

HB

498

ALASKA STATE LEGISLATURE

House of Representatives

COMMITTEE ASSIGNMENTS

RULES COMMITTEE, CHAIRMAN
LABOR & COMMERCE COMMITTEE, MEMBER
LEGISLATIVE COUNCIL, MEMBER
SPECIAL COMMITTEE ON OIL & GAS, MEMBER
SPECIAL COMMITTEE ON WAYS & MEANS, MEMBER

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Representative Norman Rokeberg

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SPONSOR STATEMENT HOUSE BILL 498

"An Act authorizing tax credits against the production tax on oil and gas for qualified expenditures for challenged or nonconventional oil or gas and for qualified expenditures for nonconventional or renewable energy resources; giving the Act contingent effect; and providing for an effective date."

New technology, innovation and creative enterprise have always been the foundation of North American economic growth, particularly as a means to increase productivity and efficiently use investment capital. The oil industry has been on the cutting edge of new technology development and in using that technology to prolong the life of oil fields. Alaska depends on the oil industry and its development of new tools to sustain production.

Lower production of oil means lower revenue for Alaska and higher cost per barrel produced. The reserves are available on the North Slope – over 17 billion barrels of recoverable oil – but getting it out of the ground can be challenging. Alaska needs to look at ways to encourage development that will provide easier access to these reserves.

HB 498 grants a 15 percent tax credit against petroleum production taxes to assist in producing these largely inaccessible and costly resources. In addition, the bill grants a 25 percent tax credit against petroleum production taxes for qualified alternative energy projects. This tax credit would enable an Alaskan oil and gas producer to invest in an Alaskan energy project (e.g., wind, solar and tidal electrical production) and earn a reduction in taxes.

HB 498 is intended to encourage use of new technologies and methods of operation that are experimental and cutting edge. Alaska's "unconventional and challenged" resources include 25 to 30 billion barrels of viscous or heavy oil, carbonate geologic formations, and oil shale. These and other hydrocarbons have an enormous potential to bring wealth to Alaskans and help meet the global demand for energy.

I request your support of this legislation.

Sponsor Statement

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: HB 498
 (H) Publish Date: 4/12/06

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
 Title: Tax Credits Nonconventional Oil/Gas RDU: Resource Development
 Component: Oil and Gas Development
 Sponsor: House Rules
 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 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
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 (FY2006) cost: 0.0
 Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

No fiscal impact anticipated to the Department of Natural Resources.

Prepared by: William Van Dyke, Acting Director Phone 269-8800
 Division: Oil and Gas Date/Time 4/6/2006
 Approved by: Michael Henge, Commissioner Date 4/6/2006
 Agency: Natural Resources

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 2
 Bill Version: HB 498
 (H) Publish Date: 4/12/06

Revision Date/Time (Note if correction): _____ Dept. Affected: revenue
 Title An Act authorizing tax credits against the RDU Tax and Treasury
production tax on oil and gas Component Tax
 Sponsor Rules Committee
 Requester _____ Component No. _____

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services	378.2	385.8	393.5	401.3	409.4	417.6
Travel						
Contractual	200.0	200.0				
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	578.2	585.8	393.5	401.3	409.4	417.6

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()	See analysis section.					
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	578.2	585.8	393.5	401.3	409.4	417.6
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	578.2	585.8	393.5	401.3	409.4	417.6

Estimate of any current year (FY2006) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill would authorize tax credits of 15% against the oil and gas production tax for qualified expenditures on challenged or nonconventional oil or gas, and tax credits of 25% on expenditures for nonconventional or renewable energy resources. These credits would be in addition to credits under AS 43.55.024 and AS 43.55.025 for the same qualified expenditure. Expenditures are qualified if they are ordinary and necessary for research, development, or production of challenged or nonconventional oil or gas, or for research, development, or demonstration of new technology as certified by the department. The Department believes these would include not only qualified capital expenditures, but also non-capital expenditures, and research and development (R&D) costs incurred out of state. The bill becomes effective only if the current Legislature passes a production tax based on a percentage of value. The effective date would be the later of the effective date of such an Act, or July 1, 2006.

Prepared by: Robynn Wilson, Michael Williams, Roger Marks, and Cherie Nier Phone 269-6634
 Division Tax Division Date/Time 4/10/06 11:00 AM
 Approved by: Jerry Burnett Date 4/10/2006
 Agency Department of Revenue

FISCAL NOTE #2

STATE OF ALASKA
2006 LEGISLATIVE SESSION

BILL NO. HB 498

ANALYSIS CONTINUATION

The figures in the table below reflect the reductions in production tax revenues from the bill under the Department of Revenue's Spring 2006 forecast prices, and at higher prices. The Department's long-term price forecast is for \$25.50/bbl ANS West Coast beginning in FY 2009. The Department's economic model assumes that investment for challenged oil is significantly reduced at prices under \$30, and production is subsequently reduced.

The following fields are believed to contain challenged oil: West Sak, Polaris, Orion, Lisburne, Tabasco, and Schrader Bluff. (Currently this totals about 90,000 barrels per day.) In addition, enhanced oil recovery (EOR) expenditures extract both conventional and challenged oil. At this time there no known expenditures anticipated for either nonconventional oil or gas, or nonconventional or renewable energy sources.

The cost assumptions are as follows:

- \$1/bbl on-going capital
- \$5.33/bbl developmental capital
- \$5/bbl operating cost
- \$433 million annually EOR
- \$333 million annually R&D

The table shows the 2006-2012 reductions in production tax from the bill, at volumes associated with the Department's price forecast, and at high prices (above \$30/bbl). These revenues are net of the additions to the state corporate income tax associated with the reduced production taxes, and their subsequent deductibility.

Operating expenditures include costs for 3 additional positions for auditors: 1 O & G Revenue Auditor IV (Range 22) and 2 O & G Revenue Auditor III's (Range 20). In addition, we request 1 additional position for a Engineering Geologist (Range 22) to certify challenged and nonconventional oil or gas and nonconventional or renewable energy sources. Personal Services reflect a 2% yearly increase.

Contractual expenses include \$200,000 in both FY 07 and FY 08 for help in writing regulations.

Fiscal Year	Revenue Reduction DOR Forecast (\$millions)	Revenue Reduction High Prices (\$millions)
2007	138	157
2008	142	162
2009	134	166
2010	133	171
2011	131	175
2012	130	176

24-LS1817S

Chenoweth

4/26/06

CS FOR HOUSE BILL NO. 498(RES)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FOURTH LEGISLATURE - SECOND SESSION

BY THE HOUSE RESOURCES COMMITTEE

Offered:

Referred:

Sponsor(s): HOUSE RULES COMMITTEE

A BILL**FOR AN ACT ENTITLED**

1 "An Act authorizing tax credits against the production tax on oil and gas for qualified
2 development expenditures for challenged oil pools; and providing for an effective date."

3 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

4 * **Section 1.** AS 43.55 is amended by adding a new section to read:

5 **Sec. 43.55.026. Credits for expenditures for development of challenged oil**
6 **pools.** (a) Notwithstanding that an expenditure that is a qualified development
7 expenditure may be a lease expenditure that is deductible for the purpose of
8 calculating the production tax value of oil and gas under AS 43.55.160(a), a producer
9 that incurs a qualified development expenditure may also elect to take a tax credit in
10 the amount of 15 percent of that expenditure. A credit under this subsection

11 (1) is in addition to any credit under AS 43.55.024 for the same
12 expenditure; and

13 (2) may be applied against a tax due under AS 43.55.011(e) on oil
14 produced on or after April 1, 2006.

1 (b) For a calendar year for which the producer makes an election under
2 AS 43.55.160(f), instead of taking a tax credit at a rate authorized by (a) of this section
3 as to each separate qualified development expenditure after it has been incurred, a
4 producer that incurs a qualified development expenditure during that year and that
5 wishes to apply a credit based on that expenditure against a tax due under
6 AS 43.55.011(e) shall calculate and apply every month an annualized tax credit in an
7 amount equal to one and one-quarter percent of the producer's total qualified
8 development expenditures incurred during that year and for which the tax credit is
9 taken for that year.

10 (c) A credit or portion of a credit under this section may not be used to reduce
11 a person's tax liability under AS 43.55.011(e) for any month below zero, and any
12 unused credit or portion of a credit not used under this subsection may be applied in a
13 later month.

14 (d) A credit under this section is not transferable.

15 (e) A producer may not take a credit under this section for an expenditure
16 incurred

17 (1) after March 31, 2016;

18 (2) for an oil pool determined to be a challenged oil pool under (f) of
19 this section sooner than 30 days after the Department of Natural Resources provides
20 notice of the determination to the Legislative Budget and Audit Committee;

21 (3) to acquire an asset (A) the cost of previously acquiring which was a
22 lease expenditure under AS 43.55.160(c) or would have been a lease expenditure
23 under AS 43.55.160(c) if it had been incurred on or after April 1, 2006, or (B) that has
24 previously been placed in service in the state; an expenditure to acquire an asset is not
25 excluded under this paragraph if not more than an immaterial portion of the asset
26 meets a description under (A) or (B) of this paragraph; for purposes of this paragraph,
27 "asset" includes geological, geophysical, and well data and interpretations.

28 (f) A lessee under an oil and gas lease issued under AS 38.05.180 may apply
29 to the Department of Natural Resources for a determination that an oil pool within the
30 lessee's lease, other than an oil pool described in (i)(1)(A) - (D) of this section, is a
31 challenged oil pool under this subsection. The Department of Natural Resources shall

1 prescribe the application form to be used and the information to be provided by an
2 applicant. After consulting with the Alaska Oil and Gas Conservation Commission,
3 the Department of Natural Resources shall make a determination within six months
4 after receiving a complete application and shall provide notice of the determination to
5 the Department of Revenue and the Legislative Budget and Audit Committee. For
6 purposes of this subsection, a challenged oil pool is

7 (1) an oil pool

8 (A) no part of which is located at a true vertical depth of
9 greater than 5,500 feet as measured from sea level; and

10 (B) with oil that has an average API gravity of 25 or less; or

11 (2) an oil pool whose reservoir rock primarily consists of carbonates
12 and has an average permeability of three millidarcies or less.

13 (g) Except as provided in (h) of this section, the department may adopt
14 regulations to carry out the purposes of this section, including prescribing reporting,
15 record keeping, and other procedures and requirements to verify the accuracy of the
16 credits claims and to ensure that a credit is not used more than once, and otherwise
17 implementing this section.

18 (h) The Department of Natural Resources shall adopt regulations to implement
19 (f) of this section, including regulations prescribing the method to be used to
20 determine the average API gravity of oil contained in an oil pool.

21 (i) In this section,

22 (1) "challenged oil pool" means an oil pool

23 (A) in the Ugnu or Schrader Bluff formation within

24 (i) the Prudhoe Bay Unit; or

25 (ii) the Milne Point Unit, except for that portion or
26 portions of a pool in the Schrader Bluff formation produced from the
27 drill site S area;

28 (B) in the West Sak or Ugnu formation within the Kuparuk
29 River Unit, except for that portion or portions of a pool in the West Sak
30 formation produced from the drill site IC, ID, IE, or IJ drill site areas;

31 (C) in the Ugnu, Schrader Bluff, or West Sak formation within

1 the

2 (i) Tuvaag Unit;

3 (ii) Nikaitchuk Unit; or

4 (iii) Rockflour Unit;

5 (D) in the Lisburne group within the Lisburne Participating
6 Area of the Prudhoe Bay Unit; or

7 (E) that is determined by the Department of Natural Resources
8 to be a challenged oil pool under (f) of this section;

9 (2) "develop" does not include the drilling, testing, or evaluation of
10 delineation wells;

11 (3) "qualified development expenditure" means, except as otherwise
12 provided in (e) of this section, an expenditure

13 (A) that is a lease expenditure under AS 43.55.160;

14 (B) the primary purpose of which is development of a
15 challenged oil pool within an oil and gas lease issued under AS 38.05.180; and

16 (C) that is treated as a capitalized expenditure under 26 U.S.C.
17 (Internal Revenue Code), as amended, regardless of elections made under 26
18 U.S.C. 263(c) (Internal Revenue Code), as amended, and is

19 (i) treated as a capitalized expenditure for federal
20 income tax reporting purposes by the person incurring the producer; or

21 (ii) eligible to be deducted as an expense under 26
22 U.S.C. 263(c) (Internal Revenue Code), as amended.

23 * Sec. 2. The uncodified law of the State of Alaska is amended by adding a new section to
24 read:

25 TRANSITION PROVISION. Notwithstanding any contrary provision of
26 AS 43.55.026, enacted by sec. 1 of this Act, for oil and gas produced on or after April 1,
27 2006, and before January 1, 2007, the phrase "every month an annualized credit in an amount
28 equal to one and one-quarter percent" in AS 43.55.026(b), enacted by sec. 1 of this Act, shall
29 be replaced by the phrase "every month during the period April 1, 2005, through
30 December 31, 2006, an annualized tax credit in an amount equal to one and two-thirds
31 percent."

1 * **Sec. 3.** The uncodified law of the State of Alaska is amended by adding a new section to
2 read:

3 **TRANSITION: REGULATIONS AND RETROACTIVITY OF REGULATIONS.** (a)
4 The Department of Revenue and Department of Natural Resources may proceed to adopt
5 regulations to implement this Act. The regulations take effect under AS 44.62 (Administrative
6 Procedure Act), but not before the effective date of the law implemented by the regulation.

7 (b) Notwithstanding any contrary provision of AS 44.62.240, a regulation adopted by
8 the Department of Revenue or Department of Natural Resources to implement, interpret,
9 make specific, or otherwise carry out the provisions of this Act may apply retroactively to
10 April 1, 2006, if the agency adopting the regulation expressly designates in the regulation that
11 the regulation applies retroactively to that date.

12 * **Sec. 4.** The uncodified law of the State of Alaska is amended by adding a new section to
13 read:

14 **RETROACTIVE EFFECT.** Sections 1 and 2 of this Act are retroactive to April 1,
15 2006.

16 * **Sec. 5.** The uncodified law of the State of Alaska is amended by adding a new section to
17 read:

18 **CONDITIONAL EFFECT OF ACT.** This Act takes effect only if the Twenty-Fourth
19 Alaska Legislature passes a bill, and that bill becomes law, in which the oil production tax
20 and gas production tax in AS 43.55 are repealed and a production tax on oil and gas based on
21 a percentage of its production tax value is enacted in AS 43.55.

22 * **Sec. 6.** If, under sec. 5 of this Act, this Act takes effect, it takes effect on the effective date
23 of the provisions described in sec. 5 of this Act of the bill referred to in sec. 5 of this Act.

LEGAL SERVICES

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LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

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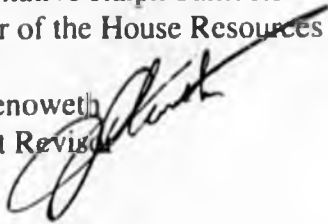
State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

April 26, 2006

SUBJECT: Draft CSHB 498(RES), proposing a credit against the oil and gas production tax for expenditures for challenged oil pools (Work Order No. 24-LS1817S)

TO: Representative Ralph Samuels
Co-Chair of the House Resources Committee

FROM: Jack Chenoweth
Assistant Revision 

The draft substantially sets out the changes transmitted to your office by the Department of Law, including late changes to the electronic draft that were penciled in and provided by fax.

Since the material was prepared elsewhere, I'm hesitant to alter anything of substance. The bill is oddly structured; rather than being set out in substantive provisions, the critical pieces appear to hang on elements of the section's definitions. Let's see if I am correct in my understanding of its provisions--

The availability of the credit turns on expenditures incurred for a qualified development expenditure (AS 43.55.026(a), page 1, line 9), and "qualified development expenditure" is, in turn, defined to mean, among other elements, an expenditure "the primary purpose of which is development of a challenged oil pool" (AS 43.55.026(i)(3), page 4, lines 14 and 15). The definition of "challenged oil pool" has four subparagraphs, (i)(1)(A) - (D), that identify specific named formations, and a fifth, (i)(1)(E), that is a catchall for determinations of the pool's status under AS 43.55.026(f), and qualification depends on meeting the standards of (f)(1) and (f)(2). Under AS 43.55.026(e), the limitation of paragraph (1) applies to cut off the credit for qualified development expenditures for all pools on March 31, 2016, while under (e)(2), there is an inception delay but only for pools that are administratively determined to qualify under (f).

In the draft, I've corrected references from "AS 43.55.011(a)" to "AS 43.55.011(e)," which conforms to the reference in the Senate-passed version of the production tax. I understand that this will be the vehicle that the House will use in its consideration of changes to the tax.

Representative Ralph Samuels

April 26, 2006

Page 2

I had a little trouble getting my mind around the department's suggested effective date -- "the later of (1) immediately under AS 01.10.070(c) or (2) the effective date [of the oil and gas production tax bill]". Since the second is the critical piece, the draft has a single effective date reference that ties the measure to the effective date of the companion tax reform bill.

JBC:med

06-339.med

Enclosure

24-LS1817L
Chenoweth
4/20/06

CS FOR HOUSE BILL NO. 498()
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FOURTH LEGISLATURE - SECOND SESSION

BY

Offered:
Referred:

Sponsor(s): HOUSE RULES COMMITTEE

A BILL

FOR AN ACT ENTITLED

1 **"An Act authorizing tax credits against the production tax on oil and gas for qualified**
2 **capital expenditures for challenged or nonconventional oil and for qualified renewable**
3 **energy expenditures for nonconventional or renewable energy resources; giving the Act**
4 **contingent effect; and providing for an effective date."**

5 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

6 *** Section 1. AS 43.55 is amended by adding new sections to read:**

7 **Sec. 43.55.026. Credits for expenditures for challenged or nonconventional**
8 **oil. (a) Notwithstanding that an expenditure that is a qualified capital expenditure may**
9 **be a lease expenditure that is deductible for the purpose of calculating the production**
10 **tax value of oil and gas under AS 43.55.160(a), a producer that incurs a qualified**
11 **capital expenditure on or after the effective date of this section for challenged or**
12 **nonconventional oil under this section may also elect to take a tax credit in the amount**
13 **of 15 percent of that expenditure. A credit under this subsection**

14 (1) is in addition to any credit under AS 43.55.024 or 43.55.025 for the

1 same qualified capital expenditure; and

2 (2) may be applied against any and all taxes due under this chapter on
3 the producer's taxable oil and gas production.

4 (b) For a calendar year for which the producer makes an election under
5 AS 43.55.160(f), a producer that incurs a qualified capital expenditure during that year
6 and that wants to apply a credit based on the annual qualified capital expenditures
7 against any tax due under this chapter, instead of taking a tax credit of 15 percent of
8 each separate qualified capital expenditure for the month when the expenditure is
9 incurred, shall calculate and apply every month an annualized tax credit in an amount
10 equal to one and one-quarter percent of the producer's total qualified capital
11 expenditures then budgeted to be incurred during that year.

12 (c) A credit or portion of a credit under this section may not be used to reduce
13 a person's total liability for taxes under this chapter for any month below zero, and any
14 unused credit or portion of a credit not used under this subsection may be applied in a
15 later month.

16 (d) A producer incurring the qualified capital expenditure giving rise to a
17 credit may not transfer the credit.

18 (e) A producer may not claim a credit for a qualified capital expenditure under
19 this section for an expenditure made after March 31, 2016.

20 (f) For purposes of this section, an expenditure

21 (1) is a qualified capital expenditure if it is

22 (A) an exploration expenditure as defined under AS 43.55.025
23 and is accompanied by the information to support that claim for eligibility as
24 required by AS 43.55.025(j); or

25 (B) incurred for activities in the state for research or
26 development of challenged or nonconventional oil, or is a material extension of
27 existing technology, as certified by the department;

28 (2) qualifies for the credit authorized by this section only if made on
29 land leased under AS 38.05 or on land leased within the National Petroleum Reserve -
30 Alaska.

31 (g) In this section,

1 (1) "challenged oil" means

2 (A) oil that has an average API gravity of 25 or less produced
3 from a reservoir or pool located, in whole or in part, north of 68 degrees, 15
4 minutes North latitude in this state and at a true vertical depth as measured
5 from sea level of 5,500 feet or less;

6 (B) oil that is produced from a reservoir located, in whole or in
7 part, north of 68 degrees, 15 minutes North latitude in this state, without regard
8 to its depth, if the oil has an API gravity of 25 or less and is produced from

9 (i) the Ugnu Formation or West Sak - Schrader Bluff
10 Formation; or

11 (ii) a formation that is stratigraphically equivalent to or
12 shallower than a formation described in (i) of this subparagraph;

13 (C) oil that is produced from a reservoir for which, as of
14 January 1, 2006, one of the following participating areas had been formed: the
15 Orion or Polaris participating area in the Prudhoe Bay Unit, the West Sak
16 participating area in the Kuparuk River Unit, or the Schrader Bluff
17 participating area in the Milne Point Unit;

18 (D) oil that is produced from a reservoir or pool having an
19 average API gravity of 18 or less, regardless of depth or location within this
20 state;

21 (E) oil with an API gravity of 25 or less and that is produced as
22 described in (A) - (C) of this paragraph and that is inherently difficult and
23 expensive to produce and is certified by the department to be challenged oil;

24 (F) all oil recovered from a separate and distinct zone or
25 geological horizon that is produced as described in (A) - (E) of this paragraph,
26 but only if the average monthly API gravity of the oil produced from that zone
27 or geological horizon does not exceed

28 (i) for oil described in (A), (C), and (E) of this
29 paragraph, the API gravity limits set in the respective paragraph; and

30 (ii) except as provided in (i) of this subparagraph, the
31 API gravity limit set in (D) of this paragraph; and

1 (H) oil produced from a reservoir whose reservoir rock is
2 primarily made up of carbonates;

3 (2) "nonconventional oil" means:

4 (A) oil produced or recovered from or associated with tar
5 sands;

6 (B) oil produced or recovered from or associated with oil shale;
7 and

8 (C) oil production not described in (A) or (B) of this paragraph
9 that is inherently difficult and expensive to produce and is certified by the
10 department to be nonconventional oil.

11 **Sec. 43.55.028. Credits for expenditures for nonconventional or renewable**
12 **energy sources.** (a) Notwithstanding that a qualified renewable energy expenditure
13 under this section may be deductible or may give rise to a tax credit under AS 43.20 or
14 under any other tax under this title, a producer that incurs a qualified renewable energy
15 expenditure on or after the effective date of this section for the development or use in
16 the state of a nonconventional or renewable energy source may also elect to take a tax
17 credit in the amount of 25 percent of that expenditure. A credit under this subsection
18 may be applied against any tax due under this chapter AS 43.55 on the producer's
19 taxable oil and gas production.

20 (b) For a calendar year for which the producer makes an election under
21 AS 43.55.160(f), a producer that incurs a qualified renewable energy expenditure
22 during that year and that wants to apply a credit based on the annual qualified
23 renewable energy expenditures against any tax due under this chapter, instead of
24 taking a tax credit of 25 percent of each separate qualified renewable energy
25 expenditure for the month when the expenditure is incurred, shall calculate and apply
26 every month an annualized tax credit in an amount equal to two and one-twelfth
27 percent of the producer's total qualified renewable energy expenditures then budgeted
28 to be incurred during that year.

29 (c) A credit or portion of a credit under this section may not be used to reduce
30 a person's total liability for taxes under this chapter for any month below zero, and any
31 unused credit or portion of a credit not used under this subsection may be applied in a

1 later month.

2 (d) Except as otherwise provided in this subsection, a producer incurring the
3 qualified renewable energy expenditure giving rise to a credit may not transfer the
4 credit. The producer may transfer the tax credit to an affiliate of the producer that is
5 also a producer subject to this chapter. Both the producer transferring the credit to its
6 producer affiliate and the producer affiliate receiving the credit shall report to the
7 department, on the respective monthly tax statements filed under AS 43.55.030, the
8 tax credit transfer, the amount of the credit transferred, and the month for which the
9 credit arose.

10 (e) An expenditure for an activity is a qualified renewable energy expenditure
11 for purposes of this section if it is

12 (1) an ordinary and necessary expenditure for the activity, as "ordinary
13 and necessary" is defined for purposes of 26 U.S.C. 162 (Internal Revenue Code), as
14 amended; and

15 (2) incurred for the development or use of a nonconventional or
16 renewable energy source.

17 (f) A producer may not claim a credit for a qualified renewable energy
18 expenditure under this section for an expenditure made after March 31, 2016.

19 (g) In this section, "nonconventional or renewable energy sources" includes

20 (1) solar power;

21 (2) geothermal energy;

22 (3) wind power;

23 (4) nonconventional kinetic energy recovery;

24 (5) exploitation of heat, cold, or another form of energy that is
25 generated from an industrial or manufacturing activity and that would otherwise be
26 dissipated into the environment, including electrical cogeneration;

27 (6) gas manufactured from the gasification of coal;

28 (7) coal bed methane;

29 (8) energy that does not involve the consumption or combustion of
30 hydrocarbons; and

31 (9) an energy source not described in (1) - (8) of this subsection that is

1 certified by the department to be a nonconventional or renewable source of energy.

2 * Sec. 2. The uncodified law of the State of Alaska is amended by adding a new section to
3 read:

4 TRANSITION: REGULATIONS AND RETROACTIVITY OF REGULATIONS. (a)
5 The Department of Revenue may proceed to adopt regulations to implement this Act. The
6 regulations take effect under AS 44.62 (Administrative Procedure Act), but not before the
7 effective date of the law implemented by the regulation.

8 (b) Notwithstanding any contrary provision of AS 44.62.240, a regulation adopted by
9 the Department of Revenue to implement, interpret, make specific, or otherwise carry out the
10 provisions of this Act may apply retroactively to the effective date of this Act, if the
11 Department of Revenue expressly designates in the regulation that the regulation applies
12 retroactively to that date.

13 * Sec. 3. The uncodified law of the State of Alaska is amended by adding a new section to
14 read:

15 CONDITIONAL EFFECT OF ACT. This Act takes effect only if the Twenty-Fourth
16 Alaska Legislature passes a bill, and that bill becomes law, in which, among other provisions,
17 the oil and gas properties production (severance) tax is repealed and a production tax on oil
18 and gas based on a percentage of its production tax value is enacted.

19 * Sec. 4. If, under sec. 3 of this Act, this Act takes effect, it takes effect on the date that is
20 the later of

21 (1) the effective date of the Act described in sec. 3 of this Act; or

22 (2) July 1, 2006.

HB 498
Proposed Definitions and Guidelines
Bill Van Dyke 4/21/06

In keeping with the theme that incentives should be designed to change targeted behavior of oil and gas lessees I propose the following definition for challenged oil and a guideline for the commissioner to use to grant credits to future challenged oil projects not covered by the definition today. An alternative definition is also offered if it is decided that a policy not as specific and focused as provided in the first definition is needed.

Definition of challenged oil (#1)

Oil produced from the following areas

1. the Prudhoe Bay Unit from the Ugnu or Schrader Bluff formations except for oil produced from the Orion and Polaris participating areas.
2. the Kuparuk River Unit from the West Sak and Ugnu formations except for oil produced from the West Sak formation in the drill site 1C, 1D, 1E and 1J drill site areas.
3. the Milne Point Unit from the Ugnu and Schrader Bluff formations except for oil produced from the Schrader Bluff formation in the drill site S area.
4. the Tuvaq Unit from the Ugnu and Schrader Bluff/West Sak formations
5. the Nikaitchuk Unit from the Ugnu and Schrader Bluff/West Sak formations
6. the Rockflour Unit from the West Sak/ Schrader Bluff and Ugnu formations

note: this definition excludes credits for development in identified "core areas" that is currently under evaluation and likely to go forward with or without credits.

If the above definition is deemed to be too restrictive, which I do not believe it is, then I propose the following alternative definition.

Definition of challenged oil (#2)

Oil produced from the Ugnu, West Sak or Schrader Bluff formations from the Prudhoe Bay, Milne Point, Kuparuk River, Tuvaq, Nikaitchuk and Rockflour units.

Note: this definition grants credits to projects in the "core areas" that are under evaluation today and likely to go forward with or without credits.

Guideline for granting credits to new areas

The commissioner may grant credits for challenged oil not identified above, except for those areas explicitly excluded (i.e., if definition #1 is adopted) if the oil is less than or equal to 22 degrees API (measured monthly and averaged over the area proposed for credit), in pools or reservoirs at depths less than 5500 feet subsea and is more expensive and more difficult to produce than oil with an API gravity above 22 degrees and at depth

HB 498

Proposed Definitions and Guidelines

Bill Van Dyke 4/21/06

greater than 5500 subsea. The commissioner shall consult with the Department of Natural Resources and Alaska Oil and Gas Conservation Commission prior to granting these credits.

The commissioner may grant credits for challenged oil produced from the areas excluded from eligibility in the definition (i.e., #1) above for challenged oil if that oil is produced using enhanced oil recovery techniques or other approved non-conventional recovery and production methods but excluding primary production, miscible gas flood or traditional waterflood methods. The commissioner shall consult with the Department of Natural Resources and Alaska Oil and Gas Conservation Commission prior to granting these credits.

Note: this guideline allows credits be awarded to future new challenged oil pools and also allows credits for certain enhanced oil recovery investment in all challenged oil reservoirs, including the "core areas".

Tim Benintendi

From: Bill D. Van Dyke [wdv@dnr.state.ak.us]
Sent: Friday, April 21, 2006 1:08 PM
To: Tim Benintendi
Subject: FW: HB 498 new definitions and guidelines.doc
Attachments: HB 498 new definitions and guidelines.doc

for the meeting today

From: Bill VanDyke [mailto:wdv@dnr.state.ak.us]
Sent: Friday, April 21, 2006 10:41 AM
To: PaskvaFA@BP.com; 'Rep. Ralph Samuels'; 'rep_Paul_Seaton@legis.state.ak.us'; 'rep_Norman_Rokeberg@legis.state.ak.us'
Cc: Marie M. Crosley; Robynn Wilson (robynn_wilson@revenue.state.ak.us); Melanie Lesh (melanie_lesh@dnr.state.ak.us)
Subject: HB 498 new definitions and guidelines.doc

Attached is a proposed definition and guideline for challenged oil. I plan to be on line this afternoon but I have to testify at another hearing starting at 3:30.

You will see that my preferred definition for challenged oil is a little more restrictive than we have been discussing to date, but I think it is fair and meets the desired intent.

Bill Van Dyke

Division of Oil and Gas

907.269.8786

CSHB 498 Changes from Version I to Version L (Latest)

1. Throughout Section .028, change "qualified capital expenditure" to "qualified renewable energy expenditure."
2. Delete Page 2, Lines 8-18 and Page 6, Lines 7-17.
3. On page 5, Line 4, specify that average API gravity be measured *monthly*.
4. Page 3, Line 12: Delete
5. Page 7, Line 8: Delete
6. Page 3, Lines 2-9: Delete, rewrite section so that credits are not transferable.
7. Page 2, Lines 5-8: Delete
8. Page 3, Line 16: Delete "made for" and after "exploration expenditure" insert "as defined."
9. Page 2, Line 13, and Page 6 line 2: delete "any tax or conservation surcharge due" and replace with "any taxes due."
10. Page 4, Section (E): Delete

24-LS1817V
Chenoweth
4/18/06

CS FOR HOUSE BILL NO. 498()
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FOURTH LEGISLATURE - SECOND SESSION

BY

Offered:
Referred:

Sponsor(s): HOUSE RULES COMMITTEE

A BILL
FOR AN ACT ENTITLED

1 **"An Act authorizing tax credits against the production tax on oil and gas for qualified**
2 **capital expenditures for challenged or nonconventional oil and for qualified capital**
3 **expenditures for nonconventional or renewable energy resources; giving the Act**
4 **contingent effect; and providing for an effective date."**

5 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

6 *** Section 1. AS 43.55 is amended by adding new sections to read:**

7 **Sec. 43.55.026. Credits for expenditures for challenged or nonconventional**
8 **oil. (a) Notwithstanding that an expenditure that is a qualified capital expenditure may**
9 **be a lease expenditure that is deductible for the purpose of calculating the production**
10 **tax value of oil and gas under AS 43.55.160(a), a producer that incurs a qualified**
11 **capital expenditure on or after the effective date of this section for challenged or**
12 **nonconventional oil under this section may also elect to take a tax credit in the amount**
13 **of 15 percent of that expenditure. A credit under this subsection**

14 (1) is in addition to any credit under AS 43.55.024 or 43.55.025 for the

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same qualified capital expenditure:

(2) except as limited by (3) of this subsection, may be applied against any and all taxes due under this chapter on the producer's taxable oil and gas production; and

(3) may not be claimed before a credit is claimed and taken under another provision of this chapter; the limitation of this paragraph does not apply to an expenditure that qualifies for the tax credit for oil and gas exploration under AS 43.55.025.

(b) For a calendar year for which the producer makes an election under AS 43.55.160(f),

(1) a producer that incurs a qualified capital expenditure during that year and that wants to apply a credit based on the annual qualified capital expenditures against any tax or conservation surcharge due under this chapter, instead of taking a tax credit of 15 percent of each separate qualified capital expenditure for the month when the expenditure is incurred, shall calculate and apply every month an annualized tax credit in an amount equal to one and one-quarter percent of the producer's total qualified capital expenditures then budgeted to be incurred during that year; and

(2) if the total annual amount budgeted by the producer for qualified capital expenditures changes as the year progresses, then (A) the amount of the total tax under AS 43.55.011 on the producer's taxable oil and gas production that is due each month, and (B) the issue of whether at least 90 percent of the full amount of the tax was paid when due each month must be determined for purposes of AS 43.55.020 based on the amount of the credit under this subsection using the producer's budget for the year's qualified capital expenditures that was in effect as of the end of the month when the producer's taxable oil or gas was produced; however, nothing in this paragraph changes the requirement that a producer shall report under AS 43.55.030(e) based on the credits under this subsection for its actual qualified capital expenditures for an entire calendar year and pay any additional tax shown in that annual report.

(c) A credit or portion of a credit under this section may not be used to reduce a person's total liability for taxes under this chapter for any month below zero, and any unused credit or portion of a credit not used under this subsection may be applied in a

1 later month.

2 (d) Except as otherwise provided in this subsection, a producer incurring the
3 qualified capital expenditure giving rise to a credit may not transfer the credit. The
4 producer may transfer the tax credit to an affiliate of the producer that is also a
5 producer subject to this chapter. Both the producer transferring the credit to its
6 producer affiliate and the producer affiliate receiving the credit shall report to the
7 department, on the respective monthly tax statements filed under AS 43.55.030, the
8 tax credit transfer, the amount of the credit transferred, and the month for which the
9 credit arose.

10 (e) A producer may not claim a credit for a qualified capital expenditure under
11 this section

12 (1) more than once; or

13 (2) for an expenditure made after March 31, 2016.

14 (f) For purposes of this section, an expenditure

15 (1) is a qualified capital expenditure if it is

16 (A) made for an exploration expenditure under AS 43.55.025
17 and is accompanied by the information to support that claim for eligibility as
18 required by AS 43.55.025(j); or

19 (B) incurred for activities in the state for research or
20 development of challenged or nonconventional oil, or is a material extension of
21 existing technology, as certified by the department;

22 (2) qualifies for the credit authorized by this section only if made on
23 land leased under AS 38.05 or on land leased within the National Petroleum Reserve -
24 Alaska.

25 (g) In this section,

26 (1) "challenged oil" means

27 (A) oil that has an average API gravity of 25 or less produced
28 from a reservoir or pool located, in whole or in part, north of 68 degrees, 15
29 minutes North latitude in this state and at a true vertical depth as measured
30 from sea level of 5,500 feet or less;

31 (B) oil that is produced from a reservoir located, in whole or in

1 part, north of 68 degrees, 15 minutes North latitude in this state, without regard
2 to its depth, if the oil has an API gravity of 25 or less and is produced from

3 (i) the Ugnu Formation or West Sak - Schrader Bluff
4 Formation; or

5 (ii) a formation that is stratigraphically equivalent to or
6 shallower than a formation described in (i) of this subparagraph;

7 (C) oil that is produced from a reservoir for which, as of
8 January 1, 2006, one of the following participating areas had been formed: the
9 Orion or Polaris participating area in the Prudhoe Bay Unit, the West Sak
10 participating area in the Kuparuk River Unit, or the Schrader Bluff
11 participating area in the Milne Point Unit;

12 (D) oil that is produced from a reservoir or pool having an
13 average API gravity of 18 or less, regardless of depth or location within this
14 state;

15 (E) oil with an API gravity of 25 or less and that is produced as
16 described in (A) - (C) of this paragraph through the application of one or more
17 enhanced oil recovery techniques, including

18 (i) steam injection;

19 (ii) microemulsion flooding;

20 (iii) in situ combustion;

21 (iv) polymer-augmented water-flooding;

22 (v) alkaline or caustic flooding;

23 (vi) immiscible nonhydrocarbon gas displacement;

24 (vii) microbial;

25 (viii) low-salinity water flooding; or

26 (ix) any other method not described in (i) - (viii) of this
27 subparagraph that is certified by the department to be a qualified
28 enhanced oil recovery technique or that is certified by the Alaska Oil
29 and Gas Conservation Commission for purposes of this section;

30 (F) oil with an API gravity of 25 or less and that is produced as
31 described in (A) - (C) of this paragraph and that is inherently difficult and

1 expensive to produce and is certified by the department to be challenged oil;

2 (G) all oil recovered from a separate and distinct zone or
3 geological horizon that is produced as described in (A) - (F) of this paragraph.
4 but only if the average API gravity of the oil produced from that zone or
5 geological horizon does not exceed

6 (i) for oil described in (A), (C), (E), and (F) of this
7 paragraph, the API gravity limits set in the respective paragraph; and

8 (ii) except as provided in (i) of this subparagraph, the
9 API gravity limit set in (D) of this paragraph; and

10 (H) oil produced from a reservoir whose reservoir rock is
11 primarily made up of carbonates;

12 (2) "nonconventional oil" means:

13 (A) oil produced or recovered from or associated with tar
14 sands;

15 (B) oil produced or recovered from or associated with oil shale;
16 and

17 (C) oil production not described in (A) or (B) of this paragraph
18 that is inherently difficult and expensive to produce and is certified by the
19 department to be nonconventional oil.

20 **Sec. 43.55.028. Credits for expenditures for nonconventional or renewable**
21 **energy sources.** (a) Notwithstanding that a qualified capital expenditure under this
22 section may be deductible or may give rise to a tax credit under AS 43.20 or under any
23 other tax under this title, a producer that incurs a qualified capital expenditure on or
24 after the effective date of this section for the development or use in the state of a
25 nonconventional or renewable energy source may also elect to take a tax credit in the
26 amount of 25 percent of that expenditure. A credit under this subsection may be
27 applied against any tax due under this chapter AS 43.55 on the producer's taxable oil
28 and gas production.

29 (b) For a calendar year for which the producer makes an election under
30 AS 43.55.160(f),

31 (1) a producer that incurs a qualified capital expenditure during that

1 year and that wants to apply a credit based on the annual qualified capital expenditures
2 against any tax or conservation surcharge due under this chapter, instead of taking a
3 tax credit of 25 percent of each separate qualified capital expenditure for the month
4 when the expenditure is incurred, shall calculate and apply every month an annualized
5 tax credit in an amount equal to two and one-twelfth percent of the producer's total
6 qualified capital expenditures then budgeted to be incurred during that year; and

7 (2) if the total annual amount budgeted by the producer for qualified
8 capital expenditures changes as the year progresses, then (A) the amount of the total
9 tax under AS 43.55.011 on the producer's taxable oil and gas production that is due
10 each month, and (B) the issue of whether at least 90 percent of the full amount of the
11 tax was paid when due each month must be determined for purposes of AS 43.55.020
12 based on the amount of the credit under this subsection using the producer's budget for
13 the year's qualified capital expenditures that was in effect as of the end of the month
14 when the producer's taxable oil or gas was produced; however, nothing in this
15 paragraph changes the requirement that a producer must report under AS 43.55.030(e)
16 based on the credits under this subsection for its actual qualified capital expenditures
17 for an entire calendar year and pay any additional tax shown in the annual report.

18 (c) A credit or portion of a credit under this section may not be used to reduce
19 a person's total liability for taxes under this chapter for any month below zero, and any
20 unused credit or portion of a credit not used under this subsection may be applied in a
21 later month.

22 (d) Except as otherwise provided in this subsection, a producer incurring the
23 qualified capital expenditure giving rise to a credit may not transfer the credit. The
24 producer may transfer the tax credit to an affiliate of the producer that is also a
25 producer subject to this chapter. Both the producer transferring the credit to its
26 producer affiliate and the producer affiliate receiving the credit shall report to the
27 department, on the respective monthly tax statements filed under AS 43.55.030, the
28 tax credit transfer, the amount of the credit transferred, and the month for which the
29 credit arose.

30 (e) An expenditure for an activity is a qualified capital expenditure for
31 purposes of this section if it is

1 (1) an ordinary and necessary expenditure for the activity, as "ordinary
 2 and necessary" is defined for purposes of 26 U.S.C. 162 (internal Revenue Code), as
 3 amended; and

4 (2) incurred for the development or use of a nonconventional or
 5 renewable energy source.

6 (f) A producer may not claim a credit for a qualified capital expenditure under
 7 this section

8 (1) more than once; or

9 (2) for an expenditure made after March 31, 2016.

10 (g) In this section, "nonconventional or renewable energy sources" includes

11 (1) solar power;

12 (2) geothermal energy;

13 (3) wind power;

14 (4) nonconventional kinetic energy recovery;

15 (5) exploitation of heat, cold, or another form of energy that is
 16 generated from an industrial or manufacturing activity and that would otherwise be
 17 dissipated into the environment, including electrical cogeneration;

18 (6) gas manufactured from the gasification of coal;

19 (7) coal bed methane;

20 (8) energy that does not involve the consumption or combustion of
 21 hydrocarbons; and

22 (9) an energy source not described in (1) - (8) of this subsection that is
 23 certified by the department to be a nonconventional or renewable source of energy.

24 * Sec. 2. The uncodified law of the State of Alaska is amended by adding a new section to
 25 read:

26 **TRANSITION: REGULATIONS AND RETROACTIVITY OF REGULATIONS.** (a)

27 The Department of Revenue may proceed to adopt regulations to implement this Act. The
 28 regulations take effect under AS 44.62 (Administrative Procedure Act), but not before the
 29 effective date of the law implemented by the regulation.

30 (b) Notwithstanding any contrary provision of AS 44.62.240, a regulation adopted by
 31 the Department of Revenue to implement, interpret, make specific, or otherwise carry out the

1 provisions of this Act may apply retroactively to the effective date of this Act, if the
2 Department of Revenue expressly designates in the regulation that the regulation applies
3 retroactively to that date.

4 * Sec. 3. The uncodified law of the State of Alaska is amended by adding a new section to
5 read:

6 **CONDITIONAL EFFECT OF ACT.** This Act takes effect only if the Twenty-Fourth
7 Alaska Legislature passes a bill, and that bill becomes law, in which, among other provisions,
8 the oil and gas properties production (severance) tax is repealed and a production tax on oil
9 and gas based on a percentage of its production tax value is enacted.

10 * Sec. 4. If, under sec. 3 of this Act, this Act takes effect, it takes effect on the date that is
11 the later of

12 (1) the effective date of the Act described in sec. 3 of this Act; or

13 (2) July 1, 2006.

24-LS1817Y
Chenoweth
4/14/06

CS FOR HOUSE BILL NO. 498()

**IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FOURTH LEGISLATURE - SECOND SESSION**

BY

**Offered:
Referred:**

Sponsor(s): HOUSE RULES COMMITTEE

A BILL

FOR AN ACT ENTITLED

1 "An Act authorizing tax credits against the production tax on oil and gas for qualified
2 capital expenditures for challenged or nonconventional oil and for qualified capital
3 expenditures for nonconventional or renewable energy resources; giving the Act
4 contingent effect; and providing for an effective date."

5 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

6 * Section 1. AS 43.55 is amended by adding new sections to read.

7 **Sec. 43.55.026. Credits for expenditures for challenged or nonconventional**
8 **oil.** (a) Notwithstanding that an expenditure that is a qualified capital expenditure may
9 be a lease expenditure that is deductible for the purpose of calculating the production
10 tax value of oil and gas under AS 43.55.160(a), a producer that incurs a qualified
11 capital expenditure on or after the effective date of this section for challenged or
12 nonconventional oil under this section may also elect to take a tax credit in the amount
13 of 15 percent of that expenditure. A credit under this subsection

14 (1) is in addition to any credit under AS 43.55.024 or 43.55.025 for the

1 same qualified capital expenditure:

2 (2) except as limited by (3) of this subsection, may be applied against
3 any and all taxes due under this chapter on the producer's taxable oil and gas
4 production; and

5 (3) may not be claimed before a credit is claimed and taken under
6 another provision of this chapter; the limitation of this paragraph does not apply to an
7 expenditure that qualifies for the tax credit for oil and gas exploration under
8 AS 43.55.025.

9 (b) For a calendar year for which the producer makes an election under
10 AS 43.55.160(f),

11 (1) a producer that incurs a qualified capital expenditure during that
12 year and that wants to apply a credit based on the annual qualified capital expenditures
13 against any tax or conservation surcharge due under this chapter, instead of taking a
14 tax credit of 15 percent of each separate qualified capital expenditure for the month
15 when the expenditure is incurred, shall calculate and apply every month an annualized
16 tax credit in an amount equal to one and one-quarter percent of the producer's total
17 qualified capital expenditures then budgeted to be incurred during that year; and

18 (2) if the total annual amount budgeted by the producer for qualified
19 capital expenditures changes as the year progresses, then (A) the amount of the total
20 tax under AS 43.55.011 on the producer's taxable oil and gas production that is due
21 each month, and (B) the issue of whether at least 90 percent of the full amount of the
22 tax was paid when due each month must be determined for purposes of AS 43.55.020
23 based on the amount of the credit under this subsection using the producer's budget for
24 the year's qualified capital expenditures that was in effect as of the end of the month
25 when the producer's taxable oil or gas was produced; however, nothing in this
26 paragraph changes the requirement that a producer shall report under AS 43.55.030(e)
27 based on the credits under this subsection for its actual qualified capital expenditures
28 for an entire calendar year and pay any additional tax shown in that annual report.

29 (c) A credit or portion of a credit under this section may not be used to reduce
30 a person's total liability for taxes under this chapter for any month below zero, and any
31 unused credit or portion of a credit not used under this subsection may be applied in a

1 later month.

2 (d) Except as otherwise provided in this subsection, a producer incurring the
3 qualified capital expenditure giving rise to a credit may not transfer the credit. The
4 producer may transfer the tax credit to an affiliate of the producer that is also a
5 producer subject to this chapter. Both the producer transferring the credit to its
6 producer affiliate and the producer affiliate receiving the credit shall report to the
7 department, on the respective monthly tax statements filed under AS 43.55.030, the
8 tax credit transfer, the amount of the credit transferred, and the month for which the
9 credit arose.

10 (e) A producer may not claim a credit for a qualified capital expenditure under
11 this section

12 (1) more than once; or

13 (2) for an expenditure made after March 31, 2016.

14 (f) For purposes of this section, an expenditure

15 (1) is a qualified capital expenditure if it is

16 (A) made for an exploration expenditure under AS 43.55.025
17 and is accompanied by the information to support that claim for eligibility as
18 required by AS 43.55.025(j); or

19 (B) incurred for activities in the state for research or
20 development of challenged or nonconventional oil, or is a material extension of
21 existing technology, as certified by the department;

22 (2) qualifies for the credit authorized by this section only if made on
23 land leased under AS 38.05 or on land leased within the National Petroleum Reserve -
24 Alaska.

25 (g) In this section,

26 (1) "challenged oil" means

27 (A) oil that has an average API gravity of 25 or less produced
28 from a reservoir or pool located, in whole or in part, north of 68 degrees, 15
29 minutes North latitude in this state and at a true vertical depth as measured
30 from sea level of 5,500 feet or less;

31 (B) oil that is produced from a reservoir located, in whole or in

1 part. north of 68 degrees, 15 minutes North latitude in this state, without regard
2 to its depth, if the oil has an API gravity of 25 or less and is produced from

3 (i) the Ugnu Formation or West Sak - Schrader Bluff

4 Formation; or

5 (ii) a formation that is stratigraphically equivalent to or
6 shallower than a formation described in (i) of this subparagraph:

7 (C) oil that is produced from a reservoir for which, as of
8 January 1, 2006, one of the following participating areas had been formed: the
9 Orion or Polaris participating area in the Prudhoe Bay Unit, the West Sak
10 participating area in the Kuparuk River Unit, or the Schrader Bluff
11 participating area in the Milne Point Unit;

12 (D) oil that is produced from a reservoir or pool having an
13 average API gravity of 18 or less, regardless of depth or location within this
14 state:

15 (E) oil with an API gravity of 25 or less and that is produced as
16 described in (A) - (C) of this paragraph produced from a reservoir whose
17 reservoir rock is primarily made up of carbonates;

18 (F) oil with an API gravity of 25 or less and that is produced as
19 described in (A) - (C) of this paragraph through the application of one or more
20 enhanced oil recovery techniques, including

21 (i) steam injection;

22 (ii) microemulsion flooding;

23 (iii) in situ combustion;

24 (iv) polymer-augmented water-flooding;

25 (v) alkaline or caustic flooding;

26 (vi) immiscible nonhydrocarbon gas displacement;

27 (vii) microbial;

28 (viii) low-salinity water flooding; or

29 (ix) any other method not described in (i) - (viii) of this
30 subparagraph that is certified by the department to be a qualified
31 enhanced oil recovery technique or that is certified by the Alaska Oil

1 and Gas Conservation Commission for purposes of this section:

2 (G) oil with an API gravity of 25 or less and that is produced as
3 described in (A) - (C) of this paragraph and that is inherently difficult and
4 expensive to produce and is certified by the department to be challenged oil;
5 and

6 (H) all oil recovered from separate and distinct zone or
7 geological horizon that is produced as described in (A) - (G) of this paragraph,
8 but only if the average API gravity of the oil produced from that zone or
9 geological horizon does not exceed

10 (i) for oil described in (A), (C), and (E) - (G) of this
11 paragraph, the API gravity limits set in the respective paragraph; and

12 (ii) except as provided in (i) of this subparagraph, the
13 API gravity limit set in (D) of this paragraph.

14 (2) "nonconventional oil" means:

15 (A) oil produced or recovered from or associated with tar
16 sands;

17 (B) oil produced or recovered from or associated with oil shale;
18 and

19 (C) oil production not described in (A) or (B) of this paragraph
20 that is inherently difficult and expensive to produce and is certified by the
21 department to be nonconventional oil.

22 **Sec. 43.55.028. Credits for expenditures for nonconventional or renewable**
23 **energy sources.** (a) Notwithstanding that a qualified capital expenditure under this
24 section may be deductible or may give rise to a tax credit under AS 43.20 or under any
25 other tax under this title, a producer that incurs a qualified capital expenditure on or
26 after the effective date of this section for the development or use in the state of a
27 nonconventional or renewable energy source may also elect to take a tax credit in the
28 amount of 25 percent of that expenditure. A credit under this subsection may be
29 applied against any tax due under this chapter AS 43.55 on the producer's taxable oil
30 and gas production.

31 (b) For a calendar year for which the producer makes an election under

1 AS 43.55.160(f),

2 (1) a producer that incurs a qualified capital expenditure during that
3 year and that wants to apply a credit based on the annual qualified capital expenditures
4 against any tax or conservation surcharge due under this chapter, instead of taking a
5 tax credit of 25 percent of each separate qualified capital expenditure for the month
6 when the expenditure is incurred, shall calculate and apply every month an annualized
7 tax credit in an amount equal to two and one-twelfth percent of the producer's total
8 qualified capital expenditures then budgeted to be incurred during that year; and

9 (2) if the total annual amount budgeted by the producer for qualified
10 capital expenditures changes as the year progresses, then (A) the amount of the total
11 tax under AS 43.55.011 on the producer's taxable oil and gas production that is due
12 each month, and (B) the issue of whether at least 90 percent of the full amount of the
13 tax was paid when due each month must be determined for purposes of AS 43.55.020
14 based on the amount of the credit under this subsection using the producer's budget for
15 the year's qualified capital expenditures that was in effect as of the end of the month
16 when the producer's taxable oil or gas was produced; however, nothing in this
17 paragraph changes the requirement that a producer must report under AS 43.55.030(e)
18 based on the credits under this subsection for its actual qualified capital expenditures
19 for an entire calendar year and pay any additional tax shown in that annual report.

20 (c) A credit or portion of a credit under this section may not be used to reduce
21 a person's total liability for taxes under this chapter for any month below zero, and any
22 unused credit or portion of a credit not used under this subsection may be applied in a
23 later month.

24 (d) Except as otherwise provided in this subsection, a producer incurring the
25 qualified capital expenditure giving rise to a credit may not transfer the credit. The
26 producer may transfer the tax credit to an affiliate of the producer that is also a
27 producer subject to this chapter. Both the producer transferring the credit to its
28 producer affiliate and the producer affiliate receiving the credit shall report to the
29 department, on the respective monthly tax statements filed under AS 43.55.030, the
30 tax credit transfer, the amount of the credit transferred, and the month for which the
31 credit arose.

1 (e) An expenditure for an activity is a qualified capital expenditure for
2 purposes of this section if it is

3 (1) an ordinary and necessary expenditure for the activity, as "ordinary
4 and necessary" is defined for purposes of 26 U.S.C. 162 (Internal Revenue Code), as
5 amended; and

6 (2) incurred for the development or use of a nonconventional or
7 renewable energy source.

8 (f) A producer may not claim a credit for a qualified capital expenditure under
9 this section

10 (1) more than once; or

11 (2) for an expenditure made after March 31, 2016.

12 (g) In this section, "nonconventional or renewable energy sources" includes

13 (1) solar power;

14 (2) geothermal energy;

15 (3) wind power;

16 (4) nonconventional kinetic energy recovery;

17 (5) exploitation of heat, cold, or another form of energy that is
18 generated from an industrial or manufacturing activity and that would otherwise be
19 dissipated into the environment, including electrical cogeneration;

20 (6) gas manufactured from the gasification of coal;

21 (7) coal bed methane;

22 (8) energy that does not involve the consumption or combustion of
23 hydrocarbons; and

24 (9) an energy source not described in (1) - (8) of this subsection that is
25 certified by the department to be a nonconventional or renewable source of energy.

26 * **Sec. 2.** The uncodified law of the State of Alaska is amended by adding a new section to
27 read:

28 **TRANSITION: REGULATIONS AND RETROACTIVITY OF REGULATIONS.** (a)
29 The Department of Revenue may proceed to adopt regulations to implement this Act. The
30 regulations take effect under AS 44.62 (Administrative Procedure Act), but not before the
31 effective date of the law implemented by the regulation.

1 (b) Notwithstanding any contrary provision of AS 44.62.240, a regulation adopted by
2 the Department of Revenue to implement, interpret, make specific, or otherwise carry out the
3 provisions of this Act may apply retroactively to the effective date of this Act, if the
4 Department of Revenue expressly designates in the regulation that the regulation applies
5 retroactively to that date.

6 * Sec. 3. The uncodified law of the State of Alaska is amended by adding a new section to
7 read:

8 **CONDITIONAL EFFECT OF ACT.** This Act takes effect only if the Twenty-Fourth
9 Alaska Legislature passes a bill, and that bill becomes law, in which, among other provisions,
10 the oil and gas properties production (severance) tax is repealed and a production tax on oil
11 and gas based on a percentage of its production tax value is enacted.

12 * Sec. 4. If, under sec. 3 of this Act, this Act takes effect, it takes effect on the date that is
13 the later of

- 14 (1) the effective date of the Act described in sec. 3 of this Act; or
15 (2) July 1, 2006.

TO: Representative Rokeberg

FROM: Robynn J. Wilson
Director, Tax Division

DATE: April 12, 2006

RE: HB 498 — COMMENTS TO "Y" VERSION

You have asked for drafting suggestions to improve HB 498. While we are happy to do so, please note that we provide such suggestions to assist the legislature in drafting a workable bill. Our suggestions do not indicate support of the bill by the Administration.

As I testified recently, the bill appears to have very broad application, perhaps unintentionally so. In this memo, I present some specific drafting suggestions, and identify areas where a policy call needs to be made. As those policy calls are made, I would be happy to further assist the committee in drafting alternative language.

1. We understand that your intention for creditable expenditures to mirror the kinds of expenditures eligible for a credit under the PPT legislation. The PPT credits apply to two categories: exploration expenditures, and those expenditures that are capitalized under the Internal Revenue Code. To make this bill consistent, we suggest the following changes:

Delete "qualified expenditure" and insert "qualified capital expenditure"
Delete "qualified expenditures" and insert "qualified capital expenditures"

In addition, since HB 498 adds AS 43.55.026, and the current PPT legislation contains the definition of "qualified capital expenditure" within AS 43.55.025, it may be necessary to move the definition to AS 43.55.900 section in the PPT bill (but see item 2 below).

2. Item #1 is a general correction that we would suggest regardless of the scope of the bill. This will clarify that the intention is generally to credit capex and not opex. However, HB 498 is designed to encourage Research and Development (R&D) which may be capex or may be opex, for federal tax purposes, depending on the election of the producer. We understand that most R & D conducted by established oil companies is expensed. The expense may or may not be recorded by the local production company, or may be recorded by the head office.

The PPT legislation allows opex to the extent that such opex is considered a "lease expense." In identifying "lease expenses," the legislation directs that substantial weight

Memorandum to Representative Rokeberg

April 12, 2006

Page 2

be given to the allowance of lease expenses in joint unit operating agreements. Thus, if an operating agreement allowed the recoupment of R & D for a particular lease, then that R & D would be deductible for the PPT. If R & D is expensed, it would not be eligible for a capex credit under the PPT.

The inclusion of R & D in HB 498 is clearly a policy call.

The second policy call is the scope of R & D activities eligible for a credit. Given the current bill language, a producer could potentially claim R & D expenses done worldwide. The committee may choose to limit this scope. One way to do that might be to allow R & D "the primary purpose of which is to develop methods of heavy oil production in an arctic environment." Another alternative would be to limit the credit to R & D activities conducted within the state. If so, it would be important to be specific about where the activities take place, rather than where the expense is "incurred." We would note, however, that crediting only in-state R & D may present a constitutional problem as that currently under judicial review in *Cuno v. DaimlerChrysler*.

If the committee's intention is to provide a credit for R & D, regardless of whether it is expensed, or capitalized, and if the committee wants the activities conducted within the state, then we would suggest something similar to the following:

(f) For purposes of this section an expenditure is a qualified expenditure if it meets the requirements of AS 43.55.025(j), or is incurred for research and development of challenged or nonconventional oil or gas, or a material extension of existing technology, as certified by the department, if the research and development activities are conducted within the state.

3. Credits under HB 498 are transferable only to an affiliate of the producer generating them. When compared with the PPT, this would set up a two-tier system of credits: HB 488 capex credits transferable to anyone; HB 498 credits limited transferability. Given this two-tier system, it would be important to add language about ordering of credits. If the HB 498 credits must be used first, then a producer would potentially have more HB 488 credits to sell. On the other hand, if the HB 488 credits must be used first, then a producer would potentially have less HB 488 credits to sell. This would be a policy call.

4. Page 4, line 4 allows a credit for EOR projects *including*... This can be interpreted here as "including but not limited to." This means that a producer could claim a credit for a project that does not meet items (i) through (viii), and that has not been certified by the department.

5. If multiple grades of oil are brought forth, and the average gravity meets the heavy oil definition, then is it the committee's intention that all capex related to that well be creditable? If not, then the bill would need to be specific about an allocation formula to be applied to the costs.

Memorandum to Representative Rokeberg
April 12, 2006
Page 3

6. Page 6, line 25 defines "ordinary and necessary" with reference to the Internal Revenue Code. We suggest the insertion of "as amended" just after "Internal Revenue Code" so that the definition will not be tied to an outdated Internal Revenue Code.

I hope that this information. Please let me know how I can be of further help.

CHANGES FROM "F" TO "Y" VERSIONS

HB 498: COMMITTEE SUBSTITUTE LANGUAGE

- 1) In Section 1 (d), specify that HB 488 (PPT) credits must be used first, before HB 498 credits.
- 2) Delete all references to gas.
- 3) Page 3, Section (f): Amend to read "For the purposes of this section, an expenditure is a qualified capital expenditure if it meets the requirements of AS 43.55.025(j), or is incurred for research and development of challenged or nonconventional oil or gas, or a material extension of existing technology, as certified by the department, if the research and development activities are conducted within the state."
- 4) Amend the term "qualified expenditure" to "qualified capital expenditure" everywhere it appears.
- 5) Page 3, Section (g): Shift section C up above A & B;
- 6) Line 27, delete "field" insert "pool."
- 7) Page 3, Section (A): Delete "Without regard to its API gravity or depth," and insert "without regard to depth, if average API gravity is 25, and"
- 8) Page 3, section (ii): insert "or shallower than" immediately after "stratigraphically equivalent to."
- 9) Page 3, Line 26: Insert "average" before "API gravity of 25."
- 10) Page 3, Line 30: "Produced from a reservoir *or pool* having an average..."
- 11) Page 4, Section (F-I): Adjust to apply EOR techniques only to (a)-(e) oil (only heavy oil, not light oil); delete lines 17-19; delete section (I), replace with lines 13-17 of 24-LS1817\F.1 Chenoweth.
- 12) Page 4, Section (2): Delete
- 13) Page 5, Lines 17-18: Amend to read "...a producer that incurs a qualified *capital* expenditure for development *in the state* of a nonconventional or renewable energy source..."
- 14) Specify that the credit applies to qualified capital expenditures made on or after the effective date (not retroactive).
- 15) Specify that federal projects do not qualify as a qualified capital expenditure unless they are made in NPR-A.
- 16) Specify that if multiple grades of oil are brought forth, and the average gravity meets the heavy oil definition, then all capital expenditures related to that well will be creditable.
- 17) Page 6, Line 25: insert "as amended" just after "Internal Revenue Code."
- 18) Page 7, Line 9: insert "(6) gas manufactured from gasification of coal; and (7) coal bed methane."

ALASKA STATE LEGISLATURE



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REPRESENTATIVE VIC KOHRING DISTRICT 14

April 13, 2006

Representative Ralph Samuels
Co-Chair House Resources
Representative Jay Ramras
Co-Chair House Resources

RE: Referral HB 498 - Letter of Intent: Tax credits for non-conventional oil

The House Special Committee on Oil and Gas heard and passed out HB 486 on April 11, 2006. We advise that in doing so the House Resources Committee address some of the issues brought up during the testimony portion of the meeting. Below you will find a list of the issues that we would like you to be aware of that our committee has some concerns with:

The bill as drafted is not clear with respect to:

- Time—when allowable costs are incurred
- Place—where allowable activities may occur
- Allowable costs—what costs are eligible

Narrow the focus of the bill to include only viscous oil.

The bill is not clear as to the timing of activities for which the producer can claim a credit, i.e. whether costs are creditable if the project is already underway at the effective date of the bill.

The bill provides for a tax credit for research and development (R & D) activities, regardless of the location of the (R & D) activities. If the policy call is to provide a credit for activities that are more restricted, such as those activities conducted within the state, then the language of the bill should be clarified as to that intention.

With respect to the EOR activities, it would be helpful if the bill is more clearly defined on the locations of qualifying projects and limited to and in the state of Alaska. Most of the EOR methods listed in the bill on page 4 are unconventional and could be applied in light oil as well as viscous oil reservoirs. The scope needs to be narrowed to include only viscous oil.

The bill allows "qualified expenditure" but does not define this term. If the intention is to mirror the qualifying expenditures for credit under the PPT bill, then this term should be changed to "qualified capital expenditure". Under the PPT bill, "qualified capital expenditure" embodies exploration costs and capitalized expenditures.

If the intention is to allow the same kinds of costs that the federal government allows in granting the Enhanced Oil Recovery credit, then the bill should make that evident. Federal allowable costs include certain items that are normally expensed rather than capitalized, such as the cost of the injectant. The cost of the injectant would not be a creditable cost under the PPT.

I support the intent of this bill. The above suggestions are intended to strengthen the bill to make it more workable for all affected. I look forward to receiving strong support from my colleagues as the bill makes its way through the process.

Thank you,


Representative Vic Kohring

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
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Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

April 5, 2006

SUBJECT: House Bill 498, an Act authorizing tax credits against the production tax on oil and gas for qualified expenditures for challenged or nonconventional oil or gas and for qualified expenditures for nonconventional or renewable energy resources; giving the Act contingent effect – sectional analysis (Work Order No. 24-LS1817F)

TO: Representative Norman Rokeberg

FROM: Jack Chenoweth
Assistant Revisor

Janet Seitz asked for preparation of a sectional analysis for the above-captioned bill.

The current version of House Bill 488, CSHB 488(RES) identifies two credits against the tax, one under AS 43.55.024 in the amount of 20 percent of qualified capital expenditures, and a second under AS 43.55.170 for an incremental credit for qualified expenditures, not to exceed \$12,000,000 per calendar year, claimable for expenditures made through March 2016. In addition to those credits, House Bill 498 proposes to add two more.

Bill section 1: One of them, to be added under AS 43.55.026, would extend a credit, not to exceed 15 percent of expenditures, for qualified expenditures incurred for research, development, and production of challenged or nonconventional oil or gas – the terms are defined in AS 43.55.026(g) but basically reflect oil or gas that is difficult or costly to produce or recover because of its inherent qualities. The new section supplies its own definition of "qualified expenditure" for purposes of claim and application of the credit under the section. An unused portion of the credit may be used or applied against tax due in a later month. The credit would not be subject to the transfer provisions of AS 43.55.024 but would enjoy limited transferability to the producer's affiliate that may be subject to the production tax added under AS 43.55. The ability to claim the challenged or nonconventional oil or gas expenditure tax credit would expire March 31, 2016. Other provisions of proposed AS 43.55.026 spell out technical applications of the credit relating to a monthly (rather than an annual) claim and determination of whether the producer has met the obligation to pay at least 90 percent of tax when it is due.

The second credit, added by proposed AS 43.55.028, extends a credit, not to exceed 25 percent of expenditures, for qualified expenditures incurred for nonconventional or

Representative Norman Rokeberg

April 5, 2006

Page 2

renewable energy sources -- the phrase is defined in AS 43.55.028(g). This further credit is authorized under substantially the same conditions and limitations as spelled out for the credit for the challenged or nonconventional oil or gas expenditure tax credit under AS 43.55.026.

Bill section 2: Following similar concepts in CSHB 488(RES), the bill section authorizes retrospective application of regulations for the two proposed tax credits of the bill back to the effective date of this bill. The inclusion reflects the fact that giving the bill a delayed effective date to allow preparation, hearing, and adoption of regulations in advance of the bill's provisions is unlikely and that the tax credit and regulations related to it should have legal effect from the same date.

Bill section 3: Claims of tax credits under HB 498 are linked to enactment of the companion bill that repeals the existing severance tax and substitutes a production tax on oil and gas based on a percentage of production tax value. This provision makes the taking effect of this bill dependent on the enactment of the companion measure.

Bill section 4 gives this measure an effective date tied to the effective date of the companion measure or July 1, 2006, whichever is later.

JBC:med

06-282.med



Kevin A. Tabler
Manager, Land and
Government Affairs

Union Oil Company of California
P.O. Box 196247
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Tel 907 263 7600
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Email tablerk@chevron.com

April 11, 2006

Representative Vic Kohring
State of Alaska Legislature
Room 24, State Capital
Juneau, Alaska 99801-1182

Re: Support for HB498

Representative Kohring:

Recently, Chevron U.S.A. Inc. (Chevron) merged with Union Oil Company of California (Union) and currently does business in the State of Alaska under both entities. Union is now a wholly owned indirect subsidiary of Chevron. For simplification, I will address my comments on behalf of both entities through Chevron.

We are encouraged to see the introduction of HB 498. Through our testimony in both House Resources and House Finance on the pending Petroleum Production Tax (PPT) legislation (HB 488), we have advocated for the inclusion of incentives for heavy oil exploration and development. Others testifying on PPT in addition to several of the State of Alaska consultants, have all recognized the need for the creation of incentives to stimulate development of challenged or nonconventional oil or gas. Neither the House of Representatives nor the Senate Committee Substitute's for HB 488 and SB 305 respectively, have incorporated to date, provisions addressing same. HB 498, introduced by the House Rules Committee, is a very well written piece of legislation providing for the authorization of tax credits against production tax on oil and gas qualified expenditures. We are pleased the legislature has listened to the testimony of industry and has addressed this matter.

In general, HB 498 accomplishes the objectives set out by prior Chevron testimony. Authorizing tax credits for qualified expenditures on heavy oil creates the much needed incentive for explorers and developers to evaluate this important state resource.

Chevron encourages you and your committee to pass HB 498 out of the Oil and Gas Committee and support same through the legislative process.

Sincerely,

Kevin A. Tabler



April 12, 2006

The Honorable Norman Rokeberg
Alaska State Representative
State Capitol Room 214
Juneau, AK 99801

Representative Rokeberg:

I offer the following as additional testimony to that given to the House Oil & Gas Committee on April 11, 2006 to provide clarity around comments on high gas production / high GORs in the Lisburne field and ask that, if appropriate, you make it available to the members of that and subsequent committees:

Additional Information on Lisburne Reservoir and House Bill 498

Gas production or high produced gas/oil ratios (GORs) from Lisburne wells are not observed to be a permanent or unconquerable problem hindering further development of the Lisburne reservoir. The GOR of new wells do tend to rise to unacceptable levels over time but this usually occurs after the wells have recovered significant quantities of oil. High GORs are a symptom of some fundamental characteristics that make Lisburne a challenged reservoir. One of these characteristics is that the Lisburne matrix rock has low permeability, typically ranging from 0.1 md to 2 md for the better intervals that feed oil into the fracture systems. Because of this low permeability the current vertical wells, which are drilled on approximately 320 acre spacing, do not effectively drain all of the area between each well and the adjacent neighbor well. Recent coil sidetrack drilling in the Lisburne indicates additional reserves can be recovered by drilling horizontal wells into areas not drained by the existing vertical wells. Production logs run in horizontal coil sidetrack wells also indicate productivity of reservoir further away from the vertical parent well dominates the total well production. Based on these results and other field based performance and studies, the Lisburne team believes significant potential may exist for increasing the recovery from Lisburne with new drilling technology. Drilling multi-lateral horizontal wells at Lisburne with underbalanced drilling conditions is new technology that has potential for accessing more undrained Lisburne reservoir rock without incurring formation damage to the fractures in the reservoir.

Drilling enough underbalanced multilateral wells to significantly increase the recovery factor will be capital intensive. The possibility of such a drilling program occurring would be more likely if capital tax credits existed for Lisburne. Such wells would be expensive and have higher than average risk based on the historical results of drilling at Lisburne.

Another reason for high gas production in many wells at Lisburne is that the pressure has dropped over time, allowing more solution gas to evolve out of the oil and occupy space in the reservoir as free gas, which more easily migrates to the producing wells than the oil does. Since field startup Lisburne has re-injected the majority of its produced gas, but this has not been enough volume to stop the pressure decline. A pilot conventional water injection project was implemented at the L2 well pad but was unsuccessful because injected water quickly broke through in offset production wells. Alternative pressure support projects are currently being evaluated, but these options would involve capital investment. Capital tax credits would make it more likely that a pressure support project would be implemented for the Lisburne reservoir. A successful pressure support project should increase recovery from the Lisburne reservoir by arresting the pressure decline and reducing the produced gas/oil ratios in many wells. This would allow wells to recover more oil before they "gas out".

As I explained in my testimony, the Lisburne reservoir has the potential to recover significantly more reserves but is dependent on new technology projects to do so. The new technology that is currently available to Lisburne is capital intensive, and any tax incentives on capital investment at Lisburne would make these projects more likely to occur. For these reasons and based on the uncommon and challenging reservoir characteristics compared to other Alaskan reservoirs, BP recommends including carbonate reservoirs, and hence the Lisburne reservoir, as reservoirs that would qualify for tax credits as described in House Bill 498.

Respectfully submitted,

Sam W. French
Project Lead, Lisburne Subsurface Development Team
Greater Point McIntyre Area (GPMA)
BP Exploration, (Alaska) Inc.
900 East Benson Boulevard
Anchorage, AK 99519

HB 498

Janet Seitz

From: Digert, Scott A [Scott.Digert@bp.com]
Sent: Tuesday, April 25, 2006 11:10 PM
To: Rep. Norman Rokeberg; Rep. Ralph Samuels
Cc: Paskvan, Frank A; bill_van_dyke@dnr.state.ak.us
Subject: HB 498 comments and visit to Juneau on 4/26
Attachments: Testimony on HB 498 Digert.doc

<<Testimony on HB 498 Digert.doc>>
Rep. Rokeberg and Rep. Samuels,

Thank you for your continued effort to progress HB 498. As the debate on the PPT progresses it seems very evident that the tax credits which this bill could provide will be important to help sustain the substantial ongoing investments needed to develop challenged projects such as viscous oil.

I had the opportunity to speak to the House Oil & Gas Committee during public comment on this bill on April 11, and have attached that statement. At that time we seemed to have agreement that future investments in our current viscous development areas could qualify for the challenged oil tax credits. I'm thus very concerned that the current version of HB 498 specifically excludes the S-Pad development of the Schrader Bluff in the Milne Point Unit, and the West Sak 1C, 1D, 1E, and 1J developments in the Kuparuk River Unit. I understand the concern that ongoing investment in projects which have already been sanctioned can be viewed as not needing this credit, but am concerned that the PPT under consideration substantially changes the economic framework under which the sanction decision was made. These viscous projects are some of our most marginal investment opportunities, and the viability of ongoing investments is always subject to review when conditions change. More importantly, though, the initial project investment in the majority of these developments has been completed, and future investment would be for additional work beyond the original project scope, generally to add infill wells or apply new technologies which have been developed since the original development. Why would these additional investments which have not yet been sanctioned be excluded from the tax credit?

For example, our Milne S-pad development was the first new pad designed specifically to develop the Schrader Bluff viscous resources on the North Slope. Since the original development in 2002/03 we have continued to develop our understanding of viscous production, and now are assessing further opportunities to improve recovery. These will likely include the sidetracking of several conventional vertical injectors to become horizontal injectors, and the drilling of several new producers and injectors to both infill existing waterflood patterns and to target additional reservoir layers which have not been fully developed. These new wells would require a pad expansion and additional surface facilities, requiring additional investment of \$10-30mm. The project has not yet been sanctioned, in large part because it is very marginal and we are still looking at ways to reduce costs, improve recovery, or otherwise improve the economics. The current PPT proposals would make this more difficult, and the current HB 498 draft would exclude it from the challenged oil credit. Yet, if we developed the same reservoir area from a different pad, it could qualify. Why should these options be distinct? Also, the draft bill would exclude "portions of a pool" but I don't know how a "portion" is defined; could be the entire pool be excluded? This defeats the purpose of the bill.

I would thus recommend several changes to the current draft:

- Page 3, lines 29-31, delete "except for that portion or portions of a pool in the Schrader Bluff formation produced from the drill site S area,"
- Page 4, lines 2 and 3, delete "except for that portion or portions of a pool in the West Sak formation produced from the drill site 1C, 1D, 1E, or 1J drill site areas;"

I will be in Juneau on Wednesday 4/26 on a CAP trip, and will contact your offices to arrange a short visit if possible. If you would like to contact me, please call my cell. Thank you, and I look forward to meeting you tomorrow.

4/26/2006

Scott Digert

Subsurface Team Leader, Western North Slope
ACT Performance Unit

office: (907) 564-4480

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email: digertsa@bp.com

Alaska State Legislature
House Bill 498, Tax Credits for Challenged or Nonconventional Oil or Gas
Testimony to House Oil & Gas Committee
Scott Digert - April 11, 2006

Good morning, Mr. Chairman and members of the committee. My name is Scott Digert. I am an Alaska resident, living with my wife and two children in Anchorage, where I am represented in the Legislature by Representative Meyer and Senator Cowdery. I've lived in Alaska for over 12 years. After an initial assignment here with ARCO in the 1980's & 90's, I spent time Outside working for ARCO in California and the North Sea. I was delighted to return to Alaska in 2000 as part of the BP merger as it's a great place to live and work, and to raise our children. I work for BP, where I am the subsurface manager for our Western North Slope assets, which includes the Milne Point field. Milne has been at the forefront of viscous oil development on the North Slope, and over the past four years we have pushed our viscous production to as much as 20,000 bopd, or 40% of our total Milne production, through heavy investment in new drilling, technology, and facility upgrades. Our investment has been enabled by a favorable fiscal framework, and we were well positioned to catch the upturn in oil prices which has provided good returns on our viscous development. However, I am very troubled by elements of the ongoing PPT debate, and the likely chilling impact that a substantial increase in our tax burden will have on our marginal investment opportunities, such as ongoing viscous development. I am pleased to have the chance to speak to you today in support of House Bill 498, which may help to offset some of this increase, and may encourage ongoing viscous development to the benefit of both the energy industry and the State and citizens of Alaska.

As I hope you are aware, BP is planning and investing for a 50-year future in Alaska. A key element in this plan is the Alaska Gas Pipeline project. This project needs to be built on a strong and stable foundation from our oil business, and it is the oil business which must bridge us to Gas. We are striving to maximize the recovery of our substantial known oil resources in Alaska, and we should be fully aligned with the State in seeking to maximize production. The production from our current world-class fields is steadily declining. Flattening this overall decline and providing a 50-year future requires that we actively work to stabilize the decline in our existing fields, and that we bring on new production. Replacing the decline in major assets such as Prudhoe Bay and Kuparuk requires major new developments. By far the largest known undeveloped oil reserves in Alaska are in viscous oil reservoirs, where we have 20-30 Billion barrels of oil that are known to be in place.

While these massive volumes are clearly attractive and are an enormous strategic prize, the development and production of these resources is difficult and costly. It requires innovation, advances in technology, and a tolerance for increased risk. The wells required are complex and costly, our existing production facilities require substantial retrofitting to handle cold viscous oil when they were originally designed for warm light oil, and the cost to operate the viscous floods is higher per barrel than our existing light oil production. To continue to develop these reserves, Alaska MUST remain competitive in the global marketplace as a good place to invest. We need to continue the successful partnership between the State and the energy industry, seeking fundamentally to increase production and then to ensure fair division of the proceeds, not to squabble over the division of a shrinking production stream.

We are currently in the middle of the development of the Schrader Bluff and West Sak reservoirs. We have mapped 5-10 billion barrels of oil in place, and in the best performing areas we may recover up to 20% of this oil. However, to date we've only recovered around 1% of this total, after investing several hundred million dollars. Major continued investment will be needed. I'm very proud of the technical advances we've made, including the drilling of very sophisticated horizontal multilateral wells in very complex reservoirs. We've succeeded in creating a viable business in reservoirs which were not commercial in the 1990's. As we move into the Ugnu reservoir, we can access a further 15-20 billion barrels of oil in place. We have not yet succeeded in sustaining commercial production rates, despite having drilled several wells with current technology. We need to continue to push our technical development, with increasingly complex wells, and the likely injection of solvents or steam to mobilize the very viscous Ugnu oil. We will likely also need new facilities that are optimized for these new recovery processes, all of which will require the investment of billions of \$ in capital. This progression is risky, and the risk needs to be balanced by the opportunity to achieve attractive returns. Our viscous business needs to be robust enough to survive in low price cycles, and be positioned to thrive when the prices are favorable, as they are now.

Unfortunately, the new tax structure being discussed as part of the PPT will significantly increase the tax burden on our viscous developments, and will make these marginal developments even less attractive. HB 498 will help to offset some of this burden, which is welcome, though the overall impact remains uncertain as the bills evolve. I believe the definitions of challenged or nonconventional oil and gas which have been included are appropriate. The bill captures the known viscous and other challenged resources, and provides definitions which should be suitable for broader development if additional resources are identified.

I encourage the Committee to pass this bill, and to seek its inclusion in a broader PPT package as it moves forward. I remain very concerned about the future investment climate in Alaska. I strongly encourage the Legislature to continue to seek a fair and balanced tax package which fundamentally continues to attract investment and provides the opportunities for innovation in developing our resources. If this is done successfully, I look forward to a continued bright future in Alaska, with great professional opportunities, and to raising my family here.



Agrium U.S. Inc.
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P.O. Box 575
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99611-0575

Lisa Parker
Government & Community Relations

April 6, 2006

The Honorable Vic Kohring
Chairman, House Special Committee on Oil & Gas
Alaska State House of Representatives
State Capital
Juneau, Alaska 99801

Subject: HB 498 "An Act authorizing tax credits against the production tax on oil and gas for qualified expenditures for challenged or nonconventional oil or gas and for qualified expenditures for nonconventional or renewable energy resources; giving the Act contingent effect; and providing for an effective date."

Dear Representative Kohring:

Agrium U.S. Inc. appreciates the opportunity to provide comments on HB 498 "An Act authorizing tax credits against the production tax on oil and gas for qualified expenditures for challenged or nonconventional oil or gas and for qualified expenditures for nonconventional or renewable energy resources; giving the Act contingent effect; and providing for an effective date."

Cook Inlet has a variety of industries that were built around an abundance of low-cost natural gas. Today the demand for natural gas is exceeding supply, which is having an impact. The first Cook Inlet industry adversely impacted is Agrium. Without a reliable natural gas supply Agrium will be forced to cease operations. In exploring alternatives, Agrium has been investigating the utilization of coal, an abundant but underutilized resource, to create the feedstock necessary to keep the facility operational.

Through the process of gasifying the coal one of the byproducts is carbon dioxide (CO₂). Some of CO₂ will be utilized in the manufacturing of urea while excess CO₂ could be injected into the aging Cook Inlet oil fields. A recent study by the U.S. Department of Energy estimates that as much as 300 million barrels of additional crude oil could be recovered from Cook Inlet fields through CO₂ injection.

In reviewing HB 498 it does not specifically address the application of enhanced oil recovery utilizing CO₂ injection. Agrium respectfully requests that the bill be amended as follows on Page 4:

(F) (viii) low salinity water flooding; [or]

(F) (ix) carbon dioxide (CO₂) injection; or

(F) (x) any other method not described in (i) – (ix) of this subparagraph that is certified by the department to be a qualified enhanced oil recovery technique or that is certified by the Alaska Oil and Gas Conservation Commission for purposes of this section;

Again, thank you for the opportunity to comment. Should you have questions or require further information please contact me.

Sincerely yours,

Lisa Parker

Cc: Senator Tom Wagoner
Representative Mike Chenault
Representative Kurt Olson



Home > Ask An Expert > Answers...

Are We Running Out of Oil Worldwide?

Oil resources are adequate to meet growing worldwide demand for at least the next 25 years. The world's oil resource base is defined by three categories: proved reserves (that is, those quantities that have been discovered already and can be recovered under present technologies and prices); reserve growth (increases in reserves resulting mainly from technological factors that enhance a field's recovery rate); and undiscovered reserves (oil that remains to be found through exploration). Estimated World Oil Resources, 1995-2025 as reported in EIA's International Energy Outlook 2005 are 2,947 billion barrels between 1995 and 2025. According to EIA's International Energy Outlook 2005 world oil consumption is expected to grow from 29 billion barrels per year in 2002 to 44 billion barrels per year in 2025. Under these growth assumptions, less than half of the world's total oil resources would be exhausted by 2025.

Furthermore, the estimate of the world's total oil resources involves only conventional sources of oil. Nonconventional oil resources are defined as resources that cannot be produced economically with today's technology and includes oil sands, gas-to-liquids technologies, biofuel technologies, and shale oil. In the case of heavy oil and tar sands, for instance, more than 3,300 billion barrels are estimated worldwide, with Canada and Venezuela having the most significant deposits. If high world oil prices are sustained at over \$35 per barrel (in constant 2002 dollars) for a long period of time, nonconventional oil could be expected to provide as much as 8 million barrels per day.

Comparing Different Energy Commodities

To make meaningful comparisons of energy commodities, you must convert physical units of measure (such as weight or volume) and the energy content of each fuel to comparable units. One practical way to compare different fuels is to convert them into British thermal units (Btu).

The Btu is a precise measure of energy—the amount of energy required to raise the temperature of 1 pound of water 1 degree Fahrenheit.

The Btu content of different energy commodities is given in the Thermal Conversion Factors tables of EIA's Annual Energy Review. (Explanation and examples of energy units)

For Energy Used in the United States, use the "Energy Calculator - Common Units and Conversions"

Average Monthly Residential Electricity Consumption

Average monthly residential electricity consumption in 2004 was 908 Kwh. For state, regional, and U.S. information on residential electricity consumption see "Electric Sales, Revenue, and Price", Table 5.

Dependency on Imported Oil

EIA measures import oil dependency based on net petroleum imports as a percentage of total petroleum consumed ("product supplied").

Gallons of Gasoline From One Barrel of Crude Oil

One barrel (42 gallons) of crude oil, when refined, produces approximately 19.9 gallons of finished motor gasoline, as well as other petroleum products. See <http://www.eia.doe.gov/kids/energyfacts/sources/non-renewable/oil.html>

Uses of Petroleum



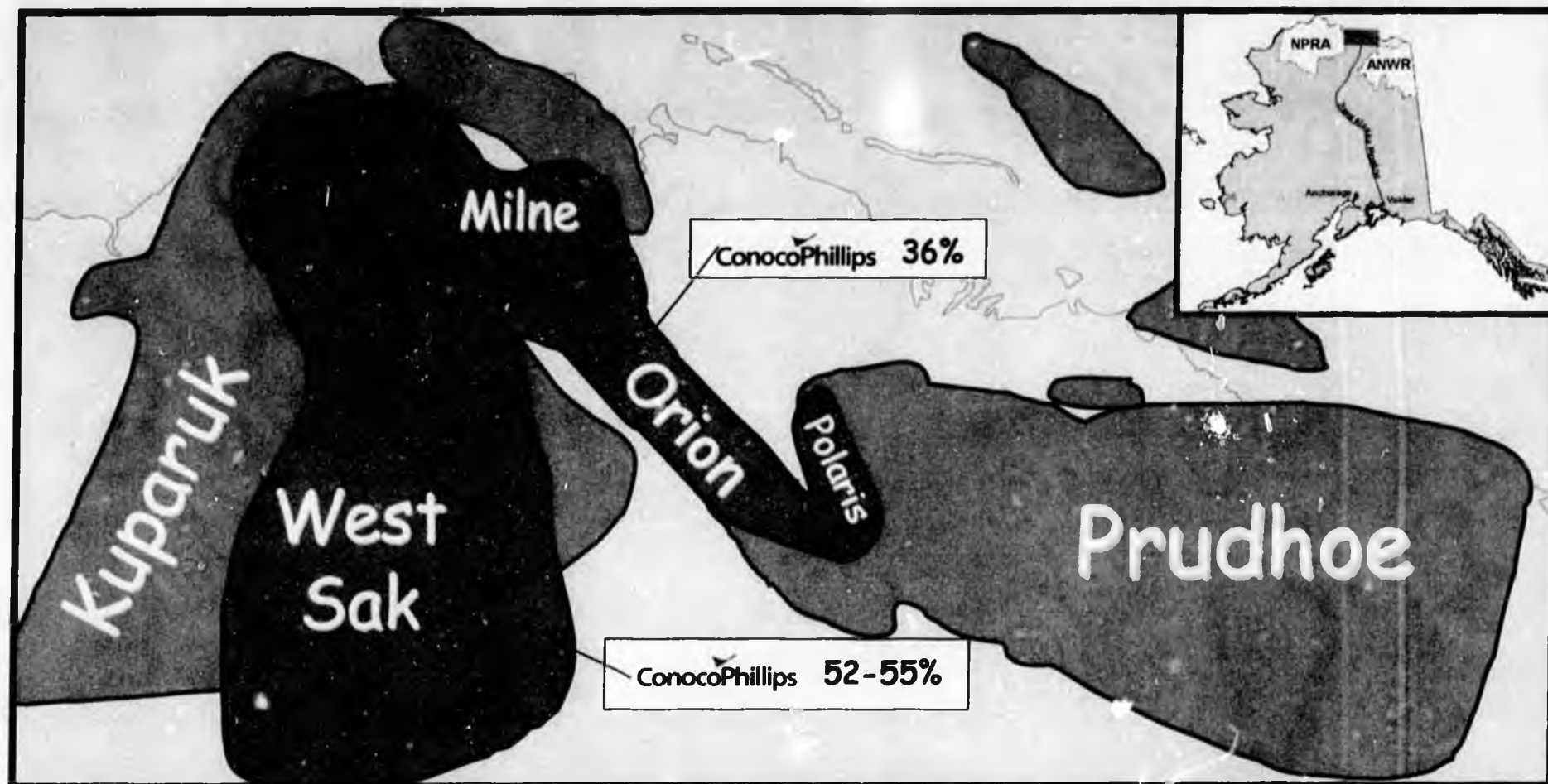
HB 498 Testimony

ConocoPhillips Alaska
April 19, 2006



Jeffrey A. Spencer
Supervisor
GKA Heavy Oil Development
ConocoPhillips Alaska

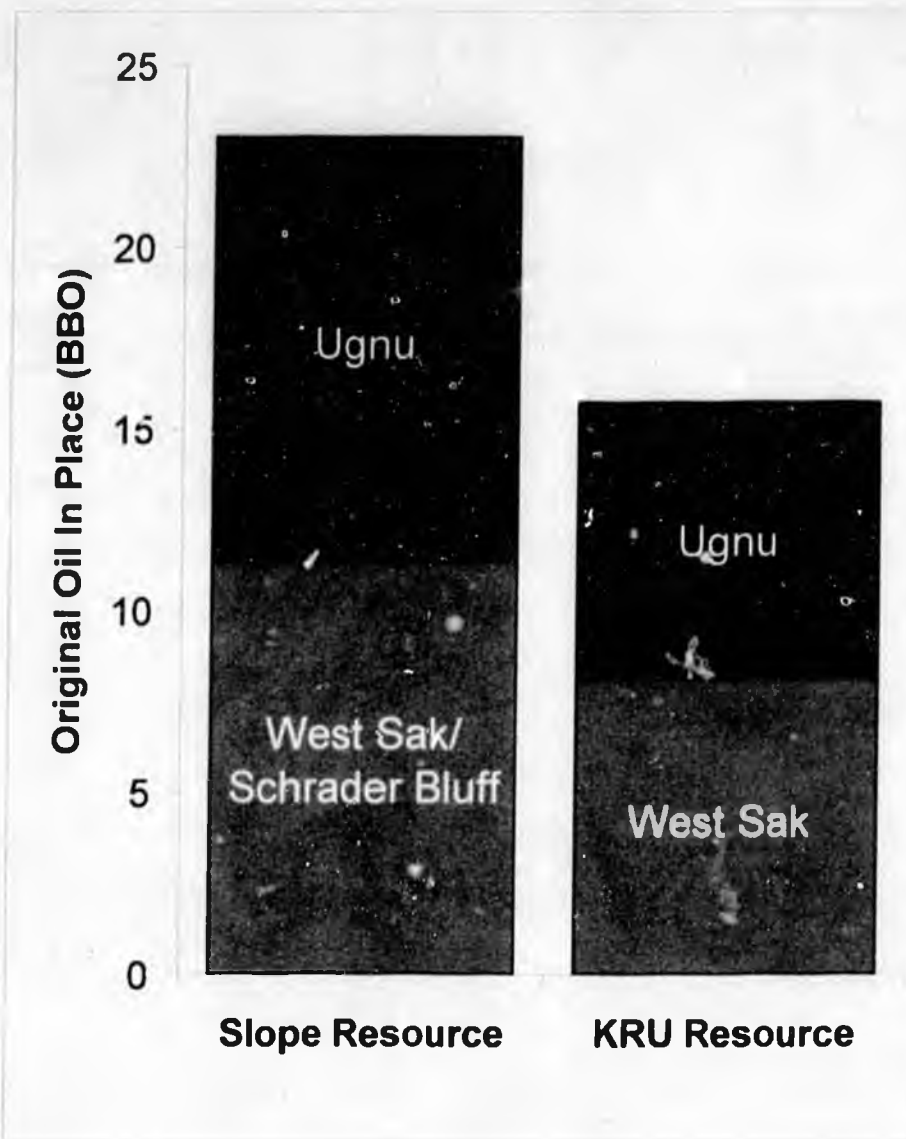
North Slope Heavy Oil Fields



 = Heavy Oil

 = Light Oil

The Prize: North Slope Heavy Oil Resources



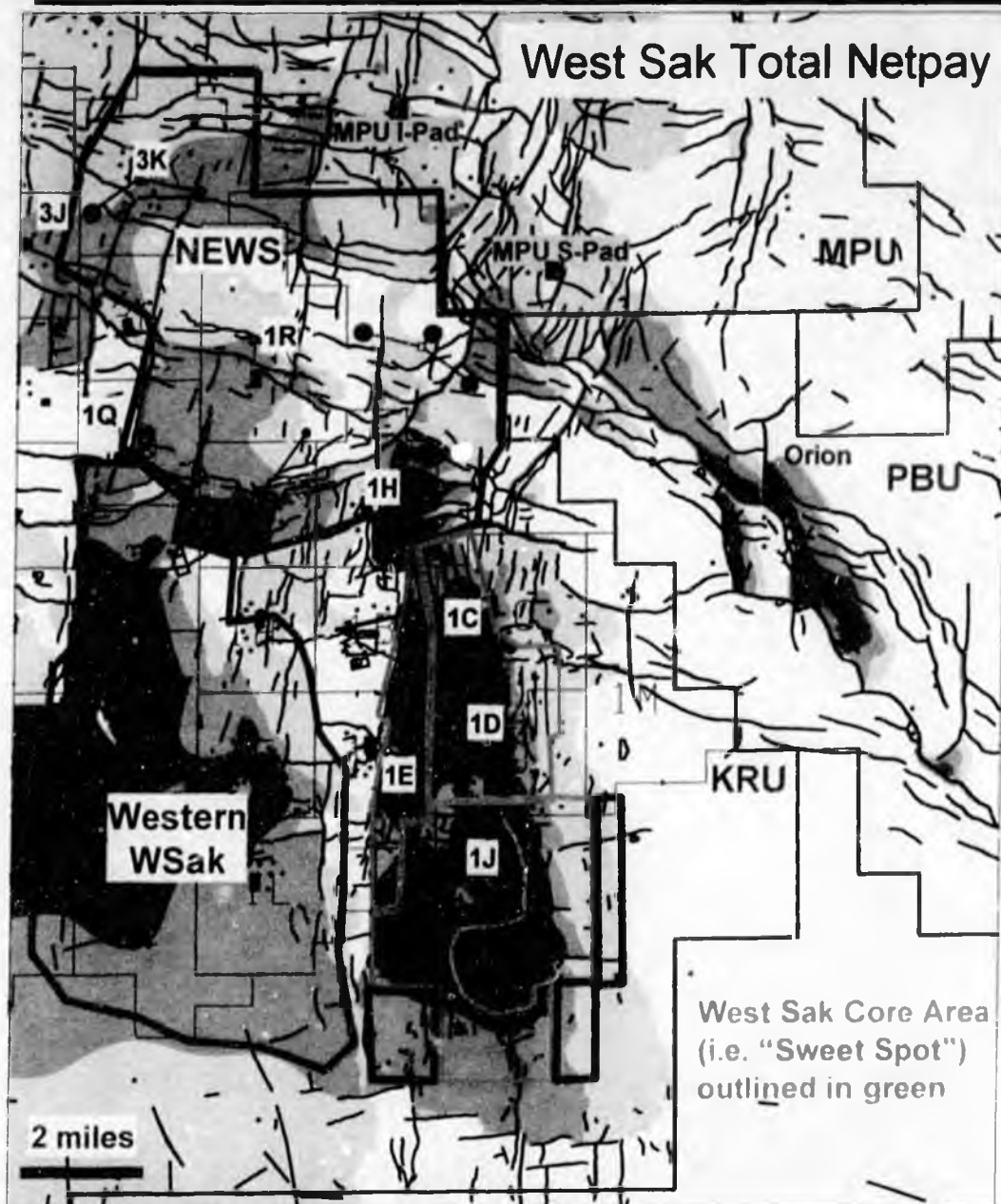
19 API Crude



10 API Crude

- Shallow reservoirs (3,000 to 4,500')
- 1,800' of permafrost
- "Cold" Temperature (40° to 90° F)
- High viscosities for given API gravities (10's to 1000's cp)
- Low rates and recovery factors

GKA Heavy Oil Development History



- **West Sak reservoir discovered in early 1970's**
 - *Explorations and appraisal wells drilled throughout 1970's*
- **Conducted DS 1J pilot project in early 1980's**
 - *15 vertical wells on 5-acre spacing*
 - *Ran pilot project for ~2 years*
 - *Acquired rock, fluid and reservoir performance data*
- **1997-98: DS 1D development**
 - *29 vertical wells on 40-acre spacing*
- **1999-2002: DS 1C/1D development**
 - *Short, dual-lateral producers*
- **2003: DS 1B/1C/1D development**
 - *Long dual-lateral producers*
- **2004: DS 1E development**
 - *Primarily long tri-lateral producers and injectors*
- **2005-2007: DS 1J development**
 - *Primarily long tri-lateral producers and injectors*



North Slope Heavy Oil Developments

North Slope Operating Conditions

- Harsh arctic conditions
- Minimal footprint
- Limited contractor resources
- Pushing limits of drilling technology

High Costs

Geologic Complexity

- Shallow depths and permafrost issues
- Unconsolidated formations
- Low reservoir temperature
- Highly faulted

Lower rate wells

Viscous Oil Properties

- Artificial lift required
- Fluid separation difficulties
- Solids handling and disposal issues
- Lower quality crude

Lower overall recovery

Lower price per barrel than light oil



If 1E pad were in downtown Anchorage



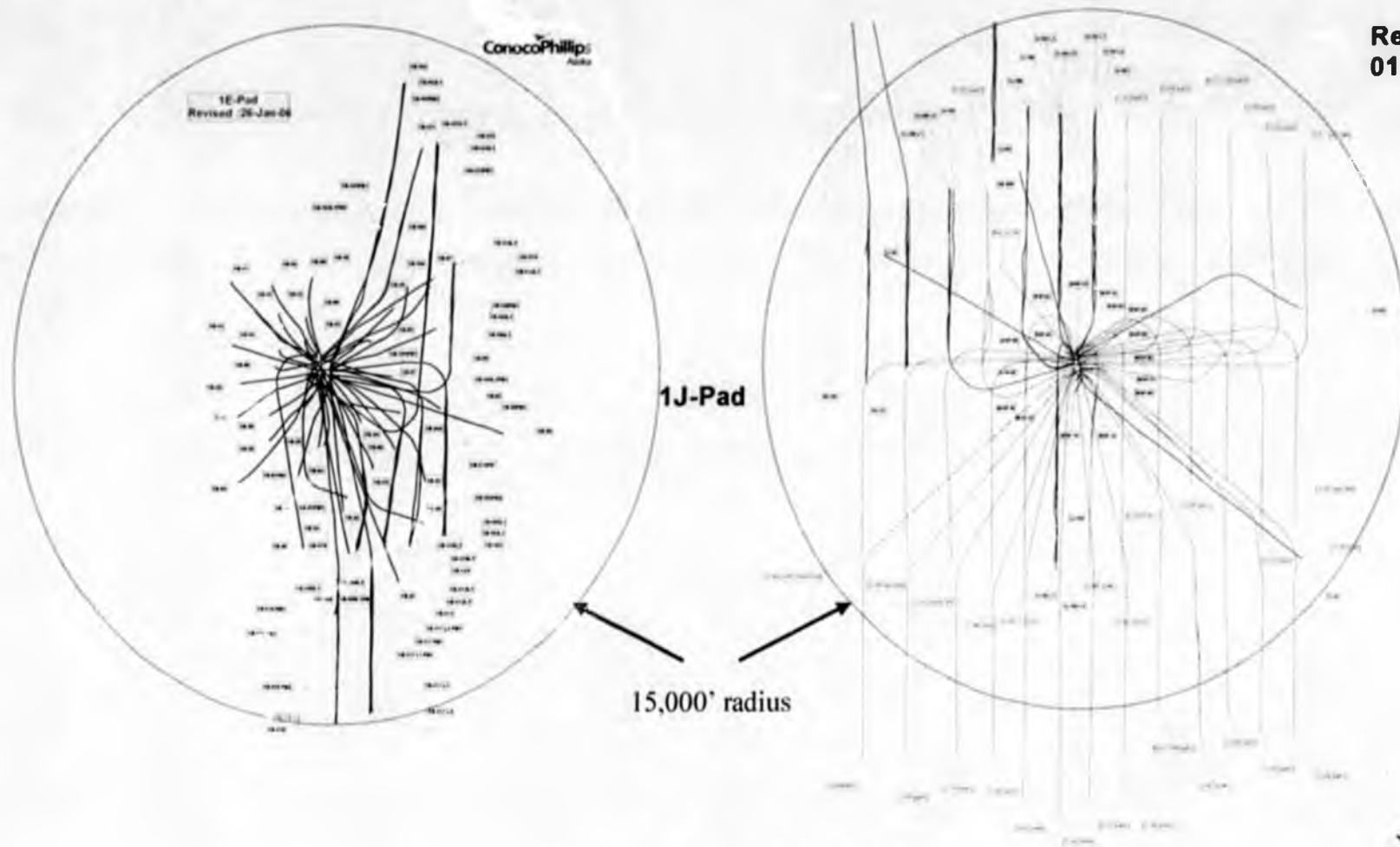
1E-102, with two 8000 foot laterals, would reach 3 miles north, beyond the Port of Anchorage

ConocoPhillips Tower

1E-117, with three 6000 foot laterals, would reach 3 miles south, into a subdivision beyond Tudor Road.



West Sak Spider Map 1E vs 1J



Revised
01/20/06

Black - Existing Wells
Red - Planned Wells

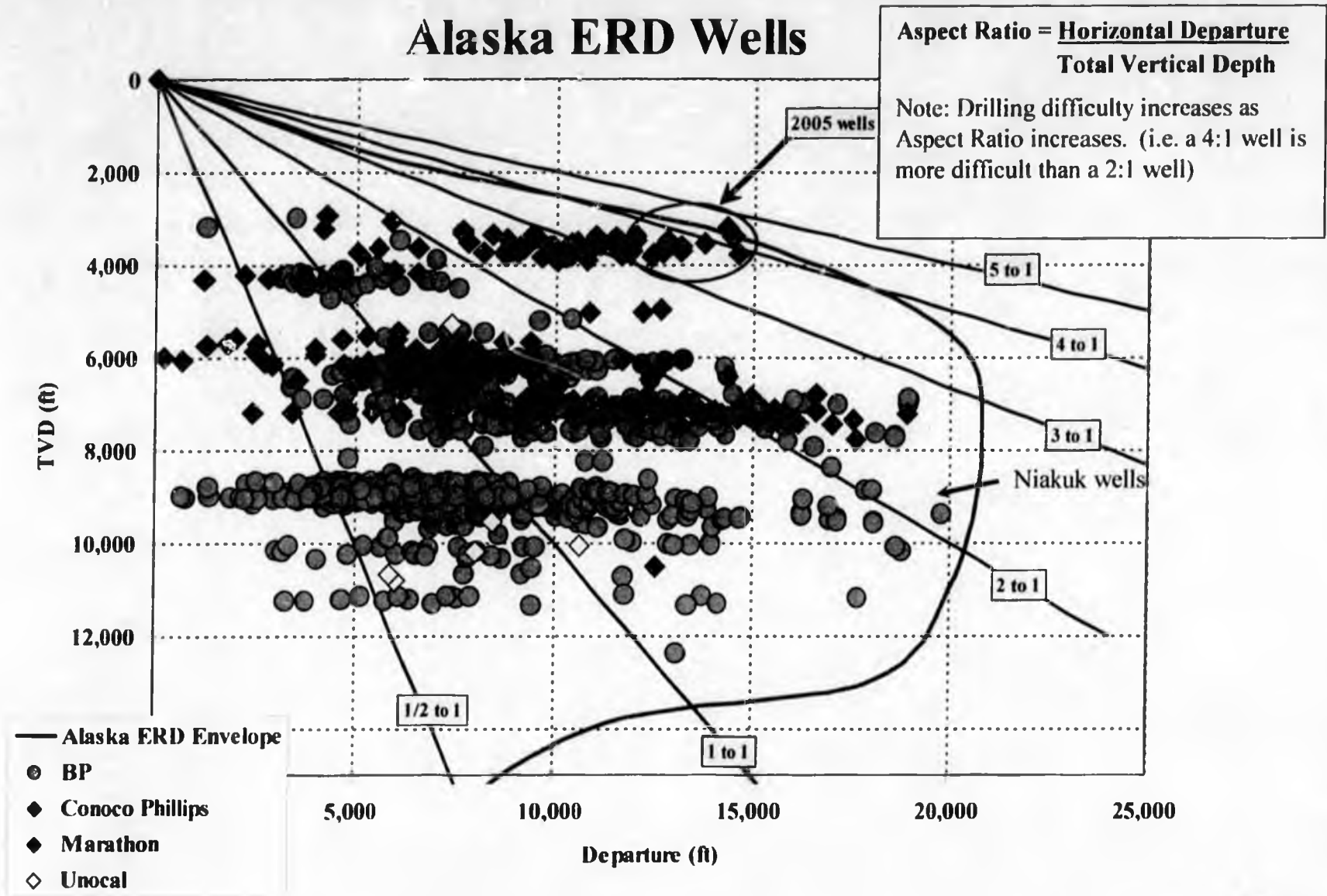


ConocoPhillips

Drilling Technical Limits – *Pushing the envelope*



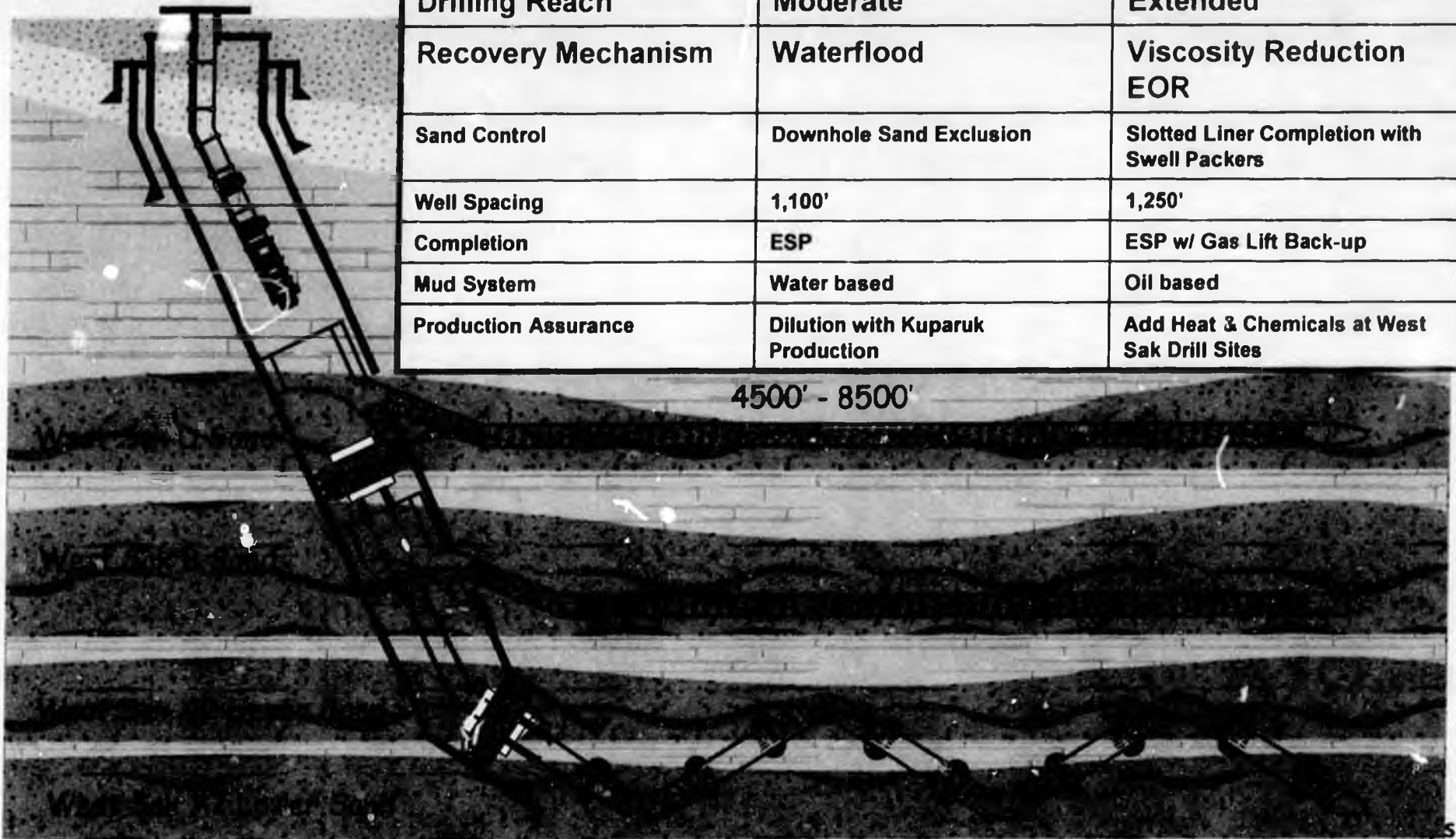
Alaska ERD Wells



West Sak Tri-Lateral Producer

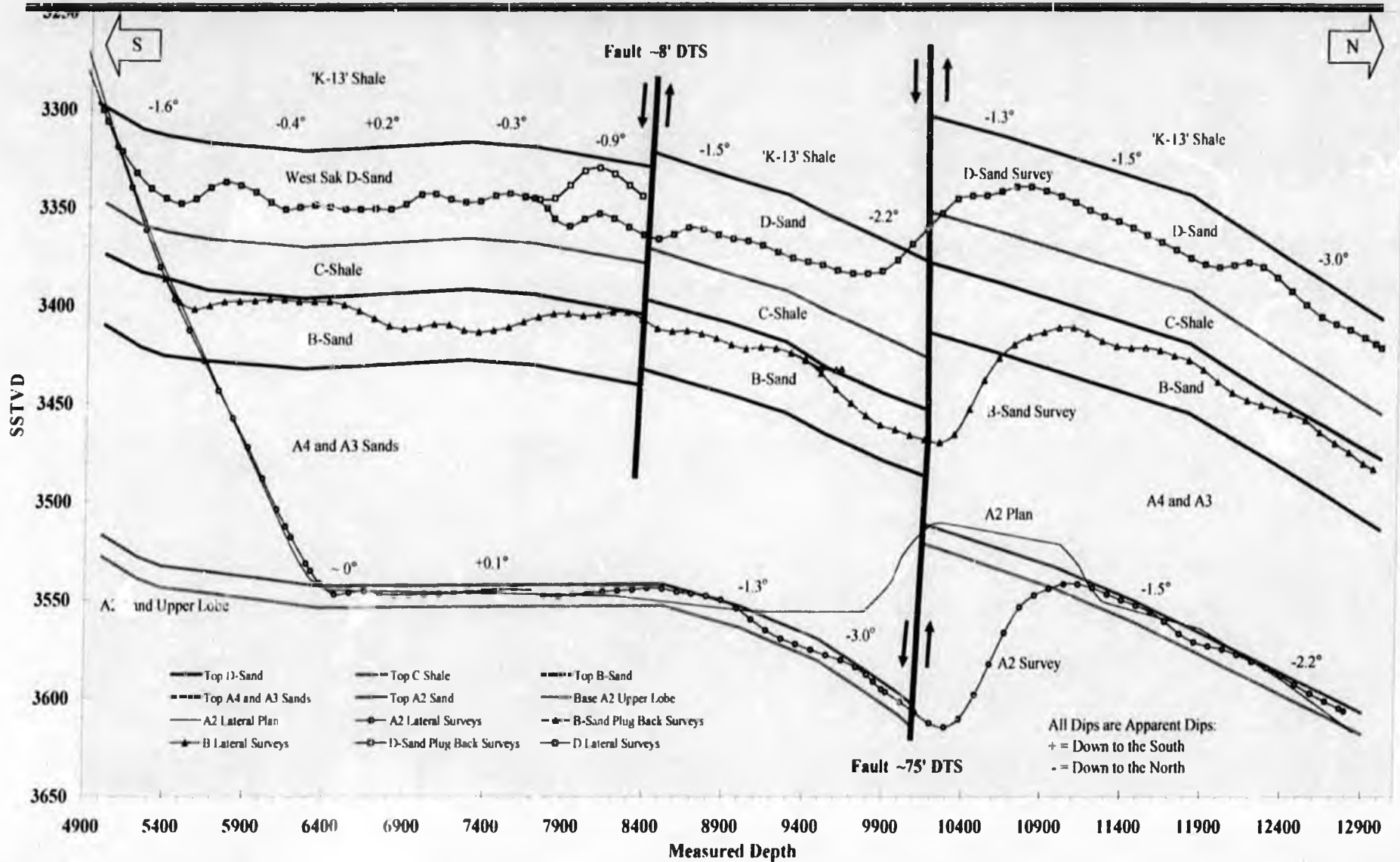


Component of Development Plan	1998	2004
Well Types	Vertical	Horizontal Multi-Lateral
Drilling Reach	Moderate	Extended
Recovery Mechanism	Waterflood	Viscosity Reduction EOR
Sand Control	Downhole Sand Exclusion	Slotted Liner Completion with Swell Packers
Well Spacing	1,100'	1,250'
Completion	ESP	ESP w/ Gas Lift Back-up
Mud System	Water based	Oil based
Production Assurance	Dilution with Kuparuk Production	Add Heat & Chemicals at West Sak Drill Sites



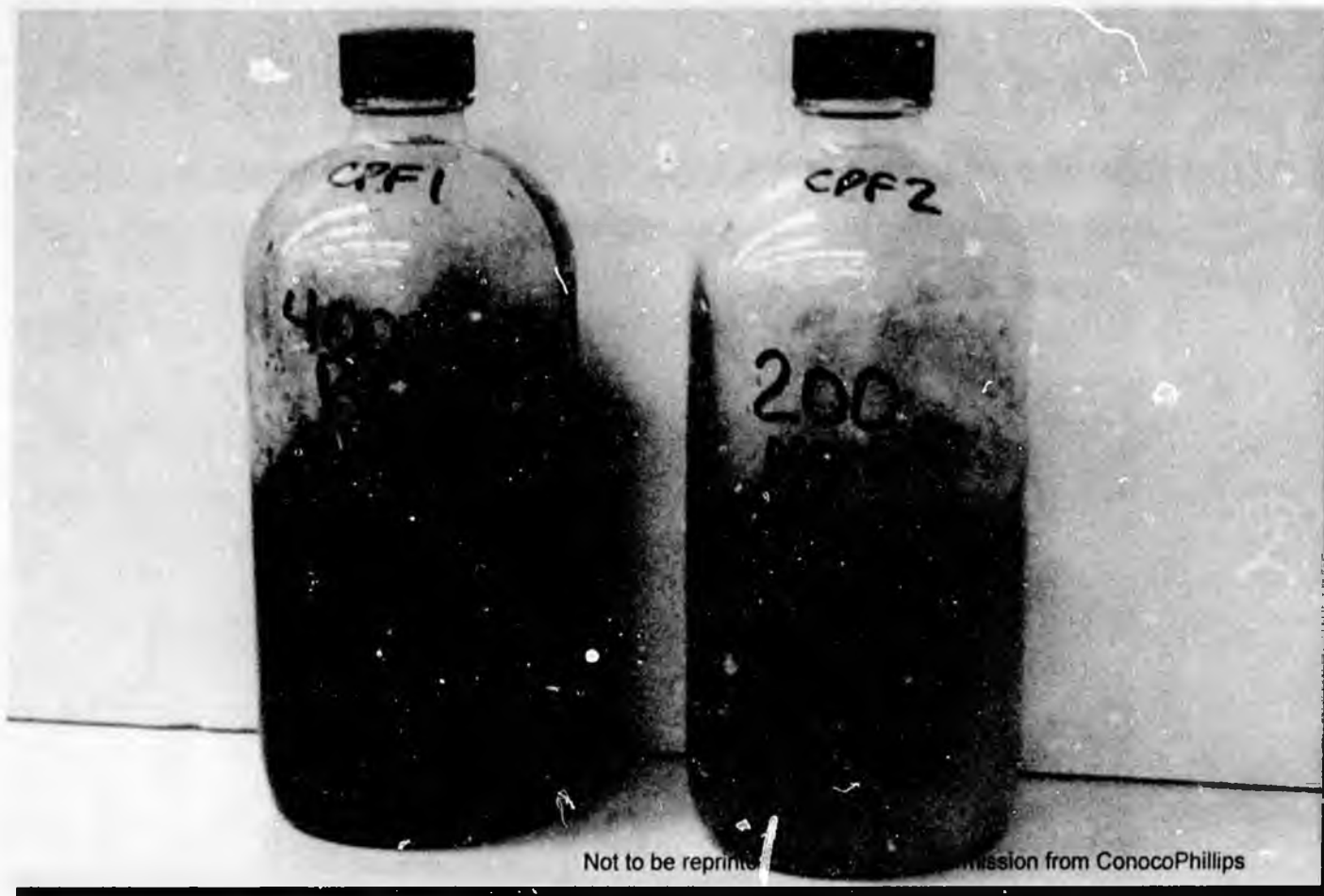


West Sak Tri-Lateral Producer Interpreted Measured Depth Profile



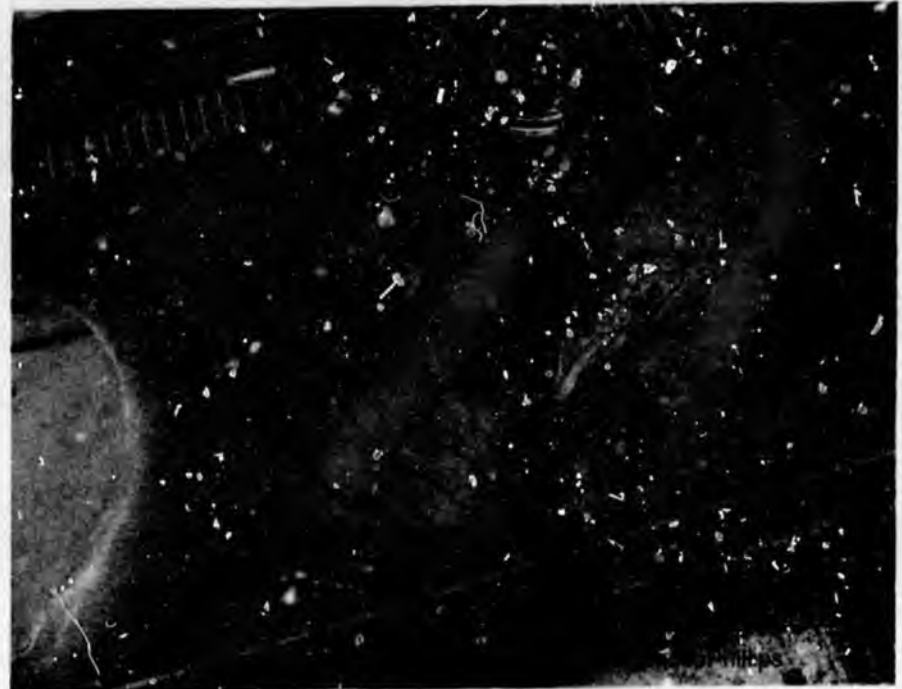
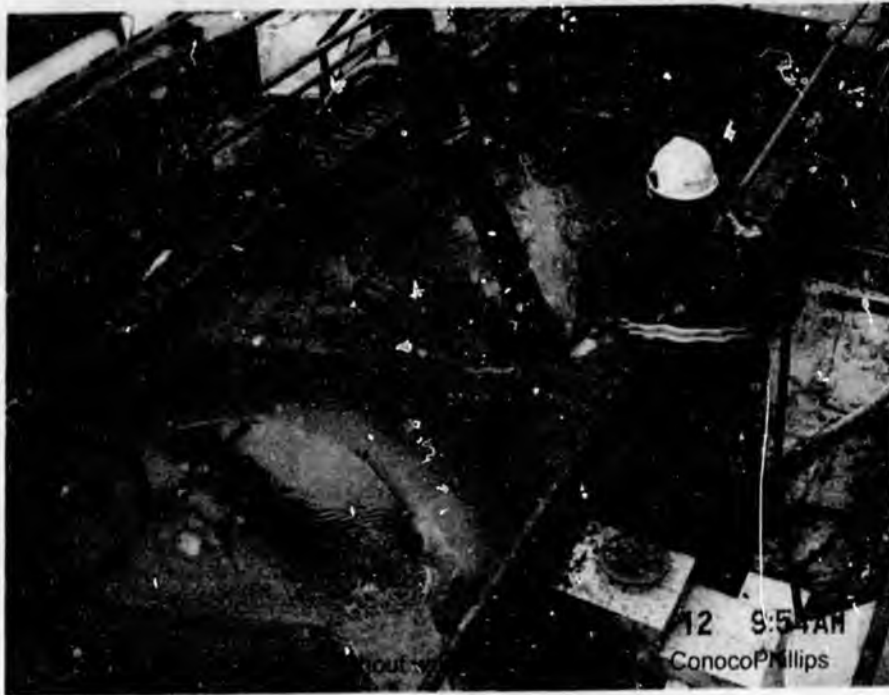
Fluid Separation Issues

CPF1 vs CPF2 Produced Water Comparison



More heat and/or more chemicals required to separate viscous oil & water

Solids Handling and Disposal Issues



Higher sand/solids production associated with viscous oil increases solids handling and disposal costs.

Equipment Degradation Issues

Typical CPF1 pump erosion damage



Increased solids production also leads to higher equipment failure in surface and downhole equipment (pumps, etc.)

North Slope Heavy Oil Developments

North Slope Operating Conditions

- Harsh arctic conditions
- Minimal footprint
- Limited contractor resources
- Pushing limits of drilling technology

Geologic Complexity

- Shallow depths and permafrost issues
- Unconsolidated formations
- Low reservoir temperature
- Highly faulted

Viscous Oil Properties

- Artificial lift required
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High Costs

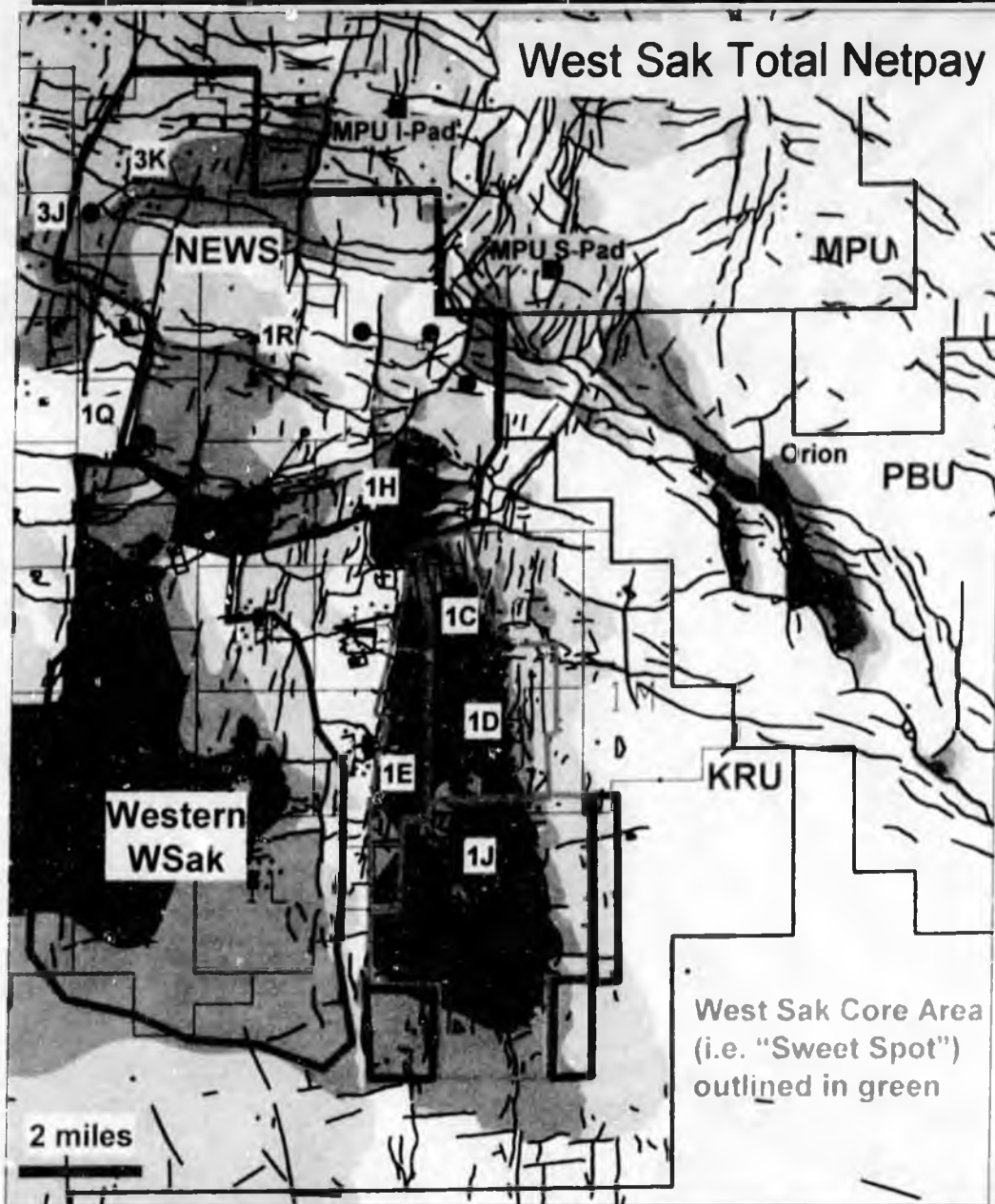
Lower rate wells

Lower overall recovery

Lower price per barrel than light oil

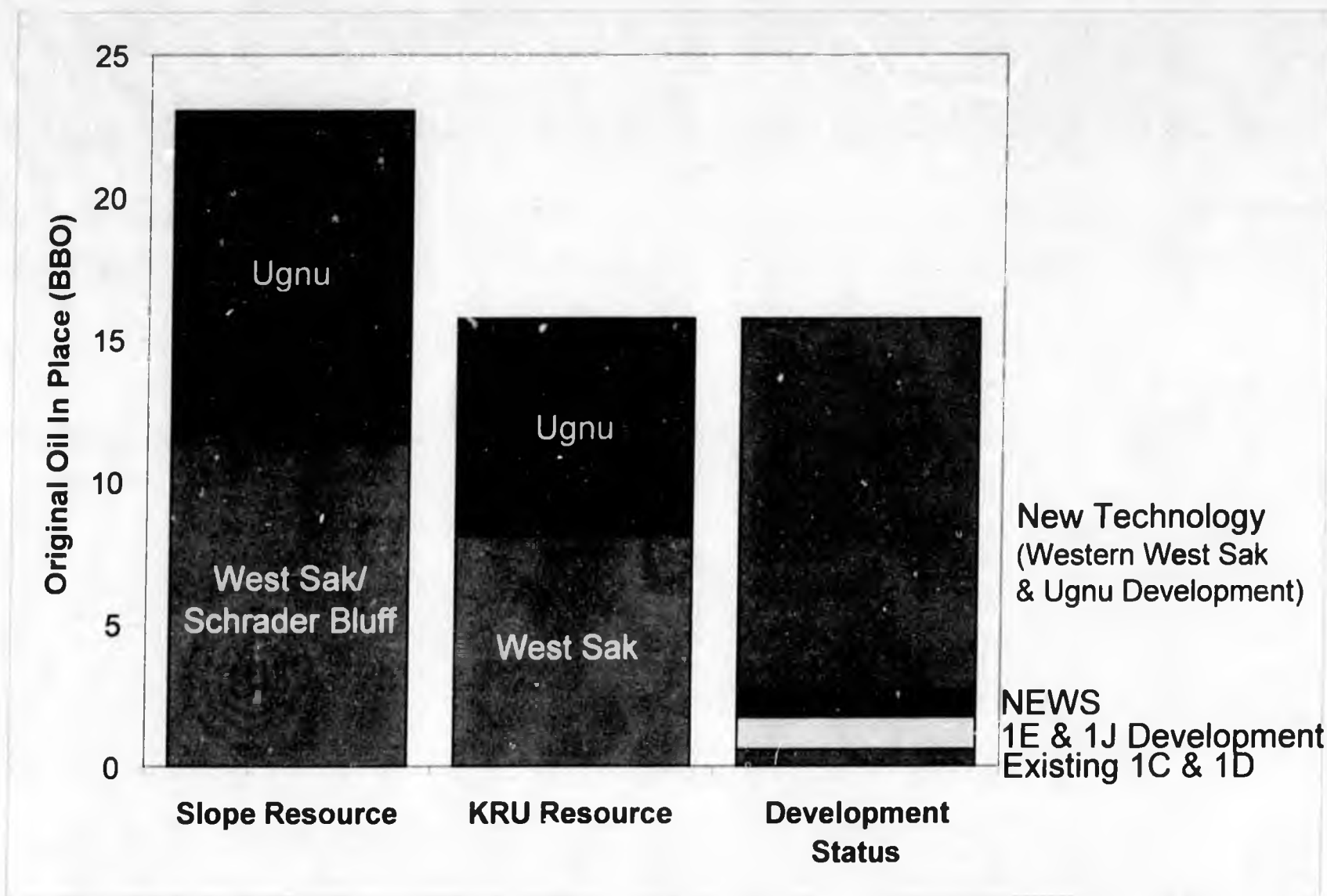


GKA Heavy Oil Development Strategy



- Continue Development of Eastern West Sak
- Develop New Technology Applications for Western West Sak & Ugnu

The Prize: North Slope Heavy Oil Resources





HB 498 - Summary

- **Vast Heavy Oil Resources on North Slope**
 - *Potentially 4-5 billion barrels recoverable*
 - *Development will be key to minimizing ANS production decline*
- **Challenged Resources**
 - *Technically complex*
 - *High cost – low rates and recoveries*
 - *Lower wellhead values*
- **Fiscal incentives could encourage heavy oil development**
 - *20/20 PPT foundation is critical*

ConocoPhillips supports this bill and believes that it could be beneficial in accelerating investment in challenged oil opportunities in Alaska.

Tim Benintendi

From: Tim Benintendi
Sent: Saturday, April 29, 2006 10:59 AM
To: Rep. Ralph Samuels; Jim Pound; Jim VanHorn; Cody Rice; Christine Marasigan; Konrad Jackson; Louie Flora; Joseph Keikkala; Marianna Carpeneti; Susan Warner
Subject: CORRECTION to amendments for HB 498....

Yesterday, I copied all H. RES committee members' offices with a memo to Jack Chenoweth of our legal staff, describing the amendments to this bill, made at yesterday's hearing. I erred in my instructions on first of two changes to Amendment #3.

Somehow, I missed the fact that the committee reversed itself when it made changes to page 1, line 8. So, the CS will retain its reference to ANS, and not be changed to "average price at the point of production."

Please clip this note to your copy of the memo. The bill will be read across today to HFC. If there are any questions, please contact me.

-tim benintendi / committee staff

4/29/2006

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

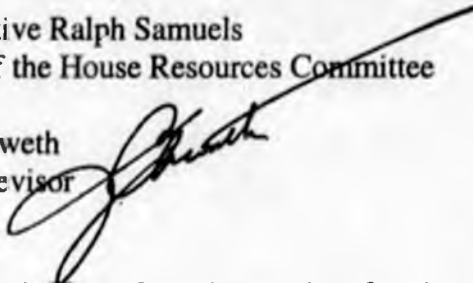
MEMORANDUM

April 29, 2006

SUBJECT: CSHB 498(RES) (Work Order No. 24-LS1817\X)

TO: Representative Ralph Samuels
Co-Chair of the House Resources Committee

FROM: Jack Chenoweth
Assistant Revisor



The third instruction in your April 28 drafting instruction for the committee-adopted Committee Substitute was to insert the text of committee amendment #3 but, in doing so, to alter page 1, line 8, to delete reference to Alaska North Slope value and to substitute reference to price at point of production. The same phrase appears in the amendment's subsection (h) and twice in the amendment's subsection (i). I checked with Tim Benintendi about making the same change in all places where it appears in the amendment. He reported that, notwithstanding the typed drafting instructions, it was his understanding that the committee had reversed its decision about making the change and that, in fact, that instruction should be ignored.

Accordingly, the bill maintains references to Alaska North Slope values.

If this is incorrect or not consistent with the committee's intent, we'll prepare a corrected committee substitute.

JBC:lmb
06-155.lmb

Enclosure

HB 498

Proposed definitions of challenged oil

(g) In this section,

- (1) "challenged oil" means oil that meets at least one of the following criteria:
 - (A) oil that has an average API gravity of 25 or less produced from a reservoir or pool located, in whole or in part, north of 68 degrees, 15 minutes North latitude in this state and at a true vertical depth as measured from sea level of 5,500 feet or less;
 - (B) oil that is produced from a reservoir or pool having an average API gravity of 18 or less, regardless of depth or location within this state;
 - (C) oil that is produced from a reservoir or pool for which one of the following participating areas has or may be formed:
 - i. the Orion or Polaris participating area in the Prudhoe Bay Unit,
 - ii. the West Sak or Tabasco participating area in the Kuparuk River Unit,
 - iii. the Schrader Bluff participating area in the Milne Point Unit;
 - iv. the Lisburne participating area in the Prudhoe Bay Unit,
 - v. any future participating area formed to develop the West Sak / Schrader Bluff or Ugnu formation, or their stratigraphic equivalent, within the boundaries of the Units named above or within the Tuvaq Unit, the Nakaitchuq Unit or the Rock Flour Unit;
 - (D) oil that is produced from a reservoir or pool that is inherently difficult and expensive to produce and is certified by the department to be challenged oil.

ALASKA STATE LEGISLATURE

House of Representatives

COMMITTEE ASSIGNMENTS:

RULES COMMITTEE, CHAIRMAN
LABOR & COMMERCE COMMITTEE, MEMBER
LEGISLATIVE COUNCIL, MEMBER
SPECIAL COMMITTEE ON OIL & GAS, MEMBER
SPECIAL COMMITTEE ON WAYS & MEANS, MEMBER

website: <http://www.akrepublicans.org/rokeberg/index.php>



INTERIM:
718 WEST 4TH AVENUE, SUITE 600
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PHONE: (907) 269-0117
FAX: (907) 269-0119

SESSION:
ALASKA STATE CAPITOL
JUNEAU, AK 99801-1182
PHONE: (907) 465-4968
FAX: (907) 465-2040

Representative Norman Rokeberg

e-mail: Representative_Norman_Rokeberg@legis.state.ak.us

April 13, 2006

Representative Samuels,

I would like to request a hearing in the House Resources Committee for the Oil & Gas Committee Substitute for HB 498. Attached are the Committee Substitute requests for HB 498; the CS is currently being drafted, but will be delivered early next week. These modifications will further clarify and narrow the intention of the bill. The CS will:

- Specify that tax credits authorized by this bill cannot be used before tax credits as authorized in HB 488.
- Eliminate the application of tax credits to gas exploration and development, limiting the scope of the legislation to heavy oil projects and nonconventional/renewable energy development.
- Clarify that Enhanced Oil Recovery techniques qualify for the tax credit only if they are used in the recovery of heavy oil, not light oil projects.
- Require all capital expenditure and research and development projects to be conducted within the state of Alaska in order to qualify for the credit.
- Provide a stronger definition of "qualified capital expenditure" to mirror the language in HB 488.

These modifications make this bill stronger and more workable, incorporating suggestions from Ms. Robynn Wilson (Director, Tax Division, Department of Revenue) and industry experts.

Thank you.

Representative Norman Rokeberg

Attachment 1

Text boxes show references referring to current bill sections or comments

(g) In this section, "challenging oil" means

(1)(D) ✓

1. API less than or equal to 18

(1)(A) ✓

2. API 18—25 on North Slope

- a. less than or equal to 5500 ft deep
- b. more than 5500 ft deep if

(1)(B) ✓

(i) formation

- Ugnu Formation
- West-Sake, Shrader Bluff
- stratigraphic equivalent

(ii) participating area

- Orion
- Polaris
- West Sake
- Shrader Bluff

Any of these if "carbonate" (E) doesn't make sense because they are already allowed.

Any of these "by EOR" (F) doesn't make sense because already allowed

Any of these if "inherently difficult" (G) doesn't make sense because already allowed

3. API greater than 25

a. if average is

(1) (H) ✓

- (i) less than or equal to 18 and meets 1 above
- (ii) 18—25 and meets 2 above

(2)

b. certain sources (nonconventional)

- (i) tar sands
- (ii) oil shale
- (iii) other nonconventional

Department of Revenue Comments on HB 498 Version Y

Robynn J. Wilson

April 19 2006

pencil 6's are for version I released 4/19 1:00 pm

fed R+D credit
need ordering for credits
constitw

1. The term "qualified capital expense" is used to dovetail with the PPT bill (.024). This term is used in both .026 and .028, but each of the two sections provides different definitions of the term, and neither term is consistent with the definition in the PPT bill.

Suggestion: adopt section-specific terms, such as "qualified challenging oil expenditure" .026 and "qualified renewable energy expenditure" in .028.

2. There is no apparent purpose in differentiating "challenged" and "nonconventional oil." In fact, there may be some overlap.

Suggestion: consolidate the terms to something like "challenging oil". Also, see Item 3 below.

3. Section AS 43.55.026(f) is unclear and it appears that many provisions overlap. For example, (D) covers oil of API gravity of 18 or less. It seems to be duplicated in (G) oil that is difficult and expensive to produce.

Suggestion: reorganize this section completely based on API, as shown in Attachment 1

4. Page 2, lines 18-28 and page 6 lines 9-19 provide rules for the 90% safe-harbor provision in the PPT bill. However, these rules conflict with the PPT 90% rules.

Suggestion: Page 2, lines 18-28 delete all material.

Page 6, lines 9-19 delete all material.

7-17

5. Page 3, lines 19-21:

a. There is still a lack of clarity as to the location of activities that qualify for the credit. Depending on the reading of the sentence, research activities would have to be conducted in the state, but development of challenged...oil would not; Also, the material extension of technology activities would not have to be conducted in the state. It should be made clear if activities in other parts of the world qualify.

b. "material extension of technology" What technology?

c. The phrase "is a material extension of existing technology" does not seem to make grammatical sense in context, namely "an expenditure . . . is a qualified capital expenditure if it is . . . is a material extension of existing technology."

Suggestion: Some clarity would be achieved by using (i), (ii), (iii) to set out each creditable activity and the allowed location of that activity.

gone into version I
but issue remains

Describe the technology that is the target of the credit. This section just needs some lawyer drafting work.

6. a. Page 5, line 8 (.026(f)(1)(H)) allows a credit to apply to all oil from a zone (reservoir?) if the average API meets certain criteria. How is the average calculated? Monthly? Daily?

Suggestion: Calculate average API on a monthly basis.

b. (H)(ii) read in conjunction with (i) is confusing. (i) addresses "oil described..." while (ii) addresses API gravity.

Suggestion: re-write (ii) as follows:

"(ii) for oil described in (D) of this paragraph, the API gravity limit set forth in that paragraph."

7. Page 3, line 12 and Page 7 line 10, says that a producer may not claim a credit... "more than once." What does that mean?

Suggestion: clarify language depending on intention of committee:

8. Page 5 line 19-21 allows a credit for oil that is "nonconventional" if certified as such by the department. However, other than tar sands and oil shale, the department is given no criteria to judge "nonconventional"

Suggestion: describe criteria to judge nonconventional.

9. Page 3, lines 2-9 and Page 6, lines 24-31 allow these credits to be transferable only to an "affiliate." There is a problem in specifying that a credit may be transferred to a producer's "affiliate," since established regulations already define a producer as "all members of a group of . . . entities in which one exercises significant influence over the others within the meaning of" APB Opinion No. 18 As currently worded the bill would cast doubt on that definition.

Suggestion: For simplicity's sake, and consistency with the PPT credits, we suggest that the credits allowable under .026 and .028 be either fully transferable, or not-transferable. This takes care of the affiliate problem, and takes care of the problem identified in Item 10 below.

10. Page 2, lines 5-8. The use of credits is still confusing. A credit under .026 is taken last, but if the same expenditure is used for a .025 credit, then this language does not specify the order. There is no ordering rule for .028 credits.

Suggestion: See Item 9 above.

11. Page 3, line 16 provides a credit under .026 for an "exploration expenditure *under* .025". Does this mean that a credit for exploration under .026 is only allowable if the producer claims a credit under .025 for the same expenditure. So, if the producer claims the exploration under .024 (PPT 20%), then the producer cannot claim the credit under .026? Or does it mean that "exploration as defined in .025"?

Suggestion: Page 3, line 16 delete "made for", and after "exploration expenditure" insert "as defined"

12. Page 2, line 3 the credit is applicable against any "tax," but on line 13 "conservation surcharge" is also mentioned. This same problem is repeated on Page 6 line ~~4~~².

Suggestion: Page 2, line 13 and Page 6 line ~~4~~², delete "any tax or conservation surcharge due" and replace with "any taxes due"

13. Starting page 3 lines 14-31. The relationship between the description of qualifying expenditures and the description of challenged oil is very confusing. The former is focused on exploration, research, or development, but the latter is tied to oil that is "produced." Why would we give credits for exploring for oil that is already being produced, or for doing research relating to oil that is already being produced?

Suggestion: close look by a drafting lawyer

14. Page 3, lines 16—19. Although this bill seems to focus on heavy oil, exploration costs are allowed for any oil.

Suggestion: Please confirm this intention.

15. Page 5, line ~~2~~⁴ "development or use" is overly broad and vague.

Suggestion: we would be please to assist the committee in drafting language to be consistent with intent. Please clarify.

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Text boxes show references referring to current bill sections or comments

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(ii) 18—25 and meets 2 above

(2)

b. certain sources (nonconventional)

(i) tar sands

(ii) oil shale

(iii) other nonconventional

Tim Benintendi

From: Robynn Wilson [robynn_wilson@revenue.state.ak.us]
Sent: Wednesday, April 19, 2006 8:57 AM
To: Rep. Norman Rokeberg
Cc: ddickinsoncpa@gci.net; 'Jerry Burnett'; Tim Benintendi
Subject: FW: HB 498
Attachments: hb 498 comments 4-19.doc

Dear Representative Rokeberg,

Thank you for faxing me a copy of the revisions for HB 498 yesterday. I see that gas has been removed, and that the other parts have been reorganized to show primary focus on heavy oil. I see also that the term "qualified capital expenditure" has been used throughout, to mirror the PPT credit. However, two new definitions have been added for "qualified capital expenditure" and neither definition is consistent with the definition in the PPT bill. In fact, neither definition in HB 498 contains a reference to "capital" expenditures. The second big issue is that the paragraphs describing qualifying gravities, participating areas, types of formations (carbonate), recovery techniques, and sources of oil (oil sands etc.) appear to overlap and are very confusing. I tried a couple of times to create a flow chart to determine qualification, and was not successful. I would suggest simplifying this section, even if the intention is to retain all of the qualifying gravities, areas, etc. I have attached my comments, along with a conceptual reorganization of section (f).

I would be happy to discuss these comments if you wish.

Robynn Wilson
Director, Tax Division

From: Robynn Wilson [mailto:robynn_wilson@revenue.state.ak.us]
Sent: Wednesday, April 19, 2006 7:44 AM
To: 'tim_benintendi@legis.state.ak.us'
Subject: HB 498

Tim,

Here it is.

rjw

Department of Revenue Comments on HB 498
Robynn J. Wilson
April 19 2006

1. The term "qualified capital expense" is used to dovetail with the PPT bill (.024). This term is used in both .026 and .028, but each of the two sections provides different definitions of the term, and neither term is consistent with the definition in the PPT bill.

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b. "material extension of technology" What technology?

c. The phrase "is a material extension of existing technology" does not seem to make grammatical sense in context, namely "an expenditure . . . is a qualified capital expenditure if it is . . . is a material extension of existing technology."

Suggestion: Some clarity would be achieved by using (i), (ii), (iii) to set out each creditable activity and the allowed location of that activity.

Describe the technology that is the target of the credit. This section just needs some lawyer drafting work.

6. a. Page 5, line 8 (.026(f)(1)(H)) allows a credit to apply to all oil from a zone (reservoir?) if the average API meets certain criteria. How is the average calculated? Monthly? Daily?

Suggestion: Calculate average API on a monthly basis.

b. (H)(ii) read in conjunction with (i) is confusing. (i) addresses "oil described..." while (ii) addresses API gravity.

Suggestion: re-write (ii) as follows:

"(ii) for oil described in (D) of this paragraph, the API gravity limit set forth in that paragraph."

7. Page 3, line 12 and Page 7 line 10, says that a producer may not claim a credit... "more than once." What does that mean?

Suggestion: clarify language depending on intention of committee

8. Page 5 line 19-21 allows a credit for oil that is "nonconventional" if certified as such by the department. However, other than tar sands and oil shale, the department is given no criteria to judge "nonconventional"

Suggestion: describe criteria to judge nonconventional.

9. Page 3, lines 2-9 and Page 6, lines 24-31 allow these credits to be transferable only to an "affiliate." There is a problem in specifying that a credit may be transferred to a producer's "affiliate," since established regulations already define a producer as "all members of a group of . . . entities in which one exercises significant influence over the others within the meaning of" APB Opinion No. 18 As currently worded the bill would cast doubt on that definition.

Suggestion: For simplicity's sake, and consistency with the PPT credits, we suggest that the credits allowable under .026 and .028 be either fully transferable, or not-transferable. This takes care of the affiliate problem, and takes care of the problem identified in Item 10 below.

10. Page 2, lines 5-8. The use of credits is still confusing. A credit under .026 is taken last, but if the same expenditure is used for a .025 credit, then this language does not specify the order. There is no ordering rule for .028 credits.

Suggestion: See Item 9 above.

11. Page 3, line 16 provides a credit under .026 for an "exploration expenditure *under* .025". Does this mean that a credit for exploration under .026 is only allowable if the producer claims a credit under .025 for the same expenditure. So, if the producer claims the exploration under .024 (PPT 20%), then the producer cannot claim the credit under .026? Or does it mean that "exploration as defined in .025"?

Suggestion: Page 3, line 16 delete "made for", and after "exploration expenditure" insert "as defined"

12. Page 2, line 3 the credit is applicable against any "tax," but on line 13 "conservation surcharge" is also mentioned. This same problem is repeated on Page 6 line 4.

Suggestion: Page 2, line 13 and Page 6 line 4 , delete "any tax or conservation surcharge due" and replace with "any taxes due"

13. Starting page 3 lines 14-31. The relationship between the description of qualifying expenditures and the description of challenged oil is very confusing. The former is focused on exploration, research, or development, but the latter is tied to oil that is "produced." Why would we give credits for exploring for oil that is already being produced, or for doing research relating to oil that is already being produced?

Suggestion: close look by a drafting lawyer

14. Page 3, lines 16—19. Although this bill seems to focus on heavy oil, exploration costs are allowed for any oil.

Suggestion: Please confirm this intention.

15. Page 5, line 26 "development or use" is overly broad and vague.

Suggestion: we would be please to assist the committee in drafting language to be consistent with intent. Please clarify.

Alaska State Legislature

Rep. Jim Elkins
Rep. Harry Crawford
Rep. Carl Gatto
Rep. Mary Kapsner
Rep. Gabrielle LeDoux
Rep. Kurt Olson
Rep. Paul Seaton




State Capitol, Room 124
Juneau, AK 99801-1182
Co-Chairs
Rep. Ralph Samuels
(907) 465-2095 fax: 465-3810
Rep. Jay Ramras
(907) 465-3004 fax: 465-2070

House Resources Committee Rep. Jay Ramras and Rep. Ralph Samuels, Co-Chairmen

DATE: April 28, 2006

TO: Jack Chenoweth, Attorney
LAA Legal Services

FROM: Rp. Ralph Samuels, Co-Chairman
House Resources Committee 

SUBJ: Request for Committee Substitute For HB 498

I would appreciate the preparation of a House Resources committee substitute bill in final form, for HB 498, "S" version, as amended. The amendments are as follows:

- #1 Labeled "#1 Mintz" – page 3, line 20 – amend as highlighted
- #2 Labeled "#2 Van Dyke" page, 3, lines 25-27 and lines 29-30, as noted
- #3 by Rp. Seaton, 24-LS1817/S.2, as amended: First amendment to #3 is page 1, line 8 – change from ANS to average price at the point of production. Second change to Amendment #3 is page 2, line 1 – change (a) to "(e)" to conform to the same reference on page 2, line 6.
- #4 Was withdrawn
- #5 Labeled "#5 Mintz" – page 4, line 20 – delete the word "producer," and insert the word, "expenditure."
- #6 Verbal by Rp. Seaton – page 2, line 19 – change 30 days to 45 days.

If you have any questions, please contact Tim Benintendi, committee staff, at 3715. Thank you.

1 (MINTZ)

Tim Benintendi

From: Rob Mintz [Robert_Mintz@law.state.ak.us]
Sent: Wednesday, April 26, 2006 7:13 PM
To: Tim Benintendi
Cc: william_vandyke@dnr.state.ak.us; DDickinsonCPA@gcl.net; BJ Jordan; Ethan Falatko; robynn_wilson@revenue.state.ak.us
Subject: HB 498

Thank you for faxing me the CS. In reviewing it, I see that subsection (h) directs DNR to adopt a regulation saying how the average API gravity of an oil pool will be calculated, but it doesn't address how the average permability of an oil pool's reservoir rock will be calculated

- I'm sure because the permability provision in (f)2) was added after (h) had been drafted.

Unless someone comes up with a reason not to, I'm thinking it would be good to add the following phrase following "pool" on p. 3, line 20:

"and the method to be used to determine the average permeability of an oil pool's reservoir rock"

adopted unanimous consent

#2 (VAN DYKE)

Tim Benintendi

From: Bill VanDyke [wdv@dnr.state.ak.us]
Sent: Thursday, April 27, 2006 8:16 AM
To: Rep. Ralph Samuels; Rep. Norman Rokeberg; Rep. Paul Seaton; Tim Benintendi
Cc: Rob Mintz; PaskvaFA@BP.com; Marie M. Crosley; Melanie Lesh; Digert, Scott A
Subject: HB 498 version S

Good job on the latest work draft—version S I hope.

One comment.

If the entire Schrader Bluff and Ugnu formations in Prudhoe Bay Unit are eligible for credits then to be consistent there should be no areas excluded in Milne Point and Kuparuk River Units. Either exclude the viscous oil core areas in all three units or include the viscous oil core areas in all three units. I think we should be consistent one way or the other. And actually the PBU core area is where most of the near term "pending" projects reside. I acknowledge though that the PBU projects are not officially sanctioned as of today so this bill helps move them along.

If the viscous oil core area in PBU remains eligible for credits then I would delete the language on Page 3 line 25 starting with the word "except" through the end of line 27 on again on Page 3 line 29 starting with the word "except" through the end of line 30. This would make the policy for all three units consistent.

After talking much more with the Kuparuk River and Milne Point folks I can agree to having all the viscous oil core areas eligible for future credits. It comes down to a policy call on the core areas. As a side note, allowing credits in all the core areas allows EOR credits in the future for all these areas, which I have always supported and I believe is the right policy.

I plan to be on line this afternoon for the Resources committee hearing if you have any questions.

Bill Van Dyke
Division of Oil and Gas
907.269.8786

adopted unanimous consent

adopted as
amended -
unanimous consent

#3

24-LS1817S.2
Chenoweth
4/27/06

AMENDMENT

OFFERED IN THE HOUSE

BY REPRESENTATIVE SEATON

TO: CSHB 498(RES), Draft Version "S"

1 Page 2, line 30:

2 Delete "(i)(1)(A) - (D)"

3 Insert "(m)(1)(A) - (D)"

4

5 Page 3, following line 12:

6 Insert new subsections to read:

7 "(g) If the department determines under (i) of this section that the average
8 price of Alaska North Slope oil on the United States West Coast during the period
9 April 1, 2006, through March 31, 2016, is \$50 a barrel or more, a producer that takes a
10 credit under this section shall repay to the department, no later than June 30, 2016, the
11 amount of the credit, with interest at the rate prescribed in this subsection. Interest is at
12 a rate equal to the rate of return, as determined by the department, that is earned by the
13 budget reserve fund established under art. IX, sec. 17, Constitution of the State of
14 Alaska, from the date the credit was applied against the producer's tax liability until
15 the earlier of June 30, 2016, or the date the payment is made to the department.
16 Interest on an amount unpaid after June 30, 2016, is at the rate prescribed under
17 AS 43.05.225(1) from July 1, 2016 until the date the payment is made to the
18 department.

19 (h) A producer that otherwise is allowed to apply a credit under this section
20 against a tax due for a month ending before April 1, 2016, may defer using the credit
21 until after April 30, 2016. If the department determines under (i) of this section that
22 the average price of Alaska North Slope oil on the United States West Coast during
23 the period April 1, 2006, through March 31, 2016, is less than \$50 a barrel, the

line 8: change from
ANS to average price
at point of production.

1 producer then may apply the credit against a tax due under AS 43.55.011(a) or may
2 request a refund from the department of the amount of the credit, with interest at the
3 rate prescribed in this subsection. Interest is at a rate equal to the rate of return, as
4 determined by the department, that is earned by the budget reserve fund established
5 under art. IX, sec. 17, Constitution of the State of Alaska, from the date the tax under
6 AS 43.55.011(e) was due against which the amount of a credit could have been
7 applied against the producer's tax liability in accordance with (c) of this section, until

8 (1) the date the amount of the credit is actually applied against a tax
9 under this subsection, if it is applied; or (2) the earlier of 90 days after a refund request
10 for the amount of the credit is received by the department or the refund is paid, if a
11 refund is requested. Interest on an amount unpaid 90 days after a refund request is
12 received by the department is at the rate prescribed under AS 43.05.225(1) from the
13 91st day after the refund request is received until the date the refund is paid.

14 (i) The department shall, by regulation, specify the method by which the
15 average price of Alaska North Slope oil on the United States West Coast shall be
16 calculated, with reference to one or more published sources of price information. The
17 department shall make available to the public no later than April 30, 2016, its
18 determination of the average price of Alaska North Slope oil on the United States
19 West Coast during the period April 1, 2006, through March 31, 2016.

20 (j) For purposes of the period of limitations provided under AS 43.05.260, an
21 amount that a producer is obligated to repay to the department under (g) of this section
22 is considered a tax imposed by this title for which a return is filed on June 30, 2016. A
23 producer that incurs an expenditure before April 1, 2016, for which a credit is claimed
24 under this section shall maintain until July 1, 2019, its records sufficient to show
25 whether the expenditure is a qualified development expenditure and to show the tax
26 liability against which the credit is or, under (h) of this section, could have been
27 applied."

28
29 Reletter the following subsections accordingly.

30
31 Page 3, line 13:

- 1 Delete "(h)"
- 2 Insert "(l)"

#5 (MINTZ)

Tim Benintendi

From: Rob Mintz [Robert_Mintz@law.state.ak.us]
Sent: Thursday, April 27, 2006 10:38 AM
To: Tim Benintendi
Cc: DDickinsonCPA@gci.net; BJ Jordan; Ethan Falatko; robynn_wilson@revenue.state.ak.us
Subject: RE: HB 498

Tim, BJ Jordan found an error on p. 4, line 20. The phrase "the person incurring the producer" is obviously not correct. I was trying to replace the phrase "the person incurring the expenditure" by the phrase "the producer," and the replacement didn't work out the way it was intended.

Just to keep things simple, probably the best fix at this point would be simply to replace the term "producer" on line 20 with the term "expenditure." In other words, return to the original bill language.

>>> Tim Benintendi <Tim_Benintendi@legis.state.ak.us> 4/27/2006 8:23:35 AM >>>

Thanks, Rob. I'll bring this up to Ralph, and he will likely want me to copy the committee members. Will you be with us today by t/c? -tim

-----Original Message-----

From: Rob Mintz [mailto:Robert_Mintz@law.state.ak.us]
Sent: Wednesday, April 26, 2006 7:13 PM
To: Tim Benintendi
Cc: william_vandyke@dnr.state.ak.us; DDickinsonCPA@gci.net; BJ Jordan; Ethan Falatko; robynn_wilson@revenue.state.ak.us
Subject: HB 498

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"and the method to be used to determine the average permeability of an oil pool's reservoir rock"