SCOMM

144:19

REPRESENTATIVE ERIC CROFT

HB 223—The Gasline Now Act
Sponsor Statement
"Build the line or pay the fine"

The Gasline Now Act is a useful tool for guaranteeing construction of a gas pipeline from the North Slope, encouraging exploration for natural gas, and for filling the state's structural budget deficit until that pipeline gets built. HB 223 allows Alaska to negotiate from a position of strength.

In recent years, each of the major North Slope producers has invested billions of dollars in overseas liquefied natural gas projects to bring foreign gas into the U.S., but for 30 years they have been unwilling to invest in an Alaska pipeline. Many people fear that the producers are sitting on Alaska's gas and developing foreign gas first. Delaying the Alaska gasline increases the oil companies' profits, but it hurts American consumers and the Alaskan economy.

The Gasline Now Act charges a fee for storing Alaska's gas in the largest gas fields, and the fee goes away once a pipeline is completed. Once gas is flowing, a company who paid the fee can get their money back as a credit against the severance tax they pay on the natural gas shipped in the line. To qualify for the credit, a producer must commit to sell or ship their gas down the pipeline.

Currently, explorers have little incentive to search for new gas reservoirs because there is no way to get the gas to market. Because HB 223 encourages timely construction of a pipeline, producers will have more reason to search for new gas. The fee only applies to gas in units leased before 2002 that have more than 1 trillion cubic feet of known gas resources, so any new gas finds will not be subject to the fee.

The Gasline Now Act will create a stable fiscal structure for Alaska in the years leading up to the completion of a natural gas pipeline by bringing in around $900 million a year until the pipeline is built. This money is necessary to pay for the increased demand on Alaska's roads, schools, public safety and other services during the construction phase of the project, and leftover money can be invested to provide a cushion for the state in future economic down years.

HB 223 is an effective means to encourage timely construction of a pipeline, increased exploration for North Slope natural gas, and to bridge the state's fiscal gap between now and the time revenues come in to the state from the sale of North Slope gas. Alaska and Alaskan jobs have been put on hold for too long. The Gasline Now Act puts Alaska's destiny back in Alaska's hands.

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FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB 223
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Revenue
Title: An Act Relating to the Taxation of Natural Gas Reserves
RDU: Taxation and Treasury
Component: Tax Division
Sponsor: Croft, Crawford
Requester: House Committee on Ways and Means
Component No.: 2476

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	•	•	•	•	•	•
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	1,010,280	1,010,280	1,010,280	1,010,280	1,010,280	1,010,280

FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY2006) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

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

*See note on page 2.

This bill seeks to create a new tax to be levied on Alaska's known gas resources as defined in, and subject to the exemptions of, the bill. Estimates of gas resources have yet to be determined, however, according to the Department of Natural Resources, Division of Oil and Gas 2004 Annual Report, about 33,676 billion cubic feet of natural gas could be subject to the tax under the proposal. The tax would be repealed when the gas on which the tax is levied is transported to market.

Assuming 33,676 billion cubic feet are subject to the tax, a $.03 tax on each 1,000 cubic feet of natural gas would yield revenues of approximately $1,010 million per year until the gas is transported to market under conditions specified in the bill. When a gas export project is complete and the gas is marketed,

Prepared by: Robynn Wilson, Michael Williams, and Cherie Nienhuis — Phone 269-1019
Division: Tax Division — Date/Time 1/4/06 4:00 PM
Approved by: Tom Boutin, Deputy Commissioner — Date 1/6/2006
Agency: Department of Revenue

(Revised 9/7/2005 OMB)

ANALYSIS CONTINUATION

lessees will be allowed to claim a credit for certain of the taxes paid under this legislation with the following limitations: (1) In any year, the credit is limited to half of the lessee's production taxes on gas exported from the slope; (2) Taxes paid pursuant to this legislation before the lessee made an irrevocable commitment to either ship or sell the gas do not qualify for the credit; and (3) Any credit not used by 2030 expires.

*Administration costs are difficult to estimate. On its face, it could be a very simple tax to administer, requiring about 1/4 of a tax technician a year and some time from the State Petroleum Property Assessor. The bill specifies that DOR will determine the volume of taxable gas after consultation with the Department of Natural Resources and the Alaska Oil and Gas Conservation Commission. Having three agencies involved in the determination of gas reserve estimates may unduly complicate the already uncertain science of reserve estimation and could result in legal challenges. *The bill specifies that no taxes will be levied on reserves of less than one trillion cubic feet, and there are at least two fields where reserves are estimated to be just about one trillion cubic feet, which could trigger an expensive conflict about whether taxes of $30 million a year were owed for each field*. Combining this with other potential legal challenges, the defense of the assessment could run very high.

At a minimum, the DOR State Petroleum Property Assessor would need $100,000 per year for contract expertise and administrative review for the purpose of determining taxable gas volumes. A tax technician at $14,000 (.25 FTE) per year would also be required. Expenses in the first year of implementation are estimated to be $50,000 for DOR personnel and $85,000 for support from the Department of Law in the development and establishment of regulations.

The above costs do not cover expenses incurred as a result of legal challenges.

Once the gas is being marketed, there will be additional costs incurred by the department for the purpose of determining the amount of credit to be applied to production tax liabilities. It is highly unlikely that these costs will be incurred prior to FY2012; therefore, these costs do not appear on this fiscal note.

Alaska State Legislature

House of Representatives

Representative Harry Crawford -- District 21
Representative Eric Croft -- District 25

HB 223—The Gasline Now Act

The Gasline Now Act is a useful tool for encouraging construction of a North Slope gas pipeline by charging a fee to gas producers for not producing Alaska's gas and refusing to ship gas or build a gas pipeline.

Once it's built, the Gasline Now Act goes away.

The fee ends when gas first flows through a pipeline, either an All-Alaska line or the Canadian line, with at least 2.0 billion cubic feet per day (bcfd) from the North Slope to a commercial market.

Any producer can get all of their fees back if they commit to sell or ship gas.

A producer can get a credit for fees paid under the Gasline Now Act if the producer makes a commitment to sell or ship gas down the pipeline that actually gets built.

The credit will be applied against the production tax owed by the producer for gas shipped down the pipeline.

The earlier they commit, the more credit they earn.

The credit is equal to the amount of fees paid from the time the producer makes the commitment to sell or ship until the gasline is built.

The credit will be applied against no more than 50% of the producer's production tax until the year 2030 or until the total amount of credit is repaid, whichever comes first.

A producer can avoid the fees altogether.

Any producer unwilling to ship their gas down a pipeline can relinquish its taxable leases back to the state for re-lease to a producer willing to cooperate in the pipeline process.

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The Gasline Now Act will encourage exploration.

The fee only applies to gas in units leased before 2002 that have more than 1 trillion cubic feet (tcf) of known gas resource (Prudhoe Bay and Point Thompson). The fee does not apply to new gas finds regardless of size. Currently, explorers have little incentive to search for gas because there is no way to get any gas to market. HB 223 gives an incentive to build a pipeline that will provide all North Slope producers a way to get gas to market and thereby encourage them to look for more.

The amount of taxable gas is determined with a formula set out by Exxon in 1997 to determine the quantity of marketable gas in a lease. It only includes gas that should be marketed but does not include natural gas liquids shipped down the TAPS pipeline, gas used to power production facilities or gas used for re-injection to enhance oil recovery.

The Gasline Now Act creates a stable fiscal structure for both industry and Alaska

By attaching the credit to a producer's production tax, producers can count on a reduced and stable tax rate until 2030. The credit will smooth any future changes in the severance tax by lessening the blow to producers of future tax increases.

The Gasline Now Act will stabilize Alaska's fiscal situation by bringing in $850-950 million in gasline revenue starting in 2007 to pay for increased demands on state services during pipeline construction. Money from the Gasline Now Act can be used for new schools, roads and public safety officers and can be invested to provide a cushion for the state in future economic down years.

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HB 233 Additional Background

What gas leases would be subject to this tax:

- Traditional natural gas fields, not gas hydrates, coal bed methane, etc.
- Gas in leases more than 10 years old
- Gas in an approved oil and bas unit before January 1, 2002
- Fields larger than 1 trillion cubic feet of known gas resources

What gas leases would not be subject to the tax:

- Any gas not yet discovered or unitized
- Gas consumed as fuel within the oil and gas unit
- Natural gas liquids to be transported via the oil pipeline
- The State's royalty share of gas

Estimate of gas reserves subject to tax

(source: DNR O&G Division 2004 Annual Report)

Kuparuk River Unit	1.15 Tcf	
Prudhoe Bay Unit	24.53 Tcf	
Point Thomson	8.00 Tcf	
Subtotal	**33.68 Tcf**	
Equivalent in Mcf	33,676,000	
Less Royalty Reserves	4,216,000	*not taxed in proposed CS(O&G)*
Gas in Taxable Leases	29,460,000	
Annual tax per Mcf	$0.03	
Annual Tax Estimate	**$883,800,000**	

Alaska State Legislature

House of Representatives

Representative Harry Crawford -- District 21
Representative Eric Croft -- District 25

HB 223 Gasline Now Act

Details

Section 1. Creates the storage fee.

Sec. 43.58.210. Tax on known gas resources.

- $0.03 per mcf
- Estimated $960 million in annual revenue

Sec. 43.58.220. Property subject to tax.

- (a) – The fee applies to "known gas resources" excepting gas described below.
- (b) – The fee does not apply to:
  - gas hydrates
  - Coal bed methane or other non-conventional gas
  - CO_2 or other non-hydrocarbon gas
  - Undiscovered gas within a lease
  - Gas used for fuel to run the facilities on the lease
    - The five year limit prevents a lessee from deducting estimate amounts of gas to be used for fuel for the life of the lease
  - Gas liquids shipped down TAPS.
- (c) – The fee only applies to gas in leases that meet certain criteria.
  - Only gas that has been discovered but not marketed for ten years will be taxed.
  - Gas must be in a lease that was in a state approved unit before 2002 (the fee will not apply to new exploration).
  - Gas must be in a unit with at least 1 trillion cubic feet of gas.

Sec. 43.58.230. Determination of volume of taxable gas.

- (a) – Revenue will consult with DNR and AOGCC to determine the amount of taxable gas each year.
- (b) – If the lessees within a unit can agree on how to allocate the taxable gas, then the Dept. of Revenue will use those allocations.

E-mail: Representative_Harry_Crawford@legis.state.ak.us, Representative_Eric_Croft@legis.state.ak.us

- (c) – If the lessees cannot agree to allocations, then Revenue can allocate in one of the following ways:
  - Revenue and lessees come to an allocation agreement
  - Based on gas in place under each specific lease
  - Based on how much gas is left in the unit
  - Based on surface area each lessee hold within the unit
- (d) – Revenue can let DNR or AOGCC allocate the taxable gas

Sec. 43.58.240. Returns and payment of tax.

- (a) through (e) Describes the method of payment and other technicalities of submitting returns and making the fee payments to the state.

Sec. 43.58.250. Regulations.

- Directs the Department of Revenue to adopt regulations to address
  - Preparing lists of property to be taxed,
  - Noticing lessees the amount of gas to be taxed,
  - Procedures for appeal, putting the burden of proof on the appellant, and
  - Certification of the final tax roll and any supplemental tax rolls.

Sec. 43.58.295. Definitions.

- Creates definition of "known gas resources."
- Defines other terms for the purpose of this act.

Section 2. Creates the credit.

Sec. 43.55.027. Credit against tax as it applies to certain natural gas production.

- (a) –Allows a credit against the lessee's severance taxes due for the fees charged in the Gasline Now Act.
- (b) –Allows lessees to claim and take the credit.
- (c) –Fees paid under the Gasline Now Act can begin to be repaid after the pipeline is built as long as:
  - (1) the lessee has agreed to sell or ship gas
  - (2) the pipeline they agreed to sell to or ship on is the pipeline that is in operation, and
  - (3) the agreement that made the lessee eligible for the credit is actually the agreement it is shipping under.
- (d) –Defines the total amount of credit allowed and how much can be repaid at a time.
  - (1) The credit is applied against the lessee's monthly severance tax payment.
  - (2) Each month, the credit can be no more than 50% of the severance owed in that month.

  - (3) The amount of credit allowed as the amount of money a lessee pays to the state after they make a qualifying agreement to ship or sell the gas until the pipeline is built.
- (e) –The credit ends at the end of the year 2030 whether or not all of the fees paid in have been refunded.
- (f) –Conforms the definition of lessee to the other sections of the bill.

Section 3. Termination of the Gasline Now Act.

- The Gasline Now Act fee sections are repealed upon completion of a 2bcf/day gas pipeline or combination of pipelines from the North Slope to either tidewater or the North American natural gas pipeline system.
- The credit provisions are not repealed.

Section 4. Surrender lease option.

- A lessee can avoid paying the fees under the Gasline Now Act for a particular lease if it gives that lease back to the state before the end of the calendar year 2006.

Section 5. Severability.

- This act is severable.

Section 6. Effective Date of the termination of the Gasline Now Act.

- See section 3.

Section 7. Effective date of lease surrender.

- A lessee can surrender its lease immediately upon passage of this act.

Section 8. Effective date of other sections.

- The Gasline Now Act takes effect January 1, 2007 so as to allow lessees time to prepare the shipping or sales agreements that would qualify them for the credit.

Memorandum

TO: House Ways and Means Committee,
Representative Bruce Weyhrauch, Chair

FROM: Representative Eric Croft

DATE: April 26, 2005

RE: HB 223—Re-injection and duty to develop

In yesterday's hearing, Representative Samuels asked two important questions concerning the Gasline Now Act that warrant further explanation.

1. Is gas used for re-injection to enhance oil recovery exempt from the fee?

No. Gas used for re-injection can still be sold at a later date, and there are non-marketable gasses that can be used for maintaining well pressure. The Gasline Now Act bases the determination of the amount of gas subject to the fee on the methodology set out by Exxon in 1997 in a letter to the Alaska Oil and Gas Conservation Commission in which Exxon describes how it determines the amount of "hydrocarbon gas available for major gas sales." In this methodology, non-hydrocarbon gas, mostly carbon dioxide, is not included in the amount of "hydrocarbon gas available for major gas sales." This non-hydrocarbon gas can be successfully used for re-injection to enhance oil recovery and to maintain well pressure and will not be subject to the fee. If a producer chooses instead to use a portion of the "hydrocarbon gas available for major gas sales" for re-injection, then that gas will still be subject to the fee.

2. Is the lessees' duty to *find* or to *develop* resources under lease?

According to oil and gas attorney Spencer Hosie who is under contract with the state, a lease can be terminated not only for a failure to find resources, as Michael Hurley of Conoco Philips stated, but also for failure to develop the resources. To overcome the failure to develop issue, the state can either bring a lawsuit or implement a more direct incentive to get the lessees to develop our gas. Because lawsuits take years to reach a verdict, they are an ineffective means to keep the producers from delaying the gasline. The Gasline Now Act gives the producers an imminent reason to stop delaying its construction, and it helps the state pay for the infrastructure and other necessary services in the build-up to gasline construction.

How the Gasline Now Act affects Alaska's ten year fiscal situation

Fiscal Year	Gasline Now Act revenue	Total Projected Gasline Revenue	Gasline Revenue without Gasline Now Act	Gasline Now credit	Projected Gasline Revenue Less Credit	Other Unrestricted General Purpose Revenue	General Fund Approp.	Total Revenue without Gasline Now Act	Total Revenue with Gasline Now Act	Fiscal Gap without the Gasline Now Act	Fiscal Gap with the Gasline Now Act	Total Annual Benefit of Gasline Now Act
2005	0.0	0.0	0.0	0.0	0.0	2946.9	2720.5	2946.9	2946.9	226.4	226.4	0.0
2006	0.0	0.0	0.0	0.0	0.0	2664.0	2665.0	2664.0	2664.0	(1.0)	(1.0)	0.0
2007	960.0	0.0	0.0	0.0	0.0	2287.7	2665.0	2287.7	3247.7	(377.3)	582.7	960.0
2008	960.0	0.0	0.0	0.0	0.0	1779.5	2665.0	1779.5	2739.5	(885.5)	74.5	960.0
2009	960.0	0.0	0.0	0.0	0.0	1684.4	2665.0	1684.4	2644.4	(980.6)	(20.6)	960.0
2010	960.0	0.0	0.0	0.0	0.0	1615.8	2665.0	1615.8	2575.8	(1049.2)	(89.2)	960.0
2011	960.0	0.0	0.0	0.0	0.0	1543.3	2665.0	1543.3	2503.3	(1121.7)	(161.7)	960.0
2012	0.0	383.0	0.0	(66.0)	317.0	1480.3	2665.0	1480.3	1797.3	(1184.7)	(867.7)	317.0
2013	0.0	864.0	0.0	(148.0)	716.0	1415.7	2665.0	1415.7	2131.7	(1249.3)	(533.3)	716.0
2014	0.0	915.0	0.0	(152.0)	763.0	1418.9	2665.0	1418.9	2181.9	(1246.1)	(483.1)	763.0
2015	0.0	963.0	0.0	(157.0)	806.0	1354.9	2665.0	1354.9	2160.9	(1310.1)	(504.1)	806.0
												0.0
Total	4800.0	3125.0	0.0	(523.0)	2602.0	20191.4	29370.5	20191.4	27593.4	(9179.1)	(1777.1)	7402.0

in millions

Assumes construction of a gas pipeline to be competed in 2012 with passage of the Gasline Now Act

Assumes construction of a gas pipeline to be competed in 2020 without passage of the Gasline Now Act

LEGAL SERVICES

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MEMORANDUM February 24, 2006

SUBJECT: Draft CSHB 223( ) (Work Order No. 24-LS0037\T)

TO: Representative Eric Croft

FROM: Jack Chenoweth
Assistant Revisor

You have from this office a draft Committee Substitute for House Bill 223( ), offered as a response to your request for a measure that is "textually identical" to the recently-submitted initiative identified by the Division of Elections as "GAS2." The bill differs from the initiative in the following respects, although it would be my contention that the variances between the sponsor substitute, if enacted, and the initiative in the form in which it has been filed should not be sufficient to void disqualification of the initiative under the "substantially the same measure" test of article XI, section 4, of the state constitution:

-- in the title clause describing the authorized tax credit, the bill uses the phrase "sale and delivery" (page 1, line 4) where the initiative uses "sale or shipment"; the relevant text provision (proposed AS 43.55.027(c)'s first line) refers to "sale and delivery";

-- again, in the title clause, the bill includes (page 1, lines 5 and 6) a clause containing reference to the "collection, handling, and use of disputed revenue derived from the tax"; the initiative omits the material;

-- the last clause of the title in both refers to the Act's effective date; the effective date of the initiative is determined by the first clause of the fourth sentence of article XI, section 6 of the state constitution:

> **Enactment.** . . . The lieutenant governor shall certify the election returns. ***An initiated law becomes effective ninety days after certification***, is not subject to veto, and may not be repealed by the legislature within two years of its effective date. It may be amended at any time. . . . .

consequently, the initiative's bill sections 8 (contingent effective date of the initiative's section 4), 9 (immediate effective date of certain provisions), and 10 (January 1, 2007, effective date for remainder of the initiative) are, and would surely be treated as,

ineffective provisions; the comparable provisions of the sponsor substitute are based on the initiative's date choices, even though those are ineffective;

-- the text of the provisions added under AS 43.58 by the draft bill and the initiative are congruent except that the section captions of AS 43.58.210 of the bill and the initiative differ: in the sponsor substitute, the reference is to "leases having taxable gas," the phrase actually used in AS 43.58.210(a); in the initiative, the caption refers to "known gas resources," the phrase that appears in the original bill (HB 223); please appreciate that section catchlines (i.e. section headings) are, by statute, not part of the statute law of this state;[1]

-- the text of the provisions added under AS 43.55.027 by the draft bill and the initiative are virtually congruent except that,

-- in AS 43.55.027(c)(1)(A), the bill corrects a manifest error in the initiative's reference to "AS 43.48.210";

-- in various places in AS 43.55.027(c), the bill draft substitutes spanned-references that conform to the style of the legislative drafting manual without change of the references' contents and substitutes references to "subparagraph(s)" at places where the initiative incorrectly refers to "paragraph(s)";

-- the bill revises the lead-in verbiage to (c)(1)(B)(i) and (ii) to avoid an unnecessary replication of references to "open season"; and

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[1] The operative provisions that make the exclusion are AS 01.05.006 :

> **Adoption of Alaska Statutes.** The bulk formal revision of the laws of Alaska which was authorized by AS 24.20.070 and prepared under the direction of the Alaska Legislative Council and published by The Michie Company, legal publishers, of Charlottesville, Virginia, and titled "Alaska Statutes," as set out in the 47 titles of the Alaska Statutes, ***but not including*** the table of contents, indexes, citations to Alaska Compiled Laws Annotated, 1949, and session laws, chapter, article, ***section***, subsection, and paragraph ***headings***, annotations, collateral references, notes, and decisions, is adopted and enacted as the general and permanent law of Alaska.

and AS 01.05.031(b), setting out editorial responsibilities of the revisor of statutes:

> (b) The revisor shall edit and revise the laws for consolidation without changing the meaning of any law in the following manner:
>
> . . .
>
> (2) ***change the wording of section*** or subsection ***titles***, or delete subsection titles, and change or provide new titles for articles, chapters, and titles; . . . .

-- the bill, in AS 43.55.027(d), retains a reference to "binding transportation ***service*** agreement described in (c)(1) because, in fact, that is what (c)(1) describes: the initiative omitted the word "service" in that phrase;

-- the bill sets out, as a separate bill section -- bill section 5 -- the "contingency notification" provision that triggers the repeal of the reserves tax under the sponsor's substitute's bill section 4;[2] the initiative contains a like provision but sets it out as a separate sentence within the "effective date of repeal and notice" provision of the initiative's bill section 8; separate treatment as set out in the bill conforms to the treatment of this material as described in the legislative drafting manual (Drafting Manual at page 36 and Appendix XXXII);

-- the lease surrender provisions of the respective section 6 of each of the bill and the initiative are the same;

-- the escrow provisions -- section 7 of the sponsor substitute and section 5 of the initiative -- are substantially similar; textually, the draft has been conformed to the initiative even though this section of the initiative is not without problems; the bill omits the word "on" that appears in the first sentence of the initiative ("In an action or appeal brought *on* by one or more taxpayers . . . ") and substitutes "cumulated" for the initiative's use of "culminated" in a reference to "interest", both instances of correction of manifest errors; in addition, the sponsor substitute, but not the initiative, retains treatment of the material in subsections rather than setting it all out within one section, and marginally changes the order of the content of the initiative's last sentence;

-- the concluding four bill sections of each measure are not substantially different except that, as earlier noted, section 8 of the initiative includes the "contingency notification" language that appears separately in bill section 5 of the sponsor substitute.

*

In my judgment, the lieutenant governor (and the courts, if judicial review of the decision of the lieutenant governor is sought) should find that the draft Committee Substitute for House Bill 223( ) constitutes substantially the same measure as the recently-submitted initiative.

Under AS 15.45.210, the lieutenant governor, with the concurrence of the attorney general, is responsible for determining whether an Act of the legislature is substantially the same as a proposed initiative.[3] The test of how similar a measure enacted by the

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[2] It is the differing treatment given to the "contingency notification" provision between the sponsor substitute and the initiative that accounts for the additional bill section in CSHB 223( ).

[3] AS 15.45.210 provides:

legislature and an initiative must be for the legislative measure to operate to invalidate the initiative was set out in *Warren v. Boucher*, 543 P.2d 731 (Alaska 1975). The *Warren* court noted:

> . . . [T]he legislative act need not conform to the initiative in all respects, and . . . the [constitution's] framers intended that the legislature should have some discretion in deciding how far the legislative act should differ from the provisions of the initiative. The question, of course, is how great is the permitted variance before the legislative act becomes no longer substantially the same.
>
> Upon reflection we have concluded that the legislature's discretion in this matter is reasonably broad. . . .

The court fashioned the following as a general test:

> . . . [i]f in the main the legislative act achieves the same general purpose as the initiative, if the legislative act accomplishes that purpose by means or systems which are fairly comparable, then substantial similarity exists. It is not necessary that the two measures correspond in minor particulars, or even as to all major features, if the subject matter is necessarily complex or requires comprehensive treatment. The broader the reach of the subject matter, the more latitude must be allowed the legislature to vary from the particular features of the initiative.

543 P.2d at 736. Recently, in *State v. Trust the People*, 113 P.3d 613 (Alaska 2005), the court explained the application of the *Warren* decision:

> *Warren* developed a three-part test to determine whether a proposed initiative and legislation are substantially the same: A court must first determine the scope of the subject matter, and afford the legislature greater or lesser latitude depending on whether the subject matter is broad or narrow; next, it must consider whether the general purpose of the legislation is the same as the general purpose of the initiative; and finally it must consider whether the means by which that purpose is effectuated are the same in both the legislation and the initiative.

> **Determination of void petition.** If the lieutenant governor, with the formal concurrence of the attorney general, determines that an act of the legislature that is substantially the same as the proposed law was enacted after the petition had been filed, and before the date of the election, the petition is void and the lieutenant governor shall so notify the committee.

Id. at 621. Notwithstanding editorial and textual differences between the two documents, the reserves tax is, I would submit, "necessarily complex" and, in the development of a bill to displace the initiative, the legislature, under the court's discussions, enjoys latitude to vary from the measure that was circulated and submitted. I am reasonably confident that the legislature's passage of CSHB 223( ) would constitute enactment of "substantially the same measure" so that its passage and becoming law as an Act of the 24th Legislature would void the initiative and displace it from the November 2006 general election ballot.

JBC:lmb:med
06-156.med

Alaska Oil and Gas Association

AOGA

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Phone: (907)272-1481 Fax: (907)279-8114
Judith Brady, Executive Director

Date: March 6, 2006

To: House Special Committee on Oil & Gas

RE: HB 223

The Alaska Oil & Gas Association (AOGA) is a non-profit trade association whose 17 member companies represent the majority of oil and gas exploration, production, transportation, refining and marketing activities in Alaska.

AOGA is strongly opposed to the concept of oil or gas reserve taxes and therefore opposes House Bill 223, which would impose a gas reserve tax on North Slope fields.

HB 223 would create, in terms of monetary impact, one of the most massive new taxes in the United States, and reflects a basic misunderstanding of how mega projects are developed, financed and approved. The $20 plus billion gas pipeline project is unique in its size, complexity and risk.

HB 223, which is touted as a way of spurring the development of a natural gas pipeline, only adds to the economic risk of this project and the potential of putting the project at risk. The fact is no project can be taxed into existence. A project can be taxed out of existence.

We appreciate your consideration of our comments on HB 223.

Sincerely,

/s/

JUDITH M. BRADY
Executive Director

Testimony Regarding Particular Aspects of HB 223, a
Gas Reserves Tax Bill

Jack Griffin
ConocoPhillips Alaska Inc.

Before the
House Oil and Gas Committee
March 7, 2006

Mr. Chairman, members of the committee:

Good afternoon. I am Jack Griffin, Vice President, External Affairs, for ConocoPhillips Alaska, Inc. Thank you for allowing my company the opportunity to present further testimony on HB 223, a bill described by its sponsors as creating an incentive for companies with rights in certain State oil and gas leases to move forward on developing a North Slope gas project.

Mr. Chairman and members of the committee, ConocoPhillips presented testimony both last year and earlier this year in opposition to this bill. My purpose today is to clarify, perhaps, some confusion regarding the effect this bill would have on ConocoPhillips, a company that not only possesses all of the incentives necessary to move forward on a North Slope gas project, but one that in fact has taken every reasonable step within its power to do so.

Mr. Chairman, as you and the other members of this committee well know, ConocoPhillips has reached an agreement with the Administration on the base fiscal and other terms that we need to move forward on a North Slope gas project. We reached an agreement in principle on October 21, 2005, and worked diligently over the following weeks to resolve outstanding technical and drafting issues. ConocoPhillips now has a deal with the State that it is willing to use as a basis for moving to the next phase of the project.

Our agreement with the State is the culmination of a multi-year effort, following our $125 million cost study, to move the North Slope gas project to the next phase of development. ConocoPhillips took a leadership role in seeking from you a reauthorization of the Stranded Gas Development Act, which has led directly to our contract with the State; ConocoPhillips took a leadership role in obtaining several critical pieces of federal legislation that will help bring greater predictability and efficiency to the federal permitting process, as well as—we hope—lower the cost of debt for the project; ConocoPhillips took a leadership role in advancing an application to the State under the SGDA; and obviously we have taken a leadership role in crafting—and finalizing—an appropriate fiscal contract for the project.

We believe the time has come to move to the next phase of North Slope gas development. We are ready and willing to take that step.

HB 223, however, undermines our gas development efforts by penalizing ConocoPhillips and other North Slope producers for taking the very steps that the Administration and this legislature have urged us to take to advance the North Slope gas project.

Specifically, and in contrast to testimony previously provided to this committee, there is nothing ConocoPhillips itself can do, under this bill as it is currently written, to avoid imposition of HB 223's new tax, short of surrendering the billions of dollars it has already invested in its leasehold interests at Prudhoe Bay.

At a previous hearing on this bill, it was suggested that ConocoPhillips could avoid this new tax by selling its gas, or by committing its gas to a project under an open season. In fact, that is not the case. This tax is automatic and unavoidable. If we started welding steel and laying pipe tomorrow, we could not avoid it.

Supporters of this new tax have claimed it will be refunded if the North Slope producers move forward with a gas project. We believe this claim is inaccurate and misleading. The amount of ConocoPhillips' obligation is likely to substantially exceed $200 million per year over the next ten years. Under the proposed legislation, these tax dollars will not be refunded until perhaps ten to twenty-five years in the future, without any allowance for the time value of money. That, coupled with limitations on the amount that can be refunded each month, as well as a final cut-off date for refunds, guarantee that only a fraction of the tax that is paid will actually be refunded.

Indeed, the ConocoPhillips' obligation to pay the tax continues even if a gas project is delayed for reasons beyond its control, such as State or federal inaction. More specifically, the project can not move forward without appropriate State and federal permits, but there is no guaranteed date by which these permits must be issued. In fact, if this bill becomes law, the State will actually have an incentive to delay the project simply to force North Slope producers like ConocoPhillips to continue to pay this punitive tax. It is difficult to imagine a more destructive tax policy for the State to adopt. We urge you to reject it.

In closing, I would like voice our belief that the bill raises additional, significant, legal and policy issues, including issues under both the State and federal constitutions. Obviously we have not tried to address all of those issues in my comments today.

Thank you for considering our views.

Alaska Oil and Gas Association

AOGA

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TESTIMONY TO THE HOUSE SPECIAL COMMITTEE ON OIL & GAS

ALASKA OIL AND GAS ASSOCIATION

March 7, 2006

Mr. Chairman and Members of the Committee, good evening. My name is Judy Brady and I am the Executive Director of the Alaska Oil and Gas Association ("AOGA"), a private, nonprofit trade association whose 17 member companies account for the majority of oil and gas exploration, development, production, transportation, refining, and refined-products marketing activities in Alaska.

Thank you for this opportunity to appear before you again this session.

AOGA is strongly opposed to the concept of oil or gas reserve taxes and therefore opposes House Bill 223, which would impose a gas reserve tax on North Slope fields.

HB 223 would create, in terms of monetary impact, one of the most massive new taxes in the United States, and reflects a basic misunderstanding of how mega projects are developed, financed and approved. The $20 plus billion gas pipeline project is unique in its size, complexity and risk.

HB 223, which is touted as a way of spurring the development of a natural gas pipeline, only adds to the economic risk of this project and the potential of putting the project at risk. The fact is no project can be taxed into existence. A project can be taxed out of existence.

We have been asked if AOGA has reconsidered our opposition to the concept of reserve tax legislation, in light of the fact that an initiative to enact a gas reserves tax has been certified for the 2006 General Election ballot.

The answer to that question is NO. AOGA continues to strongly oppose the concept of gas reserve tax legislation for the reasons outlined in our submitted testimony. Any legislation that would remove the initiative from the ballot would suffer from the same flaws that lead us to oppose HB 233.

The many difficult and complicated actions that must take place to build this mega-project simply will not be influenced or hurried because of a threat of retaliation in the form of a huge punitive tax. In fact, as we have said, a punitive tax is both counter-productive and unnecessary.

Positive progress continues to be made according to all public reports. Governor Murkowski has announced that a contract establishing fiscal terms for a gas pipeline will be available for public review and legislative action in the near future. He has announced his plans for a special session to take action on the gas contract.

We believe that as Alaskans see positive progress in the many complicated and difficult policy issues to be addressed, they will also agree that a gas reserve tax is both unnecessary and counter-productive.

The common goal is to build a gas pipeline. AOGA will continue to support each positive step that ensures that goal is accomplished. A gas reserves tax is not a positive step.

Thank you, Mr. Chairman, for allowing us to make this testimony on behalf of AOGA and its members.

Testimony of Ken Konrad
BP Exploration (Alaska) Inc.
to
House Oil & Gas Committee
March 7, 2006
on
HB 223

Mr. Chairman and members of the committee, my name is Ken Konrad. I am Sr. Vice President - Gas for BP Alaska. Thank-you for the opportunity to be here today to talk to you regarding the gas reserves tax.

BP does not support a gas reserves tax. I know that comes as no surprise to members of this committee.

We believe this bill is bad policy – bad for industry and bad for Alaska. Furthermore, it de-stabilizes Alaska's fiscal regime at the very moment Alaska is trying to attract massive oil and gas investments. Staggering levels of investment are needed from the major and also to some extent independent oil and gas companies to help secure a 50 year oil and gas future on the North Slope.

That future is anchored by the gas pipeline but it also requires significant additional ANS investment to stem the disturbing ongoing rate of oil decline to keep oil production at economic levels. That future requires a stable and competitive fiscal regime.

All our time and energy over the past six months has been dedicated towards finalizing a Fiscal Contract with Alaska. We strongly believe that is the best means to advance a project.

Simply stated, a gas reserves tax makes no sense – you don't tax projects into existence.

It seems the gas reserves tax and many of the other "gas now" ideas that have cycled through Alaska for many, many years are born out of frustration. Frustration driven by the incorrect perception by some that companies have been "warehousing" the gas.

As we sit here today poised to secure a gas pipeline deal supported by all three major producers, it is worth revisiting what has really occurred with ANS gas, how it has been conserved and put to good use and how Alaska has benefited by allowing market forces to guide ANS gas development.

From the outset, I'll remind you that BP's business is producing and selling oil and gas. We don't make money by not producing and not selling oil and gas. The so called "warehousing" of gas makes no sense for BP or its shareholders. In BP, if projects are commercially viable and if the risk / reward balance is right, those projects get funded. If they are not, they don't.

Let's, with the benefit of hindsight, look at the Alaska gas facts.

The initial plan for Prudhoe Bay gas was to build an overland pipeline to U.S. markets in the early 1980's. BP with other industry participants invested hundreds of millions of dollars towards a project that didn't work. That project would have transported ANS gas at a cost of $4 - $5 / mcf to be sold into a market averaging $2 / mcf that would have yielded a negative netback for both the resource owners and the State. It made no economic sense and was not advanced.

Through the 1990's, various LNG ideas were studied by all three major producers as well as others. Millions were spent. These LNG projects would have yielded a netback price for resource owners and the State near zero or at best, slightly positive. None of these LNG ideas made economic sense and they did not advance.

But let's not just talk about what hasn't happened and what won't happen. Let's talk about what has happened and what will happen with ANS gas.

A series of very large gas related investments have occurred at Prudhoe Bay over many years. These investments, costing billions of dollars and generating thousands of jobs, increased the oil recovery from Prudhoe by more than 3 billion barrels (energy equivalence of more than 18 TCF of gas) generating many billions of dollars of State revenue.

[see attachment]

Other North Slope fields have made many similar, albeit smaller gas related investments with similar benefits – more jobs, higher oil recovery and more State revenue.

The combination of technological innovation and allowing natural market forces to work has enabled wealth creation and benefits for both Alaska and industry. At the same time, populist gas schemes that would have effectively given Alaska's gas away without value were avoided.

Today, a modern, high pressure, large diameter pipeline as proposed by BP and the other major ANS resource owners, in partnership with the State, can bring another round of benefits from Alaska's gas.

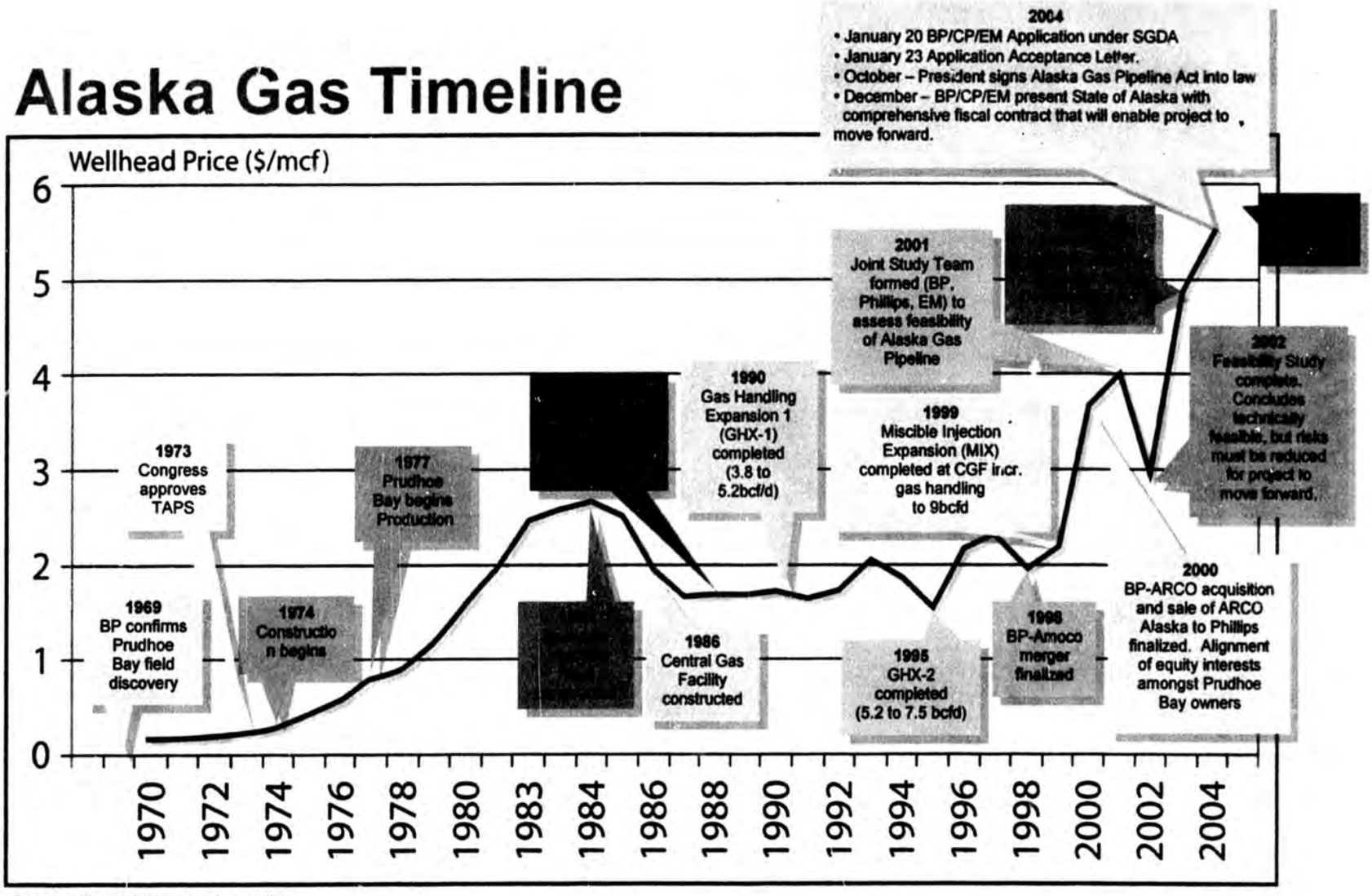
It would yield a reasonable netback price for the gas, create thousands upon thousands of jobs, generate billions of dollars in State revenues and create a new industry in Alaska. An industry exploring for, and developing, both oil and gas. An industry that with significant additional investment, can create another 50 years of oil and gas activity on the North Slope.

The stars are aligned. The State and all 3 major producers are aligned behind a single ANS gas export project – both as resource owners and as equity partners. The opportunity to advance an economically efficient gas pipeline is at our doorstep.

This Legislature will soon have an opportunity to review, and I hope support, a Fiscal Contract that will advance a gas pipeline.

Thank you for the opportunity to testify. I'd be happy to answer any questions.

Alaska Gas Timeline



Prices per Energy Information Association

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

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

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

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

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

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

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

Alaska State Legislature, Committee review, Challenged and Non-Conventional Resources
April 11, 2006, Robert Hunter Testimony

Good morning; Mr. Chairman and members of the Committee, my name is Robert Hunter and I am a geologist and project manager at Arctic Slope Regional Corporation Energy Services with offices at 3900 C St. in Anchorage. My wife and I have been Alaska residents for 17 years and are currently enjoying raising our 3 teenage children here. Thank you for the opportunity to testify on Challenged and Non-Conventional Resources for House Bill 498.

For the past 4 years, I have managed a joint U.S. Department of Energy (DOE) and BP Exploration (Alaska), Inc. (BP) Cooperative Research project to study gas hydrate on the Alaska North Slope. The research is designed to determine the resource potential of gas hydrate; the Alaska North Slope may provide a relatively accessible natural laboratory to help determine the technical feasibility of recovery of natural gas from gas hydrate and associated free gas. The DOE supports a similar research program in the Gulf of Mexico, led by Chevron and joint industry partners.

The 3 primary objectives in this testimony include:

1. Provide some background information on gas hydrate,
2. Clarify that the resource potential of gas hydrate remains unknown at present, and
3. Discuss future plans for acquiring additional data to help determine gas hydrate resource potential

Background Information: Gas Hydrate is a solid combination of gas and water (called a clathrate) that occurs within a distinct pressure/temperature stability region within porous and permeable reservoirs. Much like conventional oil and gas, where these reservoirs are higher-quality and able to trap hydrocarbons, gas hydrate can occur in sufficient concentrations to potentially become a significant resource, if the solid clathrate can be changed into liquid water and natural gas components within the reservoir by modifying the pressure, temperature, and/or chemistry of the system.

Resource Potential: Although large amounts (44-100 Trillion Cubic Feet) of in-place gas hydrate are estimated on the Alaska North Slope by the U.S. Geological Survey (USGS), the potential recoverable resource remains unproven and unknown at present. Within the Eileen gas hydrate trend, one of 2 currently-documented gas hydrate accumulations on the Alaska North Slope, the USGS estimates that the in-place gas may total up to 44 Trillion Cubic Feet (TCF). Our studies from reservoir modeling estimate that from 0 to 12 TCF of gas could potentially be recovered from 33 TCF in-place within the Eileen trend. This broad range (0-12 TCF) of potentially recoverable gas indicates the large degree of uncertainty regarding the resource potential and the necessity to acquire additional data to narrow this uncertainty and to learn more about the gas hydrate-bearing reservoir properties.

Future Plans: BP and the DOE look forward to continuing this cooperative gas hydrate research and have recently approved drilling of a dedicated North Slope stratigraphic test to help improve our understanding of the gas hydrate-bearing reservoirs. There are many remaining technical challenges to be addressed in this project before potential gas hydrate productivity is understood. While currently too early to tell, this research may contribute to determining whether or not this large potential gas resource might one day become part of the overall U.S. gas supply portfolio.

Thank you for your time. I hope this testimony has provided adequate information to help the Committee to understand the resource potential of gas hydrate and to appreciate the importance of the industry-government collaborative research.