

SB

290



Official Business

ALASKA STATE LEGISLATURE

SENATOR THOMAS H. WAGONER

- Member, Resources
- Member, Community & Regional Affairs
- Member, World Trade

Session: January – May

State Capitol, #427

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Interim: May – December

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Sponsor Statement

SB 290 – Tax Credit to Drill Wells in Cook Inlet

Sub-Cretaceous (or Jurassic zone) drilling, often referred to as “deep drilling” is one area that has not been explored offshore in the Cook Inlet, due in large part to the extremely high costs involved and lack of equipment available for deep drilling.

This bill establishes an exploration credit for the first three persons (explorers) and further defines that the explorers repay the state, in the event of successful development, 50% of those tax credits.

There are only two sections to this bill.

Section one amends the existing credits by establishing a “stampede” for 50%, 75% and finally 100% credit for exploration in the Cook Inlet.

Section two adds a new subsection to the statutes which establishes the rules for the “Cook Inlet Stampede”. Only the first three qualified and unaffiliated persons (explorers) that bore into the sub-Cretaceous zone get the credits.

- First one gets 100%, second one gets 75%, and third one gets 50%.
- Can only get credit for one well per person (explorer)
- Commissioner makes determination on amount of credit if more than one person is eligible for a credit
- If exploration results in production, person will repay 50% of the credit they received.
- Determination of “sub-Cretaceous” drilling is to be made by the commissioner.

SS SB 290: 3/29/10: maj



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Sectional Analysis

SB 290 – Tax Credit to Drill Wells in Cook Inlet

Section 1. Amends AS 43.55.025(a) (tax credits against the production tax for exploration) by adding a new subsection (5) 50, 75 or 100 percent of total exploration expenditures.

Section 2. Amends AS 43.55.025 by adding a new subsection (m) that provides for the new tax credits in Section 1 (new subsection (5)) for exploration drilling into the sub-Cretaceous zone by the first three persons.

Sets out that the first person receives 100% exploration expenditures credit, the second receives 75% exploration expenditures credit and the third receives 50% exploration expenditures credit.

Further establishes that a person can receive credit for not more than one exploration well.

In the event that more than one person qualifies, authorizes the commissioner to identify credit amounts for each person.

Also sets out circumstances for repayment of 50% of the credit if the exploration results in development.

Finally, establishes that determination of whether it is in the sub-Cretaceous zone rests with the Commissioner of Natural Resources.

SA SB 290: 3-29-10: maj



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SB 290 – Tax Credit to Drill Wells in Cook Inlet

Identified Issues with SB 290 (3-29-10)

1. Clarify that credits are to apply only to offshore exploration.
2. Change definition from “Sub-Cretaceous” to “pre-Tertiary”.
3. Consideration of expanding exploration credits to total of 6: 3 for activities from Jack-up Rig and 3 for activities from existing structure (platform).
4. Consideration of defining “transportation” as exploration cost to clarify transport of jack-up rig to/from field as allowable cost.

Credits & Deducts available for a jackup rig brought to Cook Inlet.

1. Exploration Tax Credit under AS 43.55.025:

a. 30% of the cost of surface prep, drilling, casing, cementing and logging an exploration well in Cook Inlet if the well is three miles or more from an existing well, or the well target is certified by DNR as a distinctly separate exploration target, before the well is spudded.

or

b. 30% of the cost of surface prep, drilling, casing, cementing and logging an exploration well in Cook Inlet if the well is not less than 10 miles outside the outer boundary as delineated on July 1, 2003, of any unit that is under a plan of development, certified by DNR before the well is spudded. If a dry hole, abandonment costs within 18 months after the well was spudded,.

or

c. 40% of those costs, if both conditions above are met.

The Reg's at 15 AAC 55.360(b)(4) distinguish whether or not the explorer owns the drilling rig. If the explorer does not own the rig, transportation costs to bring the rig to the state, including mob & de-mob and rig operating costs at the contract rates paid are eligible for the credit, if the well otherwise qualifies.

If the explorer owns the rig, the transportation costs to bring the rig to the state are added to the net book value of the rig, which is charged to eligible wells based on hours or days of use for all wells drilled by the rig. (This means if the explorer owns the rig, or owns a part of it – they don't get to write off the whole rig cost on one well.)

A rig owner who operates the rig on contract to other explorers would not be eligible for the credits under AS 43.55.025. The explorer must hold an interest in the well or exploration project. Explorers "renting" a jackup rig and crew would be eligible for the credit for the contract amounts actually paid and for the cost of supplies, fuel, etc. actually paid for by the explorer in connection with a given exploration well. General administrative, management and overhead costs are not eligible for the exploration credit.

Testing, stimulation and completion costs are now eligible costs for the credit under changes enacted by ACES. There are proposed draft regulations by the department to clarify these as allowable for the credit if necessary to appraise the well for its oil or gas production potential.

Transportation of the rig back out of the state after completion of exploration work might be an issue under current regulations.

October 1, 2009

Gary A. Rogers

2. Qualified Capital Expenditure Credit under AS 43.55.23 – 20% of qualified capital expenditures.

If a well does not qualify for the AS 43.55.025 credit, it might still qualify for the 20% qualified capital expenditure credit. Under proposed Lease Expenditure Regulations, de-mob out of the state does not qualify.

If the AS 43.55.025 credit of 30% or 40% is claimed for the well, then the 20% credit would not apply.

3. Deduction as a lease expenditure: transportation of the rig to the state, mobilization and rig operating costs would qualify as a deductible lease expenditure at contract rates paid, or based on net book value allocated to the activities the rig is employed in, if owned outright. The tax rate is 25%, in addition to the value of the credits above, so there is a potential of 65% cost recovery from the State – 40% credit plus 25% tax deduction or loss carry-forward credit.

If no other taxable oil or gas production, the 25% deduction may be converted to a carried-forward loss credit under AS 43.55.023 and used in a subsequent year.

4. Small Producer Credit. If the explorer has taxable production, but less than 50,000 BOE's per day, the explorer is eligible for a \$12,000,000 small producer credit under AS 43.55.024(c).

5. Cash Repurchase of Credits by the State. The exploration credits, the qualified capital expenditure credits and the carried-forward loss credits may be purchased by the state for cash, if the requirements under AS 43.55.028 are met (no unpaid delinquent taxes owed the state, no production tax liability under AS 43.55.011(e), average daily production of less than 50,000 BOEs, additional qualified capital investment or successful bids on state leases equal to or credit than the credits being purchased, for example).

6. Other. A recent Advisory Bulletin (# 2009-02) allows a company that acquires through a merger or acquisition, transferable tax credit certificates held by a dissolved company, may also qualify for the cash purchase by the State, if the acquiring company meets all the conditions and stands in the shoes of the company that originally obtained the tax credit certificates.



March 30, 2010

Senator Thomas Wagoner
26th Alaska Legislature
State Capital – Room 427
Juneau, Alaska 99801-1182

Email: Senator_Tom_Wagoner@legis.state.ak.us

RE: Senate Bill No. 290

Dear Senator Wagoner,

Escopeta Oil Company (“EOC”) is very excited to learn about the referenced Bill that you have introduced. As you know, one of the largest impediments to new exploration is the financial risk of the first well. Your Bill will significantly reduce that risk and spur new era of exploration and production in the Cook Inlet.

EOC is the lessee and unit operator of the Kitchen Lights Unit (“KLU”) in the mid-Cook Inlet, just south of the producing North Cook Inlet Gas Field. Both of these offshore units are in the Kenai Peninsula Borough. The KLU is currently the largest unit in the Cook Inlet, encompassing nearly 84,000 acres. Escopeta predicts the KLU contains approximately 440 million barrels of recoverable oil and 5 trillion cubic feet of natural gas. In addition to these recoverable reserves, it is estimated that the Kitchen Thrust Fault Trap (located in the western part of the KLU) to have an additional 830 million barrels of oil and 4 trillion cubic feet of natural gas of possible reserves. Initial production after platform and infrastructure implementation could be approximately 75,000 barrels of oil and 300 million cubic feet of gas per day, from the KLU anticlinal feature alone.

EOC has the majority of all permits already in place to drill the first KLU well to a depth sufficient enough to test the Cretaceous and Jurassic as required by SB 290. Should SB 290 be passed, EOC will amend its plans on the drilling depth to a bottom-hole depth that will penetrate and test these formations. With the passage of SB 290, EOC will commit to the delivery of a jack-up drilling rig to the Cook Inlet by August 1, 2010. The jack-up drilling rig will be mobilized from West Africa and will take approximately 45 days to reach the Cook Inlet, allowing ample time to drill the first well before the end of this year. Please allow this letter to register Escopeta Oil as the first entity that will qualify for the 100% credit provided for by SB 290.

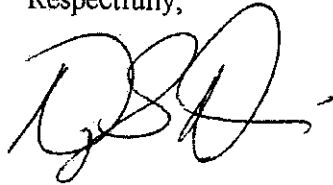
March 30, 2010

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As you are aware, there has not been an offshore exploration-drilling rig in the Cook Inlet for close to 20 years. Once this jack-up rig reaches the Cook Inlet, it is likely to remain for several years, drilling much-needed offshore exploration and development wells. I sincerely believe this Bill will result in new exploration, jobs to Alaskans, and much-needed deliverability from new oil and gas reserves.

Thank you for your foresight and service to Alaska and its people. Please feel free to forward this letter to your colleagues in support of this Bill.

Respectfully,

A handwritten signature in black ink, appearing to read 'D. Davis', with a stylized flourish at the end.

Danny S. Davis
President

Cook Inlet Oil and Gas Activity 2009-2010

