

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

May 3, 2017

1:01 p.m.

MEMBERS PRESENT

Representative Andy Josephson, Co-Chair
Representative Geran Tarr, Co-Chair
Representative Dean Westlake, Vice Chair
Representative Harriet Drummond
Representative Justin Parish
Representative Chris Birch
Representative DeLena Johnson
Representative George Rauscher
Representative David Talerico

MEMBERS ABSENT

Representative Mike Chenault (alternate)
Representative Chris Tuck (alternate)

COMMITTEE CALENDAR

HOUSE BILL NO. 238

"An Act relating to the payment of rents and royalties from oil shale leases; and relating to royalties for certain areas in the Cook Inlet sedimentary basin."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 238

SHORT TITLE: REPEAL ROYALTY RELIEF: SHALE; COOK INLET

SPONSOR(s): REPRESENTATIVE(S) GUTTENBERG

04/24/17	(H)	READ THE FIRST TIME - REFERRALS
04/24/17	(H)	RES, FIN
05/03/17	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

REPRESENTATIVE DAVID GUTTENBERG
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Speaking as the sponsor, presented HB 238 and answered questions.

ED KING, Special Assistant
Office of the Commissioner
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions during the hearing of HB 238.

ACTION NARRATIVE

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CO-CHAIR GERAN TARR called the House Resources Standing Committee meeting to order at 1:01 p.m. Representatives Tarr, Birch, Parish, Talerico, Drummond, Johnson, Westlake, and Josephson were present at the call to order. Representative Rauscher arrived as the meeting was in progress.

HB 238-REPEAL ROYALTY RELIEF: SHALE; COOK INLET

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CO-CHAIR TARR announced that the only order of business would be HOUSE BILL NO. 238, "An Act relating to the payment of rents and royalties from oil shale leases; and relating to royalties for certain areas in the Cook Inlet sedimentary basin."

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REPRESENTATIVE DAVID GUTTENBERG, Alaska State Legislature, sponsor of HB 238, informed the committee in 2014 Representative Thompson proposed a bill to explore all the [indirect] expenditures and tax credits that are not included in the budget. Representative Guttenberg referred to a report entitled, "Evaluating Indirect Expenditures: Tax Credits," issued by Legislative Finance Division, Legislative Agencies and Offices, and said members of the [Natural Resources Budget Subcommittee, implemented by the House Finance Committee and chaired by Representative Guttenberg] reviewed the Department of Natural Resources (DNR) expenditures to determine if certain expenditures warranted further review. Subsequently, Representative Guttenberg's staff reviewed all questioned DNR expenditures, and in certain instances royalty relief was identified by Legislative Finance Division as expenditures warranting action "because they didn't see what was going on."

Representative Guttenberg advised royalty relief directed by the commissioner [of DNR] would not have gone before Legislative Finance Division and [the bill] identifies three specific expenditures and tax credits. On 5/2/17 Representative Guttenberg was told by a representative of Furie Operating Alaska (Furie) - a member of the Alaska Oil and Gas Association (AOGA) - that two of the expenditures identified in the bill are of value [to the producers]. Therefore, two items in section 2 were removed from the bill, and the bill now only addresses the issue identified in section 1, which is a tax credit enacted in 1959 that has had no activity for the last five years. Further, Legislative Finance Division informed Representative Guttenberg that although the program is not meeting its legislative intent, the division recommended the statute remain because there is no cost to administer the program, and it could be used in the future. He remarked:

... I wanted to put that in front of you, that this has been a process of trying to determine what is the most important thing to do with these expenditures: Are they, have they been used? Are they relevant to the state? And [the bill is] rendered down through all of them to this section 1, this one by itself which doesn't cost anything, and nobody uses.

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CO-CHAIR JOSEPHSON asked Representative Guttenberg to identify the information provided by Legislative Finance Division.

REPRESENTATIVE GUTTENBERG said the documents he referred to are from the DNR portion of the Indirect Expenditure Book (IE Book), wherein DNR waived rent and royalty for shale oil [pages 109 and 110, included in the committee packet].

CO-CHAIR JOSEPHSON asked if the notification by Furie that two of the credits are in use means "we should abandon section 2 and just focus on section 1."

REPRESENTATIVE GUTTENBERG related Furie desires the credits in section 2 to be modified so they can be used by Furie. He added instead of repealing the statutes, the legislature may want to amend what is in existing statute, and he recommended deleting section 2 prior to moving the bill out of committee.

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CO-CHAIR TARR directed attention to the analysis portion [page 2] of Fiscal Note Identifier: HB238-DNR-DOG-04-28-17, which read [original punctuation provided]:

Analysis

This bill removes the Department of Natural Resources (DNR) Commissioner's discretion to waive payment of royalty and rental during the first five years of an oil shale lease under AS 38.05.160(b). DNR is unaware of any oil shale leases or activities ever occurring in Alaska since this statute was enacted in 1959 or planning to be conducted in the future. Accordingly, DNR does not anticipate a fiscal impact to removing the language in AS 38.05.160(b).

This legislation also repeals AS 38.05.180(f)(5). This is the 10-year royalty reduction to 5% for six specific fields in Cook Inlet that were historically shut in or undeveloped between 1988 and 1997. The last royalty relief under this provision expired in FY2012. Since this provision is no longer applicable and the last royalty relief has expired, terminating the royalty relief in 38.05.180(f)(5) will not have any fiscal impact.

Finally, this legislation repeals AS 38.05.180(f)(6) for leases that are entered after the effective date of this bill. Companies currently receiving royalty relief under this provision will continue to receive that relief. As such, DNR does not anticipate any fiscal impact by removing this provision for new leases.

For completeness, the provisions AS 31.05.030(i), 31.05.030(k), and 38.05.180(dd) also being repealed by this bill are no longer relevant once AS 38.05.180(f)(5) and (6) are repealed.

CO-CHAIR TARR concluded the provision [identified in the bill] is an unused provision and the bill does not eliminate a program in use, but seeks to clean up statutes related to oil and gas tax provisions.

REPRESENTATIVE BIRCH asked what is the motivation behind the bill.

REPRESENTATIVE GUTTENBERG informed the committee the motivation is to review the credits and expenditures to confirm that they are meeting legislative intent; all the credits and expenditures related to DNR were reviewed, and many are in use, and the

sponsor did not address those in use. The three found not to be in use were included in HB 238, and he restated the representative from Furie said provisions in section 2 are valid. Thus, the bill is rendered down to section 1, which is a credit established in 1959 and that has remained unused for the last five years. He clarified the bill is not about the value of the tax credits, but the purpose was to follow through with the intent of the indirect expenditure report.

CO-CHAIR JOSEPHSON expressed his understanding that the committee is not to delve into the merits of the [indirect] expenditures used by Furie, but is to consider repealing the provisions not in use.

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REPRESENTATIVE GUTTENBERG related Furie would like to see the credits in section 2 modified to fit the needs of the industry. However, that is not the intent of HB 238, which is to review the [indirect] expenditures relevant to DNR.

CO-CHAIR TARR further explained section 2 would have repealed AS 38.05.180(f)(5), which is a ten-year royalty reduction to 5 percent for six specific fields in Cook Inlet shut-in or undeveloped between 1988-1997. She suggested industry may be interested in this and related provisions.

REPRESENTATIVE JOHNSON asked the sponsor whether there is any opposition to the bill.

REPRESENTATIVE GUTTENBERG restated he was contacted by a representative from Furie who seeks to amend and expand section 2. He pointed out the intent of the bill is not to repeal provisions that are in use by industry.

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ED KING, Special Assistant, Office of the Commissioner, DNR, stated DNR is largely indifferent as to whether the provisions in the bill are repealed or not. He clarified Furie is not using the current royalty relief provisions, but seeks an amendment to the current provisions so that Furie would be eligible to receive [benefits] from the current provisions.

CO-CHAIR JOSEPHSON asked why Furie is currently ineligible.

MR. KING explained the provision within AS 38.05.180(f)(5) was enacted in 1988 for fields not in production at that time. Furie is currently producing gas from the Kitchen Lights Unit in central Cook Inlet which was developed around 2006. Subsequent legislation, AS 38.05.180(dd), placed a restriction that production must have been in place prior to 2004 for eligibility, thus Furie is not eligible. Furthermore, AS 38.05.180 (f)(6) is directed at oil production from Cook Inlet platforms, so Furie is not eligible under that provision either.

CO-CHAIR JOSEPHSON acknowledged a difference of opinion between the House and Senate related to [House Bill 111, passed in the Second Special Session of the Thirtieth Alaska State Legislature] and asked if Furie seeks to lift the sunset [provision], what that action would cost the state.

CO-CHAIR TARR asked Mr. King to direct his response more broadly to the industry and not to the economic impact on one specific operator.

MR. KING clarified he was not speaking on behalf of a member of the industry; however, [Furie] would not meet the current definitions of the current law, and he suggested a representative from Furie may want to submit testimony on the bill.

CO-CHAIR JOSEPHSON stated he was unclear as to Furie's position.

REPRESENTATIVE GUTTENBERG expressed his understanding that Furie seeks to expand and amend the statute, so they would be eligible for royalty relief, because they are looking for a gas supply for the Interior.

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CO-CHAIR TARR read from AS 38.05.180(dd) as follows:

A lessee is eligible for the royalty relief in (f)(5)
... only if production of oil or gas for sale begins
from the eligible field before 1/1/2004.

MR. KING said correct, and pointed out that the field from which Furie is producing is not enumerated within (f)(5), and therefore is not eligible for that reason also.

REPRESENTATIVE PARISH questioned if the statute is changed, would [Furie] receive royalty relief on a field already in production.

MR. KING, in response to Co-Chair Tarr's caution about references to a specific operator, stated all the information related to payments of royalties is public and available at DNR's web site, thus he can speak about the amount of royalty paid by an individual company. In response to Representative Parish, he said Furie is currently producing from the Kitchen Lights Unit and if certain changes are made to eligibility for royalty relief, Furie's royalty payments would be reduced from 12.5 percent.

REPRESENTATIVE GUTTENBERG, in response to Representative Parish's question as to why the state would make changes to decrease royalty payments, explained in order to make gas affordable in the Interior, royalty relief is needed, and "that would be one of the reasons why we might want to do that."

REPRESENTATIVE PARISH observed if the state wished to subsidize the cost of energy for its citizens, there are other ways to do so without giving money to the producer.

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REPRESENTATIVE GUTTENBERG pointed out the bill would only keep existing statutes "on the books" and allow further discussion between the legislature, industry, and the commissioner of DNR.

MR. KING informed the committee AS 38.05.180(j) grants the authority to the commissioner to offer or allow a modification or reduction in royalties, following a process in which the commissioner determines it is in the best interest of the state to do so for the purposes of putting a field into production, or maintaining production at the end of field life, thus a company can petition the commissioner of DNR for royalty relief due to economics. He stressed the provisions in (f)(5) and (f)(6) are direct royalty relief made by the legislature, not by the [DNR] commissioner.

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The committee took a brief at-ease.

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CO-CHAIR JOSEPHSON posited if a company does not qualify due to the location of the field or that the lease has sunset, but still seeks to expand geographic and time limitations, that would require a new bill. He questioned why the legislature would not repeal provisions that are not being used.

REPRESENTATIVE GUTTENBERG stated the bill before the committee does not include credits and tax credits that are in use by industry; in fact, an earlier response from industry would probably have led to withdrawal of the bill.

CO-CHAIR JOSEPHSON recalled previous legislation gave him the view that [indirect] expenditures are "things for which we don't receive funds, and in fact, we spend money that is at our discretion." Furthermore, regarding legislative policy, he pointed out the House Finance Committee co-chair expressed interest in searching for [indirect] expenditures that could be eliminated and to save money.

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REPRESENTATIVE GUTTENBERG stressed the bill has no cost without further legislation authorizing changes to statute. In response to Co-Chair Josephson, he said [AS 43.05.095(d)] defines an indirect expenditure as follows:

(d) In this section, "indirect expenditure" means an express provision of state law that results in foregone revenue for the state by providing

- (1) a tax credit or other credit;
- (2) an exemption, but does not include federal tax exemptions adopted by reference in AS 43.20.021;
- (3) a discount;
- (4) a deduction, but does not include costs incurred in the ordinary course of business that are deducted in the calculation of a tax under this title or in the calculation of a royalty or net profit share payment for a lease issued under AS 38;
- (5) a differential allowance.

REPRESENTATIVE GUTTENBERG further explained indirect expenditures "go all through our tax policy" and are evaluated on an annual basis.

REPRESENTATIVE TALERICO clarified Alaska Statutes cover many different operations such as non-conventional gas plays and

traditional reservoirs; the bill specifically relates to oil shale plays and thereby is "limited to just that one particular form of development, and ... a traditional reservoir wouldn't, wouldn't have an application here."

REPRESENTATIVE GUTTENBERG suggested during subsequent hearings, HB 238 may be modified or amended, "to make sure it works for a variety of people."

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MR. KING further clarified the provision within section 1, AS 38.05.160(b), is a mining provision, not an oil and gas lease provision; for example, the leasing activities of Great Bear Petroleum are not impacted by the repeal of said provision. He described the process of oil development from mining oil shales source rock, which is a process developed in the 1950s that was thought to be the next breakthrough technology in energy. Mr. King cautioned against confusing oil shale mining of rock, with shale oil production, which is now known as tight oil production, as seen in [the Bakken Formation, North Dakota] and other places. In response to Co-Chair Josephson, he confirmed oil shale does not equal shale oil.

CO-CHAIR TARR asked Representative Guttenberg to provide copies of an email [document not provided].

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MR. KING informed the committee DNR is indifferent to the removal or retention of the provision in section 1 because the provision has never been used and is not expected to be used. Similarly, DNR is also indifferent to AS 38.05.180 (f)(5), which provisions have largely expired; however, the provisions in AS 38.05.180(f)(6) are being utilized, but because the transition language in the bill holds harmless any affected leases, DNR is indifferent.

CO-CHAIR TARR noted Mr. King was referring to the bill on page 2, lines 3-5, which read:

TRANSITION. AS 38.05.160(b), as amended by sec. 1 of this Act, and the repeal of AS 31.05.030(i), 31.05.030(k), AS 38.05.180(f)(5), 38.05.180(f)(6), and 38.05.180(dd) by sec. 2 of this Act, apply to a lease entered into on or after the effective date of this Act.

CO-CHAIR JOSEPHSON asked for DNR's stance on the bill if section 2 were enacted with the transition language.

MR. KING stated as the bill is written, with the transition language in place, there is no impact on DNR or on the industry.

REPRESENTATIVE GUTTENBERG remarked:

As it's still being used, we would not see it in statute, we would not know it was being used, so that would be a consideration for you to have.

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[HB 238 was held over.]

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ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 1:37 p.m.