

The 26th Alaska State Legislature

Oil & Gas Legislation

Dan E. Dickinson CPA

Mayor's Energy Task Force

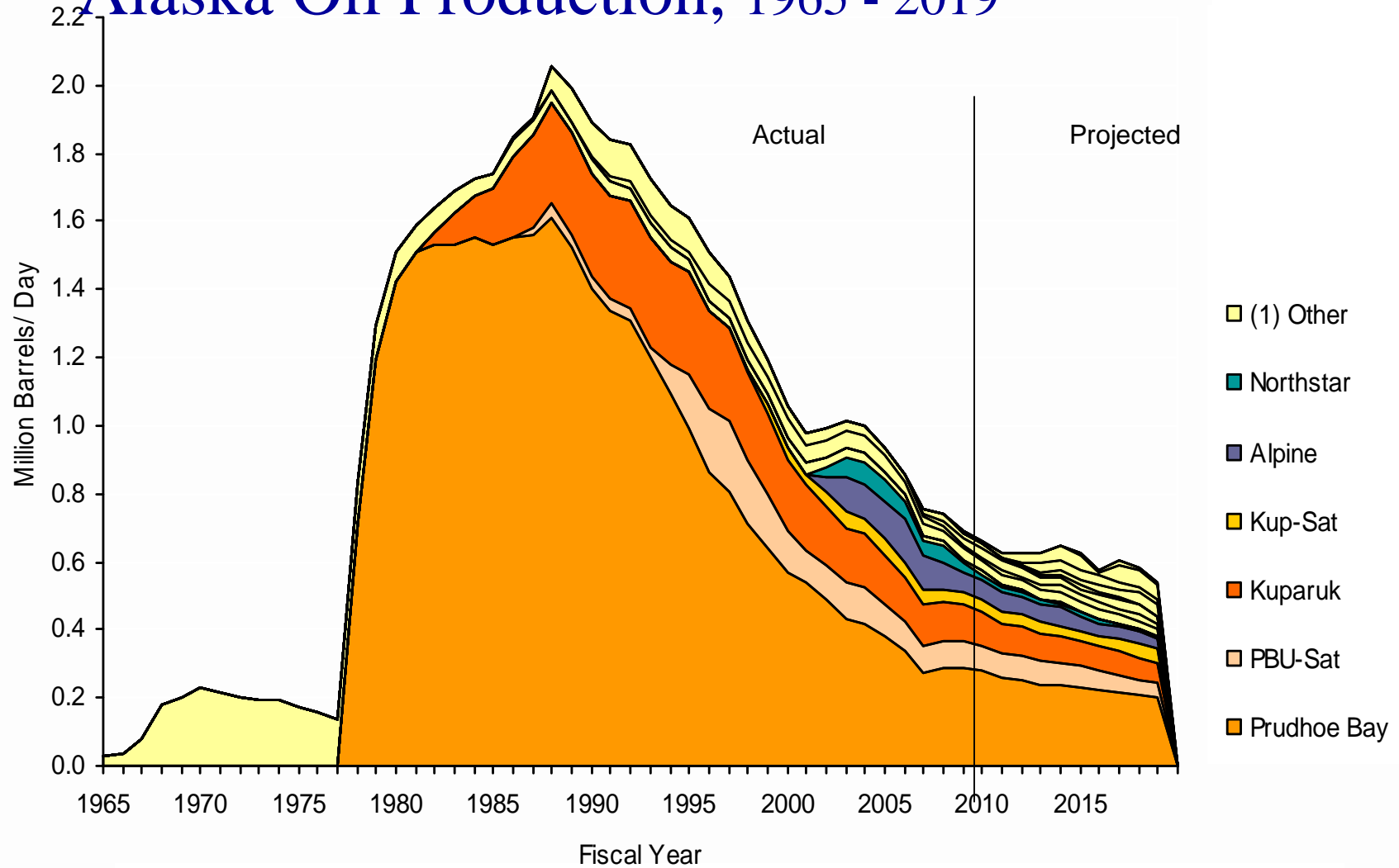
April 21, 2010

Energy in the 26th Alaska Legislature

- Highlights of Monday Presentation to IAEE
 - Overview of 104 pieces of legislation
 - Investment focused legislation
 - “Fair Share” focused legislation
 - HB280
 - SB305
 - SB309
 - Predictions from 2007
- Other Energy Legislation
 - Overview of 83 pieces of legislation
- Caution: portions prepared in haste less than 8 hours after the end of the legislative session

1 of 4 Pictures to set the Stage

Alaska Oil Production, 1965 - 2019



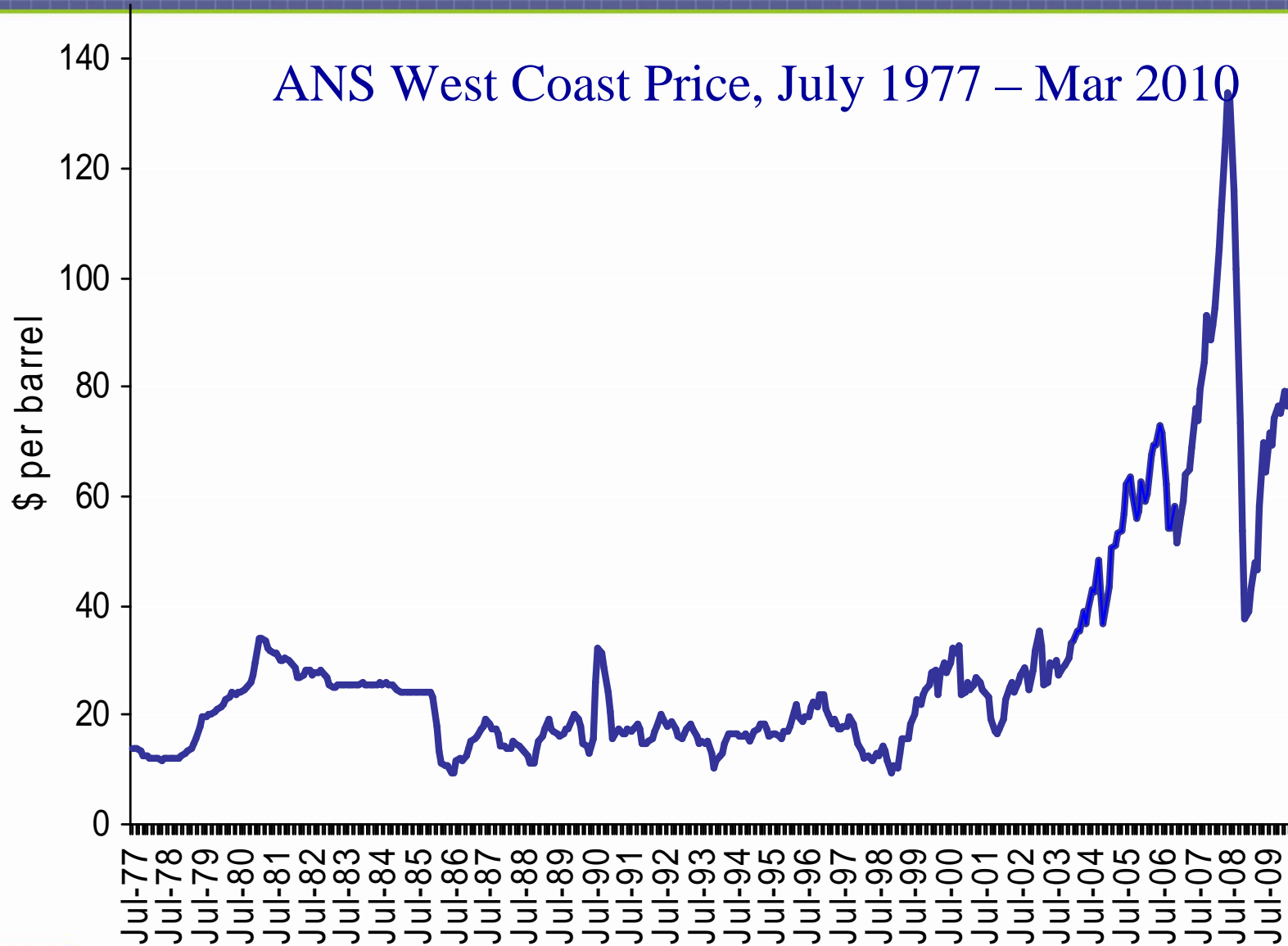
Source: Alaska Department of Revenue, Fall 2009 Revenue Sources Book & Fall 1999 RSB, DNR 2007 Oil and Gas Report
(1) Cook Inlet, Duck Island, Milne Point, Liberty, Pt Thomson, Fiord, Nanuq, Oooguruk, Nikaitchuq and NPRA.

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2 of 4 Pictures to set the Stage



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Source: Alaska Department of Revenue, Tax Division

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3 of 4 Pictures to set the Stage

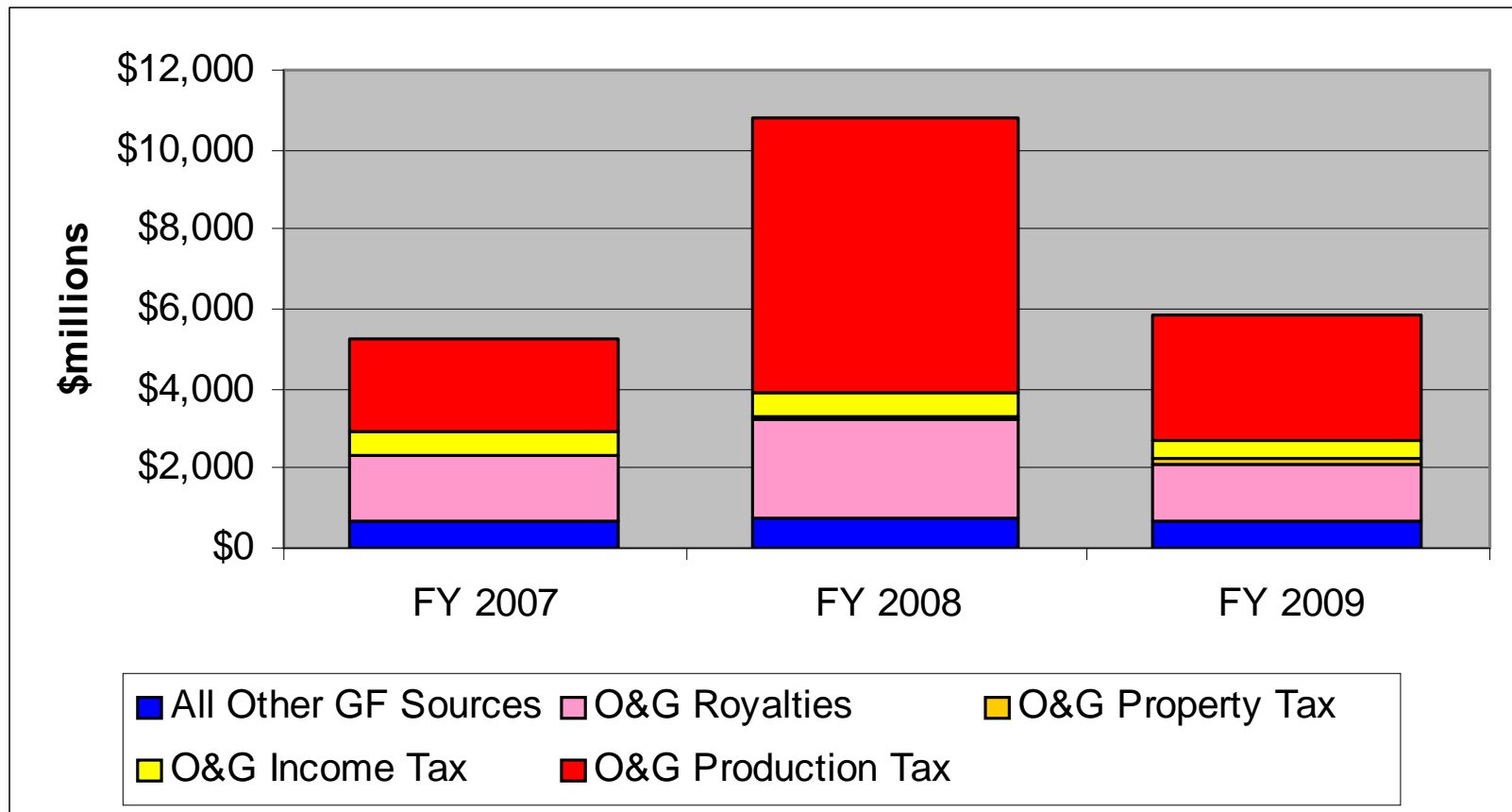
State of Alaska General Fund Revenues (& WC ANS price)

	FY 2007	FY 2008	FY 2009
Average ANS WC Price/bbl	\$ 61.63	\$ 96.51	\$ 68.34
<i>figures in \$000:</i>			
O&G Production Tax	2,292.3	6,879.0	3,112.0
O&G Income Tax	594.4	605.8	492.2
O&G Property Tax	65.6	81.5	111.2
O&G Royalties	1,613.0	2,446.1	1,465.6
O&G Subtotal	4,565.3	10,012.4	5,181.0
All Other GF Sources	675.2	780.0	650.2
Total GF	5,240.5	10,792.4	5,831.2

SOURCE: SOA DOR Fall 2007, Fall 2008 & Fall 2009 Revenue Sources Book

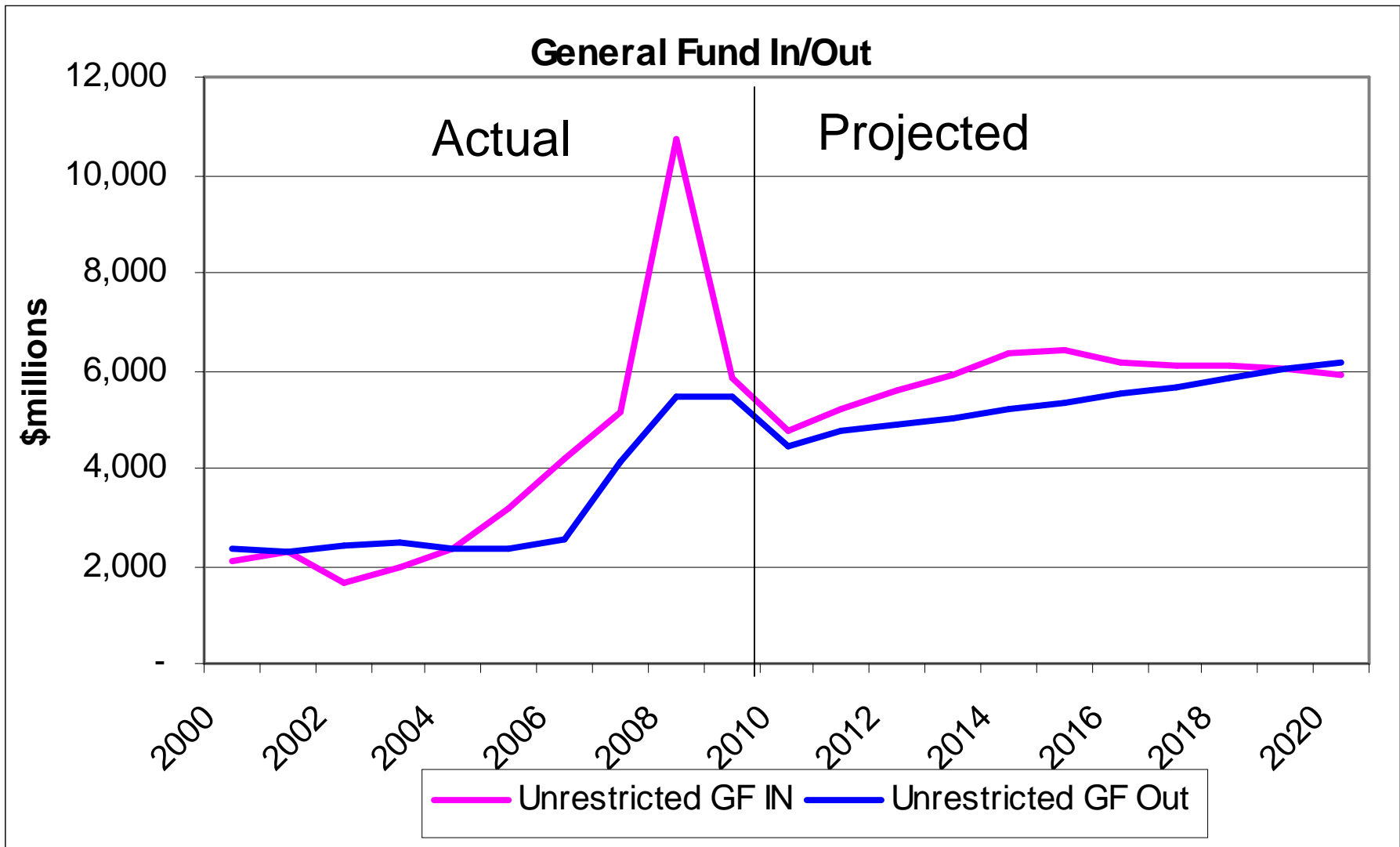
3 of 4 Pictures to set the Stage

State of Alaska General Fund Revenues (& WC ANS price)



SOURCE: SOA DOR Fall 2007, Fall 2008 & Fall 2009 Revenue Sources Book

4 of 4 Pictures to set the Stage



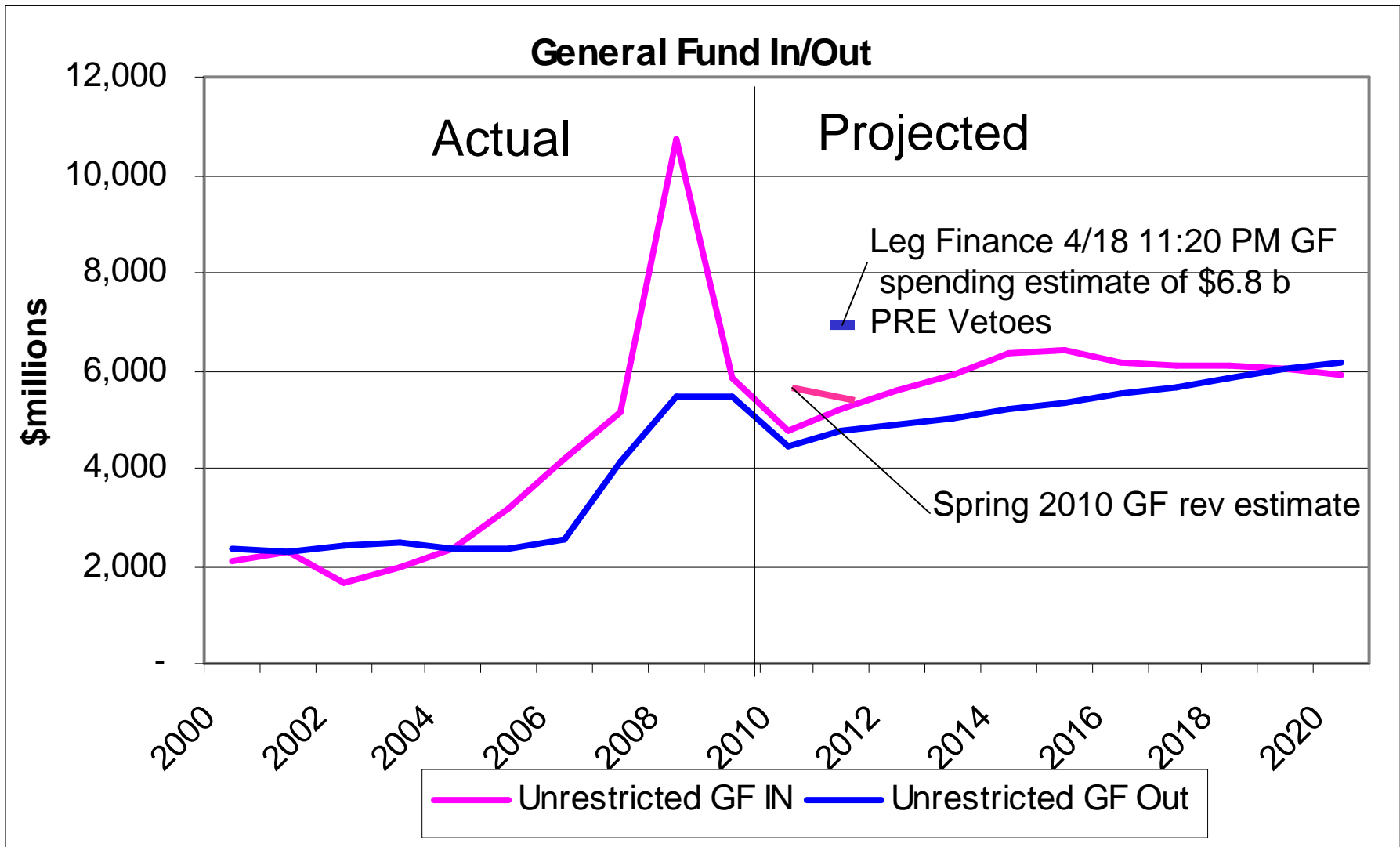
Source: SOA DOR Fall 2009 Revenue Sources Book; OMB, 2010 Long Range Fiscal Plan

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4 of 4 Pictures to set the Stage



Source: SOA DOR Fall 2009 & Spring 2010 Revenue Sources Book; OMB, 2010 Long Range Fiscal Plan, Leg Finance Adjournment Budget Reports

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Oil & Gas in the 26th Legislature

- 104 pieces of legislation are listed in BASIS as being “oil and gas” related in the 26th Alaska legislature
- What happened to them?

	Did not pass out of that body	Made into but not out of other body	Became Law or Resolve (2009)	Passed out of Legislature (2010)	Total
House					
"Oil & Gas" Bills	36	1	2	4	43
"Oil & Gas" Resolutions	7	6	5	5	23
Senate					
"Oil & Gas" Bills	23	1	1	4	29
"Oil & Gas" Resolutions	5	0	1	3	9
Total	71	8	9	16	104

2009 “Oil and Gas” Legislative Resolves

Joint Resolutions

- 24. Endorsing ANWR Leasing
- 26. Opposing ANWR Wilderness Designation
- 5. Oil Tanker Escort Vessels/Oil Spill Anniv
- 14. Urging US to Ratify Law of the Sea Treaty
- 29. Oppose Restriction on Oil/Gas Activities
- 16. Offshore Oil & Gas Revenue

2009 “Oil and Gas” Statutes

- HB 113 Supplemental/Capital/Other Appropriations
- HB 152 2009 Revisor’s Statute (nothing in title 43)
- SB 116 Approp: Energy Assistance (LIHEAP)

2010 “Oil and Gas” Legislative Resolves

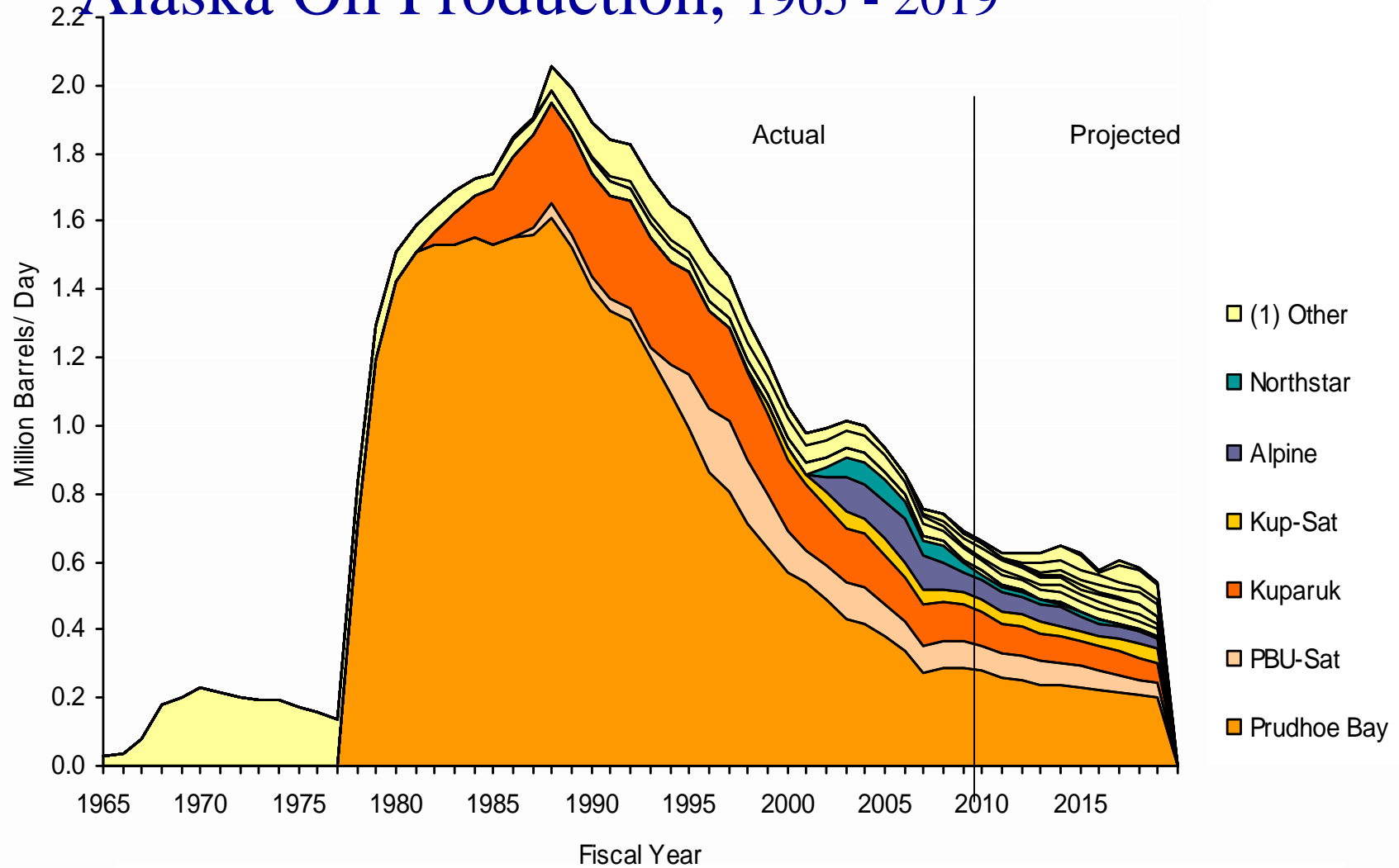
- Resolutions
- HR 17 Export License Ext. for Kenai LNG Plant
- SR 12 Export License Ext. for Kenai LNG Plant
- SR 10 Domestic Natural Gas & Alt Energy
- Joint Resolutions
- HJR 45 Oppose Federal Cap and Trade Legislation
- Concurrent Resolutions
- Suspend Uniform Rules for SB 220, SB 305 & HB 369
- HCR 2 In-State Gas Pipeline

2010 “Oil and Gas” Statutes

- **HB 280 Natural Gas Storage/Tax Credits**
- HB 306 State Energy Policy
- HB 326 Supplemental/Other Appropriations
- HB 369 In-State Pipeline/Manager Team
- SB 220 Energy Efficiency/Alternative Energy
- SB 236 Tax Credits for Education Contributions
- **SB 305 Separate Oil & Gas Production Tax**
- **SB 309 Gas Exploration/Development Tax Credit**

A Picture Tells at Least 2 Stories

Alaska Oil Production, 1965 - 2019



Source: Alaska Department of Revenue, Fall 2009 Revenue Sources Book & Fall 1999 RSB, DNR 2007 Oil and Gas Report
(1) Cook Inlet, Duck Island, Milne Point, Liberty, Pt Thomson, Fiord, Nanuq, Oooguruk, Nikaitchuq and NPRA.

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Legislative Fixes

- Rep Johnson's Proposal HB 308/SB 267
- Progressivity rate dropped from .4% to .2%
- Resident Hire rebates can drive 25% base rate down to 20%
- 30% credit for well related work (including capex and opex)
- No interest on retroactive application of new regulations; interest rate drops from 11% to Fed funds +2
- Statute of limitations on tax drops from 6 back to 3

Legislative Fixes

- Rep Millet's Proposal HB 321
- 25% base rate down to 20%
- *No change to progressivity*

Legislative Fixes

- Representative Kelly's Proposal HB 351
- Production tax holiday for “new production”
- Credit = (production from leases or properties with out commercial production before 2012/all production) * total tax

Legislative Fixes

- Rep Crawford's Proposal HB 84
- Gas reserves tax –
- Essentially a billion dollars a year on major lease holders (3 cents per mcf time 35 tcf) until they commit in the first open season to an AGIA licensed project. Can reclaim as a credit when gas is shipped.

Legislative Fixes

- Rep Crawford's Proposal HB 189
- Continue formulaic calculation of non-capital lease expenditures at Kuparuk and Prudhoe as 3% annual markup of 2006 costs.

Legislative Fixes

- Rep Gruenberg, Seaton, Cissna, Tuck, Petersen and Gatto's Proposal HB 11
- “When interpreting a lease entered into under this section, ambiguous language shall be construed in favor of the state and against the interpretation offered by the person challenging the state’s interpretation.”

What did happen:

- Three bills
- HB 280 (prefiled)
- SB 305 (introduced 3/08/10)
- SB 309 (introduced 3/25/10)

CIRA – HB 280

- HB 280
- Sponsored by Reps Hawker & Chenault
- Garnered 13 co & cross sponsors
- Short Title: “Cook Inlet Recovery Act” – CIRA
 - (Added Middle Earth – or New Development Areas to well credits)
- 1. Refundable CIT credit for creating gas storage (statewide).
- 2. Guidance to the RCA on approval of gas supply contracts (statewide).
- 3. Regulatory (RCA/DNR/DOR) guidance on storage
- 4. Cook Inlet (and ME) Credits Expanded

HB 280

- 1/15/10 Prefile Released
- 1/19/10 First House Reading (assigned L&C, Res & Fin)
- 2/17/10 Moved out of H Labor & Commerce
- 3/17/10 Moved out of H Resources
- 3/22/10 Moved out of H Finance
- 3/23/10 Second House Reading
- 3/24/10 Third House Reading, Passed House 38 Y (2 excused)
- 3/25/10 First Reading in Senate (assigned Res & Fin)
- 4/10/10 Moved out of S Resources
- 4/18/10 Moved out of S Finance
- Second Senate Reading
- Advanced to Third Reading
- Third Reading, Passed Senate 20 Y, effective date consent
- House Concurrence 40 Y, effective date consent

CIRA – Refundable Tax Credit - i

- For a qualifying gas storage facility (sec 12):
- CIT credit equal to \$1.50 for each 1000 cf of “working gas storage capacity”
- Credit capped at \$15,000,000 per facility or 25% of costs incurred to “establish” the facility
- Must commence commercial operations after 12/1/2010 and before 1/1/2016
- Must have minimum capacity of 500,000 mcf
- Must have minimum withdrawal rate of 10,000 mcf/day
- Must be regulated (i.e. not proprietary)

Quickie Math

- Quick back-of the-envelope rule of thumb:
1 million British Thermal Units (1 mmbtu)
is roughly the energy found in
1 thousand cubic feet of natural gas (1 mcf)
(NS gas closer to 1118 btu/cf)
- 1 billion cubic feet (bcf) is one million mcf.
 - So a 10 bcf capacity facility would be 10 million mcf
 - So at \$1.5 per mcf the potential credit would be \$15 million
- SI units: **1 gigajoule** is roughly 1 mmbtu
(actual is 1 gigajoule = 947,817.12 btus)

CIRA – Refundable Tax Credit - ii

- Process
- Go to AOGCC which certifies “working gas storage capacity” & withdrawal rate (sec 2)
- That certification is basis of credit (sec 12)
- If credit can’t be used department may use money from “oil and gas tax credit fund” to refund (sec 12 & 18)
- Proportional clawback if ceases commercial operations within 10 years (sec 12)

CIRA – Guidance to RCA on contracts

- RCA shall recognize the public benefit of diversified portfolio of gas supply contracts (sec 6)
- RCA shall consider risk to public if supply contracts are rejected. (sec 6)
- The “just and reasonable rate” to a utility of gas storage shall include the benefits of exemption from fees and tax credits (sec 7)
- The public advocacy group for regulatory affairs must also pay attention to these same ideas (sec 21)

CIRA – Regulatory Guidance - ii

- DNR directed, “when reasonably possible” to expedite permitting for a “gas storage facility” (sec 3)
- DNR may not deny an application because a gas storage facility would be proprietary. (sec 4)
- DNR shall exempt qualifying gas storage facilities from fees for first 10 years (sec 5)
 - Public info
 - Recapture provision
 - Value passed along in storage contracts
- Gas withdrawn from a gas storage facility is considered non-native gas until all non native gas withdrawn(secs 5 & 15)

CIRA – Regulatory Guidance - ii

- RCA jurisdiction specifically expanded to include “furnishing the service of natural gas storage to the public for compensation.” (sec 9 & 10)
 - However,
 - does not include proprietary storage (sec 10)
 - not if part of a pipeline facility, natural gas pipeline facility or North Slope natural gas pipeline facility (sec 8)

CIRA – Regulatory Guidance iii

- DOR ability to apply the AS 43.55.020(f) “higher of rule” (i.e. of value when produced and when sold) is affirmed (sec 14)
- Gas withdrawn from a gas storage facility is considered non-native gas until all non native gas withdrawn(secs 5 & 15)

CIRA – Cook Inlet Investment Credits Expanded - i

- New non-North Slope 40% credit (secs 16 & 17) for costs “directly related to an exploration well, a stratigraphic test well, a producing well, or an injection well other than a disposal well, located in the state south of 68 degrees North latitude, if the expenditure is a **qualified capital expenditure** and an ***intangible drilling and development cost*** authorized under 26 U.S.C. (internal Revenue Code), as amended, and 26 C.F.R. 1.612-4, regardless of the elections made under 26 U.S.C. 263(c); in this paragraph, an expenditure directly related to a well includes an expenditure for well sidetracking, well deepening, well completion, or well workover, regardless of whether the well is or has been a producing well”; or
- seismic work conducted within the boundaries of a unit

CIRA – Cook Inlet Investment Credits Expanded - iii

- The “as if” AS 43.55.011(m) rule that certain credits generated from CI or instate gas activity are restricted from wider use by a test of how they would have been used without the As 43.55.011(j) and (k) limitations is no longer effective for costs incurred after 1/1/2011. (sec 13)
- Investment and loss-carryforward credits from Cook Inlet (& ME) expenditures (after 6/30/2010) probably still can't (but maybe can) be used in a single year (sec 17 – “n”)
- Purchase of otherwise qualifying Cook Inlet (& ME) credits no longer requires matching “forward spend” (sec 21) (SB 309 extends this to entire state)
- DOR regs on credit purchases cannot otherwise distinguish NS and non NS credits (Sec 22)

CIRA – Cook Inlet Investment Credits Expanded - iv

- Non producer can get 65% investment back in cash
 - 40% - for all well work/IDC
 - 25% - for loss carryforward
- Major Producer can receive benefit of 65% plus progressivity in reduced taxes
 - 40% for all well work/IDC
 - 25% (base rate) from deductibility
 - ??% (progressivity rate) from deductibility
 - Theoretically could be additional 50% or total 115%
 - More practically, such investment will lower progressivity
- Production taxes on Cook Inlet production generally limited to zero on oil, average 17.7 cents per mcf on gas through 2022.

SB 309

- Sponsored by Senate Rules Committee
- Portions similar to HB 229 (sections 1-4, 6, 7,11)
- Portions similar to Governor's Proposals (sec 8, 12)
- 1. Upgrades the Cook Inlet CIT credit.
- 2. 100%/90%/80% credits for Jack up rig in CI
- 3. Interest forgiveness for retroactive regulations
- 4. "Forward Spend" requirement waved for selling credits to state

SB 309

- 3/25/2010 First Senate Reading (assigned Res, Fin)
- 4/10/10 Moved out of S Resources
- 4/16/10 Moved out of S Finance
- 4/16/10 Second Reading
- Advance to Third Reading
- Passed 19 Y (1 excused)
- 4/16/10 First Reading in House (assigned Fin)
- 4/17/10 Moved out of H Finance
- 4/17/10 Second Reading in House
- 4/18/10 Third House Reading
- Passed 37 Y 2 N (1 absent)
- Senate Concurrence Y 20

SB 309 - Upgrades the CIT credit

- 10% credit in AS 43.20.043 (a) raised to 25%
 - (played catch up to AS 43.55.023(a) 25% investment credit)
- May not also get AS 43.55 credits or royalty reductions
- Limit moved from 50% to 75% of tax liability
- Expanded to include dry holes

100%, 90%, 80% Credits for Jack Up Rig in CI

- The first three unaffiliated persons,
- “that penetrate ...in the pre-tertiary zone using a jack up drill rig”
- First: lesser of 100%, or \$25mm
- Second: lesser of 90% or \$22.5mm
- Third: lesser of 80% or \$20mm
- After March 31, 2010

- If results in sustained commercial production, 50% is repaid over 10 years. (CIRA better deal...? 023 v 025)
- DNR makes determination
- May not also claim AS 43.55.023 or other AS 43.55.025 credits

SB 305

- Sponsored by Senate Finance Committee
- 1. Creates distinct progressivity “bucket” for non-instate gas
- 2. When allocating between oil and gas, the department shall use gross value at the point of production.
- Makes explicit that North Slope gas development costs are chargeable against NS oil production

SB 305

- 3/08/10 First Reading (assigned Fin)
- 3/31/10 Moved out of S Finance
- 4/01/10 Second Reading
- Advance to Third Reading
- Passed Senate 16 Y 3 N (1 excused)
- 4/05/10 First Reading in House (assigned Res & Fin)
- 4/13/10 Moved out of H Resources
- 4/16/10 Moved out of H Finance
- 4/17/10 Second Reading in House
- 4/18/10 Third Reading in House
- Failed 19 Y 21 N
- Rescinded prior action 26 Y 14 N
- Passed House 23 Y 17 N
- Effective Date Motion Y 40
- Senate Concurrence Y 18 N 2, effective date consent

- Issues
- (1) State gets a lot of money from progressivity on oil – especially when oil prices are high
- (2) However if major amounts of gas are added in to a single progressivity calculation – state take can fall dramatically – especially when gas prices are low
- AND
- (3) Under AGIA rules, “gas production tax” for first ten years shipping on an AGIA project is capped at the “gas production tax ... in effect at the start of the first binding open season...”
- (4) TC has announced an open season to start April 30, 2010

Gaffney Cline slide:

Response to Mr. Dickinson

Gaffney, Cline & Associates

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Gaffney Cline Slide:

Pricing Parity is Key

- One way to predict the future is to look at the past
- Plot of oil price divided by gas price with “6” representing thermal and, therefore, price parity

Figure 4-5. Historical Oil to Gas Price Ratio



Source: Black and Veatch 2008, Appendix G1, Section 7.15.4.3

Updated Gaffney Cline Slide:

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- Plot of oil price divided by gas price with “6” representing thermal and, therefore, price parity

Figure 4-5. Historical Oil to Gas Price Ratio



Source: Black and Veatch 2008, Appendix G1, Section 7.15.4.3

Gaffney, Cline & Associates

02 February 2009

Gaffney Cline Slide:

Pricing Parity is Key

- Mr. Dickinson chose roughly 13:1 price parity
- This occurred <4% of the time in the last 14 years

Figure 4.5. Historical Oil to Gas Price Ratio



Source: Black and Veatch 2008, Appendix G1, Section 7.15.4.3

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Figure 4-5. Historical Oil to Gas Price Ratio

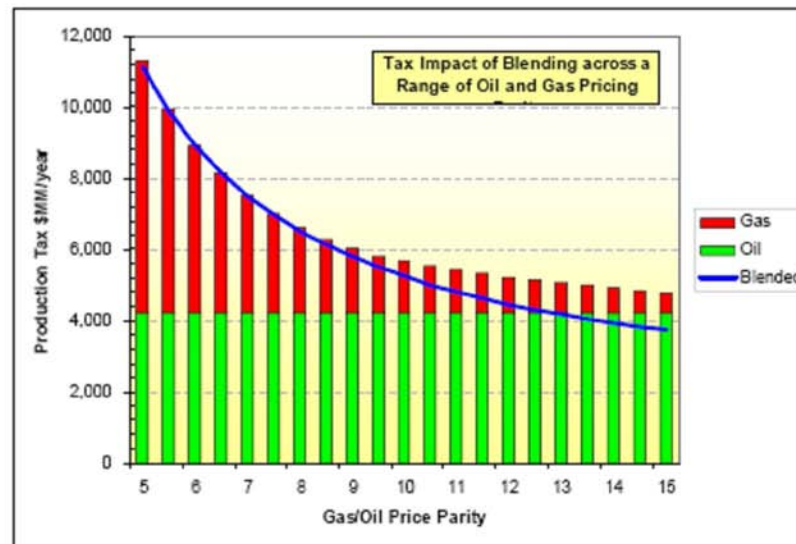


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Gaffney Cline Slide:

Collecting “less” combined tax

- Just modifying the oil/gas price parity in Mr. Dickinson’s model is revealing



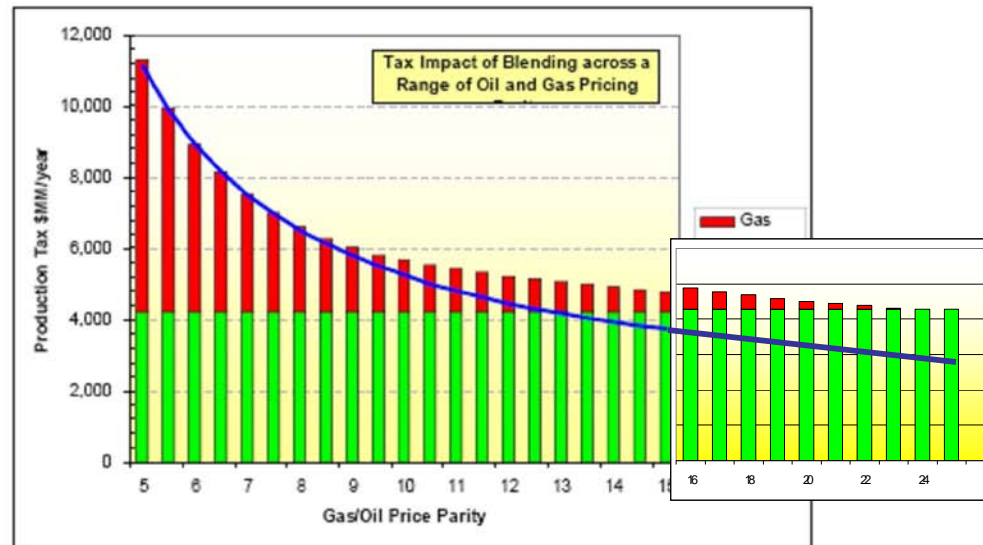
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Gaffney, Cline & Associates

02 February 2009

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SB 305

Creates two progressivity Calculations

- The current calculation found in AS 43.55.011(e)(1) – including NS oil, ME oil, all CI production and gas used in the state
- A new calculation found in AS 43.55.011(p) covering gas not produced in CI or used in the state.
- Same parameters (additional rate of .4% per dollar over \$30/boe, up to \$92.50/boe)
- Lease expenditures that are joint costs will be allocated based on gross value at the point of production.
- Updates AS 29.60.850(b) - Community revenue sharing funded from both kinds of progressivity

Note: Current oil and gas still in same bucket.

- Things to distract everyone from the broader economic issues:
- Under the possibility of limited “fiscal certainty” what will the law be “at the start of the first binding open season”
- Is the start April 30th or some longer period
- Gov has 20 days to sign.
- If he does nothing until May first...

Legislative Fixes

- Governor Parnell's Proposal SB 271/HB 337
- (1) Interest not due on retroactive changes (SB 309)
- (2) Credits Purchased without "forward spend" (SB 309)
- (3) Credits not spread over two years (HB 280 – maybe in CI and ME, though probably not)
- (4) 30% credit for well work (HB 280 – 40% credit for CI and ME well work)

My December 2007 Crystal Ball

- What happened and what insights can be gained for the future.

12.14.2007

Dan E. Dickinson Presentation to
IAEE (cleaned up)

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My December 2007 Crystal Ball

Sea Change in Juneau

- Old Paradigm – Taxes are a “tax” on productivity and economic growth; Taxes bad – constraint: need to finance government.
- New Paradigm – Resources have a special role under constitution; state resource taxes good – constraint: need for better investment climate.

12.14.2007

Dan E. Dickinson Presentation to
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My December 2007 Crystal Ball

Future Implications for Gasline

- Governor can be “dragged kicking and screaming” from campaign positions
- 2006 Legislature more assertive than Murkowski Administration
- 2007 Legislature more assertive than Palin Administration

12.14.2007

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Future Implications for Gasline

- Revisiting the production tax before an open season?
 - Carve out gas from progressivity?
 - Restructure credits to separate oil and gas investment?
 - Special regime for distance gas?

12.14.2007

Dan E. Dickinson Presentation to
IAEE (cleaned up)

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Oil & Gas in the 26th Legislature

- 83 pieces of legislation are listed in BASIS as being “energy” related in the 26th Alaska legislature
- What happened to them?

	Did not pass out of that body	Made into but not out of other body	Became Law or Resolve (2009)	Passed out of Legislature (2010)	Total
House					
"Energy" Bills	22	2	0	2	26
"Energy" Resolutions	4	5	6	6	21
Senate					
"Energy" Bills	20	0	2	4	26
"Energy" Resolutions	4	0	2	4	10
Total	50	7	10	16	83

2009 & 2010 “Energy” Statutes

- HB 20 Fisheries Loans: Energy Efficiency/Amount
- SB 88 Power Cost Equalization
- SB 116 Approp: Energy Assistance (LIHEAP)
- HB 306 State Energy Policy
- SB 220 Energy Efficiency/Alternative Energy
- SB 343 Geothermal Resource: Royalty/Permit/Fee
- SB 277 Public Utility Exemption: Renewable Energy
- SB 301 Power Project Fund

Thank You

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