

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

October 25, 2007

10:06 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 MEMBERS PRESENT

Representative Bob Buch
Representative Andrea Doll
Representative Bryce Edgmon
Representative Anna Fairclough
Representative Les Gara
Representative Berta Gardner
Representative Carl Gatto
Representative Lindsey Holmes
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
10/24/07	(H)	Heard & Held
10/24/07	(H)	MINUTE(O&G)
10/25/07	(H)	O&G AT 10:00 AM HOUSE FINANCE 519

WITNESS REGISTER

CLAIRE FITZPATRICK, Commercial Senior Vice President
BP Exploration (Alaska) Inc.
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

KEVIN MITCHELL, Vice President
Finance & Administration
ConocoPhillips Alaska, Inc. (ConocoPhillips)

POSITION STATEMENT: Testified during the hearing on HB 2001.

PATRICK GALVIN, Commissioner
Department of Revenue (DOR)

Juneau, Alaska

POSITION STATEMENT: Testified in support of HB 2001.

MARK HANLEY, Public Affairs Manager, Alaska
Anadarko Petroleum Corporation (Anadarko)
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on HB 2001.

DAN E. DICKINSON, Certified Public Accountant; Certified
Management Accountant
Anchorage, Alaska

POSITION STATEMENT: Testified in his capacity as a consultant
to the Legislative Budget & Audit (BUD) committee.

RICHARD RUGGIERO, Consultant
Gaffney, Cline & Associates Inc., (Gaffney, Cline)
Houston, Texas

POSITION STATEMENT: Testified in his capacity as a consultant
to the Department of Revenue.

STEVE PORTER, Consultant
Tehachapi, California

POSITION STATEMENT: Testified in his capacity as a consultant
to the Legislative Budget & Audit (BUD) committee.

ACTION NARRATIVE

CHAIR KURT OLSON called the House Special Committee on Oil and Gas meeting to order at [10:06:42 AM](#). Representatives Dahlstrom, Samuels, Neuman, Ramras, Doogan, Kawasaki, and Olson were present at the call to order. Also in attendance were Representatives Buch, Doll, Edgmon, Fairclough, Gara, Gardner, Gatto, Holmes, Roses, Seaton, and Wilson.

HB2001-OIL & GAS TAX AMENDMENTS

[10:06:51 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."

10:09:08 AM

CHAIR OLSON further announced that the format of the meeting would be an informal round table discussion of HB 2001 by administration representatives, industry representatives, and legislative consultants. He requested that each speaker address what is a "must-have" and what is a "deal-breaker" in the proposed bill, and to state their likes and dislikes of the bill in general.

10:09:31 AM

CLAIRE FITZPATRICK, Commercial Senior Vice President, BP Exploration (Alaska) Inc., began by relating that BP supports a net tax. She opined that the current law, the Petroleum Profits Tax (PPT), was designed to stimulate investment, and that she then said that she is not sure that BP is in a position to say that the PPT has not been effective. In fact, she pointed out that additional revenue to the state in the amount of \$1 billion was generated in the last fiscal year. Ms. Fitzpatrick stated that the PPT should be given the opportunity to meet the objectives required by the state.

10:10:57 AM

MS. FITZPATRICK, in further response to Chair Olson, opined that she has concerns with most, if not all, of the provisions of HB 2001. The provisions of the legislation that are of lesser concern are the administrative provisions, such as those which provide information to the state that will result in more accurate forecasting. She explained BP's concern with providing information is to ensure that the appropriate processes and procedures are in place. Confidentiality must be maintained to prevent breeches of the U.S. Securities and Exchange Commission (SEC) fair disclosure requirements; the Federal Energy Regulatory Commission (FERC) regulations regarding shippers versus producers; and anti-trust regulations. She commented that she is sure that the Department of Revenue (DOR) and the Department of Natural Resources (DNR) are perfectly able to

ensure that [the state] does not run afoul of any anti-trust provisions.

[10:12:52 AM](#)

KEVIN MITCHELL, Vice President, Finance & Administration, ConocoPhillips Alaska, Inc., responded to Chair Olson's question by saying that there is not a deal-breaker in the bill. However, tax policy drives behavior and there will be implications on investment levels and activity. He warned that provisions of HB 2001, that have a significant impact on investment, will drive changes in behavior.

[10:13:35 AM](#)

MR. MITCHELL opined that his company is supportive, in principle, of the administrative audit provisions and additional transparency in HB 2001. However, ConocoPhillips believes that the net, PPT type, [tax] structure is the right structure because it provides both a balance between the incentives necessary to develop more challenging fields and increased take to the state during periods of high profit margins.

[10:14:47 AM](#)

CHAIR OLSON invited comments from Commissioner Galvin.

[10:14:55 AM](#)

PATRICK GALVIN, Commissioner, Department of Revenue, explained that his department recognizes that reasonable people can come to different conclusions. The intent of HB 2001 is to provide the legislation that provides the state the tools necessary to protect the state's interest in implementing the net tax. Commissioner Galvin said that reactions to the bill have been generally favorable. He expressed his belief that the reassessment of fiscal terms is necessary, based upon the new analysis and refinement of information gathered in the past year. The effect of the tax policy must be a balance between getting the needed investment to keep production high and ensuring that the state gets its fair share. The process will include discussion of all aspects of the bill with all of the parties. However, he stated that he cannot identify one must-have provision in the bill.

[10:16:57 AM](#)

MARK HANLEY, Public Affairs Manager, Alaska, Anadarko Petroleum Corporation (Anadarko), expressed Anadarko's support of the net profits approach to tax policy. He stated that the net tax is appropriate because it takes into account the costs of higher cost fields and lower taxes when profits are low. Mr. Hanley pointed out that the state [tax] system is a combination of taxes when royalties and property taxes are considered. House Bill 2001 is a combination of policies and it is very difficult to pick out any one deal-breaker. He stated that the tax rate change was the biggest negative impact to Anadarko; the next most significant is the change in the progressivity factor, and third is the early elimination of the Transitional Investment Expenditure (TIE) credits. He opined that having good auditors is good for industry and the state, and that a change in this policy is not a huge issue for Anadarko. However, the two-year credit will result in more accounting and he questioned whether the benefit is worth the cost of more accounting work for the industry and the state. Mr. Hanley noted that, although HB 2001 improves existing law by creating the ability to purchase credits from a pool, the bigger problem remains that credits may be applied immediately to income, but a company without income must spend additional money to qualify. He stressed that this is an example of one of the many facets of the legislation that needs to be debated.

[10:23:09 AM](#)

MR. HANLEY also pointed out that there are pages of little things [in the bill] that should be addressed, such as the expansion of [earned income] credits with additional qualifying requirements, and the elimination of the suspension of wells for credits. He referred to his previous testimony and warned that while the focus is on the philosophical issues of the bill, many important issues that add up to a lot of money are going to be swept aside.

[10:23:53 AM](#)

REPRESENTATIVE SAMUELS called attention to the confusion regarding the joint interest billings. He expressed his understanding that, if BP is not claiming one-third of an expense because they think ExxonMobil Corporation (Exxon) is, and if Exxon does not claim it, the language that previously allowed the auditor to consider this expense has been excluded by HB 2001.

[10:26:05 AM](#)

COMMISSIONER GALVIN responded that the recommendation to remove those two provisions in reference to joint interest billings came from the auditor section of DOR. The intent was to maximize the auditor's ability to use the joint interest billings in compliance with the law. The concern was that the provisions added a level of complexity bound by those factors to determine compliance. Their view was that if you remove those provisions that have a mandatory aspect, and keep the general language, then DOR can use whatever tools appropriate to assess the joint interest billings.

[10:27:35 AM](#)

DAN E. DICKINSON, Certified Public Accountant; Certified Management Accountant, expressed his agreement with Commissioner Galvin's analysis, and further clarified that he supported the idea that gives the state the authority to determine that joint interest billings are the only allowable costs for a unit. Joint interest billings for costs, such as overhead, are allowable. Mr. Dickinson indicated that this policy could work if the state created this provision through regulation. The other provision was a complex scheme suggested as part of the gas line negotiations that concerning single interest owners. He opined that the second provision would probably not be successfully implemented.

[10:29:56 AM](#)

COMMISSIONER GALVIN informed the committee that the proposed bill changes the focus of the section that deals with defining lease expenditures. ACES provides for the state to define lease expenditures through regulation; this process will provide some sort of an outer limit. The two procedures together will provide DOR with the ability to define the outer limit by regulation and in a way that the auditors feel is appropriate.

[10:30:52 AM](#)

MR. DICKINSON observed that the language will clearly show that the lawmakers intended that the joint interest billing would become a starting point; the state would then move on from there. He emphasized that nothing in the current statute requires DOR to go beyond the two findings required; that the

agreement under which the joint interest billings occur is clearly defined by the state as a direct cost, and that the audits are conducted by those who have the means and the incentive to make a significant effect on cost.

[10:32:44 AM](#)

REPRESENTATIVE SAMUELS relayed that a complaint he heard is that if a company does not use the joint interest billing now, it may be assessed a fine in the future.

[10:33:26 AM](#)

MR. MITCHELL opined that a workable and logical tax structure will have a starting point that is the joint interest billing. Specific exclusions, the natural tension between parties, and the audit function between the joint interest owners keeps things in check.

[10:34:56 AM](#)

MS. FITZPATRICK agreed with Mr. Mitchell. She noted that complying with the law for tax filings is in BP's interest. She expressed concern that not using the joint interest billing as a starting point, with current and future exclusions, will result in more complexity in the future. She affirmed that joint operator billings serve a healthy purpose around the world and to ignore that process and re-create past transactional details would be impractical and expensive.

[10:37:06 AM](#)

RICHARD RUGGIERO, Consultant, Gaffney, Cline & Associates Inc., (Gaffney, Cline), informed the committee that he has experience managing joint venture interests. He stated that his company relied on the joint venture statements as a starting point to police each party's rights and to ensure that data is provided. From a tax perspective, though, there are a number of issues that come up. Corporate overhead can become a contentious issue when you are conducting business in other parts of the world, particularly when there are caps put on overhead expenses, as in Alaska. He gave an example of a company that submitted a nine figure intellectual property charge in an attempt to evade the cap on overhead expenses. Mr. Ruggiero pointed out that joint interest billings are a good starting point, but he stressed that commercial and intellectual property costs are coming through joint interest statements. The industry must be clear

on the costs that the state will, or will not, allow when they file their full return.

10:39:30 AM

MR. DICKINSON encouraged the committee to look at the most recent unit operating agreements to see the specific caps on intellectual property and intangibles, and how costs are being squeezed out of "the other places the toothpaste is coming out of the tube."

10:40:03 AM

REPRESENTATIVE DOOGAN indicated that he is not convinced that the PPT is the right law, and that he is examining a broader set of options. He asked for reasons to vote for a net tax when the perspective of the people's interest in his district is for the state to make more money. More money to the state will provide more services to his constituents over a longer period of time. Representative Doogan opined that a gross tax will provide the following: the certainty of a simple tax; and accounting that cannot be manipulated. The results of a net tax on industry's investment decisions are of an unknown effect because of changing prices. He pointed out that there is a tradeoff of money and certainty for increased investment. Representative Doogan then asked for Commissioner Galvin's level of confidence that this is a good tradeoff, and whether increased investment will result in revenue equal to, or greater than, that from a gross tax.

10:43:41 AM

COMMISSIONER GALVIN responded by saying that DOR began to develop this proposal with the goal to maximize the state's revenue this year, as well as next year. This goal is balanced by the desire to ensure production and revenue for the next ten to twenty years, so the impact on investment by the industry is a counter to that goal. Commissioner Galvin then said that the other aspect of it is that the comparison of gross to net is not similar to that of polar opposites. What you are really talking about is weighing the sense of certainty and the risk of having bad information for forecasts, versus having a tax that is flexible to the actual economics of the field and investment decisions by the industry. He opined that, as DOR looked through the options, it recognized that a gross tax has no options of accounting responsibility, and will not address the variety of field economics, particularly on the North Slope.

His department continued to look at providing capital credits, or adjustments, for heavy oil and realized that the gross tax has more "audit risk." Audit risk is the risk of the state receiving a tax payment that is less than it should be and the difference then being determined through an audit. He explained that, as additional cost-related adjustments are being added to the gross tax, the gross tax did not meet the ultimate goal of a tax system that actually reflects the economics of the fields. There was a point where, to get the so-called gross taxes to reflect the economic impact of the net, there were so many adjustments that it made the audit risk comparable to continuing with a net tax. At that point, the tax system was a quasi-gross tax that had some gaps in its ability to actually reflect the economic reality of a particular field, and it became an artificial net tax. Therefore, the choice was not between a net and a gross, but between two net-like tax systems. Commissioner Galvin continued to say that when you get down to making a choice between two alternatives, it is important to not stick to a label but to consider audit risk, economic flexibility, and the expectation of changes in cost and production in the next five years.

[10:48:51 AM](#)

COMMISSIONER GALVIN then advised the committee that he would not say whether a so-called net tax is better than a gross tax. However, of the taxes studied that had equivalent impacts on the investment side and the durability to reflect economic changes, the tax system structured similarly to the current one seemed to provide the best balance.

[10:50:23 AM](#)

MR. HANLEY stated that the gross tax seems best to constituents, due to its simplicity. He then said that his answer to Representative Doogan's question is that a gross system does not maximize revenue returns to state because it over taxes some and under taxes others. He explained that applying a gross rate for the most profitable field to all fields will make many fields uneconomic. Furthermore, setting a gross rate in the middle means insufficient revenue from profitable fields. He opined that a gross system, with credits, becomes as complex as a net system.

[10:52:32 AM](#)

MR. DICKINSON pointed out that, although state government jobs are one-third of Alaska's job market, there are no jobs in Alaska that are not directly or indirectly affected by the oil industry. He reminded Alaska voters of the importance of oil to the state's economy. He pointed out that, under a gross tax, some have said all that matters is how much volume is produced and the price. However, there are three questions to consider: volume, price, and how much investment is being made. If state take is the biggest piece of revenue to be taken from a field, more should be measured than just the volume.

[10:54:20 AM](#)

MR. MITCHELL stated his agreement with the previous speakers and added that \$80 to \$90 per barrel oil prices would seem to indicate extremely high profits for the industry. However, the reality is that costs are rising too, and during periods of increased margins the PPT performs just like a high gross tax. With progressivity in place, the PPT is taxing at a rate of 27 percent to 28 percent on top of the royalty and corporate taxes. In fact, during times of high profits, the PPT proves that the state can collect its fair share, and at the same time offer incentives for growth.

[10:56:18 AM](#)

REPRESENTATIVE DOOGAN remarked:

... assuming ... we pass a tax and things go on, how is it that I know that ... the return I get in terms of investment, which we're only really interested in ... primarily, for us, in terms of increased production, right? I mean there's some economic benefit to what gets spent, in the exploration ... how do I know that that's going to be worth more than what I give up if I leave that rate at twenty-two and one-half percent?

[10:57:34 AM](#)

COMMISSIONER GALVIN acknowledged that this is an excellent point and one that DOR had to consider. He opined that from previous experience he knows that geologists will disagree about the future of oil development and exploration on the North Slope. At this time, the majority feel that there are tremendous amounts of oil yet to be found. He expressed his optimism about future exploration by new companies with new technology. The

root of the question as to whether investment in the North Slope will result in an equal, or greater, return depends on an one's outlook. He is personally optimistic about the possibilities of new technology and new interest in the North Slope from smaller companies. For example, the Gulf of Mexico and the United Kingdom are enjoying new discoveries on legacy fields. He stressed the importance of providing an environment to encourage new explorers.

[11:00:56 AM](#)

MR. RUGGIERO commented that if you get too prescriptive on a system that is based on a series of predictions, and things go in the favor of the oil industry, profits will go to them. If profits are slim, the state will suffer and the industry may ask for changes in terms, prior to making investments, citing that the tax system is too onerous. One of the key reasons to choose a net system; it matches the industry's investment decision making. The other reason is that a net system will self-adjust to changing oil prices. [The rate] can be set at a high or low of the state's choosing, and the state does not have to predict production costs for changing conditions. There will not be a problem if facility costs or tariffs go up. A net system will bring the stability the state needs because it is robust across a wider range of scenarios.

[11:03:49 AM](#)

STEVE PORTER, Consultant, observed that all of the speakers agree on a net tax. One of the main reasons for agreement is that a net tax structure allows for the potential of a bigger "pie" to be shared. The flexibility of a net tax accommodates large and small scale development, more costly development, and future changes in price and cost. Whereas, a gross tax system is less flexible and less desirable.

[11:05:13 AM](#)

MR. DICKINSON referred to Representative Doogan's second question and said, "If you are asking an investment question ... what you are really asking is ... 'Do I have a better alternative for those dollars, and, in my portfolio, do I want to put everything in one basket or do I want to have multiple returns?'" He suggested that one way to answer this question is to plot the rate of return against the Alaska Permanent Fund Corporation, the stock market, or other investments in the

state. It is an investment question and is not a question of a guaranteed rate of return.

[11:06:17 AM](#)

MR. PORTER noted that there has been a lot of discussion about whether 22.5 percent or 25 percent is the right tax rate figure. He opined that tax is a "broad brush" and the impacts of smaller changes will have an influence over decision making; however, for most projects, the difference of 2.5 percent is not catastrophic. It is known that when taxes move up and down in broad ways, the net tax system works better than gross. In contrast, Mr. Porter stated that the 10 percent floor can very quickly impact decisions and has a potential for a negative effect on heavy oil projects, and he recommended eliminating that.

[11:08:36 AM](#)

REPRESENTATIVE DOOGAN expressed his frustration at bouncing from discussion of the details of the bill to philosophical abstractions. He stated that if net present value models are possible for oil industry investments, net present value models for income to the state should be possible as well. He referred to the editorial in the Anchorage Daily News newspaper where an attempt was made to create a forecast. The theory behind the presentation of this tax seems to be that it is the only tool available; however, further testimony talks about prices, availability of resources, and geology. Once again, this tax is presented as the "be-all, end-all" policy for investment decisions in Alaska. He pointed out that the credits are income that will be left on the table and in return there is only the possibility of investment. Furthermore, 64 percent "give-backs" to explorers will not result in an equity interest for the state. Representative Doogan asked to see numbers on the credits, when compared to prospective investment, and stated that it seems like the state should be able to generate those numbers to study.

[11:11:21 AM](#)

COMMISSIONER GALVIN explained that DOR can take a revenue generation model with a certain tax and make an assumption based upon the investment response. Then, based upon that response, an assumption can be made on the success rate of production. A further assumption would be made as to the "yes or no" choice. He then said that, as a legislator, he would not want to make a

decision based on that kind of a model because the assumptions can be intentionally built in the model to affect the outcome. Commissioner Galvin stressed that committee members need to get a sense from testimony as to whether the change in tax rate will influence the industry's risk assessment. He then referred to Mr. Ruggiero's statement comparing the difference between a net and a gross tax system and indicated that when a gross tax is applied to a wide variety of [oil] fields and such, the margin of error is extremely small in the sense that, if the assumptions are wrong, there will be a dramatic effect. So, when it came down to the options before us, the risks associated with a net tax system held less severe outcomes. The risk of being wrong in a gross tax system significantly outweighed the risk of being wrong on the audit, or net tax system, side. He pointed out that DOR searched for an empirical test for the right answer and consulted with experts. However, expert's assumptions can still be completely wrong and the choice is between systems more or less severely impacted by those assumptions.

[11:16:27 AM](#)

MR. PORTER informed the committee that he can model what Representative Doogan requested. The model will have capital and operating expenses, price, production, tax, and progressivity; modeling the sensitivities of each one of those through a broad range will reveal the relative importance of each to the future of the state and how much money is generated. What the model cannot do is indicate in a tighter world what is going to happen because each one is a continuum from A to Z with six components. In addition, one of the six components will exceed the model. He said that the best that could be provided, from a modeling standpoint, is the relative importance of each continuum.

[11:18:13 AM](#)

MR. MITCHELL opined that a simple answer to the question is whether members believe that the industry is capable of making good decisions. If the industry is making good decisions, then the state is participating in the cost of investments, by credits and deductions, and is taking a share of the profits. The state should want those investments to happen, assuming they are good investments, and should be aligned with industry in these decisions.

[11:19:23 AM](#)

REPRESENTATIVE DOOGAN responded to Mr. Mitchell's statement by saying that he has great faith in the industry making good decisions about investments with a quick and high rate of return. However, those investments may not be in Alaska. In addition, Representative Doogan also expressed his faith that industry lawyers and accountants are top notch people. The state experience with the oil industry is that there have been, and will continue to be, long disputes over taxes, royalties, and tariffs. Some of these disputes have ended with settlements of pennies on the dollar. He concluded by saying that the question of investment is in a big box, but [legislators] are talking about it like it is in a small box, and the state is left to determine its tolerance for risk.

[11:21:36 AM](#)

COMMISSIONER GALVIN agreed that, in the end, members must identify the balance of risk and reward with which they are comfortable. He distributed a memo from Spencer Hosie regarding possible future legal disputes over the tax system.

[11:24:05 AM](#)

REPRESENTATIVE NEUMAN referred to Mr. Hanley's statement regarding the use of credits for one year or two years. He noted that industry representatives have said two years is not a good thing. In fact, one company stated that the delay would mean the difference of drilling four, versus five, wells next year. Representative Neuman then asked Commissioner Galvin for the reason for the change.

[11:25:15 AM](#)

COMMISSIONER GALVIN replied that taxpayers always like their tax credits up front. He acknowledged that taxpayers will have to factor this discount into their economic decisions. The state's perspective is the value of a cost profile. He explained that if you look at a situation where you could have big capital expenditures one year and not another, that "lumpiness" is going to have an impact on the state's revenue and revenue projections. When, in one year the state is getting more revenue than in another, the state's ability to respond to revenue shifts is affected. This change will mean that state projections and forecasts will be more accurate and the overall swings will be diminished.

[11:27:45 AM](#)

MR. PORTER affirmed that he has heard the administration's statements and that he understands the concern about projections. However, he asked for the administration to look for a way to capture both values. He suggested that the state can actually anticipate the uncertainty coming toward it by recognizing the costs associated with the relative price of the wells. Mr. Porter maintained that the administration has requested some projections from the producers and knowing these plans reveals the relative costs. He concluded by saying that 85 percent to 90 percent of the information the administration needs for forecasting can be captured by understanding future projections, and without having a negative financial impact on the industry.

[11:29:58 AM](#)

MR. DICKINSON also expressed his disagreement with Commissioner Galvin on this issue and stated that a calendar year versus a fiscal year basis will make a difference in projections. In fact, the increased predictability from a two year split is minimal because a taxpayer will be deducting one-twelfth of its credits in a calendar year. A fiscal year splits into two calendar years, therefore only one-quarter of a calendar year can be used to forecast. In response to a question, Mr. Dickinson stated that the effect on the industry is a half-year time value of money.

[11:32:45 AM](#)

MR. MITCHELL provided ConocoPhillips's perspective that this change is a small erosion of value when evaluating investments. Although the company is not an advocate of tax increases, this provision is a small erosion of value that, when added to others, add up overall.

[11:33:55 AM](#)

COMMISSIONER GALVIN agreed with the characterization that this is not a big dollar item. However, he added that the cost information that the state is asking for is valuable and this change was made for balance to the tax system.

[11:34:52 AM](#)

MR. RUGGIERO commented that the distinction is between a great, and a fantastic, program for exploration. When compared to other tax systems, with the immediate write-offs and the ability to monetize credits and losses, what the state is offering is a world-class opportunity to explorers.

[11:35:28 AM](#)

REPRESENTATIVE NEUMAN expressed his belief that Alaska's future depends on the smaller, independent, explorer and that he wants to make sure that they have a good investment climate in Alaska. He asked for Commissioner Galvin's opinion on attracting smaller explorers to Alaska.

[11:36:19 AM](#)

COMMISSIONER GALVIN agreed that encouraging smaller explorers is on the right track for Alaska. The possibility of many smaller companies operating on the North Slope is a vision that needs to get a foothold; the state can provide that foothold by attracting investment with a world-class tax system.

[11:37:07 AM](#)

MR. HANLEY noted that Anadarko's previous testimony in opposition to the two year delay of tax credits indicated that these credits are valuable in reducing its costs, but will not make a huge difference. He commented that this year Anadarko had a slight improvement in its exploration economics and this is another reason to support the net tax system; exploration takes longer in Alaska than in other parts of the world and the net present value issue was a challenge. The system, with credits, is of significant value for up-front costs. He opined that the net tax system is absolutely the way to go and resulted in the slight improvement in Anadarko's economics. Mr. Hanley said that Anadarko sees a lot of potential in Alaska, but it tends to be in the smaller fields, as the U.S. Government Survey (USGS) maps show. He clarified that his company characterizes the PPT as a slight improvement, but not as a fantastic tax system.

[11:39:32 AM](#)

REPRESENTATIVE NEUMAN acknowledged that there are many pieces to this legislation.

[11:39:48 AM](#)

REPRESENTATIVE HOLMES said that a lot of legislators are trying to find certainty and predictability and from the testimony heard the state will never get certainty; however, if [the legislature] makes the wrong choice it will quickly be known. If the legislature makes the right choice, that may never be known. She opined that if a choice is made between 22.5 percent and 23 percent, the industry will know whether marginal projects were cancelled, but [the legislature] will probably never know. She then asked about the wisdom of making changes now, versus in 2011, when further information is available. Representative Holmes said, "What on earth am I really going to know in 2011, that's going to help me then decide whether or not 22.5 versus 25 is right; and whether progressivity should go up and down?"

[11:42:06 AM](#)

MR. PORTER explained that, during the debate on PPT, there were two major issues that put pressure on the discussion. One issue was the gas contract, which may come up again, and the other was the [corruption] trials. Mr. Porter opined that the question of undue influence on the current law will remain until the tax is re-evaluated, and the debate now, during the special session, will resolve this question. In addition, during a special session there is only one issue to be considered, thus the pressure of holding votes "hostage" is gone. He stated that today is the best opportunity for a clean re-evaluation of the PPT, even if no changes are made. In 2011, the pressures will be gone and the legislature can verify the tax and move forward.

[11:45:10 AM](#)

COMMISSIONER GALVIN remarked, "The root of your question is 'Is the debate going to be any different in 2011 than now?' The answer is probably not." He continued to explain that the debate will revolve around the same issues, as it did in the 70s and 80s. However, making a statement now, that there will be no changes until 2011, undermines the purpose. The reason is that the [oil] companies look at stability and anticipate that there may be a change after an investment is made. The argument that the state is making changes after just one year, and will continue to do so, contributes to the perception of uncertainty. Commissioner Galvin expressed his belief that a change now in tax policy, without the influence of the gas contract in particular, will establish a law based on open discussion of the state's interest. The companies can make their assessments of the risks to investment. A delay of this decision will allow

questions to fester in the public consciousness. In addition, the oil industry will not want to make investments in a climate that they know will change.

[11:48:52 AM](#)

MR. MITCHELL expressed his understanding that the 2011 date was to be a review, and not a rewrite, of the PPT. He agreed with Representative Holmes that the committee will never really know if you got the right answer, and said that he believes the PPT is the right tax structure. He pointed out that, even with the passage of HB 2001, the 2011 review remains in effect.

[11:50:06 AM](#)

MS. FITZPATRICK indicated that she would like the PPT to be reviewed based on "what is the policy that the State of Alaska wants to have, what is the objective that it is trying to achieve." All around the world her company must determine the fiscal policy within the oil and gas arena. There is no guarantee, unless there is a contract, that there will not be a change and that is a part of doing business. She stated that her company assesses the policy, whether the PPT meets that policy, and whether the state will make any changes that increase or decrease the risk of meeting its policy objective. She pointed out that the legislation is lengthy, may contain unintended consequences, and must be reviewed. Ms. Fitzpatrick concluded by saying that the starting point is whether or not the existing PPT meets the state's policy.

[11:52:16 AM](#)

MR. HANLEY stated his agreement that a positive to the special session is that everyone is focused; however, the time for discussion is limited and legislation of this type may need two sessions to be reviewed. He noted that the dollar per barrel impact on USGS numbers is not perfect, but those numbers, when equated with a tax increase to \$3 per barrel, result in more uneconomic oil. This could be modeled to get a sense of government take versus risk, reward, and potential. Mr. Hanley pointed out that, within this timeframe, the impact of the PPT is not known. Some data, such as the number of wells, will be more available with this [proposes] tax system. He opined that, eventually, [the legislature] will have some idea of whether the PPT is working. He then turned to a discussion about gas. Anadarko's opinion is that this is too much take on gas; its advisors will be back to testify within two years on a gas

pipeline. The risk factor of repeated negotiations on gas taxes will not be a deal-breaker, but investment decisions get tougher when there is no guarantee of set tax systems. He added that additional discussion in the next two years may not only be about gas because oil will undoubtedly be brought into it.

[11:56:35 AM](#)

MR. DICKINSON stressed that there is one very important piece of information that the commissioner will be able to present to committee members two years from now and that is accurate costs. The industry's costs have been very different from the cost estimates used by DOR during the 2006 legislative session. Mr. Dickerson said that these inaccuracies may have been due to: a law that was poorly written, cost inflation, the success of the PPT, or a random boon in investment. An audit is not going to answer all those questions, especially whether an increase in costs is closely tied to an increase in prices. Mr. Dickinson expressed his hope that in two years the link between costs and oil market price will be known.

[11:58:30 AM](#)

COMMISSIONER GALVIN observed that there has been a lot of discussion on the cost projections and costs reported. Based on the testimony of the operators of the two largest fields sitting here at the table, there is more confidence in the cost estimates for this year. He requested that the industry correct the state's estimates when they are known to be inaccurate. He expressed his frustration that the state's models are corrected only when the numbers are overstated, and questioned the idea that the tax change should wait for two years until more accurate data is available from audits.

[12:00:21 PM](#)

MS. FITZPATRICK responded that BP provides monthly PPT and forecasting information. She confirmed that the forecasting information required by HB 2001 will be provided as soon as the administrative questions are answered. However, in terms of costs last time, she said there was public testimony from the companies and she said she will provide the dates of that testimony. In terms of current costs and assumptions, there may be areas of the forecasts where DOR disagrees, but it does all come down to the assumptions and models. Ms. Fitzpatrick said it is a valid exercise to have that [information] shared and to improve forecasts for the future.

12:02:27 PM

Mr. Ruggiero recalled BP's presentation to the Senate and said that his recollection is not that the Senate asked BP to qualify the numbers, but to provide numbers to DOR so DOR could make more accurate projections. He said that he was aghast that the commissioner did not have the data to do his job and that this is the first place he has worked in the world where the government did not have the specific data that the companies possess. In addition, it was surprising that the companies did not bring more accurate data regarding the \$800 million discrepancy. The industry was aware of this situation and did not bring more accurate data to the special session to assist with clearing up this question. It is not expected that this data would be disclosed to the public, but he said that he would have expected that data that is shared between companies would have been provided to [DOR]. He suggested that this information could be signaled to the government to ensure accurate projections. Mr. Ruggiero noted that the only signal he saw was in a footnote of a report from the Alaska Oil and Gas Association (AOGA) report and he opined that this was not being offered in a very cooperative manner. He explained that his experience is working in regimes where business was best when the industry worked with the government as a partner. He concluded by saying that he would have expected that there would have been more of the accurate data, that [industry] people know about the relationship between investment, barrels, and cost projections, offered to the government.

12:06:38 PM

MR. MITCHELL stated that speakers have discussed the information about actual costs, deductions, projections, and economic modeling. With the recent change in the net structure brought by the PPT, all parties have been caught by surprise that there was not the information exchange that the state needed. Industry is also not seeing the information that is needed to understand what is happening. He assured the committee that more information is being provided now, although it might not be exactly what DOR needs. Mr. Mitchell said that there is a common interest in supplying the administration with adequate information.

12:08:17 PM

REPRESENTATIVE DAHLSTROM suggested committee members lock the door and have everyone sign disclosure statements, but of course, she said, that will not happen. In a perfect world the industry could protect its confidential information while legislators protect their constituents. She relayed that her constituents are asking about the revenue that was not received and inquired as to whether the expected revenue was backed-up with [supporting documents]. Representative Dahlstrom also expressed her surprise at the lack of data provided to the state. She said that it is amazing to know that some companies are sending the state a check with no back-up with it, and applauded the companies that are providing the needed documentation. She explained that her personal tolerance for risk depends on the length of time needed to see results. The responsibility of a legislator is providing stability to the people of Alaska, including stability for the businesses here that provide jobs to Alaskans, and to keep the money that is generated in the state. She asked Commission Galvin to further explain about the discrepancy in expected revenue.

[12:13:27 PM](#)

COMMISSIONER GALVIN said that he agreed with Representative Dahlstrom's starting point. The expected revenue figure was published to demonstrate what was expected and what experience is showing now. The \$800 million is based upon the difference between the assumptions that went into the fiscal note, primarily costs, and the assumptions we have now, based on actual costs from the companies. All else being equal, that difference, at the \$60 dollar [per barrel] price, equals \$800 million. It is merely a reflection of the difference between the costs estimates of a year ago and our experience since then. It is important to note that the estimate is a matter of freezing the other variables, thus one can not accept figures based solely on the increase in price and have a clear and analytical tool.

[12:16:09 PM](#)

MR. DICKINSON recalled answering Representative Doogan's question a couple of days ago and thinking about revenue sufficiency. To determine revenue sufficiency, when a budget is being debated, one can compare dollars or one can look at an analysis of costs. Clearly, if costs have essentially doubled, then our predictions, based on \$2 billion, are now doubled to \$4 billion and the deficit is roughly \$750 million. Mr. Dickinson passed out a work-sheet to show his calculations.

[12:18:55 PM](#)

MR. DICKINSON continued to say that the general point he wanted to make is that revenue sufficiency is one issue; how we raise money for the state. The other issue is the mechanics of the tax. Clearly, if costs are higher because the system is designed to encourage costs, there are huge effects on the tax. He stated that the questions to be figured out are: Are the costs what were permitted? What is the effect of localized inflation? Why are the costs higher? Should the costs have been anticipated?

[12:20:06 PM](#)

COMMISSIONER GALVIN acknowledged that, when discussing the rate for the future and with the encouragement of an increased level in costs as a factor in the new system, lower than estimated revenue is an accepted outcome. But that is not what happened a year ago. The department did not have an unexpected change in the environment; it had the wrong number to put in the economics models. The way the projections work is that the rate is set and the revenue expectation follows. Previously, there was a lot of discussion about what is the crossover point when the economic limit factor (ELF) and the PPT are equivalent, and at what price will the new tax exceed the existing tax. This was a very important part of the analytical discussion one year ago. Because the cost assumptions were wrong, the crossover point was incorrectly predicted. The cost deviation did not happen because we did not predict the future well; the cost deviation happened because the department did not have realistic numbers at that moment. Commissioner Galvin acknowledged Mr. Dickinson's point that when one accepts forecasting, one accepts variability due to unexpected results; however, that implication ignores that Alaska is a resource development state and when the values go up expected revenue from the sale of resources goes up.

[12:23:31 PM](#)

MR. DICKINSON agreed with most of what Commissioner Galvin said except for the notion that we can take a set of costs at \$70 to \$80 per barrel, with lifting costs of \$20, and expect lifting costs to remain at \$20 per barrel if oil prices retreat to levels of 1986 through 1999.

[12:24:53 PM](#)

REPRESENTATIVE DAHLSTROM asked whether the numbers were wrong because [the state] did not have the data from industry, or due to a mistake by a state agency.

[12:25:15 PM](#)

COMMISSIONER GALVIN answered that we do not know. The companies were consulted one year ago and provided with the cost estimates. Overall, the estimates were accepted with a few comments, however, different costs were submitted with tax returns. Some possible reasons are: higher costs associated with the corrosion issue; inflation; or the possibility that the tax returns were padded.

[12:26:34 PM](#)

REPRESENTATIVE DAHLSTROM repeated her question for industry representatives.

[12:26:40 PM](#)

MR. HANLEY assured the committee that Anadarko did not pad the bills. He opined that there will be honest disagreements over some issues, and without the adoption of the regulations assumptions are going to be made by the companies. In addition, he guaranteed that there will be disputes over allowable deductions. Mr. Hanley pointed out that there are two ways to drive up costs; one is to spend more, and the other is that the cost of goods went up. The tax system proposed encourages taxpayers to spend more, and he reminded members that when explorers make investments their tax burden can go down to almost zero; that is the state's goal. Furthermore, the assumptions on the models must be agreed to by the parties for meaningful discussions to take place. He added that increased costs for drilling and production resulted in the state's revenue going down; thus, returns to the industry went down also. This fact has not been adequately discussed; in fact, profit projections were not met by the industry due to increased drilling, steel, and labor costs.

[12:31:10 PM](#)

MR. MITCHELL said that ConocoPhillips does business throughout the world and does not operate by padding bills. He also acknowledged areas of dispute; however, the dollar value of the disputes is relatively small in comparison to the total tax due.

He stressed that the calculation of taxes is done under the company's best interpretation of the law. He added that cost projections were at 2004 levels and there have been significant increases since then. Mr. Mitchell opined that information presented during last year's debate of the PPT was misleading.

[12:33:25 PM](#)

MS. FITZPATRICK suggested that the discussion might be more constructive if the parties would agree to discuss the present situation and the state's policy for Alaska's economic future.

[12:34:17 PM](#)

COMMISSIONER GALVIN remarked:

Mr. Chair, just because there were two references to 2004 as if the numbers that were presented last year were presented as 2004 numbers, and that somehow, you know, we didn't expect that things had changed so drastically from 2004 to 2007, or 2006. That's not the nature of it. Last year they were brought forward as the assumptions of the 2006 numbers. Now, the last numbers that the companies had shown us were 2004, that's true. But in discussions with the companies it was, 'Are these representative of the current costs?' so, they weren't brought forward as 2004 numbers and we made a poor assumption about how much they had increased. So, just to make sure that that's clear on the record. I think that, um, it is a valid point that we, we have spent, I believe, far too much time talking about what happened a year ago. I think we do need to talk about where we go from here. And what I agree with, um, Ms. Fitzpatrick about is we just need to make sure that we are on the same page today and maybe we can get confirmation that the cost numbers that we are using in our current projections are reflective of, of the numbers that they are anticipating ... We've got the numbers now that there's agreement that those reflect today's expectations, and those are the appropriate ones for us to be using in our modeling, for, for both of us going forward.

[12:35:53 PM](#)

REPRESENTATIVE DAHLSTROM asked:

"...if we don't know what was wrong with those numbers, how do we know that the numbers we're dealing with today are right? ... I would rather hear, "This is the area that we missed, or here is where we miscalculated, or we left this off the table, and now we've got it all." ... I want to do this right, I believe the companies want to do this right, I believe that the Commissioner of Revenue ... wants this right. ... How can we learn from our mistake?"

[12:36:51 PM](#)

COMMISSIONER GALVIN answered that the primary difference is that now the department has information directly from the companies on their certified statements of costs under the tax law. A year ago the department was dealing with consultations with the companies. In addition, DOR was using building blocks to make assumptions that were not sophisticated. Today, the numbers are reported, and he assured the committee that the department will go back and ensure that the costs are properly deductible. He acknowledged that the department may not be able to discern the incorrect assumptions from last year.

[12:38:45 PM](#)

REPRESENTATIVE DAHLSTROM asked whether each of the company representatives agreed that 2006 numbers have been submitted and that accurate information has been given to DOR.

[12:39:16 PM](#)

MR. MITCHELL said yes.

[12:39:26 PM](#)

MS. FITZPATRICK asked Representative Dahlstrom to confirm the question.

[12:39:37 PM](#)

REPRESENTATIVE DAHLSTROM said:

"The question I'm asking is if the statement ... that Commissioner Galvin made is correct, that all the companies have complied with providing the accurate, complete, information that they had for 2006, so that

we're all on the same page looking at the same numbers.

[12:40:01 PM](#)

MS. FITZPATRICK said,

Forgive me if I'm just checking on ... which question I'm actually answering. Um, if this is a case of you know, have we complied ... filed our sort of information as requested in respect of 2006 information, to the Department of Revenue, the answer is yes.

[12:40:19 PM](#)

MR. HANLEY asked whether the reference was to the estimates of costs based in 2006, or for the tax year 2006.

REPRESENTATIVE DAHLSTROM clarified that the question was for the tax year of 2006.

MR. HANLEY repeated, "Did we provide the data that was requested".

REPRESENTATIVE DAHLSTROM said that the committee has been told that those are the numbers that everybody is working with.

[12:40:56 PM](#)

MR. HANLEY remarked:

Did we provide information in 2006, for 2006? ... I don't know what information, to be honest with you, we've provided, so I can't, I can get ...

[12:41:07 PM](#)

MR. DICKINSON said that, as he understood the question, for nine months of 2006, the PPT was in effect; under the current law that is the one time period for which returns with actual costs are required. Thus, the only data that has no estimation in it will be from March 1, 2006 through December 31, 2006.

REPRESENTATIVE DAHLSTROM concurred.

[12:41:59 PM](#)

MR. HANLEY responded that, due to joint filing, most of [Anadarko's] expenses are at Alpine Oil Field. He opined that Anadarko filed what it was supposed to file for 2006 and that he will get the right answer. He said that he does not do the filing, but assured the committee that the 2006 taxes were paid.

[12:42:45 PM](#)

COMMISSIONER GALVIN added that, as far as he knew, Anadarko filed, but that he was not in the position of knowing if what they filed is accurate or not. He said that he felt the important confirmation from the discussion today is that the companies agreed that the forecast today is based upon the reported costs that are an accurate reflection of what they have provided to the state.

[12:43:42 PM](#)

MS. FITZPATRICK remarked:

... one further clarification, I absolutely agree with what the Commissioner has said in terms of the information that is in, sort of, the data we have been looking at ... we all agree ... we need to provide some other information going forward to enable them to forecast beyond that ... I've made comments elsewhere, we see our costs going up, so I just want to ensure that if in 2008 ... the numbers will not hold true for many years, it's a one year only view.

[12:44:26 PM](#)

REPRESENTATIVE DAHLSTROM asked for any estimate on what the difference is going to be in the costs that the companies are going to incur, in order to provide the additional information needed by the state.

[12:44:53 PM](#)

MS. FITZPATRICK expressed her hope that there would be no additional administration costs incurred to provide the requested information. She based this on her confidence that DOR will work with the companies to provide a process to provide the right information, but that does not create an inordinate amount of work.

12:45:49 PM

REPRESENTATIVE DAHLSTROM gave an example of a request that asks for the cost to an oil company to produce a barrel of oil. The [legislature] would then know what the state gets back and the transportation and maintenance costs.

12:46:39 PM

REPRESENTATIVE SAMUELS stated that he disagreed with Representative Holmes about whether [the legislature] will know if it gets [the tax rate] wrong. He referred to the weakening real estate market in Juneau and the low consumer confidence of Juneau residents. He also noted that the industry in Juneau is government and that the government has less operating and capital monies going into the community. Representative Samuels told the committee that his district, District 29, is middle income and borders more affluent neighborhoods. He revealed that his personal choice is not to put his disposable income in his home. He asked the speakers whether each would take the risk of making the commitment to buy his home, at today's appraisal price, seven years from now. He then stated that if investments are made in Alaska, the value of his home will increase. However, if the economy deteriorates, owning a home is an individual risk and that is what he needs to consider; not theory, but the real effect of the legislature's actions on his constituents.

12:50:54 PM

MR. DICKINSON said no.

MR. HANLEY said yes.

MR. RUGGIERO said yes.

COMMISSIONER GALVIN said yes.

MR. MITCHELL said yes.

MS. FITZPATRICK responded that she will answer after further analysis of the pros and cons.

MR. PORTER asked whether the pipeline is proceeding.

REPRESENTATIVE SAMUELS replied that the deal is applicable only under today's conditions.

MR. PORTER added that the DOR is projecting a substantial decline in revenue five years; however, four or five years of appreciation will probably allow the property to weather the resulting recession.

[12:53:04 PM](#)

REPRESENTATIVE SAMUELS recalled that ten years ago in Ketchikan and Wrangell, citizens were probably confident about the value of their homes, but a federal government policy passed at the change of administration ended the timber industry. He opined that, sooner or later, he must consider the personal risk to Alaskan homeowners. Representative Samuels concluded that the confidence of Juneau residents is low because their industry is not investing in Juneau.

[12:54:36 PM](#)

MR. HANLEY commented that the risk is manageable if money is invested today and he is confident about the next couple of years. The bigger question on buying a house, he said, is whether the seller can change their mind on the price. So the risk is harder to manage when the price, or tax rate, can be changed. In this case, the stability of the tax system is an influence on the risk.

[12:55:48 PM](#)

REPRESENTATIVE SAMUELS added that world events will have an impact on Alaska's oil economy. If Alaska's economy was certain, then voting for a higher tax rate would not be questioned. He concluded that future world events are uncertain and he must consider his constituent whose wealth is in her home.

[12:56:50 PM](#)

REPRESENTATIVE RAMRAS said that consumer confidence is also low in Fairbanks; he has decided, as a private citizen, not to make further capital investments in his community. He expressed his disappointment with ExxonMobil Corporation's statement that the current tax rate is too high, and again requested that Commissioner Galvin generate a risk delta to facilitate the committee's consideration of the bill.

12:59:10 PM

COMMISSIONER GALVIN said O.K.

12:59:14 PM

REPRESENTATIVE RAMRAS reminded the committee that the \$800 million in increased costs deducted by the industry did not go from the state to someone else's pocket. Because that money represents a deduction, it went back in the economy to pay for a good or service, and became a profit item for an oil field service company, or somebody along the chain. He stressed that the oil industry in Alaska generates \$12 to \$20 billion in gross revenue and is by far the largest contributor to the state's budget of \$4 billion. Looking at the incremental gain from the tax rate increase is similar to the production of wheat or potatoes, that, as commodities, are interchangeable. The fact is that Alaska's commodity is oil, and like other commodities, it must be produced and transported to the marketplace in the cheapest manner. Representative Ramras recalled that Dr. Pedro van Meurs testified that the gas pipeline may no longer be economical and Mr. Porter stated that the legislature must begin to save its money. He also recalled that there was an editorial in the Alaska Daily News that suggested saving and investing the \$600 million; it will grow to \$4.5 billion in five years. He advised the committee that if, in his business, he has a choice of taking a sale now, or later, he will take it now. Representative Ramras recalled discussion last August regarding the production loss from the corrosion of the BP pipelines; the consensus was that some of the lost oil will be flushed up by the reservoir when production resumes, and some will be recovered at the end of production from that field. He then asked whether the incremental gain in taxes is worth the risk of not being able to potentially collect as much oil out of the ground now. In addition, he asked whether the new, proposed, tax regime brings us closer or further from bridging a way to a necessary, second, and more robust income stream.

1:06:19 PM

COMMISSIONER GALVIN answered yes. He stated that the increased tax rate will provide the bridge in two ways: by the savings of the additional tax revenue; and by getting the investment that will result in increased production in later years.

1:07:14 PM

MR. PORTER informed the committee that the bill does not help the legislature increase savings in any way, and does nothing to enhance investment. The PPT is more helpful to investment; this bill takes additional increments out of industry's pockets, albeit hurting some parties less than others.

[1:09:05 PM](#)

MR. MITCHELL agreed with Mr. Porter and added that any form of tax increase, such as in this proposal, will cause investments to deteriorate and be at risk.

[1:10:11 PM](#)

MS. FITZPATRICK opined that the bill moves Alaska further away from a more robust revenue. She further stated that the bill chips away from projects that may currently be marginal, and increases the risk [to] achieving the state's objective.

[1:11:04 PM](#)

MR. DICKINSON stated that he believes that the state has a negative time value of money. He explained that a \$1.4 billion general spending budget means that, in the near future, the state will prefer to have a dollar after the next price correction than the equivalent dollar today. He encouraged the state to get less revenue today, in order to secure investment, and thus, receive higher revenue tomorrow. He concluded by saying that the governor's proposal will increase the immediate take, but will decrease the relative value of investment and will shift the balance to fewer dollars down the road.

[1:13:06 PM](#)

REPRESENTATIVE DOOGAN commented that this is an argument against the existence of the Alaska Permanent Fund Corporation.

[1:13:19 PM](#)

REPRESENTATIVE NEUMAN referred to Commissioner Galvin's opening statement that the legislature must analyze the testimony from all parties and decide the tax rate. He relayed that he was trying to understand all of the information and gave an example of comparing the situation to that of a farm. He expressed his feeling that Alaska is an owner state with a citizen

legislature, and legislators must explain the testimony from all of the parties to their constituents. He asked Commissioner Galvin whether this was an accurate way to simplify the oil tax situation.

[1:17:17 PM](#)

COMMISSIONER GALVIN advised two things: Alaska chose not to have the kind of a relationship with the oil companies that a farmer would have with a company that produces and markets his hay by a production sharing contract; and Alaska leases its land to the oil companies on a royalty basis. Thus, the royalty contract provides a certain amount that the state will get as the owner, and the additional part as a tax. This is a different kind of relationship where there is on-going discussion about the sharing of profits, although this discussion would not happen very often. Furthermore, the owner must be careful about price competition. Thus, the question is not so much about a breach of contract, because there is no contract, but the responsibility of the owner to reassess and reapply expectations. He stressed that a contract with set terms is not the relationship that the state has with the companies.

[1:20:27 PM](#)

REPRESENTATIVE NEUMAN affirmed that his constituents are no different than anyone else's, and that they want the most revenue possible; however, he re-stated his question to ask whether the farmer can get more hay or more money for the same hay.

[1:21:17 PM](#)

COMMISSIONER GALVIN further explained that the state is looking at both worlds; a system that encourages newcomers to take advantage of opportunities, and an opportunity to identify and reassess that share in such a way that industry opts to re-invest because the value of the hay is driving the profit decision. The change in share will not change industry's decisions because those decisions are based on its opportunities for profit. He said that profit margins are high and this is an opportunity for the state to ensure that it can meet its future obligations. Furthermore, HB 2001 is a revenue bill, not an appropriations bill, and the department is fully aware that it will not determine where the revenue goes or whether it is

saved. However, the first step to saving money is the administration's obligation to bring in the state's fair share.

[1:24:18 PM](#)

CHAIR OLSON invited Representatives Buch and Fairclough to ask questions.

[1:25:35 PM](#)

REPRESENTATIVE FAIRCLOUGH recalled previous testimony regarding the possibility that industry padded the bills for deductions on its tax returns. She pointed out that there are contingency funds built into every project for cost overruns, and asked whether the companies have cost overrun contingency accounts to meet cost overruns on the oil fields.

[1:27:25 PM](#)

MR. MITCHELL responded that the notion of a cost contingency overrun is something ConocoPhillips looks at when evaluating a project. He affirmed that sometimes there are some forms of contingencies; however, they are not always accurate and the actual costs of engineering services and raw materials can be much higher. What ConocoPhillips actually spends does not necessarily go into a cost overrun account; the actual cost of a well is accounted as the cost, no matter what the estimates were. He explained that his company has internal controls around expenditures if a project overruns its authorization.

[1:29:55 PM](#)

REPRESENTATIVE FAIRCLOUGH stated that, for large projects in Alaska with which she is familiar, steel and transportation prices have increased 25 percent. Also, she suggested that corporate structures, such as vacancy factors, can be used to balance budgets. She then asked:

Explicitly, did the Department of Revenue receive that in the cost estimates that came forward because it's not necessarily an accounting code that you would quantify to bring forward to the Department of Revenue. So, you'd estimated a project, you have some kind of contingency for normal, normal response, do we have that?

[1:31:03 PM](#)

MR. MITCHELL answered that the detailed information given to DOR is a reflection of the 2006 tax return and it reports what his company actually spent.

[1:31:29 PM](#)

REPRESENTATIVE FAIRCLOUGH further asked whether the percentage basis used is significant.

[1:31:52 PM](#)

MR. MITCHELL clarified that Representative Fairclough was asking whether the 2006 results are indicative of the 2007 projections.

[1:32:15 PM](#)

REPRESENTATIVE FAIRCLOUGH confirmed that she is trying to determine the percentage difference. She assumed that ConocoPhillips has submitted accurate information; however, she asked whether the variable is large enough that the state will still be incorrect in forecasting and open to exposure to the risk of cost overruns.

[1:32:55 PM](#)

MR. MITCHELL replied that, as we put in place the right process for data sharing and information, we need to ensure that this information is reflected.

[1:33:20 PM](#)

MS. FITZPATRICK added that when BP is looking at contingencies it would be for the bigger development. Contingencies make prudent business sense. She said that for this year's and next year's numbers, the level of uncertainty around a contingency is smaller when BP is more certain about the planned activity, or when there is a track record to review. Sharing more forecast information must include making sure that DOR actually understands what the information is to prevent a disparity.

[1:34:58 PM](#)

MR. HANLEY added that, for Anadarko, as an explorer with partners, the numbers for estimates and contingencies are the best estimates for the costs. There is no incentive for the

company to not give the best guess and there will be no separate contingencies. He pointed out that there will be discrepancies, partly because total approval from its partners often comes after estimates are submitted to DOR. He warned that future estimates, particularly on exploration, will be helpful but will be all over the board for projects beyond this next winter.

[1:37:18 PM](#)

MS. FITZPATRICK added that forecast information provided to DOR will be a best estimate done in good faith, and not a promise.

[1:37:47 PM](#)

REPRESENTATIVE SAMUELS asked the commissioner whether he was willing to give [the committee] everything DOR's consultants advised even when he disagreed or decided against its inclusion in the bill.

[1:39:08 PM](#)

COMMISSIONER GALVIN answered that the nature of [DOR's] relationship with its consultants was different than from previous administrations. He said that the department did not ask its consultants to provide a tax rate or structure. The consultants provided data; in that regard he said he could not think of any advice that was provided in a report, or some other form, that was ignored. He stated that most of the data went directly to the economic team that produced the reports.

[1:40:59 PM](#)

REPRESENTATIVE SAMUELS assumed that the department would comment on data from the consultants.

[1:41:15 PM](#)

COMMISSIONER GALVIN said that the department did not use its consultants in that way.

[1:41:28 PM](#)

MR. RUGGIERO gave an example: [Gaffney, Cline's] role in assisting the commissioner included interpretation of what is being said between the lines during presentations by the producers and big oil. In addition, based on his experience in different countries and with other regimes, Mr. Ruggiero was

able to improve the DOR responses to requested information by expanding the responses to be more useful and robust.

[1:42:49 PM](#)

REPRESENTATIVE SAMUELS re-stated that he would like to see all of the information provided by consultants.

[1:43:19 PM](#)

COMMISSIONER GALVIN stressed that the nature of the way that DOR is trying to engage in this discussion will result in all of the information coming out. He assured committee members that they will not be presented with previously withheld information at a later date.

[1:43:50 PM](#)

CHAIR OLSON asked each speaker whether the PPT is broken.

[1:44:10 PM](#)

MR. DICKENSON said no.

MR. HANLEY said no.

MR. RUGGIERO said it can be improved.

COMMISSIONER GALVIN said, "The answer is yes. It doesn't provide the state the tools, and the rates that were set need to be reevaluated."

MR. MITCHELL said no.

MS. FITZPATRICK said that there is no evidence to say that it is broken.

MR. PORTER said it is not broken, but tweaks won't break it.

[1:44:58 PM](#)

CHAIR OLSON thanked members, guests, and speakers.

[HB 2001 was held for further discussion.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at [1:45:07 PM](#).