

HB

61

SENATE COMMITTEE REPORT

DATE: 5/2/03

FURTHER:

DATE TURNED
IN TO OFFICE: 5-8-03

Resources Committee considered CS FOR HOUSE BILL NO. 61(FIN)

HB 61 OIL & GAS TAX CREDIT FOR EXPLORATION/DEV

"An Act establishing an exploration and development incentive tax credit for operators and working interest owners directly engaged in the exploration for and development of gas for sale and delivery without reference to volume from a lease or property in the state; and providing for an effective date."

and recommends:

- be replaced with S CS: CSHB 61 (RES)
- adopt previous _____ CS _____
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to _____ Committee

Senate Bill:

- same title
 new title

House Bill:

- same title
 technical title
 new: SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#
REV	3/11/03		✓	2
DOR	3/4/03		✓	1

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	Do PASS	Do NOT PASS	No REC	AMEND
<i>Ralph Jenkins</i>	✓			
<i>Ben Stevens</i>	✓			
<i>Thomas H. Wagoner</i>	✓			
<i>Deanna J. ...</i>			✓	
<i>Scott ...</i>	✓			
CHAIR: <i>Scott ...</i>	✓			

Alaska State Legislature

Interim

145 Main Street Loop, Suite 223
Kenai, Alaska 99611
Phone: (907) 283-7223
Fax: (907) 283-7184



Session

Capitol Room 502
Juneau, Alaska 99801-1182
Phone: (907) 465-6890 or 465-3779
Fax: (907) 465-2833

House Finance Committee

Representative Mike Chenault

Memorandum

Date: May 1, 2003
To: Senator Scott Ogan, Chair
Senate Resources Committee
From: Representative Mike Chenault
Re: Hearing Request for CS for HB 61 (FIN)

Please schedule CS HB 61 (FIN) for a hearing in the Senate Resources Committee at your earliest convenience. Included in this packet are the Sponsor Statement, Fiscal Note, copy of the CS for HB 61 (FIN) and letters of support.

If you have any questions, please contact my staff, Leona Oberts at #6890.

STATE OF ALASKA

REPRESENTATIVE
MIKE CHENAULT

Official Business

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145 Main St. Loop, Second Floor
Kenai, Alaska 99611
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HOUSE OF REPRESENTATIVES

Session:
Capitol Building, Room 432
Juneau, Alaska 99801-1182
(907) 465-3779
Toll Free: (800) 469-3779
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Sponsor Statement HB 61

HB 61 creates a new income tax credit to encourage increased exploration and development of natural gas reserves south of the Brooks Range. To qualify for the credit, operators must successfully drill and develop reserves that produce natural gas for sale and delivery. This is a successful efforts bill which means that no credits will be given for dry holes.

The Cook Inlet continues to have great potential for additional natural gas development. Other Alaska basins outside of the North Slope have similar potential. However, the combination of exploration risk, high development costs and historic low natural gas prices has created a disincentive to drill for new reserves as compared to other areas of the world. By providing a credit for successful efforts, more exploration will occur in Southern Alaska leading to much needed new natural gas reserves. This will benefit all residents and businesses at no direct cost to the state.

In addition to the benefit of developing new gas reserves, increased Cook Inlet drilling will also aid the general economic status on the Kenai Peninsula and in Anchorage as well as other areas of Alaska. Moreover, increased tax revenue from additional gas production will more than offset any fiscal impact from the proposed credit.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: CSHB 61(O&G)
 (H) Publish Date: 3/14/03

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
 Title Oil and Gas Tax Credit for Exploration. BRU Oil and Gas Development
 Component Oil and Gas Development
 Sponsor Chenault, Kohring, Wolf
 Requester House Oil and Gas Component No. 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
 Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

HB 61 would authorize the Dept. of Revenue to grant credits against a taxpayer's state corporate income tax liability for certain oil or gas exploration and development investments made in the state.

Prepared by: Mark D. Myers Phone 269-8800
 Division Oil and Gas Date/Time 2/4/03 7:46 AM
 Approved by: Tom Irwin, Commissioner Date 2/4/2003
 Agency Natural Resources

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 2
 Bill Version: CSHB 61(O&G)
 (H) Publish Date: 3/14/03

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Oil and Gas Tax Credit BRU Revenue Operations
for Exploration / Development Component Tax Division
 Sponsor Representative Chenault
 Requester House Committee on Oil and Gas Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES () *See Analysis*

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill is intended to promote the exploration and development of natural gas south of the Brooks Range, particularly in Cook Inlet. This bill allows a tax credit equal to 10 percent of qualified capital investment -- as well as annual labor, seismic and associated costs -- related to gas exploration and development work to be applied against corporate income tax (AS 43.20) for up to 50% of a corporation's total tax liability. The credit applies only to gas exploration and development of reserves south of the Brooks Range. The credit can only be taken if the reserves produce gas for sale and delivery.

Corporations could use their tax credits under this legislation to reduce taxes paid to the state for North Slope production or production from elsewhere in the state.

Oil and gas corporate income tax collections in FY 2003 and FY 2004 are currently projected at \$160 million and \$200 million per year, respectively.

Prepared by: Chuck Logsdon, Chief Petroleum Economist Phone _____
 Division: Tax Division Date/Time 3/11/03 9:46 AM
 Approved by: Larry Persily, Deputy Commissioner Date 3/11/2003
 Agency: Department of Revenue

FISCAL NOTE #2

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 61(O&G)

ANALYSIS CONTINUATION

It is not easy to evaluate the overall revenue effect of a tax credit. On the plus side, if exploration activity discovers developable reserves, the state could receive royalty and production taxes that more than offset the revenue loss due to the tax credit. And the availability of the credit could enhance the attractiveness of exploring for new oil and gas resources, which may or may not result in creditable expenditures depending on whether discovery and development occurs.

The credit is targeted to natural gas exploration and development activity south of the Brooks Range, while the bulk of current oil and gas corporate income tax against which this credit could potentially be taken is from production and transportation of high-value oil on the North Slope. As a result, an oil and gas corporation that has profitable operations on the North Slope could, by investing in development outside of the Slope, reduce its total oil and gas corporate income tax liability through this new credit provision.

The key state revenue issue with regard to this tax credit is the extent to which the additional incentive is needed to encourage exploration and development. Natural gas price levels are critical in determining the commercial incentive to explore and develop. Natural gas prices probably will be a bigger factor in a commercial venture than the tax credits in this legislation, but this tax credit provision could also play a factor in a corporate decision to invest in exploration and development. A risk to the state is if high gas prices spur development on their own, regardless of the tax credit, the state could be in the position of providing a tax credit that is no longer necessary to promote development.

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Oilfield Services

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Anchorage, Alaska 99503-5711
(907) 273-1700
Fax (907) 561-8317

Schlumberger

Representative Mike Chenault
House of Representatives
Alaska State Capitol, Room 502
Juneau, AK 99801-1182

Re: House Bill 61 (O&G)

Dear Representative Chenault:

This letter is in support of the Act establishing an exploration and development tax credit for persons engaged in the exploration and development of gas south of the Brooks Range in the state of Alaska (HB 61).

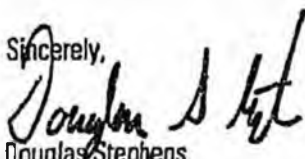
Schlumberger Technology Corporation is a Delaware company with substantial oilfield services operations in Alaska, where we presently employ approximately 500 people, the vast majority of whom are residents of the state, where we have operated for the past 35 years. The services we provide assist Operating Companies, during the exploration, development and production phases of oil and gas exploration.

Alaska's gas exploration and production activities are in need of economic stimulus in order for the state to realize its potential in energy development. The incentives provided by proposed HB 61 are designed to deliver to the State's economy this needed stimulus, with the expected result of increased employment and increased consumer and business spending. The stimulus provided by HB 61 would apply not only to new gas exploration, but also to other economic benefits realizable with respect to marginal reservoirs, which may be discovered while exploring for gas.

HB 61 creates an incentive tax credit to increase exploration and development of natural gas in the Cook Inlet and other prospective Alaskan basins south of the Brook Range. The Cook Inlet reserves have continued to decline over time, due in large part to high exploration and production costs. The Cook Inlet (and the Kenai peninsula) is a mature oil province, where the economics of developing cost effective energy sources have changed, hence the incentive for undertaking additional exploration activity which would result from the passage of HB 61 is critical to the long term viability of the State's gas market, a key component of the Cook Inlet, Kenai and Alaska economies.

Accordingly, we trust you will give your support to HB 61.

Sincerely,


Douglas Stephens
General Manager
Schlumberger Alaska

The logo for ConocoPhillips, featuring the word "ConocoPhillips" in a bold, sans-serif font. Above the letter "o" in "Phillips", there is a stylized graphic of a checkmark or a winged arrow pointing upwards and to the right.

J. Scott Jepsen
Cook Inlet Asset Manager

P.O. Box 100360 - ATO 1420
Anchorage, AK 99510-0360
Phone 907-263-4348

Feb. 27, 2003

Representative Vic Kohring
Chairman, House Oil and Gas Committee
Alaska State Capitol, Room 24
Juneau, Alaska 99801

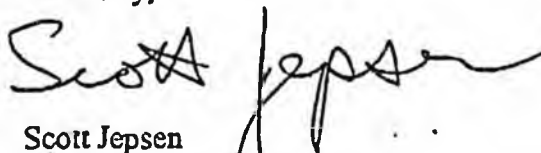
Re: House Bill 61

Dear Rep. Kohring:

ConocoPhillips Alaska would like to express our support for HB 61 - An Act Establishing Oil and Gas Tax Credits for Certain Exploration and Development Projects. We believe that passage of this bill has the potential to spur additional efforts to explore for oil, and in particular gas, in places like Cook Inlet and the surrounding area that have not seen much exploration in recent years.

Thank you for your continued support for our efforts in Alaska. If you have any questions, please call me at (907) 263-4348.

Sincerely,

A handwritten signature in black ink that reads "Scott Jepsen". The signature is written in a cursive, flowing style.

Scott Jepsen
Cook Inlet Asset Manager
ConocoPhillips Alaska, Inc.

Cc: Rep. Chenault
Rep. Kelly Wolf

HB 61 WITNESS LIST

MARATHON OIL CO.

**John A. Barnes, P.E.
Alaska Region Manager
Anchorage**

907-564-6400

**Douglas E. Thierwechter, Manager
Government Affairs
Houston, Texas**

713-296-4146

Union Oil Company of California
Testimony on HB 61
Senate Resources Committee
May 7, 2003

Mr. Chairman and members of the Senate Resources Committee--My name is Kevin A. Tabler, Manager of Land and Govt. Affairs for Union Oil Company of California (Unocal) in Alaska. I appreciate this opportunity to be heard today and to present a few comments regarding House Bill 61. We appreciate your consideration of HB 61 as a vehicle to stimulate gas exploration and development south of the Brooks Range.

Although we recognize this bill may serve to improve the economics of marginal oil reservoirs discovered or defined while exploring for gas, it is the identification and development of new gas reserves in the Cook Inlet which are needed if we are to sustain our local economy in southcentral Alaska. Without new gas reserves, value added businesses and industrial exporters will suffer cutbacks in production, yielding to the ever present southcentral utility needs. These disruptions in supply, if left unchecked, will lead to a lower tax base, unemployment and underemployment and loss of the monetary cycling effect as dollars change hands throughout a community.

I place an emphasis on Cook Inlet as Cook Inlet is where Unocal's infrastructure base and manpower are best defined. Although we do have working interests in fields on the North Slope, our ownership interest is such that we play a minor role in the exploration and development operations of those fields. While we recognize that incentives available to North Slope explorers and producers will have a beneficial impact on Unocal, the beneficial impact of incentive legislation in Cook Inlet is magnified when applied to the marginal nature of the mature fields and the declining gas reserve base in Cook Inlet. For this reason incentive legislation such as HB 61 will help achieve the desired effect of identifying new gas reserves by providing a predictable and quantifiable credit to help lessen the inherent risk of costly exploration. The increased tax revenue from additional hydrocarbon production will more than offset the initial financial impact from the tax credit. The objective is not to shift a larger share of an existing pie to industry; rather the objective is to increase the size of the pie for everyone.

Unocal's considerable stake in its Cook Inlet infrastructure, manpower and capital investments are continually threatened by internal global competition for investment dollars. Evidence of this vulnerability is confirmed by the recent drilling of three dryholes on the Kenai Peninsula in an effort to meet the growing demand of the natural gas market. Although, we were rewarded by the discovery of the Ninilchik Unit with our partner Marathon, the expense, risk and uncertainty of success, has reduced our Alaska capital budget from \$75 million last year down to \$35 million for 2003. Providing a credit for successful efforts will definitely improve the attractiveness of our Alaskan exploration projects.

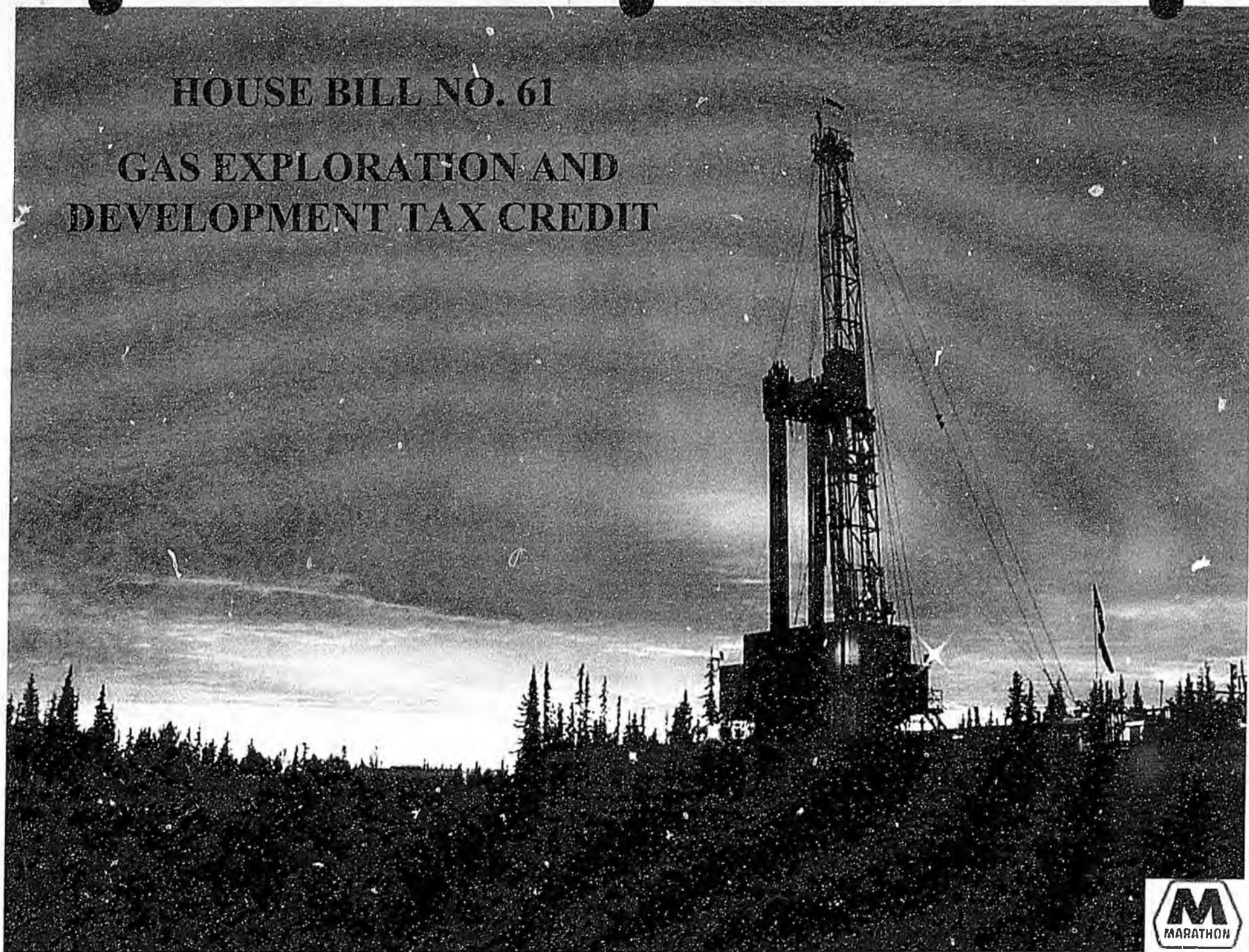
Not only will HB 61 create an incentive for companies currently active in gas exploration in Cook Inlet, the attractiveness of such a credit will act as an industry incentive to those thinking of investing in exploration south of the Brooks Range. If you think of the credit as costing the state \$1 for every \$10 dollars invested by someone else, and paid out only in a success scenario, the risk to the State of Alaska is negligible when compared with the ancillary benefits of new reserve identification.

In conclusion, we believe this Bill will add certain attractive parameters to companies during the investment decision making process with very little exposure to the State of Alaska. Therefore we encourage passage out of your committee.

Thank You,
Kevin A. Tabler

HOUSE BILL NO. 61

**GAS EXPLORATION AND
DEVELOPMENT TAX CREDIT**





HB 61 – What Does it Do

- Draws more E&P Investments to Alaska
- Creates income tax credit to encourage exploration and development of gas reserves south of Brooks Range
- Primary focus is on Cook Inlet, but applies to other Alaska basins
- Focus is on natural gas.
- Levels the playing field somewhat with other exploration opportunities around the world.



HB 61 – How Does it Work?

- Applies to 10% of Qualified Capital Investment
- Applies to 10% of Qualified Expense
- May offset no more than 50% of corporate income tax in any one year (up to five additional years)
- Only applies to successful efforts.
- Incentive can be factored into project economics.

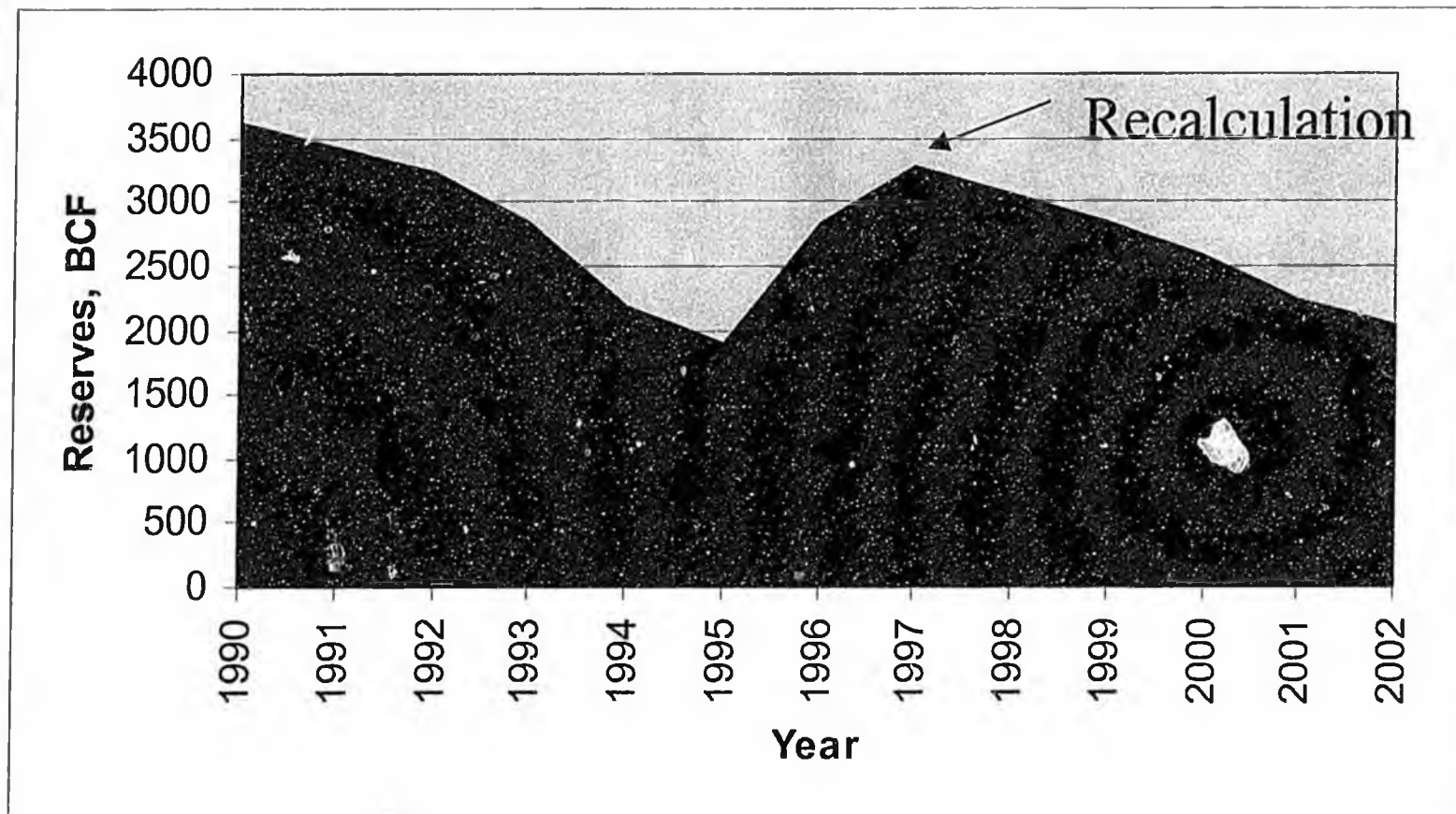


HB 61 – Why is it needed?

- Currently there is not enough Alaska E&P Activity
- Natural Gas Reserves have been and are continuing to decline in the Cook Inlet.
 - Current Cook Inlet proven natural gas reserves are estimated at 2 TCF
 - (Based on DNR DOG 2002 report, less 2002 production)
- Despite recent increase in Cook Inlet exploration activity, reserves are not being replaced on an annual basis



Cook Inlet Proven Gas Reserves



Source: Alaska DNR

May 7, 2003

*Testimony of John A Barnes to Senate
Resources Committee*

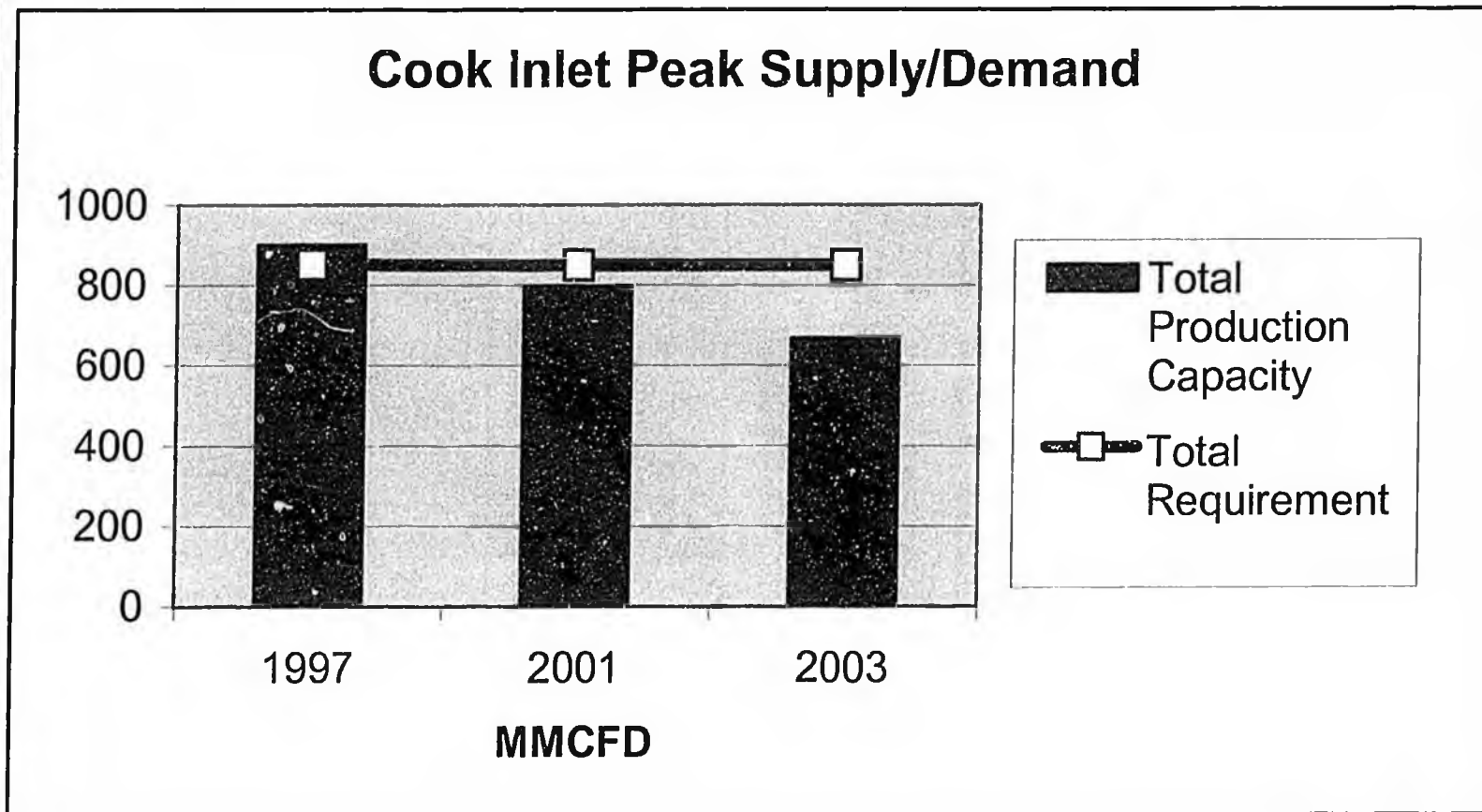


HB 61 – Why is it needed?

- Cook Inlet deliverability has declined over last several years.



HB 61 – Why is it needed?





HB 61 – Why is it needed?

- Supply and demand rationalization is occurring.
 - Not enough gas to feed low price consumer. *Agony*
 - Gas price increasing
 - Enstar average gas cost (WACOG) \$2.55/mcf –
 - Most recent Enstar contract gas price \$2.75 to Henry Hub
 - Henry Hub recently over \$9.00/mcf



Cook Inlet Reserves & Resources

- Current proven reserves – 2000 BCF - 2 TCF
 - Approximately 10 year production life, assuming no decline.
- Potential Gas Committee Resource Estimates - INCLUDE SHALLOW GAS
 - Probable Reserves – 1050 BCF 50%
 - 3150 BCF Potential
 - Possible Reserves – 2100 BCF -



Impacts to State of Alaska

- Stimulates Cook Inlet, and potentially other basin exploration.
- Aids in maintaining Cook Inlet 200+ BCF/year production.
 - Equivalent to a 13th month of North Slope Production.
- Provides gas for Cook Inlet utilities, industrials, jobs, royalties, taxes.



Fiscal Impact to State of Alaska

- Incentive will be clearly positive to State of Alaska, factors are...
 - How many developments will be incentivized?
 - How much gas will be discovered?
 - What will be the gas sales price (royalty value)?
 - How much will be spent for exploration and development?
 - Successful efforts driven – no incentives for dry

holes

Depends on



Fiscal Impact to State of Alaska

- Conceptual Estimate of Impact, assumptions:
 - Varied field size from 0 to 500 BCF
 - Development Cost \$0.50/mcf
 - Royalty – 12.5%
 - Severance Tax – 7.5%
 - Ad valorem – 2.7%
 - Gas sales price - \$2.50/mcf



Marathon Oil Company



Fiscal Impact to State of Alaska

Field Size (BCF)	Development Cost	Tax Credit	Gross Revenue	Royalty (12.5%)	Severance (7.5%)	Ad Val	Total Tax
0	0	0	0	0	0	0	0
50	\$25,000,000	\$2,500,000	\$125,000,000.0	\$15,625,000	\$9,375,000	\$1,050,000	\$26,050,000
100	\$50,000,000	\$5,000,000	\$250,000,000.0	\$31,250,000	\$18,750,000	\$2,100,000	\$52,100,000
150	\$75,000,000	\$7,500,000	\$375,000,000.0	\$46,875,000	\$28,125,000	\$3,150,000	\$78,150,000
200	\$100,000,000	\$10,000,000	\$500,000,000.0	\$62,500,000	\$37,500,000	\$4,200,000	\$104,200,000
250	\$125,000,000	\$12,500,000	\$625,000,000.0	\$78,125,000	\$46,875,000	\$5,250,000	\$130,250,000
300	\$150,000,000	\$15,000,000	\$750,000,000.0	\$93,750,000	\$56,250,000	\$6,300,000	\$156,300,000
350	\$175,000,000	\$17,500,000	\$875,000,000.0	\$109,375,000	\$65,625,000	\$7,350,000	\$182,350,000
400	\$200,000,000	\$20,000,000	\$1,000,000,000.0	\$125,000,000	\$75,000,000	\$8,400,000	\$208,400,000
450	\$225,000,000	\$22,500,000	\$1,125,000,000.0	\$140,625,000	\$84,375,000	\$9,450,000	\$234,450,000
500	\$250,000,000	\$25,000,000	\$1,250,000,000.0	\$156,250,000	\$93,750,000	\$10,500,000	\$260,500,000

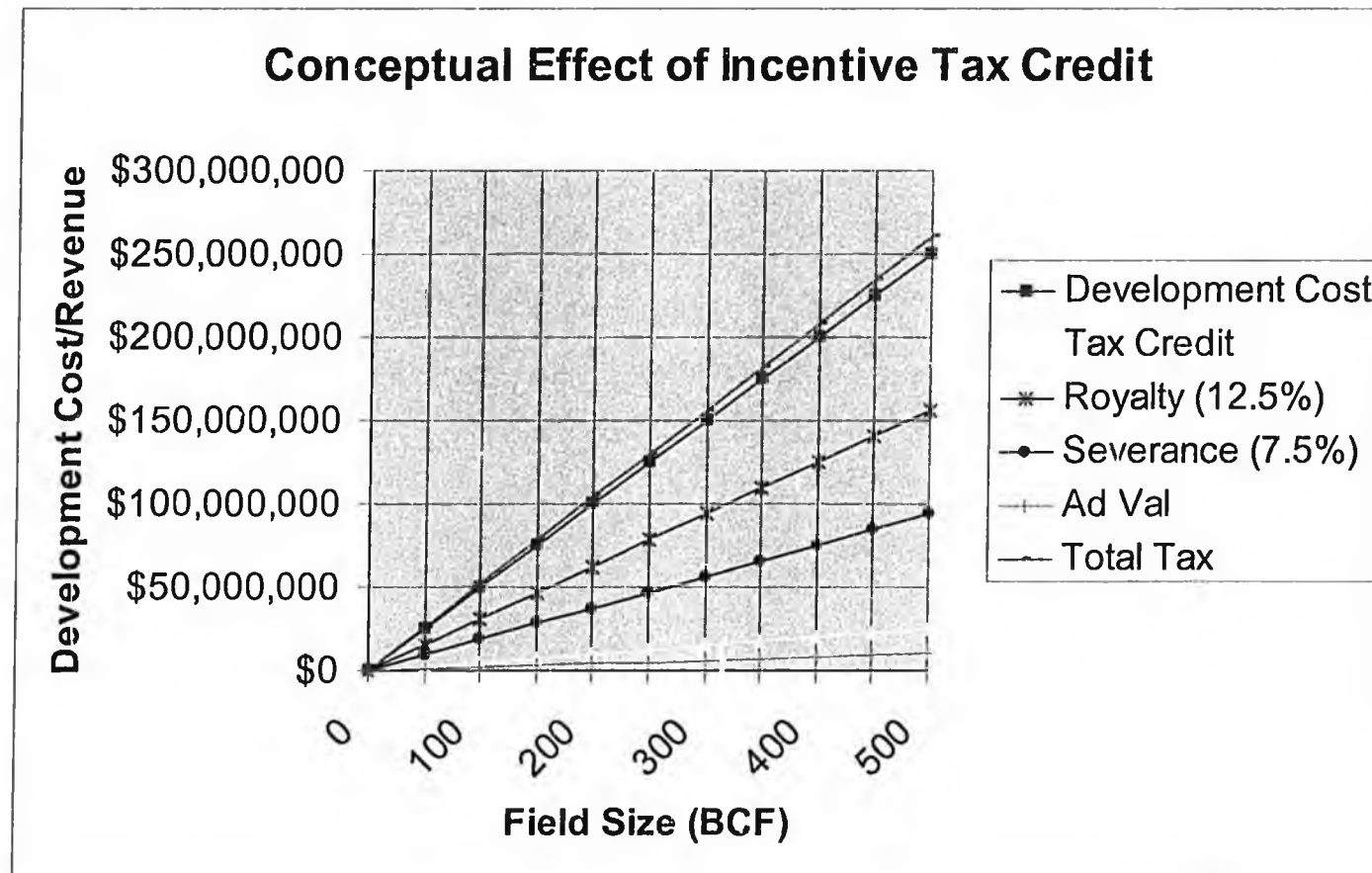
May 7, 2003

*Testimony of John A Barnes to Senate
Resources Committee*

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Fiscal Impact to State of Alaska





HB 61 – Conclusions

- Based on conceptual model, State of Alaska receives from \$3 to \$10 additional revenue for each \$1 of tax credit.
- Credit is needed now!
 - Not enough exploration in Cook Inlet to meet demand.
 - Other areas of state need exploration and development.
 - New discoveries will take a minimum of 3 years to bring to first gas



HB 61 – Success Measures

- Increased Lease Activity
- Increased Drilling Rig Activity
- Increased Construction Activity
- Increased Production and Deliverability
- Credits Applied to Income Tax
 - For every dollar of credit approximately **TEN DOLLARS** were spent successfully developing new reserves, and ultimately paying new taxes!

John A. Barnes, P.E.
Alaska Business Unit Manager



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