ALASKA STATE LEGISLATURE

Trans Alaska Pipeline Throughput Committee

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LETTER OF INTENT

The Senate Special Committee on Trans Alaska Pipeline System (TAPS) Throughput was formed specifically to evaluate solutions designed to reverse or significantly reduce the historical decline in the quantity of oil produced from leases or properties north of 68 degrees North latitude and shipped through the Trans Alaska Pipeline System. The Committee recognizes that oil revenue is extremely important to the State of Alaska and currently funding over 90% of Alaska's essential services and critical infrastructure including education, public safety, health and social services and transportation. The Committee is also aware that projected declines in the Trans Alaska Pipeline System throughput may compound the operational and cost issues that could jeopardize the viability and safe operation of the Trans Alaska Pipeline System.

The Committee was the first to consider SENATE BILL 21 "An Act relating to appropriations from taxes paid under the Alaska Net Income Tax Act; relating to the oil and gas production tax rate; relating to gas used in the state; relating to monthly installment payments of the oil and gas production tax; relating to oil and gas production tax credits for certain losses and expenditures; relating to oil and gas production tax credit certificates; relating to nontransferable tax credits based on production; relating to the oil and gas tax credit fund; relating to annual statements by producers and explorers; relating to the determination of annual oil and gas production tax values including adjustments based on a percentage of gross value at the point of production from certain leases or properties; making conforming amendments; and providing for an effective date."

The Committee held six meetings with the intent of framing the discussion around SB 21 through a lens of evaluating direct impacts to the TAPS production decline. The Committee process was designed for fairness and equal participation by majority and minority members. The Committee included expert consultant, agency, the Alaskan public and industry testimony in the process through many productive hours and publicly-available meetings evaluating the potential positive and negative effects on production through revised Alaska oil tax policy. Most importantly, the Committee provided over five hours of Committee time for public testimony from every LIO in the state, as well as telephonically from any location. Every Alaskan that chose to address the Committee was warmly welcomed and given the opportunity to share their support and/or concerns.

The Committee has arrived at several key findings after completing the process of evaluating SB 21 and the effects of oil tax on production. They include:

- Regarding oil revenue that funds the vast majority of governmental functions for the people of Alaska, there are many factors in which the State has little control, including the price of North Slope oil. Total government take through oil taxation is the only lever under the control of the people of Alaska.
- The ACES tax structure has likely contributed to advancing the decline of oil production and throughput in TAPS, primarily due to a lack of competitiveness with other OECD producing regions.
- When evaluating with increased production as a primary objective, ACES credits should have been more specifically directed toward projects resulting in production and less toward general spending.
- Specific incentives and a competitive oil tax regime in Alaska will likely result in additional production-related spending.
- There has been a direct correlation in other OECD producing regions between production-related spending and increased production.
- Current fiscal spending policies appear to have an adverse effect on the business climate and willingness to invest in the State of Alaska. Policies must deliver the clear message to the business community that Alaska will not continue taxing to fund unsustainable levels of government spending.
- Although SB 21 is an adequate platform from which a respectful dialogue can begin, in the current form the bill may not adequately provide production credit incentives and opportunities; a level revenue proportion for Alaskans; and protections for Alaska hire and re-investment.

The Committee's intent to pass the bill to the Senate Resources Committee in the original form for further processing is in no way an expression of support by Committee members for SB 21 in current form. In fact, most members have expressed concern for key concepts that would require revision prior to supporting the bill as it moves through the legislative process.

Key concerns being passed through this letter with an expectation of consideration moving forward will be communicated in two sections. The first section below includes throughput-related Committee recommendations:

- Evaluate providing a guarantee of investment in Alaska and a further incentive for stemming production decline from leases or properties north of 68 degrees North latitude by fixing the amount of production used in determining the reasonable transportation costs to determine transportation deduction costs for pipelines and gas treatment plants under the Oil and Gas Production Tax and Oil Surcharge, AS 43.55, so that producers receive a benefit for increased oil production and throughput in the Trans Alaska Pipeline System but incur a corresponding limitation on deductions due to throughput declines after December 31, 2015.
- Evaluate expanding the application of the Gross Revenue Exclusion in units formed before 2003 (Legacy Areas). The Senate Resources Committee should specifically inquire about expansions of existing Participating Areas, increasing recovery factors in

existing Participating Areas, and Participating Areas that contain oil with an API gravity of 20 degrees or less.
- Evaluate specific production-related credits allowed under ACES for inclusion in SB 21 as a direct incentive for costs that deliver production. Require that credits are charged against actual production to eliminate currently-existing negative revenue liability to the State.

The Committee is united in several philosophies that are also recommendations to be considered in SB 21, not related to throughput, including:

- Firm incentives for Alaska Hire and Alaska Purchase,
- Evaluating significant and specific incentives for unconventional and heavy oil,
- Evaluating a production credit system for producers willing to provide propane fuels for the people of rural Alaska in areas unlikely to receive natural gas distribution if/when a natural gas pipeline is constructed, and
- Evaluating employing progressivity as a tool to level the proportion of take for Alaskans across the various oil price environments.

Although not supported unanimously by the Committee, yet in the spirit of fairness for all Committee members, the Minority Committee member has requested the following considerations to be passed onto the Senate Resource Committee:

- Evaluate a time limit into the future for the 20% Gross Revenue Exclusion.
- Evaluate removing the Net Operating Loss provision in SB 21.
- Evaluate adding a 10% minimum gross tax at the gross value at the point of production.
- Consider bracketing progressivity at varying rates as the price of oil varies.

The Senate Special Committee on Trans Alaska Pipeline System (TAPS) Throughput will continue to convene to identify and evaluate additional mitigation solutions for operational and regulatory TAPS production-related obstacles in the future. The Committee looks forward to the constructive dialogue and additional processing that will occur within the Legislature related to SB 21 the remainder of this session.

Respectfully submitted to the Senate Resource Committee on February 7, 2013,

Sen. Peter A. Micciche, Co-Chair

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