HB

280

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Bullock
3/9/10

CS FOR HOUSE BILL NO. 280( )

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-SIXTH LEGISLATURE - SECOND SESSION

BY

Offered:
Referred:

Sponsor(s): REPRESENTATIVES HAWKER AND CHENAULT, Johnson, Olson, Thomas, Ramras, Harris, Millett, Lynn

A BILL

FOR AN ACT ENTITLED

"An Act relating to a gas storage facility; relating to the Regulatory Commission of Alaska; relating to the participation by the attorney general in a matter involving the approval of a rate or a gas supply contract; relating to an income tax credit for a gas storage facility; relating to oil and gas production tax credits; relating to the powers and duties of the Alaska Oil and Gas Conservation Commission; relating to production tax credits for certain losses and expenditures, including exploration expenditures; relating to the powers and duties of the director of the division of lands and to lease fees for a gas storage facility on state land; and providing for an effective date."

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

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

SHORT TITLE. This Act may be known as the Cook Inlet Recovery Act.

* **Sec. 2.** AS 31.05 is amended by adding a new section to read:

Sec. 31.05.032. Certification of gas storage capacity. (a) An owner of a gas storage facility that seeks an exemption under AS 38.05.180(u) or a credit under AS 43.20.046 shall apply to the commission for certification of the facility's working gas storage capacity and certification of the facility's gas withdrawal capability. The application shall be on a form prescribed by the commission.

(b) Within six months after receiving an application under (a) of this section, the commission shall determine and certify

(1) the working gas storage capacity of the facility on the date the facility commences commercial operation rounded to the nearest 500,000,000 cubic feet; and

(2) whether the gas storage facility is capable of withdrawing a minimum of 10,000,000 cubic feet of gas a day.

(c) The commission shall provide a copy of the certifications required by (b) of this section to the owner of the gas storage facility that requested the certification, the commissioner of natural resources, and the commissioner of revenue.

(d) If a gas storage facility ceases commercial operation, an owner of the gas storage facility shall give written notice to the commission that commercial operation has ceased. The notice must be filed with the commission before April 1 of the year immediately following the year in which the gas storage facility ceases commercial operation.

(e) In this section,

(1) "ceases commercial operation" means that the gas storage facility fails to inject or withdraw more than 100,000,000 cubic feet of gas during a calendar year following the year in which a gas storage facility commences commercial operation;

(2) "commences commercial operation" means the first injection of non-native gas into a gas storage facility for purposes other than testing;

(3) "cushion gas" means native and non-native gas in a gas storage facility that is needed to pressurize the facility and that allows the facility to function;

(4) "gas storage facility" means a tank or a depleted or nearly depleted

reservoir or pool in the state that is available for the storage of gas;

(5) "native gas" means gas in a gas storage facility that was not injected;

(6) "non-native gas" means gas that is produced elsewhere and injected into a gas storage facility;

(7) "pool" has the meaning given in AS 31.05.170;

(8) "working gas storage capacity" means the maximum volume of non-native gas a gas storage facility may safely contain without creating or causing waste; the maximum volume of non-native gas does not include the volume of cushion gas present or the volume required for proper functioning of the gas storage facility at the working gas storage capacity certified under (b) of this section.

*** Sec. 3.** AS 38.05.035(a) is amended to read:

(a) The director shall

(1) have general charge and supervision of the division and may exercise the powers specifically delegated to the director; the director may employ and fix the compensation of assistants and employees necessary for the operations of the division; the director is the certifying officer of the division, with the consent of the commissioner, and may approve vouchers for disbursements of money appropriated to the division;

(2) manage, inspect, and control state land and improvements on it belonging to the state and under the jurisdiction of the division;

(3) execute laws, rules, regulations, and orders adopted by the commissioner;

(4) prescribe application procedures and practices for the sale, lease, or other disposition of available land, resources, property, or interest in them;

(5) prescribe fees or service charges, with the consent of the commissioner, for any public service rendered;

(6) under the conditions and limitations imposed by law and the commissioner, issue deeds, leases, or other conveyances disposing of available land, resources, property, or any interests in them;

(7) have jurisdiction over state land, except that land acquired by the

Alaska World War II Veterans Board and the Agricultural Loan Board or the departments or agencies succeeding to their respective functions through foreclosure or default; to this end, the director possesses the powers and, with the approval of the commissioner, shall perform the duties necessary to protect the state's rights and interest in state land, including the taking of all necessary action to protect and enforce the state's contractual or other property rights;

(8) maintain the records the commissioner considers necessary, administer oaths, and do all things incidental to the authority imposed; the following records and files shall be kept confidential upon request of the person supplying the information:

(A) the name of the person nominating or applying for the sale, lease, or other disposal of land by competitive bidding;

(B) before the announced time of opening, the names of the bidders and the amounts of the bids;

(C) all geological, geophysical, and engineering data supplied, whether or not concerned with the extraction or development of natural resources;

(D) except as provided in AS 38.05.036, cost data and financial information submitted in support of applications, bonds, leases, and similar items;

(E) applications for rights-of-way or easements;

(F) requests for information or applications by public agencies for land that is being considered for use for a public purpose;

(9) account for the fees, licenses, taxes, or other money received in the administration of this chapter including the sale or leasing of land, identify their source, and promptly transmit them to the proper fiscal department after crediting them to the proper fund; receipts from land application filing fees and charges for copies of maps and records shall be deposited immediately in the general fund of the state by the director;

(10) select and employ or obtain at reasonable compensation cadastral, appraisal, or other professional personnel the director considers necessary for the

proper operation of the division;

(11) be the certifying agent of the state to select, accept, and secure by whatever action is necessary in the name of the state, by deed, sale, gift, devise, judgment, operation of law, or other means any land, of whatever nature or interest, available to the state; and be the certifying agent of the state, to select, accept, or secure by whatever action is necessary in the name of the state any land, or title or interest to land available, granted, or subject to being transferred to the state for any purpose;

(12) on request, furnish records, files, and other information related to the administration of AS 38.05.180 to the Department of Revenue for use in forecasting state revenue under or administering AS 43.55, whether or not those records, files, and other information are required to be kept confidential under (8) of this subsection; in the case of records, files, or other information required to be kept confidential under (8) of this subsection, the Department of Revenue shall maintain the confidentiality that the Department of Natural Resources is required to extend to records, files, and other information under (8) of this subsection;

(13) when reasonably possible, give priority to and expedite the processing of an application for a lease or assignment of a lease of state land for development and operation of a gas storage facility, for a right-of-way to a gas storage facility, for a change to the allocation of production within a unit, and for a permit necessary for the operation of a gas storage facility; in this paragraph, "gas storage facility" has the meaning given in AS 31.05.032.

*** Sec. 4.** AS 38.05.180(u) is amended to read:

(u) To avoid waste or to promote conservation of natural resources, the commissioner may authorize the subsurface storage of oil or gas, whether or not produced from state land, in land leased or subject to lease under this section. This authorization may provide for the payment of a storage fee or rental on the stored oil or gas, or, instead of the fee or rental, for a royalty other than that prescribed in the lease when the stored oil or gas is produced in conjunction with oil or gas not previously produced. A lease on which storage is so authorized shall be extended at least for the period of storage and so long thereafter as oil or gas not previously

produced is produced in paying quantities. **Notwithstanding the authorization for payments under this subsection, when requested by a lessee, the commissioner shall exempt a gas storage facility that qualifies for a tax credit under AS 43.20.046 from any payment described in this subsection for the periods described in this subsection. The exemption is available for the calendar year in which the facility commences commercial operation and for each of the nine calendar years immediately following the first year of commercial operation; however, an exemption is not applicable for the calendar year after the facility ceases commercial operation or for any subsequent calendar year. The lessee shall provide the commissioner with any information the commissioner requests to determine if the exemption applies. The information related to state land leased for a gas storage facility under this subsection is public information and may be furnished to the Regulatory Commission of Alaska. On request, the commissioner shall provide the name of each person using state land leased for a gas storage facility under this chapter, the years for which an exemption was granted, and the amount of the exemption. Gas withdrawn from a gas storage facility is considered to be non-native gas and is not considered to be produced and subject to royalty until all non-native gas injected into the gas storage facility has been withdrawn from the gas storage facility. A person receiving an exemption for a payment under this section that contracts to store gas for a utility regulated under AS 42.05 shall reduce the storage price to reflect the value of the exemption. In this subsection, "ceases commercial operation," "commences commercial operation," "gas storage facility," and "non-native gas" have the meanings given in AS 31.05.032.**

*** Sec. 5.** AS 42.05.141 is amended by adding a new subsection to read:

(d) When considering whether the approval of a rate or a gas supply contract proposed by a utility to provide a reliable supply of gas for a reasonable price is in the public interest, the commission shall

(1) recognize the public benefits of allowing a utility to negotiate different pricing mechanisms with different gas suppliers and to maintain a diversified portfolio of gas supply contracts to protect customers from the risks of inadequate

supply or excessive cost that may arise from a single pricing mechanism; and

(2) consider whether a utility could meet its responsibility to the public in a timely manner and without undue risk to the public if the commission fails to approve a rate or a gas supply contract proposed by the utility.

*** Sec. 6.** AS 42.05.381 is amended by adding a new subsection to read:

(k) The cost to the utility of storing gas in a gas storage facility that is allowed in determining a just and reasonable rate shall reflect the reduction in cost attributable to any exemption from a payment due under AS 38.05.180(u) and the value of a tax credit that the owner of the gas storage facility received under AS 43.20.046. The commission may request the (1) commissioner of natural resources to report the value of the exemption from a payment due under AS 38.05.180(u) that the gas storage facility received; and (2) commissioner of revenue to report information on the amount of tax credits claimed under AS 43.20.046 for the gas storage facility. In this subsection, "gas storage facility" has the meaning given in AS 31.05.032.

*** Sec. 7.** AS 42.05.990(4) is amended to read:

(4) "public utility" or "utility" includes every corporation whether public, cooperative, or otherwise, company, individual, or association of individuals, their lessees, trustees, or receivers appointed by a court, that owns, operates, manages, or controls any plant, pipeline, or system for

(A) furnishing, by generation, transmission, or distribution, electrical service to the public for compensation;

(B) furnishing telecommunications service to the public for compensation;

(C) furnishing water, steam, or sewer service to the public for compensation;

(D) furnishing by transmission or distribution of natural or manufactured gas to the public for compensation;

(E) furnishing for distribution or by distribution petroleum or petroleum products to the public for compensation when the consumer has no alternative in the choice of supplier of a comparable product and service at an equal or lesser price;

(F) furnishing collection and disposal service of garbage, refuse, trash, or other waste material to the public for compensation;

(G) furnishing the service of natural gas storage to the public for compensation;

*** Sec. 8.** AS 42.05.990 is amended by adding new paragraphs to read:

(9) "natural gas storage facility" means a facility that receives natural gas volumes from customers, holds the gas volumes in a reservoir, and delivers the gas volumes to the customer; in this paragraph, "facility" includes

(A) all parts of the facility from the point at which the natural gas volumes are received by the facility from the customer to the point at which the natural gas volumes are delivered by the facility to the customer;

(B) a facility consisting of a reservoir, either underground or aboveground, and one or more of the following components of the facility:

(i) pipe;

(ii) compressor stations;

(iii) station equipment;

(iv) injection and extraction wells;

(v) on-site or remote monitoring, supervision, and control facilities;

(vi) gas processing plants, treaters, and separators;

(vii) other equipment necessary to receive, place into the reservoir, monitor, remove from the reservoir, process, and deliver natural gas;

(10) "service of natural gas storage" means the operation of a natural gas storage facility primarily or exclusively for the benefit of third-party customers, and not for the benefit of the owner, operator, or manager of the natural gas storage facility; "service of natural gas storage" does not include the storage of natural gas

(A) owned by or contractually obligated to the owner, operator, or manager of the natural gas storage facility;

(B) that is incidental to the production or sale of natural gas to one or more third-party customers; or

(C) for which the price of storage is not separately itemized.

*** Sec. 9.** AS 43.05.230 is amended by adding a new subsection to read:

(j) The name of each person claiming a credit and the amount of credit claimed by that person under AS 43.20.046 is public information. The commissioner shall furnish the information to the Regulatory Commission of Alaska on request.

*** Sec. 10.** AS 43.20 is amended by adding a new section to article 1 to read:

Sec. 43.20.046. Gas storage facility tax credit. (a) A person that is an owner of a gas storage facility described in (b) of this section that commences commercial operation after December 31, 2010, and before January 1, 2016, may apply for a refundable credit against a tax liability that may be imposed on the person under this chapter for the taxable year in which the gas storage facility commences commercial operation. The tax credit under this section shall be an amount equal to $1.50 for each 1,000 cubic feet of working gas storage capacity that is certified under AS 31.05.032 less any amount of credit received under this section taken in earlier tax years for that capacity. The total amount of the credit that may be received for a single gas storage facility under this section may not exceed $15,000,000. The tax credit in this section is in addition to any other credit under this chapter for which the person is eligible.

(b) A gas storage facility qualifying for the credit in this section

(1) must have a working gas storage capacity of at least 500,000,000 cubic feet of gas other than cushion gas;

(2) must have a minimum withdrawal capability of 10,000,000 cubic feet a day as certified by the Alaska Oil and Gas Conservation Commission under AS 31.05.032;

(3) must not have been in operation as a gas storage facility before January 1, 2011;

(4) must be available for the storage of gas that is owned by a utility regulated under AS 42.05; and

(5) if located on state land and leased or subject to a lease under AS 38.05.180, must be in compliance with the terms of the lease.

(c) To claim the credit, the person shall submit to the department a copy of the certification of working gas storage capacity and withdrawal capability issued under

AS 31.05.032, the date that the gas storage facility commenced commercial operation, and other information required by the department. A person applying the credit against a liability under this chapter shall claim the credit on the person's return.

(d) A person entitled to a tax credit under this section that is greater than the person's tax liability under this chapter may request a refund in the amount of the unused portion of the tax credit.

(e) The department may use available money in the oil and gas tax credit fund established in AS 43.55.028 to make the refund applied for under (d) of this section in whole or in part if the department finds that (1) the claimant does not have an outstanding liability to the state for unpaid delinquent taxes under this title; and (2) after application of all available tax credits, the claimant's total tax liability under this chapter for any taxable year ending before the date of the refund claim is zero. In this subsection, "unpaid delinquent tax" means an amount of tax for which the department has issued an assessment that has not been paid and, if contested, has not been finally resolved in the taxpayer's favor.

(f) For the purpose of determining the amount of the credit under this section, the working gas storage capacity on which the credit is based shall be the capacity certified by the Alaska Oil and Gas Conservation Commission under AS 31.05.032.

(g) A person may not receive a credit under this section for the acquisition of a gas storage facility for which a credit has been granted under this section.

(h) If the gas storage facility for which a credit was received under this section ceases commercial operation during the nine calendar years immediately following the calendar year in which the gas storage facility commences commercial operation, the tax liability under this chapter of the person who claimed the credit shall be increased. The amount of the increase in tax liability

(1) shall be determined and assessed for the taxable year in which the gas storage facility ceases commercial operation, regardless of whether the gas storage facility subsequently resumes commercial operation; and

(2) is equal to the total amount of the credit taken multiplied by a fraction, the numerator of which is the difference between 10 and the number of calendar years for which the gas storage facility was eligible for a tax credit under this

section and the denominator of which is 10.

(i) The issuance of a refund under this section does not limit the department's ability to later audit or adjust the claim if the department determines, as a result of the audit, that the person that claimed the credit was not entitled to the amount of the credit. The tax liability of the person receiving the credit under this chapter is increased by the amount of the credit that exceeds that to which the person was entitled. If the tax liability is increased under this subsection, the increase bears interest under AS 43.05.225 from the date the refund was issued.

(j) A person claiming a tax credit under this section shall, when contracting with a utility regulated under AS 42.05 to store the utility's gas, reduce the price it would otherwise charge the utility to reflect the value of any tax credits received under this section.

(k) A person claiming a tax credit under this section for a gas storage facility that ceases commercial operation within nine calendar years immediately following the calendar year in which the gas storage facility commences commercial operation shall notify the department in writing of the date the gas storage facility ceased commercial operation. The notice must be filed with the return for the taxable year in which the gas storage facility ceases commercial operation.

(*l*) A refund under this section does not bear interest.

(m) In this section, "ceases commercial operation," "commences commercial operation," "gas storage facility," and "working gas storage capacity" have the meanings given in AS 31.05.032.

*** Sec. 11.** AS 43.55.011(m) is amended to read:

(m) Notwithstanding any contrary provision of AS 38.05.180(i), AS 41.09.010, AS 43.55.024, or 43.55.025, the department shall provide by regulation a method to ensure that, for a calendar year for which a producer's tax liability is limited by (j), (k), or (o) of this section, tax credits **based on a lease expenditure incurred before January 1, 2011, that are** otherwise available under AS 38.05.180(i), AS 41.09.010, AS 43.55.024, or 43.55.025 and allocated to gas subject to the limitations in (j), (k), and (o) of this section are accounted for as though the credits had been applied first against a tax liability calculated without regard to the limitations under

(j), (k), and (o) of this section so as to reduce the tax liability to the maximum amount provided for under (j) or (o) of this section for the production of gas or (k) of this section for the production of oil. The regulation must provide for a reasonable method to allocate tax credits to gas subject to (j) and (o) of this section. Only the amount of a tax credit remaining after the accounting provided for under this subsection may be used for a later calendar year, transferred to another person, or applied against a tax levied on the production of oil or gas not subject to (j), (k), or (o) of this section to the extent otherwise allowed.

*** Sec. 12.** AS 43.55.020 is amended by adding a new subsection to read:

(i) Cushion gas in a gas storage facility is not considered to be gas used in the operation of a lease or property or gas used for repressuring as described in (e) of this section. Gas withdrawn from a gas storage facility is considered to be non-native gas until all non-native gas injected into the gas storage facility has been withdrawn from the gas storage facility. Non-native gas withdrawn from a gas storage facility is not considered to be gas produced for the purposes of AS 43.55.011 - 43.55.180. Gas withdrawn from a gas storage facility after all non-native gas previously injected into the gas storage facility has been withdrawn is gas considered to be produced from the lease or property for the purposes of AS 43.55.011 - 43.55.180. In this subsection, "gas storage facility," "native gas," and "non-native gas" have the meanings given in AS 31.05.032.

*** Sec. 13.** AS 43.55.023(a) is amended to read:

(a) A producer or explorer may take a tax credit for a qualified capital expenditure as follows:

(1) notwithstanding that a qualified capital expenditure may be a deductible lease expenditure for purposes of calculating the production tax value of oil and gas under AS 43.55.160(a), unless a credit for that expenditure is taken under AS 38.05.180(i), AS 41.09.010, AS 43.20.043, or AS 43.55.025, a producer or explorer that incurs a qualified capital expenditure may also elect to apply a tax credit against a tax levied by AS 43.55.011(e) in the amount of 20 percent of that expenditure; **the full amount of the credit for a qualified capital expenditure incurred in the Cook Inlet sedimentary basin after December 31, 2010, may be applied for a single**

calendar year; however, not more than half of the tax credit **for a qualified capital expenditure incurred outside of the Cook Inlet sedimentary basin after December 31, 2010,** may be applied for a single calendar year;

(2) a producer or explorer may take a credit for a qualified capital expenditure incurred in connection with geological or geophysical exploration or in connection with an exploration well only if the producer or explorer

(A) agrees, in writing, to the applicable provisions of AS 43.55.025(f)(2);

(B) submits to the Department of Natural Resources all data that would be required to be submitted under AS 43.55.025(f)(2).

*** Sec. 14.** AS 43.55.023(d) is amended to read:

(d) Except as limited by (i) of this section, a person that is entitled to take a tax credit under this section that wishes to transfer the unused credit to another person or obtain a cash payment under AS 43.55.028 may apply to the department for transferable tax credit certificates. An application under this subsection must be in a form prescribed by the department and must include supporting information and documentation that the department reasonably requires. The department shall grant or deny an application, or grant an application as to a lesser amount than that claimed and deny it as to the excess, not later than 120 days after the latest of (1) March 31 of the year following the calendar year in which the qualified capital expenditure or carried-forward annual loss for which the credit is claimed was incurred; (2) the date the statement required under AS 43.55.030(a) or (e) was filed for the calendar year in which the qualified capital expenditure or carried-forward annual loss for which the credit is claimed was incurred; or (3) the date the application was received by the department. If, based on the information then available to it, the department is reasonably satisfied that the applicant is entitled to a credit, the department shall, **except as provided in (n) of this section,** issue the applicant two transferable tax credit certificates, each for half of the amount of the credit**; the** [. THE] credit shown on one of the two certificates is available for immediate use. The credit shown on the second of the two certificates may not be applied against a tax for a calendar year earlier than the calendar year following the calendar year in which the certificate is

issued, and the certificate must contain a conspicuous statement to that effect; a [. A] certificate issued under this subsection does not expire.

*** Sec. 15.** AS 43.55.023(g) is amended to read:

(g) The issuance of a transferable tax credit certificate under (d) **or (n)** of this section or the purchase of a certificate under AS 43.55.028 does not limit the department's ability to later audit a tax credit claim to which the certificate relates or to adjust the claim if the department determines, as a result of the audit, that the applicant was not entitled to the amount of the credit for which the certificate was issued. The tax liability of the applicant under AS 43.55.011(e) and 43.55.017 - 43.55.180 is increased by the amount of the credit that exceeds that to which the applicant was entitled, or the applicant's available valid outstanding credits applicable against the tax levied by AS 43.55.011(e) are reduced by that amount. If the applicant's tax liability is increased under this subsection, the increase bears interest under AS 43.05.225 from the date the transferable tax credit certificate was issued. For purposes of this subsection, an applicant that is an explorer is considered a producer subject to the tax levied by AS 43.55.011(e).

*** Sec. 16.** AS 43.55.023 is amended by adding new subsections to read:

(m) A producer or explorer may apply for a tax credit for a Cook Inlet well lease expenditure incurred after December 31, 2010, as follows:

(1) notwithstanding that a Cook Inlet well lease expenditure may be a deductible lease expenditure for purposes of calculating the production tax value of oil and gas under AS 43.55.160(a), unless a credit for that expenditure is taken under (a) of this section, AS 38.05.180(i), AS 41.09.010, AS 43.20.043, or AS 43.55.025, a producer or explorer that incurs a Cook Inlet well lease expenditure may also elect to apply a tax credit against a tax levied by AS 43.55.011(e) in the amount of 40 percent of that expenditure. A tax credit under this subsection may be applied for a single calendar year;

(2) a producer or explorer may take a credit for a Cook Inlet well lease expenditure incurred in connection with geological or geophysical exploration or in connection with an exploration well only if the producer or explorer

(A) agrees, in writing, to the applicable provisions of AS

43.55.025(f)(2); and

(B) submits to the Department of Natural Resources all data that would be required to be submitted under AS 43.55.025(f)(2).

(n) For a lease expenditure incurred in the Cook Inlet sedimentary basin after December 31, 2010, that qualifies for tax credits under (a) and (b) of this section, and for a Cook Inlet well lease expenditure that qualifies for a tax credit under (m) of this section, the department shall issue a transferable tax credit certificate to the person entitled to the credit for the full amount of the credit. The transferable tax credit is available for immediate use and does not expire.

*** Sec. 17.** AS 43.55.028(a) is amended to read:

(a) The oil and gas tax credit fund is established as a separate fund of the state. The purpose of the fund is to purchase [CERTAIN] transferable tax credit certificates issued under AS 43.55.023, [AND CERTAIN] production tax credit certificates issued under AS 43.55.025**, and to pay refunds claimed under AS 43.20.046**.

*** Sec. 18.** AS 43.55.028(e) is amended to read:

(e) The department, on the written application of **a** [THE] person to whom a transferable tax credit certificate has been issued under AS 43.55.023(d) **or (n)** or **to whom** a production tax credit certificate has been issued under AS 43.55.025(f), may use available money in the oil and gas tax credit fund to purchase, in whole or in part, the certificate if the department finds that

(1) the calendar year of the purchase is not earlier than the first calendar year for which the credit shown on the certificate would otherwise be allowed to be applied against a tax;

(2) **except for the application of a person for the purchase of a transferable tax credit certificate issued under AS 43.55.023(n),**

(A) within 24 months after applying for the transferable tax credit certificate or filing a claim for the production tax credit certificate, the applicant incurred a qualified capital expenditure or was the successful bidder on a bid submitted for a lease on state land under AS 38.05.180(f);

(B) [(3)] the amount expended for the purchase would not exceed the total of qualified capital expenditures and successful bids described

in **(A)** [(2)] of this **paragraph** [SUBSECTION] that have not been the subject of a finding made under this **subparagraph** [PARAGRAPH] for purposes of a previous purchase of a certificate;

(3) [(4)] the applicant does not have an outstanding liability to the state for unpaid delinquent taxes under this title;

(4) [(5)] the applicant's total tax liability under AS 43.55.011(e), after application of all available tax credits, for the calendar year in which the application is made is zero;

(5) [(6)] the applicant's average daily production of oil and gas taxable under AS 43.55.011(e) during the calendar year preceding the calendar year in which the application is made was not more than 50,000 BTU equivalent barrels; and

(6) [(7)] the purchase is consistent with this section and regulations adopted under this section.

*** Sec. 19.** AS 43.55.028(g) is amended to read:

(g) The department may adopt regulations to carry out the purposes of this section, including standards and procedures to allocate available money among applications for purchases **under this chapter and claims for refunds under AS 43.20.046 when** the total amount of **the applications for purchase and claims for refund exceed** [WHICH EXCEEDS] the amount of available money in the fund. **The regulations adopted by the department may not, when allocating available money in the fund under this section, distinguish an application for the purchase of a credit certificate issued under AS 43.55.023(n) or a claim for refund under AS 43.20.046.**

*** Sec. 20.** AS 44.23.020(e) is amended to read:

(e) There is established within the Department of Law the function of public advocacy for regulatory affairs. The attorney general shall participate as a party in a matter that comes before the Regulatory Commission of Alaska when the attorney general determines that participation is in the public interest. **When considering whether participation is in the public interest, the attorney general shall consider the issues the Regulatory Commission of Alaska must take into consideration under AS 42.05.141(d).**

*** Sec. 21.** This Act takes effect immediately under AS 01.10.070(c).

Representative Mike Hawker
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House Bill 280
"The Cook Inlet Recovery Act"
Changes in Work Draft v. C

The changes from the House Labor and Commerce committee substitute (Ver. P) are:

- **Sec. 2.** Directs the Alaska Oil and Gas Conservation Commission to certify a natural gas storage facility's working gas capacity rounded to the nearest 500 million cubic feet instead of the nearest 1 billion cubic feet.

- **Sec. 2.** Increases to 100 million cubic feet the minimum annual injection or withdrawal of natural gas required for a gas storage facility to qualify for and retain its tax credit and state land lease fee exemption.

- **Sec. 2.** Eliminates pipelines as eligible for the gas storage facility tax credit.

- **Sec. 8.** Clarifies the boundaries and facilities of a gas storage facility that would be subject to regulation by the Regulatory Commission of Alaska, and specifies that RCA regulation extends only to gas storage facilities operated exclusively or primarily for the benefit of gas owned by third-party customers.

- **Secs. 10, 17 and 19.** Changes the tax credit offered for development of a gas storage facility from a transferrable tax credit to a refundable tax credit. The end result is the same — the taxpayer could receive a payment from the state for the full value of the refundable credit if the taxpayer does not have enough tax liability to fully use the credit. The Department of Revenue advised that a refundable tax credit would be easier to administer than a transferable tax credit.

- **Sec. 10.** Reduces the maximum tax credit for a gas storage facility to $15 million from $30 million in Version P.

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HB 280
"Cook Inlet Recovery Act"
Sectional Analysis (version C)

Prepared by Representative Mike Hawker's Office

Section 1: Sets out a short title for the legislation: Cook Inlet Recovery Act (CIRA).

Section 2: Establishes an application process, criteria and timeline for the Alaska Oil and Gas Conservation Commission (AOGCC) to certify that a gas storage facility (GSF) meets the minimum working gas storage capacity and daily delivery rate requirements to be eligible for the financial incentives provided in this bill.

Requires a GSF owner to notify the AOGCC if the facility ceases operation.

Provides definitions for terms used in CIRA.

Section 3: Requires the Director of the Division of Mining, Land and Water to give priority to and expedite "when reasonably possible" any applications, permits and lease assignments needed for development and operation of a GSF.

Section 4: Directs the Department of Natural Resources (DNR) to waive any state land lease fees or rents for the first 10 years of a GSF's operation. The waiver would stop if the storage facility ceases commercial operations.

States that any waivers of lease fees or rents would be public record.

Requires that the GSF pass on the financial benefits of any lease exemption to utilities that use its service.

Clarifies that any gas withdrawn from a GSF is considered to be non-native gas and not subject to royalty until all non-native gas is withdrawn.

Section 5: Directs the Regulatory Commission of Alaska (RCA), when considering the approval of a utility's gas supply contract, to consider the impact on consumers if the commission rejects a utility's gas supply contract and to recognize the value of a utility holding a diversified portfolio of gas supply contracts with different pricing mechanisms in order to protect consumers from inadequate gas supplies and the risk of a single pricing mechanism.

Section 6: Requires that a utility's cost of gas storage that is passed on to consumers reflect the financial benefits of any tax credits and state lease exemptions provided in this legislation.

Section 7: Specifies that the Regulatory Commission of Alaska has jurisdiction over natural gas storage services provided for gas that is owned by a regulated utility.

Section 8: Further defines "natural gas storage facility" and clarifies what is considered part of the storage facility.

Further defines that RCA regulation of gas storage facilities is limited to facilities operated primarily or exclusively for third-party customers; regulation does not extend to a proprietary storage facility operated exclusively or primarily to hold gas owned by the storage facility owner or operator.

Section 9: Clarifies that the names of taxpayers and the amount of credits claimed for gas storage facilities under this legislation shall be public information. Requires the Department of Revenue (DOR) to furnish the information to the RCA.

Section 10: Establishes a credit against corporate income taxes of $1.50 per thousand cubic feet of new gas storage capacity opened in Alaska during 2011-2015. The credit is limited to $15 million per GSF. This section sets out minimum capacity and deliverability requirements to qualify for the credit, including that the GSF must be available for use by regulated utilities and, if utilizing state land, must be in compliance with its DNR storage lease. The credit can be refunded by the state at full value if the owner does not have enough taxable income to fully utilize the credit.

Section 11: Sunsets on Jan. 1, 2011, the rule that limits how certain tax credits arising from activity in Cook Inlet or from producing gas for in-state use are used. This would allow a Cook Inlet explorer or producer to explore or produce elsewhere in the state and have full access to the credits it earned from its Cook Inlet activities.

Section 12: Clarifies that any native gas in a gas storage facility shall be deemed not to be produced for production tax purposes until all of the non-native gas injected into the storage facility has been withdrawn.

Section 13: Allows explorers in Cook Inlet to receive their full production tax credit in the first year rather than over two years (as in current statute).

Section 14: Makes additional statutory changes to allow explorers in Cook Inlet to receive their full production tax credit the first year rather than over two years (as in current statute).

Section 15: Adds the new Cook Inlet-related well tax credits to the section in statute dealing with audits of transferred tax credits.

Section 16: Provides a 40% credit for exploration expenses in Cook Inlet against production taxes, rather than the two-tiered 30% / 40% credit in existing statute. In addition, all well-related lease expenditures in Cook Inlet, including non-capital and non-exploration related lease expenditures, also qualify for the credit.

Section 17: Allows the state to use funds from the oil and gas tax credit fund to refund the tax credits issued to a GSF.

Section 18: Makes additional changes to make it easier for a company to sell its Cook Inlet exploration credits to the state. Current law requires that before a company can sell credits back to the state it must prove it has spent an amount equal to the

credit in Alaska. HB 280 would eliminate that requirement for Cook Inlet exploration credits.

Section 19: Authorizes the Department of Revenue to write regulations implementing certain aspects of Section 17.

Section 20: Directs the Office of Public Advocacy for regulatory affairs at the Department of Law, when considering whether to participate in a utility rate case regarding a utility's gas supply contract before the RCA, to consider the impact to consumers if the commission rejects a utility's gas supply contract and to recognize the value of a utility holding a diversified portfolio of gas supply contracts with different pricing mechanisms in order to protect consumers from inadequate gas supplies and the risk of a single pricing mechanism.

Section 21: Immediate effective date clause.

HB 280
Cook Inlet Recovery Act (CIRA) - Overview

Prepared by Representative Mike Hawker's Office

CIRA provides a statutory framework and financial incentives for developing large-scale natural gas storage facilities and also makes changes to Cook Inlet exploration tax credits to encourage exploration and development of new gas discoveries.

Gas Storage Facilities

- Incentives include:
  - Land lease and fee exemption for 10 years
  - NEW income tax credit
    - Credit is based on capacity, certified by AOGCC: $1.50/1,000 cubic feet (cf) of working storage capacity
    - Maximum credit is $15 million per facility
    - Credit is fully refundable by the state
  - Expedited/priority processing of applications by DNR, when reasonably possible
- Incentives apply to gas storage facility that meets minimum capacity and delivery requirements, certified by AOGCC:
  - Minimum Working Storage Capacity: 500 million cf
  - Minimum Daily Delivery Capacity: 10 million cf
- Incentives are available for gas storage facilities that commence operations between Jan. 1, 2011, and Dec. 31, 2015
- All financial benefits and the names of those receiving the benefits are public information
- All financial benefits must be passed on to utilities, which then pass on to consumers
- All financial benefits stop when a project ceases operation
- CIRA also mandates RCA regulation of gas storage facilities that hold gas owned by regulated utilities.

Gas Exploration in Cook Inlet

- Changes to existing credits:
  - Allows 100% of credits earned by explorers in the Cook Inlet to be used elsewhere in the state; current statute generally limits those credits to be applied only to actual taxes paid on Cook Inlet production
  - Allows the full amount of the credit to be used in the year issued; current statute allows only half of the credit to be used in one year
  - Provides a 40% credit for exploration within Cook Inlet; current statute contains a variable (30% or 40%) credit based on the proximity of the exploration to an existing well

HB 280 Overview (cont.)
Definitions

Gas storage facility: A depleted or nearly depleted reservoir or aboveground tank used to store natural gas produced offsite and delivered to the storage facility to hold until needed. The owner of the gas — a utility, for example — would inject gas into the facility and would pay the facility operator for storage service.

Working gas storage capacity: The maximum amount of natural gas the storage facility could safely hold for its storage customers.

Cushion gas (also known as pad gas): The volume of gas that must be maintained in the storage facility to provide adequate pressure for operations. The storage operator, not the storage customers, would own the cushion gas.

Native gas: In the case of a nearly depleted reservoir, native gas is the natural gas that exists in the reservoir at the time it is developed for use as a storage facility. Native gas is used as cushion gas to maintain pressurization. If all of the non-native working gas that was injected for storage is withdrawn and native gas is eventually produced, state tax and royalty would be assessed.

Non-native working gas: Natural gas that is produced from another reservoir and delivered to the storage facility and held until needed. For example, a utility could purchase gas from a Cook Inlet producer and have it delivered to the storage facility for safekeeping until the utility needs the gas to meet customer demand. At that point, the utility would instruct the gas storage operator to deliver the quantity of gas required. The utility, not the storage operator, would own the gas in storage. State tax and royalty would be assessed on the non-native working gas when it is first produced and sold to the utility; no additional taxes or royalties would be due when it is withdrawn from storage for delivery to the utility.

HB 280 Overview (cont.)
FAQs

1. What are the minimum requirements for a gas storage facility (GSF) to qualify for financial incentives in the Cook Inlet Recovery Act? Who determines if a GSF meets these requirements?

   In order to qualify for the financial incentives in CIRA, a GSF must have the capacity to store more than 500 million cubic feet of working gas and deliver gas at a rate of at least 10 million cubic feet per day. The Alaska Oil and Gas Conservation Commission (AOGCC) will be required to certify these capacities within six months of receiving an application and provide the certification to the applicant, the Department of Natural Resources and the Department of Revenue.

2. What happens if the GSF stops operating?

   A GSF ceases operations if it doesn't inject or withdraw at least 100 million cubic feet of gas in a calendar year. The operator is required to notify the AOGCC by April 1st of the following year. If this happens, the GSF will no longer be eligible for state lease fees exemptions or tax credits.

3. Sections 4 and 12 of the bill state that gas withdrawn from a GSF is considered to be non-native gas and not considered to be produced until all non-native gas has been withdrawn. What does this mean and why do we need this language?

   This language requires that state follow last-in, first-out accounting rules for gas in a GSF. "Native gas" is any gas that is already in a storage facility and will be subject to existing royalty and production taxes when it is produced. "Non-native gas" includes all gas that is injected into the facility for temporary storage - royalty and production taxes were assessed when it was produced. By including this language, it is clear that non-native gas extracted from a GSF is not taxed twice and native gas is not subject to royalty and production taxes until all non-native gas is withdrawn.

4. Gas storage companies are receiving lease exemptions and tax breaks under CIRA. Are these savings passed on to the consumer?

   Yes. Language in sections 4, 6 and 10 require the owner of a GSF to reflect the savings of any financial benefits enacted in CIRA in their gas storage price.

HOUSE COMMITTEE REPORT

(9)

Date Referred to Committee: February 17, 2010 **FURTHER REFERRALS: Finance**

Date of Committee Action: 3/15/10

The RESOURCES Committee considered: **HOUSE BILL NO. 280**

"An Act relating to natural gas; relating to a gas storage facility; relating to the Regulatory Commission of Alaska; relating to the participation by the attorney general in a matter involving the approval of a rate or a gas supply contract; relating to an income tax credit for a gas storage facility; relating to oil and gas production tax credits; relating to the powers and duties of the Alaska Oil and Gas Conservation Commission; relating to production tax credits for certain losses and expenditures, including exploration expenditures; relating to the powers and duties of the director of the division of lands and to lease fees for the storage of gas on state land; and providing for an effective date."

HB 280-NATURAL GAS

Recommends it be replaced with [ ] HCS *or* [X] CS *for* HB 280 (RES)

For Senate Bills with new title: [ ] Technical Title [ ] New Title: HCR_____ **[ ] Same Title [X] New Title**

[ ] attach amendments
[ ] add new referral to _____Committee
[ ] Letter of Intent_____Committee

List of Abbrev for Depts.:
ADM
CED
COR
CRT
EED
DEC
DFG
GOV
DHS
LWF
LAW
LEG
MVA
DNR
DPS
REV
DOT
UA

NEW FISCAL NOTES *Assigned by Chief Clerk's Office				
List by Dept(s):	*FN#	Fiscal	Indet.	Zero
DNR			✓	
REV		✓		

PREVIOUS FISCAL NOTES				
List by Dept(s):	FN#	Fiscal	Indet.	Zero
ADM	1			✓
CED	2			✓

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
Bryce Edgmon	Edgmon	✓			
	OLSON	—			
Peggy Wilson	WILSON	✓			
Pearl Stoltze		✓			
Chair: Craig Johnson	Johnson	—			
Chair:					

FISCAL NOTE

STATE OF ALASKA
2010 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: **CSHB 280(L&C)**
() Publish Date:

Identifier (file name): CSHB280-DNR-DOG-03-05-10
Title: Cook Inlet Recovery Act
Sponsor: Rep. Hawker and Chenault
Requester: HRES

Dept. Affected: Natural Resources
RDU: Resource Development
Component: Oil and Gas Development
Component Number: 439

Expenditures/Revenues (Thousands of Dollars)

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

	Appropriation Required	Information					
OPERATING EXPENDITURES	**FY 2011**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**
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**	**0.0**
CAPITAL EXPENDITURES							
CHANGE IN REVENUES ( )	**indeterminate**						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts							
1003 GF Match							
1004 GF							
1005 GF/Program Receipts							
1037 GF/Mental Health							
Other Interagency Receipts							
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2010) cost:

POSITIONS

Full-time							
Part-time							
Temporary							

ANALYSIS: *(Attach a separate page if necessary)*

HB 280 offers tax credits for Cook Inlet gas storage facilities and attempts to promote gas exploration and production in the Cook Inlet.

There is no anticipated fiscal impact to the Division of Oil and Gas for the management of gas storage on state land. However, Sec. 4 of the bill will provide a ten year "holiday" on all storage fees and rentals for the storage lease. Also, the accounting convention described means that "non-native" gas will be withdrawn from storage first and no royalty revenue will acrue to "native" gas until all non-native gas is withdrawn. How industry will respond to the tax credits offered by this bill is unknown, therefore, the impact on fees, rents, and royalty revenues is negative indeterminate.

Prepared by: Kevin Banks, Director — Phone 269-8800
Division: Oil and Gas — Date/Time 3/5/10 12:00 PM
Approved by: Tom Irwin, Commissioner — Date 3/5/2010
Natural Resources

(Revised 11/6/2009 OMB)

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FISCAL NOTE

STATE OF ALASKA
2010 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: **CSHB280 v P**
() Publish Date:

Identifier (file name): CSHB280(L&C)-REV-TAX-03-07-10
Dept. Affected: Revenue
Title: Cook Inlet Recovery Act
RDU: Taxation and Treasury
Component: Tax Division
Sponsor: Representative Mike Hawker
Requester: (H) Resources
Component Number: 2476

Expenditures/Revenues (Thousands of Dollars)

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

	Appropriation Required	Information					
OPERATING EXPENDITURES	**FY 2011**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**
Personal Services	108.9	108.9	108.9	108.9	108.9	108.9	108.9
Travel	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Contractual	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Supplies	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Equipment	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Land & Structures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**
CAPITAL EXPENDITURES	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CHANGE IN REVENUES ( )	***	***	***	***	***	***	***

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1003 GF Match	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1004 GF	117.3	117.3	117.3	117.3	117.3	117.3	117.3
1005 GF/Program Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1037 GF/Mental Health	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Interagency Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**

Estimate of any current year (FY2010) cost: 0.0

POSITIONS

Full-time	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**
Part-time	0.0	0	0	0	0	0	0
Temporary	0.0	0	0	0	0	0	0

ANALYSIS: *(Attach a separate page if necessary)*

HB 280 would make multiple changes to the existing law on tax credits and gas storage facilities. The portions of the bill that specifically apply to the Department of Revenue would change the treatment of credits under AS 43.55.023 (Qualifying Capital Expenditures) and create a credit against corporate income tax (CIT) for gas storage facilities (AS 43.20.046). The language relating to credits has the potential to be interpreted quite broadly with the potential for large reductions in state revenues when compared to future developments that might occur under the current law.

The Department is requesting a Corporate Income Tax Auditor III position (Range 22) to audit the tax credits and manage the approval, issuance and tracking of the new and modified state credits. (continued)

Prepared by: Cody Rice, Petroleum Economist II — Phone 907-269-1024
Division: Tax Division — Date/Time 03-04-10; 4:27pm
Approved by: Ginger Blaisdell, Director — Date 03-07-10; 1:31pm
Administrative Services Division

(Revised 11/6/2009 OMB)

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ANALYSIS CONTINUATION

There are three gas storage facilities currently operating in the Cook Inlet region. None of the existing gas storage facilities would qualify for the corporate income tax credits under this bill as currently written. However, it is unclear if the existing gas storage facilities could qualify for credits if they shut-down and re-opened or changed ownership. Any estimate of the change in revenues to the state under this legislation would be based on hypothetical development in the future. As a result, the full revenue impact of this legislation cannot be accurately determined at this time.

The following scenarios may provide some perspective on the range of potential revenue impacts.

Scenario 1: Corporate income tax credit effects on a small facility

The first scenario assumes the construction of a small gas storage facility in a depleted reservoir similar to one of the smaller currently operating gas storage facilities. The facility is assumed to be capable of approximately 1.25 cycles a year and to have a working gas capacity of approximately 1Bcf. Under the terms of HB 280 this facility would be entitled to a credit of $1.5 Million against state CIT.

In 2004, the Federal Energy Regulatory Commission (FERC) estimated the median cost-of-service rate for firm storage service at $0.64/Decatherm. One Decatherm is equal to one Mcf of natural gas if the natural gas contains 1,000 Btu/cubic foot. Escalating this cost for inflation produces a 2009 cost-of-service rate of approximately $0.72/Mcf of firm storage service.

Given the estimated cost-of-service, volume of gas cycled and reasonable assumptions about debt to equity and other factors, the Department of Revenue estimates that this gas storage facility would owe approximately $95,000/year in state CIT. This rough estimate suggests that the corporate income tax credit for gas storage created under AS 43.20.046 of this bill would entirely offset the state corporate tax liability for nearly the first 16 years of operation. It is important to note that the credit created in this bill under AS 43.20.046 is eligible to be transferred or refunded.

There is a credit clawback provision that applies if the gas storage ceases commercial operations within ten years. However, in this scenario, the amount of the original credit remaining after ten years of commercial operations is estimated to be $550,000. This means the storage operator in this scenario could cease to operate at the beginning of year 11 and theoretically retain as much as $550,000 in refundable state credits. Additionally, under HB 280, the facility would be exempt from rental and storage fees charged by the Department of Natural resources (DNR) for the first ten years of commercial operations. There is also some question about whether the existing statute of limitations would allow the state to exercise the clawback provision.

Under this scenario the reduction in state taxes to the state is $1.5 million in undiscounted terms for each qualifying facility of this type. This does not include reductions in estimated rental and storage fees.

Scenario 2: Corporate income tax credit effects on a large facility

Scenario two assumes the construction of a large gas storage facility in a depleted reservoir. The facility is assumed to be capable of cycling approximately one time each year and to have a working gas capacity of

ANALYSIS CONTINUATION

Under the terms of HB 280 this facility would be entitled to the maximum credit of $30 million against state corporate income tax.

Using the same cost-of-service and financial assumptions as scenario one, the Department of Revenue estimates that the gas storage facility owner would owe approximately $1.5 million annually in state CIT. This rough estimate suggests that the corporate income tax credit created under AS 43.20.046 would completely offset the state corporate income tax liability for about 20 years of operation. It is important to note again that the credit created in this bill under AS 43.20.046 is eligible to be transferred or refunded. There is a credit clawback provision that applies if the gas storage ceases commercial operations within ten years. However, in this scenario, the amount of the original credit remaining after ten years of commercial operations is estimated to be $15,000,000. This means the storage operator in this scenario could cease to operate at the beginning of year 11 and theoretically retain as much as $15,000,000 in refundable state credits. The facility would also be exempt from rental and storage fees charged by the Department of Natural resources (DNR) for the first ten years of commercial operations.

Under this scenario the reduction in state taxes to the state is $30 million in undiscounted terms for each qualifying facility of this type. This does not include reductions in estimated rental and storage fees.

Scenario 3: Broader interpretation of HB 280 benefits

Previous scenarios have assumed gas storage facilities operated at nearly 100% of capacity, using 100% of certified storage capacity. This scenario assumes a gas storage operator takes full economic advantage of a broad interpretation of the language in HB 280. Specifically, the facility uses a reservoir with a working gas capacity of 20 Bcf and the operator only cycles the minimum amount of gas to prevent the loss of the credits: 10,000 Mcf of natural gas annually. Using the same cost-of-service and financial assumptions as the previous two scenarios, the Department of Revenue estimates that the gas storage facility owner would owe less than $1,000 annually in state CIT. The storage facility owner would be eligible for a credit of $30,000,000 for the facility based on the working gas capacity. In this scenario it would take nearly 4,000 years of operation under this scenario for a gas storage operator to exhaust the state corporate income tax credit provided under this bill. Alternatively, after 10 years of commercial operation the owner could shut the facility down and retain $29,990,000 in refundable state credits.

Scenario 4: Lost or deferred production and production tax revenue

Previous scenarios have assumed gas storage in a depleted reservoir. It is possible that an oil and gas lessee could elect to shut-in production at a currently producing field earlier than would have otherwise occurred in order to take full advantage of plentiful native gas for free cushion gas. Under this bill the remaining native gas could be produced at the end of commercial operations for the gas storage facility. This deferred or lost production tax revenue would be in addition to lost revenue impacts equivalent to any of the previous three scenarios. The time value of deferred production is not calculated but could be substantial.

Scenario 5: Tax Ceiling

Existing state law provides the benefit of a tax ceiling for certain production under AS 43.55.011(j)(k) and (o). The tax ceiling applies to Cook Inlet production as well as any natural gas produced for use in state. Currently, credits earned under AS 38.05.180(i), AS 41.09.010, AS 43.55.024 or AS 43.55.025 are required to be applied first to a producers tax liability under AS 43.55.011(e) as though it were not limited by AS 43.55.011(j)(k) or (o).

ANALYSIS CONTINUATION

Under HB280, the limitation on application of credits does not apply to Cook Inlet production after January 1, 2011. This change would allow credits from Cook Inlet expenditures to also be applied to other non-Cook Inlet tax liability. In essence producers would earn credits and apply their full value against state wide tax liability and also receive the benefit of the reduced tax rate resulting from the comparison of actual tax rate (using those credits) and the prior ELF rate or ceiling rate. This repeal is likely to have the effect of reducing Cook Inlet tax collections to zero and allowing Cook Inlet credits to be used to shield taxes due from operations in other parts of Alaska such as the North Slope. This provision would be a particular benefit to companies operating in both Cook Inlet and on the North Slope.

Scenario five entails a producer with production in both Cook Inlet and on the North Slope. Assume the producer is entitled to a credit of $12 million under AS 43.55.025 because of Cook Inlet Exploration Expenditures, and assume that the producer's total production taxes are approximately $18 million, with $16 million attributed to North Slope production and $2 million attributed to Cook Inlet production.

Under existing law, AS 43.55.011(m) requires the producer to apply the $12 million in Cook Inlet credits to the full value of its hypothetical .011(e) Cook Inlet tax liability even though the Cook Inlet tax ceiling rate is applicable. Applying the $12 million credit against $2 million of .011(e) Cook Inlet production tax leaves $10 million in excess credits that may be used to offset tax liability elsewhere in the state. The tax ceiling rate on Cook Inlet oil is zero; therefore $2 million of the credit is considered "used" under AS 43.55.011(m).

Under current law, the North Slope tax liability of $16 million would be offset by the $10 million in credits left over after application of AS43.55.011(m), leaving a production tax liability of $6 million. Under HB 280, the producer would not have to draw down its $12 million of Cook Inlet tax credits, and instead be allowed to apply the full $12 million to the $16 million North Slope tax liability. As a result, the producer would pay a total of $4 million in production tax under this scenario, or $2 million less than under the existing law.

This scenario is a simplified version of how HB 280 might affect state revenues. Because AS 43.55.011(m) applies to multiple types of credits, and multiple taxpayers, the revenue effects could be significant.

Additional Scenarios and Fiscal Impacts:

The effect of increasing the value of credits for well work in Cook Inlet to 40% under AS 43.55.023(m) is not quantified in this analysis but would reduce tax revenues.

There could be additional reductions in state tax revenues if other existing facilities or natural gas pipelines were certified as gas storage and eligible for credits. This bill does not limit the credit for gas storage to the Cook Inlet, and in fact could be applied to gas stored on the North Slope or other areas of the state.

Cook Inlet production tax and additional production caused by the injection or withdrawal requirements under this proposal are very unlikely to generate more than a small fraction of the revenue that would be required to fund this credit. This means production taxes from other areas of the state, such as the North Slope would likely be the source of funds to the tax credit fund for the state to repurchase this credit.

Representative Mike Hawker
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Bird
Girdwood
Portage
Whittier
Sunrise
Hope

House Bill 280
"The Cook Inlet Recovery Act"
Sponsor Statement

Residents of South Central Alaska are at risk that in the near future there will not be enough natural gas produced in Cook Inlet to heat and light their homes and businesses. Legislative action now can help address this challenge before it becomes a crisis.

A critical and universally recognized part of the solution is large-scale gas storage, allowing utilities to purchase gas during lower demand periods; hold the gas in storage; then withdraw it when needed. Establishing gas storage is crucial, and the state needs to promote the rapid development of storage facilities. House Bill 280, the Cook Inlet Recovery Act (CIRA), provides tax incentives and regulatory assurances to attract the private investment necessary to develop storage facilities and help reduce the cost of storage to consumers.

Specifically, CIRA provides a 10-year exemption from state land lease fees and rents to owners of new gas storage facilities. Since storage is needed urgently, these financial incentives will be available only for facilities put into operation before December 31, 2015. CIRA sets standards, such as minimum size and access requirements, for qualifying projects. Consumers will benefit from increased energy security and lower energy costs, as any financial incentives are required to pass through the supply chain to utilities and, in turn, to their customers.

In addition to storage, South Central also needs new gas discoveries. CIRA increases the incentives for exploration in Cook Inlet and allows explorers and producers to take their full benefit in one year rather than over two years.

CIRA also provides statutory guidance to the Regulatory Commission of Alaska in its consideration of utility gas supply contracts to help ensure adequate supplies of reasonably priced gas in the years ahead.

2/5/10

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HB 280
"Cook Inlet Recovery Act"
Sectional Analysis (version P)

Prepared by Representative Mike Hawker's Office

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Provides definitions for terms used in CIRA.

Section 3: Requires the Director of the Division of Mining, Land and Water to give priority to and expedite "when reasonably possible" any applications, permits and lease assignments needed for development and operation of a GSF.

Section 4: Directs the Department of Natural Resources (DNR) to waive any state land lease fees or rents for the first 10 years of a GSF's operation. The waiver would stop if the storage facility ceases commercial operations.

States that any waivers of lease fees or rents would be public record.

Requires that the GSF pass on the financial benefits of any lease exemption to utilities that use its service.

Clarifies that any gas withdrawn from a GSF is considered to be non-native gas and is not subject to royalty until all non-native gas is withdrawn.

Section 5: Directs the Regulatory Commission of Alaska (RCA), when considering the approval of a utility's gas supply contract, to consider the impact on consumers if the commission rejects a utility's gas supply contract and to recognize the value of a utility holding a diversified portfolio of gas supply contracts with different pricing mechanisms in order to protect consumers from inadequate gas supplies and the risk of a single pricing mechanism.

Section 6: Requires that a utility's cost of gas storage that is passed on to consumers reflect the financial benefits of any tax credits and state lease exemptions provided in this legislation.

Section 7: Specifies that the Regulatory Commission of Alaska has jurisdiction over natural gas storage services provided for gas that is owned by a regulated utility.

Section 8: Clarifies that the names of taxpayers, the amount of credits issued for gas storage facilities under this legislation, and how much, if any, of the credit was sold to the state is public information. Requires the Department of Revenue (DOR) to furnish the information to the RCA.

Section 9: Establishes a credit against corporate income taxes of $1.50 per thousand cubic feet of new gas storage capacity opened in Alaska during 2011-2015. The credit is limited to $30 million per GSF. This section sets out minimum capacity and deliverability requirements to qualify for the credit, including that the GSF must be available for use by regulated utilities and, if utilizing state land, must be in compliance with its DNR storage lease. The credit can be transferred or sold to another taxpayer, or sold to the state at full value if the owner does not have enough taxable income to fully utilize the credit.

Section 10: Sunsets on Jan. 1, 2011, the rule that limits how certain tax credits arising from activity in Cook Inlet or from producing gas for in-state use are used. This would allow a Cook Inlet explorer or producer to explore or produce elsewhere in the state and have full access to the credits it earned from its Cook Inlet activities.

Section 11: Clarifies that any native gas in a gas storage facility shall be deemed not to be produced for production tax purposes until all of the non-native gas injected into the storage facility has been withdrawn.

Section 12: Allows explorers in Cook Inlet to receive their full production tax credit in the first year rather than over two years (as in current statute).

Section 13: Makes additional statutory changes to allow explorers in Cook Inlet to receive their full production tax credit the first year rather than over two years (as in current statute).

Section 14: Adds the new Cook Inlet-related well tax credits to the section in statute dealing with audits of transferred tax credits.

Section 15: Provides a 40% credit for exploration expenses in Cook Inlet against production taxes, rather than the two-tiered 30% / 40% credit in existing statute. In addition, all well-related lease expenditures in Cook Inlet, including non-capital and non-exploration related lease expenditures, also qualify for the credit.

Section 16: Allows the state to use funds from the oil and gas tax credit fund to purchase tax credits issued to a GSF.

Section 17: Makes additional changes to make it easier for a company to sell its Cook Inlet exploration credits to the state. Current law requires that before a company can sell credits back to the state it must prove it has spent an amount equal to the credit in Alaska. HB 280 would eliminate that requirement for Cook Inlet exploration credits.

Section 18: Authorizes the Department of Revenue to write regulations implementing certain aspects of Section 17.

Section 19: Directs the Office of Public Advocacy for regulatory affairs at the Department of Law, when considering whether to participate in a utility rate case regarding a utility's gas supply contract before the RCA, to consider the impact to consumers if the commission rejects a utility's gas supply contract and to recognize the value

of a utility holding a diversified portfolio of gas supply contracts with different pricing mechanisms in order to protect consumers from inadequate gas supplies and the risk of a single pricing mechanism.

Section 20: Immediate effective date clause.

FISCAL NOTE

STATE OF ALASKA
2010 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: **CSHB280(L&C)**
() Publish Date:

Identifier (file name): HB280CS(L&C)-DNR-O&G-02-16-2010
Title: Cook Inlet Recovery Act
Sponsor: Rep. Hawker and Chenault
Requester: H(RES)

Dept. Affected: Natural Resources
RDU: Resource Development
Component: Oil and Gas Development
Component Number: 439

Expenditures/Revenues (Thousands of Dollars)

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

	Appropriation Required	Information					
OPERATING EXPENDITURES	**FY 2011**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**
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**	**0.0**
CAPITAL EXPENDITURES							
CHANGE IN REVENUES ( )	***Indeterminate***						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts							
1003 GF Match							
1004 GF							
1005 GF/Program Receipts							
1037 GF/Mental Health							
Other Interagency Receipts							
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2010) cost:

POSITIONS

Full-time							
Part-time							
Temporary							

ANALYSIS: *(Attach a separate page if necessary)*

HB 280 offers tax credits for Cook Inlet gas storage facilities and attempts to promote gas exploration and production in the Cook Inlet.

There is no anticipated fiscal impact to the Division of Oil and Gas for the management of gas storage on state land. However, Sec 3 of the bill will provide a ten year "holiday" on all storage fees and rentals for the storage lease. Also, the accounting convention described in this section means that "non-native" gas will be withdrawn from storage first and no royalty revenue will acrue to "native" gas until all non-native gas is withdrawn. How industry will respond to the tax credits offered by this bill is inknown, therefore, the impact on fees, rents, and royalty revenues is negative indeterminate.

Prepared by: Kevin Banks, Director — Phone 269-8800
Division: Oil and Gas — Date/Time 2/15/2010
Approved by: Tom Irwin, Commissioner — Date 2/16/2010 1:35 pm
Natural Resources

(Revised 11/6/2009 OMB)

3981

FISCAL NOTE

STATE OF ALASKA
2010 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: **CSHB 280**
() Publish Date:

Identifier (file name): CSHB280-REV-TAX-2-14-10
Dept. Affected: Revenue
Title: Cook Inlet Recovery Act
RDU: Taxation and Treasury
Component: Tax Division
Sponsor: Representative Hawker
Requester: (H) Labor andCommerce
Component Number:

Expenditures/Revenues (Thousands of Dollars)

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

	Appropriation Required	Information					
OPERATING EXPENDITURES	**FY 2011**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**
Personal Services	108.9	108.9	108.9	108.9	108.9	108.9	108.9
Travel	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Contractual	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Supplies	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Equipment	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Land & Structures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**
CAPITAL EXPENDITURES	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CHANGE IN REVENUES ( )	***	***	***	***	***	***	***

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1003 GF Match	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1004 GF	117.3	117.3	117.3	117.3	117.3	117.3	117.3
1005 GF/Program Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1037 GF/Mental Health	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Interagency Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**	**117.3**

Estimate of any current year (FY2010) cost: 0.0

POSITIONS

Full-time	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**	**1.0**
Part-time	0.0	0	0	0	0	0	0
Temporary	0.0	0	0	0	0	0	0

ANALYSIS: *(Attach a separate page if necessary)*

HB 280 would make multiple changes to the existing law on tax credits and gas storage facilities. The portions of the bill that specifically apply to the Department of Revenue would change the treatment of credits under AS 43.55.023 (Qualifying Capital Expenditures) and create a credit against corporate income tax (CIT) for gas storage facilities (AS 43.20.046). The language relating to credits has the potential to be interpreted quite broadly with the potential for large reductions in state revenues when compared to future developments that might occur under the current law.

The Department is requesting a Corporate Income Tax Auditor III position (Range 22) to audit the tax credits and manage the approval, issuance and tracking of the new and modified state credits. (continued)

Prepared by: Cody Rice and Gary Rogers, Petroleum Economists — Phone 907-269-1024
Division: Tax Division — Date/Time 2-12-10; 3:53pm
Approved by: Ginger Blaisdell, Director — Date 2-14-10; 3:49pm
Administrative Services Division

(Revised 11/6/2009 OMB)

ANALYSIS CONTINUATION

There are three gas storage facilities currently operating in the Cook Inlet region. None of the currently existing gas storage facilities would qualify for the corporate income tax credits under this bill as currently written. However, it is unclear if the existing gas storage facilities could qualify for credits if they shut-down and re-opened or changed ownership. Any estimate of the change in revenues to the state under this legislation would be based on hypothetical development in the future. As a result, the full revenue impact of this legislation cannot be accurately determined at this time.

The following scenarios may provide some perspective on the range of potential revenue impacts.

Scenario 1: Corporate income tax credit effects on a small facility

The first scenario assumes the construction of a small gas storage facility in a depleted reservoir similar to one of the smaller currently operating gas storage facilities. The facility is assumed to be capable of approximately 1.25 cycles a year and to have a working gas capacity of approximately 1Bcf. Under the terms of HB 280 this facility would be entitled to a credit of $1.5 Million against state CIT.

In 2004, the Federal Energy Regulatory Commission (FERC) estimated the median cost-of-service rate for firm storage service at $0.64/Decatherm. One Decatherm is equal to one Mcf of natural gas if the natural gas contains 1,000 Btu/cubic foot. Escalating this cost for inflation produces a 2009 cost-of-service rate of approximately $0.72/Mcf of firm storage service.

Given the estimated cost-of-service, volume of gas cycled and reasonable assumptions about debt to equity and other factors, the Department of Revenue estimates that this gas storage facility would owe approximately $95,000/year in state CIT. This rough estimate suggests that the corporate income tax credit for gas storage created under AS 43.20.046 of this bill would entirely offset the state corporate tax liability for nearly the first 16 years of operation. It is important to note that the credit created in this bill under AS 43.20.046 is eligible to be transferred or refunded. There is a credit clawback provision that applies if the gas storage ceases commercial operations within ten years. However, in this scenario, the amount of the original credit remaining after ten years of commercial operations is estimated to be $550,000. This means the storage operator in this scenario could cease to operate at the beginning of year 11 and theoretically retain as much as $550,000 in refundable state credits before starting the process over with a new facility. Additionally, under HB 280, the facility would be exempt from rental and storage fees charged by the Department of Natural resources (DNR) for the first ten years of commercial operations. There is also some question about whether the existing statute of limitations would allow the state to exercise the clawback provision.

Under this scenario the reduction in state taxes to the state is $1.5 million in undiscounted terms for each qualifying facility of this type. This does not include reductions in estimated rental and storage fees.

Scenario 2: Corporate income tax credit effects on a large facility

Scenario two assumes the construction of a large gas storage facility in a depleted reservoir. The facility is assumed to be capable of cycling approximately one time each year and to have a working gas capacity of approximately 20 Bcf. (continued)

ANALYSIS CONTINUATION

Under the terms of HB 280 this facility would be entitled to the maximum credit of $30 million against state corporate income tax.

Using the same cost-of-service and financial assumptions as scenario one, the Department of Revenue estimates that the gas storage facility owner would owe approximately $1.5 million annually in state CIT. This rough estimate suggests that the corporate income tax credit created under AS 43.20.046 would completely offset the state corporate income tax liability for about 20 years of operation. It is important to note again that the credit created in this bill under AS 43.20.046 is eligible to be transferred or refunded. There is a credit clawback provision that applies if the gas storage ceases commercial operations within ten years. However, in this scenario, the amount of the original credit remaining after ten years of commercial operations is estimated to be $15,000,000. This means the storage operator in this scenario could cease to operate at the beginning of year 11 and theoretically retain as much as $15,000,000 in refundable state credits before starting the process over with a new facility. The facility would also be exempt from rental and storage fees charged by the Department of Natural resources (DNR) for the first ten years of commercial operations.

Under this scenario the reduction in state taxes to the state is $30 million in undiscounted terms for each qualifying facility of this type. This does not include reductions in estimated rental and storage fees.

Scenario 3: Broader interpretation of HB 280 benefits

Previous scenarios have assumed gas storage facilities operated at nearly 100% of capacity. This scenario assumes a gas storage operator takes full economic advantage of a broad interpretation of the language in HB 280. Specifically, the facility uses a reservoir with a working gas capacity of 20 Bcf and the operator only cycles the minimum amount of gas to prevent the loss of the credits: 10,000 Mcf of natural gas annually. Using the same cost-of-service and financial assumptions as the previous two scenarios, the Department of Revenue estimates that the gas storage facility owner would owe less than $1,000 annually in state CIT. The storage facility owner would be eligible for a credit of $30,000,000 for the facility based on the working gas capacity. In this scenario it would take nearly 4,000 years of operation under this scenario for a gas storage operator to exhaust the state corporate income tax credit provided under this bill. Alternatively, after 10 years of commercial operation the owner could shut the facility down and retain $29,990,000 in refundable state credits. The operator could then begin the process again.

Scenario 4: Lost or deferred production and production tax revenue

Previous scenarios have assumed gas storage in a depleted reservoir. It is possible that an oil and gas lessee could elect to shut-in production at a currently producing field earlier than would have otherwise occurred in order to take full advantage of plentiful native gas for free cushion gas. Under this bill the remaining native gas could be produced at the end of commercial operations for the gas storage facility. This deferred or lost production tax revenue would be in addition to revenue impacts equivalent to any of the previous three scenarios. The time value of deferred production is not calculated but could be substantial.

Scenario 5: Tax Ceiling

Existing state law provides the benefit of a tax ceiling for certain production under AS 43.55.011(j)(k) and (o). The tax ceiling applies to Cook Inlet production as well as any natural gas produced for use in state. Currently, credits earned under AS 38.05.180(i), AS 41.09.010, AS 43.55.024 or AS 43.55.025 are required to be applied first to a producers tax liability as though it were not limited by AS 43.55.011(j)(k) or (o).

ANALYSIS CONTINUATION

This provision does not apply to production occurring after January 1, 2011. The effect would be to allow credits earned on the full tax liability prior to the tax ceiling to be applied to the reduced or capped tax ceiling. In essence producers would earn credits on the full value of production but only pay taxes limited by the tax ceiling. This repeal is likely to have the effect of reducing Cook Inlet tax collections to zero and allowing Cook Inlet credits to be used to shield taxes due from operations in other parts of Alaska such as the North Slope.

Scenario five entails a producer with production in both Cook Inlet and on the North Slope. Assuming the producer is entitled to a credit of $12 million under AS 43.55.024(c)(1) and that the producer has average oil production of 3,000 Btu equivalent barrels a day, we can estimate the production taxes as approximately $18 million.

We further assume approximately $16 million in production tax liability for the North Slope production and approximately $2 million for the Cook Inlet production. The credit is apportioned similarly: $11 million for the North Slope and $1 million for the Cook Inlet.

Under existing law, AS 43.55.011(m) requires the producer to apply the $1 million in credits to the full value of their Cook Inlet tax before the application of the tax ceiling. After applying the $1 million credit against $2 million in Cook Inlet production tax, leaving a $1 million production tax liability in Cook Inlet. However, the tax ceiling for oil produced in Cook Inlet is zero.

The North Slope tax treatment is the same: applying the $11 million in credit apportioned to the North Slope to the $16 million in North Slope tax liability leaves a production tax liability of $5 million. Under HB 280, the producer is allowed to apply the Cook Inlet credit to the Cook Inlet tax liability after the tax ceiling is calculated. The Cook Inlet tax ceiling for oil is zero. This leaves all $12 million in tax credits intact for the producer to apply against the $16 million in production tax liability on the North Slope. As a result, the producer would pay a total of $4 million in production tax under this scenario, or $1 million less than under the existing law.

This scenario is a simplified version of how HB 280 might affect state revenues. Because AS 43.55.011(m) applies to multiple types of credits, and multiple taxpayers, the effects could be significantly more than the $1 million annual figure calculated in this example.

Additional Scenarios and Fiscal Impacts:

The effect of increasing the value of credits for well work in Cook Inlet to 40% under AS 43.55.023(m) is not quantified in this analysis but would reduce tax revenues.

There could be additional reductions in state tax revenues other existing facilities or natural gas pipelines were certified as gas storage and eligible for credits.

Cook Inlet production tax and additional production caused by the injection or withdrawal requirements under this proposal are very unlikely to generate more than a small fraction of the revenue that would be required to fund this credit. This means production taxes from other areas of the state, such as the North Slope would likely be the source of funds to the tax credit fund for the state to repurchase this credit.

FISCAL NOTE

STATE OF ALASKA
2010 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: CSHB 280(L&C)
(H) Publish Date: 2/17/10

Identifier (file name): HB280-CED-RCA-02-08-10
Dept. Affected: DCCED
Title: Natural Gas
RDU: Regulatory Commission of Alaska (399)
Component: Regulatory Commission of Alaska
Sponsor: Hawker, Chenault
Requester: House Labor & Commerce
Component Number: 2417

Expenditures/Revenues (Thousands of Dollars)

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

	Appropriation Required	Information					
OPERATING EXPENDITURES	**FY 2011**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**
Personal Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Travel							
Contractual							
Supplies							
Equipment							
Land & Structures							
Grants & Claims							
Miscellaneous							
TOTAL OPERATING	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CAPITAL EXPENDITURES							
CHANGE IN REVENUES ( )							

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts							
1003 GF Match							
1004 GF							
1005 GF/Program Receipts							
1037 GF/Mental Health							
Other Interagency Receipts							
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2010) cost: 0.0

POSITIONS

Full-time							
Part-time							
Temporary							

ANALYSIS: *(Attach a separate page if necessary)*

The proposed legislation would provide financial incentives for natural gas storage facilities and for exploration in the Cook Inlet basin, and provide general guidance to the Regulatory Commission of Alaska (RCA) on natural gas pricing. Statutes governing the general powers and duties of the RCA would be revised to require the RCA, when considering whether approval of a natural gas supply contract is in the public interest, to (1) recognize the public benefits of a utility's ability to negotiate different pricing mechanisms with different suppliers and maintain a diversified portfolio of gas supply contracts to protect customers from the risks of inadequate supply or excessive costs that may arise from a single pricing mechanism, and (2) consider whether the utility could meet its responsibility to the public in a timely manner should the rate of gas supply contract not be approved.
(ANALYSIS CONTINUED)

Prepared by: Robert M. Pickett, Chairman — Phone 907.276.6222
Division: Regulatory Commission of Alaska — Date/Time 2/8/10 11:30 AM
Approved by: Emil R. Notti, Commissioner — Date 2/8/2010
Commerce, Community, and Economic Development

(Revised 11/6/2009 OMB)

STATE OF ALASKA
2010 LEGISLATIVE SESSION

BILL NO. CSHB 280(L&C)

ANALYSIS CONTINUATION

This legislation would require that certain factors be recognized or considered when the RCA determines whether to approve natural gas supply contracts. The RCA expects to implement the provisions of this legislation with existing resources. The RCA can incorporate this review into the existing review process for natural gas supply contracts.

FISCAL NOTE

STATE OF ALASKA
2010 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 280(L&C)
(H) Publish Date: 2/17/10

Identifier (file name): HB280-DOA-AOGCC-02-08-10
Dept. Affected: Admin
Title "An Act relating to natural gas; relating to a gas storage facility; relating to the Regulatory Commission of Alaska..."
RDU AOGCC
Component AOGCC
Sponsor Representatives Hawker and Chenault
Requester (H) L&C
Component Number 2010

Expenditures/Revenues (Thousands of Dollars)

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

	Appropriation Required	Information					
OPERATING EXPENDITURES	**FY 2011**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**
Personal Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Travel	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contractual	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Supplies	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equipment	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Land & Structures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CAPITAL EXPENDITURES							
CHANGE IN REVENUES ( )							

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1003 GF Match	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1037 GF/Mental Health	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Interagency Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2010) cost:

POSITIONS

Full-time							
Part-time							
Temporary							

ANALYSIS: *(Attach a separate page if necessary)*

Additional work for the Alaska Oil and Gas Conservation Commission resulting from this bill could be managed by existing staff. The agency therefore submits a zero fiscal note.

Prepared by: Jody J. Colombie, Special Assistant I
Phone (907 793-1221
Division Alaska Oil and Gas Conservation Commission
Date/Time 02/08/10 12:00pm
Approved by: Rachael Petro, Deputy Commissioner
Date 2/8/2010
Department of Administration

(Revised 11/6/2009 OMB)

HB 280
Cook Inlet Recovery Act (CIRA) - Overview

Prepared by Representative Mike Hawker's Office

CIRA provides a statutory framework for developing large-scale gas storage facilities and also makes changes to existing Cook Inlet exploration tax credits in order to encourage exploration and development of new gas discoveries.

Gas Storage Facilities

- Incentives include:
  - Land lease and fee exemption for 10 years
  - NEW income tax credit
    - Credit is based on capacity, certified by AOGCC: $1.50/ 1,000 cubic feet (cf) of working storage capacity
    - Maximum credit is $30 million per facility
    - Transferable and can be sold back to the state
  - Expedited/Priority processing of applications by DNR, when reasonably possible
- Incentives apply to gas storage facility that meets minimum capacity and delivery requirements, certified by AOGCC:
  - Minimum Working Storage Capacity: 500 million cf
  - Minimum Daily Delivery Capacity: 10 million cf
- Incentives are available for gas storage facilities that commence operations between Jan. 1, 2011, and Dec. 31, 2015
- All financial benefits and the names of those receiving the benefits are public information
- All financial benefits must be passed on to utilities, which then pass on to consumers
- All financial benefits stop when a project ceases operation
- CIRA also clarifies RCA's role in regulating gas storage facilities

Gas Exploration in Cook Inlet

- Changes to existing credits:
  - Allows 100% of credits earned by explorers in the Cook Inlet to be used elsewhere in the state; current statute requires these credits to be applied only to taxes paid on Cook Inlet production
  - Allows the full amount of the credit to be used in the year issued; current statute allows only half of the credit to be used in one year
  - Provides a 40% credit for exploration within Cook Inlet; current statute contains a variable (30% or 40%) credit based on the proximity of the exploration to an existing well

HB 280 Overview (cont.)
Definitions

Gas storage facility: A depleted or nearly depleted reservoir, aboveground tank, pipeline or other structure used to store natural gas produced offsite and delivered to the storage facility to hold until needed. The owner of the gas — a utility, for example — would inject gas into the facility and would pay the facility operator for storage service.

Working gas storage capacity: The maximum amount of natural gas the storage facility could safely hold for its storage customers.

Cushion gas (also known as pad gas): The volume of gas that must be maintained in the storage facility to provide adequate pressure for operations. The storage operator, not the storage customers, would own the cushion gas.

Native gas: In the case of a nearly depleted reservoir, native gas is the natural gas that exists in the reservoir at the time it is developed for use as a storage facility. Native gas is used as cushion gas to maintain pressurization. If all of the non-native working gas that was injected for storage is withdrawn and native gas is eventually produced, state tax and royalty would be assessed.

Non-native working gas: Natural gas that is produced from another reservoir and delivered to the storage facility and held until needed. For example, a utility could purchase gas from a Cook Inlet producer and have it delivered to the storage facility for safekeeping until the utility needs the gas to meet customer demand. At that point, the utility would instruct the gas storage operator to deliver the quantity of gas required. The utility, not the storage operator, would own the gas in storage. State tax and royalty would be assessed on the non-native working gas when it is first produced and sold to the utility; no additional taxes or royalties would be due when it is withdrawn from storage for delivery to the utility.

HB 280 Overview (cont.)
FAQs

1. What are the minimum requirements for a gas storage facility (GSF) to qualify for financial incentives in the Cook Inlet Recovery Act? Who determines if a GSF meets these requirements?

   In order to qualify for the financial incentives in CIRA, a GSF must have the capacity to store more than 500 million cubic feet of working gas and deliver gas at a rate of at least 10 million cubic feet per day. The Alaska Oil and Gas Conservation Commission (AOGCC) will be required to certify these capacities within six months of receiving an application and provide the certification to the applicant, the Department of Natural Resources and the Department of Revenue.

2. What happens if the GSF stops operating?

   A GSF ceases operations if it doesn't inject or withdraw at least 10 million cubic feet of gas in a calendar year. The operator is required to notify the AOGCC by April 1st of the following year. If this happens, the GSF will no longer be eligible for state lease fees exemptions or tax credits.

3. Sections 4 and 10 of the bill state that gas withdrawn from a GSF is considered to be non-native gas and not considered to be produced until all non-native gas has been withdrawn. What does this mean and why do we need this language?

   This language requires that state follow last-in, first-out accounting rules for gas in a GSF. "Native gas" is any gas that is already in a storage facility and will be subject to existing royalty and production taxes when it is produced. "Non-native gas" includes all gas that is injected into the facility for temporary storage - royalty and production taxes were assessed when it was produced. By including this language, it is clear that non-native gas extracted from a GSF is not taxed twice and native gas is not subject to royalty and production taxes until all non-native gas is withdrawn.

4. Gas storage companies are receiving lease exemptions and tax breaks under CIRA. Are these savings passed on to the consumer?

   Yes. Language in sections 4 and 6 require the owner of a GSF to reflect the savings of any financial benefits enacted in CIRA in their gas storage price.

From: Larry Persily
Sent: Thursday, January 28, 2010 5:13 PM
Subject: RCA and gas storage regulation

I prepared the following report from today's order issued by the Regulatory Commission of Alaska. The commission responded to a request for declaratory judgment from Cook Inlet Natural Gas Storage, which is looking for certainty on the question whether gas storage is or is not regulated by the RCA under state statute.

Larry, 465-6959

RCA says legislative answer would be best decision on gas storage regulation

The Regulatory Commission of Alaska Jan. 28 denied the request from Cook Inlet Natural Gas Storage (CINGS) for a declaratory judgment that gas storage is outside the regulatory jurisdiction of the commission. The RCA essentially said the Legislature is the best place for this decision.

There was no consensus among parties to the docket, with some arguing that state statute requires or at least allows the RCA to regulate a gas storage operation and others contending that state statute does not allow the RCA to regulate a storage operation.

"The most expeditious way to clarify our jurisdiction is through amendment to our statutes, explicitly authorizing us to regulate natural gas storage or exempting natural gas storage from our regulation," the commission stated in its order. "The Alaska Legislature is the only entity that has the power and the process necessary to provide CINGS the immediate certainty it seeks."

CINGS, a newly created subsidiary of TransCanada, is looking at developing a gas storage operation in a nearly depleted reservoir at the Cannery Loop Unit near Kenai. It would like to know before it commits to the project whether it would be directly regulated by the state or indirectly regulated when each utility that contracts for storage requests RCA approval of its costs before passing them on to their customers. State statute does not include "gas storage" in its definition of a utility subject to direct RCA regulation, though some have argued the commission could interpret its laws to assume such authority.

"We find that our statutes do not provide explicit authority to regulate natural gas storage, nor do they definitely set natural gas storage outside of our jurisdictional boundaries," the commission stated in its order. "With no consensus among interested persons on statutory interpretation and the question being a matter of legal interpretation, our own opinion on jurisdiction would hardly be the final word," the commission said.

A legislative decision would avoid the risk that a party could challenge an RCA interpretation of statute, possibly sending the issue to court and delaying development of gas storage for Southcentral gas customers.

"Despite their conflicting conclusions about our jurisdiction, all interested persons agreed that storage in the Cook Inlet area is a serious or even critical need," the commission said.

"Whether it is good public policy or bad public policy to regulate CINGS is not a valid factor in deciding whether we have jurisdiction to regulate CINGS," the commission added.

Rep. Hawker is reviewing the RCA order and will bring forward a proposal to deal with the issue when the Cook Inlet Recovery Act (HB280), co-prime sponsored by Speaker Chenault, comes before House Labor and Commerce Committee.

AlaskaDispatch
News and voices from the Last Frontier

Energy

Gassing up

Rena Delbridge
Dec 27, 2009

Southcentral's 350,000 residents are snug this winter in homes with plenty of heat and Christmas lights twinkling.

But the sense of security fed by light and warmth is a false one in the state's major population area, where utilities are a step or two away from rolling power outages if the weather turns bitter cold -- cold enough to put out of order the complex metal machinery that pushes natural gas through lines and into homes; cold enough to push demand off the charts.

And by the winter of 2011-12, deliverability could be an issue beyond peak demand in the coldest spells.

Natural gas, used to heat buildings and to generate 90 percent of the region's electricity, is probably not going to be available in quantities enough to meet peak demand on cold winter days -- this winter, or next -- under certain scenarios.

Along with deliverability challenges, a recent state geological report shows there's about 10 years worth of gas left in Cook Inlet, should companies choose to invest their global dollars in production for a limited, small market.

One company, a TransCanada subsidiary, wants to build a storage facility to warehouse gas produced in summer months, when demand is one-fourteenth of peak winter loads. The resource could be drawn out in winter.

The company's proposal is a dream come true for some -- a private-sector solution that isn't seeking a dime from the government. All that Cook Inlet Natural Gas Storage, LLC, needs is assurance that the Regulatory Commission of Alaska will allow utilities -- its customers -- to recover storage fees in rates charged to consumers.

But lawmakers, state officials and even utility chiefs could tangle over whether gas storage facilities -- new to the 49th state -- should fall under the Regulatory Commission of Alaska's jurisdiction. If they take too long sorting that out, TransCanada's plans will be delayed -- possibly enough to leave Southcentral facing a nightmare by winter 2012 or 2013.

"On the coldest day of the year, what will we pay to stay warm?" Sen. Hollis French asked. "You'll probably pay anything, which is a bad place to be as a consumer. You don't have an alternate source for your natural gas supply. You want to have some oversight so there's not price gouging at a time when you are most vulnerable."

The problem

To be clear, Cook Inlet isn't near running out of gas next year, or in the next five years. On the contrary, the state estimates there are hundreds of trillions of cubic feet remaining, although that gas is more difficult to access -- and thus, more expensive to produce and purchase.

The real problem is deliverability. Utility and municipal managers, lawmakers and others are seriously concerned that when Southcentral soaks up huge amounts of gas to ward off Alaska's bitter winter temperatures, the supply may not hold.

Municipality of Anchorage Mayor Dan Sullivan drafted an energy task force that's studying the potential for emergencies and running tabletop exercises to test procedures in case of extreme shortages or -- more likely -- breakdowns in the machinery that pushes gas to pilot lights.

"If we had to go to that extent, to call upon people to conserve ... and go to rolling blackouts, at least we have a procedure in place," Municipal Manager George Vakalis said. "We know how to do it."

Since 1969, the liquefied natural gas export plant at Nikiski has provided a buffer for the supply and demand swings -- in essence, offering companies an outlet for gas that the Southcentral market couldn't absorb. However, a shortfall is annual production supply is anticipated in 2012 or 2013. The federal LNG export permit runs out in March 2011, and ConocoPhillips hasn't announced whether it will apply for an extension.

"We're faced with a unique environment in Cook Inlet with the demand swings," said John Sims, Enstar's spokesman. "The LNG facility is very important. It creates incentive for (companies) by having that large, industrial export customer."

ConocoPhillips, financially strapped after the past year's global economic downturn, hasn't said yet whether it will close or sell the facility, turn it into storage, or seek continued exports.

Solution on the table

Cook Inlet Natural Gas Storage, the newly formed TransCanada subsidiary, wants to build a 19 billion cubic foot gas storage facility near Kenai. A member of TransCanada's projec team, Bob Gibb said the company is working on land purchases and, if regulatory issues can be sorted out, is ready to start construction next summer

The timeline is tight, and critical work must be done in summer, Gibb said. He figured the schedule has enough to flexibility to still meet an in-service date for winter 2012-13, if politics delay immediate approval.

Gibb confirmed the company is talking with prospective clients Enstar, an anchor tenant; Municipal Light & Power; and Chugach Electric Association, which is representing two smaller electric utilities, Homer Electric Association and Matanuska Electric Association.

He isn't releasing cost estimates at this point.

CINGS wants to build 20-year contracts with its clients, with warehousing fees to be paid out equally over the full term -- also called levelized rates. The big question is whether the

RCA will allow some certainty that the long-term rates are acceptable, and that the utilities will be allowed to recoup their gas-warehousing costs from customers.

To regulate or not to regulate?

Attorneys, policymakers and company reps packed an RCA meeting room in Anchorage in early December for a daylong workshop on storage. The participation was significant, with nearly all parties involved discussing solutions, potential hangups and how rate payers could fare under different gas storage scenarios.

"We were very encouraged by the workshop," Sims said. "That not only shows the urgency that everyone realizes, but also how willing everyone is to work together and try to resolve the issues."

At the heart of the discussion was whether or not gas storage should fall under the RCA's jurisdiction, which would involve time-consuming hearings but, in return, offer consumers some protection in rates charged.

But the RCA statutes don't allow for regulation of storage facilities that supply to utilities. Instead, the commission's authority rests in regulating utilities that supply consumers, and approving the contracts those utilities make with suppliers to ensure customers are getting a reasonable deal.

TransCanada reps at the meeting said they don't mind being regulated, and in fact, storage operations in the Midwest are regulated. But they need to know, and soon, whether they'll face regulation and the filings, hearings and challenges that come with it and could soak up so much of the construction timeline that the company may have to forfeit next summer.

"There are pros and cons with both," Sims said. "The nice thing about it being regulated is there would be some sort of surety from Enstar's standpoint for rate recovery."

The utility needs to know whether it will be able to recover storage costs in rates -- and if so, to what extent. CINGS needs that assurance, as well.

"We need to have surety ... before we can close on some of the properties and move forward with some of the construction," Gibb said. "It is critical."

Lawmakers step in

Some lawmakers are heading out in front with bills they'll file when the session starts Jan. 19 enabling a storage facility and, ideally, additional drilling.

In December, Sen. Hollis French, an Anchorage Democrat, released a draft of a bill he plans to introduce during the session allowing a substantial tax credit of 20 percent of capital costs for companies who invest in storage to serve Southcentral gas needs. He expects to tack on a caveat once the session starts, enabling the credit only if the storage facility owner agrees to come under the RCA's jurisdiction.

The RCA issue is the biggest one for Southcentral's gas problems, French said.

"At least one avenue is to get away from the gas storage operation, and focus more on the contracts that CINGS strikes with the utilities, which is a function the RCA is far more experienced with," he said.

A farther-reaching bill, the Cook Inlet Recovery Act, was proposed last week by House Speaker Mike Chenault of Nikiski and Rep. Mike Hawker of Anchorage, both Republicans. Their working draft offers incentives for storage, but also smoothes state bureaucratic processes to spur private investment in finding new reserves.

"This bill is narrowly focused on Cook Inlet production," Hawker said. "It's all about the urgency of the issue. We need to address these challenges and address them now ... Every penny of cost relief or credit we can provide here ultimately flows through as savings to consumers. Adding storage, which is critical, is going to add money. It's not going to be cheap."

The bill also included direction for the RCA to consider the consequences of saying no to a matter -- something the commissioners haven't had the authority to do. Beyond that, changes to the commission's authority aren't addressed in the draft, in part because of the potential for prolonged conflict in the Capitol.

"If the extent of the RCA's authority becomes an uncertainty because the legislature has thrown it into the ping pong match, no one is going to move one step forward on any project until that issue is totally resolved," Hawker said.

Chenault said he couldn't say yet whether storage should be regulated.

"But if you have people out there interested in doing it, and you have a need, then the decision needs to be made," he said. "We can't wait around for years. The longer you wait, the less opportunities you have and, probably, the more it's going to cost."

Enstar and CINGS haven't formed opinions on the legislation yet.

"We are moving forward with our contracts as if there were no additional input from the Legislature," Gibb said. "If it comes into being, we'll consider it as it does."

Contact Rena Delbridge at rena_alaskadispatch.com

CORRECTION: This story was updated Jan. 7, 2009, to correct the spelling of Bob Gibb, a member of TransCanada's project team, and to clarify TransCanada's anticipated timeline

ALASKA
Journal of Commerce
Alaska's Paper of Record • Established 1977

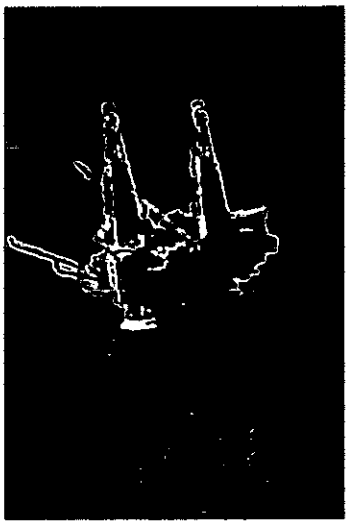
Web posted Friday, June 12, 2009

Lawmakers get another wake-up call on Inlet gas supply

By Tim Bradner
Alaska Journal of Commerce

It's a tough thing to say, but the days will start getting shorter soon and January is only six months away. The usual midwinter cold snap is almost surely in the cards, and the gas distribution system serving consumers and local electric utilities is likely to be strained once again. No one wants their supply of natural gas to be cut when it's minus 20 degrees.

There's nothing very secure, or simple, about the supply of natural gas in Southcentral Alaska, however. Aging gas fields in the region are being depleted and gas wells, many 30 years old, can't produce enough now to guarantee meeting midwinter demand.



Cook Inlet oil and gas platforms supply natural gas to local utilities as well as crude oil for the Tesoro Alaska refinery near Kenai. The platforms are more than 30 years old, and are approaching their economic limits. *Photo/Rob Stapleton/AJOC*

What keeps disaster at bay is the liquefied natural gas, or LNG, plant near Kenai, which stops making LNG in very cold weather so gas can be diverted to the local utilities. The LNG plant may close in 2011, however, when its federal license to export LNG expires.

So far the utilities have no plan B for that possibility, although they are working on one.

There are large reserves of gas on the North Slope, but without a pipeline there's no way to get the gas to the state's largest communities. Studies are now underway by the state for a 24-inch bullet pipeline to bring gas to Southcentral from the Slope but no one knows how much this will cost. It couldn't be finished until 2016 to 2018 in any event.

There's also more gas to be found in Cook Inlet but there's little new drilling, for a complex set of reasons.

State legislators got an earful about all this on June 5, when the Senate Resources Committee, meeting in Anchorage, listened to managers of gas producing companies, utilities, and state and federal officials, as well as private landowners.

State Sen. Bill Wielechowski set a sober tone for the meeting.

"Cook Inlet gas production has declined considerably," he said. "In the last three years it has declined by more than 50 billion cubic feet annually. Current demand is about 140 billion cubic feet per year, so this is significant."

By 2012, annual in-state demand will exceed supply from existing wells. This assumes no export of Cook Inlet gas, Wielechowski said.

"We have three years before we have a supply problem if we look at production from existing wells," he said.

State oil and gas director Kevin Banks said it's almost certain that oil and gas companies will add reserves in the producing fields if they drill more wells.

But petroleum companies told legislators too few new wells are being drilled, and that consumers and local utilities aren't doing enough to promote energy conservation, which is the cheapest was to ease the tight supply situation. Companies also said the Regulatory Commission of Alaska is too focused on price and should weigh energy security for consumers in its decisions as well.

John Zager, Chevron Corp.'s Alaska manager, said Cook Inlet is not attracting sufficient investment capital to offset the reserve declines, and that remaining resources are likely to be in smaller gas deposits that will be more expensive to drill.

Zager said he believes government estimates of remaining reserves in the Inlet are too optimistic. Estimates are that 1.3 trillion cubic feet to 1.7 trillion cubic feet of proven gas reserves remain in producing gas fields.

The State Division of Oil and Gas plans to have an updated estimate of gas reserves by early fall, said Kevin Banks, the division director.

For now, the economics just aren't right for drilling a lot of new production wells. "People have to accept the concept that the (gas) price must be high enough to encourage investment, and there are recent indications that this is not the case. The recent state lease sale in the Inlet was a no-show," in terms of bidding, Zager said.

Zager and Marathon Oil manager Carri Lockhart criticized regulatory agencies for inconsistencies and creating an environment of uncertainty as to whether gas sales contracts with utilities will be approved. The uncertainty that creates is almost as important as the price of gas.

A contract negotiated several years ago with Enstar Natural Gas Co., but rejected by the regulatory commission would have met all of Enstar's needs until 2016, Lockhart said. The utility now has short-term gas supply contracts and after 2011 it will have only two-thirds of the gas it needs under contract, Mark Slaughter, Enstar's gas supply manager, told legislators.

"It's a situation we don't like to be in," Slaughter said.

Lockhart also said regional electric utilities should focus more on power plant efficiency. "There should be dual-fuel capability when new generation capacity is built," she said, an indirect criticism of Chugach Electric Association for its plan to build a new gas-fired power plant in south Anchorage without also adding standby capability to use oil as a standby fuel. Anchorage's city-owned Municipal Light and Power has dual-fuel capability in one of its power plants.

Zager and others said there must be investment in gas storage, facilities that can store gas produced in the summer, when demand is low, for use during peak demand periods in

winter. Chevron and Marathon both maintain some storage capabilities of gas in depleted gas reservoirs for their customers, but this isn't enough to meet the total need.

The LNG plant near Kenai could play a long-term role in storage, or even imports of LNG if the export license ends in 2011.

Dan Clark, ConocoPhillips' asset manager for south Alaska, whose responsibilities include the LNG plant, said it is possible that facilities at the plant could be available for gas storage or even regasification of LNG that would be imported if LNG exports end in 2011.

"It's possible," Clark told the legislators. "There are marine terminal facilities and storage tanks, although added investment would be needed."

Zager said has producers have invested in some storage but in other U.S. states utilities invest in and operate gas storage. Suzanne Gibson, Chugach Electric's gas supply manager, said Chugach, ML&P and Enstar are working jointly to determine how much storage might be needed, but there are concerns as to whether enough suitable underground reservoirs are available, because not all depleted gas reservoirs can be efficiently to store gas.

Above-ground storage could supplement underground storage but that will be costly, she said. The utilities may need state assistance.

Also, gas stored underground in depleted reservoirs is usually withdrawn gradually as used to supplement gas wells through the winter. It's difficult to get large volumes of gas at short notice needed to meet unexpected needs during a cold snap.

Stored LNG is very efficient at meeting this "peaking need," however, because the LNG can be regasified fairly quickly. LNG regasification facilities have been built in many parts of the U.S. to handle mid-winter peaks.

Facilities at the existing ConocoPhillips-Marathon LNG plant could help support a long-term storage role, but some utility managers think the plant's facilities are too big, too aged, to be efficiently used to support a small regional market.

New, smaller LNG regasification units, like those commonly used in the Lower 48, might be more appropriate, said Jim Posey, manager of Anchorage's ML&P.

Storage will help resolve the issue of meeting mid-winter peaks but it's not a solution when overall annual production from the gas fields dips below annual demand. At that point new gas is needed from somewhere, wither from new discoveries, by pipeline from the North Slope, or through imports of LNG.

Summary of the 2006 Southcentral Energy Forum

Sponsored by Alaska Oil and Gas Conservation Commission

Anchorage • Sept. 20-21, 2006

Prepared by Peter Larsen, Pamela Cravez, and Scott Goldsmith
Institute of Social and Economic Research, University of Alaska Anchorage

Why Was There an Energy Forum?

Nearly 70% of Alaskans rely on relatively inexpensive natural gas from Cook Inlet. That gas heats homes and businesses, generates electricity, and fuels industrial processes.

Cook Inlet gas benefits the state economy not only because it provides inexpensive energy for homes and businesses but also because industrial uses of the gas create jobs and add to the local tax base. More than half the gas currently being produced is either processed and exported as liquefied natural gas (LNG) or used to create fertilizer for export.

But growing demand has depleted 80% of the known Cook Inlet gas reserves. Many Alaskans are concerned about where Southcentral Alaska will get affordable energy in the future.

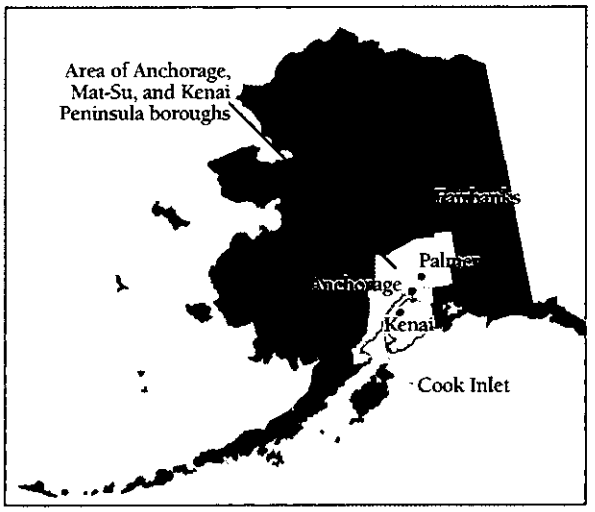
There are big unknowns. Will the Cook Inlet producers look for more gas? When will a natural gas pipeline from the North Slope be built, and will there be a spur line to bring gas to Southcentral? What will future industrial demand be? Will alternative energy sources help offset demand for gas?

In September 2006, the Alaska Oil and Gas Conservation Commission brought community leaders, gas producers, large consumers, geologists, engineers, economists, and the general public together at a two-day forum in Anchorage to talk about the problem and propose solutions for meeting the region's future energy needs.

The commission asked the Institute of Social and Economic Research (ISER) at the University of Alaska Anchorage to summarize forum proceedings. The information presented here is not a product of ISER research. It is a summary of statements, opinions, and projections of those attending the forum.

Why is This Gas "Inexpensive"?

"Inexpensive" natural gas from Cook Inlet means relative to prices of gas in the rest of the country and to prices of other energy sources in Alaska. The price residential customers pay for Cook Inlet gas has more than doubled since 1996—but it remains 30% to 50% below prices in other states, according to ENSTAR Natural Gas Company. It's also far cheaper than the diesel Alaskans without access to natural gas rely on.



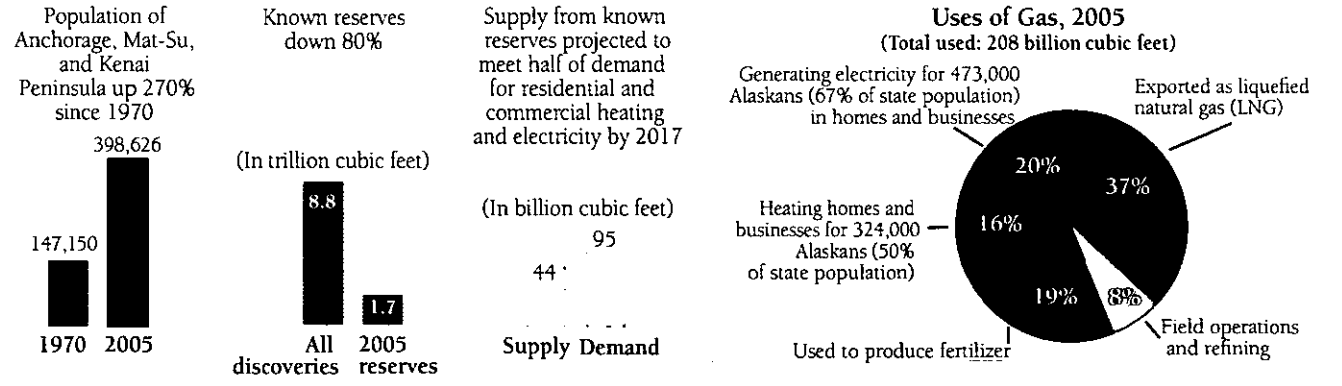
The price of Cook Inlet gas has historically been low because oil companies incidentally found trillions of cubic feet in the 1950s and 1960s, while they were looking for oil. The absence of a ready market for that gas provided Alaskans with a much less expensive energy source, compared with oil, and it made some industrial development possible.

Who are Consumers and How Do They Use Gas?

Most of the consumers are in Anchorage and the Kenai Peninsula and Mat-Su boroughs—where more than 60% of all Alaskans live (see map). That regional population has almost tripled since 1970. Communities along the railbelt north to Fairbanks also use electricity generated by Cook Inlet gas, and some gas is super-chilled to a liquid form so it can be trucked to Fairbanks .

The biggest current uses of Cook Inlet gas are industrial– 37% is liquefied and exported and another 19% is used to produce fertilizer for export. Heating homes and businesses in Southcentral Alaska takes about 16% of production, and another 20% is used to generate electricity throughout Southcentral and into the Interior. The remaining 8% is used for oil and gas field operations and refining oil.

Figure 1. Snapshot of Cook Inlet Natural Gas



Sources: Alaska Department of Labor; Alaska Division of Oil and Gas; Science Applications International Corporation

How Does Cook Inlet Gas Get to Consumers?

Current gas producers in Cook Inlet include Chevron, Marathon Oil, Conoco Phillips, and others. Most, but not all, the gas for heating goes through ENSTAR Natural Gas Company, a major public utility in Alaska and a subsidiary of Semco Energy, headquartered in Michigan. The producers themselves also market a small amount of gas directly to consumers.

ENSTAR is regulated by the Regulatory Commission of Alaska (RCA). ENSTAR and the producers negotiate, with RCA oversight, future prices and conditions for gas delivery from the producing fields to the consumer. The RCA must approve rates ENSTAR proposes to charge consumers.

ENSTAR supplies gas to about 325,000 commercial and residential users and also delivers gas to electric utilities. It has about 3,000 miles of distribution and transmission mains.

Municipal Light and Power and Chugach Electric Association are electric utilities also regulated by the RCA. They generate electricity almost entirely with gas. Together they serve about 473,000 residential and commercial customers from Southcentral into the Interior, either directly or through sales to other electric utilities.

Why Worry?

With the reserves declining, it's become harder to deliver gas to consumers as they need it, on a daily basis. Assuming no new investments in exploration or development, that problem is expected to worsen, especially in the winter. Consultants to the U.S. Department of Energy and others have projected the future demand for and supply of Cook Inlet gas.

The assumptions used in individual studies vary somewhat, but they all show the same general result: that the demand for Cook Inlet gas will soon exceed the current supply, even if industrial uses drop sharply.

Projections by Science Applications International Corporation (Figure 2), a consultant to the U.S. Department of Energy, are based on specific assumptions that other analysts may disagree with. Those include:

- Assumption: that the Agrium fertilizer plant will cease operating in the near future. Agrium hasn't run at full capacity since 2001, and it recently announced it will shut down during peak use winter months. Agrium has identified high gas prices as the main reason for the cutbacks—but high prices are related to short supply. (Agrium is, however, investigating alternatives to gas; see page 7.)
- Assumption: that the federal Office of Fossil Energy in the U.S. Department of Energy will not renew the export license for the LNG facility, which expires in 2009. To have the license renewed, the operator has to show that exporting LNG will not jeopardize local gas supplies.
- Assumptions: that a spur pipeline to carry North Slope natural gas to the Southcentral region will be built by 2015 and that most of the future demand will be residential and commercial, including the proposed Pebble mine in southwest Alaska.
- Assumption: that some industrial uses might be feasible, but that the cost of North Slope natural gas will make the current methane-intensive industrial uses (like producing fertilizer) uneconomic.

The projected decline in gas supply is essentially based on known reserves. Economists would argue that as supply shrinks, prices rise—and that rising prices would ultimately cause the producers to look for more gas. (But in the largely regulated Cook Inlet market, that might not happen).

Is There More Undiscovered Gas?

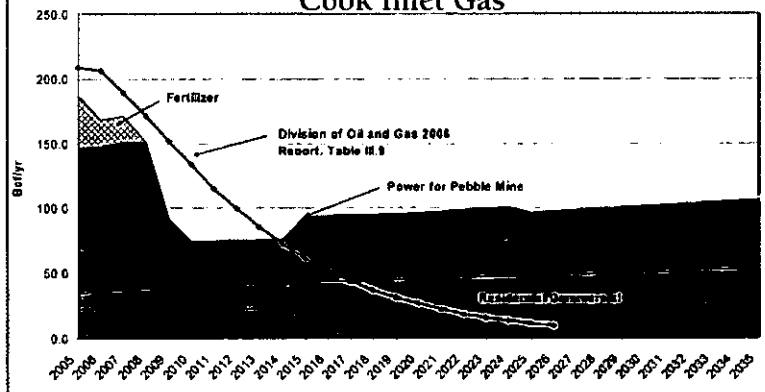
In the 1950s and 1960s, oil companies drilled as many as 30 wells a year in Cook Inlet (Figure 3). They were looking for oil—and found oil as well as trillions of cubic feet of natural gas. Those gas reserves, large enough to last for many years, left no need to look for more.

Then, in the late 1960s, world-class oil reserves were discovered at Prudhoe Bay, on the North Slope, and the petroleum industry's focus shifted away from Cook Inlet. The last commercial gas discovery in Cook Inlet was in 1979 and the last major oil discovery in 1991.

Net gas production—that is, production beyond what the producers re-injected to increase oil recovery—peaked in 1996 at 223 billion cubic feet. By 2005, net production had dropped to 208 billion cubic feet.

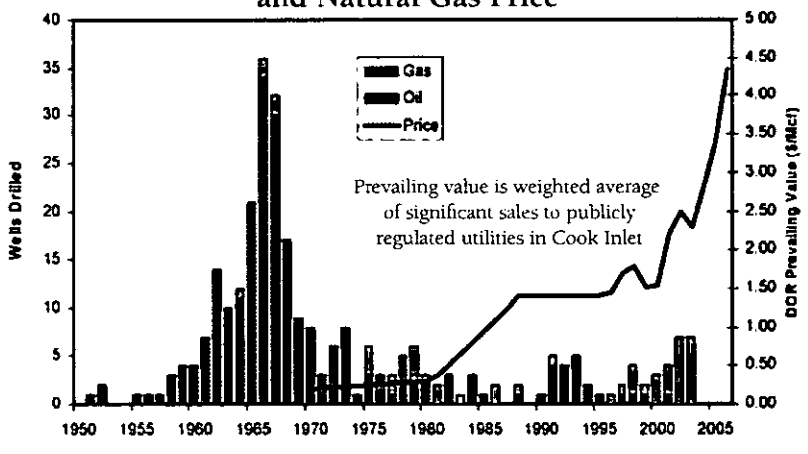
Many geologists think Cook Inlet basin is under-explored, compared with other gas exploration regions. Speakers at the forum said analysis of the distribution of field sizes in the basin suggests there may be large undiscovered fields remaining.

Figure 2 . Projected Supply of and Demand for Cook Inlet Gas



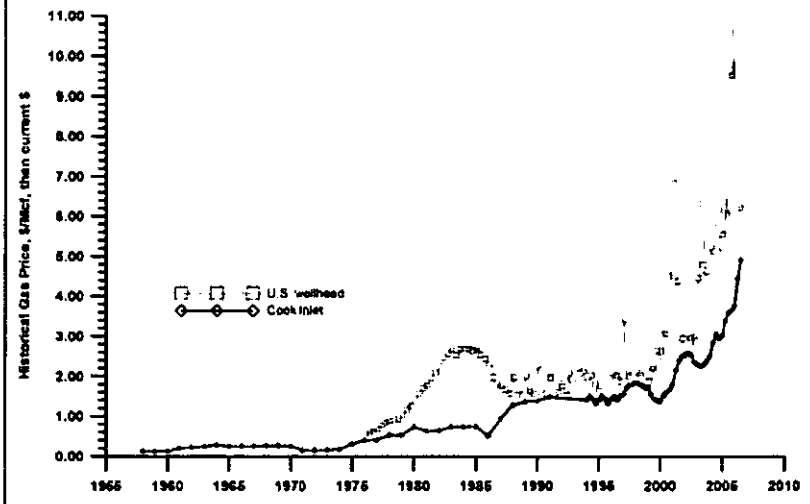
Source: NETL/DOE Study (2006) and Division of Oil and Gas (2006)

Figure 3. Exploration Wells Drilled in Cook Inlet and Natural Gas Price



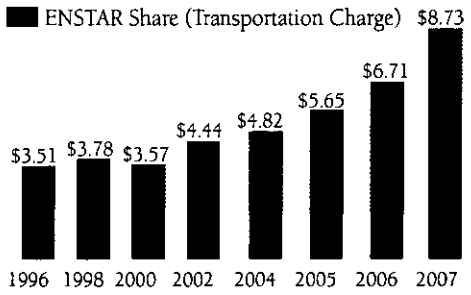
Sources: Alaska Departments of Revenue and Natural Resources; AOGCC

Figure 4. U.S. and Cook Inlet Natural Gas Price
(Wellhead Price per Thousand Cubic Feet, In Current Dollars)



Source: Alaska Department of Revenue and EIA

Figure 5. Residential Natural Gas Price
(Per Thousand Cubic Feet)



Source: ENSTAR Natural Gas Company

But no one is certain how much gas may be left in the basin, because few exploratory gas wells have been drilled there since the 1970s. Data from the Alaska Department of Revenue show that the bulk of the 240 exploration wells drilled in Cook Inlet since 1955 have been for oil. Only in the last five years has there been any focus on locating more natural gas—and that increased exploration coincides with rising gas prices (Figure 3).

The Alaska Department of Natural Resources estimates that 8.8 trillion cubic feet of gas have been found in Cook Inlet basin to date, with 7.1 already produced and 1.7 remaining. The U.S. Department of Energy estimates potential undiscovered natural gas reserves at between 13 and 17 trillion cubic feet. Other estimates are lower, with no analysis conclusively showing where new fields may be located. Whatever the remaining reserves, the level of future exploration will depend on gas prices.

How Have Prices Changed?

As the supply dwindles, the price of Cook Inlet gas has increased rapidly —although not as rapidly as elsewhere in the nation (Figure 4).

The price residential customers pay for Cook Inlet gas roughly doubled between 1996 and 2006, and it will increase another 30% in 2007 (Figure 5).

But that price includes both what the oil companies get for producing the gas and what ENSTAR charges for transporting it to customers.

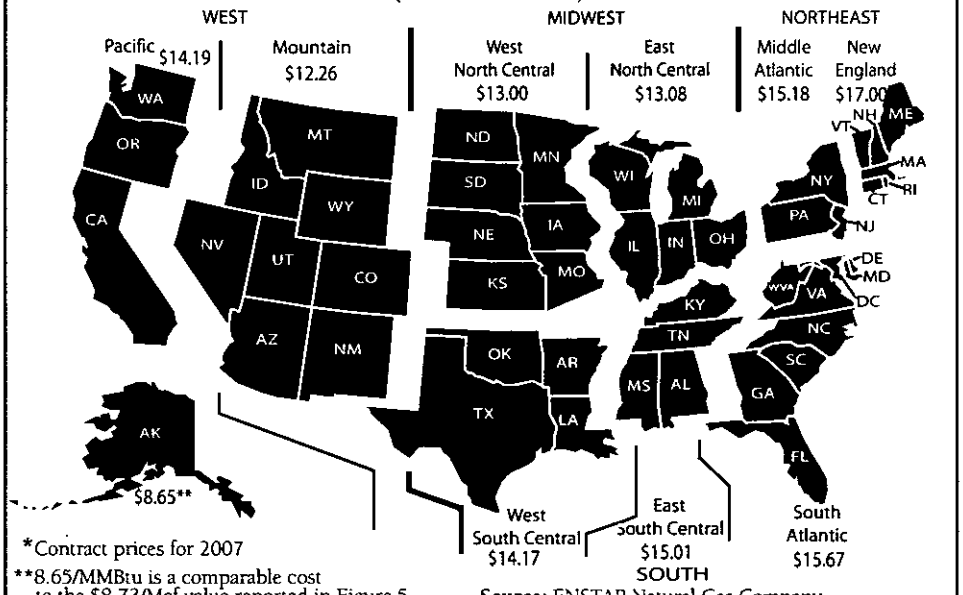
ENSTAR is a regulated utility, and it reports charging about the same (per thousand cubic feet) to transport gas today as in 1996. Virtually all the recent increase in the price to residential customers has gone to the producers.

ENSTAR also reports that despite sharp increases in what Alaskans pay for natural gas, they still pay about 30% to 50% less than other Americans.

Figure 6 compares 2007 contract prices for residential customers nationwide. In 2007 Alaskans will pay $8.65 per million Btus (British thermal unit, a standard energy measurement). Customers in the mountain states and the north-central states will pay $12 to $13. The highest natural gas prices will be in the mid-Atlantic, south-Atlantic, and New England states, where prices are expected to be nearly double the Alaska price.

Natural gas is also much less expensive than alternative ways of heating homes and businesses in Alaska. Figure 7, provided by ENSTAR, shows that natural gas for heating is about one-quarter to one-half the price of diesel, propane, or electricity, as measured by energy content.

Figure 6. Prices of Natural Gas for Residential Customers, 2007*
(Per Million Btu)

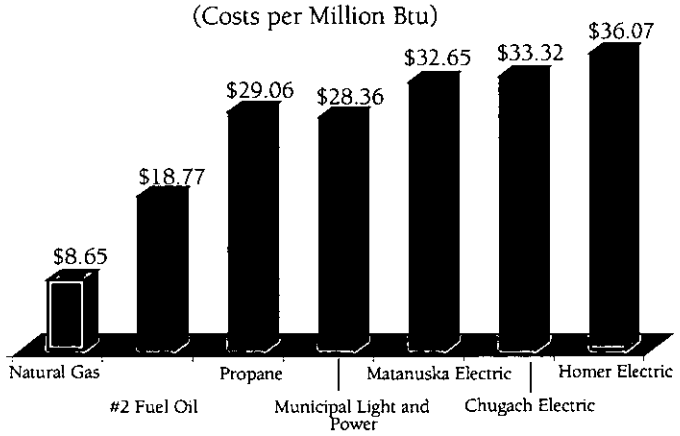


*Contract prices for 2007
**8.65/MMBtu is a comparable cost to the $8.73/Mcf value reported in Figure 5

Source: ENSTAR Natural Gas Company

Figure 7. Comparing Current Costs of Home Heating Sources for Southcentral Alaska

(Costs per Million Btu)



Source: ENSTAR Natural Gas Company

As for the electric utilities using Cook Inlet gas, Municipal Light and Power is not actively seeking new gas contracts now—because it owns part of a Cook Inlet gas field estimated to meet its demand for the next 10 to 15 years. Chugach Electric Association has sufficient gas under contract to meet demand only until 2011.

What Is the Price Headed?

As Figure 8 shows, the Alaska Division of Oil and Gas forecasts that the price of Cook Inlet gas will increase until 2008 and then drop, staying in the range of $6 per thousand cubic feet through 2016. (This forecast takes into account the recent ruling by the RCA.)

Figure 9 shows the division's estimates of the potential range of future demand from residential and commercial consumers, at higher or lower gas prices. The higher the price, the less consumption increases.

What Determines Price?

The price residential customers pay for Cook Inlet gas is actually the average of various prices in several contracts ENSTAR currently has with the producers. The contracts were all negotiated separately, and each has its own terms that can influence price.

In some contracts, for instance, the gas price is linked to oil prices. In two of the most recent contracts, Cook Inlet gas prices are linked to gas prices at what is known as the Henry Hub. That hub is in Louisiana, near where gas supplies from the Gulf of Mexico arrive. It is the pricing point for natural gas futures contracts traded on the New York Mercantile Exchange.

Increasingly, gas contracts in the U.S. are being set in relation to the Henry Hub benchmark price, with transportation and other charges added to that base to determine local prices.

Some analysts believe linking Cook Inlet prices to that hub will stimulate exploration, by raising those prices closer to the U.S. average.

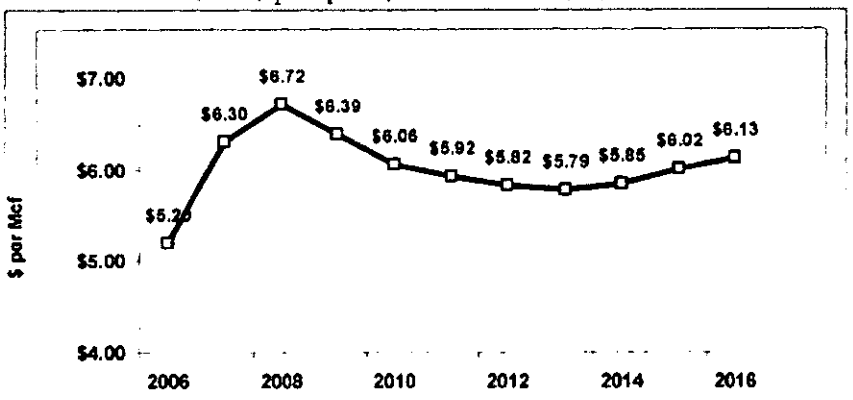
However, application of Henry Hub prices to Cook Inlet gas has been controversial, and the RCA recently rejected a proposed new contract between ENSTAR and Marathon Oil Company, benchmarking a portion of ENSTAR's future purchases of Cook Inlet gas to that hub.

The RCA found that "responsibility for paying gas prices that encourage new gas exploration and production should not rest exclusively with gas ratepayers."

ENSTAR is now in the process of renegotiating that contract with Marathon, which—if successful—would give it enough gas to meet its projected requirements through 2017. Today the utility has enough gas contracted only through 2008.

Figure 8. Projected Price of Natural Gas

(Price per Thousand Cubic Feet)

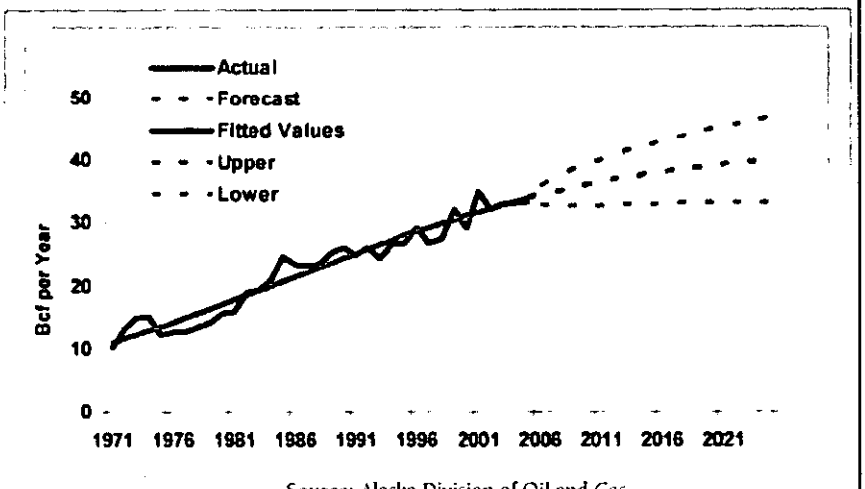


Estimates based on DOE oil and gas price forecasts and four ENSTAR gas supply contracts: Marathon-APL4; Beluga; Moquawkie; Unocal

Source: Alaska Division of Oil and Gas

Figure 9. Projected Residential And Commercial Demand for Cook Inlet Gas

(In Billions of Cubic Feet per Year)



Source: Alaska Division of Oil and Gas

These forecasts are based on the best current information—but it is difficult to predict future costs of natural gas, because all public gas and electric utility contracts are subject to approval by the RCA.

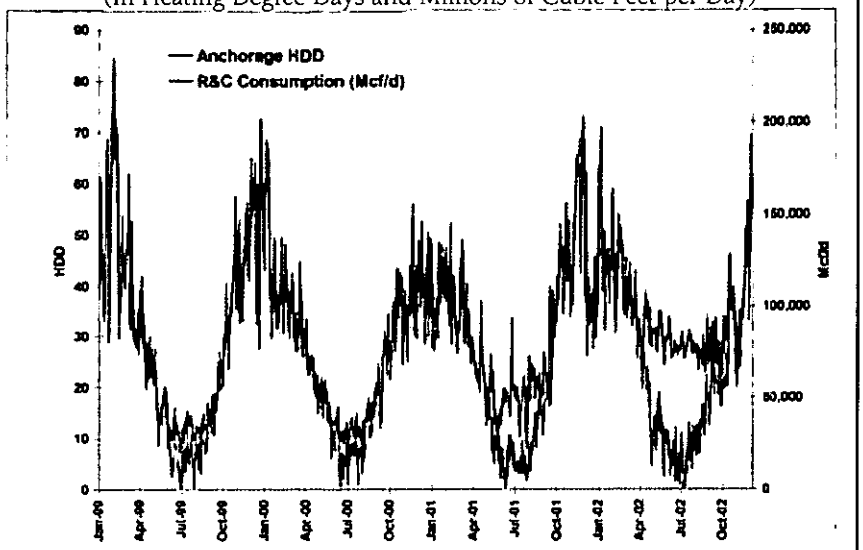
What is the Current Situation?

The Alaska Division of Oil and Gas reports that with gas reserves shrinking, increased residential and commercial consumption in the winter has occasionally outstripped the system's capacity to deliver. Figure 10 shows the sharp winter increases in demand for Cook Inlet gas. Spokesmen for the division say that if no new reserves are added, the number of days when peak demand exceeds the system's capacity will increase as time goes on.

Current industrial users—the Agrium and LNG plants and oil and gas field operations—consume almost two-thirds of the gas produced in Cook Inlet. (See Figure 1). Industry representatives at the forum said that industrial demand for gas is driven by export markets and depends on the availability of cheap gas to use in industrial processes.

Figure 10. Seasonal Residential and Commercial Demand for Cook Inlet Gas, 1999-2002

(In Heating Degree Days and Millions of Cubic Feet per Day)



Source: Alaska Division of Oil and Gas

The fertilizer plant has not run at full capacity since 2001. With the price of gas rising and supplies uncertain, Agrium reported at the forum that it is now making only year-to-year contracts for Cook Inlet natural gas. It is looking for long-term solutions—like coal gasification—to replace Cook Inlet gas.

The other big industrial user is the LNG plant at Nikiski, which currently uses more than a third of the gas produced. However, the plant needs approval from the federal Office of Fossil Energy to export LNG, and its current export license will expire in early 2009. (As of late 2006, no application to renew had been filed.)

To renew the license, the company needs to show that it is in the public interest to extend the contract and that exporting LNG would not jeopardize gas supplies for local consumers. Demonstrating that will become increasingly difficult as the supply of Cook Inlet gas declines.

However, representatives of the producers said at the forum that the loss of these big industrial users would reduce their incentive to explore and, consequently, hurt long-term stability of the supply of Cook Inlet gas

What are Short-Term Solutions?

One short-term way of meeting peak utility demand is temporarily storing gas. Since 2001, producers in Cook Inlet have stored their own gas underground in depleted reservoirs, to help meet utility demand.

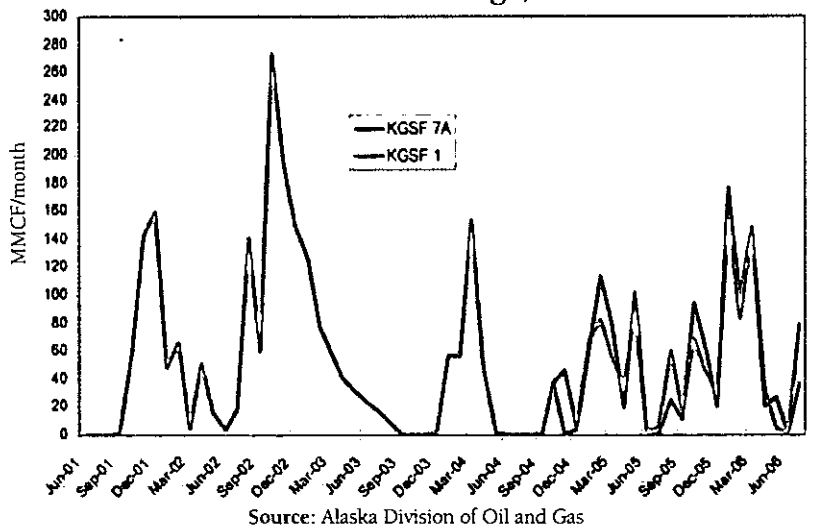
To date the federal Bureau of Land Management has approved three gas storage agreements with Chevron at the Swanson River field; two of those are currently storing and delivering gas. The Alaska Department of Natural Resources and the Alaska Oil and Gas Conservation Commission have approved two gas storage leases for active facilities at Chevron's Pretty Creek field and Marathon's Kenai field.

Figure 11 shows how draw-downs for utility demand from the storage facilities at the Swanson River field vary with the season, spiking in the winter.

Another way of easing short-term supply problems is interruptible contracts (allowing producers to curtail sales when demand is high). Agrium's fertilizer plant uses them to accommodate winter shutdowns. Also, as long as the LNG plant is operating, it can continue its historical role of providing "swing" gas that can be diverted to consumers when needed.

But industry speakers said at the forum that in the long run better solutions are needed—encouraging more exploration in Cook Inlet; bringing gas in from elsewhere (North Slope gas or imported LNG); or examining the feasibility of alternatives to natural gas—ranging from coal to tidal power.

Figure 11. Seasonal Draw-Downs for Utility Demand from Cook Inlet Storage, 2001-2006



Source: Alaska Division of Oil and Gas

Why Isn't There More Exploration?

There is some ongoing exploration in Cook Inlet basin. A number of both established and new companies are looking for oil and gas in the basin, according to petroleum industry presenters at the forum. Chevron, Marathon Oil, Aurora Gas, Forest Oil, and Conoco Phillips are among the Cook Inlet producers exploring for oil or gas.

Chevron reported in late 2006 that it has found about 150 billion cubic feet of gas since 2000, and that Chevron and its partner companies expect to spend $300 to $350 million for exploration and capital projects in Cook Inlet over the next several years.

Newer companies include Benchmark Oil and Gas, which is focusing on Upper Cook Inlet; Pioneer Natural Resources, which has one oil-producing project in Southcentral; and Rutter and Wilbanks, which is operating three projects: the Copper River project (gas), the Northern Lights project (oil), and the onshore Eagle/West Eagle project (oil and gas). Renaissance Resources and Stormcat Energy are also involved in exploration of undeveloped areas.

Many of the smaller companies are staying onshore, according to industry spokesmen, and all companies are affected by the higher costs of exploration in Alaska and the lower price of gas, compared with other areas of the country.

The number of exploratory wells in the past few years falls far short of the numbers in the 1960s, despite rising prices. At the forum, representatives of the gas producers said the price still hasn't offset the high costs of doing business in the inlet. The U.S. Department of Energy estimates the cost of identifying and developing just half the reserves it believes may remain in the inlet (13 to 17 trillion cubic feet) at more than $5 billion, in current dollars.

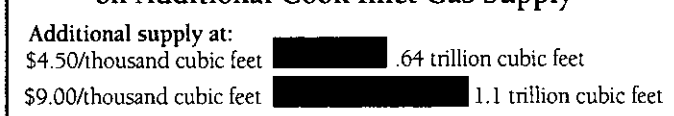
Figure 12 shows the U.S. Minerals Management Service's estimate of how much the supply of Cook Inlet gas would increase, at different wholesale prices for that gas. MMS estimates that at a price of $4.50 per thousand cubic feet, the additional supply might be 0.64 trillion cubic feet. But at double that price, the additional new supply would also nearly double—because the oil companies would have more incentive to explore.

The Cook Inlet producers also argue that they need more access to prospective fields. The producers estimate that between 30% and 50% of the prime exploration areas have restricted access or are entirely off limits, because they fall within protected areas of federal or state conservation units.

Industry spokesmen and representatives of the Minerals Management Service identified other things hindering large-scale exploration in Cook Inlet. Those include aging platforms, lack of a jack-up rig, regulatory matters—including gas well spacing and bonding requirements—and a general lack of 3-D seismic data of the basin. They say that these problems, as well as company reorganizations and the limited sale area in 1997, continue to hinder exploration.

The next Cook Inlet Special Interest lease sales are scheduled for 2009 and 2011.

Figure 12. Estimated Effects of Price on Additional Cook Inlet Gas Supply



Source: U.S. Department of the Interior, Minerals Management Service

What About Tax Incentives?

In 2006 the Alaska Legislature passed the Petroleum Production Tax (PPT), a major revision in the state's method of taxing oil and gas production. Among other things, the new PPT is intended to encourage more investment in oil and gas exploration.

The PPT operates differently on the North Slope and in Cook Inlet. It caps per-unit tax liability for Cook Inlet producers at the level of the old production tax system, during the year before the PPT was passed in April 2006. This means that even if the price of gas or production rises, Cook Inlet producers—current and future—will never pay more than the average per-unit tax rate in April 2006.

In essence, the PPT will not just limit or lower taxes in Cook Inlet—*it should also encourage new exploration and production*. Because the PPT is so new, it's too early to say what effect it might have on future gas supplies.

What are the Alternatives?

What about finding other energy sources or reducing consumption as a means of dealing with falling gas reserves? At the forum Dunmire Consulting discussed alternatives for increasing gas supplies from outside Cook Inlet, reducing consumption, and replacing gas with other sources.

The Dunmire analysis was funded by the Alaska Natural Gas Development Authority, which is a state corporation approved by Alaska voters in 2002 to promote construction of a natural gas pipeline from the North Slope. ANGDA has so far concentrated on plans for some sort of pipeline—either a spur from a main pipeline or a pipeline directly from the North Slope to Southcentral Alaska—to supply in-state consumers with North Slope gas.

Below we just report the alternatives Dunmire Consulting identified. Their order below doesn't indicate feasibility or the length of time they would take to develop, if they were feasible. Some could help ease potential gas shortages relatively soon, but many would have long lead times and uncertain capital costs.

• **Conservation.** If Alaskans conserved more natural gas and electricity, they could save anywhere from 3.0 to 7.5 billion cubic feet of gas a year, according to estimates of Dunmire Consulting. Conservation measures include things like upgrading residential and commercial appliances and improving weatherization of houses and businesses. Some analysts believe Alaskans won't conserve more unless the prices of residential and commercial heat and electricity increase more than they already have.

• **North Slope Gas.** A major uncertainty affecting the future of Cook Inlet gas development is when North Slope gas might be available to Southcentral consumers. That uncertainty makes it more complicated for Cook Inlet producers to decide how much to invest in exploration and development in Cook Inlet and for utilities and other consumers to decide about investing in gas-using equipment.

The North Slope has very large known reserves of natural gas. The North Slope oil producers have said they support construction of a pipeline to carry natural gas to world markets—although by the end of 2006 they hadn't actually committed to building a pipeline.

But at some future time, Southcentral consumers could get North Slope gas either through a spur line from a main pipeline or through a direct bullet line—that is, a pipeline direct from the North Slope to Southcentral. A pipeline bringing North Slope gas to Southcentral could also be enriched with hydrocarbons, to make certain kinds of industrial development feasible.

• **Coal Gasification**. Agrium is investigating a proposal to substitute synthetic gas from coal for natural gas from Cook Inlet. The proposed Project Blue Sky would take coal from Healy in the Interior south by rail, transfer it to barge, and ship it to a coal gasification plant on the Kenai Peninsula. The synthetic gas would be used to produce fertilizer and could also add electricity to the Southcentral power grid.

Proponents say coal gasification allows for efficient capture of concentrated streams of carbon dioxide (CO_2), virtually eliminating emissions of this greenhouse gas. The captured CO_2 could then be used for advanced oil recovery. It's estimated that 13 Cook Inlet oil fields might produce an additional 300 million barrels, through enhanced oil recovery using CO_2.

• **Other Potential Sources of Gas in Southcentral.** The Bristol Bay area and Alaska Peninsula have been estimated to hold anywhere from 7 to 23 trillion cubic feet of gas and the Nenana Basin 3 to 10. It's beyond the scope of this paper to describe how this gas could be brought to market.

• **Import LNG**. Southcentral Alaska could import LNG via the Kenai LNG plant, if the plant were modified to import rather than export LNG. This option would not have as long a lead time as some other alternatives and it would ensure ample supply—but Alaskans would be exposed to world market prices (which are significantly higher than current local prices). A big consideration in the feasibility of this option would be the capital costs of modifying the LNG plant.

• **Coal-Bed Methane**. Coal-bed methane is a form of natural gas that has been identified in the Susitna Basin north of Anchorage. However, the economic potential of coal-bed natural gas has not been established, and its development in Alaska has been controversial.

• **Coal**. Alaska has abundant sources of coal. An objection to coal is that it has higher CO_2 emissions than other energy sources. But the state government sponsored construction of a clean-coal plant at Healy, to help generate electricity. That plant has yet to be operated, because the utility originally planning to use the coal decided not to—but there are now plans to start it up, possibly within the next 18 months. It could offset some demand for gas to generate electricity. Additional coal supplies could further reduce natural gas use for electricity but at a high capital cost.

• **Wind Power**. With support from Chugach Electric, Municipal Light and Power, and others, the Fire Island Wind project is underway, with preliminary permitting and feasibility to be completed by 2011. This project would involve construction of wind turbines on Fire Island, just offshore from Anchorage. The turbines would be able to supply electricity to the Southcentral power grid and help offset demand for natural gas. However, there is uncertainty about how the wind turbines might affect air traffic at Anchorage's nearby international airport.

• **Hydropower**. Chugach Electric already uses hydropower to a small extent. Proponents say use of this renewable resource has relatively few effects on land and water systems. But further development of hydropower in this region would require a long lead time for licensing and a significant amount of capital for plant development.

• **Nuclear Power**. A small-scale nuclear "demonstration project" is being proposed for the community of Galena along the Yukon River. It would start up in 2012. Power from this facility, if it were built, would not be available for Southcentral. However, if it were successful it could promote more local interest in this abundant but controversial source of energy. Problems with nuclear power include long-term land use, the risk of accidents, and nuclear waste storage.

• **Tidal Power**. A demonstration project of tidal power in Knik Arm is scheduled to be under construction by 2015. Tidal power is a renewable resource—but it might affect aquatic life and boat traffic.

• **Geothermal Power**. A geothermal unit began operating at Chena Hot Springs Resort in the Interior in August 2006. Other potential geothermal sites, including Mt. Spurr in Southcentral, are under consideration. Geothermal power is a renewable resource, but the costs of connecting to the local electrical grid may make many sites uneconomic to develop.

• **Distributed Generation.** Distributed generation is the practice of replacing central gas-fired generation with on-site co-generation, or fuel cells. If those systems were fueled by sources other than gas, they could reduce gas consumption. Distributed generation may eventually become a realistic option in Southcentral, as the costs of the technology continue to fall.

What About Economic Contributions of Cook Inlet Gas?

So far in this summary we've talked about the importance of Cook Inlet gas to residential, commercial, and industrial consumers. The gas also broadly contributes to the state economy, because it is an inexpensive source of energy. ENSTAR estimates, for example, that it makes an annual economic contribution of $230 million to the economy.

People attending the forum pointed out that petroleum operations in Cook Inlet also create jobs for Alaskans and add to local tax bases. The economic effects of Cook Inlet gas are most concentrated in the Kenai Peninsula Borough.

In 2006, the oil and gas industry paid property taxes of over $10 million in that borough. The Cook Inlet producers and Agrium made up nine of the top ten taxpayers, with the highest assessed property valuations in the borough. In 2005, the industry supported 1,340 jobs, or 7.4% of borough employment, and 18.7% of total borough payroll.

Petroleum industry jobs also pay well—the average annual wage for oil and gas workers in 2005 was $88,764, compared with the average of $35,148 among all workers in the Kenai Peninsula Borough.

Statistics on the economic contribution of Cook Inlet gas for the other two boroughs were not provided at the forum. But it is clear that the petroleum industry also provides a significant wage and tax base for both Anchorage and the Mat-Su Borough.

What Did We Learn from the Forum?

In the past few decades, residents of Southcentral Alaska have enjoyed abundant gas supplies at low prices. Unfortunately for consumers, demand is now starting to run ahead of supply. Opinions differ on how much more gas is yet to be found in Cook Inlet and on the best way to stimulate exploration for new supplies.

Whether the two biggest current users of Cook Inlet gas—the LNG and fertilizer plants on the Kenai Peninsula—will keep operating in the face of shrinking supplies and rising prices makes the future market for gas uncertain. However, residential and commercial demand for both heating and gas-generated electricity are expected to keep growing.

Uncertainty also surrounds the future sources of gas supply (including gas from the North Slope) and the feasibility of developing alternative fuels that may be able to help offset some of the demand for natural gas. Many of the proposed alternatives come with long lead times and unpredictable costs.

But one thing is clear. Southcentral Alaska needs to find additional supplies of gas, or ways to offset demand. Otherwise, the region may soon see large-scale shortages.

A list of forum participants and transcripts of presentations are on AOGCC's Web site: www.aogcc.alaska.gov

Comments on this summary or the forum can be mailed or sent by e-mail to:

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Alaska Department of Revenue, Tax Division: www.tax.state.ak.us
Alaska Natural Gas Development Authority: www.angda.state.ak.us
Alaska Oil and Gas Association: www.aoga.org
Alaska Oil and Gas Conservation Commission: www.aogcc.alaska.gov
Anchorage Chamber of Commerce: www.anchoragechamber.org
Anchorage, Municipality of: www.ci.anchorage.ak.us/homepage/index.cfm
Aurora Power: www.aurorapower.com
Benchmark Oil and Gas: www.benchmarkoil.se
BP: www.bp.com
Chevron: www.chevron.com
Chugach Electric Association: www.chugachelectric.com
Conoco Phillips: www.conocophillips.com/index.htm
Cook Inlet Regional Citizens Advisory Council: www.circac.org
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ENSTAR Natural Gas Company: www.enstarnaturalgas.com
Kenai Peninsula Borough: www.borough.kenai.ak.us
Matanuska-Susitna Borough: www.matsugov.us
Municipal Light and Power: www.mlandp.com
National Energy Technology Laboratory:
www.netl.doe.gov/technologies/oil-gas/index.html
Pioneer Natural Resources: www.pioneernrc.com
Regulatory Commission of Alaska: www.state.ak.us/rca
Science Applications International Corporation: www.saic.com
Stormcat Energy: www.stormcatenergy.com
U.S. Department of the Interior, Minerals Management Service:
www.mms.gov/alaska/re
Usibelli Coal Mine: www.usibelli.com/index.html
Information on Coal to Liquids and Fischer-Tropsch refining processes:
www.aidea.org
Cook Inlet Energy Supply Alternatives Study available at:
www.angda.state.ak.us
Kenai Peninsula Borough information on Cook Inlet oil and gas:
www.cookinletoilandgas.org

Acknowledgments

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Jody Colombie and Ceresa Tolley at the AOGCC provided the forum with logistical support and helped the authors collect and disseminate information from the proceedings.

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Finally, the authors thank all the forum participants for taking the time to discuss this important issue.

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Whittier
Sunrise
Hope

TO: Representative Craig Johnson
Representative Mark Neuman
Co-Chairmen, House Resources Committee

FROM: Representative Mike Hawker

DATE: February 3, 2010

RE: House Bill 280

I request that House Bill 280, the Cook Inlet Recovery Act (CIRA), be scheduled for a hearing in the House Resources Committee at your earliest convenience. CIRA would provide incentives for developing gas storage facilities and make changes to our current tax incentives for gas exploration in the Cook Inlet.

House Bill 280 is currently in the House Labor and Commerce Committee and scheduled for hearing on Monday, February 15th. If possible, I would respectfully request that HB 280 be scheduled, pending referral, for the House Resources next week.

I expect to see a House Labor and Commerce CS next Monday and will provide you with a current version of the bill and revised sponsor statement as soon as they are available. I have attached the current work draft and accompanying sectional, a Sponsor Statement, a few simple overview documents, and some background materials for your review. Please feel free to contact me or my legislative aide, Juli Lucky, if you need any additional information.

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