

**ALASKA STATE LEGISLATURE  
SENATE RESOURCES STANDING COMMITTEE**

March 19, 2006

1:00 p.m.

**MEMBERS PRESENT**

Senator Thomas Wagoner, Chair  
Senator Ben Stevens  
Senator Fred Dyson (via teleconference)  
Senator Bert Stedman  
Senator Kim Elton

**MEMBERS ABSENT**

Senator Ralph Seekins, Vice Chair  
Senator Albert Kookesh

**OTHER LEGISLATORS PRESENT**

Senator Gene Therriault  
Senator Gretchen Guess

**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

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
03/01/06	(S)	Heard & Held
03/01/06	(S)	MINUTE(RES)
03/02/06	(S)	RES AT 1:30 PM BUTROVICH 205
03/02/06	(S)	Heard & Held
03/02/06	(S)	MINUTE(RES)
03/02/06	(S)	RES AT 3:30 PM BUTROVICH 205
03/02/06	(S)	Heard & Held
03/02/06	(S)	MINUTE(RES)
03/03/06	(S)	RES AT 3:30 PM BUTROVICH 205

03/03/06 (S) -- Meeting Canceled --  
 03/04/06 (S) RES AT 10:00 AM SENATE FINANCE 532  
 03/04/06 (S) Presentation by Legislative Consultants  
 03/06/06 (S) RES AT 3:30 PM SENATE FINANCE 532  
 03/06/06 (S) Heard & Held  
 03/06/06 (S) MINUTE(RES)  
 03/07/06 (S) RES AT 3:30 PM BUTROVICH 205  
 03/07/06 (S) Heard & Held  
 03/07/06 (S) MINUTE(RES)  
 03/08/06 (S) RES AT 3:30 PM BUTROVICH 205  
 03/08/06 (S) -- Meeting Canceled --  
 03/09/06 (S) RES AT 3:30 PM BUTROVICH 205  
 03/09/06 (S) -- Meeting Canceled --  
 03/10/06 (S) RES AT 3:30 PM BUTROVICH 205  
 03/10/06 (S) -- Meeting Canceled --  
 03/11/06 (H) RES AT 10:00 AM CAPITOL 106  
 03/11/06 (H) -- Meeting Canceled --  
 03/13/06 (S) RES AT 3:30 PM BUTROVICH 205  
 03/13/06 (S) Heard & Held  
 03/13/06 (S) MINUTE(RES)  
 03/14/06 (S) RES AT 3:30 PM BUTROVICH 205  
 03/14/06 (S) Heard & Held  
 03/14/06 (S) MINUTE(RES)  
 03/15/06 (S) RES AT 3:30 PM BUTROVICH 205  
 03/15/06 (S) -- Testimony <Invitation Only> --  
 03/16/06 (S) RES AT 3:30 PM BUTROVICH 205  
 03/16/06 (S) -- Meeting Canceled --  
 03/17/06 (S) RES AT 3:30 PM BUTROVICH 205  
 03/17/06 (S) Heard & Held  
 03/17/06 (S) MINUTE(RES)  
 03/18/06 (H) RES AT 10:00 AM CAPITOL 124  
 03/18/06 (H) -- Meeting Canceled --  
 03/19/06 (S) RES AT 1:00 PM BUTROVICH 205

**WITNESS REGISTER**

JOHN P. ZAGER, General Manager  
 Chevron - Alaska Area  
 Anchorage, AK

**POSITION STATEMENT:** Testified that Chevron cannot support  
 SB 305, Version Y; urged return to the original PPT terms while  
 retaining a Cook Inlet provision.

PAT FOLEY, Manager  
 Lands and External Affairs  
 Pioneer Natural Resources  
 Anchorage, AK

**POSITION STATEMENT:** Voiced concerns about SB 305, Version Y; said the balance is being tipped to the disadvantage of some investors as the bill evolves.

MARK HANLEY, Manager  
Public Affairs for Alaska  
Anadarko Petroleum Corporation  
Anchorage, AK

**POSITION STATEMENT:** Expressed concerns about SB 305, Version Y; cautioned that there are no credits to compensate for the tax increase, making the economics worse for exploration.

#### **ACTION NARRATIVE**

**CHAIR THOMAS WAGONER** called the Senate Resources Standing Committee meeting to order at [1:00:02 PM](#). Members present were Senators Ben Stevens, Bert Stedman, Kim Elton and Chair Thomas Wagoner; Senator Fred Dyson (via teleconference) joined the meeting in progress. Also in attendance were Senators Gene Therriault and Gretchen Guess.

#### **SB 305-OIL AND GAS PRODUCTION TAX**

CHAIR WAGONER announced SB 305 to be up for consideration. He brought attention to his memorandum to members regarding amendments. In packets and under discussion was a proposed committee substitute (CS), Version Y, labeled 24-GS2052\Y, Chenoweth, 3/16/06. He noted that members would hear testimony that day from the companies known as explorers and independents.

[1:00:35 PM](#)

SENATOR BEN STEVENS pointed out that page 11, line 13, subsection (e), is a substantive policy change that allows the transferable tax credit to be used against corporate income tax liability. He reported he'd looked in all other draft versions and it wasn't listed in the memo. Line 13 - which refers to AS 43.20, the corporate income tax chapter - isn't in the House version or the governor's version. Nor was it discussed, and he'd stumbled across it. He said he'd like to find out where the language came from and how it got inserted.

CHAIR WAGONER replied that he'd check to see where it came from.

[1:02:40 PM](#)

SENATOR STEDMAN referred to page 11, lines 7-13, subsection (e). He asked whether the intent is still to have a maximum reduction of 20 percent on the tax due, so that someone would always be

paying at least 80 percent of the taxes, regardless of what rate was set.

CHAIR WAGONER opined that the aforementioned was in the House bill, not the Senate bill.

SENATOR STEDMAN recalled that it was in the original bill. "I thought we were still operating under that," he added, suggesting it could be clarified later. He noted that it ties in with the whole tax paragraph.

CHAIR WAGONER said he'd check. He announced that Senator Dyson was on teleconference.

1:04:16 PM

Chevron Alaska - John Zager, Manager, Alaska Division

JOHN P. ZAGER, General Manager, Chevron - Alaska Area ("Chevron"), noted that accompanying him was Kevin Tabler, Manager, Lands and Governmental Affairs. Mr. Zager called attention to a handout and his own testimony March 1 that Chevron would support the bill and key terms as written, with one main concern: the possible effect on Cook Inlet, which has a very different nature from the North Slope. He'd also emphasized the results when adjustments are made to the bill. Turning to Version Y, he applauded its recognition that Cook Inlet cannot support an additional tax. However, he said Chevron no longer can support the bill in its entirety because of substantive changes in many areas.

He mentioned the difficulty of crafting one bill to fit every asset in Alaska, and suggested this bill was drafted primarily with the North Slope in mind. Mr. Zager reminded members that his previous testimony addressed the difficult financial position in Cook Inlet, with issues including production levels at a fraction of what they used to be; water production that has risen to over 90 percent; and platforms that are 35 to 40 years old, which adds greatly to the expense. He pointed out Cook Inlet has less than 2 percent of Alaska's oil production, and indicated it's the least profitable. In the overall scheme, he suggested, it isn't a huge financial impact.

He referred to testimony that ConocoPhillips, the state's largest producer, employs about 900 people. A big component of Chevron's expense is its employees as well, Mr. Zager said, with 385 people, including some full-time contractors. He remarked

that Chevron's labor costs per barrel are astronomically higher than those of the North Slope producers.

SENATOR GENE THERRIAULT joined the meeting at [1:07:47 PM](#).

MR. ZAGER highlighted another unique aspect of Cook Inlet: its value to the Southcentral economy. Fueling the economy is the gas produced there, which heats homes and runs the power generation. He said the importance of Cook Inlet cannot be overemphasized in providing that service. Mr. Zager mentioned power provided to the Kenai Peninsula, where Chevron has roughly 300 employees, hires contractors and other service companies, and is the "anchor tenant" for the Kenai oil and gas business.

He addressed the codependent nature of Cook Inlet production, with its small infrastructure supported by the assets of Chevron and others. Once an asset becomes uneconomic, the fixed overhead costs will be shared among the few remaining assets; a domino effect will drive the remaining assets to become even more uneconomic. Examples include shore bases in the Nikiski area and onshore treating facilities on the west side, as well as the Cook Inlet pipeline.

He reminded members that during previous testimony Chevron presented a couple of options to consider to help Cook Inlet. Noting that Version Y considers carving out the Cook Inlet oil production, Mr. Zager remarked, "That is a route we could go"; he pointed out, however, that it's not the only route to achieve these end results. He emphasized not increasing the tax burden for Cook Inlet, which is already marginal, and continuing to provide incentives for additional oil and gas development.

He discussed the importance of Cook Inlet, predicting that sometime in the next decade, if there isn't additional gas exploration, the legislature will be considering whether to build a state-subsidized pipeline to Cook Inlet in order to provide needed energy to that region. Mr. Zager said he doesn't see a viable alternative to gas as the energy source there. If not from there, it will have to be obtained from somewhere else. Depending on whether the main pipeline has been built, there could be difficult decisions about how to transport that gas.

[1:11:11 PM](#)

MR. ZAGER agreed with many points made by the large producers during the previous day's testimony with regard to Version Y. He said the balance in the original bill - which all parties could live with - is gone. For one thing, the tax rate is

raised from 20 to 25 percent, a clear disincentive for further investment. In addition, changing the April 1 commencement date will force producers to guess what taxes they owe, with high interest rates and punitive penalties for guessing wrong. Furthermore, the 11 percent interest rate tips the balance too far in the state's favor with regard to audits; often those don't happen for two years after the event, and the 11 percent would be charged retroactively for something unintentional. This may result in a larger interest penalty than the original payment, Mr. Zager told members.

He continued, noting the transitional cap is greatly diminished. Mr. Zager pointed out that in the House bill the transitional cap is reduced by about 80 percent a year. Version Y is slightly more favorable, since it's allocated over four years instead of seven, but the total amount is reduced in a proportion similar to that in the House bill.

1:13:10 PM

MR. ZAGER continued, saying the standard \$73 million deduction appears to be lost. In Version Y, to his understanding, it is replaced with a "capital credit" for exploration. From the previous day's discussion, however, he understood that the exploration credit would be deleted from the bill, bringing it back to a "20/20" provision, with no additional incentive for exploration and without the standard deduction.

He turned to the idea of progressivity, saying it's new to the proposed CS in the House as well as in the Senate. Noting that there has been quite a bit of discussion about the intent of Version Y, Mr. Zager said he'd read it to be a 0.2 percent rise for every \$10 increase in price. He surmised, however, that the intent was 0.2 for every dollar increase, the range contemplated by the House. If that is a correct interpretation, Mr. Zager said, it's a highly significant adjustment to the bill, especially starting at \$40 a barrel instead of \$50 a barrel. At today's prices of around \$60, it would be a 29 percent tax instead of the 20 percent originally proposed by the governor.

He spoke against the idea that taking away the high price and windfall would result in a lot of extra money that should be allocated differently. From an investor's standpoint, Mr. Zager said, it is part of the expected value of any investment. Offering commercial fishing as an analogy, where some days are much better than others, he likened this to taking up to half of the earnings on those good fishing days - which certainly would affect a fisherman's desire to invest in the business.

He pointed out that in the oil industry the cycle moves in years or decades. It is tempting to look at good times with regard to prices, such as now, and say there are windfall profits. In the overall scheme, however, Mr. Zager said investments are made on the expected value, distribution and possible outcomes, which include higher-price scenarios. He cautioned that changes with regard to the aforementioned would affect investment decisions.

[1:16:24 PM](#)

MR. ZAGER reported that other issues include tying escalation to West Texas Intermediate (WTI). He mentioned selling Alaska North Slope (ANS) crude, saying in his mind there is often a "disconnect" of \$2 to \$6. He questioned having it pegged to something that doesn't directly relate to the product being sold. Furthermore, gas production is being pegged to WTI, which he said is a real stretch. He suggested that if gas is sold from the North Slope someday, it will be tied to a Henry Hub price; gas sold in Cook Inlet usually is under longer-term contracts, and not at all tied to WTI. Mr. Zager urged members to consider these issues as they look at the bill's provisions.

He said, overall, increasing taxes will make Alaska less competitive relative to the original proposal, perhaps relative to world markets and certainly relative to North American investments, which are usually given a premium as investments because of their low risk. It will put Alaska at the bottom of the distribution for North American investments, he cautioned.

[1:18:04 PM](#)

MR. ZAGER suggested there is a debate between two schools of thought: "Let's get the most revenue off the oil and gas business we can now, while it's still good" versus a "grow the pie" option in which a longer-term view is taken, with effort to invest and keep the production coming. Legislators have to decide which way to go. The first option includes increasing taxes as much as possible, and will balloon state revenue in the short term. Mr. Zager said this puts an onus on legislators to be good stewards of such capital, and to ensure it's well managed for future generations.

He acknowledged the consultants' good work in coming up with reasonable expectations, but pointed out that they'll leave one day and everyone else must live with the decisions. After legislators vote on behalf of the Alaskan people, investors will "vote" with their dollars over the coming years. Mr. Zager noted that with the original bill, the industry said the huge

increase in taxes, though tough to swallow, was manageable - a position they aren't taking with the current version.

1:23:18 PM

MR. ZAGER concluded by saying Chevron cannot support Version Y. He urged return to the original PPT terms while retaining a Cook Inlet provision. Chevron has been in Alaska many years, he said, and intends to continue with active exploration and production in the state if a sound and stable fiscal regime can be offered.

1:24:05 PM

SENATOR STEDMAN highlighted one point of discomfort for Chevron: the escalator clause that provides for a higher rate as prices advance.

MR. ZAGER said he'd only referred to the incremental effect on the PPT and not the total government take. He recalled saying at \$60 a barrel - roughly where it is now - he believed it would be a 29 percent tax, rather than 25 percent, because of the escalator. It'd be an additional 4 percent from \$40 to \$60.

SENATOR STEDMAN agreed it's a substantial tax change for the industry. He pointed out that under the current scenario from Econ One's analysis, however, with no escalator and at 25/20, the government take is 60; with the escalator, it's almost 62. The current system, by contrast, puts it at under 53 percent. Thus the biggest magnitude of change is getting from the current system up to 25/20 - and, under the House version, to 20/20. He said he wasn't disagreeing with Mr. Zager's numbers, but the picture looks a little different when viewed in its entirety.

1:27:58 PM

SENATOR STEDMAN suggested Mr. Zager's point about using ANS rather than WTI should be looked at by legislators.

1:28:40 PM

SENATOR THERRIAULT referred to the issue of whether the state will act prudently if it receives a lot of money now. He said the legislature has mechanisms for setting extra revenue aside; in fact, he is working with Legislative Legal Services currently on a mechanism to do that.

He asked whether Mr. Zager agreed that the credit encourages the industry to specifically "grow the Alaska pie." He suggested the current system makes it fairly easy for companies to generate money and take it wherever they want in their worldwide

operations in order to get the highest return; it's a business decision. From the Alaskan perspective, however, the desire is to have the industry reinvest in Alaska. The PPT is a new mechanism to provide incentive for that activity.

MR. ZAGER said he believes that's right. There'll be additional incentives to invest in Alaska, but it will still be measured against a company's worldwide portfolio, which is dynamic and constantly changing. Thus it's hard to predict how it will look five or ten years from now.

He addressed the reinvestment credit, estimating it will have a positive effect on reinvestment, especially for the smaller companies. It's really a risk-sharing mechanism. He surmised that people's desire to share that risk with the state will depend largely on their risk tolerance and their financial positions. Mr. Zager said the trade-off for sharing the risk up front is giving up value on the backside. A lot of bigger companies are probably willing to make the investment on their own if they can be exposed to the full range of results. He pointed out that it was hard to answer specifically.

[1:31:24 PM](#)

SENATOR STEDMAN suggested the issue isn't one of trying to increase state revenue to meet budgetary requirements. Rather, it's the changing global marketplace and how it puts a value on a commodity owned by Alaskans, as well as the relationship among producers and governments that are in flux around the world. The current system was put in place several decades ago and is structurally flawed, he said, noting there also is a desire to build a multibillion-dollar gas line.

SENATOR GRETCHEN GUESS joined the meeting at [1:32:54 PM](#).

SENATOR DYSON requested that Mr. Zager provide a rough estimate of his company's profits in Cook Inlet ten years ago, five years ago and for 2005. He said he didn't want confidential information, but wanted to know the trend and magnitude of the profits there.

MR. ZAGER answered that he didn't have the information with him. Over that time period, however, oil production declined dramatically, although it's offset by increased oil prices. He said the company is more profitable now than two years ago, but he couldn't say about five or ten years ago.

[1:34:42 PM](#)

Pioneer Natural Resources - Pat Foley, Manager, Lands and External Affairs

PAT FOLEY, Manager, Lands and External Affairs, Pioneer Natural Resources ("Pioneer"), highlighted the common theme heard from investors and ascribed to by Pioneer: the governor's initial proposal held a balance they all could accept, but as the bill has evolved, the balance is being tipped to the disadvantage of many investors.

He said Pioneer is new to Alaska, having been here since 2003, but has jumped in with both feet. He cited a project in the Beaufort Sea, a \$500 million development that will produce 50 million to 90 million barrels of the state's resources. Slated to start up in 2008, it should have a peak rate of about 17,000 barrels a day - a huge amount for a company like Pioneer, but an average Kuparuk drill site, relatively minor in the grand scheme. Mr. Foley mentioned other exploration wells and a development project in Cook Inlet, saying Pioneer is deeply committed to the state. He suggested the state should foster an environment that encourages new entrants.

[1:38:31 PM](#)

MR. FOLEY discussed risks, noting that some are beyond a company's control, but some can be controlled by the way the state sets its policy. He cautioned that as the tax rate goes up and investment credit is stripped away, the climate is turning a bit cold.

[1:40:25 PM](#)

MR. FOLEY noted he'd previously testified about the significance of the \$73 million exemption to new entrants and smaller companies like Pioneer. He encouraged members to find another mechanism to replace it, since it's no longer in the bill. He pointed out that at high oil prices, the cost to drill wells increases for explorers.

[1:42:21 PM](#)

MR. FOLEY referred to Senator Ben Stevens' discussion that day of new language in Version Y relating to a company's ability to use credits against corporate income tax. Mr. Foley said this would greatly benefit a company like Pioneer. He also discussed options for giving or transferring credits, as well as broadening the pool of companies that might be willing to purchase credits beyond just the large oil producers. Noting that companies wrestle with marginal opportunities, he said policies like PPT will have a huge impact on decisions.

Pointing out that Pioneer employs 26 people in Alaska, Mr. Foley emphasized the need to craft a fiscal policy that makes it easier for small companies.

[1:45:47 PM](#)

SENATOR DYSON asked whether Pioneer's increase in drilling expenses has been mostly from fuel costs.

MR. FOLEY replied no. The largest driver is the day rate - the money the company pays for drilling rigs, which are in limited supply. He disagreed with the idea that as oil prices increase, the profit margin rises accordingly. He suggested it's a little out of phase. People might start large investment programs when prices go high. They'll be competing for the same scarce resources, and costs will go up. In response to Chair Wagoner, he agreed to put his remarks in writing and send them to the committee.

CHAIR WAGONER called an at-ease from [1:49:43 PM](#) to [1:53:02 PM](#).

[1:53:06 PM](#)

Anadarko Petroleum Corporation - Mark Hanley, Manager, Public Affairs for Alaska

MARK HANLEY, Manager, Public Affairs for Alaska, Anadarko Petroleum Corporation ("Anadarko"), reminded members that Anadarko's position on the original bill was that it was a delicate balance, a tenuous truce among companies; it increased taxes, but provided some downside protection and improved exploration economics. Mentioning forecasts for declining North Slope production, Mr. Hanley emphasized that Anadarko wants to find more oil and stop that trend, a goal shared by many. He pointed out that the total revenue source from new production isn't just from production taxes - it includes royalties and corporate taxes as well.

He presented a slide from Dr. Pedro van Meurs' report, chart "11.20" showing WTI oil prices, an example of a 150 million barrel oil field. Mr. Hanley emphasized that even under today's system there isn't enough drilling on the North Slope. Production is declining and more is needed. The system needs to improve exploration economics beyond the current system; otherwise, there won't be additional investment - new fields.

He gave Anadarko's view that at \$36 WTI, the 25/20 "with zero" is worse than the current system and won't provide incentive for more exploration. With the \$73 million, however, he pointed out

on the slide that the lines converge. Mr. Hanley noted that Anadarko's previous testimony was based on 20/20, which wasn't in Dr. van Meurs' chart.

He countered the idea that 25/20 is better than 20/20 for exploration - an idea he suggested came from Econ One's testimony indicating a company's economics are better at low prices. Mr. Hanley acknowledged that the state gets less money at low prices - the "downside protection" for companies - but explained, "At the numbers at which we do better, exploration isn't better because it's not economic."

[1:57:54 PM](#)

MR. HANLEY emphasized that a higher tax rate results in poorer economics for exploration and that the \$73 million is highly important to new or smaller companies. Looking at the bill as a whole, for his company at 20/20, if the \$73 million is reduced, it's like raising the tax rate to 25 percent. Thus the \$73 million is worth about 5 percent on the tax rate. Similarly, if 20/20 is raised to 20/25 and the \$73 million is eliminated, it equates to a 30 percent tax rate. If those two things happened, most of his company's projects would be worse economically than under the current system - and thus Anadarko would drill fewer wells.

He pointed out that it's the credits in the original bill that counter the apparent irony of having the state receive more money and yet still have exploration, since higher taxes generally mean less activity. The credits do provide incentive to invest, but also offset that tax increase.

He explained that 25/25 is worse for exploration economics than 20/20 because there isn't a one-to-one relationship. Rather, it's a four- or five-to-one relationship, as he recalled from legislative consultant Daniel Johnston's testimony. Mr. Hanley said if something is being taken away, something must be given back. Thus there should be a credit increase, although it's not a linear relationship. Somewhere around 25/40 keeps the exploration economics the same, he suggested.

[2:01:00 PM](#)

MR. HANLEY discussed progressivity. Still referring to the Dr. van Meurs' slide, he offered Anadarko's perspective that with a progressive tax rate, the change from the existing system would be even greater, since it takes more of the "high side." Where that high side begins makes a difference. Anadarko takes a number that is its hurdle rate, takes a low rate to see if

there is even cash flow at that level, and also takes a high rate - companies generally play for the high side. To the extent there is a progressive tax increase, Mr. Hanley concluded, it does affect Anadarko's decisions regarding exploration.

[2:03:03 PM](#)

MR. HANLEY addressed other concerns. Regarding the progressive rate itself, he said applying a gas-tax increase based on oil price isn't proper. The two shouldn't be linked directly. Also, if a price is started at a certain level, it's unclear whether the tax is based on gross revenues. He pointed out that the House version bases the tax on the gross, not the net. He also noted that cost factors have an impact. To the extent there is no inflation adjustment on the base number, Mr. Hanley said, he believes there's an assumption that costs wouldn't have risen - when, in fact, those costs might have gone up.

[2:05:06 PM](#)

MR. HANLEY referred to talk that the government take is too low currently. He cautioned that investment also is too low, at least with respect to exploration, and that higher taxes won't improve it. He suggested it's only one factor to consider. He showed an example, emphasizing that not every field has the same economics, since some are farther from the infrastructure, for instance.

[2:07:03 PM](#)

MR. HANLEY noted that there are a number of little issues, some of which may be addressed already. He concluded by expressing concern that the tax rate is increasing with no credits to compensate for it, making the economics worse for exploration. "We want to drill more wells, not less," he added, noting that there are a lot of marginal prospective areas where an increase in the economic viability would help.

CHAIR WAGONER remarked, "We'll see if we can tip that the other way."

[2:07:54 PM](#)

SENATOR STEDMAN referred to the escalator issue, saying it's on the net, like regular PPT. He added that the language is, regrettably, a little dysfunctional and being worked on. He provided details, concluding that the intent with the escalator isn't so much to grab the upside above the \$40 range, but is to keep the state- and federal-government take from ever getting smaller as the price rises from \$50 to \$60 to \$70 a barrel in

the future. He recognized that it impacts "marginally" the analysis on the upper end.

2:10:12 PM

SENATOR THERRIAULT urged care in having the escalator applied at the trigger point. He gave an example, stressing that costs might rise over time - despite testimony that technological breakthroughs help to keep costs down - and that the trigger point could keep rising and never be reached. Turning to Mr. Hanley's remark that investment is too low even under today's system, he highlighted his desire for a systematic change to encourage companies to invest their dollars to "grow Alaska's pie" for the benefit of companies and the state alike.

MR. HANLEY replied that he thinks the system has worked as it was presented, with credits that can encourage additional investment. In the end, however, his company looks at the economics in Alaska versus somewhere else they might invest. He emphasized the need to keep the balance.

2:13:41 PM

CHAIR WAGONER recalled that at the previous day's hearing, one of the major companies said even 20/20 didn't provide enough incentive for investment to keep production at a higher level. He surmised Mr. Hanley wasn't insinuating that with respect to exploration.

MR. HANLEY said no. The tax increase is on existing production, which doesn't get the benefit of the tax credits for previous investment that was made. "Forget the look-back for just a minute," he added. He said Anadarko has a foot in both camps: it will probably pay more through the existing production at Alpine, but also views itself as an exploration company.

2:14:57 PM

SENATOR ELTON referred to page 7 of Dr. van Meurs' presentation the previous day. He recalled that Dr. van Meurs had suggested, for large companies, 25/20 provides slightly less investment incentive than the governor's proposal; for smaller companies, however, there'd be more investment no matter what rate was set. Senator Elton asked where those assumptions might be wrong.

MR. HANLEY replied that he hadn't seen the slide. Generally, however, the economics go down as the tax rate rises. He noted that the slide he himself was showing was Dr. van Meurs' chart. Mr. Hanley pointed out that 20/20 would help, but not 25/20.

SENATOR ELTON agreed to share the aforementioned with Mr. Hanley.

[2:18:16 PM](#)

SENATOR THERRIAULT explained that the calculations on page 7 of the Dr. van Meurs' presentation related to whether expected rates of return would change enough to alter a company's investment decisions. It's not an exact science, and companies have different expected rates of return. He indicated the chairman was working on language for a different mechanism with respect to the \$73 million, which is important to companies like [Anadarko].

He said there is a possibility somewhere in the process of considering additional incentives on pure exploration. Noting that Anadarko's investment over the last five years has been substantial, Senator Therriault asked whether Mr. Hanley had given thought to the "two for one" or a multiple to capture previous investment dollars, and whether this would provide adequate incentive for investing.

MR. HANLEY indicated he'd rather have four for one. He reported that Anadarko has invested hundreds of millions of dollars in the last few years; he cited examples of two [satellite fields] at Alpine that haven't come on line yet. He acknowledged that two for one is better than nothing, and stated the intention of continuing to invest. However, he said the original look-back approach is preferable. But if not that, anything his company can do to get credit for money it has spent, and decisions already made, would be helpful.

SENATOR THERRIAULT recalled that Dr. van Meurs' criticism of the look-back was that it's "all sunk costs to the company" and that if the credit mechanism is to shape future investment decisions, the state should get something out of it too.

MR. HANLEY said it would be helpful, and his company would rather have it than nothing. However, he believes it would have a minor impact on whether his company goes forward. For the two satellite fields, he pointed out, it hadn't been anticipated that they'd ever pay a severance tax. Thus he views this as quite a large tax increase. Some fields aren't economically viable if they have to pay a severance tax, he noted.

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MR. HANLEY referred to testimony by ConocoPhillips about what decisions it would've made two years ago if the company had

known there'd be a new system. Similarly, Mr. Hanley indicated he feels Anadarko is getting the worst of both worlds for its two satellite fields, since the company might have waited.

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SENATOR STEDMAN returned to the comparison of oil prices at 25 percent versus 20 percent tax, each with a 20 percent credit. He recalled that Mr. Hanley had said 25/20 isn't better at low oil prices. Senator Stedman also recalled that one consultant was zeroing in on the value of the credit mechanism, because under either scenario the explorers wouldn't be paying a PPT tax.

MR. HANLEY replied by emphasizing that 25/20 isn't better for exploration. At those low prices, the projects aren't economic and his company wouldn't be drilling any of those wells. To the extent 25/20 versus 20/20 at very low prices might cost his company less money than under the existing system, however, it could. Thus the consultants weren't absolutely incorrect.

[2:26:15 PM](#)

SENATOR STEDMAN returned to pricing for gas versus oil.

CHAIR WAGONER responded that an amendment suggested by Dr. van Meurs, which the House put in, addresses that. He said he'd provide a copy.

MR. HANLEY replied he thinks that's the approach. Eventually, when there's gas production, there must be someplace such as Henry Hub to work back from to get the wellhead value. However, basing a gas-tax increase on what happens with oil prices doesn't make sense. "I think they've figured out something," he added.

[2:27:56 PM](#)

CHAIR WAGONER informed members that Mr. Robert Mintz, Department of Law, was working with Dr. van Meurs on some language that the committee would receive Monday; it would relate to the "two to one" changes and the different escalator for gas. He noted that on Monday they also would hear from the public and could pose questions to Dr. van Meurs. He held SB 305 over.

There being no further business to come before the committee, Chair Wagoner adjourned the Senate Resources Standing Committee meeting at [2:28:55 PM](#).