

HOUSE FINANCE COMMITTEE
April 9, 2006
1:11 P.M.

CALL TO ORDER

Co-Chair Kevin Meyer called the House Finance Committee meeting to order at [1:11:32 PM](#).

MEMBERS PRESENT:

REPRESENTATIVES

Representative Mike Chenault, Co-Chair
Representative Kevin Meyer, Co-Chair
Representative Bill Stoltze, Vice-Chair
Representative Richard Foster
Representative Mike Hawker
Representative Reggie Joule
Representative Mike Kelly
Representative Beth Kerttula
Representative Carl Moses

MEMBERS ABSENT

Representative Jim Holm (Teleconferenced)
Representative Bruce Weyhrauch

SENATORS:

Senator Lyda Green
Senator Gary Wilken
Senator Fred Dyson
Senator Donny Olson
Senator Bert Steadman
Senator Ben Stevens
Senator Gary Stevens
Senator Thomas Wagoner

REPRESENTATIVES

Representative Harry Crawford
Representative Carl Gatto
Representative Ralph Samuels
Representative Paul Seaton

ALSO PRESENT

Daniel Johnston, Legislative Consultant, Daniel Johnston & Company Incorporate, Hancock, New Hampshire

SUMMARY

HB 488

An Act repealing the oil production tax and gas production tax and providing for a production tax on the net value of oil and gas; relating to the relationship of the production tax to other taxes; relating to the dates tax payments and surcharges are due under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the treatment of oil and gas production tax in a producer's settlement with the royalty owner; relating to flared gas, and to oil and gas used in the operation of a lease or property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55; providing for tax credits against the tax due under AS 43.55 for certain expenditures, losses, and surcharges; relating to statements or other information required to be filed with or furnished to the Department of Revenue, and relating to the penalty for failure to file certain reports, under AS 43.55; relating to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue, under AS 43.55; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the oil and gas production tax; relating to the deposit of money collected by the Department of Revenue under AS 43.55; relating to the calculation of the gross value at the point of production of oil or gas; relating to the determination of the net value of taxable oil and gas for purposes of a production tax on the net value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making conforming amendments; and providing for an effective date.

HB 488 was HEARD & HELD in Committee for further consideration.

#HB488

HOUSE BILL NO. 488

An Act repealing the oil production tax and gas production tax and providing for a production tax on the net value of oil and gas; relating to the relationship of the production tax to other taxes; relating to the dates tax payments and surcharges are due under AS 43.55; relating to interest on overpayments under AS 43.55; relating to the treatment of oil and gas production tax in a producer's settlement with the royalty owner; relating to flared gas, and to oil and gas used in the operation of a lease or property, under AS 43.55; relating to the prevailing value of oil or gas under AS 43.55;

providing for tax credits against the tax due under AS 43.55 for certain expenditures, losses, and surcharges; relating to statements or other information required to be filed with or furnished to the Department of Revenue, and relating to the penalty for failure to file certain reports, under AS 43.55; relating to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue, under AS 43.55; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the oil and gas production tax; relating to the deposit of money collected by the Department of Revenue under AS 43.55; relating to the calculation of the gross value at the point of production of oil or gas; relating to the determination of the net value of taxable oil and gas for purposes of a production tax on the net value of oil and gas; relating to the definitions of 'gas,' 'oil,' and certain other terms for purposes of AS 43.55; making conforming amendments; and providing for an effective date.

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DANIEL JOHNSTON, LEGISLATIVE CONSULTANT, DANIEL JOHNSTON & COMPANY INCORPORATE, HANCOCK, NEW HAMPSHIRE, provided a handout to Committee members, titled - Further Discussions of SB 305 & HB 488. (Copy on File)

Mr. Johnston remarked that the oil industry is working diligently to maintain their position and enumerated threats received from the industry:

- Investments will dry up with 25/20% proposal, including the progressive features
- Alaska reputation will be seriously harmed
- There may be no gas pipeline
- Philanthropic donations would be at risk

Mr. Johnston pointed out that large oil companies are fighting similar battles around the planet. It is important that Alaska understand why oil companies are fighting hard.

He provided an "independent view", expecting to continue work for the oil companies. He stated that he would never identify the actual profits made by the companies. Oil companies in general lost hundreds of millions of dollars before the 1970's. They continued to pump oil in expectation that those prices would rise.

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Mr. Johnston suggested that times like the present should be rather glorious for the State of Alaska, however, the current system is regressive. Oil prices could easily continue to rise.

Page 2 of the handout provides a comparison of Alaska with peer groups from around the world. He recommended that Alaska not be compared to Kansas or Colorado. Alaska does have problems but the major players would rather be here than any other state. There are a couple countries that compare to Alaska, one of which is Russia. Russia has fields governed through a royalty tax system. The terms under that contract are so "tough" that it would make Alaska look like one of the "finest places on the planet". The Russian terms are difficult given the royalty tax arrangement, where they expect tariffs at \$30 dollars a barrel off the top. He pointed out that the same producers in Alaska operate in Russia.

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Mr. Johnston took threats being made by the oil companies with a "grain of salt", pointing out their continued involvement in those places.

Mr. Johnston referenced the graph on Page 2, indicating government take from oil prices from around the world. The graph demonstrates that fiscal terms could be priced @ the \$60 dollars per barrel price. Moving from \$20 to \$60 dollars per barrel indicates a 90% profit. Governments do not change terms in that fashion and instead, the graph indicates the upside of barrel prices at each rate. Alaska is proposing only a 5-percentage point increased intake not 30.

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Page 3 highlights the countries that are progressive. Mr. Johnston pointed out that Azerbaijan has a progressive rate throughout the range, with a system rate of return featuring no royalty or cost recovery limit. The world today captures rate of return features. The government takes are under the government contracts and fluctuate; the kind of option most governments wish they had. Most systems are regressive systems, but that 20% have progressive features.

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Mr. Johnston stated that the version from the Senate Finance Committee does not destroy the State's reputation.

Page 4, China's finance ministry added a 20% tax with a sliding scale for prices above \$40 dollars a barrel a scale is similar to what is being proposed in Alaska and is

referred to as a windfall profit type-tax or price cap formula. He stressed the actions taken in China are "horrifying" to the oil companies.

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Pages 5 & 6: Mr. Johnston commented on a response he received from Dr. Juan Carlos Boue, Oxford University, regarding the question of rigging the rules, understanding the profitability and prospects of upstream oil activities in the offshore U.S. Gulf of Mexico. It is not unique that in Alaska, oil companies have significant power. It is frustrating for governments, when those companies operating in there, rival the power of the government. One of the "worst situations" exists in Mexico with PEMEX having "way too much control".

Mr. Johnston referenced the United Kingdom (UK) North Sea output maturing fields, often put forward as a prime example of the power of a more flexible taxation scheme. He discussed industry and taxation, central to Alaskans. Increasing the government take is another name for an "effective tax rate".

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British Petroleum (BP) claims that after 1993, they increased their investment in the North Sea. They were selective in their choice of statistics and focused only on what they did; however, the information points out that in general, investment in the North Sea after 1993 that industry did not increase investment activity and development activity remained the same.

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Page 10 indicates Norwegian production increased significantly at a time when they did not drop the tax rates. When taxes did drop in 1993, production appeared that the industry was responding to an anticipated drop rate, that was not the case. In 1968, the UK allowed the equivalent of credits for exploration drilling, which is why it increased dramatically. Taxes were reduced but it was moderate. It is understood that allowing credits, reduces taxes.

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Page 10: Mr. Johnston continued the number of fields brought on line after 1993:

- Andrew
- Harding

- Fionaven
- Schiehallion
- Eastern Trough Area Project (ETAP)

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Page 11: Mr. Johnston spoke to the Norwegian development activity before and after 1993. Taxes were not changed during that period. Oil companies are threatening Alaska with false hope and loss of the gas pipeline, which does not fit with information existing in other parts of the world. He reiterated that the Norwegian exploration activity before and after the 1993 huge tax cuts. He recommended that Alaska demand information stating that there will be a severe drop in economic activity through the proposed changes. Enough information has not been provided to justify that conclusion.

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Page 12: Mr. Johnston read an article from the "Economist" dated March 16th, 2006, which highlight that new taxes would bump a 10% increase in government take. At today's oil price, the impact on development would be minimal. The danger comes when prices start to slip. Mr. Johnston mentioned the Wyoming experience, which is second only to Alaska in regard to the importance that the oil industry plays to the economy and is important research to what is happening in Alaska.

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Mr. Johnston recommended that information provided by the oil industry should be presented more fairly, emphasizing that those companies are "bullying" Alaskans. He offered to answer questions of the Committee.

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Co-Chair Meyer had not recalled the comparison of Alaska to Kansas but had heard a comparison to Texas and the Gulf shores. He noted that in Texas, drilling is allowed most of the year with lower drilling costs. Mr. Johnston acknowledged comparisons in states throughout the U.S. He was aware of the weather windows as compared to Texas, given the permitting and low cost environment there and thought it would be more appropriate to compare such places to Cook Inlet.

The North Slope consists 90% - Prudhoe Bay and Kaparuck. Most oil tax action does not involve exploration. Mr. Johnston suggested Alaska has not made enough room made for smaller oil companies. In order to compete with places like

Texas with easier permitting, more must than what is being offered in the proposed legislation must be done. He reiterated Russia is the best comparison.

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Co-Chair Meyer asked which parts of Russia were being compared. He was hopeful to discover more exploration sites and in a country like Russia, it would be difficult to compete with those costs. Mr. Johnston advised that the big companies are already in Alaska. Russia does not have the permitting problems, however, many more bureaucracy concerns. He emphasized the huge advantages that Alaska offers; the conditions would have to be glorious in Russia to invest there rather than here.

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Co-Chair Meyer thought that the potential for larger fields would be better in Russia than in Alaska. He referenced the known oil accumulations on the North Slope. He asked if the Governor's proposal was enough incentive to get at that oil.

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Mr. Johnston pointed out that ConocoPhillips first went to Russia in the 1990's, which has been "a bit of a nightmare". To imply that Russia has virtues that do not exist in Alaska is untrue. Heavy oil hasn't changed much over the years. None of the proposals before the Legislature adequately address heavy oil unless oil prices stay at \$60 dollars a barrel. The proposed system attempts to be all things to those involved.

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In response to comments by Co-Chair Meyer, Mr. Johnston clarified that he does not expect prices to stay at \$60 dollars per barrel.

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SENATOR GARY WILKEN recalled times when oil was projected to stay below \$20 dollars a barrel for decades. He asked what part prospectivity plays for Alaska.

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Mr. Johnston advised that the issue is complex and that treats the National Petroleum Reserve-Alaska (NPR) areas separately from the Alaska National Wildlife Refuge (ANWR) area. He mentioned that the field size expectation, distribution and prospectivity are significantly different in those areas. Prospectivity identifies exploration

activity; 80% of the current drama discussions are not about exploration.

Mr. Johnston said the State will be short changed with the proposed plan. He did not know how many more alpine fields exist. He recommended designing terms accommodate to all situations for the two big fields.

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Senator Wilken asked to what degree does prospectivity drive a project. Mr. Johnston replied it is the major driver.

Senator Wilken pointed out comments regarding cataclysmic events assuming a change. At the highlighted numbers, it could mean a \$300 - \$400 million dollar per year to people of Alaska, a 4% increase to government take. He questioned if 4% in government take, could fuel the industry to remove operations from Alaska.

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Mr. Johnston said he has been doing this kind of work for 25 years and has never ever seen statistics lowering indicating the level of activity from changes in a tax rate. He questioned how ConocoPhillips could make the statement that a 2% increase in government-take would reduce investment by 20%.

Mr. Johnston noted the change in the UK tax rate, pointing out that investment remained the same. In Venezuela on April 1, 2006, new harsh terms were declared and most companies agreed to the terms and remained. Increasing the government take by 3 - 4 percentage points is not significant. He noted that industry agreed to the terms offered by the Governor and he concluded that the difference between those numbers and the ones being proposed is not significant.

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Senator Wilken stated that the well-being for Alaskans had not been addressed. He pointed out assertions that Mr. Johnston does not live in Alaska & really does not have an investment in Alaska. He inquired why Alaskans should listen to Mr. Johnston. Mr. Johnston observed that his reputation could be judged by his statements during the Committee process and maintained that he cares deeply about what happens here.

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Representative Kerttula expressed concern with statements that "we cannot separate out" legacy fields from exploration

in Cook Inlet for the heavy oil. Mr. Johnston agreed it would be better to separate them, but did not think it was feasible, especially within the legislative session. He emphasized the vast differences.

Representative Kerttula questioned the rough boundary differences for treating legacy fields from exploration and heavy oil. Mr. Johnston stated that the differences are dramatic. In the legacy fields alone, there are production rates of decline. The spectrum of exploration could create an additional category of reserve, subject to different terms. The incentive for exploration could be different with higher risks. Cook Inlet has its own problems and boundary conditions such as the high water cut over 90%. A couple of platforms have been abandoned in Cook Inlet, which is discouraging, given the number of jobs that exist; he voiced concern with further withdrawals.

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SENATOR FRED DYSON acknowledged the issue of the high water cuts in Cook Inlet. He observed that the Alaska Regulatory Commission (ARC) allows for gas discoveries but that there is not much of a market for new gas. There is not an easy place to sell new gas. He stated that Alaskans are on the edge of encountering demand concerns while looking at supply problems over 5 years. The concern is how to give incentive for more exploration and production in Cook Inlet.

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Mr. Johnston observed that he is not well versed in Cook Inlet gas and hoped to explore those issues in the future. Senator Dyson noted that some of the non-legacy owners in Prudhoe Bay would have access to processing facilities because they are bumping up against their capacity to handle water. He asked how could short-term incentives for those facilities to be expanded.

Mr. Johnston noted that one of the founding principles of the Administration's work is to provide access to facilities and the infrastructure for small producers. In order to provide facilities for the bigger producers, there will be costs and it might have to be a tariff or fee of some sort. He did not have further information on the issue.

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SENATOR LYDA GREEN addressed the underlying concern regarding the surety of the 30-year window. She questioned how other entities balance these situations. Mr. Johnston advised that his position had not changed regarding the producers need for certainty, especially in light of increases in the steel prices. He observed that there is a

range of possibilities for certainty and maintained that one of Alaska's sovereign rights is to make changes. He stressed that once a change is made, it remains for many years and said certainty must have a "value". A robust progressive system is needed to address what is requested & required. He observed how the capital costs for the gas pipeline have increased. In similar situations, producers have moved forward without certainty.

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Senator Green inquired where a cap on progressivity could fit. Mr. Johnston noted that the Chinese capped their progressivity at \$60 a barrel with a tax rate of 40%. He acknowledged that progressivity could go "to far", but questioned why capping the price, which could allow everyone to share in the high prices of oil.

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Mr. Johnston understood the desire for an incentive based arrangement. He observed that an oil reserve tax is fairly punitive and expressed concern with the approach. He observed that there are a number of situations in which the government would like to see the oil companies move faster. Oil companies hold the acreage and have a lot of power. He did know what incentives could be put into a gas pipeline contract to assure that it goes forward. Companies can delay if they feel abused and must be unanimous to move forward, which places Alaska at a disadvantage.

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Senator Dyson asked if credits could be structured so that they can offset to help achieve the pipeline. Mr. Johnston had not considered that, but thought it sounded "interesting".

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Vice Chair Stoltze noted that he was puzzled with the Governor's 20/20 proposal and asked if it was "usual dynamics" for oil companies. Mr. Johnston thought so and was surprised by the protection mechanisms offered by the industry.

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SENATOR DONNY OLSON referenced an article submitted to the Senate Finance Committee (SFC) by the Eastern Nova Scotia Province, asking for Mr. Johnston's comments regarding the stringent tax structure proposed. Mr. Johnston responded that he had seen the article, which fascinated him. The last time he was in New Foundland, he discussed those

concerns with the Prime Minister and the circumstances there are similar to Alaska. The federal government taxes at the federal level, leaving little maneuvering ability. That providence rivals North Slope conditions with offshore icebergs and worse conditions than the North Sea. In order to work, the area would have had to bend further than they are willing. He could add no any further information on the situation.

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Mr. Johnston acknowledged the article was valid and the main purpose article highlighted that "negotiations broke down and oil companies walked away". He did not know the terms or conditions offered under the contract and recommended finding out more information regarding the circumstances.

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Representative Kelly inquired if Mr. Johnston stuck by his original proposal. Mr. Johnston stated that he was not comfortable with the Governor's 20/20 or the neutrality of that proposal. He noted the amount of lobbying pressure occurring during the process; lobbying power of the oil companies is substantial. They are not going to try to resurrect the process. There are many dimensions to the certainty. He voiced strong support for starting at 25/20, attaching a progressivity scale.

Representative Kelly asked if Mr. Johnston supported the progressivity ratio of 50/40. Mr. Johnston advised that he recommended the start point be about \$25 dollars a barrel. Most producers have made it clear that they are not interested in major investments at that price. He said that \$40 dollars a barrel would be a significant change and that he was comfortable with that number. Mr. Johnston felt there was room for negotiations beginning at \$40 dollars a barrel.

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Representative Kelly inquired the maximum terms of the contract that the State of Alaska should consider. Mr. Johnston claimed that it would be unfair to insist on both certainty in gas and oil. A typical contract is 25-years, which he said was "unthinkable" & recommended that 10-years was more reasonable. If the State leaves money on the table, the oil companies would not fix it. If the State asks too much, they have the power to change. There should be certainty with regard to the gas line as it will take 12-years before the State starts producing. To reach half-life of the gas will take 25-years. He recommended that offering all equity interest could help and pointed out that he has strongly lobbied for progressive terms on oil and now gas.

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Representative Kelly addressed bottom tax concerns. Mr. Johnston responded that it should not matter if it went to zero, if oil prices fall below \$25 dollars a barrel. At zero, a severance tax could be okay if a royalty amount was included. To a large extent, it is an estimate on what the expected prices of oil will be. He did not think oil prices would weaken significantly as the pressure seems to be moving upward.

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Representative Kelly mentioned the no-start date for a gas contract. Mr. Johnston voiced concern regarding a hard and firm start date; industry has proven that mega projects usually come in over-budget and never are on time. It is difficult to account for that. Crafting language for something new is worrisome. It usually takes ten years before contract language can appropriately address possible outcomes. He could not offer any alternatives to a firm start deadline.

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Representative Kelly worried about any contract that would affect Alaska for 15-years. Mr. Johnston added that there are circumstances governed by the commerciality of a contract, determining if a field is viable or not. He emphasized that the option before the Committee presents a unique situation that might not be best for the State.

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Representative Kelly addressed the challenges of pipeline in-fill and the gamble associated with that for Alaska.

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Co-Chair Meyer appreciated the 2 for 1 idea coming from the Senate Resource Committee (SRC). Mr. Johnston stated that his first impulse was negative to that idea. The House Resource Committee (HRC) attempted to determine if that result would achieve increased investment. The 2 for 1 proposal could help satisfy both conditions of fairness and economic logic on investments made during that time made and it encourages the original investment because it enables recouped costs.

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Co-Chair Meyer commented that the goal of the State, similar to that of the oil companies, is to maximize the return to

the State's shareholders. He asked if the goal should rather be getting more out of declining existing fields. Mr. Johnston pointed out a general consensus that "80% of the action" is in existing fields. The idea of the demise of exploration is premature; there is virtue in further exploration. He thought, there would be some pleasant surprises. Dollar for dollar, the two big legacy fields and significant accumulation of heavy oil, is where the State should be spending most of their time; however, not to the exclusion of exploration.

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Co-Chair Meyer recommended that the issues be addressed separately. Mr. Johnston stated that during his testimony on March 6th, the tax and the credits were directly discussed, an attempt to balance the existing tax production.

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Co-Chair Meyer questioned if larger oil companies would opt to spend their dollars in Alaska or the Gulf of Mexico if Alaska chooses the 25/20 plan. Mr. Johnston stated that he could run those numbers to determine the choice including progressivity, reserves, cost rates and costs involved.

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Co-Chair Meyer recommended comparing Alaska to Texas & the Gulf of Mexico rather than Russia. He thought that opportunities for working year round and tax rates were more favorable in Texas.

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Representative Kerttula mentioned negotiation considerations and the unlikelihood of a low side and worried about incorporating a "floor" at the low side. When she had written contracts, a date certain was always included to address delays.

Mr. Johnston responded that oil prices falling below \$25 dollars a barrel could happen at the end of exploration. A mechanism must be in place to accommodate such situations. The \$9 a barrel scenario happened in 1998, but did not last long. If that happens again, the State and the industry will need to revisit the situation. He continued, a start date is a difficult consideration and he could not conceive of a hard date with all the uncertainties.

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Mr. Johnston responded to Representative Kerttula that he was not able to provide a single tax rate to cover all fields and situations.

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SENATOR BEN STEVENS referred to the graph on Page 9 of the handout. He observed that of the 10 largest fields brought on line during that time (1980 - 2000), 8 were in Norway. He thought that the increase in those fields resulted from the access to resources. They were the largest fields outside of the Middle East during that period. He suggested that if Alaska's productions were overlaid, those challenges could become obvious. Mr. Johnston responded that the characterization of the tax rate impact the United Kingdom (UK) was over simplified and not correct. He noted that the investment activity in Norway and the production profile was dramatic and he believed that exploration must have occurred earlier when fiscal terms were tough. He pointed out that the climate and the regulatory terms in Norway are severe.

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Senator Stevens suggested that government-owned oil companies were doing the exploration. Mr. Johnston doubted that they were doing all or even most of the exploration.

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Senator Stevens referred to Page 3, graph 2. He counted 9 progressive systems and 23 countries that have production-share agreements and 4 with service agreements. He concluded that there appears to be a small percentage with progressivity, including the "R" factor. He was curious about the terms of a production sharing agreement, recalling that the average time of such an agreement was 23 years. Mr. Johnston responded that 10 years would be reasonable in the absence of a certainty clause. If a change were made by the Legislature, it would be unthinkable that it could be reconsidered sooner than 10 years. He clarified that the average term of a production contract is about 25 years. That does not mean that the fiscal terms cannot be changed and noted that contract terms have changed worldwide. Some of the production-sharing contracts are more stable, but he knew of no country that gave up their sovereignty.

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Senator Stevens questioned why statements regarding onerous tax increases & their impacts should be discarded. Mr. Johnston disagreed that the tax rates being discussed were onerous. He observed that those working in the industry are not as objective as they should be. He pointed out he had been given a mandate to be "objective". He stressed his

intent to be objective and to provide prospective for both sides & advised that he was not being onerous but attempting to protect those non-oil interests.

Senator Stevens continued, the decisions being made will impact the people of Alaska, who should be listened to. Mr. Johnston stressed that the process has included all types of people and that he had listened to testimony from all sides to learn the process. Industry is not the only entity that needs to have representation. He maintained that Alaskans want to take care of the oil industry "almost to a fault", because no one wants to hurt Cook Inlet.

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SENATOR BERT STEADMAN stated that the only way the State can really know what the resource is worth is to have them withdrawn and re-bid. He questioned the range if the resource were relinquished. Mr. Johnston referred to Indonesia where contracts were relinquished and then re-bid. He observed that after 30 years, terms had been renegotiated. It was acknowledged that if the government had taken ownership at the end of the contract, the industry would have stopped production 5 years before the terms ended; the result was a \$60 million dollar bonus.

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Senator Steadman assumed that the government's take could be higher than what currently is on the table. He understood that the intent was to stimulate production and exploration until the gas line comes on. The hope is to leave some on the table, not driving off the industry. Mr. Johnston maintained that there is stillroom to error on the conservative side, although it is difficult to know what that number is. He referred to other markets, observing that there have never been prices demonstrated in the 1990's. He said that many of his friends living in the United Kingdom (UK) believe that the terms being offered in Alaska are "luke warm".

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Representative Kelly referred to the prospective price and asked what sort of adjustment was needed. Mr. Johnston explained that there were two dimensions and relatively speaking, prospectivity has not changed a lot as oil prices have. Increase in oil prices does not happen immediately; it takes a couple of years of drilling activity, costs of services are increasing.

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Representative Kelly commented that the relative progressivity could change little and asked if the numbers could be changed at a later date. Mr. Johnston did not know the mechanisms that exist to address royalty reductions but believed that someone must have the authority to do it. Presently, there are no beneficiaries.

Representative Kelly spoke to the fairness of the 2 for 1, derived from a base average initial investment and asked about the effective date. Mr. Johnston had not thought about inserting a threshold. Regarding the effective date, he recommended that it be sooner rather than later. He identified sense of urgency to fix a "broken system". He spoke to the amount of money that the State would be loosing by not putting the systems in place. He thought that January 2006 might be an appropriate start date and was open to discussion.

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Representative Kerttula asked about critical audit functions. Mr. Johnston agreed it was a big issue, stating that auditors are worth their weight in gold. There are many concerns about having profit-based mechanisms in place. About 70% of what governments receive in this world comes from profit-based mechanisms. Most of the means by which governments insure that the accounting is done properly, is "field-proven" off the shelf methods, often done with great success. He pointed out royalty determination disputes. He recommended that it is important to get the tax rate right at the beginning when determining a correct structure.

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Senator Dyson noted his support for the Governor's proposal and the blanket credit for development work. He asked if a standard definition had been used. Mr. Johnston explained that with the boundary conditions placed on the Department of Revenue, they did what they had to do to accommodate the situation within a single system and determined:

- Tax Rates
- Credit Systems
- Allowances

Mr. Johnston recommended a system to cover all the structures. For enhanced oil, there are no well-established guidelines for what could be appropriate; which is important to establish guidelines, as there is a substantial amount of heavy oil in Alaska.

HB 488 was HELD in Committee for further consideration.

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3:59:04 PM

ADJOURNMENT

The meeting was adjourned at 3:58 P.M.