

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

January 19, 2008

11:04 a.m.

MEMBERS PRESENT

Senator Charlie Huggins, Chair
Senator Lyda Green
Senator Gary Stevens
Senator Bill Wielechowski
Senator Thomas Wagoner

MEMBERS ABSENT

Senator Bert Stedman, Vice Chair
Senator Lesil McGuire

OTHER LEGISLATORS PRESENT

Senator Fred Dyson
Senator Joe Thomas
Senator Johnny Ellis
Senator Hollis French
Senator Gene Therriault
Representative Mike Hawker
Representative Beth Kerttula
Representative Paul Seaton

COMMITTEE CALENDAR

Alaska's Gas: How Our Current Fiscal Policies Stack Up

PREVIOUS COMMITTEE ACTION

No previous action to report

WITNESS REGISTER

MARCIA DAVIS, Deputy Commissioner
Department of Revenue (DOR)
Anchorage, AK

POSITION STATEMENT: Discussed oil and gas fiscal issues.

MICHAEL WILLIAMS, Chief Economist
Department of Revenue (DOR)
Anchorage, AK

POSITION STATEMENT: Discussed oil and gas fiscal issues.

KEVIN BANKS, Acting Director
Division of Oil and Gas
Department of Natural Resources (DNR)
Anchorage, AK

POSITION STATEMENT: Discussed oil and gas fiscal issues.

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Resources Standing Committee meeting to order at [11:04 AM](#). Senators Wielechowski, Wagoner, Green, Stevens, and Huggins were present at the call to order. Representatives Kerttula, Hawker and Seaton and Senators Dyson, Thomas, Ellis, French, and Therriault were also present.

Alaska's Gas: How Our Current Fiscal Policies Stack Up: North American and International Regimes

CHAIR HUGGINS said discussion today will be the first chapter of setting Alaska's new tax regime for gas. The goals are to educate everyone on where gas taxes are headed and to set a window of when gas tax will be addressed, if necessary.

[11:06:37 AM](#)

MARCIA DAVIS, Deputy Commissioner, Department of Revenue (DOR), said there will be a lot of information coming from AGIA licensing and "any other types of information you solicit as alternates." She referred to a March, 2007, letter from Senator Huggins, which presaged many "crux issues" that are now in focus. At the time of the letter, AGIA was under consideration and the issue was locking in a gas tax during open season. Concern was expressed about taking care of gas taxes now. The recommendation was to push ahead with a tax system that focused on oil, knowing the gas component may need to be retooled. The letter also considered whether Alaska was competitive. Alaska doesn't want a fiscal system that impairs a gas line, she said.

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MS. DAVIS said oil and gas are treated the same under the PPT [profit-based petroleum production tax of 2006], because it wasn't clear during ACES [Alaska's Clear and Equitable Share] deliberations if taxes were going be gross or net. Should the taxes be dealt with the same way? ACES continues to treat oil and gas taxes the same, because "we did park the issue of gas taxation during the debate."

CHAIR HUGGINS asked the current tax rate for gas, and if that was raised during the special session.

MS. DAVIS said the base tax is 25 percent.

CHAIR HUGGINS asked if that was raised during the last special session. Many people have asked him why the gas tax was raised, and he cannot answer that.

MS. DAVIS said it was 22.5 percent in the PPT.

11:11:06 AM

MS. DAVIS said oil taxes were raised and gas taxes were not really considered. In order to have a refined tax that incentivizes production and is fair, "we needed to know more about what that gas project was going to be." An LNG project might have different features than an overland pipe project, for example. There are different economic drivers for different projects. The legislature has a strong desire for economic stability, so when the state is ready, the gas tax should be done right and then locked in. The time is now approaching - "we are at the beginning of the vortex." There wasn't a decision to increase gas taxes during ACES but to raise oil taxes and defer gas taxes until it could be done correctly and permanently.

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CHAIR HUGGINS noted that gas taxes were raised. He asked if there was a discussion to disconnect the two.

MS. DAVIS said yes, and separate economic analyses were done before ACES was even drafted. There is research on hand, but at the time no one knew if there would be a net or a gross tax. We ended up with a net system, where it is very challenging to make a distinction between gas and oil tax rates or progressivity formulas. There would need to be two separate calculations, and the costs must be allocated to each product. There are fields with both gas and oil, making it a huge auditing challenge. The goal was to not deal with that if it can be avoided. There are many reasons why the tax rates weren't segregated, she said.

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CHAIR HUGGINS said the state received multiple applications for the gas pipeline and only one conformed.

MS. DAVIS said yes, but one is under reconsideration.

CHAIR HUGGINS asked if the lack of fiscal certainty had a bearing on the applications.

MS. DAVIS said she has been fully engaged with ACES, but she is not sitting on the team that did that analysis.

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SENATOR WIELECHOWSKI asked when the administration wants to make the change in gas taxes. He asked her to address what the public is hearing from ConocoPhillips about working out a tax structure for the next 20 to 25 years. Is that the best course for the state to take, and should it be done administratively or through the legislature?

MS. DAVIS said beginning the gas tax discussion here is not inappropriate. The gas tax is going to be locked in at open season for ten years if that's what that taxpayer wants, but the provision allows the company an option to accept a change. It doesn't restrict the state from making further refinements to the tax, but it affects how a producer would analyze an open season, and it is important to have the best tax structure at that time. The system needs to be well thought out and put in place by then. The one qualifying bidder had hope of an open season in 18 months. That bidder may or may not be the licensee, so to do the tax now would be premature. The state needs to get through this session to decide what the gas pipeline goal and structure is and then dive into the information and decide on the optimum structure for gas and get it in place by the next session. That is ideal. She said she feels hamstrung right now to provide the committee with the necessary information to arrive at the wisest choice for a gas tax because of not knowing if it will involve LNG or gas overland or what the in-state component is, and there are a lot of pieces. "I really do feel strongly that we need to honor the principle that we give stability and certainty to the industry." It needs to be done right and then left alone.

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MS. DAVIS said she has not been in the group analyzing ConocoPhillips' bid. We have a gas tax and we are talking about making changes, but she does not know what kind of certainty that ConocoPhillips is asking for. During passage of AGIA [Alaska Gasline Inducement Act] there was discussion about the ability of one legislature to lock in taxation for later legislatures. During negotiations on stranded gas, fiscal certainty had a price tag of about \$3 billion. There are many

things that ConocoPhillips could mean by fiscal certainty. She noted that BP and Exxon need to be involved.

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CHAIR HUGGINS said some people say he is working for the producers, but his "innate feeling is that whomever is going to build the gas pipeline is the biggest beneficiary to setting the tax regime in Alaska, because it starts some certainty factors when they're trying to get the financing and to get commitments for gas, otherwise it creates a major uncertainty for them."

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MS. DAVIS said stability aids all players in the marketplace. Under ACES, -- notwithstanding that the tax went from 22.5 to 25 percent -- the progressivity creates a huge incentive for gas owners to sell their gas at the same time they sell their oil. Your starting point will be to assess where things stand and then decide if it is sufficient incentive. Where Alaska sits today is not a bad place for moving the gas project forward. What more needs to be done remains to be seen. "There is certainty - this is the tax law." This body can decide to change it. She said any builder of the pipeline would want certainty and stability when approaching an open season.

CHAIR HUGGINS asked if the tax is at the right level.

[11:25:30 AM](#)

MS. DAVIS said Alaska is the middle of the international pack, but the fiscal terms are only one piece. The rocks, price, transportation, and the timeframe all play a big role. "But if you look at strictly the fiscal system that we have ... when we assess those in a macro view, we're about middle of the pack."

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CHAIR HUGGINS asked about factoring in delivery.

MS. DAVIS said that is more challenging. Looking at the TransCanada proposal, or any other proposal, the full market will be part of the discussion.

SENATOR WIELECHOWSKI said producers - namely ConocoPhillips -- want to negotiate a tax plan with the administration. He asked if that is acceptable.

MS. DAVIS said that was tried and it was unsuccessful. The plan now is to work with the legislature to deliver fiscal terms and

widen the opportunity to all-comers to have a shot at building our gas pipeline.

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MS. DAVIS said a key factor was that the state must not give away resource value which is not necessary. The state has to be intelligent and make sure that what the state gives away has value for the industry so that it incentivizes their behavior. The state must know the business as well as industry, and getting information was a key goal of ACES. That makes the state a better negotiator and a better partner. In order to get the gas tax right, the state needs to know all the variables in production and the state's location relative to other entities. People today will speak to how Alaska's fiscal terms stack up against others.

The committee took an at-ease from [11:31 AM](#) until [11:35 AM](#).

KEVIN BANKS, Acting Director, Division of Oil and Gas, Department of Natural Resources (DNR), said it is a pleasure to share a table with someone as smart as Marcia Davis and to follow someone like Cathy Foerster [AOGCC Commissioner]. He will try to draw a distinction between the economic and development parameters that surround the reservoir at Prudhoe Bay and Pt. Thomson, and he will discuss the exploration potential. In terms of impact of fiscal regimes on gas, "we have a wider distribution of individual kinds of issues to deal with, with respect to the type of development that we're going to be trying to incentivize." The challenge will be to create a system that works for widely different situations. He will discuss the incentives that are in place in Alaska for gas development.

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MR. BANKS showed the mean and distribution estimates of potential undiscovered resources on the North Slope - onshore and offshore. The distributions are shown with a 5 percent possibility of success to a 95 percent probability. The "sure things" are a smaller predictor of resources. Only the means can be added together; therefore, there is some range of values that surround each of the numbers. "These are not the numbers that Cathy Foerster was referring to when she was talking about reserves. These are undiscovered, technically recoverable, given today's technologies, but it doesn't address the question of economics." Some estimates suggest that about half of these resources are economically recoverable - "but, mind you, they are still undiscovered, so there is a probability that they may never be found or that we may find more than is listed."

MR. BANKS displayed the known reserves of gas - the potential of gas that has been discovered. The SEC reserve estimate has been used by the producers and it is much lower "than this 35 ... I think Michael Williams told me it was close to 9, or something, by his estimate." It represents gas that is close to development capability. That number has not changed since the late 1980s. He surmised that it represents an SEC balance-sheet definition.

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CHAIR HUGGINS asked, "On the fiscal part of how much gas is there, that's not disputed, it's the definition?"

MR. BANKS said right. Yesterday Commissioner Foerster discussed SEC reserves and how the Federal Energy Regulatory Commission (FERC) will treat those. At an open season a pipeline company will want their suppliers/customers/shippers to commit gas to supply the pipeline. The supplier need not have all of the gas that it might get over the next several years if that is what the commitment requirements are. It also depends on the strength of the company and its chances of discovering more gas. The FERC is concerned "that that bar is not set so high that the competition for space in the pipeline in an open season isn't somehow interfered with." The FERC has to strike a balance that the open season is competitive and the pipeline shipping commitments are sufficiently underwritten.

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MR. BANKS turned to the Prudhoe Bay and the Pt. Thomson units. He said to keep in mind that things are more blurry than presented. For example, Prudhoe Bay is a reservoir that is well-understood and well-developed, so the infrastructure needed to deliver gas to a gas treatment plant and to a pipeline is mostly in place now. Some investments will be required in the field, but it won't be a large part of the problem that the state needs to examine when deciding cost structure and fiscal incentives. The challenge is that the operators at Prudhoe Bay have already begun upgrading the facilities. It is very important that the facilities that are there go through routine maintenance and upgrade. Commissioner Foerster wants to see aggressive development of the oil so when a gas sale occurs, the loss of oil is minimized. "Each time there's some failure in the systems up there and the flow of oil is interrupted, that's oil that is the opposite of aggressively being developed. That's oil that is pushing out the timeliness of a sale, in some respects."

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MR. BANKS said the reservoir risks are relatively low. All methane has been cycled, at least once or twice, through the facilities to retain pressure and enhance oil recovery. The pipeline will begin near the Prudhoe Bay unit so it will have the highest net back value. The difference in the net back value between Prudhoe Bay, Pt. Thomson, and others is not the most important issues, but it should be kept in mind. Much of the market value of gas is eaten up by transportation, which needs to be taken into account for determining fiscal systems for gas.

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SENATOR HUGGINS said he shoots his father's old gun, but it is expensive to maintain and upgrade with modern innovations. It works and it looks shiny when he gets it back, but it costs the same as buying a new one. He suspects that it is expensive for the industry to maintain and upgrade a facility.

MR. BANKS said it is probably not as expensive as developing the field from scratch. "This is the distinction I want to make."

CHAIR HUGGINS said there is no doubt that it is more expensive to start from scratch.

MR. BANKS said his old Subaru is expensive to maintain, so he understands his point. Pt. Thomson has minimal exploration risk - relative to Prudhoe Bay. Its reservoir has been penetrated many times and "we have a fairly good idea about the extent of the reservoir. We also know something about the oil potential in other zones within the unit area, but we don't know everything that we need to know." Although there is a minimal risk of finding gas and oil there, there are still many challenges. The high pressure of the reservoir adds expense. None of the wells there have flowed, so there are questions about how the reservoir will perform under different production techniques. He expects a few more exploration wells will be drilled that may not be production wells. There may be wells for testing before full-scale development. There is a large component in delineating this field before going into full development.

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MR. BANKS said oil production will bear some of the costs, "and because of the value of oil it may be able to afford it more than the gas." There is high exploration risk. There are still questions about the resources. Where Anadarko is drilling in Gubik and Chandler, gas has been discovered, but the wells are so old that Anadarko needs to apply more modern techniques to assess the reservoir's potential. It gets back to delineation

and long lead time. Money will have to spent, and there may not be a commercial resource in the end.

CHAIR HUGGINS asked how much money.

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MR. BANKS said, "You're stepping through gates." He has heard that exploration wells are \$40 million each. The next step with more infrastructure and drilling may cost hundreds of millions. Alaska's net tax system goes a long way to incentivize the explorers, including incentive credits and the potential for credits for investment.

CHAIR HUGGINS said Ms. Davis played a leadership role in ending up with the net tax system. He thanked her.

MR. BANKS said transportation may not be ready for the first open season. "We can expect ... assurances of access on the mainline and the potential for expansion -- even before construction begins -- is important for our early explorers, so they have an opportunity to get their resource monetized, get it to market." It is an important feature of the gas line. "The fact that most of these resources will have to be touched by some kind of upstream pipeline means that the netback value will be lower than it is at Prudhoe Bay. Obviously; you have more tariffs to pay." The proportion of the market value that goes to the delivery to market is exacerbated for explorers.

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MR. BANKS said the Division of Oil and Gas is stepping into modeling independent from the AOGCC for two reasons: AOGCC's relationship with the industry is different, and they can acquire "more leveraged" information. Also, gas is used in fuel injection and viscous oil development projects and exported to market through a pipeline. The state needs to examine how gas will fit into a host of applications. He said DNR wants to address those issues to optimize the modeling. Gas is sold to other units to use in other reservoirs for enhanced oil recovery. The ownership of one reservoir may be very different from another, so the state problem is not so different than the operator's problem. DNR has a wider spectrum of issues that it wants to examine. So having an independent review of the reservoirs is extremely important.

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SENATOR WAGONER asked about the gas that is used in other reservoirs and if it can later be retrieved. On the [Kenail

peninsula, retrieval of gas that was used in Swanson River for pressurization has been poor.

MR. BANKS said the project at Kuparuk has an agreement with DNR about how gas will be lifted out of Prudhoe Bay. It will bear a royalty and then it is reinjected. DNR has deemed a number for how much is lost. It is mostly gas liquids, and there is a certainty that some of that gas will not be produced again. There is an accounting arrangement so that the operators are not paying twice for the same gas. At North Star, where it is a pressure maintenance issue, more gas will be recovered. So, it depends, he said. In the Kenai, gas is injected into a very huge reservoir, so it is like filling a car tire with a bicycle pump.

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MR. BANKS said he will discuss current incentives that could be used to enhance gas economic development. The royalty modification statute allows for a drop in the lease rate for an undeveloped field, like the Nikaitchuq or Oooguruk. It allows the DNR commissioner to modify state royalty share down to 5 percent for undeveloped fields that would otherwise be uneconomic. Most of the leases in these fields are 12.5 to 16.66 percent. Under this statute, the applicant must provide a clear and convincing showing that the royalty modification will be efficient and effective. "It has to work. It has to change behavior." It can't be a situation whereby no matter how much royalty relief, the project still wouldn't be economical.

CHAIR HUGGINS asked how many times the state has given royalty relief prior to 2006 and in 2007, and what it means.

MR. BANKS said zero before 2006, one in 2006 and one in 2007. In 2006 the state awarded relief to Oooguruk, and last week there was a best-interest finding for issuing royalty relief to Nikaitchuq. For Oooguruk, the idea was to provide the relief, based on price, until the unit was in payout. "We actually have a net profit share lease in the unit. We will be measuring the economics of the project through time, and at some point the project will ... have recovered its capital costs and it will be earning more than its operating costs, and the state will share in those profits. After that point, the royalty rate will creep back up to the lease rate." In Nikaitchuq, the state has offered royalty relief at five percent when the market price for ANS falls below \$42.00 (adjusted for inflation).

CHAIR HUGGINS asked if others have requested royalty relief.

MR. BANKS said there have been discussions regarding Cook Inlet, but no formal application. There is not project that is mature enough to get to that clear and convincing standard.

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MR. BANKS said he will give a brief refresher on credits. "Tax credits apply for the qualified capex for exploration credits, and then also the loss carry-forward credit of 25 percent, where, in fact, the state participates to some extent in the commodity risk of the resource." A large slice of the market value is eaten up by transportation, so the price could potentially fall below zero at a netback giving an opportunity to be counted as a loss. The state will be willing to provide a loss carry forward of 25 percent. There is also the issue of net present value problems where the state is giving up a little, and it helps companies a lot. ACES has a tax credit fund giving 100 percent of the credit rather than a discount when selling to others. There is also the \$12 million credit for small producers, "and that really will apply, in some cases, to new people into the state." The tax is capped at \$00.17 per mcf for instate gas sales, but it is a challenge because the tax rate is measured on a barrel-of-oil equivalent basis. Gas sales for oil producers will lower their oil tax rate.

MR. BANKS showed a chart of Prudhoe Bay effective tax rate at varying oil prices with and without a 2017 gas sale. Because the margin is determined on an average basis and the price of gas is lower, it effectively reduces the tax rate of oil. It is a significant benefit to the industry given by ACES.

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MR. BANKS said AGIA offers a gas certainty for ten years for gas committed to the initial open season. "We are willing to establish a royalty valuation methodology that is different than what is in the lease now and which is arguably today complicated."

CHAIR HUGGINS asked to see a model of how it works, "before you do regulations."

MR. BANKS said when it is done he will provide it, and the administration will try to get input from everyone.

MR. BANKS said the state's right to switch between collecting royalty-in-kind vs. royalty-in-value is to insure that lessees' capacity is neither stranded, nor insufficient. "Under AGIA ... the opportunity for expansion and access to the pipeline, and

terms that are designed to assure rolled-in rates, capital structure that should contribute to low tariffs, and as well, the \$500 million contribution - that we make very early on in the project -- has a fairly sizable impact on the tariff that our explorers will be seeing ... or anyone committing gas to the pipeline."

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CHAIR HUGGINS said Ms. Forrester spoke of sharing facilities, "and that we're at essentially 100 percent ... and to give someone access, you have to vacate some of your..." He asked about that.

MR. BANKS said the gas/oil ratio from a legacy field may be very high, and new fields may be relatively low. If 90 percent of the legacy fields are gas, "you have the makings of a commercial deal there, because you can back out a tenth of a barrel and get nine tenths of a barrel in place of it, and so, in addition to paying for whatever operating cost adjustments may apply, the back out means that the new oil coming in bears a lower cost impact to the owner of the facility." They have to back out their oil because it is running at capacity, but in losing one tenth of a barrel and paying for it with nine tenths of a barrel, it is possible that a person seeking facility access can afford it. It will cost less than building their own facility. "That's the way I view the economics of facility access."

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CHAIR HUGGINS said it works, and he hopes that Pioneer will run the gauntlet on that.

The committee took an at-ease from [12:15:33 PM](#) to [12:33:36 PM](#).

[12:33:51 PM](#)

CHAIR HUGGINS asked for a refresher on AGIA applications.

MS. DAVIS said the application deadline was November 30, and five applications were received. In January, DNR and DOR determined that only one was complete. Since then, an applicant has asked to be reconsidered. The applications went out to the public and the legislature. The public has 60 days to comment. The state is also analyzing the one application and will decide what to recommend to the legislature. The department will wait for public comment before it finalizes its determination and sends it to the legislature in March or April. The commissioners of DOR and DNR will decide whether to recommend licensing. It may be just TransCanada or one other.

CHAIR HUGGINS said he wants to get it done during the regular session.

MS. DAVIS said staff is making every day count, and it is why she is here on a Saturday. The earliest will be early March, which will give the body up to six weeks. Legislators will be looking at the application during the public comment period.

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SENATOR STEVENS asked what happens to the 60 days with the other applicant under reconsideration.

MS. DAVIS said she doesn't know and would need legal advice.

CHAIR HUGGINS noted that AGIA doesn't have a system for reconsideration. That process needs to be described.

MS. DAVIS said AGIA didn't put in all administrative appeal procedures, and it relies on the existing appeals law. Citizens have a right to seek procedural reconsideration. She is not sure there were provisions in AGIA regarding the right to contest or litigate decisions, and would have to defer to the AG office.

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CHAIR HUGGINS asked for a description of that procedure and who is on the gas team.

MS. DAVIS said she will provide that. She referred to a list of 10 international projects. DOR asked three consultants to assess where Alaska was positioned with other gas projects of comparable size, risk, and challenges. The effort provided more understanding of the different fiscal structures, she said. The chart she provided listed the largest and most current projects, including seven LNG projects, two gas pipeline projects, and one gas-to-liquids project. They are not homogeneous with Alaska's project, but Alaska's exact project is unknown.

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MS. DAVIS said almost all of these projects are profit-sharing structures except for two Norway projects. Throughout the world, large projects use profit-sharing contracts, because those contracts get used by developing countries that don't have legislative systems, and they aren't of long duration. Companies have more comfort in dealing with such countries in a contract mode, she stated, rather than in a regulatory mode. The evaluation needs to be taken with a grain of salt, she warned, because ten is not a large number. The discounted share of

economic rent is the government share of the "gravy." The average for these projects is 80-81 percent. That is exactly where Alaska is: 81-82 percent - in the middle of the pack.

CHAIR HUGGINS said Alberta's activity is oil sands, and gas activities had layoffs. He is concerned.

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MS. DAVIS said the commissioner and other staff have been there, and the DOR has had many discussions with Alberta.

MICHAEL WILLIAMS, Chief Economist, Department of Revenue, said the layoffs in gas relates to a new law that overhauled the royalty system. For oil and natural gas, Alberta "got rid of the provisions based on the date, and they're now based on productivity. What did not change was the cost recovery for the oil sands. So companies now can still get a very similar deal under the oil sands; whereas, the royalty on conventional natural gas is higher, and that's why, I believe, they're focusing more on the oil sands."

CHAIR HUGGINS said they raised taxes and asked what happened.

MR. WILLIAMS said the conventional gas and oil became far less profitable; it was no longer based on the date that the well was studded, but on productivity. Therefore, many of the wells became unprofitable. He said it was expected that some wells would no longer be profitable. Alberta is closing unprofitable wells and moving resources over to oil sands.

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CHAIR HUGGINS said our tax is retroactive, and Alberta's is forecasted to 2009. He said he put in a bill to address retroactivity for obvious reasons.

MS. DAVIS said the Commissioner of the Department of Labor went to Alberta to investigate workforce issues. His impression was that things were booming even though there was a shift to oil sands. He was even offered a job a couple of times. It is booming, but there has been a shift.

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CHAIR HUGGINS said it amazed him to see the number of placards on the side of the road to get people on the payroll. It is absolutely booming for everything other than gas.

MS. DAVIS spoke to tax and royalty government comparisons. Information has been added from a previous presentation.

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MS. DAVIS said Alaska's production tax is a net tax; there is a property tax; the corporate income tax is a combination of both state and federal; oil and gas are treated the same. Because it is a net tax, the difference between costs of oil and gas development will come out in the wash. It only taxes the margin of the profit element.

CHAIR HUGGINS asked about progressivity.

MS. DAVIS said the actual tax change was not a huge impact, but progressivity was. We agreed to take more of the pie at higher prices and less at the low oil price margin. "If your gravy is more than \$30, then we're sharing more heavily in it."

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CHAIR HUGGINS asked if the administration will make progressivity part of the equation with gas.

MS. DAVIS said having separate tax rates with oil throws the state into the difficult and costly audit challenge of separating oil and gas costs. If the decision is made that the gas tax structure needs a boost, it would be good to come up with a way to do it without needing separate accounting. It is a huge nightmare for the industry to have two calculations. There are other tools. Alberta has a royalty range, from 5 to 50 percent, no production tax, and the corporate tax is additive. Alberta makes no distinction between oil and gas. Norway doesn't either, but relies on the net structure to achieve the distinction. One marginal gas project was incentivized with a slightly quicker depreciation schedule. The United Kingdom does not distinguish between oil and gas.

CHAIR HUGGINS said Alaska wasn't operating under the Stranded Gas Act, but our gas is still stranded.

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MS. DAVIS said the Gulf of Mexico is interesting in that the royalty rate was raised twice recently. The gulf created an exclusion for the first 87.5 million barrels of oil equivalent, but failed to put in the trigger price, so the exclusion applies at all oil prices and the federal government tragically missed out. Australia has royalties on the gross, depending on the productivity, and the tax is net, but there is an excise tax

calculation on a gross basis. The Netherlands has a royalty and state profit share of 50 percent of net income. It has an uplift feature that doesn't go as far as Alaska goes. ACES gives 100 percent deductibility in the first year.

MS. DAVIS concluded that almost all of the taxes are based on the net income. The net structure accommodates differences in the cost of development and transportation, so they are essentially identical when applied to oil and gas. There are some exceptions for a marginal project or a unique system. That is the trend globally.

1:01:00 PM

CHAIR HUGGINS said Alaska has a "really accelerating" progressivity, and he asked if that was accounted for.

MS. DAVIS said yes. "Essentially where we are at, comparing us to the tax and royalty ... we find ourselves pretty similarly based as to where we talked about with oil on the gas side as well." The state is higher than the Gulf of Mexico and the U.K., and it is below Norway. Alaska is in the bottom of the top third, and that position is justified based on the geology. Alaska can't be competitive based solely on the fiscal system. The companies are focused on profit. The state is in about the same position, relative to others, as it is with oil.

MR. WILLIAMS said Alaska has a very powerful credit system. The other governments don't offer credits, except Alberta and Norway offers cost recoveries. Alaska has positive attributes with regard to up-front incentives.

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MS. DAVIS said there have not been gas sales yet in Prudhoe Bay, but she wants to give a range of possibilities to show, depending on the differential in price between oil and gas, how beneficial the ACES provision can be.

She described the progressivity formula. The example on slide 7 indicated 300,000 barrels per day, which is a likely number in the Prudhoe Bay Unit (PBU) if a gas sale happened. Using those numbers, there is a \$1.2 billion progressivity surcharge if only oil is produced. Gas price on a per barrel oil equivalent is usually lower, but transportation is higher. That is why there will be a lower number for gas than oil. "So when you do the combined calculation for progressivity, and put what was oil yielding a \$1.2 billion progressivity and blend in a much lower number, you've dragged down the number."

[1:07:26 PM](#)

MS. DAVIS said the progressivity goes down to \$234 million. From the state's perspective it is not a total loss because there will be an increase in the base tax for gas and royalty for gas, so it is pretty much a wash. At Prudhoe Bay, the state essentially tells the owners that selling gas will almost cover the added production tax and royalty. It is a huge incentive. If the gas were higher, there would be a differential of \$661 million, "so you've got a boost of about \$600 million." For a \$70 per barrel of oil with a \$7 price of gas, the boost is \$360 million, and at a \$60 oil and \$6 gas, there is no surcharge, "and you've saved yourself \$175 million." It runs a range. "Everyone needs to do their own price forecasting and decide what the differential's going to be between oil and gas at the time of the gas sale, but the structure is there to provide a huge incentive to owners that have oil on the slope and to proceed with a gas sale."

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SENATOR WAGONER said the information was very helpful.

CHAIR HUGGINS said there have been communication challenges between the Senate and the administration. Ongoing formal communications is important. He said he is revisiting the past tax regime, including the standard deduction, which "we did not debate, and what we did on retroactivity. I hope we can make those kinds of traits go away when we do this, and some other things of that nature." He asked for communications, weekly and daily. He wants a closer friendship and professional camaraderie. Senator Thomas asked about Cook Inlet. Customers there enjoy baseline costs from Enstar. Future gas for Delta or Fairbanks will have a different tax structure, "and what does that do to the prices?" The state is 10 to 15 years from a gas pipeline, and he wants to know who does the compilation of information of known reserves. During the break, several people told him they like Ms. Davis and that she is straightforward.

There being no further business to come before the committee, Chair Huggins adjourned the meeting at [1:13:40 PM](#).