

HOUSE FINANCE COMMITTEE
April 29, 2006
4:27 p.m.

CALL TO ORDER

Co-Chair Chenault called the House Finance Committee meeting to order at [4:27:53 PM](#).

MEMBERS PRESENT

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

MEMBERS ABSENT

Representative Jim Holm
Representative Richard Foster
Representative Bruce Weyhrauch

ALSO PRESENT

Representative Kurt Olson; Representative Paul Seaton;
Representative Vic Kohring; Representative John Coghill;
Senator Gene Therriault; Representative Ethan Berkowitz

PRESENT VIA TELECONFERENCE

Dr. Tony Finizza, Special Consultant, Econ One, Research, Contractor, Legislative Budget and Audit Committee

SUMMARY

CSSB 305(FIN) am

"An Act repealing the oil production tax and the gas production tax and providing for a production tax on oil and gas; relating to the calculation of the gross value at the point of production of oil and gas and to the determination of the value of oil and gas for purposes of the production tax on oil and gas; providing for tax credits against the production tax on oil and gas; relating to the relationship of the production tax on oil and gas to other taxes, to the dates those tax payments and surcharges are due, to interest on overpayments of the tax, and to the treatment of the tax in a producer's settlement with the royalty owners; relating to flared gas, and to oil

and gas used in the operation of a lease or property under the production tax; relating to the prevailing value of oil and gas under the production tax; relating to surcharges on oil; relating to statements or other information required to be filed with or furnished to the Department of Revenue, to the penalty for failure to file certain reports for the tax, to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue as applicable to the administration of the tax; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the tax, and to the deposit of tax money collected by the Department of Revenue; amending the definitions of 'gas,' 'oil,' and certain other terms for purposes of the production tax, and as the definition of the term 'gas' applies in the Alaska Stranded Gas Development Act, and adding further definitions; making conforming amendments; and providing for an effective date."

CSSB 305 (FIN) am was heard and HELD in Committee for further consideration.

[4:28:16 PM](#)

CS FOR SENATE BILL NO. 305(FIN) am

"An Act repealing the oil production tax and the gas production tax and providing for a production tax on oil and gas; relating to the calculation of the gross value at the point of production of oil and gas and to the determination of the value of oil and gas for purposes of the production tax on oil and gas; providing for tax credits against the production tax on oil and gas; relating to the relationship of the production tax on oil and gas to other taxes, to the dates those tax payments and surcharges are due, to interest on overpayments of the tax, and to the treatment of the tax in a producer's settlement with the royalty owners; relating to flared gas, and to oil and gas used in the operation of a lease or property under the production tax; relating to the prevailing value of oil and gas under the production tax; relating to surcharges on oil; relating to statements or other information required to be filed with or furnished to the Department of Revenue, to the penalty for failure to file certain reports for the tax, to the powers of the Department of Revenue, and to the disclosure of certain information required to be furnished to the Department of Revenue as applicable to the

administration of the tax; relating to criminal penalties for violating conditions governing access to and use of confidential information relating to the tax, and to the deposit of tax money collected by the Department of Revenue; amending the definitions of 'gas,' 'oil,' and certain other terms for purposes of the production tax, and as the definition of the term 'gas' applies in the Alaska Stranded Gas Development Act, and adding further definitions; making conforming amendments; and providing for an effective date."

[4:29:06 PM](#)

Co-Chair Chenault asked for clarification of the various tax rates on gas production under different tax systems. He noted concern on the 1/3 gas revenue reduction scenario.

DR. TONY FINIZZA, SPECIAL CONSULTANT, ECON ONE, RESEARCH, CONTRACTOR, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, discussed the risk of the credit rate in terms of the view of the future. He said that oil companies are using a distribution of prices when planning, which has a central value around \$40 WTI, plus or minus \$15, to get to the P 20 and P 80. That is consistent with Dr. Van Meurs' data. He pointed out that there is no one view of the future. He said, "You really have to think of these things in terms of distribution." He speculated that it could amount to \$25 or \$50. Also, the central tendency might be closer to \$40.

Dr. Finizza discussed his analysis of three types of fields using a distribution of prices, which estimates the probability of a negative tax position. The first field was for new exploration. It is likely that small field would be found, given the fact that ANWR is not open and that the distribution of fields in the Central North Slope and NPRA are likely to be smaller fields. He said there could be a non-economic development and the possibility of a negative credit in new exploration. He estimated that probability at 35 percent at the 20 percent credit, with a 25 percent credit that probability might go up 5 percent. He opined that moving to a 25 percent credit doesn't do that much more damage, given the already high-risk situation.

[4:35:26 PM](#)

Dr. Finizza looked at a satellite field under this future price distribution. The chance of the state having a negative tax position is 25 percent at a 20/20 rate. He also applied that same data to a legacy field wedge and found only a 5 or 6 percent chance of a negative tax. He stated that there is a huge risk already at 20 percent credit and going to 25 percent would boost the risk only a little bit.

[4:37:12 PM](#)

Dr. Finizza related that there is a natural protection at low prices, because there would be little exploration. The advantage of the credit system is when exploration takes place at \$40 and then the price of oil drops to \$20. He maintained that 25 percent does no more damage than 20 percent.

Dr. Finizza addressed the progressivity feature. He emphasized that it is important to strike a balance between the upside and the downside. He suggested \$50, which is above the central tendency. He voiced a concern that the progressivity rate is in nominal dollars and could harm producers when costs rise. He suggested various thresholds, especially one that is sensitive to changes in costs. He opined that SB 305 should have a cap on progressivity.

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Dr. Finizza thought that a 25 percent tax rate was appropriate. He noted that investment should rise when prices rise, which should produce more investment. He predicted that there would be more investment under PPT at today's prices.

Dr. Finizza referred to legacy fields and the decline rate. He maintained that PPT helps lower the effective severance tax rate by 3 to 4 percent at \$40.

[4:46:02 PM](#)

Representative Kerttula asked how high the tax risk is at 20 percent. Dr. Finizza replied that a satellite field would have a 25 percent chance of losing money, but the large legacy fields would have a much lower rate of 3 to 4 percent. The higher the credit, the more likely chance of a negative tax. He restated his position that the risk is already high at 20 percent, so 25 percent is not that much greater.

Representative Kelly concluded that Dr. Finizza is less concerned than the governor or Dr. Van Meurs about the level of credit going from 20 to 25 percent. Dr. Finizza rephrased Representative Kelly's question to ask if there is risk to investors that would prevent investing in Alaska. Dr. Finizza thought it was not necessary to have a safety net.

Representative Kelly summarized that Dr. Finizza would not favor the safety net even though there is a 35 percent chance of high risk. He asked why the tradeoff is needed if there is a safety net. Dr. Finizza responded that the sweet spot in the price curve is between \$25 and \$50 - where the

world will be in the future. The PPT credit and tax system will give protection on the low end and will still be ahead on the upside. He predicted it would bring in more exploration.

[4:53:21 PM](#)

Representative Kelly wondered where the floor should be. Dr. Finizza replied, "When there is a 10 percent chance." He added that he needed more time to think about it. Representative Kelly asked about a floor for the tax when it is approaching zero. Dr. Finizza replied that the 35 percent possibility is for new field exploration. If it is not for the legacy fields, it would work. For legacy fields the risk is only 3-4 percent. If a floor for exploration is designed, tradeoff is loss of exploration. Representative Kelly noted that he is trying to write a tax for everyone. He requested more information.

Co-Chair Meyer commented that if oil gets down to \$20, Alaska is in big trouble. The Committee needs to keep in mind that the government take consists of royalty, property taxes, and corporate taxes.

[4:57:57 PM](#)

Dr. Finizza spoke to concerns about the effective tax on gas under various systems.

Co-Chair Chenault referred to the three charts that deal with "Illustration of Potential Effective Tax Rate on Gas Production Under Different Tax Systems (copy on file.) The current Senate Finance CS before the Committee contains 25/20 with gas revenue reduction to 1/3 of actual value.

Dr. Finizza addressed the issues on the graph that deals with Senate Finance 22.5/25 Alt: With Gas Revenue Reduction to 1/3 of Actual Value. He related that the graph shows the downstream value of gas at \$4, \$6, and \$8 (\$MCF). Cost to the downstream market, the wellhead value, and the taxable wellhead value under the 1/3 scenario in Prudhoe Bay is shown. The final column depicts the total tax under the three tax systems after analyzing production costs, net "profit" per taxable MCF, taxable value, and PPT Tax. He discussed what happens when this analysis is applied to Point Thompson and a new field. He related what would happen under the current ELF.

[5:03:58 PM](#)

Co-Chair Chenault noted that some of the Committee's concerns were about the actual percentages of wellhead value at Prudhoe Bay, Point Thompson, and in new fields. The

chart depicts that there are no costs associated with OPEX or CAPEX in Prudhoe Bay.

Dr. Finizza agreed that there would be costs associated with that in the future. He spoke to how capital allocation would affect Point Thompson. The capital should be allocated in proportion to the gas.

Representative Kelly said the numbers under the 1/3 scenario don't seem to work. Dr. Finizza said at first he thought it was a mistake because it makes Prudhoe and ELF numbers look the same.

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Representative Kelly thought there was an attempt to figure whether costs were ascribed to oil or to gas. He termed it a policy call. Dr. Finizza agreed, depending on what is trying to be accomplished. For Point Thompson all the capital should go to gas because oil is a by-product. Representative Kelly said it is a problem.

Dr. Finizza agreed that more time should be taken. Representative Kerttula echoed Representative Kelly's concern. Dr. Finizza could not offer a number, but said 1/3 won't work.

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Representative Kerttula said the legislature was told the effort was to help the small companies. She questioned whether oil and gas should be treated separately.

Representative Kelly gave an example of a larger-than-expected field discovery. He opined that the state still has drilling potential and should group this together to accommodate that. He suggested pursuing it further.

Dr. Finizza agreed to do more research on the topic.

Co-Chair Chenault wondered if the scenario was thrown in by mistake.

Representative Kelly asked about the safety net and the oil price protection point. He suggested trying to protect Alaska at the lower price of the commodity.

Representative Kerttula asked Dr. Finizza to show the results in dollars for the different scenarios of likely prices and likely volumes. Dr. Finizza said he was trying not to bring gas into the PPT scenarios. He suggested "a rule of thumb". He suggested oil price scenarios using a ratio of market value gas to oil, an 8 to 1 ratio, at \$30, \$40, and \$50. Representative Kerttula said that is what she is looking

for. Representative Kerttula also asked for volume information.

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ADJOURNMENT

The meeting was adjourned at 5:21 PM.