

SENATE FINANCE COMMITTEE

November 14, 2007

9:21 A.M.

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at [9:21:30 AM](#).

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

Senator Lyda Green; Senator Gary Stevens; Senator Hollis French; Senator Bill Wielechowski; Senator Gene Therriault; Representative Mark Neuman; Representative Mike Kelly; Pat Galvin, Commissioner, Department of Revenue; Steve Porter, Legislative Consultant, Legislative Budget and Audit Committee; Kevin Mitchell, Vice President, Finance & Administration, ConocoPhillips; Tom Williams, Senior Tax Counsel, British Petroleum, Alaska; Pat Foley, Land & External Affairs Manager, Pioneer; Mark Hanley, Manager, Public Affairs, Anadarko-Alaska; Dan Seckers, Tax Counsel, ExxonMobil; Dan Dickinson, Consultant, Legislative Budget and Audit Committee; Bob George, Consultant, Gaffney, Cline and Associates, Inc.; Bernard Hajny, Production Tax and Royalty Manager, British Petroleum, Alaska; Claire Fitzpatrick, Senior Vice President, Commercial, British Petroleum, Alaska.

PRESENT VIA TELECONFERENCE

Craig Haymes, Production Manager, ExxonMobil, Alaska; John Zager, General Manager, Chevron-Alaska.

SUMMARY

CSHB 2001(FIN) am
OIL & GAS TAX AMENDMENTS

SCS CSHB 2001 (FIN) was reported out of committee with a "no recommendation" and with zero fiscal note 1 by the Department of Administration, new fiscal note 9 by the Department of Revenue, new fiscal note 10 by the Department of Revenue, and new fiscal note 11 by the Department of Natural Resources.

#hb2001
CSHB 2001(FIN) am

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; providing a limit on the amount of tax that may be levied on the production of certain gas that is produced outside of the Cook Inlet sedimentary basin; relating to the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; expanding the period in which the Department of Revenue may assess the amount of oil and gas production tax and conservation surcharges; prohibiting a producer or explorer from receiving tax credits if certain judgments are not satisfied and requiring, as a condition of receiving the tax credits, the deposit of the amount of certain unpaid judgments and certain interest on those judgments in the court during an appeal and relating to that interest; relating to state oil and gas audit masters; making conforming amendments; and providing for an effective date."

[9:26:04 AM](#)

Co-Chair Hoffman MOVED to ADOPT SCS CSHB 2001 (FIN), GH-0014\R, dated 11/13, as the working document. There being NO OBJECTION, it was so ordered.

[9:27:27 AM](#)

DAN DICKINSON, CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, reviewed "Summary Comparison between Various Approaches to Production Tax" (copy on file.) He said the

new document was prepared based on a draft version of the Committee Substitute (CS), therefore the bill sections are incorrect.

Mr. Dickinson addressed some of the major economic issues in the bill before the committee. The base tax rate is 22.5 percent. The progressivity is a formula which starts out at .6 percent, and at a margin of \$90 it flattens out and only goes up at a rate of .1 percent for every dollar of increased profitability per barrel, and caps out at 50 percent. The gross floor looks like the floor under current law with a caveat that there are certain credits that can not be taken against that floor.

Mr. Dickinson referred to a handout entitled "Proposed Senate Finance CS - Illustrated" (copy on file.) He compared the "Structure of the Levy" between AS 43.55.011(e), .011(g), and .011(h) in each of the four bills.

[9:34:05 AM](#)

Senator Dyson questioned the relevance of AS 43.55.011(i). Mr. Dickinson explained that it referred to private landowners, which is probably less than 1 percent of the production.

Mr. Dickinson explained the differences in the "Credits Against Floor" chart related to the different versions of the bill. Under current law, when the floor is in place, .023 credits cannot be deducted, whereas .024 and .025 can. Under the Governor's bill, none of them can be deducted. The House version of the bill mirrors current law, and in the proposed Senate Finance bill only .024 credits can be deducted.

Senator Huggins noted that the Senate Finance version is more protective at low price rates than the House bill. Mr. Dickinson agreed. Senator Huggins pointed out that the Governor's floor is not in any version. Co-chair Stedman clarified that the original PPT floor is being retained. Mr. Dickinson agreed.

[9:39:23 AM](#)

Mr. Dickinson reviewed comparisons of "Investment Credits." The Senate Finance version retains the Governor's proposal

in which an investment credit is spread over two years. The House version and current law state that the credit would be taken in the year of investment.

Mr. Dickinson explained "Loss Carry Forward Credits" in the various versions. In the Senate Finance version a current producer and a new entrant are treated equally at 22.5 percent.

Senator Huggins asked about differences between the Senate Finance version and the House version. Mr. Dickinson clarified that both versions line up with the tax rate. Co-Chair Stedman remarked that this was more of a clean up language issue.

Senator Dyson requested an explanation of why the Senate Finance bill does not allow the exploration credit.

[9:42:39 AM](#)

Mr. Dickinson explained "Transitional Investment Credits" (TIE). The Senate Finance version eliminates TIE credits with some exceptions. In the House Finance version there is a five-year period in which capital spending "fills the bucket." All taxpayers are allowed application of TIE matching spending during that period. If there was no production before 2008, the TIE credits would be figured by a formula based on previous spending. Everyone would be treated equally.

Co-Chair Stedman remarked that would be about \$200 million a year.

[9:47:27 AM](#)

STEVE PORTER, LEGISLATIVE CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, LEGISLATIVE AFFAIRS AGENCY, clarified that the \$200 million number is minus the producers' tax credits.

Senator Huggins remarked that TIE credits are an incentive to produce. Mr. Dickinson agreed.

[9:49:05 AM](#)

Mr. Dickinson moved on to the Senate Finance version of the TIE credits comparison - page 5. It has the same five-year

period of matching spending with the same formula as the House version of the bill. An entity that did not produce between April 1, 2006, and December 31, 2007, is no worse off than if the TIE credit were not repealed. There is a six-year window involved through 2013. TIE credits end December 31, 2007.

Page 6 combines the information provided on pages 4 and 5 of the handout.

9:52:15 AM

Co-Chair Stedman requested more information about operating and capital spending trends in 2005 and 2006. Mr. Dickinson thought that would be best answered by the Department of Revenue (DOR). Mr. Dickinson understood that there was a spending increase during those years. Co-Chair Stedman rephrased his question regarding TIE's. He related that the intent under PPT was to have a 2 for 1 incentive for the petroleum industry to increase capital spending to help stem the decline in production. Mr. Dickinson remarked that the intent was to give the reward to the taxpayer who was investing.

9:55:50 AM

Mr. Dickinson moved on to comparisons of "Exploration Credits" on page 2. The Senate Finance version of the bill reflects closely to what was contained in the Governor's bill. Confidentiality of well data is limited to two years; however, DNR can decline disclosure of the data. Senator Olson asked how private landowners are affected by the bill. Mr. Dickinson replied that the specific exclusion regarding private landowners, as found in the House Finance version of the bill, is not included.

Mr. Dickinson discussed pre-existing well comparisons, where the season is expanded to two consecutive drilling seasons so that delineation wells could also qualify for the 40 percent credit. Any seismic data previous to 2003 is eligible for up to 5 percent credit.

10:00:26 AM

Mr. Dickinson moved on to explain "Exceptions to Tax Credits". Non-profits are excluded from buying and selling credits.

Mr. Dickinson compared "State Purchase of Credits". The Senate Finance bill reflects current law in that there is no special fund created. He said he believes that the \$25 million cap may still be in state law.

Mr. Dickinson explained "Allowable Lease Expenditures" on page 3. The Senate Finance bill contains all of the concepts contained in current law and adds that deductions must be authorized by the Department of Regulations. Producer audits of operators are allowed, but only costs that have been approved by other owners are allowed.

[10:05:30 AM](#)

Senator Elton asked for clarification of "can use" versus "must use". Mr. Dickinson answered that there is a great amount of discretion by the department of what is allowed. The state wants to take advantage of work going on between producers, but not be taken advantage of. There is much sensitivity around this issue.

Mr. Dickinson discussed the disallowing of bad acts. Insertion of AS 43.55.165(e) says that royalties and net profit shares are not deductible costs. The Senate Finance bill adds a footnote that says a net profit share or lease granted by the Department of Natural Resources (DNR) is deductible.

Mr. Dickinson discussed the corrosion issue. There is a disallowance provision at \$.30 a barrel. Unscheduled interruption costs and field topping plants are not allowed. The language found in the Governor's bill regarding off leases is the same as in the Senate version of the bill. There is a list of public outreach costs. Unlike the House bill, this bill maintains that actual costs are used to calculate the operating cost deduction.

[10:09:46 AM](#)

Senator Thomas questioned if the language "shall consider, among other factors" allows for enough discretion. Mr. Dickinson pointed out the location of that language on page 40, lines 6 and 7, of the Senate version of bill and in AS 43.55.165(b). Mr. Dickinson emphasized that the regulations still have to tie back to the list of allowable lease expenditures.

Mr. Dickinson called attention to AS 43.55.165(c), which looks at the unit operating agreement. First, the department has to find that the unit operating agreement meets the standards and only allows direct costs, and that there is a working interest owner party with substantial incentive and ability to effectively audit billings under the agreement - lines 26 and 26 on page 40. He continued to read from line 27, "subject to conditions prescribed under regulations adopted by the department, to treat as that portion of its lease expenditures for a calendar year applicable to oil and gas produced from a lease or property in the state" for only those costs incurred by the operator.

Senator Thomas talked about the differences in the use of the words "may" or "shall." Mr. Dickinson agreed with Senator Thomas' interpretation. Senator Thomas referred to page 41, lines 25 and 26, the language used regarding fraud and willful misconduct, and asked for Mr. Dickinson to comment. Mr. Dickinson replied that the House Finance added "criminal language".

[10:16:07 AM](#)

Mr. Dickinson turned attention to disclosure of tax information found on page 3 of the handout. In the Senate Finance version of the bill, the information regarding DNR sharing royalty information with DOR, and DOR sharing tax information with DNR, is the same as in the Governor's proposal.

Mr. Dickinson addressed "Statute of Limitations." The current bill states four years for statute of limitations. Senator Elton questioned if having four years puts more pressure on oil and tax auditors than six years, as provided for in other versions of the bill. Mr. Dickinson replied that if, after four years, the tax information has not been attained, there are three options. One is to let the statute of limitations expire, which is not a good option. The other choices are to assign an extension or to issue a "blue sky assessment".

[10:20:01 AM](#)

Mr. Dickinson moved on to "DOR Auditors" and the creation of new exempt positions of master auditors in DNR and DOR.

Mr. Dickinson discussed the "Effective Date" differences. He announced that there would be a technical amendment that would make the "unscheduled interruption" language retroactive to April 1, 2006. Senator Thomas questioned the 6-year versus 4-year statute of limitations, auditor increase, and the deletion of the penalty. He wondered if the increase in the number of auditors would be enough to speed up the auditing of returns. Mr. Dickinson replied that under the federal system the way to avoid the gross understatement penalty is to flag the issue. He agreed that Senator Thomas had correctly identified a way, in the first year of a new tax, that the taxpayer could meet obligations, but not over meet them. He predicted that there still would be issues.

[10:24:42 AM](#)

Mr. Dickinson moved to "Downstream Costs" on page 4. In the current bill, the language says that downstream costs are actual costs unless reasonable costs are lower. He opined that in "a tankering business" the state already looks at actual costs. He predicted that there would be a change in the Trans Alaska Pipeline System (TAPS) tariff. He summarized that the expectation is to lower actual and reasonable costs for both tankers and transportation.

In response to a request by Co-Chair Stedman, Mr. Dickinson defined TAPS, which is owned by BP, ConocoPhillips, and ExxonMobil. There are companies on the North Slope that don't have ownership of TAPS.

[10:29:29 AM](#)

Mr. Dickinson moved on to "Gas Ceilings thru 2002" on page 4. The current bill does not include the exception of Cook Inlet and gas used in the state. It does include an interaction between ceilings and credits that was not well delineated in the original regulation.

Senator Thomas asked what impact the pipeline tariff has on the state's royalty shares shipped through the pipeline. Mr. Dickinson explained that the change for how taxes are calculated will not have any effect on royalties. In response to a question by Senator Thomas, Mr. Dickinson replied that there would be no effect on the wellhead value.

Senator Thomas asked for information on the range between Cook Inlet gas and potential Prudhoe Bay gas. Mr. Dickinson said that the range would be large because Cook Inlet price has been below market price and moving toward a world market standard. The problem on the North Slope is that there is essentially no established market. The tax will affect gas sellers, but not gas purchasers. Typically, gas sales contracts include a reimbursement for the severance tax.

[10:35:40 AM](#)

Senator Huggins asked if the House Finance and the Senate Finance versions of the bill raise the tax on both gas and oil. Mr. Dickinson related that the tax and progressivity apply to both gas and oil in both versions. Senator Huggins expressed concern that gas is not being adequately addressed and that Alaskans have been misled.

Mr. Dickinson spoke to "Additional Penalties", which were in the House Finance version, but not in the Senate Finance version.

Mr. Dickinson reviewed "Intent "Language. The dollars that float from retroactivity will flow to the public education fund. Incremental dollars will go to other investments.

[10:39:21 AM](#)

Co-Chair Stedman referenced page 2, line 15, of the CS; a list of the public education fund, the budget reserve fund, unfunded liabilities of state employees, and the development and implementation of a long-range fiscal plan for the state. He noted that there is a substantial revenue change to the state with the implementation of the legislation. There is an opportunity for the legislature to move funds forward to help the state get to the point when there is a gas pipeline or "first gas." If a gas line does not move forward and become a reality, the Senate Finance Committee will be looking at long-term fiscal plan for the state. The intent of the funds is not to increase the size and the scope of the operating account of the state.

[10:41:38 AM](#)

Senator Elton referred to page 2, line 21, of the work draft, the areas to where the appropriations would be made. He stressed the importance of moving forward with a plan to use the funds from the gas and oil tax as intended in the bill and not to increase the size and scope of the operating budget. Senator Elton referenced page 2, line 21, regarding the development of a long-range fiscal plan. He opined that some of the revenue stream would be reserved "to implement, but not to develop" such a plan. Senator Stedman agreed.

[10:42:51 AM](#)

Mr. Dickinson discussed the administrative provisions in the bill. The monthly estimated payments language was changed to clarify ambiguities. There is a technical amendment to whistleblower provisions regarding bad faith.

Mr. Dickinson noted that a report to the legislature would be required in 2011. This provision was deleted in the House Finance version.

In response to a question by Senator Elton, Mr. Dickinson responded that in the Senate Finance version, the whistleblower language allows for a \$500,000 recovery.

[10:45:29 AM](#)

Senator Thomas questioned language in the progressivity section regarding the installment plan. Mr. Dickinson referenced page 14, section 21. On page 15, line 3, mentioned is made of the installment payment and it does not include progressivity. Page 17, line 5, states that any tax levied by AS 43.55.011(e)-(i) is due at the end of the year. Even though progressivity is calculated on a monthly basis in the bill, it retains the Governor's proposal that the payments are not due until March 31.

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[11:15:15 AM](#)

PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, commented on his disappointment regarding the fiscal terms in the bill. The Administration believes that the appropriate

base rate is 25 percent and the progressivity rate in the Senate Judiciary and House Finance versions of the bill is reasonable, when not including a robust floor. In looking at the comparison between the House Finance version and the Senate Finance version, there is a tradeoff of looking to get a higher share at substantially high prices, versus a fair share when looking at a long-term future. The crossover point of \$71 West Coast price is an example of a recent phenomenon. The Administration looks at the tax proposal as a long term solution to provide a reasonable share at the cost and price expectation for the next 25 years.

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Co-Chair Stedman questioned whether there was an analysis done on the base rate. Mr. Galvin responded that the analysis provided looked at a range of net values as well as gross tax rates. It showed that a move to a base rate of 25 percent provided a positive investment environment and did not have a negative impact in that the state could position itself in the price range that is within expectations, and balance the state's share with having an investment environment.

Co-Chair Stedman recalled testimony from the Administration's experts that they were not involved in the selection of the ACES combination of lowering progressivity and keeping the base at 25 percent. He questioned whether the Commissioner was not now advocating for ACES. Commissioner Galvin said he recognized that the votes were not there and so had to adapt to the direction the legislature was headed, recognizing that there was a balance to be had. The primary focus is the price/cost relationship and the appropriateness of a 25 percent rate.

Co-Chair Stedman noted that EconOne reviewed the Senate CS taking into consideration expected price ranges in the marketplace. He summarized that the price of oil is volatile at best. He recalled discussion of oil at \$40 per barrel. He asked if the Administration wants to set the price at that range.

Mr. Galvin replied that they were not advocating for setting the rates for \$40 per barrel. He explained that when the various versions of the bill are compared, the

issue is not a tradeoff between \$80 and \$40, but rather whether oil will fall below a \$71 price.

Co-Chair Hoffman commented that Alaskans don't relish the concept of higher prices. There needs to be a tax structure that anticipates the possibility of higher prices. The finance structure recognizes that. At \$100 per barrel the tax structure difference between the House version and the Senate version brings \$400 million into the state treasury. He agreed that the price of oil would be changing and the Senate version's tax structure anticipates higher prices, which makes more sense and provides protection from higher savings.

Commissioner Galvin commented on fair share and the question of retroactivity, which he maintained is a separate question. He discussed fair share in terms of the House version and of the Senate version. He felt comfortable with the House version, which does not include retroactivity.

Senator Huggins felt that Alaskans were being misled in terms of limiting the discussion to 22.5 versus 25 percent. He pointed out the economics of highly populated countries. He observed that futures markets are at \$80 a barrel. He questioned the durability of the bill. He noted that progressivity and other factors add to the debate.

[11:39:47 AM](#)

Co-Chair Stedman maintained that a fair share was inadequate in PPT and not supported by the Administration. He did feel that the current Administration's proposal represented a fair share. The fair share is up to \$2 billion at \$100 per barrel. There is little correlation at high oil prices between the fair share in ACES and in the legislature.

Mr. Galvin responded that the allocation of risk is at issue. Risk sharing is across the spectrum. The Administration's proposal was a derivative of more data, which was not available to the previous legislature. The previous legislature was also considering AGIA. The current proposal is based upon an analysis of the relationship between the state and the industry and the sharing of oil revenues. It points to the appropriateness of a 25 percent rate.

Co-Chair Stedman disagreed.

[11:43:52 AM](#)

Co-Chair Hoffman pointed out that the Administration's proposal is only 30 days old. He opined that the tax rate cannot be isolated and ought to take progressivity into consideration. He pointed out that Alaska's take increased by over 100 percent from the Administration's previous proposal. He questioned how supporting the House version relates to fair share.

[11:45:50 AM](#)

Mr. Galvin discussed the relationship between progressivity and the base rate. When the swing is down there is no progressivity. The question is whether the state can live with the floor. The legislature has changed the dialog. The Administration is comfortable with the floor.

Co-Chair Hoffman responded that the delta between the Administration's proposal at \$80 - \$100 is far greater than the delta between what the House or the Senate numbers are.

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[1:49:12 PM](#)

Commissioner Galvin returned to the issue of progressivity. Under the House Finance version, both the base rate and progressivity payments would be monthly; under the Senate Finance version base rate payments would be made monthly, but there would be an annual progressivity payment due on March 31.

Co-Chair Stedman noted that it was an oversight and would be corrected to monthly payments.

Commissioner Galvin spoke to the language differences related to allowable deductions for lease expenditures. One of the primary rules associated with ACES was to put the Department of Revenue in the position of having to define, through regulations, what are allowable lease expenditures as opposed to having it being open ended. The administration would prefer to return to the original ACES

language in this area as well as for joint interest billings. The purpose is to allow the department to use those joint interest billings as a tool to begin the auditing process and identify the appropriate costs, but not to bind the department in how they are to be used. He mentioned the flexibility of the ACES language.

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Commissioner Galvin highlighted the Transitional Investment Credits (TIE), whose purpose was to have parity between new explorers and existing incumbents. Under the House version, those companies that did not have any production yet could freeze the TIE credits earned and use them against future production. The Senate version changes that entirely to where, upon the effective date, expenditures that a new entrant has made during the PPT period would have no consequence. Only from the effective date forward would the explorers earn TIE credits on new investments. The intent of the Administration is to create equity. He requested a reinstatement of the language in the House version, which is the same as the House Judiciary version.

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Senator Elton asked what the net fiscal impact would be when comparing the old and new language. Commissioner Galvin replied that there is no difference. The goal is to have the same "deal" for both producers and explorers.

Commissioner Galvin addressed the exploration incentive program (EIC), which predated PPT. With PPT there was a 20 percent credit for all capital expenditures. The EIC provided either a 20 percent or a 40 percent credit depending on certain conditions. Because of the limited nature of the EIC program, given 20 percent for PPT or for EIC, there would be no reason to choose the EIC option. The ACES 30 percent credit for mid-range EIC's was dropped in the Senate Finance Committee Substitute. It is the Administration's opinion that 30 percent needs to be reinstated.

Commissioner Galvin discussed the language that was added on the House side as it relates to seismic data generated on private lands. There is a choice to be made by the party applying for the credit in that if they want to avail themselves of the credit, they must provide the state with

the seismic data. The question became how much of the data should be made public. The crafted language states that if the seismic data is shot on private lands, and the state is going to pay its share through the credit program, that data will be made available to the state, but it won't be made public without the consent of the private landowner. The Administration feels that that language should be reinstated.

Commissioner Galvin mentioned concern with the statute of limitations. Tax programs in the state have a 3-year statute of limitations. He stated support for a 6-year statute of limitations for production taxes due to the complexity of the tax. He felt a 4-year statute of limitations puts both the state and the taxpayer into a situation where a decision has to be made whether to go to a formal discussion, which could become confrontational. He assured the committee that the auditing process would continue to be productive in spite of the extended time period.

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Commissioner Galvin addressed the corrosion provisions which are going to be retroactive to April 1. He addressed concerns about in-state gas issues. During the special session, several interests requested that the Cook Inlet tax treatment apply to their potential projects. There were projects brought forward from other locations dealing with local gas and local areas. Commissioner Galvin maintained that production tax was not intended to address tax statewide. The resolution was to make it clear that those developing gas for instate purposes would get the same tax rate treatment as Cook Inlet. These are parity issues. He hoped that the Regulatory Commission of Alaska would be in alignment with the tax savings to be enjoyed by the consumer.

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Co-Chair Hoffman referenced parity. He reported that during the initial discussion of PPT, it was well known that the tax structure in Cook Inlet was well below the tax structure in other places and that resulted in gas being sold cheaper than in the lower 48 states. He said, "We would be at parity if the rest of the state was using gas, such as the Anchorage Bowl and now Fairbanks is currently

converting to that." He questioned the issue of parity when vast portions of Alaska are not using natural gas for consumption.

Commissioner Galvin agreed that there is not parity in the costs. The only focus of this provision is production tax that is applied to gas that is produced within the state. "We can't affect the cost of fuel oil that's arriving because it's not produced here, necessarily," he added.

Co-Chair Hoffman asked if there was assurance that those using gas would continue to have lower costs than Lower 48 states, but those not using gas would surpass Anchorage and all other states in cost. He wondered how all Alaskans could benefit. Commissioner Galvin responded that the cost of gas is based upon factors that are beyond the production tax. The Administration wants to insure that the imposed production tax does not provide a higher burden for some.

[2:06:41 PM](#)

Co-Chair Hoffman voiced concern about the policy associated with consumption of energy, whereby "the rich get richer and the poor get poorer." He asked if there was a way for all to win. Commissioner Galvin explained that the Administration does recognize the current high oil costs and higher energy costs for communities. It is the responsibility of the state to take that into account and find a way to buffer it.

Co-Chair Stedman added that access to economic benefits must be addressed when building the state gas system. The issue is huge.

Senator Thomas commented that the intention of the resolution was to add equity throughout the state. He summarized that the Cook Inlet rate was 5 percent and the effective rate at Prudhoe Bay would be 22.5 or 25 percent, depending on the version of the bill. Commissioner Galvin said that was the base rate, but there would also be progressivity at higher oil prices.

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Senator Thomas noted that there was gas currently sold at Prudhoe Bay. He questioned how that rate was determined. Commissioner Galvin replied that there is a prevailing

value that is set based upon regulations, which are currently being rewritten.

[2:10:42 PM](#)

Senator Elton inquired about additional penalties. Commissioner Galvin replied that penalties are an important tool to ensure that there is a disincentive for under reporting income or for overstating costs. There are criminal penalties for fraud. The Administration appreciates the desire of the legislature to create an additional disincentive for potential underpayment and for inclusion of provisions requiring recoument of costs associated with recovery.

Senator Elton suggested that Commissioner Galvin's answer was ambivalent. Commissioner Galvin stressed that they do not know what might happen regarding understating production tax. He acknowledged the skepticism around the issue.

[2:14:24 PM](#)

In response to a question by Senator Huggins, Commissioner Galvin spoke to "unscheduled interruption or reduction". He noted that the issue has been evolving throughout discussions of SB 80. The struggle has centered around determining what standards should be used for making sure deductions for improperly maintained equipment are not allowed. A bright line standard was identified and is included in the current version of the bill. Triggers occur with violations of criminal or AOGCC standards.

[2:20:41 PM](#)

BOB GEORGE, CONSULTANT, GAFFNEY, CLINE, AND ASSOCIATES INC., provided members with a power point presentation entitled "Government and Petroleum Tax Take" (copy on file). He compared government take in PPT, HB 2001, Senate Judiciary CS, and Senate Finance CS.

There is an underlying assumption of \$20 per barrel for this model. The Y axis represents percent of government take, less costs, and the X axis is oil price. The take in Norway and the UK are represented. UK has a 50 percent take for new fields. Legacy fields, those developed before 1983, have a higher take. Together, that amounts to 75

percent of profits. Norway has the highest take with two taxes, which amounts to 78 percent of profits. The graph shows that there is royalty take in all categories. It also shows production tax take and total government take.

In response to a question by Co-Chair Stedman, Mr. George reported that he used a flat \$20 cost in creating the slides.

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The red line in each of the slides represents the production tax. The blue line represents the total government take, which includes the take from royalty, the take from property tax, and the take from state/federal income tax.

Mr. George turned to the slide on government take as it relates to ACES, or HB 2001. It shows the base rate at 25 percent and a slight lowering of the progressivity.

Mr. George discussed the Senate Judiciary CS in terms of government take. It has a 25 percent base rate with a progressivity that increases at .4 percent for every dollar up until there is a total take of 50 percent.

The Senate Finance version has a 22.5 percent base rate and a sliding progressivity scale.

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Co-Chair Stedman spoke to "fair share." In response to a question by Co-Chair Stedman, Mr. George pointed out that the legislature would consider where the fair share line would be. Co-Chair Stedman asked if the Senate Judiciary version would have a similar shape to the blue line. Mr. George replied that it would. Co-Chair Stedman thought there would have to be a significant policy change to take the "belly" out. He questioned if a substantial overhaul would be needed.

Mr. George noted the difficulty of finding a suitable level. Co-Chair Stedman questioned if there were models used in the comparison. Mr. George said none were used.

Senator Thomas asked if the various credits are factored in. Mr. George observed that none were factored into this

chart. The UK does not have any uplift or credits. Norway has an uplift for some of the credits, but has not been included.

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Co-Chair Stedman inquired if Alaska modeled its legacy field with government take similar to UK and Norway, would the economy in Alaska be subjected to possible acceleration of volume declines in the pipeline, or would it stimulate production volume. Mr. George stressed that the specific proposals would have to be considered in order to answer that question. One of the facets of the structure of all of the proposed systems, with the progressivity feature included, is that while there may be a higher rate on legacy properties, it can, at the same time, help those fields by lowering the tax across the portfolio as a whole.

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Co-Chair Hoffman asked if costs would go up as prices continue to rise and if there is a model to show that. Mr. George explained that the projections could be changed to depict different relationships between price and cost.

[2:35:05 PM](#)

Senator Thomas asked for feedback on standard deductions. Mr. George could not respond to the request.

Senator Huggins inquired about the Zulu Fields, the marginal fields, and how the Senate Finance version of progressivity would affect them. Mr. George reviewed progressivity as investments were added, which would lower the effective tax rate on the investments below what they would attract as a stand alone investment. He reiterated a past presentation on progressivity.

Senator Huggins summarized that steeper progressivity equaled potentially enhancing marginal fields. Mr. George did not agree with that interpretation. He clarified that existing reservoirs begin with higher rates than the other three rate systems.

Senator Huggins wondered if, without PPT, the Senate Finance version would assist marginal fields better than the other two systems. Mr. George agreed.

RECESS: [2:39:58 PM](#)

RECONVENED: [2:46:01 PM](#)

Co-Chair Stedman explained that industry representatives had been contacted and would be given an opportunity to speak to the Senate Finance Committee regarding Version R of HB 2001. He observed that the industry would bear the brunt of a new tax adjustment.

KEVIN MITCHELL, VICE PRESIDENT, FINANCE AND ADMINISTRATION, CONOCOPHILLIPS, highlighted prior written comments from ConocoPhillips regarding HB 2001 which still stand. He maintained that the CS has serious concerns. Higher taxes will have an impact on investment. It is unrealistic to expect that an increase of this magnitude would not have an impact. He maintained that testimony given that increased taxes would not have an impact was misleading. He observed that the legislation has moved significantly away from the Governor's original proposal with a 25 percent base rate, with progressivity at .2, starting at \$30 profit per barrel. That proposal would have been effective January 1, 2008. The current version has the same base rate, but has a very steep progressivity rate with a retroactive effective date of July 1, 2007. He said he understood the desire to have a higher take at higher prices.

[2:53:16 PM](#)

Mr. Mitchell emphasized that the potential upside of higher oil prices is being removed. The retroactive application of tax law is almost universally seen as unfair. There should be some time to transition into the new tax structure. Under this proposal there would be two consecutive years of retroactive tax change, which reinforces concerns regarding the stability of the investment climate in Alaska. The retroactive component is a penalty.

[2:55:31 PM](#)

Mr. Mitchell spoke to the overall unfairness of the bill and hidden taxes. The proposal abolishes TIE credits, which were put in place to provide some measure of transition from ELF into PPT. Removing them hurts investors that have invested in the past and plan to

continue investing into the future. TIE credits soften the transition, and removing them results in another tax increase.

Capital credits can be taken at 100 percent in the year which they occurred under PPT. In the current version of the bill, they are split over two years which amounts to another form of tax increase because of the timing change.

Lease expenditures are subject to definition by the Department of Revenue through regulation. The CS allows the department to put in place allowable deductions through the regulatory process. It provides the opportunity for legitimate lease expenditures to be excluded, which is, in effect, another tax increase. The unscheduled maintenance provision language from the Governor's bill is back in the current CS. It disallows expenditures related to unscheduled maintenance.

Mr. Mitchell provided a graph on "Daily Kuparuk Production" that demonstrated the constant change in production over a 12-month period (copy on file.) He stressed the difficulty in administering the unscheduled maintenance provision. He felt that the House version was more workable. The Senate language would equate to another tax increase.

Mr. Mitchell spoke to transportation costs, which will add another layer of complexity and will likely result in another tax increase.

[3:00:21 PM](#)

Mr. Mitchell commented that the period of confidentiality on exploration well data was being reduced from ten years to two years. The receipt of the credit is conditional upon the receipt of the data. He argued that this is a disincentive. The Senate version gives the state access to non-state land, which is a potential conflict.

Mr. Mitchell maintained that credits alone will not get explorers to invest. The entire development scenario will be taken into consideration. If the revenue stream is subject to higher taxes, it would offset the value created by the credits.

[3:02:56 PM](#)

Mr. Mitchell reported that the House version of the bill contained a standard deduction for operating expenses for Prudhoe Bay and for Kuparuk. That standard deduction would be a disincentive to investing in new activity and new production. He explained the standard cost deduction.

Mr. Mitchell did not know how ConocoPhillips would be affected by the requirement that lease expenditures must be incurred in the state, but felt that it would be a disincentive.

He noted that all of the previously mentioned components of the bill have the impact of reducing allowable expenditures by about 5 percent and are equivalent to a one percent tax rate increase. He asserted that some of the changes would have staggering affects.

Mr. Mitchell concluded that the changes are moving in the direction of a hybrid tax system.

Mr. Mitchell discussed the penalty provisions for underpayment. He maintained that payments will be off without any deliberate intent due to the lack of clarity in the regulations.

[3:08:06 PM](#)

Mr. Mitchell summarized that the legislation is a huge tax increase at today's prices. It is not just about the base rate and the progressivity having an impact to the overall structure. It is the administrative complexity and difficulty of compliance which give grave causes for concern. The tax structure in Alaska has become more restrictive to investors.

Senator Olson asked if the legislation was a disincentive to offshore exploration activity. Mr. Mitchell noted that off-shore activity would not be subject to the legislation. He described the permitting difficulties associated with off-shore exploration.

[3:11:44 PM](#)

Co-Chair Stedman questioned how the impact of progressivity after capital/operating/shipping could be weighed. Mr. Mitchell acknowledged that the cost structure will move as prices move. An aggressive progressivity removes the

upside and causes the downside to be reevaluated. He acknowledged the state's role.

[3:14:56 PM](#)

In response to a question by Co-Chair Stedman, Mr. Mitchell discussed base tax versus progressivity. Mr. Mitchell said it depends on future prices that are difficult to pick.

[3:15:47 PM](#)

Senator Elton asked for clarity as to why investment decisions should change dramatically. PPT is higher than any of the alternatives. Given the expected tax bite of PPT, it is as if ConocoPhillips knew projections were wrong. Mr. Mitchell responded that cost assumptions were higher now. PPT is higher due to a much lower cost assumptions. With the different cost assumptions the projections seem better. He spoke to ConocoPhillips testimony regarding trends in the previous legislature.

[3:19:07 PM](#)

CLAIRE FITZPATRICK, SENIOR VICE PRESIDENT, COMMERCIAL, BRITISH PETROLEUM, ALASKA, addressed the Committee Substitute. She referred to the handout by Mr. Dickinson. Ms. Fitzpatrick asserted that there are "many, many hidden taxes" contained in the legislation. She expressed pleasure that the CS contained a 22.5 percent tax base, which removes one element of concern.

Ms. Fitzpatrick spoke to the steepness of the progressivity in the bill. She acknowledged the desire to use progressivity as a tool, but noted that adding progressivity would prevent investment.

[3:26:05 PM](#)

BERNARD HAJNY, PRODUCTION TAX AND ROYALTY MANAGER, BRITISH PETROLEUM, ALASKA, commented on investment credits spread over a two-year period creating a hidden tax. He spoke of administrating difficulties with such a time period. He asked the committee to re-evaluate the provision.

[3:28:04 PM](#)

Co-Chair Stedman asked for specific numbers on the hidden taxes. Mr. Hajny thought it would be over "tens of millions". Co-Chair Stedman guessed at \$150 million and Mr. Hajny said he would not be surprised at that figure.

Mr. Hajny talked about the TIE credits. He noted that two dollars for everyone dollar of fixed credit would need to be spent to reach that benefit. The credits expire in 2013 according to the current PPT formula. The Department of Revenue testified that the credits in 2006 were approximately \$114 million.

[3:31:59 PM](#)

Ms. Fitzpatrick added comments about removing the transition credits. It assumes a risk for all other available credits.

Ms. Fitzpatrick noted that BP does not do exploration, but she echoed and endorsed the remarks of Mr. Mitchell.

Ms. Fitzpatrick described allowable lease expenditures and unscheduled interruptions. She thought that it was nearly impossible to identify an unscheduled interruption, which is complicated to define and identify.

[3:34:50 PM](#)

Ms. Fitzpatrick said that a failure problem or event is not allowed and costs would prevent improvements that could occur at the same time. The question is should credits be given now or later. She concluded that it is a policy choice, but there is a financial impact.

Mr. Hajny discussed regulations for lease expenditures and information sharing.

TOM WILLIAMS, SENIOR TAX COUNSEL, BRITISH PETROLEUM, ALASKA, reported that current law defines lease expenditures in AS 43.55.165 and joint interest billing is found in subsections (c) and (d). Both areas say that the Department of Revenue "may authorize or require" the use of joint interest billing. He observed that Commissioner Galvin testified that he wants to be able to use joint interest billings as a tool. He discussed compliance. He remained concerned about unintended consequences related to

billed costs. He addressed discretion and the need to take care to establish clear intent.

3:40:26 PM

Mr. Hajny requested more information about the use of regulations to define lease expenditures. Mr. Williams referred to page 38, line 28, of version R. He said, "For purposes of this chapter, a producer's lease expenditures for a calendar year are cost, other than forbidden items under (e) of this section, that are (A) incurred by the producer during the calendar year after March 31, 2006, to explore for, develop, or produce oil or gas deposits in the state." He continued to explain (B), on page 39, line 6, "allowed by the department by regulation". He noted that the costs must be upstream, ordinary and necessary, and direct.

3:44:10 PM

Mr. Williams continued to describe direct costs on page 39. The definition of "ordinary and necessary" is found in subsection (j): "ordinary and necessary" has the meaning given in 26 U.S.C. 162 (Internal Revenue Code), as amended, and regulations adopted under that section. It is a term of art. He didn't think there was anything in these categories that the legislature intended to disallow. He suggested that this section not be rewritten by regulation. He questioned if the commissioner should be allowed to change those items that are currently not allowed as direct costs.

3:50:27 PM

Senator Elton pointed out that DOR cannot put anything in regulation that contravenes any of these three points. The Regulatory Review Committee would prevent that from happening. It should not be a problem, but if it is, DOR would be directed that the regulations were not supported by statute.

Mr. Williams described allowable costs and said that the commissioner's list would only exclude items.

Senator Elton assumed the list would be helpful to industry. Mr. Williams acknowledged that a list could be helpful and pointed to the Senate Judiciary version of the

bill where items are added to subsection (b). That context gives clarity.

[3:54:40 PM](#)

Mr. Hajny discussed sharing confidential information. He had concerns with information leaking and pointed to a \$1,000 a day penalty for something that might not be forthcoming. He questioned the definition of "not forthcoming".

Ms. Fitzpatrick touched on the sharing of information between departments. She requested confidentiality during that process.

Mr. Hajny added concern about the additional three years proposed in the statute of limitations.

[3:59:11 PM](#)

Mr. Hajny described concerns regarding pipeline transportation costs. In the event that there is a retroactive adjustment to the pipeline tariff, BP's liability would be affected. The CS creates uncertainty in this area. He described the most straight-forward approach which would continue to utilize the current TAPS Tariffs.

[4:01:23 PM](#)

Ms. Fitzpatrick brought up the issue of retroactivity and the concerns she has regarding the inconsistencies. She questioned whether this type of provision would incentivize investment. She further commented on cost increases. She said that the costs will go up with the price of oil. In addition, she noted the high costs of extracting heavy oil and that many of those costs would be done out of state because the technology is not available in the state. She addressed penalties, which she felt was just an additional tax as there is never 100 percent accuracy in tax returns. With a 400 percent tax increase, investment is highly unlikely. She said her company put a plan together to provide sustainability in the future but many of things in the plan will not be possible.

[4:07:22 PM](#)

Co-Chair Steadman asked if there is anything that would stimulate production. Ms. Fitzpatrick said perhaps some of the exploration credits.

Co-Chair Steadman asked Ms. Fitzpatrick which of the combinations of the lower/higher base and lower/higher progressivity is the most palatable to British Petroleum.

Ms. Fitzpatrick made a comment equating both the base tax and progressivity as important ingredients.

Senator Hoffman asked if standard deductions were removed from heavy oil, would projects fall off as a result.

Ms. Fitzpatrick said she could not give definitives as she would have to plug all variables into her business plan. She noted that the standard cost acts as a cap or a gross floor.

[4:10:51 PM](#)

CRAIG HAYMES, PRODUCTION MANAGER, EXXONMOBIL, ALASKA, (TESTIFIED VIA TELECONFERENCE). He read from written testimony regarding ExxonMobil's views on the Administration's proposed tax increase (copy on file.) He related that ExxonMobil believes that the proposed increase will not result in additional investment needed to maximize the development of Alaska's resources. Taking into consideration Alaska's resource potential and the current production decline, ExxonMobil does not support the proposed tax increase and will need to re-assess all current and future projects in Alaska. In addition to the significant increase in base and progressivity aspects of the proposed tax bill, there is also significant uncertainty in allowable cost recoveries and credits. This uncertainty combined with another tax increase will significantly reduce the attractiveness of future projects in Alaska.

Mr. Haymes predicted that at today's prices, since 2005, there would be a 580 percent increase in production tax within three year.

Mr. Haymes pointed out that Alaska has significant undiscovered resources. He said that ExxonMobil is pleased to see that the Senate Finance CS does not increase the base tax rate beyond 22.5 percent. He reported that oil

production is declining and Alaska's world ranking has declined from 14th to 30th. Increasing the base tax rate and progressivity will not help attract investments. He urged the committee not to adopt Section 17 of the bill.

[4:15:45 PM](#)

Mr. Haymes addressed Alaska's future oil production. He maintained that Section 24 limits to 50 percent the amount of a tax credit that may be claimed in a single calendar year. He did not see how reducing the 20 percent tax credit would increase the capital investments necessary to mitigate Alaska's oil decline.

Mr. Haymes drew attention to the DOR North Slope Production Forecast and described the declining revenue forecast. He thought that between \$30 to \$40 million in investments would be needed in the next ten years to achieve DOR's forecast. The impact on all economic parameters must be weighed before a decision to invest is made. Investment tax credits enhance the present value economics of new investments and help alleviate a project's otherwise high cost. The tax rate and investment tax credit levels must be carefully balanced.

[4:18:42 PM](#)

Mr. Haymes discussed Section 28, line 12, of page 21, which proposed to eliminate the availability of tax credits for capital expenditures incurred during the five years immediately preceding the enactment of PPT for producers with existing production. He described ExxonMobil's position on the transition provision and suggested that the committee reinstate the transition credits originally intended by the legislature to mitigate the impacts of converting to PPT.

[4:20:01 PM](#)

Mr. Haymes pointed out that Alaska has large oil fields. He reported that ExxonMobil was pleased to see Section 50 removed from the bill. Mr. Haymes opined that it is unfair for industry to be held to a 3 percent benchmark versus actual costs. This proposed limitation denies true recovery of costs to operate fields.

Mr. Haymes emphasized that fiscal predictability is important. The chart on page 7 shows that the proposed tax increases are significant.

Mr. Haymes said that all provisions in the CS amount to tax increases, cause greater uncertainty, and are excessive.

He addressed page 8 of the handout, additional reporting requirements for exploration tax credits, which ExxonMobil is opposed to. The confidentiality provisions in the bill are also of serious concern.

[4:25:13 PM](#)

DAN SECKERS, TAX COUNSEL, EXXONMOBIL, reported that he was happy to see the substantial penalties removed from the bill. Regarding information requests, he said it is troubling to see the legislature try to craft broad tax statutes. He addressed page 30, section 41, line 8, where DOR requests information every month. He objected to the request for other records and information the department considers necessary.

[4:27:56 PM](#)

Mr. Seckers addressed the production of taxpayer information. He voiced two concerns. He spoke against the proposal that taxpayers with at least 100,000 barrels a day production must report their gross sales revenues and expenses. He testified against a four-year statute of limitations. He reported that the statute of limitation in federal law is three years. There are exceptions to six years, but three is standard.

Mr. Seckers addressed paragraph 6 of Section 52, line 26, page 41, which disallows costs from non-compliance. He questioned why the state should draft tax policy. Contracts have specified remedies. He discussed the disallowance for scheduled maintenance. He agreed with the previous testimony on regulations by Mr. Williams. Mr. Seckers echoed concerns regarding what will be allowable under regulations. He pointed out that regulations change all the time without legislative approval.

[4:35:32 PM](#)

Mr. Haymes concluded that ExxonMobil does not support the proposed changes and questioned what would be allowed for cost recovery and credits. Current and future projects would be uncertain. Alaska needs a long-term resource development policy.

[4:37:52 PM](#)

Senator Elton referred to the graph comparing the various tax increase proposals. He thought that it was not helpful because it does not refer to the "sweet spot", but rather to the price of oil today. He requested information about industry profits at current prices in order to determine the issue of fair share. He question the 580 percent increase in taxes and wanted to know if that is a tax increase for ExxonMobil, a blended rate, or something else. He understood that the more profits exported from the state, the higher the tax.

Mr. Haymes responded that the graph is based on DOR's four-year 2008 production forecast. It includes CAPEX and OPEX spending, is representative to the industry, and the estimate is conservative.

[4:41:59 PM](#)

In response to a question by Senator Elton, Mr. Haymes explained that ExxonMobil is involved in all Prudhoe Bay activities. They have invested over \$20 billion in Alaska and are active investors in Alaska.

Senator Elton asked about reinvestment. Mr. Haymes reported that they invest as actively as any company in Alaska.

Senator Thomas asked if the 580 percent increase is based on the entire field. Mr. Haymes confirmed that. The graph came from the Department of Revenue's current 2008 CAPEX/OPEX numbers and reflects the entire industry.

[4:47:19 PM](#)

Senator Thomas asked what the total net revenue is. Mr. Haymes replied that the graph depicts a 44 percent net tax rate based on the Department of Revenue's model; for PPT the effective net tax rate would be 29 percent. He concluded that it is a significant increase.

[4:48:45 PM](#)

Senator Thomas asked if it is a little less than half of what would be \$16 billion of revenue "if we ran the chart up". Mr. Haymes reported that he had not done a government take analysis. He summarized that PPT was around 61-62 percent of government take; ACES increased to about 68-70 percent, heading toward 75 - 80 percent.

Co-Chair Stedman referenced a similar table from EconOne.

AT EASE: [4:51:02 PM](#)

RECONVENE: [5:39:32 PM](#)

Senator Steadman noted he had invited Chevron earlier but they were not available. He wanted to provide the courtesy to them to address the CS.

JOHN ZAGER, GENERAL MANAGER, CHEVRON-ALASKA, (TESTIFIED VIA TELECONFERENCE). He outlined his concerns as follows: the latest revisions regarding progressivity are a considerable adjustment to what was originally fair and equitable in ACES.

He referenced the EconOne chart, "Total Revenue Under Various Scenarios", and noted a \$1.5 billion difference between the original progressivity and the latest figures in the Senate Finance CS. He said the underlying assumption in the graph is that taxes do not affect investment, and therefore, do not affect production. He shared calculations needed to maintain the 6 percent decline and to shift the decline to 8 percent. He looked at the effects five years and ten years forward. He suspected that if one looked at the curve and how it affects investment, things could change significantly.

Mr. Zager pointed out that when the legislation moved from ACES progressivity to the more aggressive progressivity, part of the rationale was the removal of the gross floor; however, taking the floor out had an effect. Referencing the EconOne numbers, he noted that the gross floor provided \$200 to \$300 million of downside protection to the state. He thought that removing the gross floor may equate with increasing the progressivity from .2 to .25.

Mr. Zager reported that according to EconOne calculations, at the price range of \$80 - \$90, today's government take is about 73 percent. He said that incremental government take is about 85 percent. He felt that progressivity is valuable and should lead to more stability and more durable fiscal terms.

Mr. Zager felt that it was important to look at what motivates investment. He cited the Gulf of Mexico, according to the Wood Mackenzie Study, where large fields, at \$50 a barrel, have a government take of 47 percent. He reported that at \$45, the government take is 45 percent. With increased prices the government take is less.

Mr. Zager warned of unintended consequences. He further noted concerns about progressivity based on nominal dollars, not real numbers.

In addition, he touched on TIE credits; he felt that it was not fair to change the rules midstream. He found the "corrosion language" unworkable. He discussed language issues regarding "unscheduled events" and he cited examples of unscheduled events such as pumps that eventually fail and then are replaced. He suggested returning to the House Resources version of the bill for "bad intent language" and "criminal negligence" provisions.

He expounded on retroactivity: it is normal when tax law changes.

He concluded that the industry provides the largest source of jobs for the private sector. He went on to say that it is not only the monetary value to the state that is at stake.

[5:54:14 PM](#)

Senator Gene Therriault, Representative Mark Neuman, and Representative Mike Kelly joined the meeting.

Co-Chair Steadman agreed with the tradeoff of the removal of the gross floor and inserting progressivity. Mr. Zager agreed that it is not an equal tradeoff.

Mr. Zager noted that Norway has the highest tax rate in the world and should not be Alaska's benchmark.

5:56:18 PM

Senator Dyson asked for more information regarding trigger points. Mr. Zager said that the value of the trigger point will erode and he noted that costs in the oil industry wouldn't be tracking the Consumer Price Index. Mr. Zager said that the cost of goods and services is calculated in the net. He posed a scenario that when barrels are at \$120, the profits to the business get smaller at the \$30 trigger point.

5:59:15 PM

PAT FOLEY, LAND AND EXTERNAL AFFAIRS MANAGER, PIONEER, reminded the committee that many of the concerns that the big companies have, the smaller companies also have. He noted the various projects that his company is involved in, including involvement with Anadarko. He noted that his company has behaved as a model new investor. He outlined concerns regarding the tipping of the tax scale. He reiterated that the consultants said the raising of taxes will not affect investment. The industry says it will.

Mr. Foley related that the legislature has considered a tax based on gross, not net. He stated opposition to that idea.

Mr. Foley reported that during the past winter, Pioneer had over 650 employees on the Slope. He said there were thousands of employees in Oooguruk. He thought the message of those employees would be to please be careful not to jeopardize jobs.

Mr. Foley noted that there is no progressivity feature in other states in which Pioneer does business. The effect of the progressivity feature is that the company would prefer to do business elsewhere when prices are high because it does not have that feature. He did note that Alaska has the advantage of having large amounts of oil. The disadvantage is the amount needed for investment. He noted that Oooguruk is unique, as it is based on net profit share leases, and the government take is 80 percent or more. They have made an appeal to the Governor and legislature regarding this concern. It is the understanding, as a result, that the lease payments can be deducted from the production taxes. He expressed appreciation to the

Governor's office and requested the committee to retain this provision.

Mr. Foley reported that Pioneer spent \$100 million during the window when transitional investment credits could be earned, and has spent roughly \$200 million since the inception of PPT. They, in good faith, followed all the provisions. Under the current CS they could not use the last two years of investment. He noted that in the House version, the company could enjoy the credits and he stated support for that language.

[6:10:32 PM](#)

Mr. Foley asked the committee to adopt the language regarding the EIC, changing the 20 percent to 30 percent. He further noted that the Senate bill describes all data that must be given to the state and includes all derivative work products. He asked that the EIC version from the House be placed in the Senate version.

He discussed splitting the credits, one half in one year and one half in the next. From the perspective of Pioneer, it just reduces the credits. He requested that the credits be available to be used in the same year.

The House version says it applies only to gas. In the Senate version it applies to both oil and gas. Mr. Foley interpreted this to mean that the \$12 million small company exemption could be used only on the North Slope and would not be allocated to also include an oil property in the Cook Inlet. He voiced concerned with the change offsetting profits.

Mr. Foley discussed the loss carry forward percentage. He noted that the Senate version matched the House version and said that this was agreeable to Pioneer.

[6:16:59 PM](#)

MARK HANLEY, MANAGER, PUBLIC AFFAIRS, ANADARKO-ALASKA, outlined specific concerns.

[6:18:33 PM](#)

He said that many provisions in the bill are a tax increase, whether it is through credits, progressivity, or TIE credits. He underlined that these provisions have an impact on company costs and profits.

He went on to say Anadarko supports the language in the House Finance version giving the Cook Inlet tax rate to all players and he noted that this provision is also in the Senate Judiciary version. He explained that this provision helps keep the tariffs down, which enables more volume and lower transportation costs.

He said that Anadarko does not support retroactivity.

He noted that the EIC language that came over from the House was a consolidation of concerns and he encouraged the committee to adopt that language.

With regards to penalties, he said if the intent is to apply 10 percent or ten million, it's the lesser of the two. This is a concern as the companies do not even have the regulations in place. He further noted that the effective date should be a year after the regulations are adopted so companies can consider all costs.

He addressed the lease cost issue and noted the various concerns in the language regarding allowable lease costs. He questioned the intent of limiting costs to in state. He noted that under EIC the state intends to get seismic data and requires the companies to provide this. He noted a concern that no one does seismic data calculations in Alaska, so the cost incurred for that would not be allowable.

[6:30:01 PM](#)

Mr. Hanley went back to the question regarding which tax scenario would be more palatable. Mr. Hanley referenced a chart he made noting the curve of the progressivity. The range in which they are making decisions are made on an average price, rather than the current actuals. An increase in progressivity increases costs.

AT EASE: [6:33:50 PM](#)
RECONVENE: [9:22:17 PM](#)

Co-Chair Hoffman MOVED to ADOPT Amendment 1, labeled 25-GH0014\R.14, Chenoweth/Bullock, 11/14/07. He OBJECTED in order to reference a handout entitled "Increases in Total State Revenue under Various Production Tax Systems" which indicates changes to the rate. (Copy on File)

Co-Chair Hoffman explained that the amendment changes the base tax rate from 22.5 percent to 25 percent and changes the progressivity rate from .6 percent to .4 percent and follows the House progressivity rate with the exception that at the tail end it goes back up. At \$90 it levels out at 1 percent with a 50 percent overall cap.

Co-Chair Hoffman pointed out that the brown line on the chart represents the Senate Finance Committee's version of the tax system. The green line is the new line depicting Amendment 1.

Co-Chair Hoffman withdrew his OBJECTION.

There being NO OBJECTION, Amendment 1 was adopted.

[9:24:36 PM](#)

Co-Chair Hoffman MOVED to ADOPT Amendment 2, labeled 25-GH0014\R.22, Luckhaupt/Bullock, 11/14/07, and OBJECTED for discussion purposes. The amendment says that collection of the progressive tax payments is due on a monthly basis instead of on an annual basis. Co-Chair Hoffman removed his objection.

There being NO OBJECTION, Amendment 2 was adopted.

[9:25:02 PM](#)

Co-Chair Hoffman MOVED to ADOPT Amendment 3, labeled 25-GH0014\R.23, Cook/Bullock, 11/14/07, and OBJECTED for discussion purposes. On pages 38 and 39 of the bill there was testimony by the industry that there were serious problems with all of the work on PPT that gave definition to expenditures. In the bill there was language that allowed the department to adopt those expenditures by regulation. This amendment would remove that provision and the status quo found in PPT would remain.

Senator Elton OBJECTED for a question. He wondered if the amendment reverts the provision to PPT and not to the Governor's original bill. Co-Chair Hoffman deferred to Mr. Dickinson.

Mr. Dickinson explained the intent of the amendment which was in agreement with the comments of Senator Elton.

Senator Elton WITHDREW his OBJECTION.

Senator Dyson OBJECTED.

AT EASE: [9:28:09 PM](#)

RECONVENE: [9:28:41 PM](#)

Senator Dyson spoke to the OBJECTION. He requested that the Administration speak to the amendment.

Commissioner Galvin addressed Amendment 3. He stated that it would undermine a fundamental part of ACES, which is to provide the state with the ability to determine what an allowable expense is. The existing PPT states that if the expense is directly related to exploration production and is ordinary and necessary, it is deductible. Under ACES one of the requirements was to have clear rules to establish what is deductible. Amendment 3 deletes that provision. He stated that the Administration strongly opposes Amendment 3.

Co-Chair Hoffman pointed out that the legislature has spent many hours addressing the concern and is proud of the work done on this legislation.

[9:31:36 PM](#)

Senator Dyson MAINTAINED his OBJECTION. He pointed out that the Administration has put together a team to work on this issue.

A roll call vote was taken on the motion.

IN FAVOR: Elton, Huggins, Olson, Thomas, Hoffman, Stedman
OPPOSED: Dyson

The MOTION PASSED (6-1).

There being NO further OBJECTION, Amendment 3 was adopted.

[9:32:43 PM](#)

Co-Chair Hoffman MOVED to ADOPT Amendment 4, labeled 25-GH0014\R.17, Kane/Bullock, 11/14/07. He OBJECTED for the purpose of an explanation. Co-Chair Hoffman recalled a reference to spending a percentage of the money saved with progressivity on statewide energy needs of Alaskans to assist with rising energy costs. That is the purpose of Amendment 4.

Senator Dyson OBJECTED in order to hear testimony from the Administration.

Commissioner Galvin commented that the Administration recognizes the need for excess revenue to be spent on rising energy costs. He spoke in favor of the amendment.

Senator Dyson WITHDREW his OBJECTION.

There being NO OBJECTION, Amendment 4 was adopted.

[9:34:27 PM](#)

Senator Olson MOVED to ADOPT Amendment 5, 25-Gh0014\R.15, Kane/Bullock, 11/14/07, and OBJECTED for further testimony. He explained that the amendment changes the near field explorer tax credit from 20 to 30 percent. He reported that the Administration is in favor of the amendment, as are "people on the Arctic Slope". He WITHDREW his OBJECTION.

There being NO OBJECTION, Amendment 5 was adopted.

[9:35:08 PM](#)

Senator Olson MOVED to ADOPT Amendment 6, labeled 25-GH0014\R.13, Cook/Bullock, 11/14/07. He OBJECTED for comment. He explained that the amendment has to do with exploration information confidentiality and allows seismic and geophysical information to be held in a confidential manner, especially on private lands. Private land owners on the North Slope have been pushing for this to happen. Senator Olson WITHDREW his OBJECTION.

There being NO OBJECTION, Amendment 6 was adopted.

9:36:09 PM

Co-Chair Hoffman MOVED to ADOPT Amendment 7, labeled 25-GH0014\R.19, Chenoweth/Bullock, 11/14/07. He OBJECTED for further explanation.

Mr. Dickinson explained that there are two places in the bill that refer to credits - AS 43.55.023 and AS.55.025. Both have a list of "bad acts". If costs arose from those bad acts, they would not qualify for the credits. The lists were different and the amendment conforms that language.

AT EASE: 9:37:39 PM
RECONVENE: 9:39:14 PM

Mr. Dickinson noted that the first part of the amendment, on page 23, sets the costs for the .025 credits, the exploration credits. On page 41, the same standards are set for allowable lease expenditures.

Co-Chair Hoffman WITHDREW his OBJECTION.

There being NO OBJECTION, Amendment 7 was adopted.

9:40:05 PM

Co-Chair Hoffman MOVED to ADOPT Amendment 8, labeled 25-GH0014\R.21, Cook, 11/14/07. Co-Chair Hoffman OBJECTED for discussion purposes.

Mr. Dickinson explained that the amendment deals with AS 43.55.024(a) credits, which are small producer credits of \$12 million each, and new area development credits, "middle earth", which qualify for an additional \$6 million. These credits are non-transferrable and non-saleable and, as in ACES, no credits are allowed against the floor.

Co-Chair Hoffman WITHDREW his OBJECTION.

There being NO further OBJECTION, Amendment 8 was adopted.

9:41:46 PM

Co-Chair Hoffman MOVED to ADOPT Amendment 9, labeled 25-GH0014\R.24, Cook/Bullock, 11/14/07. He OBJECTED for the purpose of discussion.

Mr. Dickinson explained that the language deleted in the amendment was not needed in the Governor's proposal for a floor. It removes the requirement that credits move from the legacy fields to fields like Endicott, Milne Point, or other North Slope fields.

Co-Chair Hoffman WITHDREW his OBJECTION. There being NO OBJECTION, Amendment 9 was adopted.

[9:43:27 PM](#)

Senator Elton MOVED to ADOPT Amendment 10, labeled 25-GH0014\R.8, Cook/Bullock, 11/14/07, and OBJECTED in order to provide a short explanation. Senator Elton informed the committee that the amendment addresses an issue regarding municipal entities, which was not clear in the original bill. It brings clarity to the liability for production taxes of municipal entities that are producers of gas or oil. Under the amendment, and consistent with a Supreme Court ruling, municipal entities are not liable for taxes and surcharges, nor eligible for credits for production of oil or gas used in house. Also, under this amendment, municipal entities are liable for taxes and eligible for credits for production of oil and gas that is sold to another party, just as any other producer would be.

Senator Elton reported that Anchorage has been working with the Administration on this matter. He termed the amendment an "artful solution to the original bill." Senator Elton WITHDREW his OBJECTION.

Co-Chair Stedman OBJECTED. Senator Dyson thanked Senator Elton for bringing forward the change. He noted that it was important to his district.

Co-Chair Stedman MAINTAINED his OBJECTION.

Senator Huggins requested testimony from the Administration.

[9:45:25 PM](#)

Commissioner Galvin explained that the original language excluded those entities that exempt from the production tax the production tax credit. He cited an example of an entity that was selling some product under a contract that

required it to make a production tax payment. The amendment will allow that entity to enjoy the credits.

Co-Chair Stedman WITHDREW his OBJECTION to Amendment 10.

There being NO further OBJECTION Amendment 10 was adopted.

[9:46:17 PM](#)

Senator Elton MOVED to ADOPT Amendment 11, labeled 25-GH0014\R.6, Mischel/Bullock, 11/13/07, and then OBJECTED in order to provide a short explanation. He explained that the amendment deals with the issue of exempt auditors. The bill provides for four exempt auditors in the Department of Revenue and two exempt audit masters in the Department of Natural Resources. The issue has always been what happens to this very special group. The amendment sunsets the six exempt auditors and provides an opportunity to make a decision on December 31, 2011, on the best approach for the state. He pointed out that this is not the only audit provision in the bill. There is also a provision that provides for contract auditors. He suggested that the Department of Revenue testify in response to Amendment 11.

Senator Elton WITHDREW his OBJECTION.

Commissioner Galvin objected strongly to Amendment 11. He stated that the purpose of creating the exempt positions is to allow the department to attract highly experienced auditors. He predicted that it would be difficult to provide incentive to attract auditors if the position is for only three years. He emphasized that Amendment 11 would undermine the whole purpose for having exempt positions. He stated that requesting only a few exempt positions was already a compromise.

[9:49:29 PM](#)

Senator Elton voiced appreciation for those concerns. He suggested that creating a new job class would make recruitment easier.

Senator Dyson OBJECTED. He thought that the auditor positions would be very high level positions and would not need protection. He reflected on the Administration's strong need for highly qualified auditors and his willingness to accommodate the Administration's request.

A roll call vote was taken on the motion.

IN FAVOR: Elton, Stedman, Olson, Thomas, Hoffman, Huggins
OPPOSED: Dyson

The MOTION PASSED (6-1).

There being NO further OBJECTION, Amendment 11 was adopted.

9:51:26 PM

Co-Chair Hoffman MOVED to ADOPT Amendment 12, labeled 25-GH0014\R.18, Bullock, 11/14/07. He OBJECTED for comment.

Mr. Dickinson explained the technical changes. The first change on page 15, lines 4 and 8, removes a superfluous reference to the tax on private leasehold interests. The second change on page 34, following line 17, is new language, which is an addition to the whistleblower language, and was adopted on the House floor. It further clarifies what comprises a whistleblower situation.

Mr. Dickinson explained the third change found on pages 47-50 of the bill. It deals with the complications of making the changes to AS 43.55.165.(e)(19) related to unscheduled interruptions. Those items which cannot be included in costs are being made retroactive to the passage of PPT. Most of the language is in the uncodified section of the law making sure that when the changes become retroactive, the taxpayer is able to catch up.

9:54:29 PM

Co-Chair Hoffman WITHDREW his OBJECTION.

There being NO further OBJECTION, Amendment 12 was adopted.

Co-Chair Hoffman MOVED to REPORT SCS CSHB 2001 (FIN), as amended, out of committee with individual recommendations and updated fiscal notes.

Co-Chair Stedman commented on the hard work done by the Senate Finance Committee. He thanked the committee and staff for all their hard work.

Senator Dyson voiced his appreciation of the work done on the bill.

SCS CSHB 2001 (FIN) was reported out of committee with a "no recommendation" and with zero fiscal note 1 by the Department of Administration, new fiscal note 9 by the Department of Revenue, new fiscal note 10 by the Department of Revenue, and new fiscal note 11 by the Department of Natural Resources.

ADJOURNMENT

The meeting was adjourned at 9:56 P.M.