

HOUSE FINANCE COMMITTEE
April 4, 2024
1:34 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Bryce Edgmon, Co-Chair
Representative Neal Foster, Co-Chair
Representative DeLena Johnson, Co-Chair
Representative Julie Coulombe
Representative Mike Cronk
Representative Alyse Galvin
Representative Sara Hannan
Representative Andy Josephson
Representative Dan Ortiz
Representative Will Stapp
Representative Frank Tomaszewski

MEMBERS ABSENT

None

ALSO PRESENT

Representative George Rauscher, Sponsor; Craig Valdez, Staff, Representative George Rauscher; John Crowther, Deputy Commissioner, Department of Natural Resources; Derek Nottingham, Director, Division of Oil and Gas, Department of Natural Resources; Representative Tom McKay, Sponsor; Trevor Jepsen, Staff, Representative Tom McKay.

PRESENT VIA TELECONFERENCE

Jhonny Meza, Commercial Manager, Division of Oil and Gas, Department of Natural Resources; Brandon Spanos, Acting Director, Tax Division, Department of Revenue.

SUMMARY

HB 223 TAX & ROYALTY FOR CERTAIN GAS

HB 223 was HEARD and HELD in committee for further consideration.

HB 387 OIL & GAS TAX CREDIT: JACK-UP RIG

HB 387 was HEARD and HELD in committee for further consideration.

Co-Chair Foster reviewed the meeting agenda.

#hb233

HOUSE BILL NO. 223

"An Act relating to the production tax and royalty rates on certain gas; and providing for an effective date."

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REPRESENTATIVE GEORGE RAUSCHER, SPONSOR, introduced HB 223. He read the sponsor statement (copy on file):

House Bill No. 223 represents a crucial step in revitalizing Alaska's critical natural gas industry in the Cook Inlet sedimentary basin and acts as a legislative response to the impending natural gas availability shortage. This bill addresses a longstanding barrier to new investment and production in this sector: the current royalty rates. By proposing strategic modifications to these rates, HB 223 aims to elevate Alaska's competitiveness and attractiveness for natural gas investments in new and underutilized fields.

This legislation introduces a significant adjustment to the royalty rates and payments structure for certain oil and gas production, by reducing the royalty payments to zero for qualified new gas and cutting the minimum fixed royalty share by 50% for qualified new oil, this legislation creates a more favorable economic environment for energy companies to invest in untapped resources. These incentives are designed to catalyze the commercial production of oil and gas from fields or pools that have not been

previously utilized for commercial sale before January 1, 2024.

This legislation is a testament to Alaska's commitment to fostering innovation and investment within the energy sector, addressing the immediate challenges faced by the Cook Inlet and Railbelt region, and laying the groundwork for a prosperous and energy-secure future. The enactment of House Bill No. 223 will mark a significant step forward in achieving these objectives, demonstrating Alaska's proactive approach to energy policy and economic development.

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CRAIG VALDEZ, STAFF, REPRESENTATIVE GEORGE RAUSCHER, read the sectional analysis (copy on file):

Section 1: AS 38.05.020(a)

Page 1, lines 7,8

This section amends the Authority and Duties of the Commissioner so they shall make determinations under new subsections (mm) and (nn)

Page 1, lines 9 through 12

Directs the Commissioner to adopt regulations as necessary to carry out subsections (mm) and (nn), including differentiating qualified new oil and gas production from existing fields or pools.

Section 2: AS 38.05.180

Page 1, lines 14 through Page 2, line 9

A new subsection, (mm), is added to introduce terms for complete payment of royalties due to the state for qualified new gas and oil produced from the Cook Inlet sedimentary basin, specifying a zero royalty for qualified new gas and a 50% minimum fixed royalty share for qualified new oil, under certain conditions.

Page 2, lines 11 through 26

A new subsection, (nn), is added to define "qualified new gas" and "qualified new oil," including criteria based on production commencement dates and economic feasibility of producing from new wells.

Section 3:

Page 2, line 27

Repeal of Sections AS 31.05.030(i), AS 38.05.180(f)(5), and AS 38.05.180(dd): Simplifies the

regulatory framework and aligns provisions with the current needs of Alaska's oil and gas industry, removing outdated or redundant criteria to encourage development and streamline operations.

Section 4:

Page 2, line 28

This Act takes effect immediately under AS 01.10.070(c).

Co-Chair Foster asked if the sponsor would like to comment.

Representative Rauscher added that there had been a couple of different versions of the bill, but the core of the bill remained relatively the same. The governor and his staff decided that the governor's version of the bill would merge with the existing version and elements from both bills would be combined. He explained that a representative from the administration was also available to talk about the bill.

Co-Chair Foster suggested that the Department of Natural Resources (DNR) give its presentation.

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JOHN CROWTHER, DEPUTY COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, introduced the PowerPoint presentation "HB 233 Tax and Royalty for Certain Gas" dated April 4, 2024 (copy on file). He explained that Mr. Derek Nottingham would be providing the majority of the presentation. He hoped the presentation would help the committee understand the mechanics of the bill. The slides would detail the projected outcome of the bill, which was influencing new oil production.

DEREK NOTTINGHAM, DIRECTOR, DIVISION OF OIL AND GAS, DEPARTMENT OF NATURAL RESOURCES, began on slide 2, which detailed the "runway" of Cook Inlet gas with the maximum state fiscal incentives. The slide did not reflect the specific impacts of HB 223, but examined the runway, which was the amount of gas that could be available if the state's fiscal system, production taxes, state property tax, and royalty were maxed out or taken to zero. He explained that the blue line was the forecasted runway. The gray line represented that technical forecast and did not include the commercial aspects of the individual fields and

pools. The gray line was Cook Inlet's gas capability excluding any real commercial constraints. By simply reducing the fiscal system, the runway would build out to about 2029 and the shortfall would be below the 70 billion cubic feet (BCF) parameter. The projects that could be coming online in Cook Inlet could create a surplus if the projects were activated within the projected timeframe. The maximum runway was represented by the black dashed curve which showed when gas would be sold into storage, put away for later use, and then sold into the market in the future. The chart indicated that if the gas was brought online by 2037 and properly incentivized, it could be in the "cooking lab."

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Mr. Crowther noted that there was a large amount of information on the slide. He thought that it was consequential to show that it was valuable to energy supplies if the fields could be brought online and continue to produce. The continuation of the fields would be dependent upon provisions found in HB 223 and similar pieces of legislation. He asked if there were questions.

Representative Josephson understood that the technical forecast was synonymous with the term "no commercial restraints." He asked if Mr. Nottingham could elaborate.

Mr. Nottingham responded that he meant that if the market was in line with the current fields and operating at a certain cost, the fields would continue to decline. He explained that as the fields declined, the per thousand cubic feet (MCF) cost increase in some fields within the next few years would not allow the fields to generate positive cashflow. The fields represented by the blue line would shut down because the fields would no longer be able to sufficiently operate at a profit. The technical forecast assumed that there was no requirement for a positive cashflow and the fields would technically be able to continue to produce if economics were not a factor.

Mr. Crowther added that the cost presumptions, while presented to be informative, were technical and complex. He noted that the cost holding and the untruncated forecast did not take the consumer price into account. There was a price interplay that was not depicted on the chart but was an interesting proxy for what could be recovered

irrespective of cost. If consumer prices dramatically escalated, the gray line could become more accurate than the blue line. He stressed that consumers would bear the cost. He remarked that it was a rough description of a very complex set of assumptions and deductions.

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Representative Galvin had a question related to the tan colored portion of the chart representing known but undeveloped gas resources. She asked whether DNR currently had the authority to reduce the royalty if it would make a project more economic.

Mr. Nottingham responded that there were specific statutes that allowed the department to reduce royalties. One of the issues was that the statutes had strict requirements in order to prove that the royalty modification was necessary. The process was lengthy and the outcome was uncertain for companies. He felt that it was important to provide certainty to potential developers in the Cook Inlet.

Representative Galvin asked Mr. Nottingham why there was a need for something more broad-based and infinite. She understood that the department could already reduce royalties and it was not helping.

Mr. Crowther responded that Representative Galvin was correct and the short answer was that the department could already offer royalty relief. There were a couple dynamics that made the process challenging for operators. The first challenge was the requirement to develop, submit, and review analysis data, and develop, according to the statutory standard, a very clear finding that the project is not economic. The submission then had to be reviewed by the Legislative Budget and Audit Committee (LB&A). Once the analysis was complete, it was a slow process for the modification to go into effect. While the authority was available, the benefit of HB 223 was that it would be easier to offer relief as the timeframe would be greatly reduced. A long analysis would not be required and there would not be a runway of uncertainty before data could be presented to the legislature and for the modification to be put into effect. The department had offered royalty relief on the North Slope for a few projects, but it was complicated and the legislation would immediately promote investment.

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Representative Galvin understood that it was appropriate given the circumstances for a broad based form of relief as opposed to a more precise approach. She thought it was important for the legislature to understand the approach because some companies would already be taking in data to determine whether or not it was economic. She suggested that perhaps the state was asking for more information than was necessary. She agreed that the process sounded complicated.

Representative Stapp asked what the material difference was between the various approaches. He looked at the maximum state fiscal incentives, zero royalties, zero production, and zero property tax at the bottom of slide 2. He asked why it would not be logical to simply allow the price to float upward to compensate for the margin.

Mr. Crowther responded that there were a couple of policy considerations driving the choices. One of the considerations was that the market changes could be abrupt and contracts would need to be facilitated at different prices, which would then be subjected to a review which could frustrate financing up front due to the slow timeline. The other consideration was that the department aimed to develop natural resources of all kinds and the governor's energy policy was focused on access to renewables and working on transmission, among other topics. There were situations in which the price would increase above switching prices for other resources. The department thought the most effective strategy was to ensure that the state had a highly competitive royalty environment, was making appropriate investments, encouraging companies to make investments, and bringing resources into development in the near term. The goal was to allow the market and the price to compete for the best options and to extend the shortfall.

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Representative Stapp asked if the issue was that the gas was available, but the projects would not yet make economic sense. There was either a problem with the cost for production, or the price at the point of sale. He understood that the bill would effectively make the cost at

point of production as low as possible and the state would no longer receive royalties or property taxes. He suggested that the other way to accomplish it would simply to mandate that producers pay double the price in gas. He asked if it would have the same impact as the bill.

Mr. Crowther responded that there was some price level that would have a similar effect, although the mechanics would be different. The purpose of the legislation was to control the levers to encourage investments. The price was already moderating in response to the supply, and both forces would likely drive increased supply.

Representative Galvin thought that the bill could have a great outcome. She wondered if it would be pointless to offer relief for the whole lease time period, as opposed to a limited time frame such as 15 years to allow for income to build.

Mr. Crowther replied that page 2, line 6 of the bill referred to a time limit in the 10 years following the commencement of commercial production that would begin after July 1, 2024. The legislation included a cap for the period under which royalty reduction would be available. There was a resource development potential in Cook Inlet that would continue to be present for years, and it was unlikely that there would be a massive expansion of supply. However, in the event that there was an expansion, a time limit would be in place.

Representative Galvin asked if the department expected it to take 10 years before gas was developed and provided to Alaskans.

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Mr. Nottingham responded that the royalty provision would only apply when a well was in production or development. The timeframe of 10 years was only applicable to the first 10 years of the production of the new pool. There was a slide later in the presentation that would show the typical timeframe for a major gas project in the Cook Inlet, which was four to six years. The 10-year timeframe would allow the project to achieve payout as well as provide some buffer time.

Representative Josephson remarked that he was frustrated with slide 2. The slide said there were known but undeveloped gas resources and there would be more production if the state provided maximum fiscal incentives, of which he was aware. He was confused about the part of the slide that referenced "billion cubic feet." He thought that the slide demonstrated basic economic principles that he was already aware of, but beyond that information, he had not learned anything new.

Mr. Crowther apologized for the ambiguity. He explained that the billion cubic feet per year referred to consumption per year. The intent was to show the production possibilities relative to the estimated demand of about 70 billion cubic feet per year.

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Mr. Nottingham continued on slide 3 to explain why the legislation was necessary. He relayed that 70 percent of Alaskans used Cook Inlet Natural Gas for power and heating. Gas was forecasted to drop below the demand of 70 BCF per year within the next few years and action was needed. Improved fiscal terms would directly impact project economics, such as payout and rate of return for developing companies. Royalty reduction was a mechanism that DNR could implement expediently, and the resulting steps could be quickly accomplished by producers.

Mr. Nottingham continued to slide 4, which showed the department's perspective on the mechanics of the bill. The yellow diamonds represented milestones or decision points in terms of whether the field or pool qualified. If a field or pool had never produced in the Cook Inlet before, it would automatically qualify. The bottom oval shape represented the decision points if a field was produced before 2024 but was not online during 2024. Bringing the field back online would qualify it for the royalty reduction. He clarified that there were three main qualifications: if a field was new, if a field was brought back online after a period of production but was shut in recently, and if the prospect fell outside of what existing wells could produce.

Mr. Nottingham continued on slide 5, which he thought would answer some questions posed by Representative Stapp. The slide described the gas supply cost under the current

royalty regime as compared to the royalty regime of HB 223. There were three examples on the slide that each showed a variety of outcomes on undeveloped gas resources. The first scenario was optimistic with a lower investment amount and cumulative resource of about 275 BCF and a development time of three years. Scenario two was a "mid-case" with an investment amount of \$350 million, 250 BCF, and a development time of three years. The third scenario was a more pessimistic view with a higher investment amount of \$400 million, a longer development timeframe, and 250 BCF. The scenarios did not reflect any one particular project, but were simply intended to provide information.

Mr. Nottingham explained that the left side of the slide showed the cost of gas supply, which was the minimum price that investors needed in order to move forward. The chart assumed that one of the most important criteria was a payback time of around four years and a minimum annual return rate of 15 percent. The first three bars were the cost of supply under the current royalty regime for scenario one, two, and three, and the arrows tied back to the cost of supply under the royalty regime of HB 223. He explained that scenario two under the current royalty regime would cost \$12.26 per MCF to the developer in order to onboard a project at the investor requirements of four years for payback and a 15 percent rate of return. The orange bar was the cost of royalty. If royalty was brought down to zero, the cost of supply would be reduced by \$1.74 to \$10.48. The cost would not be passed on to a consumer.

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Representative Galvin wondered if it was possible that the bill would encourage a project to go offline for a year in order to qualify for royalties. She asked what the state would do to make sure that the system would not be manipulated.

Mr. Nottingham responded that the intent was not to encourage manipulation. The legislation would not consider fields that were to be shut in during 2025 or 2026, only fields that were shut in during 2024 or earlier. Any manipulation of the system was protected by the date restriction.

Mr. Crowther added that the department already knew which fields would be eligible for royalties.

Representative Galvin asked for confirmation that the legislation would not incentivize manipulation of the system because the department already knew which fields would be eligible.

Mr. Nottingham responded in the affirmative.

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Mr. Nottingham continued on slide 6 of the presentation which detailed the economics from a hypothetical company's point of view. On the right-hand side of the slide, the graph showed the internal rate of return to the company, and the yellow line and the black line represented the internal rate of return under the royalty regime proposed by HB 223. The graph also included the internal rate of return for the current royalty regime under the same hypothetical company. As gas prices increased, the rate of return also increased, but there was an incremental internal rate of return benefit to the company of about 5 percent under HB 223 as compared to the current royalty regime.

Mr. Nottingham explained that the left-hand side of the graph showed that the payback time was also improved. The payback time under the current royalty regime was represented by the gray bar and the payback time under HB 223 was represented by the blue bar. Under the proposed legislation, the payback time would be greatly reduced, thereby creating a financial incentive for companies.

Representative Galvin asked what the 5 percent difference would translate to in terms of dollar amounts.

Mr. Nottingham responded that he was uncertain, but the division's commercial manager could respond to the question.

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JHONNY MEZA, COMMERCIAL MANAGER, DIVISION OF OIL AND GAS DEPARTMENT OF NATURAL RESOURCES (via teleconference), responded that slide 6 reflected the impact of the reduced royalty rates on the investment metrics potentially required by investors. If the internal rate of return was increased as a result of the policy, new projects would

become available. He thought there would be a positive impact in terms of revenue; however, because there were a variety of potential scenarios and the scope of the new projects was uncertain, it was difficult to pinpoint the specific revenue impact.

Co-Chair Foster asked Mr. Meza to model a few scenarios and provide the information to the committee.

Representative Galvin added that the modeled scenarios would help answer her question. She asked if a specific number could be extrapolated in example scenarios.

Mr. Crowther responded that he believed so. He understood that Representative Galvin was referring to project-wide costs. He confirmed that the division could develop scenarios and present the scenarios to the committee.

HB 223 was HEARD and HELD in committee for further consideration.

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#hb387

HOUSE BILL NO. 387

"An Act relating to a tax credit for certain oil and gas equipment in the Cook Inlet sedimentary basin; and providing for an effective date."

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REPRESENTATIVE TOM MCKAY, SPONSOR, explained that HB 387 attempted to help oil and gas development in the Cook Inlet. He realized that a "jack-up" rig would be required if drilling activity in the inlet were to be increased. The current rig in the inlet was being fully utilized drilling wells for Hilcorp. He explained that it was not possible to drill year-round in Cook Inlet but it was possible to drill from approximately May through October with a jack-up rig. He thought the rig was needed in order to increase production. He read the sponsor statement (copy on file):

As we face the reality of a shortage in natural gas production in Cook Inlet, the backbone of Southcentral Alaska's energy supply, the urgency to act has never been more critical. Cook Inlet gas has been an invaluable resource as an affordable, reliable energy source that has powered homes, businesses, and industry for decades. Projections indicate a rapid decrease in gas supply in the coming years under the current market conditions, a scenario that threatens the energy security of over half of Alaska's population and could lead to our reliance on imported Liquefied Natural Gas (LNG), which is likely to be significantly more expensive.

Jack-up rigs are specialized offshore drilling rigs necessary for developing Cook Inlet gas reserves. Currently the state has only one rig available, a handcuff on any significant increase in drilling activity. The bill proposes a targeted incentive that will increase the project economics for investing in another jack-up rig to be used in Cook Inlet to explore for and extract natural gas by providing a carry-forward tax credit equal to the costs associated with purchasing and transporting the rig to Alaska. HB 387 has a clear goal: to increase exploration and production activities, thereby enhancing Cook Inlet gas reserves and increasing gas production.

I urge my colleagues of the 33rd Legislature and the people of Alaska to support, HB 387 as a step towards energy development, economic resilience, and the long-term prosperity of our great state.

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TREVOR JEPSEN, STAFF, REPRESENTATIVE TOM MCKAY, introduced the PowerPoint presentation "HB 387 Cook Inlet Jack-Up Rig Credit" dated April 4, 2024 (copy on file), and began on slide 2. He relayed the projected Cook Inlet gas shortage would threaten the energy security of the Southcentral region of the state and there could be a potential shortfall as early as 2027. A public opinion poll from July of 2023 suggested that 72 percent of residents reported a high level of opposition to importing natural gas and 60 percent of residents supported incentives for oil and gas companies to find and produce more Cook Inlet gas. He noted that residents' opposition to imports decreased markedly in

the unlikely scenario that liquified natural gas (LNG) imports would be cheaper. Many stakeholders, such as the Alaska Energy Authority (AEA), believed that LNG imports would be significantly more expensive than locally produced Cook Inlet gas. He argued that the legislature owed Alaskans a solution to help incentivize more Cook Inlet gas exploration, production, and development. He relayed that figure 1 on the slide showed the projected fuel costs for coal, natural gas, LNG, and diesel over the next 16 years. The information was compiled by AEA. The actual price of gas to the consumer was unknown and the numbers were projections, but it was worth considering the projections when making policy decisions.

Mr. Jepsen continued to slide 3 and explained that jack-up drilling rigs were specialized rigs in the mobile offshore drilling unit class and were intended for relatively shallow waters up to roughly 500 feet. The rigs consisted of a floating hole that could either be self-propelled or pulled by a barge to a drilling location. The rigs had extendable legs that provided the support for the rig on the sea floor. He stressed that jack-up rigs were necessary to develop offshore Cook Inlet gas. The slide included a drawing of the different mobile offshore drilling classes, not drawn to scale, and the jack-up rig was circled in red.

Mr. Jepsen continued to slide 4 and relayed that there was presently one jack-up rig in Cook Inlet. The bill was solely focused on implementing a second rig in the inlet, which was required in order to adequately explore and develop gas reserves. The current jack-up rig in Cook Inlet, Spartan 151, would be fully utilized by Hilcorp for the foreseeable future. He explained that any new major developments would require a second rig. The decline in the Cook Inlet gas shortage projections did not account for a potential second rig in the inlet. In addition to developing known reserves in Cook Inlet on state land, there were federal leases in Cook Inlet which were too deep below the surface for the Spartan rig to operate in and a more capable jack-up rig was needed. Market interest had shown that investing in Cook Inlet exploration and production was not a highly popular option. The primary factors came down to risk and rate of return. The high cost nature of oil and gas exploration and development operations in Cook Inlet directly impacted both risk and rate of return. The state fully or partially subsidizing the purchase or transfer of another jack-up rig to develop

Cook Inlet offshore reserves would offset the risk and increase the rates of return for a potential project. There was some risk to the state, but a "silver bullet" solution to address Cook Inlet did not exist. He reiterated that Alaskans wanted incentives to be offered and HB 387 represented a strong incentive to implement a second rig in Cook Inlet.

Mr. Jepsen continued to slide 5 and explained that the bill would introduce a Title 43 tax liability reduction credit, which was not a cash credit. The credit was equal to 100 percent of the cost of purchasing and transporting a jack-up rig to Alaska limited to a maximum credit value of \$75 million. The credit would only apply to jack-up rigs for Cook Inlet and included language that would ensure the rigs were used for at least three years, which would disallow the credit to be used as a pass-through in order to move the rig to a different location. He thought that the risk to the state was not as large as it may seem because the new rig would benefit Alaskans if the rig was used in Alaska for three years. There would be no cost to the state if the credit was not utilized and the state did not acquire a second jack-up rig.

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Mr. Jepsen relayed that there was an old jack-up rig credit which was a drilling credit that was only applicable to drilling costs for a rig exploration well that was drilled with the jack-up rig. The only possible recipients of the old credit were oil and gas companies. The new credit proposed by the bill was for any Title 43 tax liability and would not be limited to oil and gas companies' drilling.

Co-Chair Foster invited Mr. Jepsen to review the sectional analysis.

Mr. Jepsen reviewed the sectional analysis on slide 6 (copy on file):

Section 1: Amends AS 43.98 by adding a new section (43.98.080) which introduces a tax credit for persons installing a jack-up rig in the Cook Inlet sedimentary basin.

Section 2: Repeals a prior jack-up rig drilling credit

Section 3: Provides for an immediate effective date.

Representative Galvin asked why the jack-up rig was chosen to be in federal waters as opposed to state waters.

Representative McKay responded that the intent was to allow the rig to be utilized in state waters or federal waters. He explained that jack-up rigs were typically leased from the Gulf of Mexico or Southeast Asia. There were three important elements of jack-up rig drilling: the depth of the water, the desired drilling depth, and configuration of the drilling platform. If a drilling platform was set at a location with known gas, the important information to know was the water depth, the platform height, and the depth of the wells to be drilled. The appropriate jack-up rig could then be acquired with the known specifications. He reiterated that the intention was for the rig to work in state or federal water.

Representative Galvin asked if there was a reason why a project on the water was chosen over a project on the land. She understood that there was gas available everywhere and wondered if there was a reason that the focus was on Cook Inlet.

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Representative McKay responded that there were already land rigs on the shore and some of the bigger gas prospects were offshore.

Representative Galvin asked how the bill would be an improvement upon what had already been done in the past. She was aware that the state had spent hundreds of millions of dollars in the past on new rigs and the efforts were unsuccessful. She asked why Representative McKay thought the bill would be more successful than past efforts.

Representative McKay responded that in many of the energy focused bills he was sponsoring, he was trying to leverage reserves that were in the ground already instead of taking funds out of the treasury. He thought leveraging existing reserves would have a different result than past efforts. He did not want to criticize what was done in the past and he was certain the intentions were good. He relayed that there was gas in the ground that may not be produced unless the state leveraged and incentivized operators to monetize it for the benefit of all Alaskans. He explained that his energy bills were all structured to leverage reserves

rather than utilize cash from the treasury. He suggested that Mr. Jepsen could add more details.

Mr. Jepsen clarified that the bill was not specifically targeting federal waters or state waters. He continued that the older version of the jack-up grid credit was specifically for drilling costs associated with exploration wells. The credit would only apply for the first three exploration wells with a jack-up rig and it was limited to \$25 million for the first well, \$22.5 million for the second, and \$20 million for the third. The credit proposed by HB 387 intended to keep the jack-up rig in the state for three years with the assumption that it would be drilling nonstop. The rig could be drilling exploration wells or development wells. The bill would ensure that the three-year drilling contract was in place and that the rig would be working nonstop to meet the gas demand.

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Representative Galvin understood that the credits would not be displacing revenue.

Mr. Jepsen replied that the state would be reimbursing oil companies and gas companies, but there was a benefit to Alaskans because the rig would be in the state for three years and it would be drilling nonstop. The payout of the credit would be a reimbursement, but it would still be leveraging gas in the ground because both exploration wells and development wells would be eligible. He argued that the drilling of the wells for a significant period of time would benefit the state.

BRANDON SPANOS, ACTING DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE (via teleconference), explained that the way the tax credit was structured was that the credit could be applied against the taxpayers' tax revenue in the year in which the credit was claimed. The credit would first need to be earned, which would generally line up with the taxation time period. For example, if a taxpayer brought a rig up to Alaska in 2026 and also had production tax due in 2026, the taxpayer could apply the credit in 2026. If there were any credits left over, the taxpayer could apply the credits in subsequent years.

Representative Galvin understood that the credit would only be earned if the tax bill was over \$75 million. She asked

for confirmation that a company would be receiving the credit in exchange for a promise that it would drill for at least three years.

Mr. Jepsen responded in the affirmative.

Representative McKay commented that everyone had seen the projection that showed there would be a gas gap in approximately 2027 or 2028 and the earliest date LNG would be imported was 2030. The intended purpose of the bill was to bridge the gap to ensure that the state had sufficient gas supplies at least until the state had the ability to import LNG.

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Representative Cronk asked how long it would take for gas to be utilizable if the second jack-up rig was drilling and hit gas. He understood the process would not only involve finding the gas, but also building the pipeline. He asked how long the entire process would take.

Representative McKay responded that there would be a certain amount of pressure to take action quickly to allow the industry to react and plan. He explained that it would take two to three years to procure a new platform. Any new platform would need a subsea gas pipeline to shore and tie the gas into the NSTAR gas line. He noted that the process would take time and none of the steps could happen quickly. There could hypothetically be around 30 new wells after three years between two different platforms. Offshore work was time intensive, but it had been done before in Cook Inlet and could be done again.

Representative Cronk understood that if there was a new field in the water, a new platform would need to be built before any drilling could occur.

Representative McKay responded in the affirmative. He explained that subsea developments were the only developments that did not need a platform because the wellheads were on the sea floor. Most scenarios that would work for Cook Inlet were centered around building a new platform. The platform would likely be built in Korea or Japan and transported to the state and then the platform would be anchored to the sea floor. The jack-up rig could

then drill the wells and begin production. The process had been employed in the inlet for decades.

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Representative Cronk asked how long a jack-up rig would take to get to Alaska in the best case scenario.

Representative McKay responded that the jack-up rig would likely come from the Gulf of Mexico and could either be towed up or hauled up to the state. The rig would be mobilized in summer or early spring. He acknowledged that it was a substantial operation and required supply vessels, materials, and manpower, among other resources.

Representative Coulombe commented that she liked the bill. She referred to slide 3 which detailed the various types of drilling rigs. She asked why the bill would not be expanded to other types of rigs for future drilling purposes.

Representative McKay responded that jack-up rigs were the most efficient and the most economical. There had been drill ships used in Cook Inlet in the past, but the rigs had to be dynamically positioned, which required a significant amount of power. The ships were designed to sit in the tides without moving, which required a tremendous amount of fuel.

Representative Coulombe understood that there was only one jack-up rig in the inlet currently and it was being fully utilized by Hilcorp. She asked Representative McKay how confident he was that there would be enough drilling opportunities to keep the two jack-up rigs busy.

Representative McKay responded that determining the scope was up to the private sector. There were two gas reservoirs that could be exploited and two platforms, which would take at least two years to drill to completion. He noted that it was a hypothetical situation at the moment. He thought the legislature was responsible for setting up the environment and the industry was responsible for deciding how to proceed. The projects would likely proceed if the legislature was able to ensure that the projects would be economically viable. He pointed out that none of his energy bills required that the state take action, but instead offered opportunities to the private sector. He thought that the private sector knew how to operate drilling

projects better than the state. The role of the state was to offer incentives and put forth appropriate legislation. The owner of the potential jack-up rig in the Gulf of Mexico or Southeast Asia would likely not likely bring the rig to Alaska for an abbreviated program, but for a two-year or three-year contract to ensure that there would be a return on investment.

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Representative Josephson understood that the credit was not limited to oil and gas companies. He asked which party would receive the tax credit in the following hypothetical situation: a jack-up rig drilling in the Gulf of Mexico was not producing oil and the owner of the rig decided to enter into a contract with an oil or gas producer in the Cook Inlet. He assumed that the producer would receive the credit and the producer would enter into an independent contract with the owner of the jack-up rig.

Mr. Jepsen responded that the tax credit was structured to apply to any Title 43 tax liability. The intent was to open up the credit eligibility to Alaska Native corporations that do not drill for oil or a transportation company with a high corporate income tax liability. The credit would make it easier to transport the rig to Alaska, lease the rig, and become the owner of the rig, which would make the rig an asset to Alaska. He explained that the overall idea was not to limit the credit to oil and gas companies and allow other corporations or entities in the state to potentially become an owner of a rig.

Representative McKay added that Representative Josephson had described a typical scenario. He explained that an oil and gas company would contract with a drilling contractor and pay the contractor to lease the rig, then the oil and gas company would receive the tax credit.

Representative Josephson provided a hypothetical example where the Northwest Alaska Native Association (NANA) initiated the development. He asked if the corporate taxes would be written off against NANA's assets or if the credit would belong to the ultimate developer. In the example scenario, NANA would be the general contractor.

Representative McKay responded that he would offer a different example. He relayed that Doyon Incorporated would

be considered the parent company, and beneath the parent would be Doyon Drilling. The two were considered separate divisions. He noted that Doyon could contract or purchase a jack-up rig which would become part of its fleet, but it would have nothing to do with Doyon's other divisions and their other businesses.

Representative Josephson asked if Mr. Spanos could respond to the question.

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Mr. Spanos responded that he understood that the question was how the credit would be applied if a non-producer were to take on the cost of bringing up a jack-up rig to the state. He relayed that it would depend upon the company. If the company was a C corporation, the credit would apply against its AS 43.20 C corporation taxes, which were net income taxes. If the company was another entity with a different type of tax, such as a fishing company, the company could bring up a jack-up rig and apply the credit against its fish taxes.

Representative McKay thanked the committee for its time.

HB 387 was HEARD and HELD in committee for further consideration.

Co-Chair Foster reviewed the agenda for the following day's meeting.

#

ADJOURNMENT

[3:01:36 PM](#)

The meeting was adjourned at 3:01 p.m.