

SENATE FINANCE COMMITTEE
November 13, 2007
2:22 p.m.

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at [2:22:09 PM](#).

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice-Chair
Senator Kim Elton
Senator Donny Olson
Senator Joe Thomas
Senator Fred Dyson

MEMBERS ABSENT

None

ALSO PRESENT

Senator Gary Stevens; Senator Johnny Ellis; Representative Eric Crawford; Steve Porter, Legislative Consultant, Legislative Budget and Audit Committee, Legislative Affairs Agency

PRESENT VIA TELECONFERENCE

Barry Pulliam, Senior Economist, EconOne, Research, Contractor, Legislative Budget and Audit Committee

SUMMARY

CSHB 2001(FIN) am

An Act relating to the production tax on oil and gas and to conservation surcharges on oil; providing a limit on the amount of tax that may be levied on the production of certain gas that is produced outside of the Cook Inlet sedimentary basin; relating to the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; expanding the period in which the Department of Revenue may assess the amount of oil and gas production tax and conservation surcharges; prohibiting a producer or explorer from receiving tax credits if certain judgments are not satisfied and requiring, as a condition of receiving the tax credits, the deposit of the amount of certain unpaid judgments

and certain interest on those judgments in the court during an appeal and relating to that interest; relating to state oil and gas audit masters; making conforming amendments; and providing for an effective date.

CSHB 2001 (FIN) am was HEARD & HELD in Committee for further consideration.

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Co-Chair Stedman commented on the Legislative Finance charts presented on November 12. He thought that too much reliance on one model provides an opportunity for potential error, which is why he asked Legislative Finance to create its own model. He said he intends to keep Legislative Finance involved in the process.

Co-Chair Stedman noted that EconOne's analysis is the main piece of information the legislature uses to make decisions.

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BARRY PULLIAM, SENIOR ECONOMIST, ECONONE, RESEARCH, CONTRACTOR, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, testified via teleconference on EconOne's plan.

STEVE PORTER, LEGISLATIVE CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, LEGISLATIVE AFFAIRS AGENCY, was present to answer questions.

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Mr. Pulliam began with "Tax Rates vs. Net Taxable Value Under Alternative Tax plans" (copy on file.) He compared all versions of the tax plans before the Committee. He explained that the far left column was Net Taxable Value listed in ten dollar increments between \$20 and \$200. That is the net value after transportation costs and operating and capital costs are subtracted. The columns to the right show, for each of the different proposals, the tax rate applied. All of the proposals apply taxes to the net taxable value, including PPT that is in place now, the Governor's proposal - SB 2001, the Senate Judiciary CS, the Senate Finance CS, and the House Bill. The chart depicts the tax rates that would apply at different taxable values inclusive of progressivity.

Mr. Pulliam used an example from the PPT column: at \$20, the rate is 22.5 percent and stays at that rate until the net taxable value is at \$40. The cap of 47.5 percent happens at \$140 net taxable value. He gave examples under various plans. He noted that the Senate Judiciary numbers are the same as the House Bill and have a steeper progressivity.

Mr. Pulliam explained the tax rates under the Senate Finance CS. He pointed out the numbers under the Net Trigger and Per-Dollar Rate.

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Mr. Pulliam turned to the second slide to explain the crossover rates. The Senate Finance overall rate would cross the SB 2001 rate at about \$37 of taxable value. That would be equivalent to \$64 West Coast ANS price. The Senate Finance CS would cross the House Bill at a taxable value of about \$43 or \$71 West Coast ANS price.

Mr. Pulliam explained that the House Bill and the Senate Judiciary CS would both cap out at 50 percent, however, the Senate Finance CS would continue to move up beyond 50 percent. Overall, the progressivity is higher on the Senate Finance proposal, which has a lower base tax than the other proposals. At higher prices, more tax would be collected, but at lower prices, less would be collected.

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Mr. Pulliam explained the slide "Estimated Average Effective Tax Rate on Gross Taxable Value at Various West Coast ANS Price Levels". This slide differs from the November 12 version in that the Senate Finance CS was added.

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Mr. Pulliam turned to the slide entitled "Estimated Total Government Share at Various West Coast ANS Price Levels". Again, the Senate Finance CS has been added.

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Mr. Pulliam discussed the "Estimated Marginal Government Share at Various West Coast ANS Price Levels" slide. He reviewed the idea that the marginal government share would cap out at a little over 85 percent for all plans. The Senate Finance CS would have a marginal rate a little lower than the House Bill or the Senate CS at the point at which it caps. Instead of the cap feature, the rate of increase is slowed down.

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Mr. Pulliam highlighted the final slide, "Estimated Average Effective Tax Rate, Government Shares and Revenue Impacts at Various West Coast ANS Price Levels". He reported that he has added the 2007 state forecast to this chart. That number is roughly \$62 in real terms. Consistent with other charts, the Senate Finance CS was added. At \$80 and above, the Senate Finance CS shows revenues that are higher than the other proposals. At lower prices, it shows revenues that are considerably less than other proposals. At the state forecast prices, the proposals are closer together.

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Mr. Pulliam also brought up price expectations reflective of the current NYMEX futures market. Pricing on NYMEX currently is showing forward pricing of about \$80/barrel. He projected the prices over the next five years. Revenue generation for the Senate Finance CS would be about \$100 million over the House Bill and \$600 million over SB 2001. He emphasized that the break point should be taken into consideration.

Co-Chair Stedman requested clarification of the last point.

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Mr. Pulliam explained that if you look forward to 1 year out of 5 at \$80/barrel and 4 years out of 5 at \$40/barrel, the numbers would suggest that the Senate Finance CS would generate the same overall revenues as SB 2001 over a 5-year period. That is the result of bigger differences at higher prices.

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In response to a question from Senator Huggins, Mr. Pulliam explained that when looking at prices over the next five

years, the average price level on NYMEX is about \$80 per barrel. That in 2008 real numbers is about \$75 per barrel. He explained how that would fit into the charts. Senator Huggins thought that the Senate Finance version's progressivity would generate more money than the other versions. Mr. Pulliam agreed. He added that it would be about \$100 million higher per year than the House Bill.

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Senator Thomas expressed concern about PPT and PPT-expected being based on costs. He inquired if progressivity is the only thing that ensures making more money.

Mr. Pulliam replied that progressivity is certainly a key piece of it. The price itself is also a big piece. If prices are lower, then rates will be lower and the state will collect less. The variables include costs. He opined that there was little one could do as far as setting rates to get back to where the PPT expected line is.

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Senator Thomas asked what the costs entailed. Mr. Pulliam responded that the charts assume costs that are going to be at \$60 per barrel; \$27 per barrel total transportation and production costs. They will rise by \$1.50 per barrel for every \$20 increase in cost above that point and fall by that same amount for every \$20 decrease.

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Co-Chair Hoffman referred to a previous comment by Mr. Pulliam and noted at \$40 per barrel Alaska would be bringing in only \$230 million and experiencing a financial crisis. He said that at \$100 per barrel, the state would get an additional \$400 million. He suggested that the state needs to protect itself at the lower end. He thought the better option would be to take the Senate proposal, which contains more assurances of being able to continue to provide expected state services. He recalled testimony by Dr. Pedro Van Meurs regarding government take. At \$40 per barrel, expected revenue would not address the financial disaster the state would be facing.

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Senator Elton said he was drawn to the state forecast column on the chart and how NYMEX fits into the picture. He questioned the assumption that Alaskan production costs might rise higher than production costs around the world.

Mr. Pulliam explained the NYMEX numbers are suggesting a price level a little above the state's forecast, but a little below the \$80 level.

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Co-Chair Stedman asked for clarification of the 1:5 relationship of \$40 per barrel vs. \$80 per barrel. He asked for comments on various scenarios.

Mr. Pulliam explained he was trying to look at what a break even point would be. He questioned if the rate should be at 22 or 25 percent and at what point it should start to increase. He examined whether the two different types of tax systems would produce similar revenues if a 1:4 relationship was assumed. Two years of high price for every one year of low price would ultimately bring in more revenue for the system with the steeper progressivity.

Co-Chair Stedman acknowledged that Senator Stevens, Senator Ellis, and Representative Crawford were present.

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Senator Huggins brought up the issue of OPEC's ability to influence the price of oil. He pointed out that their ability to moderate prices around the world is limited; however, OPEC could drive price up by reducing production.

Mr. Pulliam commented that there is some capacity within OPEC to increase production. Turmoil in the Middle East is limiting. Calm in the region would probably result in increased production. High prices tend to influence an increase in production.

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Senator Huggins questioned what revenues would look like at \$40 per barrel.

Mr. Pulliam responded that if oil prices fell to the \$40 range, though he didn't see it as a likely scenario, it would put prices for gasoline at \$1 to \$1.50 a gallon. Current station prices haven't caught up to current barrel prices of \$90 to \$95.

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Senator Elton stated that he feels the state is pretty protected for now. He questioned if the Senate Finance CS makes the tax retroactive to July 1, and recent prices of oil have been high, how many months the state would be protected from low barrel prices. Mr. Pulliam restated the

question. Senator Elton thought there would be protection in place with the retroactivity piece and high progressivity. Mr. Pulliam agreed and expected that for that half year, additional state revenue would be in the \$250 million to \$300 million range.

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Senator Elton asked what the expected income would be without the additional monies. Mr. Pulliam said it would be in addition to the revenue from the new tax that started in January, as opposed to July. Senator Elton asked if the \$250 to \$300 million was the amount above what would be generated in the House Bill. Mr. Pulliam said that was correct.

Co-Chair Stedman asked how the same scenario would look under PPT. Mr. Pulliam replied that his answer would be the same because PPT would be in place from January to July.

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Senator Thomas questioned, under PPT and PPT Expected, the factoring in of \$2 for every \$20 over the \$60 amount. Mr. Pulliam clarified that for every \$20 increase it is about \$1.50 per barrel increase in costs. That is factored into all scenarios except for PPT Expected.

Senator Thomas pointed out that the tax rate lines on the charts differ greatly from the dollar figure on the PPT Expected. Mr. Pulliam agreed that the costs do not change with price under PPT Expected.

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Senator Thomas compared the differences at 22.5 percent compared to 25 percent. Mr. Pulliam pointed out that it comes down to risk preferences. Tolerance for risk will affect those choices. Having higher taxes on the higher end, and lower taxes on the lower end, shares more of the risk. If the state has the ability to bank the reward at higher prices, it can insulate itself against lower prices.

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Mr. Pulliam commented on the House Bill. Operating costs would be level with 2006 costs for Prudhoe Bay and Kuparuk. Those operating costs would be allowed to inflate 3 percent per year. This is not per barrel cost, but overall cost level. He questioned if that was the right thing to do. He thought that the net system was the correct choice. To deem costs potentially introduces an artificial element that

could hurt the state. During 2006 a lot of changes occurred on the North Slope and world wide.

Mr. Pulliam related that a second concern is that Prudhoe has the potential for additional production in heavy oil. Costs are higher for heavy oil. Deeming costs may not accommodate the kind of development for those fields. It would be better to get the numbers right through the audit process.

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Mr. Pulliam brought up the Trans-Alaska Pipeline System (TAPS) issue - whether the tax rate was appropriate. The House Bill contains a provision for a "just and reasonable rate" where the state determines a reasonable cost for operating the TAPS system. That provision is worth considering for all scenarios. He discussed FERC's regulations and position. He related that the department has predicted the impact of a just and reasonable rate to be \$50 million per year over 7 years.

Mr. Pulliam explained that the just and reasonable rate provision was not included in the charts.

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Senator Elton reviewed concerns expressed by Mr. Pulliam. He asked if Mr. Pulliam's concerns would be mitigated by a three-year sunset, which would allow auditors to review OPEX costs for legacy fields. Mr. Pulliam responded that his concerns would be mitigated if there were a sunset because it would be stronger than a review. He emphasized that the Prudhoe Bay and Kuparuk fields need to be done correctly and quickly.

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RECONVENE: [3:34:20 PM](#)

CS HB 2001 (FIN) am was HELD in Committee for further consideration.

ADJOURNMENT

There being no further business before the committee, the Senate Finance Committee meeting was adjourned at 3:57 PM.