

HOUSE FINANCE COMMITTEE

April 5, 2016

8:32 a.m.

8:32:22 AM

CALL TO ORDER

Co-Chair Thompson called the House Finance Committee meeting to order at 8:32 a.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair  
Representative Steve Thompson, Co-Chair  
Representative Dan Saddler, Vice-Chair  
Representative Bryce Edgmon  
Representative Les Gara  
Representative Lynn Gattis  
Representative David Guttenberg  
Representative Scott Kawasaki  
Representative Cathy Munoz  
Representative Lance Pruitt  
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Ken Alper, Director, Tax Division, Department of Revenue.

PRESENT VIA TELECONFERENCE

Richard Ennis, Managing Director, ING Capital; Jared Green, President, ENSTAR Natural Gas; Moira Smith, Vice President, ENSTAR Natural Gas; Moira Smith, Vice President and General Counsel, ENSTAR Natural Gas.

SUMMARY

HB 247 TAX;CREDITS;INTEREST;REFUNDS;O & G

HB 247 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson reviewed the agenda for the day. The committee would be hearing from ENSTAR Natural Gas and ING.

#hb247

HOUSE BILL NO. 247

"An Act relating to confidential information status and public record status of information in the possession of the Department of Revenue; relating to interest applicable to delinquent tax; relating to disclosure of oil and gas production tax credit information; relating to refunds for the gas storage facility tax credit, the liquefied natural gas storage facility tax credit, and the qualified in-state oil refinery infrastructure expenditures tax credit; relating to the minimum tax for certain oil and gas production; relating to the minimum tax calculation for monthly installment payments of estimated tax; relating to interest on monthly installment payments of estimated tax; relating to limitations for the application of tax credits; relating to oil and gas production tax credits for certain losses and expenditures; relating to limitations for nontransferable oil and gas production tax credits based on oil production and the alternative tax credit for oil and gas exploration; relating to purchase of tax credit certificates from the oil and gas tax credit fund; relating to a minimum for gross value at the point of production; relating to lease expenditures and tax credits for municipal entities; adding a definition for "qualified capital expenditure"; adding a definition for "outstanding liability to the state"; repealing oil and gas exploration incentive credits; repealing the limitation on the application of credits against tax liability for lease expenditures incurred before January 1, 2011; repealing provisions related to the monthly installment payments for estimated tax for oil and gas produced before January 1, 2014; repealing the oil and gas production tax credit for qualified capital expenditures and certain well expenditures; repealing the calculation for certain lease expenditures applicable before January 1, 2011; making conforming amendments; and providing for an effective date."

8:33:33 AM

RICHARD ENNIS, MANAGING DIRECTOR, ING CAPITAL (via teleconference), shared that his company had utilized that oil and gas tax credit program in the state. He shared that the bill proposed a "phase-down" of credits over a multiple years, and felt that it was beneficial to the Alaskan companies. He remarked that two of his clients were in multi-year development programs in the North Slope and Cook Inlet. He felt that the provision was beneficial for their decision making processes. He noted that the current bill included an ongoing assignment provision to the lender of the tax credit, which was an important part of the credit division. He felt that ING was in the position of buying and remitting the credit upon its maturity. He expressed concern with the bankruptcy in the underlying client, and the ability of other creditor and/or the state to come between his company and the assignment provision. He noted that the legislation did not contain clarifying language concerning bankruptcy intervention. He noted the new provision in the bill, which allowed the right of offset by the state against the client or oil company. He remarked that the provision kept his company from realizing the value of the assigned credit. He did not want to return to the lender to obtain representation or audit review of any offsetting claims that may impact the already assigned tax credits. He noted the discussions regarding a cap on the amount paid. He shared that the cap was originally \$25 million, and the current discussion was \$200 million. He felt that \$200 million would satisfy almost everyone to keep the reimbursement of the credits at short-term. He was not concerned with a reduction of the \$200 million, and was comfortable taking a multi-year repayment obligation. He noted that the appropriations issue was the overriding issue, but did not know if that was fixable. He remarked that appropriations were assigned annually. He wanted clarification in the current legislation regarding a multi-year commitment to the program.

8:39:19 AM

Vice-Chair Saddler requested more detail related to the right of offset. Mr. Ennis replied that the current legislation had a provision that said, should the state have any claim for other taxes or license fees; or state excised tax on gasoline or diesel fuel; any claims against the oil company that assigned the credit to the bank could

be offset against the credits. Therefore, it reduced value of the credit after it had been assigned to his company.

Vice-Chair Saddler surmised that there would be other obligations that the recipient of the credit would pay back to the state before it would pay the banker. Mr. Ennis agreed, and furthered that the state a right to reduce the value of the credit.

Vice-Chair Saddler wondered how an exploration or development company would use the credits; and where ING fit into the provision of resources. Mr. Ennis responded that the credit program took between 15 to 20 months from the time that money was expended to the time that it could be reimbursed by the state. He stated that ING provided the working capital through the 20-month financing, by advancing immediate money to the company. He stated that ING was "stepping into" the oil company's rights to receive those credits when the credits were available.

Vice-Chair Saddler asked Mr. Ennis about his background. Mr. Ennis provided his professional background of which he had been a banker for over 30 years.

[8:43:33 AM](#)

Representative Gara queried an opinion on the \$25 million cap per tax credit holder. Mr. Ennis replied that \$25 million was not a very large credit amount for the types of expenditures that ING was funding. He remarked that the credits were currently designed to expire after 10 years, which would limit the total value to \$250 million. He felt that there was a significant appropriations risk under those circumstances, should the repayment be limited to ten years, as opposed to 10 months.

Representative Gara wondered if Mr. Ennis was aware of the provision of the law which was that the state, in lower revenue years, was only required to pay a lower amount of money in total tax credits. He shared that the formula for the current year resulted in a total of \$72 million; the formula in the previous year resulted in approximately \$96 million. He stressed that those provisions were in place to protect the public money, because most the state's revenue was from oil. Mr. Ennis replied that he was aware of the provisions.

Representative Gara stressed that ING was a risk-based company. He remarked that the statute that he mentioned outlined a specific risk. He wondered if that was a factor in the investment decision. Mr. Ennis responded affirmatively. He added that the bank was willing to take multi-year payment risk, which was essentially the meaning of the provision.

Representative Gara noted that the payment requirement was much lower than the historic average, because of the drastic downturn in oil price. Therefore, he wondered if the risk was still acceptable. Mr. Ennis replied in the affirmative.

Representative Wilson queried the effect on interest rates. Mr. Ennis indicated interest rates would increase.

Representative Wilson wondered if a determined time of credit delivery would affect the rate less. Mr. Ennis responded that it would help to know the tenor of the financing.

[8:48:48 AM](#)

Representative Guttenberg queried an explanation of the change of the worldwide climate on investing in hydrocarbons over the two recent years of plummeting oil prices. Mr. Ennis replied that it was a difficult market. He shared that there were certain parts of his business that were benefitting from the downturn. He shared that petro-chemicals were receiving very inexpensive feed stocks. He shared that the refining and retail entities were in a similar situation. He shared that the truck stops and gas stations were seeing a higher level of demand, which improves their provision. The upstream and major oil companies were suffering from the recent downturn. He shared that he had a group based in Houston that only did upstream oil and gas financing. That group was struggling with bankruptcies and distressed clients. He shared that he had been through a few downturned cycles, but felt that his company would get through it.

Representative Guttenberg queried the difference between the current climate and no credits at all. Mr. Ennis responded that the provided credits in Alaska were only against the tax credit, because of the small size of the companies that were financed. He shared that Fury had one

producing well in Alaska, and Brooks Range had zero operating wells; therefore, ING could not lend money against the value of their reserves. He remarked that continuing to drill wells, would create diversification and producing reserves. He stated that the ongoing commitment to provide financing in Alaska was predicated on how the state's tax credit program would continue to provide support. Currently, the small clients were too small for conventional lending.

Representative Guttenberg clarified that the bank was only lending to the small developers because of the state's tax credits. Mr. Ennis relayed that the larger companies did not go through his entities. Some of the mid-market names had not come to ING Capital to finance them.

Representative Guttenberg asked for a rough amount of loans. Mr. Ennis stated that the bank had \$150 million.

[8:55:02 AM](#)

Representative Pruitt wondered whether he had clients in other regimes who had experienced a tax increase or elimination of incentives to produce or explore. Mr. Ennis replied that the Norwegian tax credit program was very similar to Alaska's tax credit program. He shared that his counterparts in Europe had heard from the Norwegian authorities who wanted to reduce the amount of credits for the same reason that Alaska was looking to reduce credits.

Representative Pruitt asked if there were any regimes that were looking to increase incentives or lower taxes to maintain investment. Mr. Ennis responded in the negative.

Representative Pruitt believed Mr. Ennis had been very careful with his words. He mentioned that the legislature's challenge was to maintain the investing climate. He wondered how Mr. Ennis viewed the governor's version of the bill versus the current version. Mr. Ennis stated that the natural gas investors in the Cook Inlet area had been a good investment. On the North Slope it was small baby steps that he was seeing. The legacy production was enormous. He would like to keep doing business in Alaska.

[9:00:45 AM](#)

Representative Pruitt wondered how the phasing approach versus immediately eliminating the credits would affect future decisions to invest in Alaska. Mr. Ennis replied that it did not directly affect his future investments, but it caused financial uncertainty for the oil and gas companies. He did not want financial uncertainty for those companies.

Representative Pruitt shared that the legislature was facing two different approaches: a measured approach to manage its way out of the credits; or make an immediate reaction. He wondered if that risk was worth investment. Mr. Ennis replied that the approach was a political tax risk, but was routinely analyzed. He stressed that all taxes were analyzed, in all regimes. He remarked that ING hoped that it was a gradual, measured approach; as opposed to a sudden "shift of gears." He spoke in support of the proposed "phase down" of the credits.

[9:03:49 AM](#)

Representative Edgmon commented that the Cook Inlet was a high-risk and high-cost area as related to exploration. He noted that the development of Cook Inlet was a separate part of its model. He wondered if there was a consideration of the attractiveness of the Cook Inlet Basin, in terms of its potential and the smallness of the companies. Mr. Ennis viewed the Cook Inlet Basin as a local supply of natural gas in an area with no other supply available. He felt that it was a non-competitive business, with a willing buyer of the gas. The price was much higher than world or Lower-48 prices for natural gas. He felt that it was an excellent prospect to make a loan. There was long-term value to both the company and the state.

Representative Edgmon indicated that what he was hearing that the tax credits were crucial to the lending, but not the most important element to a lending determination. Mr. Ennis disagreed. He would not be financing the small player without the tax credit program.

[9:08:24 AM](#)

Vice-Chair Saddler queried the general views on the tax and credit structure as a tool for achieving the state's goals of both production and revenue. He wondered if revenue and production could be achieved with the same mechanism. Mr.

Ennis remarked that the credit program allowed development to occur, which would not have occurred without the credits. He remarked that the credit program showed significant benefit in Cook Inlet, but not as significant in the North Slope. He felt that an incentive program was a good way to "kick start" new development. He felt that, in the long run, the state would be the ultimate beneficiary as the primary royalty holder and tax collector.

Vice-Chair Saddler queried metrics to capture the values of employment stability, future prospects for continued production, or keeping the pipeline open. Mr. Ennis understood the question as whether there was tool to determine which credits to extend. He stated that the state must make a decision to provide credits to different companies based on the plan. He recalled that the state had programs to make those determinations, but were not successful, because it became like a "beauty contest" for the companies that were making the proposals. He stated that there should be a "blind" system, without trying to determine the "winners and losers."

[9:12:41 AM](#)

Vice-Chair Saddler queried a repeat of the thoughts on bankruptcy protection, and the importance of that issue. Mr. Ennis replied that at the moment of the credit assignment by the company, the credit did not mature until the filing of the tax return. He explained that a loan did not become a true security interest until the company filed its tax return. The company could file bankruptcy in the interim, so the bank could return to an unsecured place. The state could provide clarity on the topic, but felt that Mr. John Iverson could provide some suggested language to create clarity regarding the intervention of a bankruptcy while the credits fully mature.

Vice-Chair Saddler wondered if the bank wanted a stronger position in the chain of interest holders to ensure repayment of the loan. Mr. Ennis responded affirmatively.

Vice-Chair Saddler queried the tax credit protection for the lender in Norway's tax credit proposal. Mr. Ennis replied in the affirmative. He stated that, in Norway, once the assignment was executed the credit was good, regardless of the underlying company's financial standing. The bankruptcy filing did not matter, because the bank could

collect against the stat program without invention from any other creditor.

Vice-Chair Saddler queried the importance of the bankruptcy protection provision. Mr. Ennis replied that he would appreciate the provision, but furthered that the bank would continue to make loans. He stressed that there would be more scrutiny with the companies.

Vice-Chair Saddler asked about the importance of confidentiality agreements. Mr. Ennis stated that the bank had a waiver.

[9:18:00 AM](#)

Vice-Chair Saddler asked if the confidentiality provision made a big difference. Mr. Ennis stated that the legislation was public, the company information was not public. The bank was happy with the flow of information.

Representative Guttenberg commented that the rating agencies have notified the state that it needed to get its "Fiscal House" in order. He wondered how the stated would be perceived by the rating agencies. Mr. Ennis did not wish to comment.

Co-Chair Thompson thanked Mr. Ennis for being available for questions.

[9:21:17 AM](#)

JARED GREEN, PRESIDENT, ENSTAR NATURAL GAS (via teleconference), read from a prepared statement:

Good morning Co-Chair Thompson, members of the Committee, I am Jared Green, President of ENSTAR and with me is Moira Smith, Vice President and general Counsel of ENSTAR. We thank you for allowing us an opportunity to speak today. ENSTAR is here today as the largest purchaser of natural gas in the Cook Inlet. Ultimately, our customers are a beneficiary of the tax credit program that has been in place since 2012. Our customers depend on the natural gas from the Cook Inlet to heat their homes, their businesses, our schools, our hospitals and our industries. Fundamentally, our interest is the fostering of a stable and appealing natural gas environment in the

Cook Inlet. This environment needs to exist in the short term, the medium term and the long term.

Mr. Green turned to slide 1: "Natural Gas Supply Needs." He continued to read from a prepared statement:

- ENSTAR's number 1 priority is safe, reliable natural gas service to our customers.
- Founded in 1959, the same year as statehood
- Average year is 33 Bcf [Warm = 30Bcf, Cold = 35Bcf]
- Enalytica said total in state use was 80Bcf
- ENSTAR has a very high seasonality to its gas needs. Moira will explain this further in a moment, but from a high level, we generally vary by a roughly 12:1 ratio of winter to summer gas needs.
- The final aspect of setting the stage is the daily variability. We live in an environment that can have substantial variability in gas demands due to weather. With our current customer base, we have a potential daily demand of 287 mscf/d. This level of demand is most likely to occur in January of any given year. Now, we also have the potential of needing less than 100 mscf/d if we have a warm spell like we had this January.
- When ENSTAR plans its natural gas portfolio, we look many years in advance. Operating in a small closed supply network such as the Cook Inlet requires very long lead times. We need to know that we have firm gas supply set for our customers at least 2 years in advance. Anything less puts the marketplace at risk of supply shortages.
- In ENSTAR's business we must have gas available for our customers on the coldest days, no matter what. When it is 20 below on a dark January evening, every single one of our 140,935 customers must have their gas needs met.
- So, what does it mean to be a natural gas supplier to ENSTAR?
- There is no doubt, it is challenging to supply natural gas in the Cook Inlet today. ENSTAR is the largest purchaser of natural gas and we have very demanding needs as I just noted.

- Between the CINGSA storage facility and our producer contracts, we need to have the 287 mmmcf/d of gas available. However, we do not need it each and every day. This means producers need to have significant capacity beyond the average production rates. It means producers need to have the operational capability to ramp up production and also throttle it back.
- This is a very different world than the lower 48. With the integrated transmission and storage network, producers can simply drill a well, open up the taps 100 percent and the large market simply absorbs it. From the utility perspective, it is also a nice easy world down there. Utilities have a lineup of marketers trying to sell them gas. However, if a contract isn't fulfilled for any reason, they simply go back to the trading screen and source the gas from one of the thousand other suppliers lined up.

9:27:04 AM

Mr. Green continued to read from a prepared statement:

- We do not have that luxury here. We have a very small, and illiquid market with a handful of buyers and an even smaller number of suppliers. Layer on to that the fact that Conoco is selling its assets which will take another supplier out of the market and also shrink the buying market with ML&P becoming largely self-supplied.
- This leaves us in an extremely delicate marketplace.
- Now, I am not saying that the sky is falling. We are in a much better place than we were in 2012. We have transitioned from a time where we were looking at shortages, from both a total supply and a deliverability perspective. Today Moira is going to talk to you about the contract that ENSTAR has signed with Hilcorp as a key foundation in our supply portfolio. This contract takes us out to 2023, which from ENSTAR's view takes us just beyond the short term window.
- We are in a position where I have good visibility for our supply into 2021. With a continuation of activity by Hilcorp, by Furie, by the revived

Cook Inlet Energy and hopefully other new players like Blue Crest or others, I am optimistic that we can see our supply horizon moving into the 2025's, however, that statement hinges on the continued activity by these and new producers. We need to encourage and foster an environment which keeps producers engaged.

- I strongly feel that the utilities in the inlet have a responsibility for this. We have designed our supply portfolio to balance our number 1 priority of safe, reliable natural gas service, with the need to foster the long term viability of the inlet. We have put our support behind Furie's development of Kitchen Lights and we have also left open 10 percent of our supply portfolio for other producers.
- Since 2012 the State has also provided a huge support to the viability of the gas supply market in the Cook Inlet.
- ENSTAR is cognizant of the short term budget challenges facing the state. ENSTAR would love to see the State continue to help the encouragement of this marketplace in whatever form keeps it as an attractive investment for producers.

Before I pass the presentation over to Moira, I have one final note. I have mentioned, as have others over the past few days that we are in a good place in the Cook Inlet right now. And we are. However, weather has been a very advantageous tailwind over the past 2 years. We are through 2 full warm years and 2016 is tracking very balmy as well. If we had experienced 3 cold winters, the current facilities may have been stretched. As a reminder, today we only have 1 well into Kitchen Lights. There are no production wells in Cosmo. We have 4 large fields in the inlet which are old and are aging more every year. With cold weather, or even if one of the existing platforms or fields had an issue, we do not have a large contingency of backup alternatives. As this committee knows, we have no inter-ties into the lower 48 or Canada and we are 100 percent dependent on this small, illiquid market to keep half of the State's population warm.

[9:31:06 AM](#)

MOIRA SMITH, VICE PRESIDENT, ENSTAR NATURAL GAS (via teleconference), began with slide 3 "Supply and Demand." She read from a prepared statement:

This graph illustrates why, as Jared mentioned, ENSTAR is a complicated customer. Producers prefer to produce gas from wells at consistent rates. The graph depicts the variability in our customers' daily demand, as well as ENSTAR's daily supply, in 2014 and 2015. This is actual data as to which companies supplied gas each day of those years, represented in the different colors on the chart; and how much gas was consumed on each day of those two years, which is represented in the black line that tops off the chart. A couple things are worth noting:

- First, the day to day variability is marked - our customers' demand changes as the weather changes.
- Second is the seasonal variability. In some years, our customers' demand has a 12 to 1 swing from winter to summer. This means that in a day in the winter, our customers consume twelve times as much gas as on a day in the summer.
- Finally, have a look at the blue lines at the bottom of the slide. These represent CINGSA injections and withdrawals. As you can see, on cold days, ENSTAR withdrew significant volumes of gas from CINGSA to meet its customers' demand. Look for example at the middle of November 2015. For those of you who live in and around Cook Inlet, you'll remember that cold spell. It is reflected on the chart. Similarly, while last winter was overall very warm, we did have some cold weather in February. That, too, is reflected here. On warm days, ENSTAR injects gas into CINGSA. ENSTAR's withdrawal capability from CINGSA is 91 million a day; a little less than 1/3 of ENSTAR's daily demand. Having CINGSA available is critical in light of the declining production, which Enalytica detailed in their presentation.

Ms. Smith continued to slide 4: "Seasonal Average Deliverability." She continued to read from a prepared statement:

This chart is a further illustration of the seasonality of our demand. This illustrates ENSTAR's average daily deliverability in each month in 2019—again, our goal is to have 287 MMcf/day under contract

or available from storage in the coldest months of the year. Here, you can see in blue the Hilcorp contract Jared referenced, which I'll talk more about in a moment. The dark blue represents firm deliveries; the light blue represents optional volumes ENSTAR can call on if the weather is cold. The dark green represents firm deliveries under our new contract with Furie, and the light green represents optional volumes ENSTAR can purchase in cold weather. So it is important to understand that our suppliers not only provide critical volumes throughout the year, they also provide significant additional deliverability on each day in winter months.

Ms. Smith moved on to slide 5: "Supply Contract 2016-23." She continued to read from a prepared statement:

This slide projects ENSTAR's gas supply from now to 2023. Focusing on 2016 and 2017, you see ENSTAR's portfolio of relatively small contracts. Because we knew that these contracts were all expiring in 2018, ENSTAR issued an RFP in late 2014 to solicit gas to meet its customers' needs in 2018 and beyond.

ENSTAR then engaged in intensive, protracted negotiations with multiple producers and potential producers throughout 2015 and into 2016. Our first priority was to secure an anchor contract, at reasonable prices, which could form the foundation for gas supply in the post-2018 world. These negotiations took a year and resulted in APL-14, a new contract with Hilcorp that was just filed with the Regulatory Commission of Alaska on Monday.

[9:35:44 AM](#)

Ms. Smith advanced to slide 6: "(TA 280-4) APL-14 GSA." She continued to read from a prepared statement:

APL-14 is a five year contract that begins on April 1, 2018. It will supply approximately 70 percent of our customers' needs from 2018-2023. It has both firm as well as optional volumes - it will supply around 22 billion cubic feet per year of firm gas. And if you remember the light blue from two slides ago, it also offers optional volumes to help ENSTAR manage its weather related variability. This means that ENSTAR

can ramp deliveries up or down depending on its customers' needs, a key feature in light of our variable annual demand.

Another key element of the contract is its reasonable price. You will remember that, in 2013, the State of Alaska entered into a Consent Decree, which resolved an antitrust investigation and set price caps. The price caps escalated 4 percent annually. The weighted average annual price under APL-12 during its last contract year will be \$8.33 per Mcf, whereas the weighted average annual price for firm deliveries during the first contract year under APL-14 will be \$7.56 per Mcf. This is almost a 10 percent decrease in price.

Perhaps the most important feature of this contract is what it doesn't do. It does not meet all of ENSTAR's gas supply requirements. What this means is that fully 30 percent of our portfolio was left open for other producers to fill. As a public utility, we value safety and reliability above all else. And we understand the need to have a diversified supply portfolio. This not only diversifies supplier risk, but it also helps to foster investment and drilling, which is good for the long-term stability of Cook Inlet supply. Between APL-14 and the new Furie contract, ENSTAR has 90 percent of its needs met through 2021. To ensure the entire market has an opportunity to participate, we sent a second RFP to producers on Friday to try to acquire supply for the remaining 10 percent of our portfolio.

We believe this contract represents a huge measure of stability in the Cook Inlet gas market. Indeed, if approved, it will be the most significant gas contract ENSTAR has had approved in 15 years. Assuming Commission approval, we will have laid the foundation of ENSTAR's gas supply well into the next decade. Given where we were just three years ago, this is very good news.

[9:38:31 AM](#)

Mr. Green concluded the ENSTAR presentation by reading from a prepared statement:

As I noted before, we are working with a very delicate market with a small number of buyers and a very small number of producers. ENSTAR has contracts meeting most of our needs out to 2021 and 2023, but we will need to negotiate extensions in the next couple of years. It is very important to all of south central Alaska that we have a capable producer marketplace who will be there to provide the gas molecules and the deliverability that Southcentral Alaska needs.

9:39:17 AM

Representative Wilson queried ENSTAR's current credits. Mr. Green responded that ENSTAR was a purchaser of natural gas, and was then flowed through to customers. Therefore, ENSTAR did not directly receive credits. He stated that the company bought the gas from the producers who had received the credits.

Representative Edgmon noted that he did not hear any comments regarding Blue Crest. He queried more information about Blue Crest. Mr. Green replied that the Blue Crest project was the development of the oil reserves. He shared that there was a deep portion of the reservoir where the oil resided, and the shallower portion of the reservoir held the gas reserves. He stated that Blue Crest was able to access the oil from the onshore pad, but in order to access the natural gas the reservoir must be developed offshore. He stated that, currently, that portion of the development was not in Blue Crest's plan. He hoped that the gas would be developed in the future. He stressed that it required the installation of an offshore platform, development wells, and a pipeline to attach the platform.

Representative Edgmon thanked Mr. Green for the clarification.

Vice-Chair Saddler queried the impact of the credits on the improvement of the security of ENSTAR's gas supply. Mr. Green replied that the entities had already shared whether or not they invested in Cook Inlet because of the credit program. He stated that Hilcorp entered the market because of the credit program. Hilcorp was a key operator in the Cook Inlet, because they had taken over some significant fields that supplied the majority of the natural gas to south-central Alaska. Hilcorp spent approximately \$600 million to date on the erection of their off-shore

platform, and the development of their one well. He remarked that the Furie reservoir had abundant reserves, and was hopeful that it would be further developed.

[9:45:13 AM](#)

Mr. Green shared that with the removal of each molecule, the reservoir declined. He felt that Furie must continue to develop. He remarked that Hilcorp must continue to invest in its asset, even to satisfy the current contracts. He remarked that originally Buccaneer had drilled a well in the Cook Inlet, because of the credit program. He stated that Buccaneer had experienced a financial bankruptcy, and AIX Inc. had received assets after the bankruptcy. He stated that there were debtors who took issue with the bankruptcy, but the molecules continued to flow into the system. He stated that, from ENSTAR's perspective, the bankruptcy presented a risk, but the molecules continued to bring value to customers. He reiterated that the credits were helpful to encourage the current producers to complete their work. He noted that a slight pause in development and drilling activities could cause a shortfall in the reserve development. He stressed that the molecules must be available to stay warm.

Vice-Chair Saddler asked about the stepdown provisions versus completely eliminating the credits. Mr. Green commented that if the credits had to be reduced a stepdown would be a much more stable action. An abrupt action would be more harmful. He advocated predictability and stability.

[9:49:57 AM](#)

Representative Gara remarked that the Henry Hub price for natural gas was close to \$2 and MCF, but the Alaskan price was more than triple that amount. He remarked that, without cash subsidies from the state, the price could go even higher. He wondered why the high cost of the natural gas was not a factor in attracting companies to explore when a new contract became available. Mr. Green responded that companies know of the high cost of development and drilling. The prices reflect the cost of the development activities. He stated that new producers will invest, if there was a stable marketplace. He agreed that the Cook Inlet was currently appealing, but producers did not make decisions simply on the cash flow over a 12-month period. He stressed that the greater stability in the forecast

periods resulted in producers continued investment interest. He looked at slide 3, which identified the challenge of being a producer in the Cook Inlet. He encouraged the committee to relate the slide to a producer in the Lower-48. He stated that a producer in the Lower-48 would open a level to its most efficient producing level, and was left running full tap. That well would be produced at a flat-line basis, which was how producers wanted to produce that gas. He stressed that when his company negotiates with producers, the producers want to produce at a flat-line basis. Those producers wanted to sell "flat gas" for the entire year to ENSTAR. He pointed out that, as reflected in slide 3, ENSTAR could not buy "flat gas" for the entire year. He looked at the top red line, which was the maximum needs for deliverability. A Lower-48 producer would be able to "color everything below" the top red line and call it "cash flow." He stressed that because of the deliverability needs in the Cook Inlet, the producers must build their assets to very robust levels in order to reach the peak winter needs-but they did not get to sell it year-round. The summer months did not provide much cash flow to the producers. The deliverability required overproduced assets, which resulted in higher costs.

[9:55:14 AM](#)

Representative Gara wondered if the buyers were dropping out because of the higher cost of gas. Mr. Green replied that the price change followed the actions, from a Cook Inlet perspective. He remarked that he saw the world LNG price drop from nine dollars to five dollars. He stated that it was a good and challenging market. He looked at the larger projects, which was looking at a market that was much different than it was at the point of initial investment. He stated that the ConocoPhillips LNG facility was looking at world LNG prices, and did not feel that there would be much LNG produced in that facility. The Agrium facility was shut down because of the market prices and overall supply cost to produce throughout the world. He stated that the price was more driven by the customer need, rather than the producer need, once more producers dropped out.

Representative Gara remarked that the state did not receive any production tax revenue from Cook Inlet, however there were many tax credits granted to Cook Inlet. He shared that many industry people had admitted that the tax structure

was unsustainable. The governor had hoped to finance the producers at a better interest rate than the private market. He wondered why financing was not considered a decent way to move forward. Mr. Green replied that there were many ways to address the problem. He felt that the best solution was to maintain predictability.

10:00:40 AM

Vice-Chair Saddler had heard that loans from Alaska Industrial Development and Export Authority (AIDEA) would not bring much value and would only be replacing a traditional lender. He stated that the credits allowed the producers to receive 8 percent of financing in addition to the valuable credit, as opposed to 20 percent. He queried the impact of reopening Agrium on the gas supply in south-central Alaska. Mr. Green replied that ENSTAR was originally opposed to the ConocoPhillips LNG facility being approved to export natural gas, seven years prior. He stated that, at that time, the molecules would not be available for local markets. He stated that ENSTAR had changed its views, and had supported the most recent applications from ConocoPhillips. He explained that ENSTAR was currently supporting those applications, because encouraging a stronger demand market increased the supply attraction. He felt that reopening Agrium, with the supply to run the facility, would result in fairly active producers in the Cook Inlet to supply the needs. The active producers in the Cook Inlet would benefit ENSTAR's overall needs. He stated that a large industrial load would provide a greater security to the freezing weather, because of the greater supply of gas. Therefore, the large industrial load would benefit ENSTAR. He stated that, over the long run, the producers will follow the gas demand.

Vice-Chair Saddler understood that most export licenses included provisions that forced the export of gas to halt in order to fund domestic needs. He looked at slides 4 and 5, and queried the role of the Cook Inlet natural gas facility, CINGSA, had in tax situation. He noted that there was no supply forecasted up until 2018. He wondered if CINGSA ceased to exist moving forward, or was it too small to register. He queried CINGSA's role in the long-term gas supply forecast. Ms. Smith replied that slide 4's graph represented average daily deliverability on any day in the depicted months. She explained that, as ENSTAR forecasted its supply for the months from 2019 to 2021, the injections

were forecasted. The withdrawals would occur, but would occur on colder than average days. Therefore, they would not be depicted in the graph. She noted that the total in January was the total deliverability of approximately 148 million cubic feet per day. She explained that the peak day was 287 million cubic feet per day, and any day could be between 100 million and 287 million in the winter time. She stated that CINGSA provide 91 million cubic feet per day, would be important in the winter supply withdrawal strategy well into the future. She looked at slide 5, and explained that ENSTAR had a 20-year contract with CINGSA that ended in 2032. She explained that the slide forecasted the gas that would be purchased to put into CINGSA. She stressed that storage supply was part of the forecast. The slide only reflected what was purchased from the marketplace. She furthered that slide 3 clearly depicted the actual way that ENSTAR used CINGSA.

[10:08:10 AM](#)

Vice-Chair Saddler surmised that he should not consider that CINGSA was included in the undesignated supply. Ms. Smith answered in the affirmative.

Representative Pruitt wanted to understand at what point in time the ramifications were understood. He stated that it took until 2010 until there was a decision by the legislature to address what had reached a critical mass. He discussed that between 2010 and 2012 the state had started to see the brownout drills. He was concerned about the lag time. Mr. Green stated that the point would be in 2023, but it could occur in a terrifying emergency. He shared that ENSTAR examined its gas supply portfolio in the short-term, medium-term, and long-term scenario. He stressed that ENSTAR was expecting to be the natural gas distributor in south-central Alaska for many decades in the future. He stated that ENSTAR wanted a stable supply environment, so the "ups and downs were scary." He stated that there was a fortunate scenario in Hilcorp's entering the marketplace. He reiterated that the credits were a factor in Hilcorp's entering the marketplace.

[10:14:31 AM](#)

Representative Pruitt assumed that the price point allowed a recovery at a reasonable profit, and reinvest to ensure a supply through 2023. He wondered if there was an

opportunity to invest beyond 2023. He asked if the customer would be charged for the initial costs to continue to add to the reserves, to go beyond 2023. Mr. Green responded that ENSTAR contracted with the producers to provide at a high winter rate. The peak rate delivery was the most challenging aspect of the producer's ability to build their assets. He shared that, if the producers chose to not continue to invest after 2023, the reserves would not cease to exist, but there may not be a daily deliverability at the needs of the Cook Inlet.

[10:18:32 AM](#)

Co-Chair Thompson invited Mr. Alper to comment on the presentation.

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, asked for guidance of where to begin.

Co-Chair Thompson requests comments on the current investment climate.

Mr. Alper stated that ING, Bank of America, and other larger operators joined the Alaska market three years prior in response to legislation that enabled the credit payments to be directly assigned to the bank. He stated that DOR was directly writing the check for the credit to the bank. He stated that it had developed a "greater than first priority" in the terms of a secured loan. He commented on the assertion that the security did not mature until the underlying net operating loss was patented at the end of the year; therefore, the entity was in a position of a secured lender. He stated that money was lent against the tax credits, but the companies were not lending the entire company lend. He explained that, with an expectation of a percentage of money through the tax credit program, the entity would only lend what was expected to be available in the form of the credit. The companies still needed to seek other financing for the remaining project costs. He stated that, by changing the credit program, there was a shift of balance to need more money at the high interest and could not access the money at lower interest.

Co-Chair Thompson felt that the legislation would have a negative effect on the number of jobs; exploration; and development. Mr. Alper replied that it was difficult to determine the impact of the tax structure change, because

of the decline in the oil price. He stressed that the industry was "retrenching" in response to the legislature's actions. He stressed that production had slowed down as a result of the low oil price. He remarked that many companies had halted work, but were holding onto their leases while waiting for the market to return. He shared that Black and Veatch had a methodology called "The Tornado Diagram." The diagram had wide swaths of variables, and looked like a tornado. He stated that the largest variable for any of the projects was the price of the resource. He furthered that interest rate, risk, and other variables were of secondary or tertiary importance. He stressed that the program would not "make or break" the market. He remarked that that the program was not a jobs program, rather it was in place to encourage investment in the oil and gas industry. He remarked that there should be an expectation of a reasonable return on the state's investment.

[10:24:59 AM](#)

Representative Wilson queried the modeling on the assertions. She felt that the Cook Inlet, Middle Earth, and North Slope must be divided, because they were very different from each other. She wondered if the administration had analyzed the impact on removing all credits in Cook Inlet. Mr. Alper replied that there had not been specific analysis of the elasticity of changing one factor.

Representative Wilson remarked that micromanaging and drastic decisions were each poor decisions. She queried proof that the proposal would not crash the market. Mr. Alper replied that, under current law, the state provided 50 to 60 percent of an ongoing development project in Cook Inlet. He stressed that it was a larger number than anything in history. He stated that the credit was intended to be large, because of the potential crisis in utilities. He stressed that the state wanted all pilot lights going. He remarked that the credit had resulted in better emergency preparedness. The intention of the legislation was to provide a level of support that was keeping with a mature basin.

[10:32:21 AM](#)

Representative Wilson wondered why the Cook Inlet was not taxed in the same manner as the North Slope. Mr. Alper suggested that a legislator would have to initiate a Cook Inlet tax in the following 5 years. He stated that, without a legislative change before 2022, there was an awkward and unstable tax regime in Cook Inlet. It had a 35 percent net tax, but a 25 percent NOL, with no per barrel credit. He stressed that there should be a Cook Inlet tax.

Representative Wilson felt that the state did not need to reinvent the tax regime. She opined that Cook Inlet should not be considered greater than other locations in the state. She stressed that the tax credits were already in place, and felt that the same tax structure on the North Slope could be used in Cook Inlet. Mr. Alper agreed that an immediate change the tax regime would be to apply SB 21 statewide. He felt that there would need to be discussion about the definitions about new GVR oil, and whether the criteria in SB 21 was appropriate for the entire state. There needed to be a per barrel credit for gas, which did not currently exist in SB 21.

[10:36:30 AM](#)

Representative Gara surmised that, under the governor's proposal, a 25 percent credit would be retained. He wondered if the small producer credit would be retained in the proposal. Mr. Alper replied that the governor was not looking to modify the small producer credit in the bill, with the exception of the floor-hardening provisions. The small producer credit was sun-setting over the next few years. He explained that the credit said that you must apply and receive the small producer credit, with first production before May 1, 2016. He stated that receiving the credit by that deadline, allowed for a claim of up to \$12 million per year for the first nine years of production. He explained that someone could keep the credit through 2024. Furthermore, the producers who had received the credit at its initiation would be required to pay the tax without the credit beginning the current or following year.

Representative Gara wondered why the administration found the limitations of Cook Inlet to be in the state's best interest in the state loan program. Mr. Alper replied that, currently AIDEA was already in the business of lending to entities across the state. He remarked that AIDEA had made several high-profile loans in the oil and gas industry. He

remarked that AIDEA was required to have balanced and diversified multi-sector portfolio, but oil loans were fairly large causing an unbalance in the portfolio. Therefore, AIDEA felt that there should be a dedicated fund for oil and gas. He remarked that within that dedicated fund, AIDEA was able to negotiate competitive interest rates. He remarked that there was also a provision for AIDEA that allowed AIDEA to defer payments, or lend money to an oil project without requiring payments of principle or interest for four or five years until the company began production. He stressed that traditional financing did not often offer payment deferment. He remarked that the combination of deferred payment and the continuation of the 25 percent operating loss credit, seemed to ensure that the companies could continue with the development projects.

[10:40:33 AM](#)

Representative Gara surmised that there was an intention to repay the existing tax credit system with a cap of \$25 million per year. Mr. Alper replied that there were currently \$675 million in credit applications. He shared that the FY 18 payments was mostly related to operating losses and expenditures for calendar year 2016. He stressed that calendar year 2015 was recently ended, which was mostly FY 17 credit expenditures. He remarked that it was related to the tax-filing deadline, with a 120 statutory turnaround that required certificate issuance. He remarked that the bulk of the NOL certificates were issued in July and August, and the companies immediately asked for more money.

Representative Gara thought the \$1 billion was to capitalize AIDEA. He wondered if \$1 billion was intended to pay all the past-due tax credits. Mr. Alper replied that the \$1 billion was intended to pay the past-due and anticipated future tax credits. It also was for the additional \$200 million fund capitalization in the AIDEA proposal.

[10:44:19 AM](#)

Vice-Chair Saddler queried the guiding principles in proposing HB 247. He wondered if the tax credit system was achieving the goals of the program; and was the tax credit program providing enough revenue to the state. He wondered if the legislation was a "money maker" or tax credit

reform. Mr. Alper replied that the legislation was primarily tax credit reform. He commented that that the legislation would be considered a "money maker" as related to AIDEA.

Vice-Chair Saddler wondered if the legislation deprived the oil producers the ability to recover losses from individual fields. Mr. Alper responded that the provision was intended to be at a field-by-field level. He explained that, should a field have a gross value below zero, it would be incorporated into the calculation as a zero. Therefore, it would not be used to offset positive value elsewhere.

Vice-Chair Saddler restated his question. He wondered if the prohibition against gross value at the point of production against going below zero deprived the industry of the ability to deduct that loss in the calculation. Mr. Alper replied in the affirmative as related to the portion that brought the gross value below zero. He explained that the company would still enjoy the full value of its lease expenditures, which was the difference between the gross value and net value.

HB 247 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson reviewed the agenda for the afternoon.

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ADJOURNMENT

10:51:27 AM

The meeting was adjourned at 10:51 a.m.