

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 2, 2006

1:35 p.m.

MEMBERS PRESENT

Senator Thomas Wagoner, Chair
Senator Ralph Seekins, Vice Chair
Senator Ben Stevens
Senator Fred Dyson
Senator Bert Stedman
Senator Kim Elton
Senator Albert Kookesh

MEMBERS ABSENT

All members present

OTHER MEMBERS PRESENT

Senator Hollis French
Senator Gene Therriault

COMMITTEE CALENDAR

SENATE BILL NO. 305

"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."

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 305

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

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|----------|-----|------------------------------------|
| 02/21/06 | (S) | READ THE FIRST TIME - REFERRALS |
| 02/21/06 | (S) | RES, FIN |
| 02/22/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/22/06 | (S) | Heard & Held |
| 02/22/06 | (S) | MINUTE(RES) |
| 02/23/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/23/06 | (S) | Heard & Held |
| 02/23/06 | (S) | MINUTE(RES) |
| 02/24/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/24/06 | (S) | Heard & Held |
| 02/24/06 | (S) | MINUTE(RES) |
| 02/25/06 | (S) | RES AT 9:00 AM BUTROVICH 205 |
| 02/25/06 | (S) | -- Reconvene from 02/24/06 -- |
| 02/25/06 | (H) | RES AT 10:00 AM SENATE FINANCE 532 |
| 02/25/06 | (S) | Heard & Held |
| 02/25/06 | (S) | MINUTE(RES) |
| 02/27/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/27/06 | (S) | Heard & Held |
| 02/27/06 | (S) | MINUTE(RES) |
| 02/28/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/28/06 | (S) | Heard & Held |
| 02/28/06 | (S) | MINUTE(RES) |
| 03/01/06 | (S) | RES AT 3:30 PM BUTROVICH 205 |

WITNESS REGISTER

MARK HANLEY, Public Affairs Manager
Anadarko Petroleum

POSITION STATEMENT: Presented Anadarko's position on SB 305.

ACTION NARRATIVE

CHAIR THOMAS WAGONER reconvened the March 1st meeting of Senate Resources at [1:37:34 PM](#) on March 2, 2006.

SB 305-OIL AND GAS PRODUCTION TAX

[1:37:34 PM](#)

CHAIR THOMAS WAGONER announced SB 305 to be up for consideration. He said that Mr. Hanley would present Anadarko's position on SB 305.

MARK HANLEY, Public Affairs Manager, Anadarko Petroleum, said Anadarko is a large "independent" - meaning it is not integrated and doesn't have downstream facilities or refineries. It also does not have gas stations, which is the reason most people don't know its name. Anadarko has a market capitalization of \$23 billion and has over 3,000 employees worldwide.

Anadarko is listed on the S&P 500 Exchange; it came to Alaska in the early 90s and first partnered with Exxon in an offshore well, called Thetis Island. Since then, it has partnered with many other companies in Alaska from BP to EnCana. (A map displayed Anadarko's ownership positions in its Alaskan fields.) It is now partnering with a new worldwide gas company to Alaska - the BG Group.

MR. HANLEY said that Anadarko has 2.2 million net acres in Alaska, probably running neck and neck with ConocoPhillips in terms of net acreage on the North Slope. He thought that Alaska still had a lot of different plays and the company had prepared a regional model to try and understand how the whole system up here works. He explained:

Just to give you a rough idea of what we think about Alaska. We think it's a world-class petroleum basin. We think it has significant remaining resource. It is probably not in the - you know, we don't think there's a Prudhoe Bay to be found out there, but we think there are a number of Alpine size fields - 400 MB and an awful lot of, you know, 50 MB to 150 MB fields out there. So that we think there is a lot of resource, but it's not huge and some of it is far from infrastructure in interesting areas.

As you see, we think there are anchor-type fields - an anchor field being something that would support its own facilities. So you wouldn't have to come back into

an existing facility to tie in. You could support the cost of producing your own oil and treat it. That's generally where Anadarko is looking. We tend to look for larger fields, an anchor field. They tend to be further from infrastructure and they tend to be higher risk, but also higher reward.

We see Alaska as a favorable political environment. We do business around the world and I would say that despite the fact that we are going through a tax change that has some implications for us, generally speaking this is a very favorable political environment. We've had very good reception on a lot of issues for exploration interests. We're trying to increase the tundra travel seasons to try and get regulations reduced to improve our ability to go out and do our work. So, generally speaking we see this as a favorable political environment.

As I talked about earlier, we see the abundant new entrants as partnering opportunities here in Alaska and we see that as a good thing.

He said that Alaska is very under-explored and everyone would benefit from more wells getting drilled, no matter what company does it, because the new information would either confirm or condemn assumptions. New companies coming to Alaska all have a slightly different idea and that benefits the state as well as the industry.

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CHAIR WAGONER asked when Totale drilled its exploration well.

MR. HANLEY replied it drilled a well three years ago.

CHAIR WAGONER said he thought that work fell under SB 185 [exploration incentive legislation from the 23rd Legislature].

MR. HANLEY replied that it did. He continued on saying that Alaska has other challenges, such as the fact that it is a maturing basin and that it has high costs relative to other places and a lack of infrastructure and competition for facilities. He also emphasized that from first thought to first production takes longer in Alaska than anywhere else Anadarko does business around the world - largely because of the winter season. In other places, three wells can be drilled in one year, but it would take three years for them to drill the same number

of wells in Alaska. However, he added that lengthening the tundra travel season has mitigated that somewhat, but some of the issue was still if you're farther from the market, it's going to cost you more. This long lead-time has an impact on what this bill does. You can count on the credits for recovering some of your money faster, which helps your net present value, or you can talk about reducing your costs.

The last challenge he wanted to mention was the lack of a gas market. Anadarko supports getting a gas line built because it would improve both gas and oil exploration because when you drill for oil, a lot of times you find gas. So having a market for that gas instead of it being just a cost now would improve the economics for oil.

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MR. HANLEY said he felt the Governor did a good job balancing the issues and priorities of both the state and the companies in the PPT. Under this system, the state would pick up more money, and even though Anadarko would pay more, most of its exploration economics are improved.

MR. HANLEY further summarized:

So, that means everything else being equal, we might be able to drill more wells. So, that's a positive thing for us. That could create more revenue for the state, as well.

That balanced with the fact that at low oil prices, the state is actually going to pick up some of the risk. It will, as you've seen in some of the presentations before, at lower oil prices, the companies will pay less than they do under the current system. So, balancing off the fact that we are paying more with the fact that exploration economics have improved and we have some downside risk protection, we've given up the upside, essentially, is what it's done. We think this is a good balance.

MR. HANLEY stated another important factor that most people don't recognize is that the big oil companies are not one big monolith. He described their relationship as a "tenuous truce" and that while they all support lower taxes as a way to improve their exploration economics, there are differences between the companies. Some big companies have said the tax rate is quite tilted towards the small guys, but some of the smaller players

have a little overactive imagination and were concerned that this bill was negotiated by the big three oil companies who were looking out for their own interests. Sometimes those interests are aligned with Anadarko's, but many times they are not.

He said he had modeled generic small and medium-sized fields very much like Dr. Van Meurs' presentations, but he came out with different numbers, especially regarding his chart, 11.6. He used this to illustrate his point that they need to get together on the same page regarding assumptions and how the models were put together.

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MR. HANLEY showed the committee his models of the bill's 20/20 proposal for an existing producer and a new entrant and a 20/25 for an existing producer. He explained that Anadarko, an existing producer, already has income at its Alpine field and would benefit from the \$73 million allowance and the proposed system looked worse for an existing player at 20 and 25 percent than the current system. Anchor field-type prospects had a small improvement with a larger tax rate and at real high prices, no one would be better off than with the existing system.

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MR. HANLEY'S main point, however, was that Anadarko sees increased economic opportunity for exploration and development projects under the current bill. But as the tax rate is raised, if that is all that's done, the economics are decreased and could actually be less beneficial than the current system for small fields and it would make a large field less valuable.

MR. HANLEY said he had heard on the "look-back" that Anadarko made investment decisions at low prices and prices have been high and they have been able to capture some of the value because of that. However, he countered that Anadarko hadn't had production, yet, on developments that were made under that other system.

[1:59:11 PM](#)

SENATOR ELTON said he could make the argument that the look-back goes too far back and that it should go back only to when prices went up.

MR. HANLEY replied that that was the state's policy call and that some people had not recovered at all on those previous decisions. He stated the price is important and when the markets

fell last time, it had a big impact and companies are now paying down on debt to get ready for the next downswing.

He said the \$73 million look-back is very important to the smaller producers and Anadarko, particularly, where it could be used immediately against Alpine. It would help the explorers that don't have production, and even though it might take a company three to five years before it finds something, it wouldn't cost the state a dime during that time. The allowance can only be used against production and can't be carried forward.

[2:07:31 PM](#)

He said that the ability to transfer the credits was a good concept, but the company that buys them at 90 cents to the dollar benefits - while the state still loses the dollar and the company it wants to benefit loses the 10 cents. He thought the idea of a refundable credit was appropriate because that would cut out a middleman and wouldn't cost the state any more money. He also suggested expanding the use of the credits to be applied against, for instance, corporate taxes or bidding at a lease sale.

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He summarized that raising the tax rate could cut back on exploration and companies would have to find larger fields to be economic enough to develop. Dr. Van Meurs' chart showed better numbers for a small field case than Anadarko's and he suggested that everyone should start with the same assumptions and numbers for accuracy of comparison. He also advised that the state would get more revenue with credits than taxes.

[2:15:36 PM](#)

SENATOR BEN STEVENS commented that he didn't think the five largest producers would share their internal modeling with competitors or the state.

MR. HANLEY suggested using a public model that wasn't specific to any one company. His concern was that they were so far apart right now on the baseline that it was problematic.

SENATOR BEN STEVENS asked him to rank the bill's four mechanisms - the rate, the credit, the floor and the transition period in terms of their impact on his company.

MR. HANLEY replied that he would try to do that, but right off he could say that hammering existing production with a big tax

increase to improve exploration economics was a double-edged situation for Anadarko, because it does both. The \$73 million is quite important, because it's worth a 5 percent tax rate decrease. He thought their exploration economics would go down with a 25/25 ratio and that more credits would be required to make up for the same tax increase.

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SENATOR STEDMAN returned to the net present value slide where the lines cross at about \$32 and asked if they should try to make the lines more horizontal.

MR. HANLEY responded that that chart was showing that below the \$32 wellhead value, at a 25/20, their prospects looked better, because the state would be picking up more risk.

SENATOR STEDMAN said he thought the crossover point needed to be established as a matter of policy.

[2:28:33 PM](#)

SENATOR THERRIAULT said the state had made positive regulatory changes, expanded the winter season and now the price was up on the commodity and yet lawmakers keep hearing from other companies that the state is barely attractive on a worldwide basis. He remarked that Anadarko was here before those changes were put in place and it continues to pick up acreage and says Alaska has a politically favorable environment and asked him to comment on its view compared to other companies'.

MR. HANLEY replied that Anadarko thinks Alaska has a lot of resource potential. However, it has a lot of prospects that are uneconomic and something has to be done to help those. For instance a 150 MB field, if it is 100 miles from existing facilities, is probably not economic - the same for a 500 MB field. He thought the rising price helped and new companies were coming to the state. He said that every company has its niche and different parts of the proposal would affect some of those prospects more favorably than others. Every company also has a basic philosophy about the minimum size field it will look at - everything else being equal. Some of the larger companies would say, "If we don't have a billion barrels of recoverable oil in a prospect, if we don't think it's in that magnitude, then we're not going to focus on it." The size of the company sometimes drives what they are looking for and he thought Alaska needed a mix of companies.

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SENATOR THERRIAULT asked him to comment on the drive of the companies to replace reserves either through increased exploration or just purchasing other companies.

MR. HANLEY responded that Anadarko has the need to book those reserves and different companies had different requirements. They all need to book the reserves, but Anadarko tends to drill more for them.

[2:39:00 PM](#)

SENATOR THERRIAULT asked him to comment on his level of concern with the terms that aren't defined in SB 305.

MR. HANLEY replied that the details needed to be worked over.

[2:42:05 PM](#)

SENATOR BEN STEVENS stated that for the amount of money that has been spent on running different scenarios by business analysts and consultants they could have funded a Hollywood movie called "Dueling Economists" and the scenarios, while useful, were all "what if" scenarios. He exhorted that legislators must get back to the objective of the bill, which was to maintain a healthy oil industry for the next 25 years or they would waste millions more. This bill reaches that objective of having something for all companies.

CHAIR WAGONER said this was the last of the stakeholders' presentations and thanked everyone for their comments. He adjourned the meeting at [2:45:47 PM](#).