

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

October 24, 2007

9:33 a.m.

MEMBERS PRESENT

Representative Kurt Olson, Chair
Representative Nancy Dahlstrom
Representative Mark Neuman
Representative Jay Ramras
Representative Ralph Samuels
Representative Mike Doogan
Representative Scott Kawasaki

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Bob Buch
Representative John Coghill
Representative Bryce Edgmon
Representative Anna Fairclough
Representative Carl Gatto
Representative Lindsey Holmes
Representative Michael "Mike" Kelly
Representative Bob Roses
Representative Paul Seaton
Representative Peggy Wilson

COMMITTEE CALENDAR

HOUSE BILL NO. 2001

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and gas tax credit fund and authorizing payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production tax on oil and gas and

conservation surcharges on oil; making conforming amendments; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB2001

SHORT TITLE: OIL & GAS TAX AMENDMENTS

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

10/18/07	(H)	READ THE FIRST TIME - REFERRALS
10/18/07	(H)	O&G, RES, FIN
10/19/07	(H)	O&G AT 1:30 PM HOUSE FINANCE 519
10/19/07	(H)	Heard & Held
10/19/07	(H)	MINUTE(O&G)
10/20/07	(H)	O&G AT 12:00 AM HOUSE FINANCE 519
10/20/07	(H)	Heard & Held
10/20/07	(H)	MINUTE(O&G)
10/21/07	(H)	O&G AT 1:00 PM HOUSE FINANCE 519
10/21/07	(H)	Heard & Held
10/21/07	(H)	MINUTE(O&G)
10/22/07	(H)	O&G AT 9:00 AM HOUSE FINANCE 519
10/22/07	(H)	Heard & Held
10/22/07	(H)	MINUTE(O&G)
10/23/07	(H)	O&G AT 9:00 AM HOUSE FINANCE 519
10/23/07	(H)	Heard & Held
10/23/07	(H)	MINUTE(O&G)
10/24/07	(H)	O&G AT 9:00 AM HOUSE FINANCE 519

WITNESS REGISTER

STEVE PORTER, Consultant
to the Legislative Budget and Audit Committee
Tehachapi, California

POSITION STATEMENT: Testified during the hearing on HB 2001.

MARK SHARP
Fairbanks, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

JERRY WALKER
Fairbanks, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

CHUCK LOGSDON, Consultant
Alaska Oil and Gas Association (AOGA)
Palmer, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

JERRY DIXON
Seward, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

DURAINNEY RAWLS, Owner
Durainney's Crane Service
Nikiski, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

ERIC PEIRCE
Fairbanks, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

TOM LAKOSH
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

TOM MALONEY
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

JERRY MCCUTCHEON
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

ERIC DOMPELING, President
Alaska Support Industry Alliance (The Alliance)
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

MARY SHIELDS, General Manager
Northwest Technical Services
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

DENETTE JUSTICE ROMANO
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

MARK HYLEN
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

BOB BARNDT
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

BILL WARREN
Nikiski, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

DONALD A. BENSON
Palmer, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

JIM GILBERT, President
Udelhoven Oilfield System Services Inc.
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

TOM DORAN
Seward, Alaska

POSITION STATEMENT: Testified in support of HB 2001.

TONY TENGS
Juneau, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

ACTION NARRATIVE

CHAIR KURT OLSON called the House Special Committee on Oil and Gas meeting to order at [9:33:29 AM](#). Representatives Doogan, Kawasaki, Dahlstrom, Neuman, Samuels, and Olson were present at the call to order. Representative Ramras arrived as the meeting was in progress. Other members present were Representatives Buch, Coghill, Edgmon, Fairclough, Gatto, Holmes, Kelly, Roses, Seaton, and Wilson.

HB2001-OIL & GAS TAX AMENDMENTS

[9:33:40 AM](#)

CHAIR OLSON announced that the only order of business would be HOUSE BILL NO. 2001, "An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and gas tax credit fund and authorizing

payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production tax on oil and gas and conservation surcharges on oil; making conforming amendments; and providing for an effective date."

[9:34:36 AM](#)

STEVE PORTER, Consultant to the Legislative Budget and Audit Committee, delineated four major issues of his presentation; stability, Alaska's prospectivity, incentives in Alaska's Clear and Equitable Share [HB 2001], and basic recommendations on the impacts of this bill on the future of Alaska and the ability to produce oil and gas in the state.

[9:35:51 AM](#)

REPRESENTATIVE HOLMES requested background information from Mr. Porter.

[9:36:13 AM](#)

MR. PORTER stated that he worked for 21 years in the oil and gas industry, was Deputy Commissioner for the Department of Revenue (DOR), and has extensive experience in contract negotiations. Most recently, he was a legislative aide to Senator Bert Stedman.

[9:37:18 AM](#)

MR. PORTER expressed his belief that instability is created by disproportionate sharing, or the frustration level, of either the taxpayers or the state. A balance of tax fairness at all levels creates stability. During the years the tax rate was determined by the Economic Limit Factor (ELF), the industry paid less tax, even though profits were high, and an inevitable change in tax policy by the legislature came about. He continued to explain that instability is also created when the government projects a budget that will exceed revenue. The oil industry is aware that revenue from the production of gas and oil provides 85 percent of the state's budget, thus it will anticipate changes in tax policy to balance the budget.

[9:39:13 AM](#)

MR. PORTER pointed out that recent testimony by the oil industry accused the state of creating instability by changing the tax

system three times. The first tax change cited by the oil companies was an administrative decision by the previous administration that increased costs to the oil and gas industry by \$100 million. Mr. Porter informed the committee that this was not a change in regulations or statute, but the implementation of a law that was already in effect. The implementation of this law, regarding the consolidation of facilities, resulted in increased costs to the industry and was regarded by the industry as a tax change. He opined that the first real tax system change was the passage of the Petroleum Production Profits Tax (PPT).

[9:41:32 AM](#)

MR. PORTER recalled that disproportionate unfairness was on the horizon and the state and the oil industry realized that under the ELF system, at some point, the industry would pay no tax even with higher oil prices and rising industry profits. The industry and legislature knew that changes would be coming fairly soon. At the same time, the industry was negotiating a contract for the gas pipeline project and wanted to keep the tax base rate low, tax rate certainty for a term of years, and a construction contract. Instead, there was no gas pipeline contract, no guarantee of a certain tax rate, and the tax rate base was raised higher than the industry had hoped. Mr. Porter said that PPT is a tax change, and now, to consider a further increase, raises the question of whether the oil industry is justified in its conclusion that there is instability. Governor Palin has stated that there is a cloud over PPT and that it must be re-examined to determine whether the best decisions were made during its creation. Mr. Porter noted that the administration has reviewed PPT and is making recommendations to the legislature for a clarification of the tax. He recommended that the committee take the time to determine a reasonable curve, at all prices, that is within a range of fairness and will provide long term stability to PPT.

[9:44:31 AM](#)

REPRESENTATIVE NEUMAN asked whether the industry feels that the passage of PPT was a fair change and how PPT will effect decisions made by the oil companies.

[9:45:14 AM](#)

MR. PORTER encouraged the committee to consider tax changes as sum costs. Corporate decisions are supposed to be based on risk

weights, not on emotion. The risk weights are determined for future costs, the current economic perspective risk, and the new tax. Mr. Porter explained that oil companies will study production expectations, expenditure variables, the tax rate, the possibility of delays, stress and expected price, and then assign a risk weight to a new project. Looking at the history of changes made to a tax system will determine the risk weight of instability. When the risk weight of instability is determined to be high, it will have a greater impact on the overall economics of the project. He stressed that this is still just an element of the overall economic evaluation and that the biggest element of the formula is the amount of oil production projected.

[9:47:29 AM](#)

REPRESENTATIVE NEUMAN stated that oil companies will look at many factors; however, the risk weight for stability is based on the fact of a change and not the size of the change.

[9:47:54 AM](#)

MR. PORTER explained that the risk weight is a percentage that would be multiplied by the actual amount of the tax and, therefore, results in a higher projection of the cost of taxes on the project.

[9:48:50 AM](#)

REPRESENTATIVE DOOGAN surmised that the oil companies equate the risk of change to the risk of an increase in taxes.

[9:49:13 AM](#)

MR. PORTER responded that a risk weight of lower taxes could be put in the formula, as well. The result would make the project more economic.

[9:50:06 AM](#)

REPRESENTATIVE RAMRAS interjected a comment regarding ConocoPhillips Alaska, Inc. (ConocoPhillips)'s quarterly profits in the last year, and pointed out that its earnings were down this quarter by four cents from the previous year. He encouraged the committee to consider that a publicly traded company must search for the most robust investments to report to its investors. An oil company is under pressure from its own

shareholders to produce increased profits and may not have the ability to consider Alaska projects unless they are deemed most profitable.

[9:52:50 AM](#)

MR. PORTER stated that when oil is selling at a price of \$80 to \$90 per barrel, the corporate revenue stream exceeds the portfolio expectations, and also exceeds the ability of the company to build all of the projects that are economic. Under a high-price environment, the decision to not proceed with a project would be due only to a lack of manpower. Alaska must compete at a more difficult level when the prices have dropped to \$20 to \$30 per barrel and cash flow to the industry is sufficient to support only the most economic projects. He acknowledged that projects in Alaska are more expensive than those in many parts of the world and drop-offs do occur dramatically in a low-price environment. A few years ago, for example, the value of exploration permit applications dropped from \$150 million to \$10 million within two years. Alaska must stay competitive in a low-price environment; however, when prices are high there are few obstacles to development.

[9:55:57 AM](#)

REPRESENTATIVE DOOGAN recalled testimony regarding the Ooguruk project that Pioneer Natural Resources Alaska (Pioneer) chose to develop and ConocoPhillips did not. He opined that some companies must have lower expectations for rates of return from a project.

[9:56:56 AM](#)

MR. PORTER agreed and noted two important considerations. One is that mature fields, like in Alaska, have an economic outlook with a lower rate of return. This lower rate may be economic to smaller oil companies due to lower overhead, but not for larger companies. Occasionally, large marginal fields are held by major oil companies for future development.

REPRESENTATIVE DOOGAN opined that Alaska may see more production with companies who have lower rates of return expectations than the major oil companies.

MR. PORTER said not necessarily, and to explain he will discuss Alaska's prospectivity.

9:59:24 AM

MR. PORTER informed the committee that Alaska's prospectivity is the second point to consider. Alaska's major reserves on state land are located in the area from the Colville River to the Canning River on the North Slope, and the greatest potential for revenue from royalty oil is there. Of the 100 billion barrels that may be on the North Slope waiting for discovery, less than 20 percent is expected to be located on state lands. Thirty percent of future exploration is expected to be found in the National Petroleum Reserve-Alaska (NPR-A), and over fifty percent in the Outer Continental Shelf (OCS). Comparisons that can be drawn to this situation would be the regions in the world with high cost wells similar to wells drilled on state lands, in the NORA, and in the OCS. Mr. Porter advised that within those regions, the committee should look at high cost mature fields. A second comparison for state lands is the heavy oils that are not puddles and are very expensive to harvest on a per barrel basis. He suggested that, to compare competition with the NORA, the committee should study regions that are similar to the Alpine Oil Field and that have higher costs and smaller reserves. In addition, Mr. Porter stressed that revenue from state lands between the Colville and Canning Rivers is from royalty and taxes. In the NORA, where 30 percent of the potential for new development is located, the royalty stream is cut by 50 percent. The remaining 50 percent is diminished by payments to local communities and agencies before entering the general fund. He opined that no royalty monies from the NORA have been deposited to the general fund. However, production taxes are paid to the state from oil produced there.

10:04:55 AM

MR. PORTER continued to explain that future production from the OCS will provide no tax or royalties to Alaska. He recommended that the governor begin to work with the federal government on arrangements to ensure that Alaska will receive a fair share of revenue from production in the OCS, similar to arrangements with states bordering the Gulf of Mexico.

10:05:38 AM

REPRESENTATIVE SAMUELS commented that Shell Oil Company (Shell), ConocoPhillips, ExxonMobil Corporation (EXXON), BP, and Chevron U.S.A. Inc., (Chevron) are the only companies large enough for exploration in the OCS. In general, Pioneer Oil Company, Inc.

(Pioneer) or Anadarko Petroleum Corporation (Anadarko) could not take the risk.

[10:06:35 AM](#)

MR. PORTER expressed his belief that life is unfolding as it should right now. In a mature basin the smaller companies can afford to work the "puddles" and the large companies can continue to explore and do major developments elsewhere. He said that this is beginning to happen in the area from the Colville River to the Canning River. Mid-sized companies can operate in the NORA as partners to the major companies. Small and mid-size companies can not explore in the OCS, unless as part of a large group, without the risk of bankruptcy.

[10:07:47 AM](#)

REPRESENTATIVE DOOGAN said that according to this information, in terms of the tax policy, an increase would have an effect on oil production on state lands. There would be less effect on oil production in the NORA, and no effect on production in the OCS.

[10:08:32 AM](#)

MR. PORTER clarified that the economic tax impact on projects will have the same effect on the NORA as it has on the state lands from the Colville River to the Canning River. The difference will be that royalties will go to the federal government instead of Alaska.

[10:09:06 AM](#)

REPRESENTATIVE DOOGAN asked whether all state taxes apply to the NORA.

[10:09:33 AM](#)

MR. PORTER answered that corporate income tax and property tax apply to the NORA.

REPRESENTATIVE DOOGAN re-stated that the effect of changing the tax rate will be the same on the NORA as on state lands.

MR. PORTER said yes. He then spoke of the elements of each tax that should be considered. Heavy oil is found on state land and is a separate issue. The production of heavy oil should be

encouraged as there is the potential of producing 20 to 30 billion barrels of heavy oil on state lands. He encouraged the committee to not place barriers on the production of heavy oil because of the size of the reserves and the potential revenue.

[10:11:27 AM](#)

MR. PORTER recalled that previous testimony estimated that the lifting cost of heavy oil has been established at about \$41 per barrel and that the stress cases on economics revealed costs of \$40 per barrel. In addition, the governor's proposal, with the floor in place, made the production of heavy oil at \$40 per barrel marginally economic. He opined that if an Alaska oil and gas corporation considered spending \$100 million to enhance the production of heavy oil and projected a stress price of \$40 per barrel, the company's management team would conclude that the project is not competitive and would not proceed with development.

[10:12:59 AM](#)

MR. PORTER emphasized that one thing that should be done to ACES to ensure future revenue to the state is to remove the minimum percentage floor. Removing the floor percentage is absolutely vital to make sure that the future sources of revenue are not hurt. The floor is a penalty aimed straight at the development of heavy oil.

[10:13:21 AM](#)

REPRESENTATIVE RAMRAS asked for the rational for including a minimum tax floor in the bill.

MR. PORTER replied that the rational for the gross floor is that, during a low-price environment, a source of revenue is guaranteed. However, at that point the companies will be cash poor and they will continue to cut back on operational and capital expenses which will hurt jobs and supporting industries in Alaska. The only thing a gross floor will do is exacerbate the recession that could occur. Mr. Porter recommended that money from high oil prices be set aside and managed effectively for the future.

[10:15:35 AM](#)

REPRESENTATIVE RAMRAS re-stated Mr. Porter's confidence in removal of the minimum tax.

[10:15:38 AM](#)

MR. PORTER assured the committee that he is very strong on that issue.

[10:15:47 AM](#)

CHAIR OLSON concurred with the conclusion that the state tax rate must be lower during years of lower oil prices.

[10:16:11 AM](#)

REPRESENTATIVE NEUMAN expressed his understanding that the production of heavy oil plays a large part in the future of Alaska's oil industry, and in the amount of the oil coming down Trans-Alaska Pipeline System (TAPS). He asked Mr. Porter for an estimate of how much oil will come down the pipeline in 10 years if there is an average decline of 6 percent. He opined that additional money for reinvestment is necessary to try to minimize this decline, not to just maintain the status quo. Representative Neuman said that the projected curve indicates that half as much oil will be flowing in ten years.

[10:17:52 AM](#)

MR. PORTER relayed that the 6 percent decline curve projected by the Department of Revenue begins in earnest following 2012. He observed that there is no one solution and that investment in three basic areas should occur. There needs to be an environment with a tax structure to encourage development in legacy fields. Secondly, the tax environment should encourage of development of heavy and viscous oil fields. Thirdly, independents should be encouraged to work the puddles of existing fields and the major oil corporations should be encouraged to open new high cost fields. All three areas are needed to reduce the projected decline.

[10:20:01 AM](#)

REPRESENTATIVE NEUMAN commented that the most important area is to encourage investment in legacy fields.

[10:20:18 AM](#)

MR. PORTER opined that the highest return of value would be investment in the legacy fields. He explained that dollars

spent in these fields will provide the largest return with the least risk of failure.

[10:21:11 AM](#)

REPRESENTATIVE NEUMAN expressed his understanding that the state is interested in encouraging investment in the legacy fields and in supporting the diversification of exploration companies to include mid-level and smaller companies.

[10:21:54 AM](#)

MR. PORTER stated that, although he did not participate in the development of PPT, he agrees with its structure. The PPT creates a capital investment structure, whereby, all three elements previously discussed are being supported. The oil and gas industry will be able to benefit in each division, based on capital deductions or investment credits. He opined that the state currently has a healthy environment and is seeing strong investment in legacy fields and heavy oil production. There is also a fair rate of new exploration. Mr. Porter turned to the subject of the impacts of the progressivity factor in a high-price environment and the 22.5 percent to 25 percent tax base rate in a mid-price environment. The governor's progressivity factor captures some, but not substantial, additional revenue. When oil prices per barrel are between \$80 and \$90 progressivity makes more sense. Taxes on the oil industry should not be increased during times of low prices, but in a progressive market it is appropriate to share the wealth. Mr. Porter emphasized that the share of government take needs to be fair at all price ranges.

[10:25:54 AM](#)

REPRESENTATIVE NEUMAN expressed his appreciation for Mr. Porter's praise of PPT as a good operating model. Comparing PPT with ACES, he opined that they are basically the same.

[10:27:12 AM](#)

MR. PORTER agreed and said that ACES is the same model with small changes in tax base rate percentages that increase the state revenue at certain oil prices over time.

[10:28:08 AM](#)

CHAIR OLSON requested copies of Mr. Porter's testimony from the Senate presentation on October 23, 2007.

[10:28:24 AM](#)

REPRESENTATIVE DOOGAN asked for Mr. Porter's definition of "fair".

[10:28:48 AM](#)

MR. PORTER responded that the committee must determine how to create an economic balance through the tax structure in all three regions of economics; low-price, mid-price, and high-price. The resulting "fair" tax environment will create stability over the broad range of oil prices. The exact tax will not be apparent; however, extreme figures such as a 95 percent tax rate, will obviously not create a healthy environment that encourages investment. He concluded that the current middle range is a healthy environment for all three regions of economics.

[10:30:33 AM](#)

REPRESENTATIVE DOOGAN observed that there is no difference between 22.5 percent or 25 percent or whether a percentage of operating costs can be deducted or credits given, as long as they have yields in a similar range.

[10:30:58 AM](#)

MR. PORTER re-stated his belief that if the tax rate is adjusted at 21 percent or 22 percent it will have the effect of being less friendly to the industry and will change an oil company's projections in the margins, but not necessarily in the final economic decision. The tax is a piece of the model and the base economic decision making should not be strongly affected, in most cases, by a one percent change. Regarding the deductibility of operating and capital expenses, Mr. Porter said that capital credits help the models support investment, are beneficial to the state, and are an increment that supports proposed projects.

[10:32:35 AM](#)

REPRESENTATIVE DOOGAN conceded that PPT looks good on paper, however, it may not perform as well as was expected in the real

world. He concluded that if PPT had performed as well as expected, we would not be here today.

[10:33:23 AM](#)

MR. PORTER said that Representative Doogan is referring to the \$800 million shortfall. He stated that he is unsure of the origin of that figure, beyond the fact that DOR projected the price of oil incorrectly. Other revenue forecasts by DOR have been significantly off, especially regarding production. Mr. Porter explained that DOR projections are historically conservative and do not over-project in a downward market. Expected case production figures supplied by the industry do not include unexpected shut-downs, upgrades, permitting, and other losses. The DOR estimates for production, pricing, and costs were all incorrect with the exception of the amount of the first payment. Mr. Porter questioned the basis of the \$800 million loss and how the incorrect projection influenced the debate on PPT last year. He opined that the debate over the loss is immaterial since the legislature is now in the process of reviewing the tax base rate and will decide what rate will benefit the state in the future.

[10:36:54 AM](#)

REPRESENTATIVE DOOGAN said that at some point the question of where the \$800 million is will be resolved.

[10:37:17 AM](#)

MR. PORTER explained that DOR has itemized the loss by calculating the four or five variables of price, production, and operating and capital expenses. He said that he does not know which variable accounts for the \$800 million.

[10:37:42 AM](#)

REPRESENTATIVE DOOGAN remarked:

I think that, had I been here [last year] I would have been a lot more likely to vote for a tax that brought in \$800 million more than this one appears to have, no matter how that worked. So, thank you.

[10:38:09 AM](#)

MR. PORTER said that he is not a political junky and has a hard time understanding how there would be enough energy in the legislature to vote for a bill that captures \$2 billion out of somebody's pocket. He then directed the committee's attention to the exploration of gas and noted that gas, except as a by-product to the production of oil, is not a mature resource in the state. There are areas that are gas prone; however, the market has been flat, thus there has been no exploration and development of this industry.

[10:40:01 AM](#)

MR. PORTER advised the committee that his current testimony can be found on page 4, Senate Resources, Comments on Governor's ACES Proposal, by Steve B. Porter, dated October 22, 2007. He continued to say that, although Dr. Pedro van Meurs determined that the gas pipeline was uneconomic, his feeling is that the project is indeterminate due to the following four variables: Costs of the pipeline; the future price of gas; stability of the taxes and what they are; the internal rate of return and project evaluation criteria. Mr. Porter stated that Dr. van Meurs projected the cost of the project to be \$40 billion. In addition, his estimate for the future price of gas was based on present prices. Mr. Porter expressed his belief that these factors are indeterminate. Regarding the stability of taxes, he said that if the owners of the resource decide to build the pipeline, or commit to shipping gas, then, after spending a huge amount of capital, the indeterminate risk of the state substantially raising the tax rate on gas is a high risk factor. How the companies will weight that risk and complete an internal rate of return analysis on the pipeline project is unknown. He concluded that even if the project is never economic, the gas is still an asset that a corporation might want to hold onto and try to monetize.

[10:44:29 AM](#)

MR. PORTER disclosed that, during his job for the state negotiating with the major oil producers on the gas pipeline project, he strove to enhance the overall potential for the project to occur. The project was to monetize the gas resource and to explore all ideas to that end. All of the alternatives, such as gas to liquids, need to be addressed and pursued. In addition, when the applications are reviewed, the state should be prepared to understand the risks and whether they are taken by the applicant, or delayed, or shifted to the federal government and elsewhere. Mr. Porter stressed that the

legislature will be the leaders of the state and will decide to modify AGIA or implement it. Regarding the timing for the development of gas, the length of time for the project to come on line, from the time of gas discovery to market, could minimally be one year, depending on its proximity to the existing infrastructure. Six to eight years is a fair estimate for projects within twenty-five miles of existing facilities. Large projects in remote areas could easily take ten years or more. Successful development of the gas pipeline will also need time to address environmental and subsistence concerns. He opined that a proposal with an estimated completion date of less than nine years could bring additional risks to the project.

[10:50:14 AM](#)

MR. PORTER restated his strong recommendation to remove the floor minimum tax rate in ACES. He said that he would not recommend a specific tax base rate except to keep the rate in the 20 percent to 25 percent range. Regarding progressivity, he encouraged legislators to invoke a fair share of the profits during periods of high oil prices.

[10:51:22 AM](#)

REPRESENTATIVE DOOGAN asked whether Mr. Porter could specify the highest tax rate range that is reasonable.

MR. PORTER cautioned against making a leap of five to ten percent and suggested that an increase of one to two percent would be an acceptable risk. He said that he felt a model of a five percent increase would demonstrate an unacceptable risk to the oil industry and would not be beneficial to the state.

[10:52:36 AM](#)

REPRESENTATIVE SAMUELS stated that he considers the possible changes a continuum and the increase in the base rate that will stop a project is unknown.

[10:53:35 AM](#)

MR. PORTER suggested that the committee look at the bell curve analysis; the highest point of the curve is near the center. When the tax rate falls off of the center, either less tax creates instability and a more volatile environment, or, moving down the other side, with more money out of the industry's pocket, potential projects are lost. He said that he was unsure

where the continuum lies. Mr. Porter continued to say that the committee must guess, with a broad brush, what the future will be like. Then, in ten or fifteen years, the decision can be evaluated for accuracy. He cautioned against using models with rates broken down into decimal points.

[10:55:05 AM](#)

REPRESENTATIVE DOOGAN expressed his disappointment that the committee decision will not be based on a mathematical, rational, and structured formula.

[10:55:23 AM](#)

MR. PORTER informed the committee that he is not an economist, but a lawyer by trade.

[10:55:50 AM](#)

REPRESENTATIVE SAMUELS said that, at one point last year, he and Representative Kelly sat on a conference committee where there was contention over two-tenths of a percentage point in the tax rate.

[10:56:36 AM](#)

MR. PORTER summarized his recommendations to the committee: encourage heavy oil development without penalties; encourage the governor to work with the Congressional delegation to get Alaska's fair share of OCS revenue before Shell, or any other oil company, drills in the OCS; work with local communities to make sure their concerns are addressed before development begins so that responsible development can proceed without legal challenges.

[10:58:19 AM](#)

REPRESENTATIVE HOLMES asked for Mr. Porter's opinion on the difference between a gross tax with credits and PPT.

[10:58:59 AM](#)

MR. PORTER answered that a gross tax provides models with straight lines verses a curve that would be low in a low-price economic environment and rises to follow the high-price economic trends. A gross tax alone will not benefit the state because

there is only one point at which the tax rate is fair. Otherwise, the state is collecting too little at the bottom and too much at the top. A gross tax can be altered; however, the result is very complex. He opined that the PPT creates a lot of debate over costs and operational expenses; however, this debate will encourage the industry and DOR to come to terms and avoid future conflicts. Mr. Porter opined that the PPT formula and model are very clean and simple. The argument is about how much oil companies will be allowed to take in operational and capital expenses, especially in a high-price environment. In a stable price environment, operational expenses increase only with inflation and thus will garner less debate. He pointed out that the creation of any new tax will cause debate over margins and that the true battle is clarification of operational and capital expenses, not whether a tax is based on gross or net profit.

[11:03:15 AM](#)

REPRESENTATIVE HOLMES asked whether, once a good model is established, it can be administered and implemented correctly.

[11:04:07 AM](#)

MR. PORTER said absolutely. He assured the committee that when a tax is changed a margin is created. The oil companies will work to establish their maximum value of the margin. He explained that there will be more litigation settled immediately after the change than during later years and then, after a few years of litigation, the administration of the tax change will become clear to all parties. He advised the committee that litigation often results in the assessment of penalties and interest and may increase a taxpayer's debt, even when settled at a discount. Eventually, the principles of the law will be established and payments will be made. Mr. Porter encouraged reduction of the differential on settlements and thus the industry and the state will benefit from less litigation. He stressed that the auditors will address the fluctuation of operational and capital expenses; there is no avoiding these issues. He also commented that he does not feel that the state auditors are overwhelmed by those representing the industry.

[11:08:11 AM](#)

CHAIR OLSON announced that the committee will allow time on October 25, 2007, for the House Special Committee on Economic Development, International Trade and Tourism to hold a hearing on Alaska's economy.

[11:08:44 AM](#)

REPRESENTATIVE NEUMAN inquired as to the penalty for heavy oil development that Mr. Porter referred to in his recommendations.

MR. PORTER answered that the penalty is the 10 percent gross tax on the bottom. He recommended that it be removed from ACES.

[11:09:22 AM](#)

REPRESENTATIVE NEUMAN informed the committee that the House Special Committee on Economic Development, International Trade and Tourism will be addressing Alaska's economy; past, present, and future. Governor Sheffield will testify along with other speakers from every region. He said that the topics discussed will play a large part in the decisions to be made during this special session.

[11:10:29 AM](#)

REPRESENTATIVE RAMRAS asked for clarification on what are operational expenses.

[11:11:04 AM](#)

MR. PORTER responded that operational costs are the employees and the equipment that keeps the oil flowing. Operational expenses should remain fairly stable in a stable environment; the deductions just need to be verified. He expressed his belief that operating expenses can be projected incorrectly without causing major problems. Furthermore, oil and gas production companies like to keep their operating expenses on facilities low so they can divert funds to capital expenses and bring new oil out of the ground.

[11:12:44 AM](#)

REPRESENTATIVE RAMRAS restated Mr. Porter's opinion that the 10 percent floor tax creates a penalty against heavy oil investment, thus, in a low-price environment, may lead to industry cuts in jobs for Alaskans. He also pointed out that ACES allows the industry to take deductions over a two-year period, rather than the present one-year period, and asked Mr. Porter to explain the reasons for this change.

[11:14:26 AM](#)

MR. PORTER explained that the revenue impact between a one year period and a two year period remains the same. The administration extended the time period in order to project future revenue resources more effectively; however, he voiced his belief that this benefit is insufficient to justify a change in economic decision-making.

[11:15:08 AM](#)

REPRESENTATIVE RAMRAS suggested that, similar to an accounts payable system that provides 30 days to use a vendor's money, this extension provides the state one year's worth of credits for its use.

[11:15:39 AM](#)

MR. PORTER remarked:

And in a, in a broad laymen's world, if you were discounting things at ten percent, you just cost them five. You know, so I mean, it's, because you just rolled half of it back. So it's, interestingly, it's that particular negative impact if you balance that against the payment that the state wants to make. ... The state wants to buy back the credits for the small producers, because they're getting ninety, somewhere plus ... 95 cents on the dollar, but not getting the full dollar. ... That delay for a year of half your credits, is actually a more negatively impacting than this is positively impacting. This is five percent and this is three percent. They lose ... from a net standpoint. ... On this delay of half your credits for a year, all things being equal, ... I probably wouldn't do it.

[11:17:01 AM](#)

REPRESENTATIVE RAMRAS spoke of his worry about things that are perceived as dampening agents.

[11:17:29 AM](#)

The committee took an at-ease from 11:17 a. m. to 11:20 a. m.

[11:20:24 AM](#)

REPRESENTATIVE RAMRAS asked whether a 22.5 tax, as an entry point to attract the retention of capital and new explorers, is a more welcoming figure than a 25 percent tax rate.

[11:21:14 AM](#)

MR. PORTER answered that no change is always a more welcoming environment than an increase in the tax. He opined that the industry will decide what it can live with and where it will spend its money. Therefore, keeping the existing tax holds psychological and economic benefits that can not be overlooked. By making no changes during this hearing process, the legislature will send a signal to the industry that Alaska's tax system is stable. Mr. Porter said that no change enhances the stability factor slightly.

[11:22:51 AM](#)

REPRESENTATIVE RAMRAS reviewed Mr. Porter's support of a sound tax policy to enhance oil and gas development and to maximize revenue, not at the beginning or at the end, but somewhere in the middle when the most premium is available. He said that Mr. Porter recommended the imposition of the highest tax at the time of highest oil prices, and that a savings component, on behalf of the state, should be implemented. Representative Ramras said that another factor of Mr. Porter's testimony is that the state should not be punitive toward the industry when the times of low oil prices return. Mr. Porter's prescription is to hold down taxes to present stability and lower barriers to new exploration; take the most in taxes at peak prices; and to save the revenues for future use. In addition, operating expenditures should be held in a positive light, and we should not have an element of punishment against the industry when oil prices are low. Furthermore, taxing too heavily during times of low oil prices may be at the expense of jobs for Alaskans. Representative Ramras concluded by saying that if heavy oil is the last untapped legacy asset that the state has, those barriers to entry should be as low as possible and a gross tax is the single greatest dampening agent to continued production from these legacy fields. He asked whether his summary of Mr. Porter's testimony was correct.

[11:27:50 AM](#)

MR. PORTER concurred.

[11:27:54 AM](#)

CHAIR OLSON remarked:

Steve, one of our comrades down the hall has indicated that he felt that the testimony from the ... two LB&A consultants was going to be biased and should be discounted ... because they were given direction by LB&A on ... their conclusions. I wonder if you can comment on that?

[11:28:19 AM](#)

MR. PORTER responded that he is very pleased by the terms under which he was hired. The Legislative Budget & Audit committee hired him to share his expertise with members of the legislature; he was not given a mission or directed to lean his testimony in a certain direction. He said that he felt his responsibility as an advisor is to state what he knows to be true. He stressed that LB&A did not have prior knowledge of what his testimony would be and encouraged the committee to look closely at his testimony and to test his figures for accuracy. Mr. Porter said that this testimony is his personal opinion.

CHAIR OLSON expressed his appreciation for Mr. Porter's testimony.

[11:30:16 AM](#)

REPRESENTATIVE SAMUELS confirmed that this was the first time he has heard Mr. Porter's testimony. He spoke of a previous situation and said that he wished to clear the air. He agreed that as a member of the LB&A committee he is in a difficult position; he must provide enough information, but not too much. The LB&A Committee and Wood Mackenzie are in negotiations regarding the public disclosure of its report, and he encouraged his fellow members on the House Oil and Gas Special Committee to sign the confidentiality statement and read the Wood Mackenzie report.

[11:33:01 AM](#)

REPRESENTATIVE DOOGAN expressed his feeling that the review process is based on variables and that there are no true constants to consider. He observed that the oil industry environment in Alaska began at zero barrels of oil produced per day, passed through the production peak of about 2 billion

barrels per day, and continues today at about 720 million barrels per day. During this time the price of oil has fluctuated from the lowest price of about \$8 per barrel to today's cost of over \$80 per barrel. In addition, during this same span of time; a tanker hit a reef, a person shot a hole in the pipeline; there was an emergency closure for unscheduled maintenance on feeder lines; there was a change in the tax system. He opined that the events taking place in the real world create a pretty unstable environment. He questioned Mr. Porter's advice that the committee will be able to draw a tax law that works in a stable environment.

[11:36:23 AM](#)

MR. PORTER expressed his belief that Alaska is a very stable environment. He opined that changes in the tax code are not a major impact on the oil industry, with the exception of the gross tax floor.

REPRESENTATIVE HOLMES asked whether the progressivity factor should be based on a gross or a net profit system.

[11:36:46 AM](#)

MR. PORTER advised the committee that his preference is for the net system in PPT. A gross system is designed and modeled with straight lines that must be manipulated into a curve. For progressivity, he and most other consultants prefer a net system, although a gross component in the top range, as suggested by Dr. Pedro van Meurs, would not be a cause for concern.

[11:37:58 AM](#)

REPRESENTATIVE HOLMES asked about the preference for a progressivity factor of \$30 versus \$40.

MR. PORTER pointed out that the only difference between starting at \$30 versus \$40 is that the tax will be especially hard on the production of oil that is more expensive to produce. The impact will be felt more on operations that have lifting costs of around \$40. He stated that some of the heavy oil being produced now has lifting costs greater than \$40. His recommendation was that the progressivity factor should stay at \$40.

[11:39:05 AM](#)

REPRESENTATIVE DAHLSTROM praised Mr. Porter's testimony before the committee and asked about his availability for the next few days.

MR. PORTER said that he is available.

[11:40:20 AM](#)

REPRESENTATIVE SAMUELS asked about the ramifications of a tax system with an earlier progressivity factor and a lower base tax rate. He provided a scenario that could provide more of a share for the state throughout price swings, although the cost to the industry during periods of low oil prices would be higher.

MR. PORTER said:

... the question would be, if you cross ... the line and went lower, on the, when prices were low, and picked up more when prices were high, is that more ... making the curve, I say, more extreme and giving them more in the low-price environment. Is that a good thing?

[11:42:37 AM](#)

REPRESENTATIVE SAMUELS clarified by saying that everything is bad for all parties when oil is at a price of \$25 per barrel.

MR. PORTER remarked:

I would have to model it, but my initial thought was, because you are, it depends on your view of the world, especially depends on your crossover point ... if the crossover point is 60 and you are getting more from 60 to and 80 to 100, and their, their expected case is 65, then they don't care that they, you gave them a lot of benefit at 22. ... I think what you should look for is at each point or dot along the scale, trying to find a fairness spot that makes sense. ... Tilting the curve may not be as beneficial. ... The problem is how you see the future.

[11:43:37 AM](#)

REPRESENTATIVE SAMUELS suggested that one proposal was that a company could spend money, receive credits, and buy down its tax rate to 20 percent; or a company that did not spend money on

investment in Alaska may see its tax rate go up to 25 percent. He added that Dr. van Meurs advised that this concept put too much emphasis on the credits and that could lead to huge liabilities to the state. Representative Samuels asked for Mr. Porter's opinion on this concept.

[11:45:05 AM](#)

MR. PORTER clarified how this concept would work and said that, from an investment climate and exploration incentive standpoint, this concept would result in more reserves. However, the question remains about the balance between how much money the oil industry spends against how much the state spends to get those reserves. He said that he thinks the movement of state revenue from the front end of production to the back end, similar to what is happening in Alberta, Canada, is always an economic benefit to the industry. Additionally, this is a more complex system. His final comment on the bottom curve issue is that a change on the bottom half of the curve, but not on the top half, would provide a benefit to the oil and gas companies.

[11:47:19 AM](#)

CHAIR OLSON announced that the House Special Committee on Oil and Gas meeting is recessed at 11:47 a. m. to be continued at 5:30 p. m.

[11:47:40 AM](#)

[5:36:24 PM](#)

CHAIR OLSON called the meeting back to order at 5:35 p.m. Representatives Ramras, Doogan, Kawasaki, Dahlstrom, Neuman, Samuels, and Olson were present at the call back to order. Chair Olson announced that HB 2001 is on the agenda and that public testimony is limited to five minutes per speaker.

MARK SHARP stated that he is speaking as a citizen of Alaska and appreciates the time given to him to testify. He expressed his anger at the development of the PPT and the fact that the legislature ignored the testimony of citizens. He referred to his previous testimony 18 months ago regarding the flaws in the PPT, and pointed out the fact that it was written by the oil industry. The net profits element of the PPT will lead to the gross overstatement of expenses and understatement of profits by the oil and gas industry. He said that previous testimony also

pointed out that the state has been outsmarted by the oil industry. He added that the former attorney general was not consulted before the passage of PPT. Mr. Sharp said that his advice 18 months ago was to keep the [tax law] simple and to do what is best for the state, not the industry. He said that today we are dealing with the greediest industry of all and they are not our buddies or teammates. He urged the committee not to ask the industry what it thinks the tax rate should be. Mr. Sharp stated that the 24th legislature was corrupt, and did not set fiscal policy that would allow the state to get fair value for its resources. He warned that the big three [oil companies] will continue to manipulate and corrupt the process, and should not set the ground rules for negotiation. He urged the legislature to set the tax terms and force the industry to adhere. Mr. Sharp said that the industry only wants to extract the resources and get away as cheaply as possible, as evidenced by ExxonMobil Corporation's refusal to pay damages from 20 years ago. Regarding ACES, he said that he likes the sharing of information; however, the gross tax starts at four. He noted that there is no wealth "trickling down" on him and suggested that the oil industry testimony, rather than public testimony, should be scheduled at an inconvenient time.

[5:43:57 PM](#)

REPRESENTATIVE RAMRAS clarified his statement regarding the permanent fund. He explained that all Alaskans who receive a Permanent Fund Dividend (PFD) are ExxonMobil Corporation shareholders.

[5:45:13 PM](#)

JERRY WALKER informed the committee that he is representing himself. Mr. Walker has been in Fairbanks for 18 years. His perspective is based on his experience in nonprofit community service organizations, education, retail business, and the oil and gas industry. He expressed his concern about Alaska's ability to maintain and grow positive communities in which to live, work, and compete in a global marketplace. He said that he is a board member of the Alliance Support Industry [sic] and everyone he knows is dependant upon an environment that invites and supports business and the nonprofit sector. Mr. Walker urged the committee to remember its role to recognize the value of fiscal stability and encouraged members to not change the rules. He stressed the importance of a consistent effort to maintain an investment climate that promotes jobs and paychecks.

He also encouraged members to make no changes in the PPT and to allow it to work.

[5:46:51 PM](#)

REPRESENTATIVE RAMRAS disclosed his conflict of interest with Mr. Walker.

[5:47:17 PM](#)

CHUCK LOGSDON, Consultant, Alaska Oil and Gas Association (AOGA), [Testimony garbled.]

The committee took an at-ease from 5:48 p. m. to 5:50 p. m. due to technical problems.

[5:51:33 PM](#)

REPRESENTATIVE SAMUELS suggested that Mr. Logsdon call in on an outside line.

[5:51:40 PM](#)

CHAIR OLSON asked whether Mr. Logsdon could hear.

[5:52:55 PM](#)

The committee took brief at-ease from 5:52 p.m. to 5:53 p.m. due to technical problems.

[5:53:58 PM](#)

CHAIR OLSON called the meeting back to order at 5:53 p. m.

JERRY DIXON informed the committee that he is representing himself. Mr. Dixon said that he has been an Alaska resident for 40 years, working as a smokejumper and a teacher. He spoke of the losses of the gifted program and 70 percent of the staff at the high school in Seward. He said that he wants to see an increase in the oil tax. He expressed his concern about his colleagues leaving the area due to cuts in education. He stated that there are 44 schools for over 26,000 square miles and schools are funded as if everyone lived in Soldotna. Mr. Dixon said that he appreciated the good work of the legislators and re-stated his desire to see the oil tax increased.

[5:56:12 PM](#)

REPRESENTATIVE NEUMAN asked whether Mr. Dixon wanted the tax rate increased to provide funds for education in the Kenai Peninsula.

[5:56:38 PM](#)

MR. DIXON explained that, firstly, he would like to see a tax rate increase in general. The second issue is that his school district includes four schools that are not on the road system, yet, it is funded as if everyone lived in the same city.

[5:57:10 PM](#)

REPRESENTATIVE NEWMAN suggested that Mr. Dixon talk with his legislators about more funding for schools.

[5:57:34 PM](#)

MR. DIXON restated his concern that, in his community, schools are hurting and professionals are leaving their jobs and moving away.

[5:57:59 PM](#)

DURAINNEY RAWLS, Owner, Durainney's Crane Service, informed the committee that her company is a support service for the oil and gas industry. Ms. Rawls stated that sales have been steadily declining and, with the indefinite closure of the Agrium Inc. plant and the winter closure of the BP gas to liquids plant, her business is further negatively affected. She said that her staff has been reduced by half and that if she had to face constant tax increases, similar to those that are faced by the oil and gas industry, she would have to reconsider staying in business in Alaska. Additionally, her cost of business is going up due to inflation. Ms. Rawls questioned the amount of money that is needed in the general fund to be thrown away. She emphasized that her business is totally dependent on the oil and gas industry, and thanked the committee for the opportunity to speak.

[6:00:28 PM](#)

CHAIR OLSON announced that Representative Mike Chenault is listening to this testimony.

6:00:50 PM

ERIC PEIRCE stated that he is representing himself and asked the chair to identify the committee members that are present.

6:01:22 PM

CHAIR OLSON said Representatives Doogan, Dahlstrom, Samuels, Neuman, Ramras, Kawasaki, and Olson are present.

6:01:25 PM

MR. PEIRCE said that he is pleased the governor has called a special session to address the oil tax. He noted that the Alaska constitution requires that oil and gas must be sold for the maximum benefit to the people of Alaska. He expressed his frustration that his testimony against the PPT last year was lost due to the corruption of legislators who had already sold their votes. In addition, he said that it was hard to observe legislators voting against HB 485, the bill introduced last session that would have allowed DOR to hire tax auditors that are needed to administer a very complicated tax scheme. For perspective, Mr. Peirce asked the committee to consider that, at current oil prices, oil production represents \$23.5 billion worth of finite resources that are leaving Alaska annually. On a per capita ownership basis, that represents \$35,670 for each Alaskan. He wondered what Alaskans are getting for that money, and observed that, in Fairbanks, he is paying high property taxes due to inadequate municipal revenue sharing, paying exorbitant prices for heating oil, and driving on a deteriorating infrastructure. Mr. Peirce stated that it is very clear that the state is not receiving a reasonable return from the sale of oil. He urged that the committee produce data to support the argument that a net tax scheme is more beneficial to the state and future development than a gross system with simple price indicators and capital credit. He questioned whether the data from the industry is solid enough for an accurate comparison. He recalled that Trans-Alaska Pipeline System (TAPS) tariffs increased after the passage of PPT. Mr. Peirce also questioned the sense of giving away production taxes before correcting the disincentive for independent oil companies to develop fields on the North Slope. Mr. Peirce asked to hear the debate on how Alaska will diversify its economy and develop new jobs when it stops giving away billions of dollars by under-taxing oil. He concluded by saying that no one stands up for Alaska against oil companies that falsely claim that allowing

billions of dollars to leave Alaska is somehow good for Alaska's economy. Mr. Peirce thanked the members for their time.

6:05:10 PM

CHAIR OLSON requested that witnesses submit written testimony if available.

6:05:20 PM

REPRESENTATIVE RAMRAS said that he appreciated Mr. Peirce's point of view; however, he said that he voted against HB 45 and the speaker call his office to talk about a net profits tax with credits versus a gross profits tax.

6:06:35 PM

REPRESENTATIVE NEUMAN added that a majority of legislators present voted for an increase in benefits and salary for state employees. He recalled testimony from DOR about a gross tax versus a net tax policy and the administration's conclusion that a net tax profits tax works better in Alaska. Representative Neuman agreed with the speaker about the importance of the diversification of the state's economy.

6:07:55 PM

MR. LOGSDON informed the committee that PPT is performing as it was intended in two ways; Alaska is capturing more revenue than it would have under ELF, and capital investment remains strong. In fact, the eighteen exploratory wells drilled on the North Slope recently were the most new wells drilled in this decade. He said that the changes contemplated in PPT are designed to increase revenue by increasing the size of the tax base and by lowering the threshold that triggers the tax on gross. The base tax and progressive charge are also increased. He opined that these changes will not do anything to encourage exploration. In addition, the ring fencing of the legacy fields will increase the administrative complexity of PPT, especially the separate treatment of leases and properties. Mr. Logsdon described the raising of the minimum tax on heavy oil to ten percent on gross as bizarre. These large reserves will be significantly more expensive to produce and economists have recommended that a floor tax must remain very low. Finally, ring fencing of legacy fields also results in a reduction in incentives to the reinvestment of profits. Mr. Logsdon said that one out of three jobs in Alaska are directly or indirectly tied to oil production

and a fiscal system must always recognize the trade-off between money for state spending and the profits the oil and gas industry needs to continue the production of oil. He opined that changes in the PPT are premature, especially changes that limit incentives to exploration.

[6:12:24 PM](#)

REPRESENTATIVE DOOGAN asked Mr. Logsdon what organization employs him as a consultant.

[6:12:50 PM](#)

MR. LOGSDON answered that he works for the Alaska Oil and Gas Association (AOGA).

[6:13:02 PM](#)

REPRESENTATIVE DAHLSTROM asked Mr. Logsdon whether he was testifying as a private citizen or representing AOGA.

[6:13:14 PM](#)

MR. LOGSDON replied that he was testifying on behalf of both.

[6:13:26 PM](#)

TOM LAKOSH stated that he is affiliated with all of the citizens of Alaska and asked the committee to refer to his written testimony.

[6:14:25 PM](#)

CHAIR OLSON informed Mr. Lakosh that the committee did not have his written testimony, but that it would be distributed upon receipt.

[6:15:12 PM](#)

MR. LAKOSH told the committee that the net tax system being proposed is all wrong. He informed the committee that an example of how hydrocarbons get developed in Alaska is the revocation of the Point Thompson leases. The Department of Natural Resources (DNR) and the Alaska Oil and Gas Conservation Commission (AOGCC) have the power to tell the lessees which hydrocarbons to produce, and in what quantities, in order to

meet the terms of the leases. Mr. Lakosh said that he thought that, if the committee is trying to provide incentives, maximize production, and collect windfall profits, the best way is not through taxes but to give DNR and AOGCC the authority and tools to manage leases and to get optimal production rates. His proposal, instead of multiple tax schemes, is to have adjustable royalty rates and that the agencies set rates appropriately for each type of hydrocarbon. Mr. Lakosh suggested a variable lease rate that gets periodically updated every five years. The lease rate may be set at a floor of between one and nineteen percent and DNR would be allowed, by statute, to set appropriate lease rates for each type of hydrocarbon and for its accessibility to the infrastructure. In that way, incentives would be provided for specific fields using a laser-like approach instead of the shotgun approach of net taxes. The biggest complaint from the oil industry is about the difficulty of getting to the lease areas. He encouraged the state to take money from the royalties and taxes to develop the infrastructure by providing heavy-lift helicopters and improvements to ports and rail connections. Mr. Lakosh urged the committee to increase taxes first through corporation income taxes and to create a distinct class of corporation taxes for companies that include operations to handle substantial quantities of hydrocarbons and hazardous materials. He concluded by suggesting that the committee should look to Norway and other comparable nations and determine a tax rate relative to a specific price for oil.

[6:20:39 PM](#)

TOM MALONEY informed the committee that he was representing himself and appreciated the time given to speak. He said that his background is in accounting and finance and that he is a Certified Public Accountant, a Certified Management Accountant, and a Certified Financial Planner with 30 years of experience in Alaska. He referred to discussion about the taxation levels of the legacy oil fields, and he pointed out that funding of capital costs for the North Slope infrastructure and the Trans-Alaska Pipeline System was 100 percent by private companies. The risks were also borne by the private investor. Mr. Maloney recalled that there have been fields developed that were uneconomical, such as, Badami Oil Field, and the Northstar Unit, which was developed when oil prices were at less than ten dollars per barrel. Owners took on the full cost and risk of these developments, even when risks were high. He noted that, currently in the legacy fields, production has begun a dramatic decrease that will only be stemmed by new wells producing both light and heavy oil. Mr. Maloney expressed his belief that

additional investment tax incentives related to heavy oil are required. The initial development of heavy oil will cost much more in capital and operating expenses and production volumes per well will be less. Everything possible must be done to encourage investment and production volumes as the state can not control the price of oil or natural gas. He asked members to pass a reasonable and understandable tax system to encourage billions of dollars in investment over the next ten years. He reminded the committee that producers have not been getting a free ride. In fact, producers have paid over \$50 billion in investments in Alaska and about \$80 billion in state income tax. He opined that PPT encourages new investment in existing and new fields, but heavy oil tax credits are needed to offset the high costs of research and development. He concluded by saying that his son is interested in working in the technical trades in the near future.

[6:25:30 PM](#)

REPRESENTATIVE DOOGAN thanked Mr. Maloney for his testimony and asked for an estimate of industry profits during the period that the producer companies paid \$80 billion in state income taxes.

[6:26:04 PM](#)

MR. MALONEY answered that recent public disclosures indicated that state take and industry profits were in a similar range of numbers. He added that some companies did not release financial figures for Alaska.

[6:26:22 PM](#)

REPRESENTATIVE DOOGAN agreed that some companies will not reveal what their profits are.

[6:26:43 PM](#)

JERRY MCCUTCHEON informed the committee that 30 years ago he initiated a Congressional hearing before the Senate Energy Committee. ExxonMobil Corporation represented the oil industry and stated that Prudhoe Bay would produce nine billion barrels of oil with or without a gas line. Mr. McCutcheon said that he predicted that production would be 15 billion barrels of oil without a gas line. The situation has not changed as oil and gas producers continue oil production in Prudhoe Bay and will for 30 more years. Mr. McCutcheon reviewed his previous testimony and said that the proposed taxes are far too low. He

referred to a memo to [former] Governor Murkowski from Dr. Pedro van Meurs that said state take should be higher. He stated that this memo was held from legislature. In addition, Mr. McCutcheon said that Dr. van Meurs testified that, under PPT and ACES, the percentage of state take will decline with the price of oil. He expressed his belief that the state's take should increase with the increasing price of oil. Mr. McCutcheon relayed that Dr. van Meurs testified that government take from 75 percent to 85 percent is usual and customary. Mr. McCutcheon advised the committee that the gross take on Alaska's oil should approach 90 percent and encouraged the committee to look at willing bids made when the price of oil was \$18 per barrel. He opined that it may be in Alaska's best interest for the long term for some oil companies to leave. However, Mr. McCutcheon stated that the grand jury and the FBI may address the mechanics of past legislation and this legislature should adopt a clean tax on the gross pending investigations, then add tax credits if it is necessary.

[6:31:19 PM](#)

ERIC DOMPELING, President, Alaska Support Industry Alliance (Alliance), told the committee that he is employed as a technical representative and is testifying as president of the Alliance, a trade organization representing companies and individuals who provide goods and services to Alaska's oil, gas and mining industries. Mr. Dompeling said the Alliance's 400 member companies and their 35,000 employees keep the oil industry working. These companies and workers, who's jobs depend on oil industry investment, are deeply concerned about costs and changes in fiscal policy that put these investments at risk. He advised the committee that PPT has not had time to work, and there is no compelling evidence that it is broken. Regulations for implementation of PPT, or subsequent audits, have not been completed. Mr. Dompeling said that it is unknown whether the tax rate should be 22.5 percent, 20 percent, 15 percent, or 25 percent to find the right balance for state share. However, tax dollars are dollars that will not be reinvested in Alaska to generate business opportunities for Alliance members and good paying jobs in the private sector for Alaska. Another debate about the tax rate will not encourage new oil production or the construction of a gas pipeline unless all parties begin to work together. He encouraged the committee to discuss how to work together to promote investments and ensure the state's fair share of long term jobs and business opportunities. Mr. Dompeling pointed out that the PPT was passed with provisions for a complete review in five years,

primarily so all parties could come to understand the system. He urged the committee to make the PPT work by hiring more auditors, but to reject fundamental changes that will increase taxes and costs, jeopardize the economics of critical long-term investments, and put production, Alaska jobs, and business opportunities at risk.

6:35:02 PM

MARY SHIELDS, General Manager, Northwest Technical Services, informed the committee that her company provides technical support to a variety of businesses including the oil industry. She expressed her concern about the bill's impacts on the future employment of her company's 100 employees and other Alaskan workers. She recalled that the legislative body spent considerable time in debate prior to passage of PPT. Although passage was not unanimous, a decision was reached with the provision that the tax system will be reviewed in 2011. Ms. Shields asked the committee to make no changes prior to promulgation of the regulations and audits of the first returns. She said that she is in favor of the state hiring additional auditors to review the returns. Ms. Shields concluded by saying that oil industry investment dollars create jobs for not just Northwest Tech employees, but for all. She asked the committee to please deliberate on jobs, community development, and the quality of life for all Alaskans.

6:38:09 PM

DENETTE JUSTICE ROMANO informed the committee that she is representing herself as an Alaska resident since 1986. She said that she is a financial advisor with Wachovia Securities and understands the meaning of investment and taxes. Ms. Romano told the committee that there is a simple fact that higher taxes on corporations and individuals means a decrease in spending and investment. She asked how many times the PPT tax rate will be raised to cover increases in government spending. Higher spending by government is a cycle that affects the local economy and each household. She asked members to consider how a large tax increase would affect them personally. Ms. Romano expressed her belief that the PPT tax rate should be left unchanged for five years until there is sufficient data for analysis.

6:41:01 PM

MARK HYLEN stated that he is representing himself. Mr. Hylen said that he is a lifelong Alaskan and that his wife and he own

and operate a business called Beacon Occupational Health and Safety Services. His business provides medical safety and training services to companies that service remote industries, as well as federal, state, and municipal governments. His clientele includes support services to the oil industry. Mr. Hylen recalled the time when the price of oil was \$8 per barrel, and stated that the slope seems to be busier today than ever. Whether this additional business is due to incentives within PPT or due to high oil prices, Alaskans are working and the economy has benefited. He urged the committee to be cautious when considering increasing taxes on the industry as the economy is sensitive to reductions in federal projects, the slowdown of development by court decisions, and less development on the North Slope. He observed that, although the general public is questioning the 22.5 percent tax, since the passage of PPT, the industry has thrived. He warned the committee that increasing taxes is playing with fire. Mr. Hylen encouraged the committee to not raise a tax that has only been in effect for one year.

[6:43:27 PM](#)

BOB BARNDT informed the committee that he is representing himself. He recalled that in 1983, when he held his first job on the North Slope, there was a lot of new production, exploration, and excitement. In the last two to three years new companies have come to Alaska that want to explore for new development. He warned that they may look elsewhere if tax rates change every year and business in Alaska becomes risky. Mr. Barndt urged the committee not to change PPT. He said that other industries, like mining and logging, will be looking at the risk of doing business in Alaska.

[6:45:46 PM](#)

BILL WARREN informed the committee that he is representing himself, is a retired member of Local 367 and a 55 year resident of Alaska. He expressed his concern for the state's prosperity. Mr. Warren said that the legislators need to raise taxes by a gross tax on the legacy fields to incentivize the heavy oils with the profit tax. He reported that Agrium, Inc., closed its plant due to the lack of exploration and the shortage of gas. He stressed that a gas infrastructure is needed in order to preserve Alaska's industrial base and fill the pipeline. A diversification of the energy grid away from gas and oil is the way to look ahead. In addition, he told the committee that he was disappointed to see the parade of oil producers and advisors repeating their previous testimony. Mr. Warren opined that gas

will continue to support the state; however, the monopoly of the big three producers will not build the gas pipeline. He spoke of the recent attempts to encourage exploration and development in Cook Inlet. He then advised that the legislators were elected to find a solution and that the state should act like a sovereign and take charge of the future development of the billions of dollars of the state's resources. Mr. Warren concluded by expressing his appreciation for the committee's work.

[6:49:27 PM](#)

CHAIR OLSON relayed that business may be picking up.

[6:49:40 PM](#)

MR. WARREN added that the state has had years to work on this problem, yet people are still losing jobs. He said that ConocoPhillips Alaska, Inc. has the ability to come to Cook Inlet and action is needed.

[6:50:28 PM](#)

DONALD A. BENSON informed the committee that he is representing himself. Mr. Benson expressed his agreement with the testimony of Bill Warren. He said that he is a 55 year life-long resident of Palmer, and that he wants the tax re-examined for two reasons; to restore public trust and to bring Alaska its fair share for the future. He relayed that a public opinion poll indicated that 72 percent of the respondents in Anchorage believe that the state does not get its fair share of the oil profits. Mr. Benson opined that there is a mistrust of the current tax system and all parties need to work together to remove the cloud over the legislature's good name. He encouraged the committee to revisit the PPT and listen to the public testimony to determine what is best for Alaska, not for private interest and concerns. Mr. Benson concluded by saying that ACES will ensure tax write-offs for investments and additional taxes if investments are not made. He encouraged the committee to follow the will of the Alaskan people and support a tax that is fair for everyone and that uses the same mathematical numbers.

[6:53:34 PM](#)

CHAIR OLSON asked for testimony from visitors in the gallery.

[6:54:10 PM](#)

JIM GILBERT, President, Udelhoven Oilfield System Services Inc., informed the committee that his company is an oil field service contractor working with the oil producers and with the operators of TAPS. He stated that higher taxes result in less work for his 508 employees. Mr. Gilbert recalled that a major oil company representative testified that the tax is already too high and he agrees with that testimony. He opined that bigger government is not needed, but good jobs are. Mr. Gilbert recalled receiving a recent order for six highly paid workers needed for a project lasting two to two and one-half years. That project is now cancelled and he noted that businesses in the state are already feeling the effects of higher taxes. He asked the committee to consider the jobs that are needed today.

[6:56:08 PM](#)

REPRESENTATIVE NEUMAN asked Mr. Gilbert to explain the changes in expenditures at Prudhoe Bay during the last year.

[6:56:57 PM](#)

MR. GILBERT answered that the oil fields there are mature. He opined that the recent increase in capital costs is due to the repair and inspection of the neglected and aging infrastructure. In response to a question, he added that the PPT is paying more than ELF and it has only been in effect for 14 months.

[6:58:01 PM](#)

REPRESENTATIVE RAMRAS asked Mr. Gilbert to explain the competitive bid procedure. He observed that winning bidders want to know details about the second place bid in order to determine "what was left on the table". Representative Ramras said that this insight will be helpful when the committee considers modifications to PPT.

[6:59:44 PM](#)

MR. GILBERT recalled that, last year, the producer companies expressed their preference for a tax in the 15 percent to 18 percent range; nevertheless, the present work continues at the 22.5 percent level. However, convening the special session to reconsider the tax rate has created an image of instability. He opined that the companies are probably willing to continue to produce oil, but they will not reinvest as the tax rate climbs.

Mr. Gilbert said that Alaska businesses will realize that the oil companies are not investing two years before the legislature and administration does.

[7:02:24 PM](#)

REPRESENTATIVE NEWMAN repeated earlier testimony from an industry spokesman about stability. He said that the industry accepts the tax change from ELF and the review of the PPT, but not an increase in the tax rate now. He asked whether an increase will be seen as a positive or a negative signal to the industry.

[7:04:18 PM](#)

MR. GILBERT answered that it will be a negative signal. The producer companies view a change in PPT, after only 14 months, as something that happens in third world countries. He added that the corruption of the legislators involved few people and a small amount of money.

[7:06:00 PM](#)

TOM DORAN said that he is representing himself. He testified that he is in favor of ACES and described the bill as not a tax, but a price for the sale of Alaska's product for development. Mr. Doran recommended that the tax rate be 24 percent, especially as Alaska is a stable political environment. For the first time, there are independent explorers interested in Alaska and who support the PPT. In addition, they have a vertical integrated interest and own, develop, transport, and market the resource. He opined that the state should have a higher tax rate, not because there were corrupt politicians, but because oil is a nonrenewable resource. Mr. Doran told the committee that Alaska's constitution mandates that the resource must be sold for the maximum benefit to Alaskans, in addition to supporting the creation of jobs and the economy. He pointed out that Barron's magazine expects the price of oil to go to \$100 per barrel. Mr. Doran informed the committee that he has heard a lot of testimony about the PPT and he also knows that the Seward and Kenai schools need more money in their budgets.

[7:11:13 PM](#)

TONY TENGS stated that he is representing himself, that he is also a small businessman, and that he works for the Alaska Marine Highway System. He opined that personal testimony from

some citizens may really be representing the oil industry. In addition, advertising on radio and television by the oil companies is similar to a political campaign, without equal representation from the other side. He asked the committee to consider that the public is being influenced from this advertising. Mr. Tengs disagreed with previous testimony that money paid for taxes is diverted from exploration. He informed the committee that the Chief Executive Officer of ConocoPhillips Alaska, Inc., was paid \$31 million in 2005. He urged the committee to remember that this money is untaxed and was not spent on exploration. Mr. Tengs observed that other industries, for example, commercial airlines, survive on a two percent profit margin. He stressed that taxes assessed to the oil industry are really a fee paid for materials received and serve to lower local taxes and fund projects like roads, harbors, and bridges. He encouraged the committee to consider the amount of Norway's permanent fund, which is larger than Alaska's even though Norway is a smaller resource area. He urged the committee to keep the tax simple by adopting a gross tax with a credit for development costs. Mr. Tengs expressed his support of the legislative review of the PPT.

[7:18:35 PM](#)

[HB 2001 was held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 7:18 p. m.