

SENATE FINANCE COMMITTEE  
November 8, 2007  
1:13 P.M.

CALL TO ORDER

Co-Chair Bert Stedman convened the Senate Finance Committee meeting at [1:13:31 PM](#).

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

Kevin Mitchell, Vice President, Finance and Administration, ConocoPhillips; Jim Taylor, Vice President, Commercial Assets, ConocoPhillips; Claire Fitzpatrick, Commercial Vice President, BP Alaska; Bernard W. Hajny, CMI, Manager Production Taxes and Royalties Alaska, BP; Craig Haymes, Production Manager, ExxonMobil; Dan Seckers, Senior Tax Counsel, ExxonMobil; Mark Hanley, Manager, Public Affairs, Anadarko-Alaska; Pat Foley, Manager, Land and External Affairs, Pioneer Natural Resources; John Zager, General Manager, Chevron-Alaska.

PRESENT VIA TELECONFERENCE

None

SUMMARY

SB 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."

SB 2001 was HEARD & HELD in Committee for further consideration.

SENATE 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."

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Co-Chair Stedman explained that industry representatives would be answering questions, as opposed to making presentations. He stated that the Committee would be addressing version P of SB 2001.

CLAIRE FITZPATRICK, COMMERCIAL VICE PRESIDENT, BP ALASKA, reported that BP has looked at the guiding principles in the administration's original plan: fair revenue for the state, shared upside, benefits, and risk, attractive investment climate - both for explorers and for reinvestment, and transparency to the state and taxpayer. BP has also examined the various

proposals. She pointed out that BP is looking at business in Alaska as it relates to business as a whole, as well as incremental investments. The changes proposed in version P will deteriorate BP's business situation and reconsideration is necessary. She maintained that Alaska is in the position of having a large resource base, but it is challenged. To access the resources requires infield drilling as well as new technology, satellites, new exploration, and ways of unlocking heavy oil. Changing the tax climate presents serious challenges for BP to develop a long-term sustainable business model. BP's business model will be designed around the legislation passed. She predicted that the economics and total business climate will be worse as a result of the current version of the bill.

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CRAIG HAYMES, PRODUCTION MANAGER, EXXONMOBIL, talked about the significant resource potential in Alaska. Production is currently down about one third. He spoke of the challenges in pursuing the resource including unique costs, remoteness, and environmental considerations. He predicted that in 10 years 75 percent of production will come from new oil, which will require new investment. The key question is how to maximize and commercialize the resource potential.

Mr. Haymes stated that industry needs a predictable fiscal environment. BP's investments are capital intensive and evaluated over decades. Changing the fiscal environment does reduce the attractiveness of projects. BP supports a net-based tax structure. PPT has been in effect for less than one year and has not had an audit. BP has been working with the Department of Revenue to help improve forecasting.

Mr. Haymes emphasized that policies determined today will impact future projects. He noted a five-page summary of his testimony and 30 pages of details focusing on specific aspects of the bill. The bill is viewed as a tax increase and contains other burdens.

Mr. Haymes summarized that at today's prices under the ACES proposal the production tax will increase 350 percent since 2005. The current CS will increase the production tax by 470 percent relative to 2005.

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KEVIN MITCHELL, VICE PRESIDENT, FINANCE AND ADMINISTRATION, CONOCOPHILLIPS, said when looking at future resource potential in Alaska, new technology and costs will be required. The fiscal regime will be critical to ensure new development. Investments of the past aren't the same as what will occur in the future.

Mr. Mitchell termed the new CS a tax increase. All components of the bill come together to further increase the tax burden and add to the complexity of complying with regulations. He maintained that it would not attract new investors or appeal to existing investors.

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Senator Thomas requested a graphic or handout of the 300 to 400 percent increase Mr. Haymes is suggesting will occur.

Mr. Haymes directed Senator Thomas' attention to the last page of his handout. He explained his calculations.

Senator Thomas asked if that's based on a price factor. Mr. Haymes replied that it is based on \$90 oil and on today's production levels using the Department of Revenue's formulas.

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Senator Dyson questioned Exxon's current investment, which he calculated at \$1.50 per barrel. He wondered what future investment might cost, taking into consideration capital expenditures.

Mr. Haymes related that a number of factors would determine that number. Historically, Prudhoe Bay and Kuparuk have been world class reservoirs and have been extremely productive. During the past seven years, 900 wells have been drilled or about 40 percent of production. Both the amount of reserves and the amount of investment have increased in Prudhoe Bay. The Department of Revenue's spring forecast predicts that there will be about 1.5 billion barrels of new oil in the next ten years. Infield development unit costs are going up and production is declining at Prudhoe Bay and Kuparuk.

Mr. Haymes commented on the challenges of the arctic environment in Alaska. Satellite fields are being developed because of the infrastructure already in place in Prudhoe Bay and in Kuparek. Development costs are increasing due to increased capital investment costs and transportation costs. If the crude price stays at a high level, the costs will continue to increase. Another challenge is that remaining resources aren't as attractive now because they are offshore or remote and the technology required is significant. Work on heavy oil isn't included in the previous barrel estimate.

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Senator Dyson asked what the capital expense was on Prudhoe Bay's production. Mr. Haymes recalled that it took \$19 billion of investment and that was just BP's share of expenditure, which was about 160,000 barrels.

Ms. Fitzpatrick added that it will take a substantial reinvestment to continue production another 50 years and beyond. That's why it's hard to give a definitive answer.

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Co-Chair Stedman recalled that PPT modeling indicated that capital and operating costs would be fixed. Now it looks like there is a doubling of operating and capital expenses. He inquired what could be done differently so the same thing does not happen in 18 months.

Ms. Fitzpatrick corrected that it was actually ConocoPhillips who brought the economist to the table. She suggested that to not have a repeat several things should be done. First, when moving to a new regime it is important to take time to vet it. She noted a willingness to work with the state on forecasting. There needs to be good communication between the companies and the Department of Revenue.

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Co-Chair Stedman requested Mr. Mitchell's comments.

Mr. Mitchell reported that a ConocoPhillips economist did testify about seriously rising prices. DOR is now receiving current monthly reports. Last year DOR was using very old data. Sharing of information should help with more accurate forecasts,

but it will still be wrong due to variations of price, volume, and cost.

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DAN SECKERS, SENIOR TAX COUNSEL, EXXONMOBIL, said that ExxonMobil is also willing to help with data forecasts. He voiced a concern with the bill over ambiguity in some of the wording. He pointed out that Section 46 is problematic. He said that the language "any records that the department considers necessary" is not reasonable. There is a compliance concern due to ambiguous language in the bill.

Senator Elton said he is prepared to accept that at today's prices, ACES would increase production taxes by 350 percent since 2005, and the CS for 2001 would increase production taxes by 470 percent. He inquired if Exxon Mobil was willing to accept that ACES decreases taxes compared to PPT and that the CS holds taxes level. He termed the ExxonMobil presentation as being somewhat alarmist.

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Mr. Haymes explained that BP looks at the amount of tax being paid in 2005 compared to the amount today under PPT, which at \$90 would be \$4.1 billion. From a taxpayer's perspective, \$4.1 billion is a tax increase. ACES would be a further tax increase to \$4.9 billion and the current CS would cost \$6.3 billion.

Senator Elton countered that the problem is that the argument ignores the debates from 2006. He pointed out that the expected tax rate set in 2006 is a tax decrease compared to today.

Mr. Haymes noted that when looking forward it is important to consider the correct tax rate in order to attract new investment. He questioned what the goal is. He agreed that a lot of information was shared, but perhaps not passed around properly.

Senator Elton saw no need to debate the topic at this time.

Co-Chair Hoffman recalled contemplating changes to ELF in 1989. A major difference then was that the industry was trying to convince the legislature not to make changes to ELF because it would collapse the oil industry in Alaska. That didn't happen

and there has been significant investment and development on the North Slope since then. As Alaska contemplated changing the tax structure two years ago, the oil industry said it liked ELF. Clearly times have changed. When contemplating PPT the legislature didn't consider high prices of oil and, as a result, oil companies received record profits. Although costs have gone up and the tax structure has changed, Alaska needs to get its fair share from oil taxes. The legislature isn't proposing a gross tax, but rather a net tax, and has proposed to drop out the floor at industry's request.

Co-Chair Hoffman disputed that Alaska is an unstable tax environment. He viewed the current legislation as a modification of PPT, which was the only major change since ELF, and the environment has been stable for 18 years. The Alaska legislature is cognizant that the oil industry is a major contributor to the economy, but the bottom line is there are windfall profits and the legislature needs to look at the tax structure at the high end of oil prices. The legislature needs to make certain Alaskans are receiving their fair share.

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Senator Huggins requested more information about BP's stated number of 70,000 barrels and Exxon's 50,000 barrels.

Ms. Fitzpatrick clarified that the number was from new wells - infield drilling - and well work combined.

Mr. Haymes said he quoted 40,000 barrels associated with satellite development around core fields in Kuparuk and Prudhoe Bay.

Senator Huggins requested an equivocal number from ConocoPhillips.

JIM TAYLOR, VICE PRESIDENT, COMMERCIAL ASSETS, CONOCOPHILLIPS, reported that the company has not stated such a number. He maintained that future investments are not the same investments as the past for a variety of reasons. One reason is that known resource potential on the North Slope is primarily in viscous and heavy oil and the cost to exploit that is high. The recovery rates and production volumes are much lower. Up to 70 percent of future production will need to come from new investments, which are more challenging than old investments.

Prudhoe Bay and Kuparuk are North America's largest and best fields.

Senator Huggins said this reminded him of the English Channel in 1944. He noted that Senator Hoffman previously referred to the floor. He requested comments on how the industry sees the floor.

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Mr. Mitchell related that the floor in the original ACES bill was a 10 percent gross tax on the two legacy fields. The intention with the floor was to provide fallback for the state in a low price environment; however, the floor had the potential to hurt investment. The floor could be triggered by a low price scenario - a low margin scenario. High investments are another trigger.

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Ms. Fitzpatrick added that the expectation was that the floor would kick in at the lower end of prices, but with the kind of investment profiles at the time, it was actually going to be higher, with a result that there would need to be a default assumption that the floor would kick in.

Senator Elton asked for a definition of moderate prices and high prices.

Mr. Mitchell said he was looking at the \$50 - \$60 price range for moderate prices at the time.

Ms. Fitzpatrick agreed with that assessment.

Mr. Seckers pointed out that ExxonMobil does not discuss these terms amongst the oil companies due to antitrust laws.

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Co-Chair Stedman returned to the discussion of PPT when most of the analysis was done when oil prices were below \$60. Under that modeling, operating and capital costs were held static, which isn't true today. He requested information about current operating and capital costs. He inquired about a reference to

\$550 million in integrity management costs in BP's 20-F disclosure.

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Ms. Fitzpatrick said that the \$550 million was spread over 2007 and 2008. It includes the money that has been spent and will be spent on oil transfer lines. It also includes a variety of things; improving efficiency of equipment, weather repair, facility expansion, and upgrading facilities and equipment.

Co-Chair Stedman restated that the \$550 million was phased in during 2007 and 2008. A number that appears in the paper quite often dealing with oil transfer line corrosion issue is \$260 million. He inquired about the relationship of the \$260 million and the \$550 million.

Ms. Fitzpatrick explained that \$260 million is a gross number and the \$550 million is a BP net number. Approximately one-quarter of the \$260 million is BP's interest share in Prudhoe Bay and is included within the \$550 million. In response to the question if the \$550 will go away, Ms. Fitzpatrick said those items will have been done, but there will be new items due to a new infrastructure. There will be a need for new infrastructure, so there will be capital needed over and above the previous amount.

Senator Elton asked, of the \$550 million, how much is recovered from others operating in the field. He also wondered if other companies have the same kind of infrastructure needs.

Ms. Fitzpatrick replied that the \$550 is part of BP's share of working interest owners' expenses.

Mr. Taylor commented on the ongoing development costs and prudent operatorship that goes along with the care and duty that an operator has to take on world class assets. There is a constant evaluation to maintain assets in the best way. Reservoirs require good integrity management and they must be properly maintained to last 50 years

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Senator Elton said he is still struggling with the \$550 million number. He asked how the \$550 million would be paid down.

Ms. Fitzpatrick pointed out that the \$550 million is both capital and expense in all fields.

Senator Elton repeated the question whether any part of the \$550 million would be paid by another company.

Ms. Fitzpatrick explained that the fact that it is net means it belongs to BP.

Co-Chair Hoffman recalled that EconOne said that the futures prices through 2011 are quoted at \$80 barrel. He wondered if that is an accurate projection.

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Mr. Taylor was not sure about that. He reported that the quote he received yesterday for ten years futures strip price, issued by the New York Mercantile Exchange (NYMEX), was in the \$60 range. He admitted that the companies do have planning prices that are confidential.

Co-Chair Hoffman related that it was a NYMEX strip through 2011.

Ms. Fitzpatrick reported that NYMEX changes on a daily basis. The last ten-year average was \$31.

Co-Chair Hoffman agreed that there has been a lot of change in the last 24 months.

Co-Chair Stedman brought up the issue of oil in an environment of \$80 to \$90 oil, and the idea that the committee hasn't looked at the fairness of the PPT tax structure at higher prices. A lot of time was spent on the \$20 to \$60 range. He also mentioned the inelasticity of the operating and capital expenditures imbedded within the model. He expressed a need for more time to deal with such a complex issue.

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Mr. Taylor appreciated the gravity of the responsibility the legislature has to make these decisions. He said that ConocoPhillips was glad for the opportunity to comment on how it sees some of the changes. The issue at hand is that there has been a tax increase - PPT - which introduced progressivity. The

question is whether PPT was at the right level, and how it can be improved to increase predictability. The preservation and fostering of a healthy investment environment is the goal because state revenues are a form of taxation, but also royalty. Change has occurred and it has already altered ConocoPhillips's plans, and it must reassess every time there is a change. The more frequent the change, the more difficult it is for ConocoPhillips.

Mr. Taylor addressed the global increase in demand that is driving the high prices and how it affects Alaska. The more stability there is the better. The preservation of the investment environment is the goal.

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Co-Chair Stedman addressed transitional investment credits (TIE). He requested a response from the three firms.

Mr. Mitchell said ConocoPhillips has consistently favored TIE credits because they soften the impact of tax changes. They are only of value to companies that have invested in the past and that intend to invest in the future. Companies hurt most by removing TIE credits are the ones that were most active.

Co-Chair Stedman recalled the discussion under PPT of TIE credits. He asked if TIE credits should be granted when the price of oil is higher than previous modeling. He asked what the effect of the 2 for 1 stimulus is now with the doubling of capital and operating expenditures.

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Ms. Fitzpatrick agreed that there was inflationary pressure and an increase in activity, which is causing an increase in costs. There is an increasing trend that is over and above pure inflation.

Co-Chair Stedman pointed out the \$213 million modeling number for 2008. He questioned if the state actually got 2 for 1 for exploration and development. He requested more information on which dollars went to expenditures for future development and which went for maintenance.

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Mr. Taylor looked at cost inflation and price with the benefit of hindsight. He used as an example, a regular and steady investor, and maintained that to reflect back and say 2 for 1 wasn't as good as you thought it was, isn't exactly fair.

Co-Chair Hoffman said he has heard arguments that if the base tax rate is increased to 25 percent, there would be more exploration because of the increase in credits. He said he didn't agree with that idea. He requested the producers' opinion on that point.

Mr. Haymes thought that an increase in the tax rate would not stimulate investment activity. One needs to look beyond two or three years when looking at the economics of projects. No one will explore unless they think they can move it to development which is the next phase of the cycle. The production phase has ongoing capital and operating costs. Then there is a decline and it becomes more difficult to pursue the barrels of gas. Finally, there is a site remediation phase. The entire lifecycle needs to be looked at when considering the economics of a project. Sensitivities around costs, price, and resources need to be considered. Increasing a tax rate within the same net structure system would not encourage investment activity.

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Co-Chair Stedman brought up the issue of joint interest billing.

Mr. Haymes said that as a non-operator of some of the major fields, ExxonMobil looks very hard at joint interest billings. He explained how joint interest billings are audited.

AT EASE: [2:41:47 PM](#)

RECONVENE: [2:42:40 PM](#)

Mr. Haymes continued to explain that joint interest billings are used as a starting point.

AT EASE: [2:43:36 PM](#)

RECONVENE: [2:49:24 PM](#)

Mr. Haymes explained that ExxonMobil uses joint interest billings for auditing purposes and spends over 100 weeks per year doing so to ensure accurate and appropriate records.

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Mr. Seckers said that joint interest billings form the foundation of how tax returns are filed. The process begins with going over projects. Then, as the bills are incurred, they are audited for compliance with agreements. Next, the tax department makes sure they conform to the law. Finally, they go to the tax lawyers for compliance, a return is prepared, the senior tax auditors review them, and then the return is filed. ExxonMobil will not file falsified returns under any circumstances. There is no incentive to pay more than required.

Mr. Seckers explained that Section 65 of the Committee Substitute would delete two very important sections of PPT: Sections 165(c) and (d). Those sections gave permission to the Department of Revenue to look at the joint interest billings as a starting point for audits. He testified in opposition to the removal of those sections.

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Co-Chair Stedman noted that discussion is needed on the topic of topping plants.

Co-Chair Hoffman referenced a prior presentation by ConocoPhillips. The last page of their handout lists nine negative impacts on investment climate. He questioned if they were prioritized.

Mr. Mitchell said no. He maintained that most items comprise some form of tax increase.

Co-Chair Hoffman asked where a tax increase to 25 percent might rank with the other negative items.

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Mr. Mitchell stated that ExxonMobil hasn't done that analysis in order of preference. There is an element of tradeoff between base rate and progressivity. It is debatable which is preferable.

Ms. Fitzpatrick agreed, but added that when designing a fiscal policy, in order to maximize investment in the future, flexibility should be considered. Investment at the lower end should be encouraged, but with consideration to progressivity.

Senator Huggins said he isn't interested in subsidizing a topping plant on the North Slope. He had heard it would cost \$300 million on the North Slope and \$54 million in Kenai. He asked about low sulfur diesel from Kenai and the costs of a topping plant.

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Mr. Taylor related that the issue of a topping plant culminated in a June 2005 agreement between ConocoPhillips BP and the Alaska Department of the Environment. They discussed an EPA agreement regarding clean fuels. In order to comply, a transition agreement with ADEK was made. A topping plant in the North was contemplated for economic, environmental, and safety reasons. It is more expensive to build a manufacturing facility on the North Slope than on the Kenai Peninsula. That is offset by the costs and risks associated with transportation by the road or barge. ConocoPhillips had embarked on an authorization for design and has spent \$40 million to \$50 million for a project that has been stopped.

Mr. Taylor suggested that it can be satisfied in ways other than building a manufacturing facility on the North Slope, but would require expansion of existing facilities, which already have had expansions in order to meet the state's ultra low sulfur diesel (ULSD) requirements. He suggested considering that during peak demand times, when supplies could become tight, it would be a wise investment to have the facility in place on the North Slope.

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Co-Chair Stedman inquired if the issue is access to the credit.

Mr. Taylor replied that access to the credit is an issue at hand. It is an investment for the benefit of the lease to comply with state and federal environmental regulations. Offsetting that would cause reevaluation of where to have the ULSD and decide on the best way to transport it.

Co-Chair Stedman asked if \$300 million is an accurate number. Mr. Taylor thought it was relatively accurate.

Senator Huggins emphasized that his interest is hearing from the administration's risk management people that they are willing to accept the risk if it must be transported to the North Slope. It's not about tax credits.

Co-Chair Stedman asked for an estimate of the truck traffic up the highway if the facility was not built.

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Mr. Taylor reported that the peak number of trucks would be 55.

Senator Elton asked if the cheapest option is to have the topping plant rather than transporting low sulfur diesel to the slope.

Mr. Taylor said it's more economical, more efficient, and less risky to supplement diesel manufacturing capacity on the North Slope. There already is up to 5,000 barrels a day of diesel being produced on the North Slope for the exclusive use of those leases. Environmental requirements for ultra low diesel are new. They require the investment of a physical process to remove the sulfur from the current manufacturing process. This is an enhancement and an addition to what already exists. In order to meet that requirement, if it came from other locations, it would render some of the investments that have been made redundant.

Senator Elton asked if it is more cost efficient to have the topping plant over time than it is to transport low sulfur diesel to the slope.

Mr. Taylor said it was.

Senator Elton summarized that more credits would be offered so that the producer could select the cheaper option.

Mr. Mitchell clarified that with the tax credits the North Slope ULSD plant is the lower cost option. Without the credits, trucking is the lower cost option.

Senator Olson asked if data confidentiality is for federal, state, and private land, and, if the state is subsidizing 40 percent of the exploration, why it shouldn't have access to the data.

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Mr. Mitchell responded that the concern around exploration confidentiality is the provision that in order to obtain the tax credit, exploration data is only held confidential for a two-year period. The data can be valuable or worthless. ConocoPhillips may choose not to apply for the credits if the confidential information is deemed to be more valuable than the value of the credit.

Senator Olson asked for how long a period of time the data should be held confidential in order for ConocoPhillips to take advantage of the credits.

Mr. Mitchell recalled a 10-year option under PPT and would prefer to see that in this legislation.

Senator Olson restated his question regarding federal, state, and private lands. He wondered if there a distinction between who owns the land.

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Mr. Mitchell understood that the provisions are the same regardless of who owns the land. He spoke of a conflict by the Department of Natural Resources when collecting data on non-state lands, which are competitors.

Senator Olson reported that producers haven't given feedback on that issue.

Ms. Fitzpatrick said she had brought oil samples with her in order to show the different viscosities.

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RECONVENE: [3:40:47 PM](#)

INDUSTRY STAKEHOLDERS

[3:43:05 PM](#)

JOHN ZAGER, GENERAL MANAGER, CHEVRON-ALASKA, provided opening statements. He asked the committee to consider unintended consequences of the bill, and to think about the base rate and progressivity in the context of future investment. He suggested considering if Alaska is getting what it needs. He related that he thinks of Alaska as an asset to be sold and the customers are the oil companies. How the asset is priced in the market will determine how many will show up and bid. If it is a world class asset, premium prices can be charged. He spoke of the risk/reward balance.

Mr. Zager spoke of a recent lease sale worth \$2.4 million, which he termed an abysmal amount. Recently, in the Gulf of Mexico \$2.4 billion was bid on a lease sale. He used a car analogy to make his point. He offered suggestions on how to set a price for resources in Alaska.

Mr. Zager felt that there was no debate that moving from PPT to ACES will not improve the investment climate in Alaska. It will only make it worse. He recalled the process of going from ELF to ACES, which had incentives that have begun to pay off. Going from PPT to the current legislation shows no benefits to increase investments, only an increase in taxes. He emphasized the importance of considering future investment.

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Mr. Zager highlighted a list of items more specific to the bill. He had concerns about TIA credits, retroactivity of the effective date, and disallowing certain costs for in-state vs. out-of-state. He mentioned the weakening of terms regarding taxpayer confidentiality. He expressed concern about the multiple layers of penalties for missed payments and errant reporting and those effects on operation.

Mr. Zager thought that this legislation was more complicated than PPT and there was less time to discuss its ramifications. He inquired to what degree the legislature was willing to risk the future of oil and gas investment in Alaska and in the Alaskan economy. He questioned if Alaska is really open for business.

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Mr. Zager spoke of Chevron-Alaska's commitment to the state. He questioned if there would be more or less opportunity for Alaskan's children if the bill passes. He concluded by requesting the committee to look at the bill in its totality.

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PAT FOLEY, MANAGER, LAND AND EXTERNAL AFFAIRS, PIONEER NATURAL RESOURCES, related that he wanted to focus on a single issue - progressivity. He reported that Pioneer is a large independent \$6 billion market cap company with a project in the North Slope and one in Cook Inlet.

Mr. Foley explained that Pioneer's peer group is different than other groups in Alaska because they do most of their business in the Lower 48. Pioneer's investment alternatives compares to those onshore in Texas. He referenced a website that lists all onshore wells in the U.S. He stated that the tax policy should consider motivating onshore companies to come to Alaska.

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Mr. Foley addressed progressivity. In the Lower 48, government take is low compared to Alaska. At higher prices, with progressivity, the government take in Alaska increases, making it less attractive for companies like Pioneer.

Mr. Foley described a Pioneer project where 80 percent of the resource lies on net profit leases. Thirty percent of Pioneer's net profit is paid to the state, in addition to royalty, income tax, and PPT. The government take ends up at 83 percent, which is dramatically different than 67 to 69 percent at Kuparak or Prudhoe Bay.

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Mr. Foley asked the committee to consider that net profit share payments be creditable against PPT payments, specifically against progressivity. He believed that progressivity is designed to capture the price upside. The net profit share payment already captures the price upside. He suggested that it apply not just to Pioneer, but to all net profit share leases on the North Slope. In 2006, the total sum of the net profit share

payments is about \$87 million. The highest payer of net profits is BP.

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MARK HANLEY, MANAGER, PUBLIC AFFAIRS, ANADARKO-ALASKA, voiced concern about increasing taxes and requested the lowest tax rate possible. He re-emphasized staying with the net profits approach, not just with the base rate, but also with progressivity.

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Mr. Hanley stated that Anadarko does not support retroactivity. Regulations on how much Anadarko must pay has not been finalized for the current year and now it is going to change. He thought there were adequate penalties in existing law, which can assess up to 25 percent.

Mr. Foley addressed retroactivity - there are provisions in the bill based on ACES incentive credits. He mentioned other unintended quirks in the bill. Pioneer has worked with the administration on potential fixes.

Mr. Foley spoke of lease expenditures. He voiced concern that excluded costs for legitimate expenses result in a tax.

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Senator Elton emphasized that he is looking for results that everyone can live with. He questions Mr. Foley's comparison of government take in the Lower 48 with Alaska's and maintained that there are significant differences. He requested more information. He suspected that government take is one part of picture and company take is another.

Mr. Foley related that the difference between government and company take is that company take is "one, minus government take". In the Lower 48 the government take is about 50 percent and the royalty is typically not owned by the state.

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Senator Elton said that his expectation was that in the Lower 48 profits are reduced because they are shared with another owner, rather than with the government.

Mr. Foley explained that company take is on a gross basis, and not diluted by the fact that there are other partners.

Senator Elton discussed the division of the revenue stream in Alaska; between the state, the company, and the federal government. In the Lower 48 it could be state, the federal government, and another resource owner and company.

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Mr. Zager replied that he did not see the distinction because there are multiple owners in Alaska, as well.

Senator Elton thought that in Alaska the state owns the resource. In Texas someone else may own the resource. He said he is trying to figure out if government take is different than company take in that scenario and whether it is a fair comparison.

[4:06:39 PM](#)

Mr. Foley said that regardless of where, government take plus company take equals one. The federal government is included in government take. He reiterated his company's statistics.

Senator Elton maintained that it was not fair to compare government take in Alaska and in Texas, because in Alaska the state is the government and the resource owner.

[4:08:30 PM](#)

Mr. Foley agreed. There is a royalty in the Lower 48 that is not paid to the state. He explained that he has included that in the state take. Senator Elton countered that it was not included in government take in the Lower 48.

Co-Chair Stedman used the Gulf of Mexico as an example of needing to be sure that comparisons include like calculations.

Mr. Zager thought that "we're saying the same thing". He clarified that what is left over is what the company gets and

everything else is called government take. Technically, it is a lease holder and the government.

[4:10:32 PM](#)

Senator Elton summarized that Mr. Foley was saying that Alaska is a higher cost environment, so there shouldn't be a problem sharing company take in Alaska and Texas.

Mr. Foley agreed. He reported his company take in Alaska is 17 percent; in the Lower 48 it is closer to 50 percent.

Co-Chair Stedman noted that it was important to make careful comparisons.

[4:11:44 PM](#)

Co-Chair Stedman turned to Pioneer's issue of offsetting progressivity. He recalled a debate under PPT between the administration and the legislature where the legislature wanted to include progressivity to ensure that the state's share did not decline during advancing prices. It depended on the relative magnitude of progressivity. He questioned at what point the companies would want to put profit sharing against progressivity tax.

Mr. Foley explained that his net profit is about 18 percent and progressivity is another 9 percent. On average the government take is in the high 60's, but his company pays higher than 80 percent.

[4:14:27 PM](#)

Co-Chair Stedman pointed out that the original PPT triggered \$40 on the North Slope. He wondered if dropping the slope to \$30 per barrel would help or make it worse.

Mr. Foley said that it alleviates the problem, but it still disadvantages a net profit share lease holder.

Senator Elton asked what the government take will be in the first year of production. Mr. Foley did not know, but admitted that they would not pay a net profit or production tax; however, they would pay a state income tax, a property tax, and federal income tax.

Senator Elton concluded that it is 83 percent in the future once costs are recovered.

Mr. Foley explained that the 83 percent is a total life cycle.

[4:16:01 PM](#)

Co-Chair Stedman pointed out that due to time constraints the models of life cycle costs have not been discussed. He said that Mr. Foley's point is being heard that progressivity could alter the producer take substantially.

Mr. Foley added that progressivity captures price upside and on a net profit share lease the profit upside is already captured.

[4:17:37 PM](#)

MARK HANLEY, MANAGER, PUBLIC AFFAIRS, ANADARKO-ALASKA, stated a preference for the existing PPT progressivity compared to the one in ACES because it starts higher and goes up faster. He suggested keeping in mind a third option in the Governor's proposal that annualized progressivity, which is a benefit to the company.

[4:19:15 PM](#)

Senator Elton asked Mr. Zager about investment decisions based on the PPT tax recipe, which had an outcome that did not happen. He wondered if Mr. Zager used internal assumptions. Mr. Zager explained how his projects are modeled.

Senator Elton hoped that Mr. Zager's assumptions on cost were better than the states.

Mr. Zager reported that there were dramatic increases in costs which were higher than projected 3-4 years ago. He referred to a slide that depicted dramatically increasing costs.

[4:22:57 PM](#)

Mr. Hanley commented on two categories of cost; inflationary cost and added investment. He did not know if either was driven by PPT. He pointed out that expenditures had gone up.

Mr. Hanley addressed the insinuation that costs were not disclosed when they were known or that costs were over inflated to show lower returns resulting in lower tax. He felt that companies were accused of both. Inflation vs. investment is an important distinction to make when considering why state revenues were less than expected. He suggested that inflationary costs had an impact on smaller returns.

[4:26:09 PM](#)

Co-Chair Stedman referred to earlier testimony that there were substantial inflation pressures on the operating and capital expenses whereby margins actually spread. There were substantial increases in the price of oil.

Mr. Hanley agreed.

Mr. Zager pointed out the cycle where prices go up first and then costs will tend to lag and then eventually catch up.

Co-Chair Stedman said that in the future the state will be monitoring the Opex and Capex so it can become more sophisticated in expectations.

[4:28:07 PM](#)

Senator Thomas referred to the cost lag and thought it seemed like costs accelerated with PPT. The state should be prepared for future cost lags.

Mr. Zager explained the circumstances when oil prices were at \$70 and the system was taxed to the max. Whether the incremental \$20 will incite another round of activity depends on the staying power of the \$90 price. Investments now are based on that price.

Senator Thomas wondered if the price of rigs was increased during high oil prices.

[4:30:27 PM](#)

Mr. Zager said that the drilling companies have a long memory. He clarified that there are other costs. He described how negotiating power changes during high and low prices. He

pointed out that when taxing the producers the service industry is impacted as well.

Mr. Hanley emphasized the importance of having as few unintended consequences as possible.

[4:32:27 PM](#)

Senator Thomas asked Mr. Foley if he spent time negotiating with the state about the royalty reduction and other unique issues.

Mr. Foley said that was correct. Pioneer has benefited from royalty reduction. He detailed how it worked for his company under PPT.

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

ADJOURNMENT

The meeting was adjourned at [4:37:49 PM](#).