

State of Alaska
Department of Revenue

Commissioner Bryan Butcher



SEAN PARNELL, GOVERNOR

333 Willoughby Avenue, 11th Floor

P.O. Box 110400

Juneau, Alaska 99811-0400

Phone: (907) 465-2300

Fax: (907) 465-2389

The Honorable Bert Stedman
State Capitol Room 516
Juneau AK, 99801

March 23, 2012

SUBJECT: Response to Questions from March 5, 2012 email

Dear Senator Stedman:

Thank you for your questions and the opportunity to provide our responses. The questions and responses follow.

- 1. During testimony given to the Senate Resources Committee on February 23rd, you stated that the Department of Revenue has "more information than any other jurisdiction in North America." Please expand on your comment by explaining the basis of your comparison and outlining what information the Department has access to that other jurisdictions typically do not.**

Most oil and gas jurisdictions in North America tax petroleum production under a gross value-based production tax. A production tax based on gross value is very simple to administer and audit, since the basis for the tax calculation is the value of the oil and/or gas usually at the sales point or at the wellhead. The only costs generally recognized in a gross value-based production tax system, if any, are the costs to transport the oil and/or gas to market.

Alaska's production tax is based on the net value of oil and gas production – that is, the value of the oil and/or gas minus the allowable expenditures to produce that oil and/or gas. In order to administer and audit the production tax under a net system, the Department of Revenue requires companies to report allowable operating and capital expenditures used in computing the production tax. This information is further delineated when audits on production tax and tax credits are performed.

Additionally, twice annually the Department of Revenue receives 5-year expenditure projections for capital and operating expenditures on the North Slope. The department also meets with company representatives at least once annually to discuss future work plans in North Slope units. This step is taken in addition to the department's review of company-submitted plans of development.

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In response to a request for further information about types of expenditures, this past fall the department worked with industry to identify and organize the previous 5 years of capital expenditures into expenditure categories. This was an extensive process in which multiple workshops were held to come to agreement on category lists that span a wide list of companies with hundreds of thousands of lines of data. The department continues to work with the industry to provide further categorization of expenditures going forward.

The Alaska Department of Revenue had none of this data prior to the passage of a production tax on net profits as it was not required to administer or audit the tax system. It is highly unlikely that any other jurisdiction in North America has sought and obtained operating and capital expenditure data for their oil and/or gas production, and even less likely that the industry in those jurisdictions has compiled 5 years of this data into pre-defined categories.

- 2. Additionally, during that same testimony you stated that "there is information that we could certainly get that we haven't currently had...we are working to get that information." Please outline what types of information the Department is "working to get."**

At the request of the Department of Revenue Commissioner, in May 2011, the department launched a data assessment project with a purpose to establish the foundation of data types required by the department for establishing a centralized, reliable, secure, and automated database of oil and gas production and tax information for DOR staff to evaluate tax obligations, have efficient reporting and full compliance from oil and gas producers/explorers within the state of Alaska and for data integration into a revenue management system.

The objectives of the project were to assist in the design, development, and implementation of standardized reporting forms from industry leading to the development and implementation of a standardized and automated collection of oil and gas production volume, value, expense, credits, cost forecasts and revenue information to address tax related oil and gas economic, financial, and policy issues and questions for the legislature, the Governor and DOR.

During the data gathering exercise, the department identified the type and source of oil and gas data *currently received* by the DOR, DNR, and the AOGCC from various agencies and the oil industry. Identification included type of data, statutory authority which allowed the department's to receive the information, and the format in which the

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data was currently received. The exercise also identified *information shared*, in addition to specific DOR information needs *not currently received (data gaps)*. Attachment (A) called the "Industry Information Catalogue" contains the oil and gas information compiled.

Another aspect of the data assessment project included the 5 year look back of capital expenditures into pre-defined categories which was the beginning of the data gathering exercise undertaken by the Department of Revenue. The pre-defined categories for the look back were high level common categories used across the industry to serve as a historical baseline for analysis. Going forward the department has pre-defined and proposed more detailed capital expenditure and operating expenditure cost categories to the industry. The first workshop to discuss the pre-defined capital and operating expenditure cost categories with the industry was held in early December 2011. Industry comments were requested and the next workshop will be held in April 2012, after the annual production tax filing period was concluded. Attachment (B) titled "Proposed Master Expenditure Categories List" includes the detailed pre-defined capital and the operating expenditure categories published in the first industry workshop and is the additional information the department is working with the industry to obtain.

- 3. Also, during their February 8th presentation to the Senate Resources Committee, Robin Brena and Craig Richards provided a list of industry documents and information which they opined should be available to policymakers (list attached). Please provide a brief analysis of that list and comment on whether or not you believe this information might aid policymakers (i.e. legislators and cabinet-level members of the executive branch) in setting oil and gas tax policy. In your consideration, please assume that there are no statutory barriers to providing policymakers that information.**

Generally speaking, more relevant information is always helpful in aiding policymakers who set oil and gas tax policy. However, we think it is important to fully understand: 1) what information we currently receive; 2) why we are asking for additional information; and 3) what we intend to use this new information for.

In reviewing the list that was presented to Senate Resources by Robin Brena and Craig Richards, it is clear that the State already receives some of the suggested items on the list from taxpayers (DOR and DNR both receive certain information on the list). Some of this information is received by DOR through the audit process, and other information is submitted at DOR's request. It is important to note that the information submitted to

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DOR voluntarily is offered because the taxpayers know that DOR is required to hold that information confidential. Overall, much of this data may be useful in the context of determining the right mix of fiscal terms or the effectiveness of tax credits, but proper analysis and compiling this information would be difficult and require significant resources.

DOR compiles and aggregates certain information it receives from industry, and utilizes it to create reports, forecasts, models, etc. for the executive branch, the legislature, and the general public. We believe that this type of information is most useful when it is analyzed and compiled into reports, forecasts, and models that are much easier to read than the documents where the information came from. The documents that contain the information, by themselves, would not necessarily be helpful to anyone.

You asked that we "assume that there are no statutory barriers to providing policymakers that information," and we have made that assumption in our responses below. However, we feel it is important to note that much of this information is highly confidential, company specific, proprietary type information that will not be easy to obtain. If the legislature adopted statutes to require this type of information, it may result in Alaska being viewed as "not" business friendly, thereby furthering the competitive disadvantage ACES has already put the State of Alaska in.

Following are comments/notes on each specific item in the list:

Information Used for Internal Decisions

- **The complete version of the last three field development plans, for each field, provided to the working interest owners.**
 - We believe that a unit plan of Development (POD) must be filed and approved by the commissioner of DNR. Those plans must include information, to the extent it exists, on long range development activities for the unit, including plans to delineate all underlying oil and gas reserves and detailed plans of proposed operations for at least one year after submission of the plan.
 - DOR has statutory authority to require a producer, explorer or an operator of a lease or property to provide reports or records necessary to forecast state revenues, including records relating to proposed, expected or approved unit expenditures (as long as relating to unit budget matters).
 - A "field development plan" may refer to documents provided to working interest owners or filed with DNR. DNR could perhaps provide further

details. This information may be helpful, but may contain highly confidential, proprietary type information.

- **The resource support package for each field.**
 - No one within DOR seems to know what this entails, so we cannot comment.
- **All authorization for expenditures ("AFE"), or proposed AFEs that are for amounts over \$25 million and that were drafted in the last three years.**
 - DOR audit staff receives AFE's upon request during audit.
- **All annual and quarterly strategic and budget reporting documents (e.g., strategic planning unit and group financial outlooks), for the last two years, for each producer's Alaska operations.**
 - This information may be helpful, but again, this is highly confidential, proprietary type information that would not be easy to obtain.
- **All financial analysis and internal planning documents relating to heavy or viscous oil drafted in the last two years, including each producer's long term budget plan and production forecast for heavy oil and viscous oil development.**
 - Some of this is received by DOR staff at audit.
 - As noted above, information about development plans for heavy oil may be subject to PODs (DNR could confirm) and information is requested by DOR in its twice yearly requests to industry for production forecasts and planned expenditures.
- **A list of all projects made uneconomic by ACES, including the financial analysis supporting that conclusion.**
 - While a list like this (along with the supporting documentation) may be helpful to the legislature in setting oil and gas tax policy, the word "uneconomic" would need to be defined. An NPV of +\$1.00 "economic" and an NPV of \$0.00 "uneconomic".
 - While most of the ACES debate centered around Alaska's "fair share", deciding what is "uneconomic" cannot be analyzed in a vacuum. If modeling a hypothetical filed under ACES were to show a positive IRR or NPV (or whatever other index you choose), it may be "economic" but is it **competitive** when compared to other investment opportunities.
 - If we continue to focus on "economic vs uneconomic" and ignore whether or not we are **competitive**, we will go down the same rabbit trail that ACES lead us down.

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Information Developed for Regulatory Purposes

- **Everything provided to the BP Prudhoe Bay Royalty Trust or its auditors for yearend 2010 and 2011.**
 - Unsure of what this would show (the Trust is not a taxpayer, so it is outside of the realm of DOR).
- **The last two yearend review packages for each field.**
 - No one within DOR seems to know what this entails, so we cannot comment.

Information Provided to Potential Purchasers

- **In 2010, after the Gulf well blowout, BP considered selling its Alaska assets. BP set up electronic data rooms containing the documents about its Alaska operations that were necessary for potential purchasers to conduct their due diligence reviews. It would require little effort for BP to allow the Legislature access to those data rooms.**
 - This information may be helpful, but again, the information here was most likely highly confidential, company specific proprietary information. In addition, this specific example refers to documents that may or may not be related the administration of royalties and taxes. This type of information may be compiled for a potentially short time and for a specific purpose -- due diligence review. The purpose of the compilation should be of some consideration when considering whether information would be helpful to consider long-term policy decisions related to oil and gas tax policy or whether a state agency would have statutory authority to request the documents.
- 4. **Finally, on February 14th, Sen. Paskvan's staff forwarded your office a short list of requests from Senator Stedman (email attached). A few of those requests have been addressed. However, Senator Stedman is still very interested in seeing a graph depicting "projected capex of North Slope producers for FY2011-2016, delineated by type of producer (i.e. major vs. independent producers)".**

See answer to question #5 below.

- 5. **In a February 16th letter to the Senate Finance Committee re: "Response to questions from Senate Finance Hearing on February 2, 2012", you wrote in**

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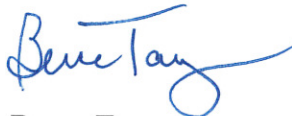
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part, "the Department of Revenue is seeking clarification from the Department of Law on the extent to which it can disclose information about expenditure forecasts provided by companies." However, in a December 21st letter to Senator Paskvan, the Department provided a table depicting capital expenditure estimates for FY2007 to FY2016. Please comment on why you might not be able to convert previously distributed information into a format committee members are more accustomed to.

As stated in our February 16, 2012 letter to the Senate Finance Committee, we are still seeking clarification about the level of disclosure the Department of Revenue can make with regard to company-submitted *expenditure projections*. In the letter to Senator Paskvan dated December 21, 2011, we provided aggregated data for North Slope capital and operating expenditure projections through FY 2016. We provided similar data in graphical form to the Senate Finance Committee on February 2, 2012. The request we noted from Senate Finance Committee, however, was that the committee requested that the department "provide further breakdown of the FY 13/14/15 expenditure forecasts as much as possible." There are several different ways that the expenditure projections could be further broken down, but we have not found clear statutory authority authorizing the department to make this information public. The department will continue to publish aggregated expenditure projection data that is used to compile revenue forecasts and seek clarification from the Department of Law on further delineation of this data.

We hope our responses fully answer your questions.

Sincerely,



Bruce Tangeman
Deputy Commissioner

cc: The Honorable Lyman Hoffman, Co-Chair Senate Finance Committee
The Honorable Donald Olson, Senate Finance Committee Member
The Honorable Dennis Egan, Senate Finance Committee Member
The Honorable Joe Thomas, Senate Finance Committee Member
The Honorable Johnny Ellis, Senate Finance Committee Member
The Honorable Lesil McGuire, Senate Finance Committee Member