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CS FOR HOUSE BILL NO. 372(O&G)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FOURTH LEGISLATURE - SECOND SESSION

BY THE HOUSE SPECIAL COMMITTEE ON OIL AND GAS

**Offered:
Referred:**

Sponsor(s): REPRESENTATIVE KOHRING

A BILL

FOR AN ACT ENTITLED

1 "An Act delaying to June 30, 2010, the last date by which hydrocarbon exploration
2 geophysical work must be performed or drilling of a stratigraphic test well or
3 exploratory well must be completed in order for a person to qualify for an exploration
4 incentive credit under the oil and gas exploration incentive credit that is not authorized
5 by the Alaska Land Act, and expanding the purposes for which that credit may be
6 applied."

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

8 * **Section 1.** AS 41.09.010(b) is amended to read:

9 (b) An exploration incentive credit extended under (a) of this section may be
10 applied against

11 (1) a payment or obligation against which a credit authorized by
12 AS 38.05.180(i) may be claimed;

13 (2) taxes payable under AS 43.20 or to the state under AS 43.56; and

1 (3) oil and gas bonus payments due the state under AS 38.05.180(f).

2 * Sec. 2. AS 41.09.010(c) is amended to read:

3 (c) An exploration incentive credit may be extended under (a) of this section
4 to a qualified applicant if

5 (1) application for the exploration incentive credit is made by the
6 qualified applicant to the commissioner and is approved before drilling or geophysical
7 work commences;

8 (2) all geophysical work is performed, and all stratigraphic test wells
9 or exploratory wells are drilled, after August 7, 1994, and before July 1, 2010 [2007];
10 and

11 (3) copies of all raw and processed data derived from drilling a
12 stratigraphic test well or exploratory well or performing geophysical work are
13 provided by the qualified applicant to the commissioner within 30 days after the
14 completion, abandonment, or suspension of the well or completion of the geophysical
15 work.

ALASKA STATE LEGISLATURE



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REPRESENTATIVE VIC KOHRING DISTRICT 14

House Bill 372 Sponsor Statement

House Bill 372 extends the exploration incentive credit (EIC) for hydrocarbon exploration to 2010, a three-year extension.

This EIC was enacted in 1994, and extended in 2002. The intent of the program is to encourage exploration of remote areas in the state. It also encourages acquisition of oil and gas geophysical and well data, and provides for evaluation of remote areas of the state on un-leased state acreage. In addition, the EIC provides the state with an avenue to obtain exploration data which otherwise would not be received from federal and private land.

The EIC can be applied toward bonus bids, rentals, royalties, and taxes. Credits are assignable to other companies. To qualify for the credit, work must have been performed after August 7, 1994 and before June 30, 2010 with passage of this bill. It may not exceed \$5 million per eligible project and the total EIC's for the entire program may not exceed \$30 million.

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB 372
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Exploration Incentive Credits RDU Revenue Operations
 Component Tax Division
 Sponsor Rep. Kohring
 Requester House Committee on Oil and Gas Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

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

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

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill extends the existing credit for hydrocarbon exploration geophysical work anywhere in the State. The only change made to existing law is to extend the credit cutoff date from July 1, 2007 until July 1, 2010. All other portions of existing law remained unchanged under this bill including:

1. The credit may not exceed 50 percent of eligible costs related to activities on State land or 25 percent of eligible costs of activities on non-State owned land.
2. The credit can be used against income or severance taxes, royalties, rentals, or bonus payments due the State.
3. The credit may not exceed \$5,000,000 per eligible project nor \$30,000,000 in total.

Prepared by: Dick Tremaine Phone 269-1021
 Division Tax Division Date/Time 2/22/06 11 a.m.
 Approved by: Jerry Burnett Date _____
 Agency Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

BILL NO. HB 372

ANALYSIS CONTINUATION

The effect of this provision is that the State pays up to 50 percent of eligible exploration expenses up to a maximum of \$30,000,000. This occurs whether or not the State owns the surface or mineral rights to the area explored. This credit is likely to induce additional exploration in marginal fields. Exploration encouraged by this legislation will result in economic activity within the State and should increase the probabilities of hydrocarbon discovery and, ultimately, production. Such production may result in increased corporate income tax and property tax to the State. Royalties and severance taxes to the State might also increase.

To date, no credits under this program have been applied for and granted.

HB 372

This exploration incentive credit (EIC) program was enacted in 1994. The intent of this program was to: 1) encourage exploration of remote areas of the state; 2) encourage the acquisition of oil and gas geophysical and well data for evaluation of remote areas of the state on unleased state acreage; and 3) provide a means for the state to obtain exploration data, which it would otherwise not receive, from federal lands and private lands.

Under this program, EICs may be granted for exploratory drilling, the drilling of stratigraphic test wells, and for geophysical work on land in the state regardless of whether the land is state-owned. Credits, subject to certain limitations, are applied against oil and gas royalties, rentals, taxes, and bonus bids payable to the state. Credits may be as high as 50 percent of eligible costs if performed on state land and as high as 25 percent if performed on private or federal land. However, in order to qualify for the credit, the work must have been performed after August 7, 1994, and before July 1, 2007.

These credits may also be assigned to other companies so that they may apply to their royalties, rentals, taxes, and bonus bids. Therefore, the company that actually performs the work and earns the credits may assign the credits to another company that may then apply them to their royalties, rentals, taxes, and bonus bids.

The decision whether to grant an EIC under this program is delegated to the discretion of the DNR Commissioner. The Commissioner is not required to grant any EICs. However, should the Commissioner decide that EICs are appropriate, he has the discretion to set the amount anywhere between 10 percent and 50 percent for state lands and between 10 percent and 25 percent for non-state lands.

In return, the state is able to obtain data. Stratigraphic test well and exploratory well data becomes public after 24 months. Geophysical data remains confidential but may be shown to third parties with appropriate confidentiality provisions.

A credit may not exceed \$5 million per eligible project and the total EICs for the entire program may not exceed \$30 million.

FEB 27 2006



22 February 2006

Representative Vic Kohring
Chairman, House Special Committee on Oil & Gas
Alaska State Legislature
State Capitol
Juneau, AK 99801

Dear Chairman Kohring:

BG Group plc is new to Alaska, having just announced our partnership with Anadarko Petroleum and Petro-Canada to explore for oil and gas along the North Slope. We are convinced there is potential in Alaska for the continued development of gas and oil reserves. However, there are also considerable risks and we along with the other independents would like to express our thanks to you and your Committee for sponsoring House Bills 372 and 386.

When making investment decisions BG looks at opportunities on a world wide basis and one of the key reasons we chose to enter Alaska and explore along the North Slope was because of the tax credits. As you know, in order to increase North Slope gas and oil production, more exploration wells must be drilled. Even with modern technology, the commercial chance of success of frontier exploration projects in Alaska is still under 10%. When compared with many other exploration opportunities worldwide, it takes longer in Alaska to begin generating revenue from investments. By reducing early expenditures, exploration tax credits provide great incentives to invest and drill more wells.

BG strongly supports extending the North Slope exploration incentive tax credits because they are effective in encouraging additional investment in gas and oil exploration, as well as in attracting new players, such as BG, to Alaska.

Sincerely,

A handwritten signature in cursive script that reads "David N. Keane".
David N. Keane

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David N. Keane
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Alaska Oil and Gas Association



121 W. Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035
Phone: (907)272-1481 Fax: (907)279-8114
Judith Brady, Executive Director

Date: March 2, 2006

To: House Special Committee on Oil & Gas

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 supports House Bill 372, which extends the deadline for geophysical activities that may be eligible for the exploration incentive credit (EIC) program under Title 41 of the Alaska Statutes. Currently all activity qualifying for this EIC must be completed by July 1, 2007. HB 372 amends the date to July 1, 2010 as follows:

AS 41.09.010 (c) (2):

"all geophysical work is performed, and all stratigraphic test wells or exploratory wells are drilled, after August 7, 1994, and before July 1, 2010 [2007]."

This EIC, adopted in 1994, allows the Commissioner of Natural Resources to grant a credit for exploratory drilling, the drilling of a stratigraphic test well, and for geophysical work on land in the State, regardless of whether the minerals are State-owned.

This program is designed to encourage oil and gas exploration within remote parts of the State and to provide a means for the State to obtain exploration data from federal, private, and Native Corporation lands. The credits may be applied against oil and gas royalties, rentals, lease sale bonus bids and taxes, or they may be assigned.

This is essentially a "pay for view" program. Application for the credit must be made to, and approved by the commissioner, before drilling or geophysical work begins. Copies of all raw and processed data derived from drilling a stratigraphic test well or exploratory well or performing geophysical work are provided by the qualified applicant to the commissioner within 30 days after the completion, abandonment, or suspension of the well or completion of the geophysical work. Drilling data will be kept confidential for two years, but there can be no extension of this period. Copies of geophysical data may be shown to interested parties by the State, but may not be transferred to third parties.

Credits may be as high as 50% of eligible costs if performed on State land, and as high as 25% when performed on federal or private land. A credit may not exceed \$5 million per eligible project

House Special Committee on Oil & Gas

March 2, 2006

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and the total of all credits may not exceed \$30 million. Drilling credits are based upon the footage (measured depth) drilled.

To our knowledge only two applications have been made for this credit and both were withdrawn prior to approval. However, as new basins are being considered and companies are moving further from established areas, it is likely there will be circumstances in which this credit could be important to a company's decision to invest in Alaska. For that reason AOGA supports the extension of time through 2010.

Thank you for your consideration of our comments on HB 372.

Sincerely

JUDITH M. BRADY
Executive Director

cc: Commissioner Michael Menge, DNR
Mr. Pat Galvin, DNR
Mr. Bill Van Dyke, DO&G

Oil and Gas Incentives

Exploration Incentive Credits

AS 38.05.180(i)

- This program authorizes the DNR Commissioner to establish an EIC system under which a lessee drilling an exploratory well on state-owned land may earn credits based upon the footage drilled and the region in which the well is located. The program also provides for an EIC for geophysical work on state land if that work is performed during the two seasons immediately preceding an announced lease sale and is on land included within the sale area and the geophysical information is made public following the sale.
- EIC provisions are set by the DNR Commissioner as a lease sale term at the time of each lease sale.
- The credits may not exceed 50 percent of the cost of the drilling or geophysical work and may be applied against royalties, rentals, or taxes under AS 43.55. The credit may not exceed 50 percent of the payment to which it is being applied.
- EICs totaling \$54,692,614.64 have been approved since 1983 for 20 wells. No applications have been filed seeking this EIC since 1994. Several applications for seismic EICs were withdrawn possibly due to public disclosure requirement.

AS 41.09.010 (Implemented 1994)

- This exploration incentive credit program was enacted in 1994. Under this program, EICs may be granted for exploratory drilling, the drilling of stratigraphic test wells, and for geophysical work on unleased state, private, or federal lands. Credits are applied against oil and gas royalties, rentals, taxes, and bonus bids payable to the state. Credits may be as high as 50 percent of eligible costs if performed on state land and as high as 25 percent if performed on private or federal land. However, in order to qualify for the credit, the work must have been performed after August 7, 1994, and before July 1, 2007.
- The intent of this EIC program was to encourage the acquisition of oil and gas geophysical and well data for oil and gas exploration in remote areas of the state on unleased state acreage and provide a means for the state to obtain exploration data from federal lands and private lands.
- No applications pursued as of this date, possibly because of prohibition of extended confidentiality for well information and limited disclosure of geophysical data to approved third parties.

Exploration Tax Credits

AS 43.55.025 Department of Revenue Oil and Gas Exploration Tax Credit

AS 43.020.043 Department of Revenue Capital Investment and Operating Cost Tax Credit.

Royalty Reduction

AS 38.05.180(j) (Amended most recently in 2003)

- This program provides a mechanism to modify oil and gas royalties to allow for production that would not otherwise be economically feasible. Royalties may be reduced to as low as 5 percent if there is new production; 3 percent if producing or shut-in.
- Goal is to encourage otherwise uneconomic production of oil and gas.
- Two companies applied in the past but later withdrew their applications. We believe two companies may soon make application under this provision, but no final applications have been received.

AS 38.05.180(f)(5) (Implemented 2003)

- This incentive program allows payments of royalties as low as 5 percent (rather than the usual 12.5 percent) for oil production from Cook Inlet platforms if production falls below specified levels.
- The goal was to prevent certain Cook Inlet platforms from being shut down and "mothballed" prematurely.
- Thus far, one platform has qualified for the incentive.

Discovery Royalty

AS 38.05.180(f)(4) Cook Inlet Discovery Royalty (Implemented 1996)

- Awarded to the first to have drilled a well discovering oil or gas in a previously undiscovered oil or gas pool and certified by the DNR commissioner within one year of completion of that discovery well. The pool must be capable of producing in paying quantities.
- Five percent royalty (rather than the usual 12.5 percent) on all production of oil or gas from that pool attributable to that lease for a period of ten years following the date of discovery.
- Intent was to encourage additional exploration in the mature Cook Inlet area.
- No applications have been received.

AS 38.05.180(f)(5) Cook Inlet Royalty Relief for small shut-in fields. (Implemented 1998)

- Reduces the royalty to five percent on the first 25,000,000 barrels and first 35,000,000,000 cubic feet for ten years (following the date on which the production for sale commences) on six specific units. The field must have been producing by January 1, 2004.
- The intent was to encourage production from six Cook Inlet oil or gas fields that were either undeveloped or shut in.
- Numerous projects qualified for royalty relief under this provision: Falls Creek Unit (now Ninilchik Unit) Nicolai Creek, Point Starichkof Unit (now Cosmopolitan Unit), Redoubt Shoal Unit, and the West Foreland Unit have all

qualified for the incentive. Only the North Fork Unit did not meet the January 1, 2004 deadline. Falls Creek, Nicolai Creek, Redoubt Shoal, and West Foreland are currently producing units.

Value of state's royalty gas used for agriculture products - AS 38.05.180(ee)
(Implemented 2003)

- Allows the DNR Commissioner to establish the value of the state's royalty share for gas that is sold under contracts entered into on or after the effective date between an oil and gas lessee and a manufacturer of agricultural chemicals. The royalty value may not be less than the price used in contracts (floor) but may not exceed the amount that would otherwise be due under the lease (ceiling).
- This incentive may have slowed the shut-down of the Agrium plant.

Nonconventional Gas Incentive - AS 38.05.180(n)(2) (Implemented 2004)

- Lessee of a gas only lease must demonstrate to the DNR commissioner that potential resources are estimated to be only nonconventional gas.
- Rental payment is \$1 per acre. If the nonconventional gas is not indirect competition with gas which a royalty rate of at least 12.5 percent is payable, then the royalty share is set at 6.25 percent.
- This incentive may have encouraged both the Healy and Holitna Exploration License Applications.

Exploration Licensing - AS 38.05.132 - .133 (Implemented 1994)

- Exclusive right to explore an area between 10,000 and 500,000 acres in size for a term of up to 10 years. Pays a one-time \$1 per acre license fee, no bonus bid, and no annual rental. Has the sole right to convert to an oil and gas lease.
- Goal was to encourage oil and gas exploration within remote areas of the state outside of known oil and gas provinces.
- So far four Exploration Licenses have been issued (Copper River Basin, Nenana, and two in Susitna, Bristol Bay Basin has been awarded, and Healy and Holitna Basins have been proposed).

<u>CURRENT INCENTIVES</u>	<u>CONVENTIONAL LEASES</u>	<u>UNLEASED STATE LAND</u>	<u>LICENSED LAND</u>	<u>SNG LEASES</u>	<u>FEDERAL & PRIVATE LAND</u>
Exploration Incentive Credits (EIC)					
AS38.05.180(i)	up to 50% of drilling costs	up to 50% of seismic costs	N/A	up to 50% of drilling costs	N/A
AS41.09.010 -- expires 7-1-2007	N/A	up to 50% of drilling & seismic costs	up to 50% of drilling & seismic costs	*N/A	up to 25% of drilling & seismic costs
Exploration Tax Credit					
AS43.55.025 -- expires 7-1-2007 (03.185)	20% of drilling costs or 40% of drilling costs if >25 mi of a unit plus 40% of seismic costs	20% of drilling costs or 40% of drilling costs if >25 mi of a unit plus 40% of seismic costs	20% of drilling costs or 40% of drilling costs if >25 mi of a unit plus 40% of seismic costs	20% of drilling costs or N/A	20% of drilling costs or 40% of drilling costs if >25 mi of a unit plus 40% of seismic costs
AS43.20.043 -- expires 1-1-2013 (03.61) for below 68° latitude*** (see note at bottom)	10% of capital investment 10% of annual cost	10% of capital investment 10% of annual cost	10% of capital investment 10% of annual cost	10% of capital investment 10% of annual cost	10% of capital investment 10% of annual cost
Royalty Reduction					
AS38.05.180(j) (03.28)	as low as 5% if new production as low as 3% if producing or shut-in	N/A	(Applies after conversion to Lease) (Applies after conversion to lease)	as low as 5% if new production as low as 3% if producing or shut-in	N/A
AS38.05.180(f)(5) (03.185)	As low as 5% for oil production from CI platforms if production falls below specified levels	N/A	N/A	N/A	N/A
Discovery Royalty					
AS38.05.180(f)(4) for Cook Inlet only for pre-1969 leases only, statewide	5% royalty for 10 yrs 5% royalty for 10 yrs	N/A N/A	(In limited area after conversion: T18N) N/A	(Applies to limited area: T18N) N/A	N/A N/A
AS38.05.180(f)(5) for following fields only: Falls Creek, Nicolai Creek, Starichkof, Nor Fork, Redoubt Shoals, & West Foreland field must be in production by 1-1-2004	5% on 1st 25 MM bbls for 10 yrs 5% on 1st 35 BCF for 10 yrs	N/A	N/A	N/A	N/A
Economic Limit Factor -- AS43.55.013	Yes	N/A	(Applies after conversion to Lease)	Yes	Yes
Contract Gas Price With a Utility vs Royalty Value -- AS38.05.180(aa)	Value of state's royalty share equals gas contract price	N/A	(Applies after conversion to Lease)	Value of state's royalty share equals gas contract price	Value of state's royalty share equals gas contract price
Value of state's royalty gas used for ag products -- AS38.05.180(ee) (03.57)	Negotiated Value	N/A	(Applies after conversion to Lease)	Negotiated Value	Negotiated Value
*** If requesting this credit, not eligible for any other tax credits or royalty modifications					
<u>INCENTIVES AS PART OF A PROGRAM</u>	<u>CONVENTIONAL LEASES</u>	<u>UNLEASED STATE LAND</u>	<u>LICENSED LAND</u>	<u>SNG LEASES</u>	<u>FEDERAL & PRIVATE LAND</u>

Exploration Licensing	AS38.05.132	N/A	N/A	Up to 500,000 acres per license	N/A	N/A
				One-time \$1/acre license fee		
				No bonus bid		
				No annual rental		
				sole right to covert to O & G leases		
Nonconventional Gas Incentive--		reduced rental	N/A	(Applies after conversion to Lease)	N/A	
AS 38.05.180(n)(2)	(04.531)	6.25% royalty if no competition with				
		12.5% leasee				