

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

February 1, 2012

1:05 p.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Alan Dick
Representative Neal Foster
Representative Bob Herron
Representative Cathy Engstrom Munoz
Representative Berta Gardner
Representative Scott Kawasaki

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Senator Thomas Wagoner

COMMITTEE CALENDAR

HOUSE BILL NO. 298

"An Act exempting sand and gravel and marketable earth mining operations from the mining license tax; and providing for an effective date."

- MOVED CSHB 298(RES) OUT OF COMMITTEE

HOUSE BILL NO. 276

"An Act providing for a credit against the oil and gas production tax for costs incurred in drilling certain oil or natural gas exploration wells in the Nenana Basin."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 298

SHORT TITLE: EXEMPTIONS FROM MINING TAX

SPONSOR(S): REPRESENTATIVE(S) SEATON

01/25/12 (H) READ THE FIRST TIME - REFERRALS
01/25/12 (H) RES, FIN
02/01/12 (H) RES AT 1:00 PM BARNES 124

BILL: HB 276

SHORT TITLE: OIL/GAS PRODUCTION TAX CREDITS: NENANA
SPONSOR(S): REPRESENTATIVE(S) THOMPSON, DICK, MILLETT, TUCK,
MILLER

01/17/12 (H) PREFILE RELEASED 1/13/12
01/17/12 (H) READ THE FIRST TIME - REFERRALS
01/17/12 (H) RES, FIN
01/30/12 (H) RES AT 1:00 PM BARNES 124
01/30/12 (H) Heard & Held
01/30/12 (H) MINUTE(RES)
02/01/12 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

WES VANDERMARTEN, Vice President, General Manager
Anchorage Sand & Gravel Co., Inc.
Anchorage, Alaska
POSITION STATEMENT: Testified in support of HB 298.

JULIE OLSON, CPA, Controller
Secon
Juneau, Alaska
POSITION STATEMENT: Testified in support of HB 298.

CHERYL SHAFER, Owner
Dibble Creek Rock, Ltd.
Anchor Point, Alaska
POSITION STATEMENT: Testified in support of HB 98

MARC COTTINI, Owner
Quest Engineering Inc.
Anchorage, Alaska
POSITION STATEMENT: Testified in support of HB 298.

TOM HEALY, Executive Director
Alaska Rock Products Association
Palmer, Alaska
POSITION STATEMENT: Testified in support of HB 298.

JOHN MACKINNON, Executive Director
Associated General Contractors of Alaska
Anchorage, Alaska

POSITION STATEMENT: Testified in support of HB 298.

JOHANNA BALES, Deputy Director
Anchorage Office
Tax Division
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: Answered questions relating to HB 298.

REPRESENTATIVE STEVE THOMPSON
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: As joint prime sponsor of HB 276, presented further information about the bill.

JANE PIERSON, Staff
Representative Steve Thompson
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: As staff to the joint prime sponsor of HB 276, assisted in providing further information about the bill.

ROBERT SWENSON, Petroleum Geologist, Acting Director
Central Office
Division of Geological & Geophysical Surveys
Department of Natural Resources (DNR)
Fairbanks, Alaska

POSITION STATEMENT: Answered questions in relation to HB 276.

JAMES MERY, Senior Vice President
Doyon, Limited
Fairbanks, Alaska

POSITION STATEMENT: Answered questions in relation to HB 276.

ACTION NARRATIVE

[1:05:12 PM](#)

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 1:05 p.m. Representatives Kawasaki, Dick, Herron, Gardner, Foster, Munoz, P. Wilson, Seaton, and Feige were present at the call to order.

HB 298-EXEMPTIONS FROM MINING TAX

[1:05:31 PM](#)

CO-CHAIR FEIGE announced that the first order of business would be HOUSE BILL NO. 298, "An Act exempting sand and gravel and marketable earth mining operations from the mining license tax; and providing for an effective date."

CO-CHAIR SEATON, prime sponsor, explained that HB 298 would exempt sand, gravel, and marketable earth mining operations from the mining license tax. This extremely cumbersome tax is based on the profits of the end product that is made from the sand and gravel. Many operations have numerous end products, such as cinderblock or asphalt, and each one of those products must be tracked to figure out the profit margin on the sand and gravel that went into it. Another way that the tax is cumbersome is that the operators are required to file a consolidated single form for their pits but under the mining license tax they are also required to do the calculation based on the entire mining operation. Therefore, it is a complex set of recording and ways in which the revenues and profits are accounted for.

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CO-CHAIR SEATON reported that the fiscal impact of the mining license tax is very small. For example, in 2011 the [Department of Revenue (DOR)] received 182 mining license returns from sand and gravel operators, but only 17 of those paid any tax. The reason no tax was paid is because net profits below \$40,000 are excluded from the tax. He reminded members about a previously considered re-write of mining tax laws in which the deduction, or the point at which taxes had to be paid, would have been increased two and one-half times to \$100,000. He said HB 298 does not go into any other mining operations such as placer or hard rock, it only deals with sand and gravel and marketable earth. By excluding all sand and gravel operations from the mining license tax, HB 298 would provide a much more direct way of getting to the same thing that was trying to be accomplished by raising the exclusion.

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CO-CHAIR SEATON said the other thing about the fiscal impact is that it has only raised about \$206,000 to \$320,000 [annually] in the last four or five years, but it costs the Department of Revenue about \$150,000 [annually] to administer the program. In one way it could be looked at as a nuisance tax because it raises so little money, but in actuality some of the larger sand and gravel operators sell 80 percent of their product to public

works projects, so 80 percent of the tax is being paid for in public works projects. Generally, operators take their costs of doing sand and gravel, including this tax, and put on a 20 percent administrative fee, so the state ends up paying a huge portion of this tax through its public works projects, plus the administrative fee for calculating the tax, and then the audits that are required. He said he thinks that calculations for public works projects would show that the state is losing money by this tax. Additionally, the tax is very burdensome on both small and large businesses. He related that some of the written testimony states that in some cases up to 200 hours of work goes into just maintaining the records and going through audits.

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CO-CHAIR SEATON further noted that folks from Southeast Alaska have said that all of that region's gravel comes from crushed quarry rock and not sand and gravel mining. Therefore, he has an amendment to extend the definition to quarry rock, sand and gravel. Drawing attention to the Department of Revenue calculations in the committee packets, he pointed out that the quarry rock was included in those calculations. He said that quarry rock gravel also includes the Alaska Peninsula.

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REPRESENTATIVE KAWASAKI inquired whether HB 298 would affect valuable metals or other minerals outside of sand and gravel or quarry rock.

CO-CHAIR SEATON replied no, the bill strictly deals with sand and gravel and marketable earth and, if the amendment is adopted, it will also deal with quarry rock. He said those are exclusive of any metallic minerals or other extractives.

REPRESENTATIVE KAWASAKI asked whether marketable earth is defined in the bill or in some other statute.

CO-CHAIR SEATON responded that marketable earth is peat and topsoil. He offered to get back to the committee with the definition.

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REPRESENTATIVE FOSTER said HB 298 sounds like a good proposal, but asked whether any department jobs would be eliminated because of the bill.

CO-CHAIR SEATON answered that the Department of Revenue's auditors would be much more profitably used by the state for auditing larger operations that produce more revenue to the state. It is not that those auditors would go to oil and gas, he said, rather their expertise is in auditing the mineral industry and that is where they would be more productively used.

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REPRESENTATIVE HERRON inquired as to how many tons or yards of sand and gravel are being talked about.

CO-CHAIR SEATON responded that back in the 1970s he was amazed to find out that sand and gravel was the state's largest extractive industry. He clarified that HB 298 only deals with the mining license tax and would not affect the royalties that are paid by operators taking sand and gravel off of state land. While he did not have the tonnage, he said the mining license tax is calculated on a profit basis, not a tonnage basis. He offered to provide more information if that was desired.

REPRESENTATIVE HERRON said he would just like for it to be on record that it is the largest extracted product in Alaska.

CO-CHAIR SEATON added that when he was looking at this for any unintended consequences, he had the [Department of Revenue] look at all municipalities that have a severance or other tax. Of the seven boroughs or municipalities in the state that have a severance tax, none of those taxes are based on the mining license tax.

CO-CHAIR FEIGE opened public testimony on HB 298.

[1:18:12 PM](#)

WES VANDERMARTEN, Vice President, General Manager, Anchorage Sand & Gravel Co., Inc., thanked the sponsor for introducing HB 298. He said Anchorage Sand & Gravel is a vertical integrated company that mines sand and gravel, and gravel-related products, such as concrete, asphalt, aggregates, block, pre-cast concrete, cement, and more. Doing business in Alaska since 1938, Alaska Sand & Gravel's products are used in a wide variety of products in the greater Anchorage area as well as over the state from residential to military and state projects. He outlined the reasons for why Alaska Sand & Gravel is in favor of passing HB 298. The amount of revenue that the state collects on this tax

is less than, or at best equal to, what it costs the state to collect it and therefore it is a neutral tax at best. Over the years the state has performed many audits on sand and gravel, with some individual audits lasting over two years. It has been a great strain on the state's auditing department with little results to show for it. The tax is burdensome because it requires a great deal of time to generate the necessary information for filing the tax. The current think of the DOR auditing division is that it is based on a fair market price and should be determined on each product to help calculate revenue. Anchorage Sand & Gravel produces 20-30 different sand and gravel products, so gathering the information is very time consuming and, if audited, the time and expense grow significantly. Anchorage Sand & Gravel's last audit took 18 months to complete and the cost was about \$50,000 to compile the information and attend meetings.

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MR. VANDERMARTEN maintained that the mining tax as it relates to sand and gravel is very ambiguous and inconsistent. Other mining operations, such as gold, silver, zinc, and coal, are indexed and the values are very easily defined and very traceable, but that is not the case for sand and gravel. The various gravel producers in the state have very different processes and markets that they deal in, thus it is difficult to determine a fair market price. For example, Anchorage Sand & Gravel is strictly a supply company, so all it does is sell to other contractors, while other producers tend to lean toward construction and their products are used on their own projects. So, coming up with a fair market value that is fair and easy to determine is the root of the problem and the auditors and producers struggle with making it a consistent tax across the board. The amount of tax paid by one producer may vary greatly on the same product that another producer might pay.

MR. VANDERMARTEN pointed out that governments are the customers for the majority of Anchorage Sand & Gravel's products; so much of the cost of the tax is just passed back to the state. Summarizing, he said the mining license tax is a non-productive tax, it is burdensome and time consuming for both the producer and the state auditing department, and it is inconsistent because there is no market index. For these reasons, Anchorage Sand & Gravel feels that sand and gravel should be exempted from the mining license tax statute.

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CO-CHAIR SEATON asked whether Mr. Vandermarten has any feelings about amending the bill to include quarried rock.

MR. VANDERMARTEN replied that he does not think it will have any effect. In further response, he said Anchorage Sand & Gravel does not do quarry rock. He understood that the production of quarry rock is very limited in the state.

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JULIE OLSON, CPA, Controller, Secon, noted that Secon is a subsidiary of Colaska. She said she was an auditor in public accounting for 11 years and has now worked for SECON for a year and a half. The volume and amount of effort going into preparing for the audit that Secon has been undergoing has been overwhelming, she continued. Secon has spent about 200 hours preparing for the audit. While the auditors have been great and are trying to do their job to make sure that Secon is complying with the tax return requirements, it has been really difficult to provide the auditors with what they need and in the right format. She stressed the difficulty of complying with the audit requirements and how burdensome that has been. She said she fully supports HB 298 and thanked the sponsor.

1:25:02 PM

MS. OLSON, in response to Co-Chair Feige, said she is the controller for [Secon] in Juneau and that there are four other accountants who do various levels of activities, but the majority of the information flows through her. In further response to Co-Chair Feige and Representative Gardner, she confirmed that she would have no difficulty in re-utilizing those other people in other areas and that HB 298 would not put anyone out of work.

1:26:19 PM

CHERYL SHAFER, Owner, Dibble Creek Rock, Ltd., stated that hers is a small, family run sand and gravel and ready mix business on the lower Kenai Peninsula. She said her company also finds it burdensome to apply the mining license tax to its sand and gravel operations, which is a basic industry with a low value product. Her company has experienced the same difficulties as stated in written and oral testimony by the big companies. Dibble Creek Rock owns and leases multiple gravel sites and it is an accounting nightmare to try to separate the company's

products from the several different sources and that are used for different products. She explained that she has to file double mining tax returns on all of her company's pits simply because the title of the property is held in a different name, which is her husband and herself, than their company name which is Dibble Creek Rock, Ltd., the operator of the pits.

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MS. SHAFER said her company is also currently being audited by the Department of Revenue for three years of mining tax returns and this audit has been going on since 2009. It is just a two-person office and she is the one who has been spending time trying to accommodate all of the information that the Department of Revenue has been asking for. Both she and the department find it difficult to separate out the company's mining activities from its integrated activities. More time is actually spent by trying to comply and file a correct mining tax report than it does for her to figure out her company's federal corporate tax. Dibble Creek Rock feels that taxing such a basic industry in such a complex way hurts the economic outlook of the state because it drives up the price on fundamental products that everyone needs. She said her company strongly supports passing HB 298 to exempt sand and gravel and marketable earth mining operations from the mining tax law. She thanked the sponsor for bringing this issue to the committee's attention.

1:29:28 PM

MARC COTTINI, Owner, Quest Engineering Inc., testified that his company got involved in the gravel business and representing clients about six years ago when the Matanuska-Susitna Borough started regulating extraction sites in the borough. Through that process, his firm learned of the requirement of the mining license tax. The company went through a long process with its clients and with two CPAs and during that process the company even had to go through back audits. Quest Engineering found the auditors in Anchorage very helpful and kind, but they were doing their job thoroughly. His company's clients are small gravel pit operators and because of the \$40,000 exemption none of them owed any taxes, but they had to fill out the forms. He said the audits were a heavy and expensive burden of time and money. Over the last six years, none of his clients in approximately seven different locations have had to pay any tax. He urged the committee to pass HB 298 because the tax is an undue burden and a hardship. If nothing else, the main thing is exempting small

firms from the paperwork. Since they are already exempt from paying any tax it would be nice to be exempt from the paperwork.

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MR. COTTINI, regarding how much burden is involved, said he spends about eight hours once a year for every site his company is at; currently, Quest Engineering is actively processing at three sites. Additionally, he spends another day answering questions from the individuals, trusts, landowners, and businesses that receive royalties from Quest to make sure that they get the information correct because the auditors compare the forms submitted by Flintstone Inc. - Quest's gravel screening business - to the forms sent in by the folks receiving the royalties. If there is a mismatch there is an audit. Therefore, he sets aside one full week every winter to process this paperwork. If he does not process this paperwork he will not get a mining license to operate the following summer, nor will the sites where his company works at.

MR. COTTINI closed his testimony by noting that after he spends his time putting together the paperwork he gives it to his CPA. He related that his bookkeeper said Quest Engineering paid the CPA about \$400 per mining license tax return, but paid the CPA less than \$300 to do the company's federal business tax returns.

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TOM HEALY, Executive Director, Alaska Rock Products Association, stated that his business association of sand and gravel producers supports HB 298. He related that the applicability of the mining license tax program to sand and gravel producers has been a concern amongst these producers for several years. One principle that supports exemption from a tax is whether the effort to collect an audit tax from a certain business is out of proportion to the tax benefit received, and this is exactly the situation that HB 298 addresses. The mining license tax as it applies to sand and gravel operations results in tax reporting and tax audit procedures that are overly complex and time consuming for both operators and Department of Revenue staff. There is no listed market value for sand and gravel products like there is for gold, silver, and other valuable minerals. Sand and gravel pricing is determined by individual contracts and bids and the same product can be priced differently by different producers on the same day. Combined with the variety of sand and gravel products, this results in a reporting and

audit process that is far more complex than that for a gold mine producing one product with a known market value.

[1:36:12 PM](#)

MR. HEALY said that sand and gravel tax revenue to the state is a relatively small portion of the total mining license revenue. The result is an inefficient upside down situation for sand and gravel producers - the lowest value mineral products are being subject to the most complex reporting and audit requirements.

MR. HEALY point out that another important distinction involving the sand and gravel industry is that its products literally form the foundation of local, state, and federal capital projects. Exempting sand and gravel operators from the mining license tax would reduce the cost to government agencies for capital projects. Finally, operators that are presently exempt from the mining license tax must still spend time and expense to submit to the state. This is not a cost effective use of limited company or state resources. He reiterated his association's support for passage of HB 298.

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JOHN MACKINNON, Executive Director, Associated General Contractors of Alaska, explained that his construction trade association is composed of over 650 business members. Since the technical problems with the mining license tax have already been discussed, he said he will instead provide a history of where the state is today. He related that last spring some of his member companies received audit letters that they immediately sent to him with comments that he cannot repeat in testimony. Looking into it, his organization realized that the present license tax structure was poorly applied to aggregate production in the construction industry. While it works well with minerals and other items from the earth, the tax does not make sense for aggregate production because of the complexity of processing. His organization approached the Department of Revenue last summer about the problems with the present tax as it applied to quarry rock and sand and gravel operations and how the present requirements could be improved. Associated General Contractors came looking for a simpler way of calculating the tax and a simpler audit process that would be revenue neutral; it was not asking for an exemption.

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MR. MACKINNON explained that the Department of Revenue came back to his organization after researching the issue and said the simplest solution would be to exempt quarry rock and sand and gravel operations from the requirements, rather than replacing a tax with a tax. Both the industry and the Department of Revenue have concluded that it is a true nuisance tax because it produces very little revenue for the state and for the construction industry it is expensive and very complicated to calculate and to prove up on an audit. The majority of the material mined and used goes into public works projects, so government is really paying the tax bill a couple of times over. So, what appears on the surface to be a self-serving piece of legislation for the benefit of the construction industry is really the result of a cooperative effort of industry, the Department of Revenue, the administration, and now the legislature to get rid of a nuisance tax and provide a long-term public benefit.

[1:40:43 PM](#)

MR. MACKINNON, in response to Representative Gardner, confirmed that it is he who can be blamed for coordinating the deluge of letters received by committee members about this tax.

CO-CHAIR SEATON commented that this shows the usefulness of associations of people acting together to bring an issue forward in a coordinated manner. He said that when this problem was presented to him he called sand and gravel operators across his district and received the same response from every person he contacted, yet most legislators had not heard from those individual operators.

REPRESENTATIVE P. WILSON added that this makes her wonder how many other laws on the books are not worth having. She said it is joy to take something away that will make life better for others and the state at the same time.

CO-CHAIR FEIGE closed public testimony on HB 298.

[1:43:42 PM](#)

CO-CHAIR SEATON moved that the committee adopt Amendment 1, labeled 27-LS1263\A.1, Bullock, 1/31/12, written as follows [original punctuation provided]:

Page 1, line 1:
Delete "**sand and gravel**"

Insert "quarry rock, sand and gravel,"

Page 2, line 3, following "earth,":

Insert "quarry rock,"

There being no objection to adopting Amendment 1, it was so ordered.

[1:44:43 PM](#)

CO-CHAIR FEIGE opened committee discussion on the bill.

REPRESENTATIVE KAWASAKI observed that the fiscal note is \$0 for the Division of Mining, Land and Water, but for the Department of Revenue in Fiscal Year 2013 and five years out it is a \$300,000 decrement while operating expenditures and fund source are \$0. He asked whether the department will be working on other things if the mining license tax is no longer itemized.

JOHANNA BALES, Deputy Director, Anchorage Office, Tax Division, Department of Revenue, provided a history of how the department got to that. When sand and gravel operators in the Matanuska-Susitna Borough were told that they needed permits the department was contacted by the borough and the department realized that it had several non-compliant sand and gravel operators in the state. The department then pulled resources from other excise tax types to do a compliance activity, which spanned about three years. The compliance activity brought approximately 150 new taxpayers into the fold with absolutely no increase in revenue. Once the department realized this it began putting those resources back on the other tax types from which they came. The department is currently closing out the sand and gravel audits that were mentioned during the testimony and is putting resources into other areas.

[1:46:49 PM](#)

REPRESENTATIVE KAWASAKI inquired whether there are other taxes that cost the state an exorbitant amount without being useful.

MS. BALES responded that the division does look at all of its tax programs and determinations to conduct audits based on looking at revenue. However, some taxes, such as alcohol and cigarette taxes, are levied not just for revenue purposes. So, the division does compliance audits in those areas hoping that everyone is paying the tax and the intended purpose of those

taxes will be reached. She said the division is open to having dialog to look at all of the taxes.

[1:48:26 PM](#)

REPRESENTATIVE P. WILSON said it is good to know that some taxes are not for the purpose of actually collecting the tax. She requested that when the department comes across something that is a waste of time that it let legislators know so it can be taken off the books. There is no sense in having things on the books that are redundant or not worth the effort, she concluded.

MS. BALES replied that the aforementioned request is duly noted and she looks forward to working with the legislature on things like this.

REPRESENTATIVE MUNOZ agreed that onerous taxes like the mining license tax should be brought to the legislature's attention by the department. She said the bill and its title is very narrow and prevents the bill from becoming a vehicle in other committees for that possibility. She wants to be clear to people in the mining community that the intention here is focused on sand and gravel operations.

[1:50:46 PM](#)

CO-CHAIR SEATON pointed out that his office investigated whether there was any large taxpayer that this would exclude, such as building a gravel island. It turns out that building a gravel island is using resources from a company's lease so that is not included in the bill's provisions.

CO-CHAIR FEIGE closed discussion on HB 298.

[1:51:39 PM](#)

REPRESENTATIVE MUNOZ moved to report HB 298, as amended, out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSHB 298(RES) was reported from the House Resources Standing Committee.

The committee took an at-ease from 1:52 p.m. to 1:58 pm.

HB 276-OIL/GAS PRODUCTION TAX CREDITS: NENANA

[1:58:21 PM](#)

CO-CHAIR FEIGE announced that the next order of business would be continued discussion on HOUSE BILL NO. 276, "An Act providing for a credit against the oil and gas production tax for costs incurred in drilling certain oil or natural gas exploration wells in the Nenana Basin." [Before the committee was Version M, the proposed committee substitute (CS) labeled 27-LS1193\M, Bullock, 1/18/12, adopted on 1/30/12.]

CO-CHAIR FEIGE invited the sponsor to discuss points that were brought up in meetings on 1/31/12.

[1:58:39 PM](#)

REPRESENTATIVE STEVE THOMPSON, Alaska State Legislature, sponsor of HB 276, related that there have been ongoing discussions with the Department of Revenue (DOR) and the Department of Natural Resources (DNR). He said that DOR and DNR are looking at how this tax credit would fit with existing tax credits and will be getting back to him on [2/6/12] with additional information. One possibility being looked at is expanding the bill to cover regions that are underserved and suffering from high energy costs.

[1:59:37 PM](#)

JANE PIERSON, Staff, Representative Steve Thompson, Alaska State Legislature, explained that one of the most interesting things discussed yesterday was that these are wildcat basins with a low potential - 5 to 15 percent - of success. So, a three-step process was looked at, the first being seismic exploration which would be shared with the state. The seismic data would increase the odds for success and would be valuable to the state to have. The second step would be pre-qualification for the drilling incentive from the Alaska Oil and Gas Conservation Commission (AOGCC) and DNR based on the seismic data provided. The third step would be the drilling and the issuance of the credit. Given that "the devil is in the details," work will continue on making all the pieces fit together so that the tax credits work smoothly with those that are already on the books and get to the sponsor's intent.

[2:00:54 PM](#)

REPRESENTATIVE THOMPSON explained that by the pre-qualification, DNR and AOGCC would have to determine that something does have a potential that is worthy of drilling. They could disallow the credits for drilling on a location that does not have much

potential, which could save the state a lot of money in the long run from a total wildcat of just going out and drilling a hole.

[2:02:00 PM](#)

CO-CHAIR SEATON pointed out that the 40 percent exploration tax credit would still be applicable, so somebody wanting to proceed with a well that did not qualify for this [proposed] enhanced credit could still take the existing credits, which are substantial. For locations that are over the distances away from someplace else, there is the 40 percent tax credit, plus conversion of the cost at 25 percent to a credit, thus basically it is 65 percent of the well cost as long it is within those parameters. He said he is just clarifying that the pre-qualification is only for this [proposed] enhanced credit.

[2:03:36 PM](#)

REPRESENTATIVE HERRON observed that there are the Cook Inlet credits and now there is this legislation for credits for the Nenana Basin. He asked whether this discussion is leading to the creating of a template so that some other basin in the state does not have to come back to the legislature.

REPRESENTATIVE THOMPSON responded yes, he is looking at other basins and possibly regions, but he has not yet put it all together.

[2:04:34 PM](#)

REPRESENTATIVE KAWASAKI commented that gas-starved Fairbanks is looking for energy solutions, and while this is the appropriate committee in which to debate a statewide policy, he does not want to get caught in the weeds. Fairbanks and other places across the state have been struggling to have something effectively passed and he would like to see the questions, especially on the pre-qualification, answered sooner rather than later.

[2:05:22 PM](#)

CO-CHAIR FEIGE recognized that HB 276, as currently written, would apply incentives directly to the Nenana Basin alone, but said he would like to step back and look at the state overall and the incentivizing of oil and gas and get a feel for the committee's basic philosophy for what should be done here. He said he would like to ask five questions, with the first being

whether it is appropriate to further incentivize oil and gas exploration above and beyond what is already on the books.

REPRESENTATIVE GARDNER responded that she has a concern any time it is a 100 percent incentive because it molds behavior in ways that are not always beneficial.

REPRESENTATIVE KAWASAKI recollected that many of the exploratory and production wells shown on the map from the Division of Geological & Geophysical Surveys are centered in two basins. The city of Fairbanks is far away from those two basins and that puts Fairbanks in a poorly placed strategic area. However, as a state he thinks Alaska ought to be wildcatting because pretty much every hole ever drilled was a wildcat hole at one point in time, including the Prudhoe Bay and Cook Inlet areas. So, there is cause for it, he agreed.

REPRESENTATIVE HERRON, looking at Mr. Swenson's PowerPoint of all the basins that have potential, said he agrees with Representative Kawasaki. The Yukon-Kuskokwim Delta has low potential for a big producer, but it has significant potential for local use. He said he therefore thinks it is the committee's responsibility to discuss that policy.

[2:08:41 PM](#)

REPRESENTATIVE P. WILSON concurred, but questioned how something found in the middle of nowhere will be taken out of there. For areas along the pipeline the product can be taken out, but for [remote areas] it will cost the state or somebody a lot of money once it is found to build a pipeline or a road. She added that she firmly believes in developing ways to get to the state's resources, and building infrastructure is probably the number one thing the state should be doing. She said she does not know how to connect the dots at this point, but it is something the committee needs to deal with.

REPRESENTATIVE THOMPSON pointed out that he did not intend for this to be something for export. He is looking at it as a way to bring relief to depressed areas and remote areas of the state. It would bring down their costs which would save the state millions of dollars in power cost equalization.

REPRESENTATIVE P. WILSON surmised that [the gas] could not be used as it comes out of the ground and would have to be refined. She asked what would therefore need to be done to help a community.

REPRESENTATIVE THOMPSON, qualifying that he is not a gas person, related that Cook Inlet gas is very dry and can nearly be used right out of the ground, while North Slope gas is very wet and has to be cleaned before it can be used in a home furnace. He allowed that there are differences and it depends on what is found as to whether it will need to be processed to be usable.

CO-CHAIR FEIGE commented that it will not be known until the gas is found.

2:11:38 PM

CO-CHAIR SEATON cautioned that he does not want the idea to be that it is just small basins with small quantities of gas that can be used only there. For example, natural gas found in the Copper River Basin would provide a ready source of gas to heat the oil in the Trans-Alaska Pipeline System (TAPS) to overcome some of the pipeline's problems; the same thing for any extra gas in Nenana. The Donlin Creek Mine is projecting to have usage greater than what the entire Railbelt and Southcentral are using right now, so in-state usage does not mean it has to be small. Depending on the quantity found, the gas could allow other economic bases in those areas to flourish as well. Most of what is being thought about is natural gas, but there could be oil in the Nenana Basin just as well as gas.

CO-CHAIR SEATON added that a bill by regions would get beyond the idea of a bill for just one group that has a license for an area. He said he wants to make sure the bill is expanded beyond [the Nenana Basin] so that it has general statewide implications. In response to Co-Chair Feige, he confirmed he is meaning for Alaska as a whole.

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REPRESENTATIVE KAWASAKI, regarding pre-qualification, stated that if the bill is expanded as mentioned by Co-Chair Seaton, thought needs to be given about anchor tenants and how to get that gas to market. The exploration credits on the books have done their job, but the problem has been with production and the realization of a project. He said he does not want to see a bunch of wildcat drilling without any results. The state's investment needs to result in gas production, not just exploration, and that should be part of the pre-qualification.

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CO-CHAIR FEIGE said he thinks it is a general consensus of the committee that some kind of incentive should be provided, but that members do not want to pay 100 percent just to punch holes in the ground. Even though the state is bringing in revenue it does not have enough money to punch holes all over the state to find the resource, so a way must be found for getting someone else to pony up the money and that is a delicate process. Therefore, the question for the committee is what the best way is to incentivize that. Given that the average wildcat well has only a 10 percent chance for success, he requested Mr. Swenson to address how the risk of drilling a dry exploratory well could be lowered and how the state could improve the information that it has through a program of incentives.

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ROBERT SWENSON, Petroleum Geologist, Acting Director, Central Office, Division of Geological & Geophysical Surveys, Department of Natural Resources (DNR), began by clarifying what wildcat and chance of success mean. A prospect said to be a wildcat prospect means that the amount of information that is had is relatively limited, so the chance of geologic or economic success is always based on just that one well rather than the entire basin. Every piece of information gathered is incredibly important because each piece provides a better understanding of what is in the subsurface, which increases the chance factors. It is not that all of these basins have a 5-15 percent [chance of success]; rather, it is that there is very little information for most of these basins. As additional information is gathered the chance factors will either increase or decrease. An example of this is Nenana Basin in which the explorer is very far down the exploration road in comparison to Minchumina Basin which has only gravity data and no subsurface information whatsoever. The Minchumina Basin is truly wildcat and drilling a well there would be incredibly difficult because it would be hard just placing where to go to get the most information.

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MR. SWENSON continued by pointing out that it is a difficult process to combine all of this together and have a template in which each basin is played the same way. The issue is to understand the data that is there and to understand what the prospect is. He said he thinks it important that the state understand what is available to it as far as the geology and the petroleum potential; it does not mean that that will take it all

the way to production, but it is understood what is available from the standpoint of resources, and this is what is important about this discussion and HB 276. Unlike many other states, Alaska has a lot of geology that is conducive to both oil and gas and minerals. He reiterated that the Nenana Basin is much further along than most of the other areas because it has a lot of seismic, three wells, and a lot of subsurface information.

[2:20:56 PM](#)

REPRESENTATIVE GARDNER, in regard to gathering information on broad areas, asked whether it would make sense for the state to do seismic work and then make it available to potential bidders, thereby increasing the value, potentially, of lease sales.

MR. SWENSON responded that how data is acquired is what he thinks this discussion is about, whether the state subsidizes or provides tax credits or some other process. Whether it is seismic data, gravity information, shallow core holes, or deep wells, each piece of information would help develop the model of what is there. For example, take away all the wells and seismic from the North Slope and think about when Prudhoe Bay was discovered. Nine wells were drilled in that region and the first eight were dry, but each well provided additional information. The target being drilled for at the time was the Lisburne, a carbonate rock beneath where the oil was actually found. When the Sadlerochit was hit, which is Triassic in age, there was absolutely no idea that this rock formation was going to be the target, and it is unbelievable how many times that type of thing happens. Going back from that serendipitous event, the issue is that it was known from the other wells that there was a lot of potential because of the active hydrocarbon that was found, along with a lot of shows and the thermal history. Much of the picture was put together and all of the pieces were there, but the picture was incomplete. When the Sadlerochit was hit and Prudhoe Bay found it was a complete surprise. That same process must be gone through to evaluate any one of these basins. It will be unknown what is actually there until it is hit and produced, but the ability to understand it increases with each piece of data - so any piece of data is important.

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CO-CHAIR FEIGE inquired whether it is fair to say that the more information available to a potential investor, the higher the likelihood that a potential investor will make that investment.

MR. SWENSON replied correct, but stressed it is specifically the basin that is being talked about. Then what must be taken into account is what infrastructure is available and how the product will be taken to market. Sticking with just the basin, he continued, the more data that is positive information, the better the chance of bringing an outside investor into that basin. The Nenana Basin has a significant amount of data.

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CO-CHAIR FEIGE presumed that the state's data is primarily stored with the Division of Geological & Geophysical Survey. He asked whether the division has an inventory of what data is available where in the state.

MR. SWENSON answered yes, and added that a number of different agencies have various types of data. The Alaska Oil and Gas Conservation Commission (AOGCC) collects all the well logs and samples from any of the oil and gas drilling in the state. The Division of Geological & Geophysical Survey gets those samples after they have become public; the division does not house any confidential information whatsoever. The Division of Oil & Gas (DOG), specifically DOG resource evaluation, and the AOGCC have a significant amount of seismic data that is proprietary because statute requires that it be turned over to the state. Some of that data becomes public after a period of 2-10 years, and once that is made public the Division of Geological & Geophysical Survey has access and can publish it, along with maps, to help people understand the geology and to facilitate exploration.

CO-CHAIR FEIGE surmised that the confidential seismic data made available to the state is data that the individual companies themselves are paying the cost to acquire.

MR. SWENSON responded correct and noted that some of that data never does become public.

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REPRESENTATIVE GARDNER inquired whether seismic data that was publicly available for a lease would tell an adjoining leaseholder anything about that leaseholder's nearby land.

MR. SWENSON said there are two levels of understanding. One is regional and tells what the basin is doing - what temperature it got to, what the basin's history is. This upfront information

would definitely help that person with an adjoining lease block in understanding the basin. However, the second level of understanding is where to specifically put down an 8.5-inch bit into a very expansive area, and the cost of getting it there is high. That is why such a tremendous amount of three-dimensional seismic is being shot now - it gives that much more information and helps to focus in on a very, very small target. For this level, an adjacent line in another area will probably not help, but for an understanding of the basin it will.

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CO-CHAIR FEIGE related his experience in seeing the great advancements that have occurred over the years in the quality of, and the means for gathering, seismic data. He asked what the most cost-effective means would be for the state to delve into to overview what a basin is really like.

MR. SWENSON concurred that the seismic data and all data acquisition technology has changed in leaps and bounds. He advised that [the state] is facilitating something everybody wants - the explorers want to find something, the state wants the explorers to find something, and the Native corporations want those companies to find something. In that scenario there will be different ideas about what the best data is, but everyone wants to get the most cost-effective look at whatever it is they are trying to get at. For example, in Minchumina Basin where there is very little data, one or two regional seismic lines to acquire the basic basin geometry would probably work. Areas like Yukon Flats, Nenana, and Kotzebue already have significantly more data, so the next step in those places would be determining the most cost-effective piece of information to provide the next phase of understanding to prove up whether there is a petroleum system or trappable structures. Rather than the state being a gate keeper, it is more of a partnership for coming up with the best idea for evaluating the basin.

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REPRESENTATIVE P. WILSON understood the state has lots of data but that some companies never give the state any data. She asked how and when the state acquires the information.

MR. SWENSON qualified that he is not the best person to answer this question and said he will get back to the committee with a detailed brief in this regard. However, he continued, sometimes there are "spec surveys" where a seismic company shoots a huge

area and then sells the opportunity to get that data with the stipulation that it cannot be passed on. He offered his understanding that for [spec surveys] on state land the state must get a copy and it is held confidential. Under certain scenarios, such as some incentive programs, the data becomes public after some period of time; for the licensing program he believes that time period is 10 years. Thus, there is a full spectrum depending on the location, the part of the confidentiality process, and how it is held.

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REPRESENTATIVE DICK noted that a dry hole that costs \$25 million to drill provides some data. He asked how the data from a dry hole compares to the other methods of gathering data.

MR. SWENSON began his reply by comparing remote sensing to the medical world, saying that even with all the different types of imaging for looking into a person's body, it is still the surgery that ultimately shows what something actually is. Because drilling is the most expensive part of the process, he continued, it behooves a company to get information to focus where that drill should go and to have a fair understanding of the basin's geometries and how deep to go. However, the only ultimate understanding is actually drilling a well, and probably more than one well, because the chance of success for any one well becomes so low.

REPRESENTATIVE DICK surmised that it might then make a lot of sense to drill maybe five holes in a basin.

MR. SWENSON responded that sometimes by the fourth well it will be known that it is not going to work, and sometimes by the first well that will be known. "It really depends on where you are," he said.

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CO-CHAIR SEATON noted that there are many basins across the state and therefore the state cannot put itself on the hook for every basin. He asked whether it would make sense to do this regionally and limit the regions and to have Mr. Swenson provide the contours for where those regions should be.

MR. SWENSON answered that a key issue in drawing the areas is that a basin not be cut in half - that the differentiation be based on geology and not geopolitical surface issues. There

will be some upfront knowledge about a basin to date, he continued. However, because the overall prospectivity of a basin will likely be relatively limited, it would probably be best to prioritize by identifying which has the highest potential from the geologic perspective of what is known, or that additional information is needed. A number of different variables will go into that equation.

[2:38:14 PM](#)

CO-CHAIR SEATON understood Mr. Swenson to be saying that regional is not the way to go; rather, prioritizing the basins statewide is the way to go.

MR. SWENSON replied that, in reality, the number of basins is less than 30, so it is important that [his division] get that information for the committee and then have the discussion again. For example, the Nenana Basin is a relatively small surficial area. It is important to look at which one of these basins maintains potential and to look at the area of extent of a basin with that potential, and to then have discussions.

CO-CHAIR SEATON requested that Mr. Swenson provide the committee with a prioritization and an estimate of regional guidelines. He said this might be part of the pre-qualification information.

MR. SWENSON agreed to do so.

[2:41:21 PM](#)

CO-CHAIR FEIGE asked what kind of information would go the greatest distance in reducing the exploration risk that Doyon, Limited is facing with projects that are currently underway [in the Nenana Basin].

JAMES MERY, Senior Vice President, Doyon, Limited, stated that there are a couple of difficulties. Because these frontier basins are not Cook Inlet or the North Slope the majors perceive them as too small, while people Outside see Alaska as scary; so it is a difficult environment. One helpful thing is that in some of these basins the oil potential has gone up substantially through Doyon's work. However, Doyon is losing partners in this venture, not gaining them. Doyon drilled a well and gained some valuable data even though it was not a productive well in terms of commerciality. The data from that well heightens the promise of these Interior basins. Doyon is undertaking its own seismic program right now because it is a strong believer in the area's

promise, but most of its other partners in the Nenana Basin are not participating in that project.

MR. MERY noted that it all comes to a head at the next stage, which is drilling. It will take at least two more wells, and maybe five, to know what is out there and getting to that point is going to be very difficult. Doyon is not in a financial position, even after it shoots the seismic, to fund 100 percent of a well that may be drilled in the future. The state has been a welcome partner through the other programs, he said, and what Doyon is looking for here is for the state to be a little bit more of a partner so that Doyon can get over the next hump to move this project forward.

[2:44:59 PM](#)

REPRESENTATIVE GARDNER inquired about the cost for Doyon's last well and the anticipated cost for the next wells.

MR. MERY answered that Doyon's last well was a summer time operation within a few miles of the road system and the costs were a little south of \$19 million. According to a recent Doyon study, a 12,000 foot well in summer time, and without pre-contingencies, will likely cost a little over \$25 million completed.

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CO-CHAIR SEATON related that since the Norway policy tour there has been a fair amount of interest in the legislature about state direct financial investment (SDFI), which is like a working interest owner. He asked whether Doyon would find it appealing to have the state as a working interest owner in the 20-25 percent range. He noted that a couple of different models have been run, including one model by Pedro van Meurs which found that the fiscal system could be made more attractive by converting the 12.5 percent royalty to a 25 percent SDFI. Another scenario is to leave the royalty as is and have some SDFI.

MR. MERY responded that Doyon has had no discussions and has not given any thought to it, but he is aware of what Mr. van Meurs has talked about. While there have not been formal or direct talks, he said he is sure that Doyon would be open to it.

REPRESENTATIVE DICK commented that the two things driving where the drilling takes place are how good the basin looks and how

desperate the market is, and that is what makes the Nenana Basin so compelling.

[2:48:50 PM](#)

REPRESENTATIVE P. WILSON inquired whether Doyon would be able to get investors to come back after there is more seismic data that indicates where the best place is to drill the next well or wells. She allowed this would depend on what the seismic finds.

MR. MERY replied that the objective is to drill wells and that with success he thinks Doyon would have no problem attracting new investors. The next biggest risky part of a venture in the Nenana Basin is drilling in the central part of the basin, and investment will follow quickly once it is established through discovery that there are many things to chase out there.

[2:50:15 PM](#)

CO-CHAIR SEATON related that the bill's structure of 100 percent has created a lot of consternation. This has resulted in discussions about 80 percent on all three, given that [HB 276] has no differentiation between the first, second, and third well like there was in the Cook Inlet issue. The committee is wrestling with how to structure a bill: one structure being an 80 percent tax credit with a payback of half of that amount if there is profitable production; the other structure being the current 40 percent exploration tax credit and 25 percent conversion of expenses to a transferable tax credit. He asked how Doyon would evaluate these two structures of credit.

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MR. MERY answered that it becomes a harder question for Doyon. Addressing it from the standpoint of previous committee discussions about "no skin in the game," he explained that the Cook Inlet legislation has a 90 percent reimbursement across three wells, with an up-to-\$25-million cap on each well. A 90 percent credit across three wells - the first, second, and third wells - would work quite well for Doyon. As far as skin in the game, he said Doyon's cost estimates are a little bit north of \$25 million. If anything goes wrong and it costs \$30 million, Doyon will only get reimbursed for \$25 million, not \$30 million, so Doyon is holding the insurance policy on cost overruns. Additionally, it is likely that later this calendar year Doyon will have to convert its license to leases, and then Doyon will have to write checks to the State of Alaska every year for about

\$1.5 million just to hold the leases. On top of that, Doyon is now spending money on doing seismic. Also, while drilling, it would be Doyon's intention to do more seismic on the southern end of the basin. The legislation that would allow Doyon to drill these things with these enhanced incentives really just triggers a whole lot of other things that will happen, and in that respect Doyon certainly has a lot of skin in the game. The notion of having the Division of Oil & Gas involved and perhaps pre-approving some of this does not trouble Doyon and Doyon welcomes that because it has an open relationship with both Mr. Swenson's division and Mr. Barron's division. Doyon has shared a lot of information that it did not have to share because it wants the participation and input of those divisions.

[2:55:09 PM](#)

CO-CHAIR SEATON, regarding the sharing of information, explained that one concern about enhanced credits was that the state should get something for that. The data would be available to the state without a long restriction on time limits because it is all under license which can be converted to leases and is therefore not competitive.

MR. MERY replied, "No problem with that at all."

[2:55:49 PM](#)

CO-CHAIR FEIGE stated that in the course of discussion the committee has gone over the rest of the questions that he had. If the committee decides it is going to incentivize and it determines exactly how it wants to incentivize, his last question is whether those incentives should be made open ended or only available for a fixed period of time. If it is open ended that becomes the state's basic structure, while a time limit might force people to respond to the state's desire to have more exploration sooner.

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REPRESENTATIVE KAWASAKI said his comments are not to the timeline, although he thinks it would be a good policy for the committee to make. Continuing, he noted that there is a limited amount of money but lots of potential areas to explore. Regarding the limited amount of money, the politics are that everybody wants to add his or her area into the whole equation and he wants to make sure that it does not become so large that

the committee cannot figure out what to do. In prioritizing the basins, he would like to come up with a policy that is fair.

CO-CHAIR FEIGE, in regard to taking the politics out, commented that some entity has to make a decision about where. He asked where the appropriate place is to have that decision made.

REPRESENTATIVE KAWASAKI responded that on the policy side he wants to make sure the committee does not pigeon it so much that it helps one group or another, which has been seen too many times.

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REPRESENTATIVE GARDNER, responding to Co-Chair Feige's question about the length of time, said the benefit of a time limit is that the legislature can always extend it if it is successful.

CO-CHAIR SEATON pointed out that the information on some basins is much farther along than that on others; for example, the Nenana Basin has seismic being shot and other development, so it is hard for something else to catch up. For people willing to drill in basins, the Nenana is well on its way. He said he thinks the committee is waiting for Mr. Swenson to come back with those prioritizations and some kind of regional mix. Regarding a timeline, he said it takes time to develop these sorts of things, so it could become problematic for a company trying to develop something because the company would not know whether that incentive would still be there. Additionally, if the committee was to look at a state direct financial investment (SDFI) model, then it would probably want restrictions based not so much on timelines, but on newer fields not going in and taking that kind of position and an old field where it has mostly been produced because there are liabilities to being a working interest owner, such as liabilities for oil spills.

[3:00:42 PM](#)

CO-CHAIR FEIGE held over HB 276.

[3:01:11 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:01 p.m.