

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

January 31, 2024

1:03 p.m.

**MEMBERS PRESENT**

Representative Tom McKay, Chair  
Representative George Rauscher, Vice Chair  
Representative Thomas Baker  
Representative Kevin McCabe  
Representative Dan Saddler  
Representative Stanley Wright  
Representative Jennie Armstrong  
Representative Donna Mears  
Representative Maxine Dibert

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

HOUSE BILL NO. 276

"An Act relating to temporarily reduced royalty on oil and gas from pools without previous commercial sales in the Cook Inlet sedimentary basin; and providing for an effective date."

- HEARD & HELD

HOUSE BILL NO. 223

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

- HEARD & HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 276

SHORT TITLE: REDUCE ROYALTY ON COOK INLET OIL & GAS

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/18/24	(H)	READ THE FIRST TIME - REFERRALS
01/18/24	(H)	RES, FIN
01/31/24	(H)	RES AT 1:00 PM BARNES 124

BILL: HB 223

SHORT TITLE: TAX & ROYALTY FOR CERTAIN GAS  
SPONSOR(s): RAUSCHER

01/16/24 (H) PREFILE RELEASED 1/8/24  
01/16/24 (H) READ THE FIRST TIME - REFERRALS  
01/16/24 (H) RES, FIN  
01/31/24 (H) RES AT 1:00 PM BARNES 124

**WITNESS REGISTER**

JOHN BOYLE, Commissioner  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** Presented HB 276 on behalf of the House Rules Committee, sponsor of the bill by request of the governor.

DEREK NOTTINGHAM, Director  
Division of Oil and Gas  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** On behalf of the House Rules Committee, sponsor of HB 276 by request of the governor, provided a PowerPoint presentation titled "HB 276 Reduce Royalty on Cook Inlet Oil & Gas," dated 1/31/2024.

JOHN CROWTHER, Deputy Commissioner  
Office of the Commissioner  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** During the hearing on HB 276, answered questions.

Craig Valdez, Staff  
Representative George Rauscher  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Provided a sectional analysis of HB 223 on behalf of Representative Rauscher, prime sponsor.

**ACTION NARRATIVE**

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**CHAIR MCKAY** called the House Resources Standing Committee meeting to order at 1:03 p.m. Representatives Saddler, Wright, Baker, Rauscher, Mears, Armstrong, Dibert, McCabe, and McKay were present at the call to order.

^#hb276

**HB 276-REDUCE ROYALTY ON COOK INLET OIL & GAS**

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CHAIR MCKAY announced that the first order of business would be HOUSE BILL NO. 276, "An Act relating to temporarily reduced royalty on oil and gas from pools without previous commercial sales in the Cook Inlet sedimentary basin; and providing for an effective date."

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JOHN BOYLE, Commissioner, Department of Natural Resources (DNR), presented HB 276 on behalf of the House Rules Committee, sponsor of the bill by request of the governor. He advised that from DNR's standpoint the current challenges in Cook Inlet aren't related to the resource because ample gas is available under existing platforms as well as platforms that could be permitted within a short period of time. Rather, he continued, it is commercial challenges that are inhibiting the development of Cook Inlet gas resources. Over the 60 years of production in Cook Inlet, the oil element has driven the economics, with gas a byproduct from those oil exploration prospects. Over time, oil has become more and more difficult to find and challenging to get, which plays a role in the economics because even when lots of gas accompanies that oil there isn't necessarily a ready market for any gas supply above and beyond Alaska's domestic needs. According to existing producers, many development projects are within the margin of being investable or not given that other investments with higher rates of return and less risk are available to investors.

COMMISSIONER BOYLE pointed out that royalty is a lever DNR can pull to contribute to the economics of these projects, reduce risk, incentivize, and push over the line of internal rates of return that can be promised to investors. At the end of last year, he related, DNR offered net share profit leases, a type of lease that already existed under DNR's authorities, instead of a royalty rate. Under net share profit leases, an operator develops the fields, starts producing oil, and then once costs are recouped the operators start paying the sovereign a certain amount. The thought was that they might give companies more confidence in the economics of bidding for new leases for prospective projects in areas that haven't been explored before

or where the exploration needs more work to delineate or prove up the resource, and a slight uptick was seen.

COMMISSIONER BOYLE explained that HB 276 deals with leases that already exist but don't currently have production; the bill specifically relates to existing leases where DNR hopes to incentivize new production. He further explained that HB 276 doesn't deal with existing production, so it doesn't lower the royalty rate for those producers in the Cook Inlet that are already producing oil. The bill only applies to producers in the Cook Inlet that have leases already established at 12.5 percent royalty, and it would lower those royalty rates, which would be a great first step to help provide better economics for Alaska's producers.

COMMISSIONER BOYLE said new development will likely not take place without proactive steps by the state. He related that banks and investors have expressed concern about the uncertainty of investing in Alaska, such as the fiscal changes that impacted tax credits available to Cook Inlet producers and proposals to change the fiscal take structure in Alaska. Advancement and passage of HB 276 would signal to investors that the state and its policymakers strongly support development within the Cook Inlet and recognize that it is in the state's interest to have a stable homegrown energy supply that is relatively affordable, and that the state is looking to enact policies which encourage rather than discourage that type of production.

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CHAIR MCKAY emphasized that HB 276 is not a tax credit program like the State of Alaska had in the past where fungible funds from the state treasury were used to help finance oil and gas projects. Rather, he said, HB 276 is a program which leverages gas that is still in the ground that may never be produced.

COMMISSIONER BOYLE added that the program proposed by HB 276 wouldn't be the state subsidizing or giving money to producers, nor anything like the tax credits under the [2010] Cook Inlet Recovery Act (CIRA). Under HB 276, he continued, instead of a 12.5 percent rate the state would collect a 5 percent royalty rate to help improve the economics for moving projects forward. Not making this tweak, he advised, could result in the state getting 100 percent of nothing rather than 5 percent of something. While Cook Inlet gas is important for heating and powering the homes of [most of Alaska's residents], Commissioner Boyle further pointed out that Cook Inlet oil supplies Alaska's

in-state refineries which produce gasoline and aviation fuels, and HB 276 would also lower the royalty rate for the oil produced in these leases.

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DEREK NOTTINGHAM, Director, Division of Oil and Gas, Department of Natural Resources (DNR), on behalf of the House Rules Committee, sponsor of HB 276 by request of the governor, provided a PowerPoint presentation titled "HB 276 Reduce Royalty on Cook Inlet Oil & Gas," dated 1/31/2024. He began with slide 2, "WHY IS COOK INLET GAS IMPORTANT?" The left side of the slide read as follows [original punctuation provided]:

**Natural Gas Utilities**

- **Enstar** serves over 440,000 people and operates in over 25 communities throughout Southcentral Alaska
- **Interior Gas Utility (IGU)** serves over 2,400 people

**Electric Utilities**

- **Chugach Electric** serves over 302,000 people in Anchorage, Whittier, Girdwood, and Fairbanks
- **Matanuska Electric (MEA)** serves the Mat-Su Borough and Chugach and Eagle River, over 180,000 people
- **Homer Electric** serves nearly 36,000 people

MR. NOTTINGHAM addressed the pie chart on the right side of slide 2 depicting the 2023 Cook Inlet Utility Gas Under Contract. He informed the committee that Enstar makes up about half of the volume of Cook Inlet gas that is under contract, with Chugach Electric making up [over one-fourth] of the volume, and with Homer Electric, IGU, and MEA [nearly equally splitting the remaining volume].

MR. NOTTINGHAM moved to slide 3, "COOK INLET OVERVIEW," which read as follows [original punctuation provided]:

**Cook Inlet is a large mature oil and gas basin**

- Has produced over 1.4 billion barrels of oil and 12 trillion cubic feet of gas
- 26 producing fields operated by 8 different companies
- There are over 200 oil and gas leases in Cook inlet

**Gas production has been declining since 1990**

- Peak gas production in 1990 was over 850,000 thousand cubic feet per day
- Current production is just over 200,000 thousand cubic feet per day

**Cook Inlet gas provides heat and electricity to 70 [percent] of Alaskans**

MR. NOTTINGHAM drew attention to the Cook Inlet units shown on the map on the right side of slide 3. He said state units are depicted in yellow, with Kitchen Lights being the biggest unit, Trading Bay a historical unit that began in the 1960s, and Ninilchik an onshore unit on state land. He noted that Swanson River, [a federal unit] depicted in green, began producing oil and gas in 1958 or 1959. Mr. Nottingham pointed out that given the maturity of these existing fields, it is getting tougher and tougher to find additional oil and gas within these fields.

MR. NOTTINGHAM proceeded to slide 4, "COOK INLET LEASES," which read as follows [original punctuation provided with some formatting changes]:

**What is a State of Alaska Oil and Gas Lease?**

- A lease is a tract of land designated for oil and gas exploration
- Leases are offered at lease sales or through exploration licenses
- Primary lease terms are between five and ten years
- Commercial production extends the lease beyond the primary term

**What is an Oil and Gas Unit?**

- Leases are combined to form a **unit** for the protection of all parties
- Facilitates joint development, conserve natural resources, and avoid waste
- Unit agreement is developed between the lessees and the State
  - Requires the development of a plan of development/exploration (POD/POE) along with other reporting requirements
  - Requires the operator to act as a prudent operator while developing the unit

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MR. NOTTINGHAM spoke to the geological maps depicted on slide 5, "COOK INLET GEOLOGY." He qualified that he is a petroleum engineer, not a geologist, but noted that the Alaska Range and volcanoes comprise the western side of the Cook Inlet and the east side is comprised of the Kenai Peninsula and Chugach Mountains. A catch basin formed between these two sides, he explained, where fluvial systems came in and deposited sand, creating the stratigraphic column depicted on the right side of slide 5. The deeper sands in the column tend to be harder rock and tend to have oil and are considered the source rock for Cook Inlet oil. Above the deep harder rock is rock that is more permeable and quite a bit of the oil production comes from these formations, the Chickaloon, West Foreland, and Hemlock formations, with oil coming particularly from the Hemlock Formation. Then, moving above these formations are the Tyonek, Beluga, and Sterling formations from which gas is produced, and that gas is formed from biogenic gas related to coals. Responding to Representative Saddler, Mr. Nottingham offered his belief that "ma" on the top left of the depiction of the stratigraphic column stands for millions of years, therefore the bottom of the column represents 208 million years.

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MR. NOTTINGHAM addressed slide 6, "UNDISCOVERED RESOURCES," which read as follows [original punctuation provided with some formatting changes]:

- **Undiscovered, Technically Recoverable Oil & Gas (U.S. Geological Survey 2011):**
  - mean conventional oil 599 million barrels of oil
  - mean conventional gas 13.7 trillion cubic feet
  - mean unconventional gas 5.3 trillion cubic feet
- **Undiscovered, Technically Recoverable Gas:**
  - 1.2 trillion cubic feet additional mean resource assessed in the federal Southern Cook Inlet Outer Continental Shelf area (Bureau of Ocean Energy Management 2011)
- Governor's Legislation targets making these prospects more economic for development

MR. NOTTINGHAM defined unconventional gas as gas that is in plays like coalbed methane.

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MR. NOTTINGHAM discussed the graphic on slide 7, "COOK INLET PRODUCTION HISTORY." He noted that oil peaked in the 1970s and has been declining since. Gas peaked in 1990 at 850 million cubic feet and has been declining from there. Much of the water production coming in is associated with secondary or enhanced recovery methods such as water flooding, and the water coming through the wells and being produced.

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MR. NOTTINGHAM continued to slide 8, "GAS PRODUCTION HISTORY," and drew attention to the graph on the left depicting production of Cook Inlet gas by lessee from state-owned oil and gas leases. He related that from the early 2000s to about 2010, many of the companies producing from state lands were the bigger companies with big capability, including ConocoPhillips, Marathon, and Chevron. However, he continued, in the last 15 years or so Hilcorp Alaska LLC has been the predominant producer along with some smaller producers, so the landscape has shifted in the companies that are producing there and their capabilities. He turned his attention to the graph on the right depicting the Cook Inlet fields that have been producing. He pointed out that all the fields have been declining over the 2000s and that no major new field has come online in that time.

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MR. NOTTINGHAM displayed slide 9, "COOK INLET PRODUCTION BY FIELD:", and noted that the chart on the left details production of oil and gas by field and company for the year 2023. He reiterated that Hilcorp is the dominant producer in the Cook Inlet with over 80 percent of the production. The Beluga River, Ninilchik, and North Cook Inlet fields are the big gas producers. He directed attention to the map on the right and said oil production is important with oil production today at around 9,000 barrels a day and on decline.

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MR. NOTTINGHAM reviewed slide 10, "GAS STORAGE," which read as follows [original punctuation provided]:

**What is gas storage?**

- Gas can be stored by re-injecting it in subsurface reservoirs and re-producing when it is needed, although it comes with costs and operational demands.

- It is used within a year to mitigate the fact that demand is much higher in the winter than the summer, but it is best to produce from fields at a relatively steady rate. Production over the summer months can be "saved up" for cold winter days.
- Storage is critical, as peak winter demand already requires more gas than is deliverable from producing reservoirs.
- Gas storage can also be used across multiple years.

**There are currently four active gas storage pools**

- CINGSA [Cook Inlet Natural Gas Storage Alaska] - Established in 2011, gas storage capacity 18 bcf [billion cubic feet], operated by CINGSA (an RCA regulated utility)
- Kenai Gas Pool 6 - Established in 2006, gas storage capacity 50 bcf, operated by Hilcorp
- Pretty Creek - Established in 2005, gas storage capacity 3 bcf, operated by Hilcorp
- Swanson River (Federal) - Established in 2001, gas storage capacity 3.4 bcf, operated by Hilcorp

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REPRESENTATIVE MEARS asked whether other potential opportunities for storage are being explored.

MR. NOTTINGHAM replied that he believes other opportunities are being explored by various producers/operators in the Cook Inlet as well as the utilities.

REPRESENTATIVE SADDLER inquired about why CINGSA is regulated by the RCA but not Kenai Gas Pool 6 or Pretty Creek.

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JOHN CROWTHER, Deputy Commissioner, Office of the Commissioner, Department of Natural Resources (DNR), answered that existing [DNR] leases grant operators the right to store their own production on their own leases. Therefore, those operated by Hilcorp have the right to store Hilcorp production so that it can be used to meet those deliverability demands. For the Kenai Gas Pool 6, he explained, [DNR] has authorized third party storage from a lessor perspective. If that storage is moved forward and brought into the market, the RCA depending on how it

exercises its authorities, might require regulation for third parties to access [the stored gas].

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MR. NOTTINGHAM spoke to slide 11, "COOK INLET GAS DEMAND," which read as follows [original punctuation provided with some formatting changes]:

**Kenai LNG Plant**

- Nikiski liquified natural gas (LNG) facility is operated by Trans-Foreland Pipeline Co. LLC - which is a subsidiary of Marathon Petroleum
- Last exported LNG was 2015
- Department of Energy (DOE) authorization for exporting LNG expired in 2018
- Dec. 2020 Federal Energy Regulatory Commission (FERC) approved LNG imports to this facility an annual capacity up to 1.8 billion cubic feet (bcf) per year

**Nutrien Fertilizer Plant**

- Second largest ammonia/urea plant in U.S.
- Shut down and mothballed in 2007, however Nutrien maintains permits and remains interested in reopening the plant
- Gas prices relative to Lower 48 makes economics difficult
- Potential source for blue hydrogen/blue ammonia

MR. NOTTINGHAM elaborated that in the early 2000s Cook Inlet gas was used for electricity and heating in the Anchorage and Railbelt areas, for producing fertilizer, and for LNG export. The fertilizer plant was shut down in 2007 and LNG exports ended in 2015, shrinking the demand for Cook Inlet gas [from a high of nearly 220 bcf] to roughly 70 bcf per year to supply current utility needs and some industrial needs such as a refinery and general oil and gas field operations.

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MR. NOTTINGHAM related that [in 2023] Hilcorp informed the utilities that it couldn't commit beyond meeting its existing contracts with the utilities. He said DNR responded by putting together a forecast to understand the gas supply and resource availability in the Cook Inlet. He paraphrased from slide 12,

"DNR 2022 COOK INLET FORECAST," which read as follows [original punctuation provided with some formatting changes]:

**Purpose of the 2022 Cook Inlet Gas Forecast:**

- Independent analysis to provide information on gas supply issues in the Cook Inlet
- Also provides production information for the Department of Revenue's revenue forecast

**Methodology:**

- Utilized public production data to assess Units producing gas in the Cook Inlet
- Generally accepted petroleum engineering practices used to develop projections
- Standardized set of economic limits were used for each Unit

**Key Assumptions:**

- Assumes 15 development wells per year until 2030, and no new wells beyond that
- Assumes gas price is flat at 70 BCF, with escalation for inflation. Does not forecast market changes responding to supply/demand
- Does not include contribution from non-producing known prospects and does not forecast likelihood of their development
- Forecasted volumes do not account for gas produced from gas storage

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MR. NOTTINGHAM spoke to the graphic on slide 13, "FORECAST PROVED DEVELOPED & PROVED UNDEVELOPED." He explained that [from 2023 to 2026] the forecast is for the gas supply to roughly meet the estimated demand of 70 BCF per year. Beginning [in 2027], he continued, the forecast is for supply to start falling off demand even with continued drilling. That continued drilling, he advised, is a large chunk of the future supply from the Cook Inlet, so it's an important piece that needs to continue for the area to continue to meet the demand.

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REPRESENTATIVE MEARS stated it is market development, investor certainty, and a flat line for demand that are being talked about. She asked if there are other potential energy demands that could be a route for proving a larger demand potential if it is being signaled that Alaska is a good place to invest.

COMMISSIONER BOYLE responded that there is an opportunity to market more or see a demand increase assuming the economics are right. Refineries and industrial users continue to need natural gas, he said. For example, Donlin Gold has explored the viability of building a pipeline from the Cook Inlet to its mine site, and several mineral and mining prospects in the Susitna Valley may be interested in consuming Cook Inlet gas. In theory, if enough gas were to be discovered, produced, and made available, there might be an opportunity for the Nutrien fertilizer plant to resume operation.

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CHAIR MCKAY pointed out that only one jack-up rig is currently operating in the Cook Inlet, and that it has a full schedule of projects. So, slide 13 is important, he said, because it forecasts the future if no changes are made. Time is of the essence for considering this seriously, he continued. "Fifteen wells per year," give or take, is vitally important or [production] will stay below the [70 BCF] line. Geologists think there is lots of gas in the inlet; it is essential to figure out how to add a second jack-up rig to get more than 15 wells per year. As can be seen on slide 13 and which shows the slide's importance, a gasline from Cook Inlet to the Donlin Gold Mine, for example, cannot be advanced in the current situation.

COMMISSIONER BOYLE concurred with Chair McKay's statements that a shortfall is seen with the status quo assumptions, that it is known where gas currently is and where opportunities are, and that a second jack-up rig is an important issue. Another issue related to the Cook Inlet industry's decline, he added, is the resulting erosion of the ability of contractors and suppliers to provide the same level of service and support that they historically provided in the Cook Inlet. Support services have been redeployed to the North Slope where investment is now flowing. It isn't just about the companies producing oil and gas, the associated service companies that enable the producers to be successful must also be considered.

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REPRESENTATIVE SADDLER related his understanding that Hilcorp and Homer Electric Association (HEA) have signed an extension of their gas supply contract, and that he understands this is done by borrowing from the future. He asked how the chart on slide

13 would change if Hilcorp begins to produce extra gas sooner to supply HEA.

MR. NOTTINGHAM replied that Hilcorp accelerates gas production from the future currently. He offered his belief that any excess above the 70 BCF would go into a storage reservoir and continue to pressure up that reservoir. When that excess gas is needed in the future for supplying HEA or any utility, then HEA could call upon that gas from storage to supply that need.

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REPRESENTATIVE SADDLER surmised that that would not change the decline seen in the graph on slide 13, it is just where it is stored short term.

MR. CROWTHER responded that the volumes at issue in the HEA contract are quite small and don't materially change the graph from a visual perspective. However, he advised, if there were to be an effort to pull forward large volumes of gas there would be constraints on rig availability, service capacity, and so forth. While it was natural for developers and utilities to manage short term year-to-year supply issues in the near term, [DNR] believes that longer term there must be a solution like this legislation which dramatically reframes and brings new prospects online.

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MR. NOTTINGHAM resumed his presentation. He displayed slide 14, "2022 FORECAST VS ACTUALS," and said the graph shows that actual [wells drilled] is tracking with DNR's forecast [18 development wells actually drilled in 2022 versus DNR's forecast of 15 development wells].

MR. NOTTINGHAM elaborated on the accuracy of DNR's forecast of 15 development wells on average per year by proceeding to slide 15, "2023 DEVELOPMENT WELL ACTIVITY," which read as follows [original punctuation provided with some formatting changes]:

**Well Activity**

17 gas development wells have been drilled and completed during calendar year 2023:

- North Cook Inlet Unit x3
- Lewis River Unit x1
- North Trading Bay Unit x1
- Swanson River Unit x3

- Beluga River Unit x5
  - Lewis River Unit x1
  - Ninilchik Unit x3
- 1 development well is currently being drilled in Kenai Unit
  - 1 development well drilling permit is currently approved for Beluga River Unit

**Production**

Major Field Contributors  
(through November 2023):

- Ninilchik - 21.8 [percent]
- North Cook Inlet - 18.8 [percent]
- Beluga River - 18.5 [percent]
- All other gas fields represent less than 10 [percent] each

The above percentages are based on gas volumes for sale, and discounts gas produced from storage as well as gas reinjected for EOR purposes

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MR. NOTTINGHAM spoke to slide 16, "COOK INLET 2023 LEASE SALE RESULTS," which read as follows [original punctuation provided with some formatting changes]:

**New, competitive lease terms offered:**

- Net profit share as the bid variable
- Fixed per-acre cash bonus
- No royalty—percentage of net profits owed to the State after recovering capital investments and operating costs to bring production online

**Six tracts received bids**

- Three from Hilcorp Alaska LLC
- Three from Hex LLC

**Net profit share rate bids: 5.6 [percent] - 11 [percent]**

**Cash bonus revenue: About \$600,000**

**Acres receiving bids: About 15,000 acres**

MR. NOTTINGHAM reiterated that DNR has the statutory ability to offer a net profit-based bid variable in its lease sales with no royalty. It was thought this might attract more exploration in the Cook Inlet by both new and existing operators/producers. Under net profit share, the producer doesn't have to pay a royalty, and net profit share payments to the state don't begin until the project becomes cash flow positive. He characterized the lease sale results as encouraging but allowed that DNR would have liked to see more bids.

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CHAIR MCKAY asked whether these new leases can be characterized as being over existing structures that are believed to have gas.

MR. NOTTINGHAM answered that the division doesn't have specific knowledge as to what the producers and operators may be looking at but given they risked some amount of cash to acquire the leases indicates that they see something there.

CHAIR MCKAY observed from the map on the right side of slide 16 that the new leases are a blend of onshore and offshore that is close to shore. He surmised these leases could be drilled by a land rig with extended reach drilling, in which case these prospects could be drilled without another jack-up [rig].

MR. NOTTINGHAM replied that that would be true for the onshore prospects. The leases that were picked up, he noted, were near infrastructure and near existing units, so ease of development may have been a consideration of the operators that bid on them.

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MR. NOTTINGHAM reviewed slide 17, "EXISTING OIL & GAS ROYALTY STATUTES." He said AS 38.05.180(f)(3) applies to new leases with no production and prescribes commercial terms for DNR's oil and gas leases which include a minimum royalty rate of 12.5 percent and the option for sliding-scale royalty rates or net profit sharing. He said AS 38.05.180(f)(4)-(5) apply to both new and existing leases with no production in Cook Inlet and provide a 5 percent royalty rate on initial production under limited circumstances. Put in place [by Senate Bill 112] in 1996, .180(f)(4), Cook Inlet Discovery Royalty, has been used only once. Put in place [by House Bill 380] in 1998, .180(f)(5) grants 5 percent royalty for 10 years; at the time of the

legislation it applied to six known fields, four of which qualified and were successful developments. Mr. Nottingham then addressed statutes relating to mature production on existing leases. He said AS 38.05.180(f)(6) reduces royalty rates on oil production for some offshore fields under limited conditions. [Put in place by Senate Bill 185 in 2003], he said this has been an effective methodology for prolonging oil production from those fields. However, he noted, it doesn't apply to some offshore fields that are producing now, and which could benefit from this. Regarding AS 38.05.180(j), royalty modification by the DNR commissioner, he noted that it applies to more than just the Cook Inlet. [Expanded in 1995 by House Bill 207], he said this statute allows the DNR commissioner to modify royalty for unproduced pools, mature pools, or shut-in pools that are uneconomic. This is a very high bar and lengthy process, he added. Mr. Nottingham advised that many of the existing statutes have restrictions which make for a cumbersome process that may be a detraction.

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CHAIR MCKAY pointed out that [the Cook Inlet] is a very mature basin. Alaska is almost like an independent country, he opined, because it is far away from the Lower 48 and other sources of gas, so charting Alaska's future is "in our hands." He noted that Alaska collects money from these fields in four ways: 12.5 percent royalty per the state constitution, production/severance tax, corporate income tax, and property tax. Royalty is what is being talked about today, he continued, property taxes are collected by the local governments, and corporate income tax is another subject. He asked whether no production tax is paid on many of these fields.

MR. CROWTHER replied that production tax revenue from Cook Inlet production is quite limited today due to policy rationale enacted by the legislature to promote development of those resources. Property tax is an important component of state revenue, he said, but also a part of the dynamic that drives investment decisions about activity in Cook Inlet. Currently there is very active debate and dispute with different operators about the appropriate property tax implications and how they affect investments. Royalty is directly within DNR to manage, and the department thinks royalty is a key economic driver of decisions in these fields. Slide 17 shows the legislature's historical enactment of significant royalty modification in different contexts to promote development to get energy supplies on the market. The intent of HB 276, Mr. Crowther continued, is

to make royalty reductions broadly applicable and clearly applicable to new production instead of having volume driven limits, or location driven limits, or a complicated process with long timelines and uncertainty.

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REPRESENTATIVE SADDLER asked whether current statutes are ineffective or were effective for their time, but circumstances have now changed.

COMMISSIONER BOYLE answered that he wouldn't say the royalty modification statutes are ineffective, but he would say they set a high hurdle that requires lots of analysis by the division and lots of back and forth with the applicant, which isn't a good tool for certainty or being able to do something quickly. He offered his belief that historically there haven't been many instances of the department granting royalty relief.

REPRESENTATIVE SADDLER offered his opinion that the State of Alaska can use royalty and tax provisions to encourage desirable outcomes like providing a supply of gas that keeps people warm and dry, so he doesn't consider the provisions as gas giveaways.

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COMMISSIONER BOYLE responded to both Representative Saddler's and Chair McKay's comments. He advised that the four kinds of state and/or local tax can be drivers on the economics of a project, particularly during the early years when there isn't yet any revenue from the project. Property tax begins as soon as any kind of infrastructure is put in the ground and must be paid by the company regardless of whether a profit is being made. The royalty obligation begins as soon as the project starts production, yet costs haven't been recovered at that point. So, property tax and royalty are key drivers in the economics of a project. After operation starts it takes time to recover the drilling, equipment, and pipeline costs and to earn enough return to repay lenders and shareholders. Commissioner Boyle said he thinks the committee rightfully should look at all the elements to understand where in the cycle they have an impact on project economics. Policies that provide benefit in the early years will have more meaningful impact in helping companies decide whether a project is a go or a no-go versus policies that are oriented towards fields that are already in production or are more mature.

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REPRESENTATIVE MEARS drew attention to the second column on slide 17 and asked what the difference is between HB 276 and [AS 38.05.180(f)(4)-(5)], which has not been heavily utilized.

MR. CROWTHER answered that AS 38.05.180(f)(4) is where a new field is discovered and certifications are required of the well, the production, and the status of the reservoir pre-well, and only the royalty is reduced for that one lease that the well is located on. The department thinks the reason that authority has only been applied for and utilized one time is in part due to how narrow and focused it is. A given unit may involve five or more leases, so that royalty reduction on the production from only the discovery lease is a limitation there. He stated that AS 38.05.180(f)(5) targeted reduced royalty for six different fields to get them online and was successful in that four of those six fields did go into production, providing oil and gas that the state has benefitted from. He said HB 276 essentially would be expanding that (f)(5) provision for all pools that are not currently in commercial production, so new resources getting into the market at that highly competitive 5 percent rate. The hope is to see the same success as with those prior fields which came online in the 1990s and early 2000s.

2:11:15 PM

MR. NOTTINGHAM paraphrased from slide 18, "HB 276: WHY IT IS NECESSARY," which read as follows [original punctuation provided]:

**Why this legislation is necessary**

- Alaskans need access to reliable, affordable energy
- Nearly 70 [percent] of Alaskans use Cook Inlet natural gas for heating, energy, and electricity generation
- Cook Inlet gas supplies are forecasted to drop below demand in coming years unless new sources are brought online
- There are several significant known natural gas fields in Cook Inlet that are not seeing development under the status quo
- Policies and actions to support future development need to be taken today
- More competitive development terms will increase total recovery and utilization of Alaska's natural

resources, which otherwise may not be developed or generate revenue for the State

- Alaska should use all the local natural gas resources available as we work on long-term energy solutions for the Railbelt

[2:12:57 PM](#)

REPRESENTATIVE MCCABE inquired about the performance clauses in the Kitchen Lights and Cosmopolitan leases.

MR. NOTTINGHAM replied that the Kitchen Lights and Cosmopolitan units both have a plan of development requiring the operators to state their plans for the current and future years. He said the division works with the operators to help them identify what they should be doing in the next and following years. The division has recently strongly indicated to both operators its expectation that these units be developed expeditiously.

REPRESENTATIVE MCCABE asked whether the Kitchen Lights and Cosmopolitan units are nearing the end of the period stated in their leases, usually five to ten years, where they must perform, or the lease will be sent to someone else to perform.

MR. CROWTHER responded that both units are currently in production and that production holds the unit. He said DNR has authorities to review the status and level of development activities for a unit, as well as the scope and size of that unit, but hasn't utilized those authorities to pare back or modify either unit. The department expects to see performance under the recently approved annual plans of development which have significant development obligations for both operators. If HB 276 or something like it were to be enacted, the department would be able to specifically tell those operators that it is a highly competitive environment and development activities must be undertaken in the near term, or the state will move forward with potential action under the unit.

REPRESENTATIVE MCCABE requested a definition of "in production."

MR. CROWTHER offered his belief that last year the Kitchen Lights Unit produced near 4 BCF of gas, so contributed to the total demand. But, he added, DNR believes that additional wells and development would push that number up to see the full development of that resource, which is an obligation of the unit agreement. The Cosmopolitan Unit currently is producing oil and a small amount of gas that is being used in the market, but DNR

similarly feels that the full development of that resource with additional wells needs to be done to meet those obligations.

[2:16:24 PM](#)

MR. NOTTINGHAM returned to his presentation. He spoke from slide 19, "HB 276: EFFECTS," which read as follows [original punctuation provided]:

**What the bill does**

- Grants a reduced royalty of five percent for the first then years of production from pools in Cook Inlet that have not previously been produced for commercial sale
- Includes know resources that are not yet in production and resources that could be discovered through further exploration
- Applies to any state land in Cook Inlet, whether or not in existing fields, units, or leases
- Does not reduce royalties for pools presently in commercial production

[2:17:06 PM](#)

MR. NOTTINGHAM spoke to slide 20, "HB 276: QUALIFYING PRODUCTION," which read as follows [original punctuation provided, with some formatting change]:

**AS 38.05.180(f)(f) is amended to read:**

"[The] lessee of *all or part of an oil or gas pool* in the Cook Inlet sedimentary basin that, subject to determination by the commissioner, *has not previously produced for commercial sale* oil or gas shall pay a royalty of five percent on oil or gas produced for sale from that pool for 10 years following the date on which the production for commercial sale commences;"

**What "has not previously produced for commercial sale oil or gas" means:**

- Production from wells or sidetracks drilled after the effective date of this legislation that would not have otherwise been produced from existing wells
- "[S]ubject to determination by the commissioner" means DNR considers if the source of oil and gas has produced in the past, proximity to existing wells,

drainage area of existing wells, and timeframe for recovery from existing wells

- Examples of qualifying production:
  - A newly-drilled well or sidetrack from the edge of an existing or previously-producing development
  - A new well or sidetrack from an unproduced accumulation of oil and gas
- The lessee or lessees shall jointly or separately apply for reduction in royalty for one or more wells with each application
- Data and interpretations will be supplied with the application, and DNR may request further data and interpretations
- A well or accumulation may be determined to receive reduced royalties before a well is drilled when supported by data and interpretations

[2:20:06 PM](#)

MR. NOTTINGHAM addressed slide 21, HB 276: SECTIONAL SUMMARY," which read as follows [original punctuation provided with some formatting changes]:

- **Section 1:** Amends AS 38.05.180(f)(5). The original statute granted a five-percent royalty rate for oil or gas for the first ten years but was limited to six Cook Inlet fields discovered before 1988 and provided a deadline of January 1, 2004, for start of production (in AS 38.05.180(dd)).

This amendment modifies the program to include new production in Cook Inlet, regardless of discovery date, and removes limits or eligible volumes of oil or gas during the ten-year period of reduced royalty. Eligibility is subject to determination by the Department of Natural Resources (DNR) commissioner, rather than being automatic.

- **Section 2:** Repeals the following statutes:

**AS 31.05.030(i):**

This section relates to the powers and duties of the Alaska Oil and Gas Conservation Commission (AOGCC) and the paragraph outlines the procedure for approving plans of development by the AOGCC. This

statute is no longer necessary because the Department of Natural Resources, not the AOGCC, is the agency that administers and approves plans of development.

**AS 38.05.180 (dd) :**

This section relates to the State of Alaska's oil and gas and gas only leasing policies. Paragraph (dd) established a deadline for start of production under the unamended AS 38.05.080(f)(5) and is no longer appropriate.

- **Section 3:** The legislation takes effect immediately under AS 01.10.070(c).

[2:22:01 PM](#)

CHAIR MCKAY drew attention to slide 10 regarding gas storage. He requested verification on whether Kenai Gas Pool 6 could have 500 BCF or more of gas storage capability.

MR. CROWTHER replied that he will get back to the committee with DNR's understanding of the general size of that asset as there are some limits to what size storage asset can be utilized. He said two things drive the size of a storage asset - 1) the raw geologic capacity, with the prior volume produced from the field being a guide there; and 2) the Alaska Oil and Gas Conservation Commission (AOGCC) sets a pressure limit based on the reservoir and regulations.

[2:23:11 PM](#)

REPRESENTATIVE SADDLER asked whether there is a reason why HB 276 limits the royalty relief to 10 years. He further asked whether offering that incentive for a longer period would be more effective.

MR. CROWTHER responded that [DNR] set a 10-year period in the proposed legislation because historically these provisions have had a 10-year period for the legislature and the public to assess the effectiveness of the program. A longer period, he continued, would be a strong signal that DNR would be happy to discuss with the committee.

REPRESENTATIVE SADDLER asked whether a longer period would cause confusion.

MR. CROWTHER answered that clear statutory language for whatever period is set can be assessed by accountants and professionals and won't create confusion.

[2:24:23 PM](#)

REPRESENTATIVE BAKER observed the zero fiscal note for HB 276. He asked whether there are any projections on how the state would benefit revenue-wise moving forward.

MR. CROWTHER answered that the department will share its hypothetical models with the committee. He pointed out that these resources aren't being developed under the status quo of 12.5 percent royalty, so the state is receiving nothing. Receiving 5 percent of new production that otherwise wouldn't be on the market could therefore be a significant revenue benefit.

[2:25:31 PM](#)

REPRESENTATIVE MEARS noted that this proposal is for the entire Cook Inlet Basin. She asked whether it would be in perpetuity or would have a limit of the time for when this can initiate.

COMMISSIONER BOYLE replied that currently the intent is for the incentives to continue indefinitely given the reliance on Cook Inlet energy for providing heat and electricity to homes. As well, he noted, oil and gas development enable the State of Alaska to monetize its resources which in turn grows the permanent fund and provides revenues for state services.

CHAIR MCKAY pointed out that more activity in Cook Inlet creates local jobs and local revenue, which is liked by constituents.

[2:27:44 PM](#)

The committee took an at-ease from 2:27 p.m. to 2:29 p.m.

[2:29:13 PM](#)

CHAIR MCKAY announced that HB 276 was held over.

^#hb223

**HB 223-TAX & ROYALTY FOR CERTAIN GAS**

[2:29:33 PM](#)

CHAIR MCKAY announced that the final order of business would be HOUSE BILL NO. 223, "An Act relating to the production tax and royalty rates on certain gas; and providing for an effective date."

2:29:50 PM

REPRESENTATIVE RAUSCHER, as prime sponsor of HB 223, explained that HB 223 is similar to HB 276 and therefore the background provided by the Department of Natural Resources (DNR) on HB 276 serves for both bills. He paraphrased from the sponsor statement [included in the committee packet], which read as follows [original punctuation provided]:

House Bill No. 223 represents a crucial step in revitalizing Alaska's natural gas industry, particularly focusing on the Cook Inlet region. This bill addresses a longstanding barrier to investment in this sector: the current production tax and royalty rates. By proposing strategic modifications to these rates, HB 223 aims to elevate Alaska's competitiveness and attractiveness for natural gas investments.

This legislation is crafted to stimulate economic growth and ensure a stable natural gas supply for our state. It introduces vital changes, such as allowing more flexible royalty and leasing options, reducing royalty rates for specific leases in the Cook Inlet sedimentary basin, and implementing a tax cap for gas production in the region. Additionally, it establishes a zero-tax rate for new gas exploration efforts post-June 5, 2023, with a focus on in-state utility prioritization.

The impact of HB 223 extends beyond mere economic metrics; it's about securing a prosperous future for Alaska through a more robust and dynamic natural gas industry. This bill specifically targets the revision of tax and royalty rates for natural gas production in the Cook Inlet basin, ensuring that the changes are focused and effective, without altering other aspects of the state's oil and gas laws.

REPRESENTATIVE RAUSCHER specified that HB 223 leverages gas that may never be produced. He stressed that the bill's purpose isn't to give away Alaska's resources to other countries, but rather that these resources will be spent in-state where they

are needed in-stated. He added that 5 percent of something is better than 100 percent of nothing. He specified that the high price of gas isn't due to the amount of gas available in the Cook Inlet, rather it is due to the availability of gas in the inlet. Money coming into the state for renewable resource projects says to the producers that they may be getting pushed out of the picture which may make them not want to invest in oil and gas. The producers, he opined, need to be enticed to find more gas, and the gas needs to be kept at a special rate for the utility companies that utilize the gas, and that is what HB 223 intends to do.

[2:34:30 PM](#)

CRAIG VALDES, Staff, Representative George Rauscher, provided the sectional analysis of HB 223 on behalf of Representative Rauscher, prime sponsor. He paraphrased from the sectional analysis [in the committee packet], which read as follows [original punctuation provided]:

**Section 1: AS 38.05.180(f)**

Page 1, lines 5,6

This section is amended to include "and (mm) of this section" as an exception to when the commissioner may issue oil and gas leases or leases for gas only on state land.

Page 2, line 14

The word "no" is replaced with "not"

**Section 2: AS 38.05.180**

Page 8, lines 17-24

A new subsection, (mm), is added to discuss contracts and royalty shares.

**Section 3: AS 43.55.011(j)**

Page 8, lines 26

This section is amended to include subsection (q) as an exemption to the tax levied by (e) of this section.

**Section 4: AS 43.55.011(p)**

Page 9, line 15

This section is amended to include (q) as an exemption for the allotted time following the commencement of commercial production of oil or gas produced from leases or properties in the state that are outside the Cook Inlet sedimentary basin.

**Section 5: AS 43.55.011**

Page 9, lines 23-27

A new subsection, (q), is added that explains how the levy of tax under (e) of this section may not exceed zero for gas that was explored for only on or after the 5th of June, 2023 and offered for sale to an in-state electric or heating utility company before being offered for sale to another person.

**Section 6: AS 43.55.020(a)**

Page 17, lines 13, 14

A new subsection (H) was added to further discuss installment payments of the estimated tax levied, that included subsection (q).

**Section 7:** Sections 1 and 2 effective dates

**Section 8:** Effective Date

[2:37:05 PM](#)

CHAIR MCKAY noted that HB 276 addresses royalties only. He asked whether he is correct that HB 223 addresses production tax and royalties.

MR. VALDEZ confirmed that Chair McKay's understanding of both bills is correct. Responding further, he explained that HB 223 affects the clause that talks [about production tax and royalties] but the bill doesn't change the production tax.

CHAIR MCKAY qualified that his questions are friendly as he is seeking to understand the bill.

[2:38:37 PM](#)

REPRESENTATIVE RAUSCHER advised that HB 223 was pre-filed in response to communications last year between members of the House Resources Standing Committee and producers, so the bill likely has some redundancy with HB 276, and he open to perhaps making the two bills into one.

[2:39:58 PM](#)

REPRESENTATIVE MEARS asked if she is correct in understanding that the differences between HB 223 and HB 276 are that [HB 223] applies in perpetuity for all Cook Inlet discovery while HB 276 has a 10-year timeline on the field production, and that under

[HB 223] the royalty is zero percent if gas is offered for in-state utilities and otherwise reduced by 50 percent to 6.25 percent [while the royalty rate is 5 percent under HB 276].

REPRESENTATIVE RAUSCHER replied that those understandings are correct. He added that the third difference is that HB 223 only encompasses Cook Inlet while HB 276 encompasses a larger area.

REPRESENTATIVE MEARS asked about the geographic limit specified in HB 276.

MR. VALDEZ responded that HB 276 specifies a geographic area that is south of the North Slope, so Middle Earth as well as Cook Inlet.

CHAIR MCKAY offered his belief that Middle Earth is somewhere around Fairbanks.

[2:42:14 PM](#)

REPRESENTATIVE ARMSTRONG asked whether other incentives were explored that would be helpful in incentivizing more production or whether the sponsor chose this alternative because it seemed the most incentivizing to Alaska's producers and operators.

REPRESENTATIVE RAUSCHER answered that, in his opinion, he must do something that helps the parties, not just one entity. He said he wants to reward the act of selling to utility companies because they need it, and he wants to make it so [producers] will want to go search for . This alternative would benefit the ratepayers, the utility companies, and the producers producing gas in the inlet, and no gas would be purchased from overseas.

[2:44:40 PM](#)

REPRESENTATIVE ARMSTRONG offered her appreciation for the zero percent to incentivize the payment to utilities. She said it is also compelling to provide help to industry when other things come online, along with capturing more of the mining value chain. So, she continued, it would be interesting to do a hybrid of the two bills. She asked whether it is correct that the royalty rate would be 6.25 percent if the gas wasn't offered to a utility first.

MR. VALDEZ confirmed that that is correct.

[2:45:18 PM](#)

CHAIR MCKAY announced that HB 223 was held over.  
#

2:46:02 PM

**ADJOURNMENT**

There being no further business before the committee, the House Resources meeting was adjourned at 2:46 p.m.