

SENATE FINANCE COMMITTEE
November 10, 2007
1:33 P.M.

CALL TO ORDER

Co-Chair Hoffman called the Senate Finance Committee meeting to order at [1:33:30 PM](#).

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Kim Elton
Senator Donny Olson
Senator Joe Thomas
Senator Fred Dyson

MEMBERS ABSENT

Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice Chair

ALSO PRESENT

Senator Gene Therriault; Senator Gary Stevens;
David Dobbs, Vice President, Managing Director of Global
Research, Cambridge Energy Research Associates (CERA)

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."

Presentation on Government Take
Cambridge Energy Research Associates

[1:34:47 PM](#)

Co-Chair Hoffman announced the presentation by the Cambridge Energy Research Associates (CERA), "A Comparison of Fiscal Regimes" (copy on file.)

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DAVID DOBBS, VICE PRESIDENT, MANAGING DIRECTOR OF GLOBAL RESEARCH, CAMBRIDGE ENERGY RESEARCH ASSOCIATES (CERA), explained that CERA is a syndicated research firm which looks at major developments in the energy market. Mr. Dobbs related that CERA was asked to prepare a report comparing fiscal regimes in the energy sector. He summarized that the concept of a "fair share" is meaningless and terms must be competitive.

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Mr. Dobbs explained that CERA looked at a peer group when comparing Alaska to other regimes and concluded that Alaska ranks near the bottom in terms of the economic attractiveness of investment. Alaskan production is declining. He pointed out that investment decisions are based on more than pure economics. They are based on the perception of stability, the growth potential, and the ease of operations in any environment. In today's environment, where costs have doubled, the biggest shortage seems to be of engineering and project management talent.

Mr. Dobbs pointed out that CERA has taken a different approach in their analysis. Charts which project state take are not very meaningful. More sophisticated analysis of fiscal terms tend to consider an example field and run that field under various fiscal regimes and compare the economic returns.

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Mr. Dobbs continued to say that the world is not homogenous and different locations have different technical challenges. CERA considered costs of development and production for a variety of models under a variety of environmental conditions, and then compared investments and returns. CERA came up with a peer group that broadly represented the Alaskan environment and cost structure. A variety of oil and gas price scenarios were also considered.

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Mr. Dobbs referred to figures 3 and 4 on page 6 of the report to show the ranking of the rates of the returns of the regimes. This shows that under PPT, Alaska is in the bottom half. He emphasized that this is not the only measure that drives a company to invest, but rather a combination of the risks, the potential for growth, and the reliability of the resource, as well as environmental factors and regulatory requirements.

Senator Elton asked when the Alberta group was considered in the peer group. Mr. Dobbs said it was in August. The recent uncertainty in Alberta has reduced its attractiveness since then.

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Senator Thomas requested a comparison of the stability of regimes.

Mr. Dobbs explained that the analysis was based on fiscal terms; however, he could speak to stability issues. He shared a story emphasizing the sensitivity of stability; even talking about changing the fiscal regime can create much the same effect as making a change. In the UK there was a pause in activity while waiting for the possibility of change. Alaska may rank higher in stability terms than in fiscal terms.

Senator Thomas commented on the psychology of change.

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Senator Dyson noted that others have said that when making comparisons one must include the royalty structure and the cost to "buy in". He thought old vs. new fields should also be taken into consideration.

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Mr. Dobbs related that CERA's analysis included all money that does not go to the investor in the notion of take. Royalties and the cost of acquiring leases should be included in the take calculation. CERA considered what funds flow to the investing company, and anything that does not come to them is part of the take.

Mr. Dobbs addressed the notion of having two different tax regimes, one for legacy fields and one for new fields. The problem with that idea in the oil industry is that investments in fixed real assets of several billion dollars are made. He maintained that two different regimes are rarely attractive.

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Senator Dyson inquired about amortizing the initial buying cost. He wondered if old leases were considered when looking at today's comparisons.

Mr. Dobbs replied that the cost of acquiring the lease is incorporated into the fiscal model. Appropriate rules for amortization have been applied for each of the environments. In response to the second question, Mr. Dobbs explained that CERA looks at how a field, over its life, would compare if the leases were acquired today at today's terms. He used the North Sea as an example.

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Co-Chair Hoffman noted that Alaska is contemplating changes in the tax structure through ACES. However, ACES has changed. For example, the floor is gone, taxing on gross is gone, and the tax rate is still under consideration. He opined that legislators are listening to the industry and are in support of 22.5 percent rate, instead of 25 percent. Many changes have occurred since ELF, PPT and ACES. He concluded that what Alaska is considering today is due to what has happened world wide in the industry. He asked Mr. Dobbs if other countries are looking at Alberta as an example.

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Mr. Dobbs agreed that others have looked at the example of Alberta. He maintained that it is harder to look at underlying costs, than at government take. Those governments have a more optimistic view of the profitability of activity than is actually being experienced. He agreed that the majority of resource holders have sought to increase state take. There have also been governments such as Columbia, who have reduced state take in order to attract more investment. Capital investments are at record high levels, but most of this is due to inflation of fiscal terms.

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Co-Chair Hoffman maintained that Alaska led the way on progressivity. The primary reason that the legislature has not moved to a gross system is awareness of increased development costs. He opined that the legislature was willing to listen to industry testimony and modify its tax structure.

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Mr. Dobbs pointed out that CERA's analysis does include the original gross tax proposal. An examination of the field models shows that gross tax doesn't make much difference to attractiveness; however, it is much better to tax on the net, rather than the gross when considering higher costs and lower prices. Risks of a recession in North America could lower prices. Regimes with a gross tax component are always less attractive. Norway is attractive because it has removed the gross element.

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Senator Elton reported that the head of BP predicted that the price of oil will be higher than expected. He asked if, given the fundamentals, Mr. Dobbs believes that the price of oil will go down to historical levels.

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Mr. Dobbs pointed out that the industry responded to the Iraq war and problems in Venezuela and Niger Delta with a price spike. He elaborated on changes in the oil price environment. He related that the industry lives in the margins. If prices go to \$40, it would be problematic for the oil companies. He doubted that prices would revert to a historical level. He maintained that the underlying fundamentals do not support a price as high as today's. He thought that the market might overcorrect and go lower. He suggested that in 1980's costs were, in relative terms, as high as they are today. Through the application of technology and disciplined project execution, the prices retreated.

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Senator Elton said he couldn't understand how ACES falls below PPT if there is a net floor of 22.5 percent in both, the rest of the government take depends on progressivity, and the royalty is the same.

Mr. Dobbs reported that at the time CERA did the analysis, the ACES proposal had a 25 percent rate. There was also a range of royalty rates that came into effect.

Senator Elton assumed that the attractiveness of Alaska as a place to invest would be the same under ACES or PPT with both at 22.5 percent.

Mr. Dobbs agreed, with regard to fiscal attractiveness; however, the attractiveness of investment under ACES is negative, because of the uncertainty of change.

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Senator Elton used an analogy of deer hunting to make a point that the tax should be durable and reliable over time, which would lead to stability. Not doing anything would be destabilizing.

Mr. Dobbs responded that if industry believes there is a greater prospect of long-term stability because there is a durable consensus, that is a better situation than if industry perceives there to be no consensus and no durable settlement. If the original settlement had been considered durable, and the debate had never arisen, that would have been the best situation. The more durable the outcome, the more certain the investment potential.

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Senator Elton suspected that if the end result was no new tax or no change to the existing tax, future discussions would be as virulent as they have been.

Mr. Dobbs pointed out that the investment cycle in the oil and gas industry is longer than the electoral cycle and that creates a tension surrounding how durable a settlement might be.

Senator Dyson asked who was paying for Mr. Dobb's testimony. Mr. Dobb's replied that ExxonMobil was funding his expenses, as well as the production of the paper. He explained the method that CERA uses for its research. In this instance, this work is a reflection of previous work for clients in the oil industry.

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Senator Thomas referred to the figures in the document and noted that Russia, East Siberia, and the United Kingdom are particularly attractive to investment. He requested more information about rate and volume as they apply to investment in those countries.

Mr. Dobbs reiterated that the rankings show only fiscal attractiveness. East Siberia is attractive due to incentives provided by the Russian government; East Siberia is less attractive because it is in a remote area and has a perception of unstable ownership rights. Investment activities in the UK have been growing and it is more attractive than Norway. Activity in Brazil ranks high due to a lot of international investment. Fiscal attractiveness is only one of several indicators. Companies are looking to developing resources off the East Coast of Canada, off-shore Brazil, and in the UK, and, in general, seem to be getting a good share of investment volume terms.

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Senator Thomas asked about the stability of various countries and speculation of future investment.

Mr. Dobbs related that there are a number of North American companies that appear to be withdrawing from foreign investment. However, Canada, China, India, Korea, and others are investing in the riskier environments. He maintained that risk is a relative term. It is difficult to generalize about the shrinking universe of investment opportunities.

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Senator Elton pointed out that the UK has two tax rates; 50 percent for new fields, and 70 percent. He asked if references to the UK include a blending of the two rates.

Mr. Dobbs reported that the analysis was post 1992 and the new field rate of 50 percent was used. He explained the process at arriving at the two different tax rates. He maintained that it is unattractive to have two rates, unless one is a reduction.

Senator Elton requested further clarification of the comparison. Mr. Dobbs said the UK was compared at a 50 percent tax rate. Senator Elton asked for a breakdown between old and new fields in the UK. Mr. Dobbs didn't know, but guessed that it was about half and half. Senator Elton asked if it would be a fairer comparison between Alaska and the UK if only new fields were considered. Mr. Dobbs thought it would be a fair comparison if the legacy fields had a reduction in taxes and the new fields had a near- abolition of taxes.

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Co-Chair Hoffman thanked Mr. Hobbs for his presentation.

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

ADJOURNMENT

There being no further business before the committee, the Senate Finance Committee meeting was adjourned at 2:34 P.M.