

**ALASKA STATE LEGISLATURE  
SENATE RESOURCES STANDING COMMITTEE**

March 25, 2011

3:35 p.m.

**MEMBERS PRESENT**

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

**MEMBERS ABSENT**

Senator Lesil McGuire

**OTHER LEGISLATORS PRESENT**

Senator Cathy Giessel

**COMMITTEE CALENDAR**

**SENATE JOINT RESOLUTION NO. 2**

Commending and supporting the aggressive actions of the governor to protect the state from federal government incursion into the care and management of state resources and to promote the economic prosperity of the state; and urging the United States Congress and the President of the United States to limit the exercise of federal powers to those enumerated in the United States Constitution and to trust and empower states to manage their own affairs.

- MOVED CSSJR 2(RES) OUT OF COMMITTEE

**SENATE BILL NO. 85**

"An Act providing for a tax credit applicable to the oil and gas production tax based on the cost of developing new oil and gas production; and providing for an effective date."

- HEARD & HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SJR 2

SHORT TITLE: LIMIT FEDERAL INTERVENTION IN STATE

SPONSOR(s): SENATOR(s) DYSON

01/19/11 (S) READ THE FIRST TIME - REFERRALS  
01/19/11 (S) RES  
03/25/11 (S) RES AT 3:30 PM BUTROVICH 205

BILL: SB 85

SHORT TITLE: TAX CREDIT FOR NEW OIL & GAS DEVELOPMENT

SPONSOR(s): SENATOR(s) WAGONER

02/07/11 (S) READ THE FIRST TIME - REFERRALS  
02/07/11 (S) RES, FIN  
02/25/11 (S) RES AT 3:30 PM BUTROVICH 205  
02/25/11 (S) Heard & Held  
02/25/11 (S)7 MINUTE(RES)  
02/28/11 (S) RES AT 3:30 PM BUTROVICH 205  
02/28/11 (S) Heard & Held  
02/28/11 (S) MINUTE(RES)  
03/07/11 (S) RES AT 3:30 PM BUTROVICH 205  
03/07/11 (S) Heard & Held  
03/07/11 (S) MINUTE(RES)  
03/09/11 (S) RES AT 3:30 PM BUTROVICH 205  
03/09/11 (S) Heard & Held  
03/09/11 (S) MINUTE(RES)  
03/25/11 (S) RES AT 3:30 PM BUTROVICH 205

**WITNESS REGISTER**

SENATOR DYSON

Alaska State Legislature

Juneau, AK

**POSITION STATEMENT:** Sponsor of SJR 2.

JONATHAN KATCHEN, Inter-Governmental Coordinator

Department of Natural Resources (DNR)

Anchorage, AK

**POSITION STATEMENT:** Commented on SJR 2.

BRADLEY MEYEN, Attorney

Endangered Species Act

Natural Resources Section

Department of Law (DOL)

Anchorage, AK

**POSITION STATEMENT:** Available to answer questions on SJR 2.

MARY JACKSON

Staff to Senator Wagoner

Alaska State Legislature  
Juneau, AK

**POSITION STATEMENT:** Provided sectional analysis of SB 85 for the sponsor.

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

**POSITION STATEMENT:** Explained issues and changes in CSSB 85.

#### **ACTION NARRATIVE**

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**CO-CHAIR TOM WAGONER** called the Senate Resources Standing Committee meeting to order at 3:35 p.m. Present at the call to order were Senators French, Stedman, Stevens, Wielechowski, Paskvan, and Wagoner. Co-Chair Wagoner passed the gavel to Co-Chair Paskvan.

#### **SJR 2-LIMIT FEDERAL INTERVENTION IN STATE**

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**CO-CHAIR PASKVAN** announced SJR 2 to be up for consideration.

**CO-CHAIR WAGONER** moved to bring CSSJR 2 (), version 27-LS0355\B, before the committee.

**CO-CHAIR PASKVAN** objected for discussion purposes.

**SENATOR DYSON**, sponsor of SJR 2, explained that it is a simple and direct expression of the sense of virtually all Alaskans and it is his intention that in representing the people of Alaska he supports what leadership has been doing in challenging "federal overreach" in controlling the state's natural resources. He said just yesterday a consortium of Alaska Native corporation executives spoke to the House concerning common state management issues including wildlife, land designations, Endangered Species Act, critical habitat on Alaska Native Corporation lands, Department of Interior management plans for parks and refuges, EPA regulations and programs, barriers to access to state lands and the overreach of federal agencies encroaching and sometimes conflicting with state agency oversight.

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**SENATOR DYSON** said that starting with statehood, Alaska has struggled to get control of development of its resources and

that Alaskan fisheries, for instance, has prospered under state management.

SENATOR FRENCH said he supports many things the federal government does and, like Senator Dyson, opposes some. But for the sake of discussion the legislature keeps sending "pokes" to the federal government for this or that reason and he asked Senator Dyson if he thought it improved our relationship with them and since about one-third of Alaska's economy depends on federal dollars, asked if he thought these kinds of resolutions help or hurt our "need" to keep federal dollars flowing strongly to the state.

SENATOR DYSON replied that his district has two of the largest bases in the state and while he appreciated the concern, he didn't think this resolution would hurt the state's relationship with the federal government any more than the state has already done in challenging it over management of state lands. But it might make a slight improvement in demonstrating that the people of the state support Alaskans having management of their lands.

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SENATOR FRENCH said a couple of times the sponsor makes references to leadership and asked if he meant that in a generic sense or whether he was making legislative references to people like the presiding officers of both bodies, the co-chairs of Senate and House Finance and so forth.

SENATOR DYSON replied "the former," the quality they all share that has been given them by their constituents.

SENATOR FRENCH asked if the clause on page 1, line 7 that says, "Whereas the federal government is attempting regulatory actions" could be softened a little by inserting "some" before "regulatory" since many of the regulatory actions the federal government takes are ones they agree with.

SENATOR DYSON said he thought that would be okay.

SENATOR FRENCH said he would propose that as an amendment when they get to that point, but he would hold off till then.

SENATOR STEVENS said the most frustrating thing for his communities in the fishing industry is the decisions that are made without scientific evidence and just taking a "blind guess" that this is the truth, particularly with the Endangered Species Act. How do we get the federal government to recognize that we

can accept scientific fact, but often these decisions on sea lions, for instance, are not based on science?

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SENATOR DYSON replied that he personally doesn't have any way to influence the federal government, but he hopes the truth will always win out. But that is not often the case in the arena they are serving in.

CO-CHAIR PASKVAN removed his objection and therefore CSSJR 2(RES) was before the committee.

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JONATHAN KATCHEN, Inter-Governmental Coordinator, Department of Natural Resources (DNR), Anchorage, emphasized that the Parnell administration is devoting a lot of time and resources to this issue. But he didn't want to give the impression that they were always fighting and filing lawsuits, because there is a lot of coordination and often it is productive. { The Department of Law steps in when necessary on things like the OCS issue and opening ANWR.

BRADLEY MEYEN, Endangered Species Act Attorney, Natural Resources Section, Department of Law (DOL), said he was available to answer questions. He said they are working diligently on the matters that have been discussed here.

CO-CHAIR PASKVAN, finding no further comments, closed public testimony.

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SENATOR FRENCH moved Amendment 1 to insert "some" before "regulatory" on page 1, line 7. There were no objections and it was so ordered.

SENATOR FRENCH moved Amendment 2 to delete "the leadership of" and insert "with strong support by" before "the Alaska State Legislature" on page 1, line 10. He added that he thought the current language singled out a few and left out a lot of legislators including the bill's sponsor.

SENATOR DYSON said he supported those changes. There were no objections and Amendment 2 was adopted.

SENATOR FRENCH moved Amendment 3 on page 2, line 3, to delete "the leadership of".

SENATOR DYSON indicated his support. There were no objections and Amendment 3 was adopted.

CO-CHAIR WAGONER moved to report CSSJR 2(RES), version B, as amended from committee with individual recommendations. There were no objections and it was so ordered.

CO-CHAIR PASKVAN transferred the gavel back to Co-chair Wagoner.

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At ease from 3:50:13 PM to 3:52:09 PM.

**SB 85-TAX CREDIT FOR NEW OIL & GAS DEVELOPMENT**

[3:52:17 PM](#)

CO-CHAIR WAGONER announced SB 85 to be up for consideration in a much revised version. He said Mr. Pawlowski, staff to Senator McGuire, another sponsor of the bill, would co-present the new version with Ms. Jackson.

CO-CHAIR PASKVAN moved to bring CSSB 85( ), version 27-LS0484\E, before the committee.

CO-CHAIR WAGONER objected for discussion purposes.

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MARY JACKSON, staff to Senator Wagoner, sponsor of SB 85, said the new committee substitute (CS) is a joint effort between Senator McGuire and Senator Wagoner. When this bill was last before the committee, Senator McGuire expressed a willingness to participate to expand the original bill so that credits would be offered for areas within units subject to certain provisions that she would go over in the sectional analysis.

MIKE PAWLOWSKI, staff to Senator McGuire, presented a power point and said the first slide showed a Department of Revenue (DOR) comparison of the projected production based on fall revenue forecasts going back for the last 10 years and said in considering the challenge facing the state about declining oil production they determined it was important to go a little bit deeper than just looking at this graph by itself. The next two graphs indicated the actual forecasted production taken from the appendices in the back of the fall forecast, his point being that it seems like the forecasting has a pretty good idea of what the production of Prudhoe and Kuparuk will be, but didn't explain why there were some discrepancies. Well, the discrepancies largely come from the Prudhoe Bay and Kuparuk

satellites. This was the concern that Senator McGuire was trying to get to. These pools are necessarily part of the major field, but are separate accumulations within the unit.

MR. PAWLOWSKI said most of the North Slope actually is unitized at this point. So, looking at Senator Wagoner's goal of getting at new oil, Senator McGuire felt there was opportunity within the existing units to go after some satellite provisions. That is part of the reason for the departure in the CS. The table shows that the percentage of new oil rose throughout the years as production in existing units declined. So, the target that Senator Wagoner and Senator McGuire jointly came together to focus on was really new oil.

Therefore, [CS] SB 85 adds a new development cost credit in AS 43.55.026 that is based on 100 percent of qualified development expenditures which are linked back to the qualified capital expenditures. To avoid the problem of stacking credits, in that some are monetizable and can be accumulated on top of each other, the qualified capital expenditure credit in AS 43.55.023(a) and the net operating loss carry forwards in AS 43.55.023(b) are subtracted from the 100 percent qualified development credits. So, it's not truly a 100 percent credit; it ends up being whatever is the net known (explained in a further slide). The key is that targeting new oil is for undeveloped pools within existing units or leases or property that have not been involved directly in sustained production as of December 31, 2010. That is the universe to which the credit is intended to apply.

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MR. PAWLOWSKI provided an example to demonstrate the net effect of the way the CS handles the .026 credit. On the left was a producer with a tax liability (conceptually he would not necessarily have a net operating loss carry forward under .023(b)) - so conceptually he is making a \$10 million capital expenditure. Then they are accumulating an .023(a) credit of \$2 million on that expenditure, which would leave an .026 credit of \$8 million. However, a producer with no tax liability making the same \$10 million expenditure would get the same .023(a) credit, and assuming that they had a carry forward loss of \$10 million, a 25 percent of that \$10 million, for an additional \$2,500,000 credit, leaving the .026 credit at \$5,500,000.

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SENATOR WIELECHOWSKI asked if these credits are taken at the time the expense is incurred or at the time of production.

MR. PAWLOWSKI answered if he was talking about the specific mechanics within the Department of Revenue of when the credit certificate application is received that he didn't feel comfortable talking about it, but said the department would talk about that on Monday.

SENATOR WIELECHOWSKI asked if under this bill, the credit would be taken at the time of production.

MR. PAWLOWSKI replied that the credits would be taken as a certificate, but can't be used until the field goes into production. That brings them to the limitations on the .026 credit. Part of Senator Wagoner's original goal was to directly link the provision of the credit to production. So, the .026 credit on page 2, line 30, through page 3, line 1, is not transferable and may not be used for a person's tax liability under AS 43.55.011(e) below zero - the key being that some of credits (like .023 and .025) can either be sold back to the state or taken against one's current tax liability.

He repeated that Senator Wagoner wanted to make sure the credits are held until production starts and a tax liability is generated. The tax levied under AS 43.55.011(e) is apportioned in the current bill. So, the tax credit as Senator Wielechowski was asking can be applied not only when the unit goes into production but only in apportion to the actual production from that new oil on which the credit was earned. So, if you think about a unit currently producing 100,000 barrels a day and a credit is earned on something that leads to 10,000 barrels a day, the producer would only ever be able to use up to 10 percent of their tax liability for that unit on that credit in any given year. Any balance would carry forward until the credit is exhausted, because it cannot reduce the tax liability below zero.

MR. PAWLOWSKI said Senator Wagoner's core goal was to create a stampede similar to the work he did last year on SB 309. The "stampede provision" is really that the expenditures to qualify for this credit have to be within seven years, before the year 2018 (page 2, line 1).

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SENATOR STEDMAN went to the slide with the \$10 million capital expenditures and asked if they would still get to fully expense the \$10 million CAPEX with their \$2 million credit and the .026 credit (\$8 million).

MR. PAWLOWSKI answered yes.

SENATOR STEDMAN asked if a model could be done on the rates of return for this type of investment to compare how the return profile changes when the credit is inserted to see if it would be more advantageous than today's system.

SENATOR WAGONER replied that they could ask the Department of Revenue to have that ready for them on Monday.

SENATOR STEDMAN said if the state has potential investments it would be nice to have data so they could model how credits would impact a project.

SENATOR WAGONER replied that he wasn't sure that could be done, because a lot of these projects hadn't even started yet, but the ones he was keen on were Great Bear, Armstrong and Brooks Range.

MR. PAWLOWSKI responded that his point was incredibly appropriate, because this slide is really intended just to demonstrate how the credit is calculated and the tax system has a suite of other incentives that need to be evaluated. He said that he had pulled the 2009 National Department of Energy's Energy Technology Laboratory assessments on potential developments within the North Slope and tried to put together a suite of some of the identified undeveloped pools that DOR could model.

SENATOR STEDMAN said he remembered presentations from both the legislature's and the governor's consultants on different aspects of credit enhancements and tax incentives and said he thought some of that data should be available even though they don't get company X's information.

SENATOR WIELECHOWSKI echoed Senator Stedman's comments and asked if this was a credit towards the development of oil.

MR. PAWLOWSKI replied yes. He noted language on application of the credit on page 2, lines 12-17, and that line 13 covered development expenditures - that area incurred after completion of the first well that discovers a pool. He noted that line 15 says "before the state of sustained production" and that the Alaska Oil and Gas Conservation Commission (AOGA) working in consultation with the DOR would define those goal posts in a following hearing.

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SENATOR WIELECHOWSKI asked if everything after punching the well in the ground is considered development and if that would include delineation wells, gravel roads, ice roads or seismic tests. And what kind of costs are they looking at?

MR. PAWLOWSKI answered that it includes "qualified capital expenditures" and a detailed list of those gets a little nuanced. They are continuing to work with the department and AOGCC on the sign posts to make it clear to everyone when exploration ends and development begins and then when development ends and production begins; the suite of spending will depend on each different field.

The analysis that Senator Stedman was referring to really needs to happen - the goal is try to narrow when the credit can be used as much as possible.

SENATOR FRENCH said two recent developments come to mind in working with DOR on modeling - Nakiachuk and Oooguruk - and it would be fascinating to see how this bill would impact those fields.

SENATOR WIELECHOWSKI said the state is picking up 100 percent of the development costs and asked what percent of exploration costs it would continue to pick up under SB 85.

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MR. PAWLOWSKI answered that the goal is not to displace or make the developers choose between any of the existing credits; this is added to them and is the reason for the attempt to subtract credits that are claimed on similar expenditures.

SENATOR STEDMAN remarked that first concept of this bill was that the credit would be "either/or," but the new CS says that the credit would be stacked.

MR. PAWLOWSKI responded that was correct.

SENATOR STEDMAN said one concern is that currently when you have the immediate write off for CAPEX (\$10 million in the example), and that one would get an additional \$8 million off the tax bill.

MR. PAWLOWSKI replied that one would deduct the additional \$8 million when whatever field the expenditure was made against

comes into production and only against the apportioned tax value.

SENATOR STEDMAN asked for another model of how much the state and federal governments are putting on the table and how close they are to 100 percent.

MR. PAWLOWSKI explained that the risk of this credit to a developer is that it may never be used. A perfect example is where BP built up a fairly healthy expenditure to try to develop the Badami unit, which didn't produce the way they thought it would and got shut down. So it never generated a tax liability to be offset by the credit.

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SENATOR WIELECHOWSKI asked if this credit would impact the existing state/federal exploration credits of 65 percent for new entrants and 76 percent for a current entrant.

MR. PAWLOWSKI replied that there was no intent to impact that, but some cases might in terms of the .025 alternative exploration credits that they are currently evaluating with the help of the Department of Law.

SENATOR WIELECHOWSKI recapped that the state would be picking up 100 percent of the development costs above the 67 and 76 percent exploration credits.

MR. PAWLOWSKI corrected that the state would pick up 100 percent of the development costs in a success case.

SENATOR STEDMAN said he didn't want the state to be in the position of crediting over 100 percent and was concerned that the CS stacks the credits as opposed to the original bill that made the producers chose between credit options.

MR. PAWLOWSKI explained that the capital expenditures to qualify for these credits have to be made before 2018. That number came from a presentation by the AOGCC to the House Finance Committee on March 16, 2011. It is intended to get through the development phase into sustained production.

SENATOR WIELECHOWSKI why asked why there is such a big difference between the Kuparuk River melt water 1.5 years and some of the other fields. Was it just the dynamics of the field? Is there are another way to speed up the development of these fields?

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MR. PAWLOWSKI said he was ill equipped to answer that question, but a future section of the bill would help in that type of question.

He explained that the other addition in section 4 establishes an Oil and Gas Competitiveness Review Board in statute rather than as a legislative commission (Senator McGuire's original concept). It is a nine-member board with members of the legislature (one House and one Senate), the commissioners of the Department of Natural Resources and the Department of Revenue, and five public members four of which have specific qualifications - geologist, petroleum engineer, economist - and a member of an environmental or conservation group.

The duties of the board are to review historical, current and potential levels of investment, identify those factors that might affect investment, review the competitive position of the state, and make written findings before December 1 of each year regarding changes to the state's regulatory environment, fiscal regime and alternative means for increasing the state's ability to attract and maintain investment (which gets back to Senator Wielechowski's question).

MR. PAWLOWSKI commented on another slide (from the AOGCC's presentation to House Finance) of a production profile of the UK North Sea that has a double peak and then a rapid decline and what the theoretical future of Alaska could look like (taken from the Energy Technology Laboratory). He commented that it includes offshore, ANWR, the kitchen sink and the geologists' best wishes, but in looking at new oil it's important to put on the table what could theoretically be possible.

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SENATOR WIELECHOWSKI asked if this slide is what the U.S. DOE is currently projecting for Alaska North Slope.

MR. PAWLOWSKI replied that he wasn't sure. ANWR isn't in their current projection but it is in this slide.

SENATOR STEVENS said he is always hesitant to give away authority and responsibility of the legislature and he asked why this board is needed and what the legislature is giving up.

MR. PAWLOWSKI replied that the board has only an advisory capacity to the state in general. Senator McGuire felt that

since oil is so important to the state that it would be helpful to have a public board that can review all of the issues related to the legislature on an ongoing basis and make recommendations to the legislature. She thought that was an important part of doing business as the state.

SENATOR STEDMAN said he had equal concerns when he first read through this and having a board do the review might encourage the legislature to get lazy about getting into the subject matter.

CO-CHAIR WAGONER said this doesn't give away their control of the state's hydro carbons, but it is part of developing a process for the legislature to get information on a regular basis.

MR. PAWLOWSKI concurred, but he said it is a fair policy debate.

SENATOR STEDMAN acquiesced that it's not a total abrogation of their duties, but it would give an easy way out for the legislature to not look at the details of how the system works and just take the board's recommendations. PPT and ACES are some examples of the complexities.

SENATOR STEVENS said he is concerned that the board might not see the enormous importance of decoupling oil and gas as some of his colleagues do.

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MS. JACKSON reminded them that a number of issues were raised when this bill was first before them and summarized that the CS now has a seven-year provision and it also excludes Cook Inlet. The AOGCC now certifies the production, not the DNR, and "production in paying quantities" is defined as "sustained production" that is a term already in statute. The AOGCC identifying the pool as it applies to shale is an ongoing conversation that will happen in committee on Monday.

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She began the analysis saying the first change is to the title that was necessary to include the new section 4, which is the Oil and Gas Competitiveness Review Board. Section 1 has no change. Section 2 was deleted from the old bill and in the new CS makes 2018 the new date that production has to occur by. It has an exclusion for the credit in the Cook Inlet Basin and the Pt. Thomson Unit. She said if the body is willing, it could add

any future credits for the development of heavy oil in this section.

SENATOR WIELECHOWSKI said page 2, lines 5, 7 and 10, have several references to December 31, 2010 and asked if it would be better to use some other wording like "the effective date of this bill".

MS. JACKSON said they just "grabbed a date" for drafting purposes, but they could use that language. She would have to check with the drafter.

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SENATOR PASKVAN asked her to explain why this does not apply to heavy oil.

MS. JACKSON answered that this bill does not apply to heavy oil because it has already been produced. It could be added as another section if that is what they want.

SENATOR PASKVAN said he wanted to see some financial models of shale oil potential in Alaska because it is highly capital intensive. It's important to distinguish between the capital expenditures of Brooks Range and Armstrong, which are potentially conventional new oil and shale oil, which is new also.

MS. JACKSON added that shale is a real problem because the first question is if the AOGCC has the statutory authority to promulgate regulations for shale. Question two is if the AOGCC can come up with a definition of a "pool" for shale and is looking at how it is being defined in other areas.

SENATOR PASKVAN said his understanding of the shale oil development is that once the process is put in place, it is kind of an industrial output in the sense that it is moving the "cookie cutter" forward and he was trying to understand how the capital expenditures would be differentiated in that type of system.

MR. PAWLOWSKI replied that it falls back to the definition of "pool" that is an accumulation and it's all about communication. The questions is can he put a well "here" and pull oil from "there" and is it related to each other. Shale doesn't communicate between different sections; so the AOGCC itself is struggling with the definition of a pool. It is a policy call

for the committee if they want to extend the credit to those things given its substantive nature.

CO-CHAIR WAGONER said his office tried to research some of this and talked to an engineer with Whiting, probably the second biggest company in North Dakota, who said theirs is an acreage allowance. If your fracing system goes out so far, then you have to go back that far from where that acreage's lines goes down in the ground so you don't take oil from the adjacent property owner. Great Bear's holdings are adjacent to one another, so that shouldn't be a problem if they are talking about associated pools.

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SENATOR WIELECHOWSKI asked if this bill wouldn't apply to heavy oil at all.

MR. PAWLOWSKI replied that is correct at this point; only to new oil.

SENATOR WIELECHOWSKI asked even if the heavy oil were located in a new unit?

MR. PAWLOWSKI responded that could be correct in theory, at least, but he has been told most of the heavy oil is within existing units.

SENATOR WIELECHOWSKI asked how the bill would apply to Great Bear.

MS. JACKSON said he didn't see how it could because they don't have a definition of a "pool" for shale. If members want to include heavy oil, they need to broaden the horizons to get better definitions for both heavy and shale oils. The AOGCC doesn't want to just pull something out of its hat. They had a definition of sorts from Commissioner Seamount who defined it as a township and then the next problem came from Mr. Bullock who said they did not want to put an AOGCC definition into a credit bill under taxes. Then the question is if they have the authority to promulgate regulations to do the definition of a pool for shale.

CO-CHAIR PASKVAN said shale oil for purposes of application is an extremely aggressive credit, because they get to deduct 100 percent as well as getting a 100 percent credit. So if the region is defined in a small sense, then a producer is perpetually getting 100 percent credit and if it's large, it all

comes down to where you want to draw the boundaries of where shale oil is different from conventional.

MR. PAWLOWSKI added that the dilemma with shale is not only the boundaries but what kind of production it will be applied against.

CO-CHAIR PASKVAN asked if Bakken or Eagle Ford have credits that apply to shale.

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MR. PAWLOWSKI said he would get back to them with that information.

CO-CHAIR WAGONER said he found no credits for shale or any other thing in North Dakota; they have a different system of 10.5 percent of the gross.

MS. JACKSON said that section 2(b) is the "goal post" target that Mr. Pawlowski alluded to where the AOGCC certifies the production. New terms were used; "sustained production" was necessary because the previous ones were DNR terms and they are now not in the bill. Because AOGCC was put in DNR's place, some terms had to be changed to conform with AOGCC. They are working with the Department of Revenue to get there.

Subsection 2(c) talks about how the credits balance against a company's production tax liability. "If they have \$40 million in CAPEX and only \$30 million in liability, they are only going to get a \$30 million credit."

SENATOR WIELECHOWSKI asked how operating expenditures are dealt with.

MR. PAWLOWSKI replied that operating costs won't be counted, but they will be included in the net operating loss credit (being subtracted from the .026 credit) and actually lessen the value of the credit.

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SENATOR WIELECHOWSKI asked if he had any sense of of operating costs versus CAPEX in the development stage. He has heard that CAPEX is a huge amount if not all.

MR. PAWLOWSKI said there are some references in the DOE report that he would go over with him.

CO-CHAIR PASKVAN asked if Bakken and Eagle Ford and other shale developments don't have a credit system with capital expenditures, do they even differentiate between CAPEX and OPEX for any substantive reason.

MR. PAWLOWSKI replied that the goal of getting back to the definition of a "qualified development expenditure" by linking it back to the AS 43.55.023 definition of a capital expenditure was to bring it into the universe of what the DOR is already issuing credits for. These are expenditures that companies are already making and filing for in .023 credits.

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CO-CHAIR PASKVAN said he appreciated that, but right now conventional oil development has a correlation between OPEX and CAPEX that it is skewed to 90 percent CAPEX/10 OPEX, and the credit is 100 percent of CAPEX. The impact on the treasury's bottom line could be "incredible" and they want to know that the new oil is not going to bankrupt the state.

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SENATOR STEDMAN said it is hard for the companies to manipulate expenses, because the IRS classifies them has "decades of IRS rulings." He also commented when they get into other basins most of those are regressive systems.

CO-CHAIR WAGONER reminded them that the amount of the credit is already capped by the amount of production; producers don't have a free run just throwing millions of dollars out there and then writing it off.

MS. JACKSON continued with the sectional analysis as follows:

(d) Page 2, line 26, restricts the use of the new credit so there aren't multiple credits.

(e) Establishes that the credit or a portion of the credit is not transferable and may not reduce the tax liability below zero.

(f) Allows the Department of Revenue to adopt regulations needed to administer the credit.

(g) Establishes procedures so that when the credit is utilized it is applied only to the production tax due for the lease or the property that qualified for the credit.

(h) Definition section that references existing statute for a "pool" with regards to "qualified development expenditures" as per the DOR's review; and "sustained production" is now used rather than "production in paying quantities."

She explained that "sustained production" was developed last year in SB 309 and pertained to the jack up rig.

Section 4 establishes the Oil and Gas Competitive Review Board.

[4:49:39 PM](#)

SENATOR WIELECHOWSKI asked how this would work from a timeframe perspective. If someone goes out and spends five years incurring capital costs to develop a well and then they start producing in year six. Do they only get to collect their costs up to year seven? How does that work?

MR. PAWLOWSKI answered it's only within the timeframe of after discovery up to sustained production. So, if you are in production in the third month of year six, it's only from the third month of year six back to post discovery. Once you pass it, you go back into the regular 20 percent credit in .023.

SENATOR WIELECHOWSKI asked at what period the .026 percent credit lapses.

MR. PAWLOWSKI replied that it doesn't lapse until it is exhausted. The policy call here is that the tax credit is applicable only to new oil and it can't go below zero.

SENATOR WIELECHOWSKI, as an example, said someone spends \$100 million and takes the full seven years; year seven they go into sustained production. They put out \$20 million for the next five years. For year one they would get a credit on their production tax, so \$20 million at \$100 barrel oil would give an effective tax rate of 27.5 percent. Do they get a 100 percent deduction off that 27.5 percent?

MR. PAWLOWSKI replied they would have accumulated a credit through their development expenditures during the development stage (\$100 million in Senator Wielechowski's example). They have production tax liability of \$20 million in year one, two, three and four. They would be able to take \$20 million a year and roll \$80 million to the next year; take \$20 million in the next year, roll \$80 million to the next year; take \$20 million in the next year and roll \$80 million for the third year and never being able to go below zero.

MS. JACKSON added that the "true up" comes when the production tax liability comes into play. Going back to the sectional analysis, she said a minor error in references in section 4 was corrected and section 6 is the immediate effective date.

4:54:58 PM

CO-CHAIR WAGONER removed his objection and finding no further objections CSSB 85( ), version E, was adopted. Finding no further business to come before the committee, he adjourned the meeting at 4:54 p.m.