HOUSE FINANCE COMMITTEE
July 25, 2006
10:17 a.m.

CALL TO ORDER

Co-Chair Chenault called the House Finance Committee meeting to order at 10:17:10 AM.

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

Dr. Pedro Van Meurs, Consultant, Office of the Governor; Robynn Wilson, Director, Division of Tax, Department of Revenue; Roger Marks, Petroleum Economist, Economic Research Section, Tax Division, Department of Revenue; Ken Griffin, Deputy Commissioner, Department of Revenue; William Corbus, Commissioner, Department of Revenue; Representative Les Gara; Representative Ethan Berkowitz; Representative Ralph Samuels; Representative Kurt Olsen; Representative Jay Ramras; Representative Paul Seaton; Representative Berta Gardner; Senator Charlie Huggins

PRESENT VIA TELECONFERENCE

Roger Marks, Petroleum Economist, Economic Research Section, Tax Division, Department of Revenue; Robert Mintz, Assistant Attorney General, Department of Law

SUMMARY

Oil and Gas Production Tax: Gross vs. Net

10:17:32 AM

Co-Chair Chenault introduced the presenters on the topic of net versus gross regarding the oil and gas production tax.

He noted that Mr. Larry Carr was invited to speak before the committee, but declined.

Co-Chair Chenault turned the gavel over to Representative Stoltze.

Co-Chair Chenault brought up a point of personal privilege. He referred to an editorial in the Juneau Empire by former member of the House, Mayor Jim Wittaker, of Fairbanks, regarding legislative conflict of interest. Co-Chair Chenault stated that his integrity, along with Co-Chair Meyer's and Representative Hawker's, has been impugned. He noted that they all had declared a conflict of interest at the beginning of the committee process, which is not required by Mason's Manual. He emphasized that it is his job to represent his district and therefore he is obligated to vote on gas and oil bills. He took issue with the article and maintained that the committee is within legal and moral rights when acting on oil and gas legislation. He stated that the article is a personal attack.

10:22:59 AM

Co-Chair Meyer agreed with Co-Chair Chenault's comments regarding the newspaper article. He recalled that a legal opinion was requested on the issue of declaring a conflict of interest. The conclusion was that at the committee level declaring a conflict of interest is not required. He maintained that the House Finance Committee has gone the extra mile, declared conflicts, and kept open meetings.

10:26:28 AM

Representative Hawker requested an opportunity for a point of personal privilege. He concurred with Co-Chair Meyer and Co-Chair Chenault's comments. He expressed disappointment and sadness over Mayor Whitaker's comments. He dispelled allegations from the article and clarified that his association with Arctic Slope Regional Corporation was severed ten years ago. He termed the allegations in the article "factual inaccuracies". He requested that committee members disassociate themselves from the impugning of the character of the co-chairs and himself.

10:28:38 AM

Representative Holm reported that he found the mayor's comments inappropriate. He opined that all members have a history of involvement in businesses and industry in Alaska. He said that Mason's Rules allows for disclosures of areas of expertise, which all members have. He disassociated himself from Mayor Whittaker's comments.

10:30:52 AM

Representative Kelly commented that conflict of interest rules in government are different from those in the private sector. In the legislature, conflicts are first declared with Alaska Public Offices Commission (APOC) and then on the floor of the House. There was a requirement for the three legislators who declared conflicts of interests to participate in voting. He concluded that there is a difference between private and legislative models.

10:34:32 AM

At-ease.

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Representative Weyhrauch added that legislators' affiliations are reported by the legislative ethics committee through APOC and are part of a public record, and declarations of conflicts of interest are not necessary.

Representative Joule reported that he represents three regional corporations with interest in the oil business and owns stock in them. He said the small population of Alaska is conducive to many possible conflicts of interest.

10:37:03 AM

ROBYNN WILSON, DIRECTOR, DIVISION OF TAX, DEPARTMENT OF REVENUE, defined net and gross, two aspects of heavy oil exploration economics. She compared gross and net tax to building and selling a house. Gross tax is a percentage of how much the house sold for. She defined tax on net as building expenses subtracted from the gross. Indirect costs are not allowed, whereas direct costs are. She gave examples of indirect and direct costs related to the oil industry. Tax on net and gross are useful shorthands to talk about the PPT system. ELF or the Economic Limit Factor is commonly referred to as a tax on gross, which is not completely true. The PPT bill is often referred to as a tax on net, which is not completely accurate. She emphasized the need to be more specific about allowable expenditures.

10:42:36 AM

Ms. Wilson related that there are two variables under ELF to account for. The first consideration is how much the oil is worth, which is measured when it is sold at market generally on the West Coast. To determine wellhead value, shipping costs to market have to be considered. The ELF is a tax on the value at the wellhead, but also somewhat of a net tax because transportation costs have been backed out.

The second consideration is the Economic Limit Factor, which is applied to the tax rate and was designed as a proxy for the cost of getting the oil out of the ground. She noted that producers could petition the Department of Revenue to use something other than ELF if it was shown that their actual costs were materially different from the proxy. It is called a tax on gross because there's no specific deduction for the cost to get the oil out of the ground or to separate the oil from the water or sediment. The PPT, on the other hand, is a tax on net, which uses the actual cost of getting the oil out of the ground. PPT is important because there has been inadequate investment on the slope. PPT focuses on encouraging investment by recognizing costs and capital credits. It is particularly important with respect to heavy oil costs.

10:45:46 AM

Ms. Wilson reported that the main concern she has heard regarding PPT is that the oil companies may manipulate costs associated with the tax. She referred to auditing procedures already in place for transportation costs, which total over $1 billion. There is general agreement that capital credits are a good stimulus for investment. Capital investments are as easy to audit as transportation costs.

10:47:17 AM

Ms. Wilson referred to a handout entitled "Sale at Market" (copy on file.) She drew attention to slide 1, which demonstrates the proportion of cost versus the tax base. It shows the gross market value of oil in 2005 at $43 per barrel, $14.5 billion of North Slope oil for 334 million barrels. It also shows $300 million of Cook Inlet oil, $40 million of North Slope gas, and $700 million of Cook Inlet gas.

Slide 2, gross value at point of production, depicts the same calculations with transportation costs of $1.7 billion subtracted. These are costs that are already audited.

Slide 3, net value or production tax value, shows $1.1 billion as operating costs, $1.7 as capital costs, and $1.7 for transportation to market. The capital costs involve auditing. The operating costs would be the distinguishing factor between the tax on gross and the tax on net and would not be audited under a gross tax, but would under a net tax.

Slide 4, net value or production tax value, is based on a previous version of the PPT with a 22.5 percent tax. Even if the operating costs were 50 percent wrong, they would not have a large effect on the tax base.

Slide 5, the tax before credits, shows $2.4 billion, and Slide 6, the tax after credits, shows $1.7 billion. Ms. Wilson noted that this is based on an old credit rate, and at 20 percent it would be smaller. This version had a TIE or transitional investment credit of 1.7 and is a small slice of the tax. It is based on a barrel equivalent credit. She noted the proportional slice being taken away.

10:53:29 AM

Slide 7, tax after credits, shows a tax of $1.7 billion based on oil of $43 per barrel, which is a very conservative view. Tax under the status quo would be less than $.9 billion.

Ms. Wilson concluded that fewer costs would be deducted under a gross tax, but more investment would be encouraged under a net tax.

10:54:55 AM

Co-Chair Chenault recognized Representatives Seaton, Ramras, Berkowitz, Coghill, and Olson, and Senator Huggins. He agreed to take questions from members outside of the committee.

REPRESENTATIVE ETHAN BERKOWITZ asked if the burden of proof for showing capital credits would lie with the state or with the oil company. Ms. Wilson replied that it would rest with the company claiming the credits. Representative Berkowitz asked who would bear the costs. Ms. Wilson replied that the taxpayers would have the burden of proof.

10:57:33 AM

Representative Kerttula thought that the state would be responsible for accepting the information. In some instances the information is supplied and is not much of a burden to the company. Ms. Wilson asked if Representative Kerttula was talking about the contract. Representative Kerttula offered to find the section which supported her idea.

Representative Kerttula noted that information applied to the "operator situation". Ms. Wilson suggested it pertained to the reliance on the operator's records but that there still is a burden of proof requirement. Representative Kerttula said there was not much of a burden of proof because there is no way to audit internal operations. "Burden of proof" is not meaningful in that circumstance. Ms. Wilson offered to return to the subject later.

11:00:13 AM

Representative Kelly asked when something is challenged, if the payment is continued during the challenge. Ms. Wilson said it could work either way. Disallowance of the cost could be assumed by the state. There is no requirement to "pay to play", however, interest would accrue.

11:01:57 AM

ROGER MARKS, PETROLEUM ECONOMIST, ECONOMIC RESEARCH SECTION, TAX DIVISION, DEPARTMENT OF REVENUE, discussed two aspects of gross vs. net as they apply to heavy oil and to exploration economics. He related that there are currently net profit share leases on the North Slope, of which upstream costs are audited without any problem. He referred to when separate accounting was enforced effectively between 1978 and 1981. He maintained that auditing litigation issues in the early 80's were philosophical issues.

11:04:05 AM

Mr. Marks referred to a handout entitled "Gross vs. Net: Two Aspects: (copy on file.) He discussed the difficulties with heavy oil and explained why it is more expensive to produce. He compared light oil to heavy oil on page 2. He related that when West Coast ANS price is $40, the net value is $15.63 for heavy oil versus $23.13 for light oil due to higher upstream costs being twice as high.

Mr. Marks figured that a rate of 15 percent on gross would be 33.6 percent tax, as percent of net for heavy oil, and 22.7 percent for light oil. Under this type of system, heavy oil, which is the most expensive to produce, is taxed at a much higher rate. He maintained that the provisions under such a tax structure would be impossible to administer. Heavy oil units are produced out of a common production facility and it is impossible to determine how much heavy oil comes out of the spectrum of gravities. He compared Kaparuk and Tarn fields and the difficulty of determining how much heavy oil comes out of each one.

11:09:35 AM

Mr. Marks discussed, on page 3, the issue of exploration economics in terms of gross versus net. He spoke of the cost of exploration and the percentage of success. If the state can reduce or share exploration costs, then there would be more likelihood for drilling. He focused on the hypothetical situation on page 3. The field target size or number of barrels is 40 million with a net price of $10. The total value would be $400 million with a discount factor of 0.4. The net present value would be $160 million. With a probability of finding oil at 15 percent, the expected value is $24 million.

Under the status quo, the expected value is $24 million, the exploration cost is $20 million, and the full cycle expected value is $4 million. If the state is sharing the costs under a net tax, it would be less expensive to drill and the full cycle expected value would be $12 million due to the credits and deductions. The net tax could be key in encouraging new exploration of oil.

11:15:13 AM

Representative Kerttula said she has heard that the net profit tax has been more difficult to administer and monitor. Mr. Marks countered that he has heard the opposite. He suggested asking for DNR's opinion.

11:16:38 AM

REPRESENTATIVE LES GARA noted that Mr. Marks is comparing incentives under a gross tax to a gross tax that has no incentive provisions. He wondered how incentives would look under a gross tax with incentive provisions such as a credit mechanism. He commented that companies on the North Slope spend about $1 billion a year on investments no matter what the price of oil. He inquired about adding a credit mechanism for money that was intended to be spent anyway. He called that a flaw of PPT.

11:18:05 AM

Mr. Marks replied if a credit is issued based on a company's spending, the spending would have to be audited and there are concerns about auditing. Referring to the first question, Mr. Marks responded that in the past few years there have been high prices and low taxes with no increase in investment. He maintained that taxes could be reduced by investing under a net system.

Representative Gara repeated that the net cash flow increased, but investment did not. He asked why Mr. Marks believes that a 40 percent tax credit/deduction is going to change that behavior. He questioned whether that was a subsidy for money already planned for investment.

Mr. Marks said if taxes can be reduced by investing, it stands to reason that a company will invest. He maintained that during exploration, 85 percent of the time there will be no oil to sell regardless of the price. A tax on net would be higher than one on gross.

11:20:51 AM

Representative Berkowitz mentioned the 85 percent failure rate with long-term oil price at $30 and at $70. He opined that the higher price would influence investment decisions regardless of the failure rate. Mr. Marks observed that it gets watered down by the probability of failure. Representative Berkowitz summarized that there is less adversity to risk at higher oil prices and Mr. Marks agreed.

Co-Chair Meyer asked if it is more likely that exploration would take place in larger fields at higher oil prices. Mr. Marks thought it would be true much of the time, but it depends on the numbers.

Co-Chair Meyer asked how price affects going after high risk fields. Mr. Marks said at higher prices fields are more attractive to drill. He added that a mechanism designed under a gross tax where oil less than one gravity gets one treatment, and oil greater than another gravity gets another treatment, would be impossible to administer. Exploration incentive programs are in place now, but have some problems and will expire in 2007. Currently, anything less than 3 miles from a current down hole does not qualify for an exploration incentive credit (EIC). Oil between 3-25 miles from a down hole target only gets a 20 percent credit. Not all exploration costs are covered in the current EIC's.

11:25:54 AM

Representative Holm asked about the effects on investment in Alaska by the international market place as the price of oil goes up. Mr. Marks replied that Alaska is not a good place to do business when prices are low. Exploration, from an international perspective, depends on geology. There are many places where exploration costs cannot be deducted, which is a disadvantage to Alaska.

Representative Berkowitz spoke to competitive advantages in Alaska in certain cases. Mr. Marks agreed. Representative Berkowitz thought that 90 percent of world's oil is under direct control by a country.

11:29:11 AM

DR. PEDRO VAN MEURS, CONSULTANT, OFFICE OF THE GOVERNOR, responded that the majority of oil produced in the world is under the control of state companies. A very small number are under the control of private companies.

Co-Chair Meyer thought that oil companies would weigh the risks versus the benefits.

ROBERT MINTZ, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF LAW, offered to address burden of proof.

11:33:06 AM

Dr. Van Meurs provided committee members with a handout entitled "Gross vs. Net Production Tax" (Copy on File). He noted differences between HB 3004 and his 2001 proposal.

Dr. Van Meurs continued to explain page 3 of his handout concerning the modifications of the ELF production tax: stronger tax rates for small fields with low productivity, a strongly price sensitive tax, provisions for heavy oil incentives, and tax credits to encourage investment.

Dr. Van Meurs addressed, on page 4, the structure which would gain maximum affect for the state. He emphasized that structure and revenue are two entirely different concepts.

11:38:54 AM

Dr. Van Meurs spoke to three fiscal options on page 5: a structure based on tax credits on statewide net revenues, one based on gross revenues per field, or a structure based on no or minor tax credits on gross revenues per field.

Page 6 depicts three fiscal options which result in identical production tax revenues to the state in order to evaluate the structures.

11:40:57 AM

Dr. Van Meurs highlighted the calibration of the 50MM–Low high cost on page 7.

Dr. Van Meurs explained the 150MM-Low high cost option on page 8.

Dr. Van Meurs explained the PPT variations on page 9. He described his original PVM 2001 variations on page 10.

Dr. Van Meurs highlighted the variations of HB 3004 on page 11.

11:45:01 AM

Representative Gara commented on the discussion. He asked about a "time-crunch" and the need to match revenue projections. He asked if a gross bill that raised the same amount of revenue would work. Dr. Van Meurs replied that it would be difficult, but it can be done. HB 3003 and HB 3004 present a field by field concept. In order to arrive at the same revenue amount, all fields would need to be matched. PPT is an Alaska-wide concept. He thought it could be reasonably close.

11:46:43 AM

Dr. Van Meurs explained the impact on investors for 50 MM Low, on page 12. The PPT and PVM variations provide for a much higher rate of return than HB 3004 because of the tax credits. The same is true for 150 MM Low, as depicted on page 13.

Dr. Van Meurs emphasized that tax credits and deductions have a very large impact on exploration economics, as shown on pages 14 and 15: EMV10 (10% Expected Monetary Value) 50 MM Low and EMV10 150 MM Low. The PPT and PVM variations provide for a nearly identical EMV10 and HB 3004 variation results in a much lower EMV10 for both structures.

Representative Berkowitz clarified that tax relief was available in HB 3004.

11:50:20 AM

Dr. Van Meurs related that HB 3004 is less attractive because if investors invest $1 million, it counts as $1 million because there are no tax deductions. Under PPT and PMV 2001, $1 million counts as $600,000 because of credits.

Dr. Van Meurs pointed out that the government ends up with the same revenues under all three variations, because under PPT and PVM 2001 it compensates the PPT tax savings with a higher tax later on. This means the structure of these two variations is more back end loaded. Under PPT and PVM the government first levies a higher tax and then permits reductions in order to end up with the same revenues as under HB 3004.

11:55:01 AM

Dr. Van Meurs commented on the fiscal structure from an international perspective. Many governments have discovered that the best way to encourage investment is to ensure that the net investments are low. Providing tax deductions and tax credits is the best way to encourage re-investment.

11:57:28 AM

Representative Gara commented that the comparison was as if there were no tax credits in HB 3004. He requested assistance to increase the tax rate in HB 3004 and offset it with tax credits to raise the same amount of revenue as proposed. Dr. Van Meurs responded that it only related to capital investments. He suggested including 40% tax credits across the board would be similar to the governor's legislation. That would be the same capital investment. He reiterated the need for a 40% credit for all capital investments.

11:59:51 AM

Representative Gara pointed out that gross tax recommendations have been provided to prior and current administrations. Dr. Van Meurs stated that he had proposed recommendations to both Governor Knowles and Governor Murkowski. Governor Murkowski was willing to tackle the production tax concept. Consequently, in 2003 it was updated. Dr. Van Meurs opined that the PPT idea is better. Dr. Van Meurs provided some history as to why PPT was recommended by the governor.

12:02:49 PM

Dr. Van Meurs pointed out, on page 22, disadvantages of a production tax based on gross with tax credits: a short shelf life, the need to define “field”, and heavy oil provisions – the most serious.

Dr. Van Meurs detailed the problems with the shelf life, on page 23. Alaska already has a fiscal system that is based on gross: the royalty, which provides about half of the state’s oil and gas income. To design a tax also largely based on gross, in addition to the royalty, is difficult economically.

12:05:42 PM

Representative Berkowitz asked why modifications to the royalty component had not been included when designing the new tax structure. Dr. Van Meurs replied that the current PPT deducts the royalty. Many other countries do not have a royalty. The concern of deducting the gross for royalty, if the costs are high, is that the field becomes uneconomic, and if the costs are low, too much money is left on the table.

Representative Berkowitz inquired about the necessity of distinguishing between small and large fields. Dr. Van Meurs agreed that the distinction is necessary; however, the matter is how profitable the field is. It is difficult to determine a formula that adds gross to gross. Most formulas have a shelf life for only 10-12 years.

12:10:22 PM

Dr. Van Meurs continued to address the problems of a short shelf life. Economic and technical conditions change rapidly and the economic basis for the formula becomes outdated, which creates losses over time.

Dr. Van Meurs addressed the difficulties of field definition, as depicted on page 26. He discussed the now mature North Slope and development opportunities that no longer qualify as a field.

12:14:32 PM

Dr. Van Meurs discussed problems regarding heavy oil and the need for special provisions, on pages 27 and 28. He termed heavy oil the most serious problem with a tax on gross. Not enough is known about heavy oil to design a reliable scale for a tax on gross. Dr. Van Meurs maintained that the future of Alaska is linked to the international oil industry spending billions of dollars to improve technology so that heavy oil becomes cheap oil.

12:18:24 PM

Co-Chair Meyer discussed heavy oil, which currently exists in Alaska. He asked if Alberta has heavy oil. Dr. Van Meurs explained the background of heavy oil. In some places in the world, such as Venezuela, there is only heavy oil. The problem in the Arctic is that there is every kind of oil, which makes it difficult to define a formula. The spectrum in the North Slope is too wide and intermingled. Alberta is different. They have oil sands with heavy oil in the rock that does not float. It is mined or heat injected. Alberta is in the same situation as Alaska today. They base their share on net in order to determine a fair share.

12:23:14 PM

Dr. Van Meurs summarized that he recommended PPT over a gross tax system because of the difficulties of defining a field, with heavy oil, and with a short shelf life. A system based on net revenues, such as PPT is easier to administer and is more durable.

Co-Chair Meyer asked if a comparable Arctic region would be Alberta. Dr. Van Meurs said no, but the heavy oil problem is the same. Co-Chair Meyer asked if there were a comparable Arctic region. Dr. Van Meurs replied that there is nothing north of Norway that is the same as in Alaska.

12:25:41 PM

Representative Gara commented on ways to solve these concerns. He separated the problem into two parts: fields that are currently being under taxed and new, expensive production that lacks a system to prompt development. There is also a concern about heavy oil. He suggested a gross production tax on the existing fields and to provide the Department of Revenue the discretion to adjust the tax rates for future fields and heavy oil - a tiered system.

Dr. Van Meurs responded that there are a number of nations in the world that address it in that manner. He agreed that the “bleeding” must be stopped. To do that, the state should use the PPT concept on existing fields. They would automatically pay a high amount of profit and yield a large share. PPT should be also used on the new fields; because of the tax credits, the economics is much better. PPT fits a wide range of situations. There is no perfect tax system in the world.

12:30:09 PM

Dr. Van Meurs emphasized that the advantage of PPT is that it taxes the existing fields and "stops the bleeding" of the existing fields, which is priority number one. It also encourages development of heavy oil.

Many nations have successfully used PPT. Norway, with its variety of fields, uses a profit based system. Alaska can also get a fair share using the PPT.

Dr. Van Meurs addressed cost control as it relates to PPT. There needs to be a law that no cost can be illegally deducted. He gave an example of a fraudulent scenario and showed that damage to Alaska would be minimal. He felt that PPT would be administered fairly because deductible items would be clearly spelled out. He highlighted Section 25 of the bill, which provides for a long list of non-deductible costs. He pointed out that the most important non-deductible cost is any expenditure in excess of fair market value. Cost control is not an issue, he opined.

12:38:58 PM

Representative Gara asked if Dr. Van Meurs would be present for upcoming meetings. Dr. Van Meurs replied that he would. Representative Gara asked for a copy of the gross production tax Dr. Van Meurs has written. Dr. Van Meurs stated that he would provide a transmittal letter with that information. Representative Gara asked if it has revenue projections. Dr. Van Meurs replied that it does not contain revenue projections from the past few months. He recommended that a revenue model be provided by the Department of Revenue.

12:40:36 PM

Representative Kelly commented that his challenge was with the rate, the lack of progressivity, and freezing the tax rate for 30 years. Dr. Van Meurs noted that there have been several proposals to include a progressive feature. He was in favor of that feature and had recommended it to the governor. He highlighted the fact that the progressive feature added by the legislature, is being added to a system that is already progressive.

12:43:15 PM

Co-Chair Chenault spoke to a gross tax on all fields and a net profits tax on new fields. He asked about incentives for a company on an old field to stop the decline rate on production.

Dr. Van Meurs agreed that for some nations, the experience of "old versus new fields" is not working. In the mid 70's, it was different for old wells and new wells. It did not work. A windfall profits tax proves that it is not easy to have a system based on old and new fields. He highlighted situations in Prudhoe Bay. It is done around the world, but there are complications. He warned to be careful.

12:46:00 PM

Ms. Wilson offered to address a previous question from Representative Kerttula regarding burden of proof.

Representative Kerttula addressed Section 25 of HB 3001, where the department has to give substantial weight to industry practices and standards. The initial burden would be on the taxpayer to file, but then the burden shifts to the department. She spoke to the shift and maintained that it was unnecessary.

Ms. Wilson noted that in that section, the bill contains a provision that would provide a balance. She added that the ability to audit is not restricted. The department has broad powers to examine through AS 43.05.

12:50:27 PM

Mr. Mintz clarified burden of proof. He referenced a review, Chapter 5, Title 43. He agreed that the department has broad auditing and investigation authority. He explained how an assessment works.

Mr. Mintz continued to explain AS 43. If a taxpayer disagrees with an assessment, a conference with the Department of Revenue is held. He explained when the taxpayer bears the burden of proof. He addressed the standards the department uses in interpreting the concepts of deductible lease expenditures. The standards don't have anything to do with particular costs claimed by a particular taxpayer, but deal with what was in effect before December 2005. AS 43 gives guidance to the department regarding deductions. It is still up to taxpayer to show evidence that claims meet the standards.

12:55:34 PM

Representative Kerttula voiced concern about the taxpayer bearing the majority of the burden. She suggested constructing the list up front. Ms. Wilson replied that it would be difficult to construct such a list. It would be easier to identify those things that should not be included. Representative Kerttula suggested not allowing the "substantial weight" standard, but rather making a determination on the department's behalf.

12:56:57 PM

KEN GRIFFIN, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, related that the range of work at an oil field, done at the field vs. done remotely, has changed. He said that Representative Kerttula's comments are worth noting. It is not in the state's best interest to determine a list of deductible costs.

12:59:29 PM

REPRESENTATIVE PAUL SEATON commented on the concern about overhead expenses and giving credit for it. He asked why credit and deductions should be given for work done in other parts of the country.

Mr. Griffin responded that the PPT tax is attempting to incentivize investment. Individual decisions within that framework need to be the best decisions. The state should not interfere with them. The industry has been very strong in local hire and local jobs, but much of the work is incidental work not done in Alaska. Those people work in international settings. He said it is not a rampant issue. He spoke to deductions on unit costs and incentives to ensure those costs are justified.

1:04:11 PM

Ms. Wilson expanded on Mr. Griffin's answer in saying that there is a bigger goal - to increase production. Incidental work is often justified in order to increase production. Representative Seaton said that industry does not care where the work is done, but the state of Alaska does. Having people based in Alaska helps Alaska's economy. He distinguished between the two different goals.

Ms. Wilson reiterated the ultimate goal of the bill, which is to stimulate production, which, in turn, will improve the economics of the state. She addressed the overhead allowance issue, which would give a certain level of direct expenditures.

Mr. Mintz concurred with Ms. Wilson's comments.

1:09:10 PM

Representative Hawker noted that he has spent years trying to increase the number of in-state oil employees. He asked if there were U.S. Commerce regulations regarding discrimination of in-state vs. out-of-state employees.

Mr. Mintz related that there are issues regarding this situation. He referred to a pending U.S Supreme Court decision. He opined that the state is in a stronger position to defend investing resources, but not as strong when dealing with outside investments. He suggested that the goal is being undercut.

1:13:00 PM

Representative Gara spoke to the goal of PPT to stimulate investment. He related that the historical average of exploration and development investment on the North Slope has been about $1 billion, regardless of the price of oil, without substantial credits or deductions. He suggested limiting the credits and deductions to investment above what is already being done. Ms. Wilson deferred to the economists and said that is a policy call.

1:14:58 PM

Mr. Griffin commented that Representative Gara's suggestion would treat all three companies on the North Slope as one entity. Those companies have a variety of investment strategies and priorities. Size has to also be considered. It would lower the bar to justify any investment in Alaska. From an industry perspective, most of them spend as much money as they can manage right now. He gave an example in Alberta.

1:17:21 PM

Mr. Gara opined that Mr. Griffin's statements just undermined the whole principle of PPT. Mr. Griffin clarified that on an international scale companies manage their workload internationally and if the bar is lowered, the investments in the state will shift relative to investments around the world.

Mr. Gara noted that Alaska is currently the cheapest place in the world. Mr. Griffin said there is a risk to investment. He shared personal experience with how taxes affect the bottom line. In 1989 when ELF was passed several projects were shut down.

1:20:55 PM

Representative Seaton asked about exploration economics in the gross vs. net handout. He asked about the current rate of dry holes on the North Slope. He wondered if gas is found instead of oil, whether that constitutes a dry hole. Mr. Griffin replied that, historically, if gas is found instead of oil, it is a dry hole. He reported that near production areas the odds are higher of having a dry hole. Raw exploration areas have lower numbers. He emphasized the difference between a technological or geological success and an economic success.

Representative Seaton referred to page 3, and noted that the figure of 15 percent could be a different number. Mr. Griffin said that the company would be looking for an economic success, but he did not know the number.

1:23:41 PM

Representative Hawker requested clarification about the statement that the Wood Mackenzie study concludes that it is less expensive to conduct oil and gas operations in Alaska than in the rest of the world. He asked if that is an accurate statement. Representative Meyer thought that was not a correct statement. Representative Gara reported that the study said the total cost of doing business in Alaska is lower. Drilling costs are higher in Alaska. Co-Chair Chenault requested a copy of that report.

ADJOURNMENT

The meeting was adjourned at 1:24 PM.