.

Another concern was about a power plant that powered Southcentral being subsidized by the corporate income tax credit. So, that was limited to power plants necessary for field operation.

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MS. DAVIS said Section 6 clarifies when the timing of the credit is being filed that was missing from the original section. Sections 7 and 8 clean up the last dates the corporate income tax credits can be used from 2017 to 2024 and from 2013 to 2020 (for the credit expiration).

She said one question was raised on HB 229 about whether this credit could be used in lieu of the other credits. And she made a misstatement there. When she read the current law, AS 43.20.043(g) it states "a taxpayer who obtains a credit under this section may not claim a tax credit or royalty modification provided under any other title." That begs the question that since this is contained in AS 43.20, and since the production tax is in AS 43.55, technically it is not in another title. She didn't think the drafter intended to alter the assumption that this is not an additive credit and so "this or any other title"

was inserted. And likewise for the benefit of the taxpayer, the second line "however a taxpayer may at the taxpayer's election forego a credit under this section in order to continue to qualify for a credit provided for in another title" was inserted.

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CO-CHAIR WIELECHOWSKI asked if the administration has a position on the bill.

MS. DAVIS replied that she didn't know.

[4:40:16 PM](#)

KAREY LOCKHART, Production Manager, Alaska Operations, Marathon Oil Corporation, said Marathon's operations are limited to Cook Inlet and they have been operating there for over 55 years. Marathon sells 87 mmcf/day to all of the current markets available to them including the utilities, Tesoro, the Department of Defense, and the LNG plant that is co-owned with ConocoPhillips.

She explained that in 2003 several bills were passed directing the state to provide incentives for new exploration and development activities. Marathon was particularly interested in HB 61, which was intended to incentivize exploration and development of natural gas reserves in Cook Inlet. Regarding SB 309, she said, one might ask the need to provide incentives for natural gas development in Cook Inlet and the answer is found by considering the long-term decline in natural gas reserves and deliverability which Cook Inlet has experienced. What must be addressed is whether there is currently sufficient exploration development activity to address such decline and reserves and deliverability not just ask simply if Cook Inlet is running out of gas. At the current level of activity, it is unlikely that Cook Inlet reserve additions will replace annual production on a long-term ongoing basis. This is the key.

Such natural gas reserves and deliverability are at risk for continued decline resulting in exposure to unmet utility needs which would impact everyone. The lack of activity is an artifact of historic oversupply of natural gas. With prices well below Lower 48 index prices create a lack of incentive for additional drilling and further regulatory processes and deterioration in market availability have added to project uncertainty. The project economics and market uncertainties make it difficult for projects to compete effectively for finite money.

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MS. LOCKHART asked what can be done to ensure the reliability, and said the answer is not simple, and includes several things that are being discussed today - storage, market access, uncertainty and economic projects.

Alaska projects are not considered solely on their absolute merits. They are compared on a relative scale in comparison to other world-wide opportunities in which companies such as Marathon may invest. SB 309 intends to level the playing field of investment opportunities around the world. It is one part of a three-part puzzle that needs to be fixed in order to ensure natural gas reliability. She reiterated that in order to qualify for this investment tax credit, the producer must make capital investments adding to some level of value back to the state and industry just to cross the value chain, which is necessary to meet the overall deliverability needs of Southcentral.

[4:44:06 PM](#)

MARK LAND, Executive Vice President, Land and Administration, Renaissance Alaska, LLC, and Vice President, Land and Business Development, Buccaneer Energy Limited Alaska, said he had prepared remarks specifically related to an amendment that he heard was going to be added to SB 309 related to the repeal of the future spend requirements under the existing tax credits.

CO-CHAIR WIELECHOWSKI said the amendment hadn't been introduced yet, but he could still comment on it.

MR. LAND said Renaissance is headquartered in Houston, Texas, and Buccaneer is a subsidiary of Buccaneer Energy Limited, a publicly traded company in Australia with an operating office in Houston. Renaissance was formed in November 2006 and completed the initial funding of a business plan that solely focuses on growth in Alaska, in particular Umiat Oil Field on the North Slope. Buccaneer Alaska is a newly formed subsidiary of Buccaneer Energy Limited and was just formed last week to solely focus on growth in Alaska, particularly oil and gas opportunities in Cook Inlet. They have over 80 years of experience worldwide. The team members have identified, captured funding, and developed oil and gas projects resulting in cumulative recoverable reserves of over 1 billion barrels equivalent. Since its formation, Renaissance has acquired BLM and state oil and gas leases on 19,000 acres located on the Umiat Oil Field, the National Petroleum Reserve and the Gubik Gas Field on the North Slope. Buccaneer has entered into a custom sale agreement with Stellar Oil and Gas to acquire 58,000

acres located in the Cook Inlet and Kenai Peninsula. Since 2006 Renaissance has spent in excess of \$40 million completing exploration evaluation operations in the state. A significant amount of these funds were focused on evaluating the existing oil field at Umiat with a modern 3-D seismic survey.

The tax credit under ACES is a significant reason why Renaissance remains in Alaska, he said, and they believe the availability of those credits will play a critical role in attracting the required investment to develop the Umiat Oil Field. The tax credits are also a significant reason for the entry of Buccaneer into the Cook Inlet. To date, Renaissance has applied for a total of \$19.2 million in tax credits and has received \$1.3 million from the state of Alaska, \$7.45 million from the North Slope tax payers in the sale of the certificate, and has approximately \$7.6 million in certificates that they have been unable to monetize.

MR. LAND repeated that Umiat is a known oil accumulation with potential near-term development. It has real potential and is one of the best opportunities to supply up to 50,000 barrels per day to TAPS in the near term. Based on the work completed by Renaissance and the state on the road to these resources, they believe they are on a path to commercializing this gas.

He said it is common for these types of developments to have a two-to-three lull in spending as they incur pre-engineering and permitting of the project. In summary, they both support the increased access, the capital credits for the new explorers, the repeal of AS 43.55.028 (e)(2)(3) as set out in the amendment to Section 8 of SB 309. They support the repeal that provides greater certainty for new investors in Alaska, and levels the playing field between new and existing operators in Alaska and eliminates the unfair double standard that they believe exists with the North Slope producers.

4:49:49 PM

STACY SHUBERT, Director, Intergovernmental Affairs, Mayor Sullivan, Anchorage, said she was testifying in support of SB 309 at the request of Mayor Dan Sullivan. She said the Municipality of Anchorage remains concerned about the declining production of natural gas in the Cook Inlet specifically as it relates to decreased deliverability through the gas system. One of the first orders of business the Mayor acted on after taking office was to create an Energy Task Force to address the serious energy issues Railbelt consumers are faced with today. These deliverability challenges will escalate in the next one to five

years, and if not addressed could result in rolling black outs or worse. Both the Task Force and the Mayor applaud the legislature's efforts to address these critical pieces of legislation that address both incentives for storage and natural gas exploration and production. The mayor also acknowledges the work of the Railbelt utilities who have been working with the administration on the Energy Watch Program, a green, yellow, red system that informs customers to adjust their behavior in the event of an impending energy crisis. "Conservation can be a critical component that helps us to help ourselves in the event of an immediate threatened energy crisis," she said.

In 2009 she said Anchorage almost experienced a catastrophic event, and that is why the Mayor asked her to testify today in support of the concepts proposed in SB 309 and HB 280, the Cook Inlet Recovery Act that supports storage efforts. Gas storage is the key to smoothing out the challenges posed by deliverability peaks on cold winter days.

[4:52:10 PM](#)

CO-CHAIR WIELECHOWSKI closed public testimony and set SB 309 aside.

#### **SB 290-TAX CREDIT TO DRILL WELLS IN COOK INLET**

[4:52:31 PM](#)

CO-CHAIR WIELECHOWSKI announced SB 290 to be up for consideration.

[4:52:53 PM](#)

MARY JACKSON, staff to Senator Wagoner, said the tax credit in SB 290 is patterned after the Oklahoma land rush and it deals exclusively with exploration. They call it the Cook Inlet Stampede. It basically says that the first, second and third explorer that comes gets a good benefit starting at 100 percent and then going down to 75 percent and down to 50 percent. It is offered under the alternative tax credit for oil and gas exploration in Section 1.

Section 2 of the bill defines exactly what it is by defining the first three explorers as those drilling into the sub-Cretaceous zone. It allows for only one credit per explorer and if more than one qualifies for one event, the department will determine the percentage of the credit goes to each. A unique twist is if the exploration results in production in paying quantities, the credits are required to be repaid by 50 percent. Finally, if

explorers come in and actually start producing it strengthens the Basin.

MS. JACKSON reviewed materials in the packet that include a sponsor statement, a sectional analysis, a memorandum of understanding from the Department of Revenue (November 2009) that said there was a recent review by the department, a letter of support from Escopeta Oil, a stratigraphic map that depicts the zones and a recent DNR oil and gas activity map. A March 30 DOR fiscal note is indeterminate. She pointed out that this new credit, if it's \$20 million and they would have originally gotten a 40 percent credit; it's a difference of 60 percent, not the full \$20 million.

She said language needed to be developed that clarifies this is intended only for offshore exploration. State leases are offshore in the Cook Inlet Basin; therefore, information received from drilling of the well becomes public and DNR gets to see it.

[4:57:18 PM](#)

The DNR recommended changing the sub-Cretaceous to the pre-Tertiary period. The third point talks about the possible need for three credits for jack-up rigs and permanent platforms that are already there. A fourth is a question from DOR as to what is considered transportation, although she is reasonably confident that is addressed. The last issue was raised by the DOR which was an oversight - a 25 percent net operating loss for capital credits - and nowhere was it ever intended that anyone get 125 percent. So that needs to be clarified.

[4:58:50 PM](#)

CO-CHAIR WIELECHOWSKI read a statement from Escopeta Oil, because he thought it was "pretty amazing." It predicts that the Kitchen Lights Unit (KLU) contains approximately 440 million barrels of recoverable oil and 5 tcf of natural gas. It goes on to say that after platform and infrastructure implementation there could be approximately 75,000 million barrels of oil and 300 mmcf of gas per day from the KLU anticlinal feature alone.

SENATOR WAGONER added that a portion of the reserves they are talking about are from the Sunfish that ARCO discovered years ago and didn't produce because the price went down to about \$9 barrel.

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MS. DAVIS said after conferring with Kevin Banks, she believed SB 290 would require DNR and DOR to work together to administer this particular credit. First they want to make abundantly clear that language on page 2, line 6, about the first to bore a hole either implies that you have spudded the well (begun to drill) or completed it. The joint recommendation would be to go with the spud date for two reasons: one, it insures that good quality field practices are being applied to the drilling well, and second, the spud date is recorded by date and hour in the event there is competition between two players. The DNR would have to come up with some sort of certification or determination on whether a well results in production in paying quantities.

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KEVIN BANKS, Director, Division of Oil and Gas, Department of Natural Resources (DNR), explained that the notion here is that you drill a well into a target that hasn't been discovered - a sub-Cretaceous or pre-Tertiary zone. If production comes from that zone, then part of the credit would be paid back. He said that typically exploration wells are not converted in producers for a number of reasons relating to location of the resource when it comes time to produce after further field evaluations.

CO-CHAIR WIELECHOWSKI asked if he had any public data on reserves in the sub-Cretaceous zone.

MR. BANKS answered that they don't know very much about what is in the sub-Cretaceous zone; possibly a well in the McArthur River that struck oil at that depth could qualify, but he didn't know if it had ever been produced.

MS. DAVIS pointed out that if the first rig that comes into Cook Inlet receives 100 percent of its cost as its credit, then you have essentially achieved the objective of getting a jack up rig into Cook Inlet. Under the current lease expenditure regulations, the cost of mobilizing that rig to the State of Alaska is fully allowed as a lease expenditure. But once that rig is in Alaska, they also allow the deduction of the demobilization to other parts of Alaska, but not if it leaves Alaska. Hopefully, she said, the rig should be put to work numerous times in Alaska.

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CO-CHAIR WIELECHOWSKI set SB 290 aside.

**HB 280-NATURAL GAS: STORAGE/ TAX CREDITS**

5:06:02 PM

CO-CHAIR WIELECHOWSKI announced HB 280 to be up for consideration. [CSHB 280(FIN)am was before the committee.]

5:06:06 PM

REPRESENTATIVE MIKE HAWKER, sponsor of HB 280, said it specifically addresses three issues regarding the needs of the Cook Inlet: the need for gas storage for utilities and proprietary storage for managing inventories, the need for additional exploration, and long-term supply contracts.

He explained that the bigger components of the bill encourage the development of gas storage facilities. It creates the first regulatory framework for those facilities that don't exist now. At the end of the day they will provide a volumetric-based development credit based on certain criteria that a storage facility has to meet. Any investment in storage in the Cook Inlet is going to increase the gas to consumers and is a supply chain cost. The development credit is intended specifically to be consumer cost relief in that the credit is to be passed through ultimately to consumers.

As far as encouraging development and further gas storage Representative Hawker said he asked DNR to expedite permitting of the storage facilities. It is important also to recognize that while this bill offers the "pass through credit" for development of gas storage facilities, for any entity to avail themselves of those credits they must also accept RCA regulation. This is an absolute linkage in the bill. The bill protects the ability of individual producers to develop storage for their own purposes for those companies who want to build proprietary storage, but very specifically no credits are available for it. Likewise, the RCA does not have regulatory authority over those privately owned proprietary interest gas storage facilities; unlike today.

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SENATOR FRENCH asked him to identify the sections that pertain to gas storage credits and those that pertain to the RCA matters.

5:12:11 PM

REPRESENTATIVE HAWKER responded that he wanted to present the bill's themes first without reference to specific sections and then he would go through a sectional. He said a couple of significant applications for long-term contracts were not approved by the RCA in the past several years. He asked the RCA

what it would need to approve them, because in hindsight they would have been very good contracts to have approved. The bill directs the RCA now when making a decision on a contract application that they not only have to look at the specifics of the contract, but at the consequences of saying no to that contract. A number of sections increase access to existing tax credits for explorers and developers working in the Cook Inlet.

REPRESENTATIVE HAWKER said this bill was developed with a great deal of help from Larry Persily (Federal Gasline Czar), Roger Marks (former Senior DOR Petroleum Economist), Jan Levy (former DOL oil and gas attorney), and Julie Lucky, legislative staff.

[5:15:12 PM](#)

HB 280

Cook Inlet Recovery Act - Sectional Analysis  
Prepared by Representative Mike Hawker's Office

Section 1: Sets out a short title for the legislation: Cook Inlet Recovery Act (CIRA).

Section 2: Establishes an application process, criteria and timeline for the Alaska Oil and Gas Conservation Commission (AOGCC) to certify that a gas storage facility (GSF) meets the minimum working gas storage capacity and daily delivery rate requirements to be eligible for the financial incentives provided in this bill.

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CO-CHAIR WIELECHOWSKI asked on page 2, line 10, if there was "any magic" in selecting 500 mmcf and on line 13 being able to withdraw a minimum of 10 mmcf.

REPRESENTATIVE HAWKER answered they were the product of consensus in discussions with the DNR and DOR. Initially they considered a bill that would pay the credit up to double the capacity, but recognized this credit does not flow to the developer; 100 percent of it flows through to consumers. They were trying to second-guess the volume of large capacity storage that will be developed in Cook Inlet, and the DOR expressed concern that they wanted the bill as close as possible to the perspective development as possible. It was an effort to try to mitigate the potential gaming of the system. The idea of the flow-through volumetrics indicates they don't want to give credits to someone building a storage facility that cannot deliver sufficient gas to meet their peak demands. They might

consider expanding the size of the credits once they see an actual project.

CO-CHAIR WIELECHOWSKI asked if it's projected that Cook Inlet would need 10 million mcf on any cold day.

REPRESENTATIVE HAWKER answered that's the minimum amount and a fairly low number. They get 400 mcf/day demand on really cold days. The idea of the storage facilities is to meet the peaking demands, not the sustained delivery. Section 2 also says if you cease using a storage facility within the first 10 years the state has a recovery provision on any credits provided that would have be refunded by the developer. The AOGCC would have to be notified on those cessations.

REPRESENTATIVE HAWKER continued the analysis:

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Section 3: Requires a GSF owner to notify the AOGCC if the facility ceases operation.

-Provides definitions for terms used in CIRA.

-Requires the Director of the Division of Mining, Land and Water to give priority to and expedite "when reasonably possible" any applications, permits and lease assignments needed for development and operation of a GSF.

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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 would stop if the storage facility ceases commercial operations.

-States that any waivers of lease fees or rents would be public record.

-Requires that the GSF pass on the financial benefits of any lease exemption to utilities that use its service.

-Clarifies that any gas withdrawn from a GSF is considered to be non-native gas and not subject to royalty until all non-native gas is withdrawn.

SENATOR FRENCH asked if the director has already denied permits to producers for their storage wells.

REPRESENTATIVE HAWKER answered that he heard that DNR's policy is that they would not permit storage facilities unless they were an open access facility. As presented to him in his conversations with Mr. Banks, the concern is that more storage capacity is needed right now and smaller producers may not have

the financial wherewithal to build their own. Until they have a very vibrant third-party storage facility, the agency had concluded that it was best to make all future storage facilities open access. To him, this crossed his line of a little too much government interference and didn't recognize the reality that he sees in the Cook Inlet where the producers have the need to manage their own inventory (warehousing). For example, Chevron had substantial warehousing capability in the Drift River Terminal Facility that sat at the foot of a volcano. That storage facility has been taken off line after volcanic activity. While it was oil storage, it is now interfering with their ability to maximize and sustain ongoing production because they don't have a warehouse to put their own product in.

The same thing with gas, he said. If producers don't have a place to store their case, the state would be encouraging them to shut in gas and not maximize production. This bill anticipates seeing proposals for a very large open access third-party owned project in the Cook Inlet in the near-term, but that would deny benefits to someone who simply wants to manage their own inventory.

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Section 5: Directs the Regulatory Commission of Alaska (RCA), when considering the approval of a utility's gas supply contract, to consider the impact on 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.

REPRESENTATIVE HAWKER explained if an open access third-party owned facility is constructed on state land, the lease fees or rents would be waived for the first 10 years of that facility's operations.

He added that this bill also provides a regulatory framework for "last in, first out" inventory accounting in these new storage facilities. This means the last gas pumped into it is the first gas that comes out. This is relevant because the last gas (residual gas to maintain some pressure in the bottom of the well) in the bottom of the well has not ever been produced and when it is produced there will be a liability and obligation to pay production taxes on it.

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Section 6: Requires that a utility's cost of gas storage that is passed on to consumers reflect the financial benefits of any tax credits and state lease exemptions provided in this legislation. It also stipulates that a portfolio representing diversified-terms of gas supply contracts is a good thing.

[5:28:19 PM](#)

Section 7: Specifies that the Regulatory Commission of Alaska (RCA) has jurisdiction over natural gas storage services provided for gas that is owned by a regulated utility and that any benefits provided in this legislation flows through to the consumer.

Section 8: Further defines "natural gas storage facility" and clarifies what is considered part of the storage facility.

-Further defines that RCA regulation of gas storage facilities is limited to facilities operated primarily or exclusively for third-party customers; regulation does not extend to a proprietary storage facility operated exclusively or primarily to hold gas owned by the storage facility owner or operator.

REPRESENTATIVE HAWKER explained that a potential loophole was discovered by DNR and DOR that it potentially could be argued that a large natural gas pipeline (if it were to be built), since it is a vessel capable of storing gas, someone might argue that it would fall under the parameters of this legislation, which was not at all the intent. So language clarifies that a natural gas storage facility that is part of a regulated natural gas pipeline is not also regulated by the utility.

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Section 9: Clarifies that the names of taxpayers and the amount of credits claimed for gas storage facilities under this legislation shall be public information.

-Requires the Department of Revenue (DOR) to furnish the information to the RCA.

REPRESENTATIVE HAWKER explained that this section specifies that the RCA does have jurisdiction over gas storage services for gas that is owned by a regulated utility. They are looking at a couple levels of storage and in this case this gas would be purchased on the market by a utility that has developed the gas storage facility itself. Other provisions talk about how a third-party facility that provides services to a public utility is also regulated.

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SENATOR FRENCH asked if he was referring to the definition on page 8, lines 18 and 19.

REPRESENTATIVE HAWKER answered yes.

Section 10: Establishes a credit against corporate income taxes of \$1.50 per thousand cubic feet of new gas storage capacity opened in Alaska during 2011-2015. The credit is limited to \$15 million per GSF. This section sets out minimum capacity and deliverability requirements to qualify for the credit, including that the GSF must be available for use by regulated utilities and, if utilizing state land, must be in compliance with its DNR storage lease. The credit can be refunded by the state at full value if the owner does not have enough taxable income to fully utilize it.

REPRESENTATIVE HAWKER explained this section picks up the third-party customer coverage.

CO-CHAIR WIELECHOWSKI asked if the definition of "natural gas storage facility" included the LNG plant in Nikiski.

REPRESENTATIVE HAWKER answered as they have defined the ability for someone to get a credit under this bill, it had to be delivering gas to consumers. An export plant and facility was not contemplated for the benefits.

CO-CHAIR WIELECHOWSKI asked if they released some of their gas on the really cold winter days.

REPRESENTATIVE HAWKER replied anecdotally he was aware that when the peak demand of coldest days had occurred in Southcentral Alaska in a past couple of winters, ConocoPhillips, who owns and operates that facility, actually voluntarily diverted gas that they had committed to export to customers overseas into the supply chain for consumers. Their good-friends relationship with their consumers in Asia allowed them to do that.

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Section 11: Sunsets the rule that limits how certain tax credits arising from activity in Cook Inlet or from producing gas for in-state use are used on January 1, 2011. This would allow a Cook Inlet explorer or producer to explore or produce elsewhere in the state and have full access to the credits it earned from its Cook Inlet activities. This section also makes sure that the names of producers and amounts of credit are public. It is necessary that the information is available to the RCA.

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CO-CHAIR WIELECHOWSKI asked if this would be a good place to stop and pick up at a future hearing.

REPRESENTATIVE HAWKER answered yes.

[HB 280 was held in committee.]

Co-Chair Wielechowski adjourned the meeting at 5:35 p.m.