

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 10, 2010

1:05 p.m.

MEMBERS PRESENT

Representative Craig Johnson, Co-Chair
Representative Mark Neuman, Co-Chair
Representative Bryce Edgmon
Representative Kurt Olson
Representative Paul Seaton
Representative Peggy Wilson
Representative David Guttenberg
Representative Scott Kawasaki
Representative Chris Tuck

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE BILL NO. 337

"An Act relating to interest on certain underpayments or overpayments for the oil and gas production tax, to certificates for certain oil and gas production tax credits for qualified capital expenditures, and to alternative tax credits for expenditures for certain oil and gas development and exploration activities for the oil and gas production tax; relating to the use of the oil and gas tax credit fund to purchase certain tax credit certificates; and providing for an effective date."

- HEARD & HELD

HOUSE BILL NO. 308

"An Act relating to the tax rate applicable to the production of oil and gas; relating to credits against the oil and gas production tax; and relating to the period in which oil and gas production taxes may be assessed."

- HEARD & HELD

HOUSE BILL NO. 369

"An Act relating to an in-state natural gas pipeline, the office of in-state gasline project manager, the Joint In-State Gasline

Development Team, and the In-State Gasline Steering Committee; and providing for an effective date."

- MOVED CSHB 369(RES) OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

BILL: HB 337

SHORT TITLE: OIL AND GAS PROD. TAX: CREDITS/INTEREST

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

02/10/10 (H) READ THE FIRST TIME - REFERRALS
02/10/10 (H) RES, FIN
03/10/10 (H) RES AT 1:00 PM BARNES 124

BILL: HB 308

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(s): JOHNSON

01/19/10 (H) READ THE FIRST TIME - REFERRALS
01/19/10 (H) RES, FIN
02/08/10 (H) RES AT 1:00 PM BARNES 124
02/08/10 (H) Heard & Held
02/08/10 (H) MINUTE(RES)
02/10/10 (H) RES AT 1:00 PM BARNES 124
02/10/10 (H) Heard & Held
02/10/10 (H) MINUTE(RES)
02/15/10 (H) RES AT 1:00 PM BARNES 124
02/15/10 (H) Heard & Held
02/15/10 (H) MINUTE(RES)
02/17/10 (H) RES AT 1:00 PM BARNES 124
02/17/10 (H) -- MEETING CANCELED --
03/10/10 (H) RES AT 1:00 PM BARNES 124

BILL: HB 369

SHORT TITLE: IN-STATE PIPELINE/COORDINATOR /TEAM

SPONSOR(s): CHENAULT

02/23/10 (H) READ THE FIRST TIME - REFERRALS
02/23/10 (H) RES, FIN
02/26/10 (H) RES AT 1:00 PM BARNES 124
02/26/10 (H) Heard & Held
02/26/10 (H) MINUTE(RES)
03/01/10 (H) RES AT 1:00 PM BARNES 124
03/01/10 (H) Heard & Held
03/01/10 (H) MINUTE(RES)
03/08/10 (H) RES AT 6:00 PM BARNES 124

03/08/10 (H) Heard & Held
03/08/10 (H) MINUTE(RES)
03/10/10 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

PAT GALVIN, Commissioner
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Introduced HB 337 on behalf of the administration.

MARILYN CROCKETT, Executive Director
Alaska Oil and Gas Association (AOGA)
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 308, suggested changes to Version E and said the bill is an important first step in a comprehensive review of Alaska's Clear and Equitable Share (ACES) legislation.

GREG VIGIL, Executive Vice President
Savant Alaska, LLC
(No address provided)

POSITION STATEMENT: During the hearing on HB 308, provided information about how Alaska's Clear and Equitable Share (ACES) has affected his company both positively and negatively.

MARK LANDT, Executive Vice President - Land & Administration
Renaissance Alaska, LLC
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 308, supported the increased access to capital credits for new explorers that would be provided by both HB 308 and HB 337.

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

POSITION STATEMENT: Supported HB 308 and reviewed the problems his company has had with ACES and operating in Alaska.

DALE PITTMAN, Alaska Production Manager
ExxonMobil Production Company
Anchorage, Alaska

POSITION STATEMENT: Testified that HB 308, Version E, is a good first step toward examining Alaska's production tax structure.

BRIAN WENZEL, Vice President-Finance

ConocoPhillips Alaska, Inc.
Eagle River, Alaska

POSITION STATEMENT: Supported HB 308 as a step in the right direction for creating a more favorable investment climate.

TOM WRIGHT, Staff
Representative Mike Chenault
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: During the hearing on HB 369, explained on behalf of the sponsor, Representative Chenault, the differences between Versions S and E.

REPRESENTATIVE MIKE CHENAULT
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Spoke as the sponsor of HB 369.

ROBERT SWENSON, Project Manager
In-State Gas Project
Alaska Mental Health Trust Land Office
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 369, answered questions.

ACTION NARRATIVE

[1:05:57 PM](#)

CO-CHAIR CRAIG JOHNSON called the House Resources Standing Committee meeting to order at 1:05 p.m. Representatives Seaton, P. Wilson, Edgmon, Neuman, and Johnson were present at the call to order. Representatives Guttenberg, Kawasaki, Tuck, and Olson arrived as the meeting was in progress.

HB 337-OIL AND GAS PROD. TAX: CREDITS/INTEREST

[Contains discussion of HB 308]

[1:06:26 PM](#)

CO-CHAIR JOHNSON announced that the first order of business is HOUSE BILL NO. 337, "An Act relating to interest on certain underpayments or overpayments for the oil and gas production tax, to certificates for certain oil and gas production tax

credits for qualified capital expenditures, and to alternative tax credits for expenditures for certain oil and gas development and exploration activities for the oil and gas production tax; relating to the use of the oil and gas tax credit fund to purchase certain tax credit certificates; and providing for an effective date."

[1:06:34 PM](#)

PAT GALVIN, Commissioner, Department of Revenue (DOR), introduced HB 337 on behalf of Governor Parnell, saying it is the administration's bill regarding oil and gas taxes. He said HB 337 would introduce four distinct concepts, the first being a 30 percent credit for all well-related work. Under current law, capital credits are 20 percent for capital expenditures and exploration incentive credits are 30 or 40 percent for work done outside of existing fields. This first concept would make it a 30 percent credit for all well-related work, including well workovers and other well work within existing fields that does not currently qualify for a credit under the existing production tax. In response to Co-Chair Neuman, he said this credit would apply to all well-related work statewide and would include the re-conditioning of old wells.

COMMISSIONER GALVIN said the second concept of HB 337 would allow for these credits to be applied in the first year, the year in which they are earned, as opposed to current law in which the credits are spread over two years.

[1:09:12 PM](#)

REPRESENTATIVE SEATON noted that the purpose of credits is to stimulate work and the taking of risk. Given that looking for new reservoirs is riskier than work done within existing fields, he said it seems to him that this differential incentive is being eliminated. He inquired whether making these two types of work equal will stimulate workover within current reservoirs instead of exploration beyond the current reservoirs.

COMMISSIONER GALVIN responded he does not believe the premise behind the current differential in credits is to incentivize exploration at the expense of in-field work. The state recognizes that risk is an inherent aspect of the economic analysis. Because of the uncertainty of the reward of any particular investment, the state's current system has a higher credit on the exploration side because those risks are higher. However, it does not mean that the decisions on whether to do

in-field work are not driven by an economic evaluation that would be impacted by adding credits. In other words, there are likely investment decisions for in-field well work that are not at a decision-making threshold under the current system, but for which additional credits would become a "green light". The intent is to move the bar to get more well work than would be done without the credit and is not being seen as diverting investment away from exploration towards in-field work. The intent is to enhance the in-field work in addition to enhancing exploration.

CO-CHAIR JOHNSON encouraged Representative Seaton to ask this question of industry representatives when they present testimony to the committee.

[1:13:33 PM](#)

REPRESENTATIVE GUTTENBERG noted that HB 337 would provide for a pre-drilling conference between the taxpayer and the Department of Natural Resources (DNR). He asked whether this occurs now.

COMMISSIONER GALVIN replied yes, it happens under the exploration incentive credit program.

[1:14:09 PM](#)

COMMISSIONER GALVIN continued his introduction of HB 337, noting the third component of the bill would eliminate the existing requirement that a company make additional investments in future years to qualify for state reimbursement of a credit. This is for companies that do not have current production tax obligations to put their credits against and are looking for ways to get compensated for those credits. Companies that are currently working in the state immediately get the full value of that credit by writing it off on their current tax obligations. Thus, there is a disparity in the value that this credit holds for these participants. A company that is looking to potentially partner as just an investor in an exploration well may be looking at the outcome of that investment as a determining factor in whether to invest again in Alaska. If a company does not know whether it will get the full value for that credit, the company will discount the value of it in its economic analysis on whether to invest in this exploration well. That is not in the state's interest because at the end of the day it is going to reduce the state's revenue by the same dollar amount. By eliminating that reinvestment risk, the state gets

the same impact to itself while boosting the value of that credit to these potential investors.

[1:16:40 PM](#)

COMMISSIONER GALVIN said the fourth component of HB 337 would provide for the waiver of interest charged on tax underpayments that are a result of retroactive regulations implementing the [2007] Alaska's Clear and Equitable Share (ACES) legislation. A provision in ACES provided that the regulations implementing the bill would be retroactive to the effective date of the bill. Currently, the Department of Revenue can waive a penalty that may apply to an underpayment if the department determines a good faith effort was made by the company to fully pay its obligation while not yet aware of what the regulation would say at the time payment was made. However, current statute does not allow the department to waive interest that may accrue on that underpayment. This provision would provide for the waiver of that interest when it is the result of a retroactive regulation and the department finds the taxpayer in good faith made what it believed was a full payment.

CO-CHAIR JOHNSON noted there are elements in HB 337 that are similar to HB 308.

[1:18:52 PM](#)

REPRESENTATIVE SEATON inquired whether the interest applies only to the production tax credit.

COMMISSIONER GALVIN answered yes and the provision can be found in Section 1 of the bill.

[1:19:27 PM](#)

REPRESENTATIVE SEATON referenced the standard deduction clause that was in effect until December 2009 and inquired whether the proposed change in law is only from 12/31/09 until now and whether it excludes Prudhoe Bay and Kuparuk.

COMMISSIONER GALVIN responded that a number of regulations have been put in place as a result of ACES beyond just the definition of qualified lease expenditures. He presumed that that is what Representative Seaton is referring to as being of less impact to those at Prudhoe Bay and Kuparuk that had the so-called standard deduction that drove their operating expenditures. There is a large range of regulations having to do with production tax

liability, he said, and given the nature of the regulation development process, he does not expect there to be a wide deviation between what companies paid in tax and what will be the actual tax due as a result of the regulation change.

[1:21:51 PM](#)

REPRESENTATIVE SEATON requested the committee be provided with an indication of the anticipated difference between what was paid and the actual tax that becomes due.

COMMISSIONER GALVIN replied the Department of Revenue is not in the position to estimate what that number would be. The department expects the taxpayers had a good understanding of what the tax would be and would have prepared their taxes at the time based upon that expectation. Now that the retroactive regulations have been prepared, he said it may be more appropriate to ask the question of the taxpayers to see what they think the difference will be.

CO-CHAIR JOHNSON pointed out that the penalties and interest would be additional income to the state, not a liability, and therefore the state is not put in any sort of jeopardy.

COMMISSIONER GALVIN added that the Department of Revenue did not include anything in the fiscal note in regard to this provision because anticipated interest payments or penalties are not incorporated into revenue projections. Additionally, the department is not in a position to identify that there would be any particular impact as a result of this. The department put this provision in the bill as an element of fairness, not because a significant dollar swing is expected.

[1:24:50 PM](#)

CO-CHAIR JOHNSON held over HB 337 and noted the committee will decide which vehicle to advance - HB 337 or HB 308. He said the committee will work with the administration to take the best of both bills and advance something that everyone can live with.

The committee took an at-ease from 1:24 p.m. to 1:25 p.m.

[Co-Chair Johnson passed the gavel to Co-Chair Neuman.]

HB 308-OIL AND GAS PRODUCTION TAX

[Contains discussion of HB 337]

[1:25:58 PM](#)

CO-CHAIR NEUMAN announced that the second order of business is HOUSE BILL NO. 308, "An Act relating to the tax rate applicable to the production of oil and gas; relating to credits against the oil and gas production tax; and relating to the period in which oil and gas production taxes may be assessed." [Before the committee was Version E, the proposed committee substitute for HB 308, labeled 26-LS1328\E, Bullock, 2/5/10.]

CO-CHAIR NEUMAN opened public testimony.

The committee took an at-ease from 1:27 p.m. to 1:28 p.m. to deal with technical difficulties in the teleconference system.

[1:29:44 PM](#)

MARILYN CROCKETT, Executive Director, Alaska Oil and Gas Association (AOGA), noted that AOGA is a trade association composed of 14 member companies with interest in Alaska. She thanked the sponsor for introducing HB 308 and said the bill is an important first step in a comprehensive review of Alaska's Clear and Equitable Share (ACES) legislation [enacted in 2007].

[1:31:44 PM](#)

MS. CROCKETT began her PowerPoint presentation by stating that AOGA sees three problems with ACES [slide 3], the first being an excessive tax rate. While many presentations have been given about the amount of industry investment in Alaska, she said a more telling statistic is the amount of new in-field drilling in Alaska [slide 4]. New in-field wells decreased from 166 in 2007 to 147 in 2009. She related that North Slope operator, "BP", has publically said its in-field drilling will be more than 50 percent lower in 2010 than it was in 2007. She further related that according to a "ConocoPhillips" presentation at a recent conference, about 450 million barrel-of-oil equivalents (BOE) were added to North Slope reserves in the last five years, but only 35 million since ACES was enacted. The telling component of that is that giant fields have the worst fiscal terms under ACES. The news for exploration wells is not good either, she added. The number of exploration wells drilled on the North Slope has declined from 11 in 2007 to only 8 in 2009.

[1:33:08 PM](#)

MS. CROCKETT said her recollection of the companies operating in Alaska does not agree with the 2/16/10 testimony of Kevin Banks, Director of the Division of Oil & Gas, in which he stated that independents are flocking to Alaska. She maintained the independent companies conducting exploratory drilling on the North Slope have been around for a couple of years and are not new players that have arrived since the enactment of ACES. She added that Mr. Banks' testimony also prompts the question of what companies are out there that could be investing in Alaska but are not, and noted that of the 20 largest U.S. drillers by footage in 2009, only 7 have operations in Alaska or interest in fields in Alaska [slide 5].

MS. CROCKETT said another disturbing trend is the closure of oil and gas leases [slide 6]. She related that last year "ConocoPhillips" relinquished 800,000 acres of its leases in the National Petroleum Reserve-Alaska (NPR-A). A total of 2 million acres of state and federal leases on the North Slope were released in 2009 and over 1.2 million acres were released in 2008.

[1:35:33 PM](#)

MS. CROCKETT, in response to Representative P. Wilson, stated that the company names shown in black on slide 5 are companies that operate in Alaska or have working interest ownership in a field in Alaska ["XTO, Anadarko, ConocoPhillips, BP, ExxonMobil, Shell, Marathon"]. The company names shown in blue do not have operations in Alaska, have not participated in lease sales in Alaska, and are not drilling exploratory wells in Alaska ["Chesapeake, EOG Resources, EnCana, Devon, Noble, Questar, Williams Production, Ultra Resources, Concho Resources, Southwestern Energy, Apache, Petrohawk, Laredo Petroleum"].

[1:36:38 PM](#)

REPRESENTATIVE TUCK, in regard to slide 5, surmised that while only 7 of the 20 largest drillers in the U.S. are in Alaska, there are other smaller companies that are drilling in Alaska.

MS. CROCKETT responded correct. She understood that two companies not on this top-20 list, but that are conducting exploration activities in Alaska, will be testifying today. The point of slide 5 relates to the question of why are not more of these 20 largest U.S. drillers conducting operations in Alaska. She clarified that the seven companies shown in black are either explorers, producers, or working interest owners in a currently

producing field. In further response, she noted there are only three companies conducting exploration on the North Slope that are not on this list of 20 largest drillers.

[1:38:23 PM](#)

MS. CROCKETT, in response to Representative Kawasaki, explained that the companies shown on slide 5 are explorers as well as producers. She clarified that the company names shown in black have operations in Alaska and the company names shown in blue are not exploring or active in Alaska but are active in the Lower 48. She said these are the top 20 companies for the amount of footage drilled, so they are the 20 largest drillers in the U.S. for the year 2009.

[1:39:34 PM](#)

REPRESENTATIVE SEATON inquired which of these 20 companies operates exclusively in coalbed methane or shale natural gas.

MS. CROCKETT replied she does not know because she is unfamiliar with some of the companies. However, she does know that some of these 20 are actively pursuing shale gas opportunities in the Lower 48, but that is not their sole interest.

[1:40:11 PM](#)

REPRESENTATIVE GUTTENBERG noted that numerous things would add to the figures being shown, such as the total number of wells drilled, whether it is private or public land, or that wells drilled in Alaska tend to be deeper than elsewhere. He asked whether another slide will speak to this.

MS. CROCKETT answered she does not have a slide in this regard, but the compelling thing for AOGA is that these companies are very active and are drilling lots of wells in the Lower 48. However, the companies shown in blue are not drilling any wells in Alaska and have not bid on any lease sales in Alaska, and the question is why.

CO-CHAIR NEUMAN concurred with Ms. Crockett.

REPRESENTATIVE KAWASAKI said he would appreciate getting the aforementioned information offered by Ms. Crockett. He understood shale gas requires the drilling of hundreds of wells as compared to reservoir gas and he does not think Alaska has any shale gas plays.

MS. CROCKETT agreed to provide this information.

[1:42:23 PM](#)

MS. CROCKETT returned to her presentation, reiterating that a great deal of lease acreage has been released by companies in Alaska [slide 6].

CO-CHAIR JOHNSON presumed that released means the lease has been given back to the state because the company does not plan to develop that acreage.

MS. CROCKETT responded correct.

[1:43:26 PM](#)

MS. CROCKETT said AOGA entitles the second problem with ACES the impossible plight of non-operators [slide 7]. She recalled that in testimony before the legislature in 2007 regarding ACES, AOGA expressed its concern about future conflicts that could result from the [Department of Revenue] not using the joint interest billings in working interest ownership and in fields where a company has other partners. A non-operator is a working interest owner that is not the operator of a particular oilfield. A non-operator pays the operator from a joint interest billing and uses that invoice to file its tax return. The problem is that a non-operator does not have access to some of the detailed information that the operator has.

MS. CROCKETT explained that the level of detail complicates things even further. Over 20,000 cost codes are used to allocate cost in the Prudhoe Bay unit, but the Department of Revenue's regulations for implementing ACES only have 336 cost code categories in which a company can deduct its lease operating costs. Thus, there is a great deal of uncertainty, especially for non-operators, about what can or cannot be deducted. There is virtually no way for a Prudhoe Bay non-operator to determine which of the 20,000 cost codes fits into the 336 categories. Additionally, one part of a cost code may fit into one category and another part into another category.

MS. CROCKETT said the point is that ACES is a very complicated and complex production tax system and the regulations that have been developed and that are continuing to be developed are equally complicated. When making investment decisions for the future, neither the operator nor the non-operator will have a

great deal of confidence in what the actual taxes will be, and this will complicate and influence investment decisions.

[1:46:21 PM](#)

CO-CHAIR NEUMAN surmised that an investment may not be made because of this uncertainty.

MS. CROCKETT replied correct; the question is what kind of influence this has when a company sits down to make a decision for investments in the future.

[1:47:33 PM](#)

REPRESENTATIVE KAWASAKI recalled that during consideration of ACES there was discussion about the complexity that would be added by going from a simple gross system to a profits-based system. Some members at the table today voted for a standard deduction, he related, the idea being to simplify the system. He inquired whether AOGA is advocating for something like a standard deduction system.

MS. CROCKETT answered no, AOGA is not advocating for a standard deduction system. Her point is that a complicated system is already in place through the joint interest billings and the unit operating agreements, and this system is a well-tested system of accounts that everyone is familiar with. She said the Department of Revenue actually has the ability to rely on the joint interest billings because this ability was not removed by ACES. However, the department also had the flexibility to adopt another system, which is what it did, and that is the point of the comments she is making. Creating another more complicated system instead of using information that is readily available does not seem to be productive from AOGA's point of view.

[1:49:58 PM](#)

MS. CROCKETT continued her presentation, noting that the third problem with ACES is the inability of taxpayers to determine with certainty the amount of tax [slide 8]. She related that the Department of Revenue's regulations have a set of provisions that the company can use in determining its tax; however, those regulations will also state that the department can determine something else. Therefore, the taxpayer does not have any great deal of certainty even though it has gone through the list of provisions spelled out in the regulations; this, then, gets back to the investment decisions.

1:51:06 PM

MS. CROCKETT discussed the six provisions proposed by HB 308 [slide 9]. Regarding the Alaska hire provision, she said AOGA believes the Alaska industry already has a good track record of Alaska hire because it makes good business sense to do so. Should this provision is adopted, she would suggest that Department of Labor and Workforce Development standards be used rather than creating a new and substantially different process. She further cautioned that while the rebate is a good idea, it would create additional complexity and ambiguity.

1:52:12 PM

MS. CROCKETT, in regard to the progressivity provision, allowed it is no secret that AOGA has opposed progressivity since Governor Frank Murkowski first introduced it in the Petroleum Production Tax. While AOGA continues to oppose progressivity, it acknowledges that lessening the steepness of the slope would reduce its negative effects; so, to that extent, Version E would represent an improvement over the present situation.

MS. CROCKETT offered AOGA's support for the proposed 30 percent tax credit for well-related expenditures.

1:52:48 PM

MS. CROCKETT said AOGA endorses the proposal in Version E to change the statutory rate of interest because the present interest rate is punitive in purpose and bears little, if any, relation to either the state's or the taxpayer's actual harm from not having had the money.

MS. CROCKETT stated AOGA agrees with the proposed provision that there be no interest on tax underpayments arising from retroactive application of new regulations. It is highly unfair to have interest accrue on tax underpayments that arise directly from the retroactivity of a newly adopted tax regulation. Also, in light of the punitively high rate of the current statutory interest, the accrual of interest on such an underpayment starting from the date the original tax was due would also present constitutional issues. In response to Co-Chair Neuman, she said AOGA recommends that Version E's proposed time period of 30 days for a taxpayer to determine and pay any additional tax that is due after a retroactive regulation becomes effective be changed to the second calendar month after the month in which

the retroactive regulation becomes effective, except when the regulation becomes effective in the first quarter in which case it should be May 1 because the beginning of the year is a busy time when true-up payments are being determined.

[1:54:53 PM](#)

MS. CROCKETT further stated that AOGA supports Version E's proposed change to the statute of limitations. She concluded by saying that Version E would not eliminate all the problems that ACES has, but it would be a good first step in improving ACES.

MS. CROCKETT, in response to Representative Tuck, said that the last paragraph on page 6 of her written testimony provides AOGA's suggestions for improving the provision in Version E regarding no interest on tax underpayments that arise from the retroactive application of new regulations.

The committee took an at-ease from 1:56 p.m. to 1:57 p.m.

[1:57:06 PM](#)

GREG VIGIL, Executive Vice President, Savant Alaska, LLC ("Savant"), began his PowerPoint presentation by noting that Savant is a relatively small company founded in 2006, but it is an Alaska-only company in terms of its focus and scope [slide 2]. He said Savant has licensed quite a bit of seismic in the state as a result of the charter agreement between some of the "majors" in the state, and is focused primarily on the eastern side of the North Slope east of Prudhoe Bay Field.

MR. VIGIL said Savant drilled an offshore exploration well in 2006 called "Kupcake #1", which was a dry hole. Following that, the company entered into a farmout agreement with BP Exploration (Alaska) Inc., which provided Savant with exclusive access to the Badami Unit. A year ago Savant opened an Anchorage operations office staffed by several Alaska-resident employees who deal with field operations. In March 2009, the company commenced the Red Wolf exploration well from Badami gravel. An apparent discovery has been made in two zones of that well and flow tests will be conducted this summer.

MR. VIGIL stated that to date Savant has invested or caused to be invested over \$43 million in Alaska exploration and development. The company just finished drilling its first Badami re-redevelopment well, which is a horizontal sidetrack in the existing Badami Sand Participation Area.

1:59:41 PM

MR. VIGIL said Savant came to Alaska because the North Slope contains a prolific hydrocarbon system that has multiple stacked pays available in that geologic section [slide 3]. The North Slope's lightly developed east side presents opportunities for Savant. Under ACES, the current 45 cents per dollar from qualified capital expenditure and net operating loss provides Savant with significant incentive and is instrumental to the company's continued investment in the state. The existing Badami infrastructure is also very advantageous to Savant in that it provides a competitive advantage in terms of turnaround times for production from first drilling.

MR. VIGIL summarized Savant's tax credits under ACES [slide 4]. He said the company has redeemed about \$3.4 million in credits to date in cash from the state. Savant currently has credits of about \$8 million that will be redeemed the second quarter of 2010, and tomorrow it will be filing an application for \$6.6 million of tax credits. From its inception to date, Savant has acquired, earned, or redeemed approximately \$19 million in ACES tax credits. He said the secondary market for ACES tax credits is relatively thin at best, and he believes that both HB 337 and HB 308 attempt to correct this unintended consequence.

2:01:38 PM

MR. VIGIL reviewed Savant's plans for the next year [slide 5]. He said the company will finish its drilling operations at Badami in the next 30 days or so. This summer it will restart production at the Badami plant, resuming some production from the existing wells along with the two new wells that it drilled. Results of the two new wells will be evaluated and additional delineation and development wells will potentially be drilled winter 2011. He said Savant is transitioning from an explorer to a producer, which means that Savant is for real and is in Alaska to stay.

MR. VIGIL offered Savant's view of the ACES tax credit system [slide 6]. In regard to exploration incentives, he said this tax credit system has provided meaningful inducement for Savant to take risk in the state. Any enhancements to the ACES system would only improve the company's ability to continue exploring and investing in Alaska. Savant generally supports the governor's proposed amendments [HB 337] because they would improve some of these exploration incentives, which would be

beneficial to his company. Speaking to prior testimony about other independents that explore in the Lower 48, he said these credits are little known or understood in the Lower 48 and getting the word out would be to the state's benefit.

[2:03:48 PM](#)

MR. VIGIL, in regard to the progressivity feature of ACES, said Savant Alaska, LLC has remained silent on this issue because it is not yet a producer. However, now that it will be transitioning to production mode in 2010, Savant sees progressivity as a disincentive to itself, as well as to all the producers in the state, in that it results in diminishing return per incremental barrel produced.

MR. VIGIL explained that slide 7 is a pictorial graph of the ACES progressivity disincentive that Savant sees in its economic models. Under the ACES disincentive to success, Savant's economic models drive the company to under-perform as opposed to over-perform under certain economic assumptions, which is not good policy in Savant's opinion.

[2:04:53 PM](#)

MR. VIGIL, in response to Representative Seaton, said the vertical axis on the graph in slide 7 represents the oil rate, or offtake, from development at Badami. In response to further questions from Representative Seaton, he noted that the progressivity under ACES is on a net income per barrel basis. As a constant price, there is an incentive to under-produce on rate because it results in lower overall net income per barrel for the development and therefore a lower overall severance tax liability. Under the current system, an optimization model can take place that dissuades a company from peak-producing a field and to instead slowly develop the field over time to incur less overall severance tax liability. He said he is pointing this out because Savant thinks there should not be a disincentive to develop a field, and progressivity, as currently constructed, creates a disincentive.

[2:07:44 PM](#)

REPRESENTATIVE GUTTENBERG presumed that the calculation Mr. Vigil is talking about would occur with any level of progressivity.

MR. VIGIL responded yes. The slope of that progressivity has an impact on any given economic model. Changing only that variable, such as making the slope shallower or the hurdle rate lower, definitely affects the outcome of the model. The nature of progressivity is such that it is going to create this disincentive.

[2:08:30 PM](#)

REPRESENTATIVE GUTTENBERG surmised that even if there was no progressivity a company would still have to determine whether it needs to produce more oil today or tomorrow, assuming that the prices would be different.

MR. VIGIL replied that under a constant prices and costs economic analysis, lack of progressivity would lead Savant to develop a field, at least on the maximum net present value analysis or discounted cash flow rate of return; thus, Savant would be inclined to try to develop the field as quickly and efficiently as possible to maximize net present value for all stakeholders.

[2:09:36 PM](#)

MR. VIGIL, in response to Representative Tuck, explained that the assumption used in the graph on slide 7 is that for a given quantity of oil, the area under the red curve is equal to the area under the green curve. Using a constant prices and costs economic analysis, the graph shows that under the current progressivity of ACES, there is more benefit to the producer to produce a field or a well along the lines of the green curve as opposed to the red curve. Due to the progressivity nature, a lower net present value is derived by over-achieving and following a true net present value approach because a company would have a higher severance tax liability under the red curve development as opposed to the green curve development. This is especially true for a company that is crossing over from the explorer phase into the producer phase.

[2:11:36 PM](#)

REPRESENTATIVE TUCK asked Mr. Vigil to provide an example of how many years it would take for the two lines to cross.

MR. VIGIL answered it would depend on the profile of any given well or field; in Savant's case, it would be on the order of five years.

REPRESENTATIVE TUCK presumed this would be proportionally the same regardless of whether the scenario is five, ten, fifteen, or twenty years.

MR. VIGIL responded yes; the intent of the slide is to show that this progressivity feature creates this incentive when looking at two different economic models.

[2:12:39 PM](#)

REPRESENTATIVE TUCK inquired whether Savant Alaska, LLC also participates in operations outside of Alaska.

MR. VIGIL replied yes; the original parent company name in the Lower 48 is Savant Resources, LLC. The nature of the parent company's business is to form specific-purpose entities for different plays in basins that it gets involved in; it has developed resources from Washington State to Kentucky.

REPRESENTATIVE TUCK asked what percentage the Alaska operation is of the parent company's overall operations in the U.S.

MR. VIGIL answered it is about 50:50 right now in terms of investment.

[2:13:40 PM](#)

REPRESENTATIVE SEATON, in regard to the slide 7 graph, asked whether this would not also be a factor that would occur on any profits-based tax. For example, a company that produces more at one time would have higher profits so more taxes would be paid versus spreading production out over time which would create less profit margin and thus less tax.

MR. VIGIL responded yes, that is a fair statement. In response to another question from Representative Seaton, he said that since its inception in Alaska, Savant Alaska, LLC has drilled about 35,000 feet of hole between its 3 wells.

[2:15:29 PM](#)

REPRESENTATIVE KAWASAKI inquired whether Savant Alaska, LLC is part of any of the closed leases that were mentioned in AOGA's testimony.

MR. VIGIL replied that Savant dropped a few leases around the Kupcake exploratory well that was a dry hole, although he does not have an exact number of acres. He said the acreage was dropped because Savant felt like it had condemned that acreage.

[2:16:23 PM](#)

REPRESENTATIVE SEATON noted that the original version of HB 308 had a provision that would have let the Alaska Retirement Management (ARM) Board purchase the tax credit certificates at an 8 percent discount from the price. He asked whether this rate would be attractive to Savant at the secondary market.

MR. VIGIL answered Savant has never sold its credits on the secondary market; it has always redeemed them with the state because of the company's forward spend. However, to the best of his knowledge, those terms would be the most competitive that he is aware of.

[2:17:25 PM](#)

CO-CHAIR JOHNSON inquired whether Savant Resources, LLC has run across regimes similar to Alaska's in any of the Lower 48 states where it is conducting business. He further asked Mr. Vigil to rank Alaska in terms of ability and complexity to do business.

MR. VIGIL responded that in regard to severance tax, Alaska is unique with its progressivity feature, and the state's overall take is certainly the highest and most regressive. His company typically deals in constant severance tax terms in the Lower 48, meaning the severance tax is fixed regardless of the amount produced.

[2:18:16 PM](#)

CO-CHAIR JOHNSON inquired whether Savant Resources, LLC expects to continue its 50:50 investment in Alaska.

MR. VIGIL replied Savant Alaska has a significant amount of money in the ground and is committed to get this plant re-started and make this project work. [Savant Alaska's] investment decisions are not the same as a major oil and gas company which has a portfolio of investment projects. [Savant Resources, LLC] formed this company and financed it accordingly, so those investment decisions have already been made and those dollars are committed to the project and will be invested in Alaska.

CO-CHAIR NEUMAN presumed it is a make-or-break situation.

MR. VIGIL answered correct.

2:19:06 PM

MARK LANDT, Executive Vice President - Land & Administration, Renaissance Alaska, LLC ("Renaissance"), noted he is commenting on both HB 308 and HB 337. He said Renaissance was formed in November 2006, is headquartered in Houston, Texas, and has completed the initial funding of a business plan that solely focuses on growth in Alaska. His company's major area of focus is the Umiat oil field on the North Slope. ARC Financial Corporation, a private investment management firm located in Calgary, Alberta, is the lead investor on the project and is focused exclusively on the energy sector with currently about \$1.4 billion under capital.

MR. LANDT noted that the Renaissance team has extensive oil and gas industry experience and over 80 years of experience directly working in Alaska. The team is composed of proven oil finders and value creators in Alaska and other basins worldwide. Under previous employers, the team members have identified, captured, funded, and developed oil and gas projects resulting in cumulative recoverable reserves of over a billion barrels. Many of the team members worked together on the discovery and development of the Alpine oil field on the North Slope. Since its formation, Renaissance has acquired U.S. Bureau of Land Management and state oil and gas leases on 19,358 acres located on the Umiat oil field in the National Petroleum Reserve-Alaska and the Gubik gas field on the North Slope.

2:21:15 PM

MR. LANDT informed members that since 2006 Renaissance has spent in excess of \$40 million completing exploration and evaluation operations in Alaska. A significant amount of these funds was focused on evaluating the existing oil field in Umiat with a modern three-dimensional survey. He said the tax credits under ACES are a significant reason why Renaissance has stayed in Alaska, and the availability of those credits will play a critical role in attracting the required investment to develop the Umiat oil field. To date Renaissance has applied for a total of \$19.2 million in tax credits: it has received \$1.3 million from the state based on the future-spend, \$7.45 million from North Slope taxpayers, and has \$7.6 million in

certificates. A majority of the \$7.6 million in tax certificates was received in July 2009, but to date Renaissance has been unable to monetize those certificates.

[2:22:07 PM](#)

MR. LANDT pointed out that Umiat is a known oil accumulation with potential for near-term development and a potential supply of meaningful oil to the Trans-Alaska Pipeline System (TAPS). He said Renaissance believes it is on a path to commerciality, based upon its work and the activities being conducted by the State of Alaska. In these types of developments it is common to have a lull in spending for two to three years for pre-engineering and permitting of the project before commencement of development drilling. Therefore, Renaissance will need to monetize its existing tax credits with one of the existing producers on the North Slope. However, none of the producers are currently willing, on reasonable terms, to acquire tax credits from Renaissance. There is no liquid market for the credits, and one producer has indicated it would only consider acquiring the credit at 50 cents on the dollar, he related. The other producers have indicated they are not acquiring credits at this time for various reasons, including a lack of clarity on the regulations.

[2:23:32 PM](#)

MR. LANDT said Renaissance supports the increased access to capital credits for new explorers. Renaissance also supports the repeal of AS 43.55.028(e)(2) and AS 43.55.028(e)(3), as set forth in Section 12 of HB 337. He said this statute requires an explorer to have future spend within 24 months after applying for the tax credit for the State of Alaska to purchase the explorer's certificate. Renaissance supports the repeal of this statute because it would provide greater certainty for new investors in Alaska. Financial institutions and other investors, including ARC Financial Corporation, need to have greater certainty on when the tax credits can be received, from whom, and on what terms in order for value to be determined; otherwise it is not an incentive. The playing field needs to be leveled between the new and existing operators. The state pays 100 percent of the tax credits regardless, so it does not cost the state any additional money. He urged elimination of the unfair double standard in which the state rewards the North Slope producers with discounts that they have received from the explorers.

[2:24:54 PM](#)

REPRESENTATIVE SEATON asked whether Mr. Landt would support letting the Alaska Retirement Management (ARM) Board purchase unlimited quantities of tax credits on the secondary market at an 8 percent discount.

MR. LANDT responded he is supportive of anything that would expand the market for the tax credits. Based upon the terms Renaissance has considered before from the tax producers, that would be a better term. However, since the state is still paying 100 percent for the tax certificates, he does not see why Renaissance must go through a third party market.

[2:26:01 PM](#)

MR. LANDT, in response to Representative Guttenberg, agreed to provide members with a copy of his written statement.

REPRESENTATIVE KAWASAKI commented that the exploration tax credit has been in effect since October 2009 and in regard to clarity there should be an explanation forthcoming soon.

REPRESENTATIVE TUCK inquired what percentage of Renaissance's new investments since 2006 have been in Alaska versus other operations in the Lower 48.

MR. LANDT said his company's business model is to focus exclusively in Alaska, so every penny of capital that has been expended has been in either the Cook Inlet or Umiat.

[2:27:42 PM](#)

REPRESENTATIVE KAWASAKI said the state is pushing for a road to Umiat, which he thinks will help in monetizing known oil resources. He requested Mr. Landt to expand on his previous statement about Renaissance being on "a path to commerciality".

MR. LANDT replied that since acquiring the leases in 2006 and 2007, Renaissance has been de-risking the process by bringing modern technology to the project, which included a three-dimensional seismic program covering the entirety of the Umiat structure. A number of engineering studies have now been done to provide cost estimates based upon facilities, development drilling, and a pipeline over to the Trans-Alaska Pipeline System (TAPS). Renaissance is trying to narrow the cost range in terms of what this project is ultimately going to cost, as

well as de-risk the reserves. With the tax credits and support on the road, he said Renaissance thinks it has a project that could move forward. Current plans are to start the permitting process on the field development itself. That will run simultaneously with the environmental impact statement for the transportation corridor over to TAPS.

[2:30:28 PM](#)

MARK HANLEY, Public Affairs Manager, Anadarko Petroleum Corporation ("Anadarko"), stated Anadarko is partners with ConocoPhillips and has 22 percent ownership in the Alpine field; thus, Anadarko has production. Anadarko is participating with ConocoPhillips in most of the NPR-A exploration, including the CD-5 drill pad that was just denied a permit. Anadarko is also exploring for gas in the Foothills where it has access to about 4 million gross exploration acres, which is 1.3 million net acres to Anadarko. On a worldwide basis, Anadarko is considered a relatively large independent, with about 50 percent of its business in the U.S.

[2:32:00 PM](#)

MR. HANLEY said he thinks it is a given that production on the North Slope is declining and eventually the immense Kuparuk and Prudhoe Bay fields will be depleted. The goal for both the state and his company is to make money, so keeping the decline rate as low as possible is critical to everyone. The issue and question is whether the investment is enough to keep that decline rate slow or even reverse it, and he suggests not. For example, just to offset one year of decline requires bringing on one new project every year or two that produces about 20,000 barrels a day at its peak, given that projects generally come on for five years to reach their peak and then decline. If there is not enough investment, something needs to be done to increase it. As a company, Anadarko will invest where it can make money. Overall, something is not right, and one thing that can be controlled is the tax rate, unlike distance from infrastructure.

[2:34:57 PM](#)

MR. HANLEY addressed the positives under the current system of Alaska's Clear and Equitable Share (ACES), saying Anadarko thinks the net system is a good system because it takes into account higher-cost fields and newer exploration. However, any system, even a net system, can have tax that is still too high. Anadarko also thinks the credits are a good thing because the

credits help with the net present value by cutting the costs in half. He cautioned, however, that some in the industry view this as going to a store that has doubled its prices while holding a 50-percent-off sale. He explained that in the Foothills Anadarko is lucky to drill one 10,000-foot well per year looking for gas. To gain an understanding of one prospect can take four wells, which takes four to five years. The costs in Alaska are generally more than double than elsewhere; for example, one rig in the Gulf of Mexico can drill four wells in one season. Thus, while the credits are helpful, Anadarko is still challenged in Alaska on a net present value basis because of the short operating season.

[2:37:09 PM](#)

MR. HANLEY handed out a graph entitled, "Comparison of Estimated Production Tax Revenue From ACES, PPT and ELF for FY 2007 - FY 2010" [page 15 from a 2/4/2010 presentation by the Department of Revenue]. He noted that under the ACES system the state has collected about \$2 billion more for each of those years than it would have collected under the Economic Limit Factor (ELF) system. He acknowledged that there was not enough investment under ELF and argued that taking \$2 billion more out of industry does not improve industry's economics or encourage more investment. Even with the ACES credits, the state is netting out more money than it did under ELF.

[2:38:50 PM](#)

MR. HANLEY said that while ACES has numerous good parts, it is too much overall. He reminded members that when originally testifying about the petroleum production tax (PPT), Anadarko said PPT would improve its exploration economics slightly over ELF, but would hammer the existing fields, including Anadarko's Alpine field; thus, on balance, PPT was not great but it was okay. Anadarko testified that ACES was even worse than ELF and that is what is shown by the department's graph.

MR. HANLEY offered Anadarko's support for HB 308, saying the credits help, particularly in-field. The progressivity slope is too high and needs changes. He provided an example of how progressivity works: Under the federal income tax system a company making \$50,000 might be in the 20 percent tax bracket. An income of \$50,001 might jump the company into the 25 percent tax bracket, but that 25 percent would apply only to that one dollar. However, under ACES, that 25 percent tax would apply to all \$50,001. Instead of just applying the extra progressivity

to the dollar amount over the \$30 per barrel trigger, the progressivity also applies to the \$30, which is a disincentive. He said it could be argued that there is somewhat of an incentive to keep a company's per barrel profits at \$30 per barrel or under, as was indicated by [Mr. Vigil].

[2:40:59 PM](#)

MR. HANLEY stated that even if the tax rate is reduced and the progressivity maintained, or if the base rate is taken down, the tax would still be too high overall. Alaska is not getting the investment and it is hard for Anadarko to compete. For example, Anadarko just announced a 500-million-barrel discovery in the Gulf of Mexico where there is a 12.5 percent royalty rate and no severance tax and no corporate income tax. For a lot of the places Anadarko does business, Alaska does not compete and what that means is that Alaska must have bigger prospects to be able to sustain this higher tax regime, but in its explorations Anadarko is seeing a lot of smaller, 50-100 million barrel fields.

[2:42:15 PM](#)

MR. HANLEY pointed out that Anadarko is almost a victim of its own success with announcements of discoveries in Ghana, Brazil, and the Gulf of Mexico. Additionally, Anadarko is conducting substantial drilling in the Marcellus Shales. The company is putting a lot of cash into things that come out right away or within a year and a half; whereas, in Alaska, Anadarko has a well that will take three to four years to test drill. He noted that unlike Renaissance, Anadarko and its partners are able to apply credits against their Alpine income right away. However, a partner with no production in Alaska would be unable to monetize the credit should Anadarko and its partners sit out one year while analyzing well data. Changing this would not affect the state, but would provide a benefit to the people spending the money. He urged members to look at how much the state needs just to offset the decline. He said Anadarko supports the provisions of HB 308 given that production is declining and investment is inadequate.

[2:44:32 PM](#)

CO-CHAIR NEUMAN agreed that the production decline could be a difficult situation in the future.

REPRESENTATIVE SEATON noted that there is nothing the state can do about the competitive advantages of places where there are no corporate or state taxes and drilling can be done year around. He noted, however, that there is very little exploration and investment in Cook Inlet despite a very low tax rate. He asked how this is explained and what is to say this would not happen elsewhere in Alaska if taxes are lowered there.

MR. HANLEY answered that Anadarko did operate in Cook Inlet, and he thinks there are multiple factors of which one is the resource potential; Anadarko did not see significant resource potential left in Cook Inlet. If legislators think there are resources to be found in Alaska, then the state must still be able to compete, he advised. A 50-million-barrel field in the Gulf of Mexico is a big find, but the same size field on the North Slope is not economic if it is more than 10 miles from existing infrastructure. It is just a recognition that there are these challenges and if the taxes are reduced, starting with HB 308, there would be more investment in Alaska, although it may still need to go a bit lower. While he thinks there is resource potential on the North Slope, he said it is challenged for numerous reasons, and one thing that can be controlled is the severance tax.

[2:48:22 PM](#)

REPRESENTATIVE OLSON inquired whether Anadarko is acquiring its tax credits from its partners.

MR. HANLEY responded Anadarko has purchased some credits but not all. As a small producer on the North Slope, the statute only allows Anadarko to reduce its tax by 20 percent using these credits. Thus, Anadarko has only a limited amount of tax credits that it can actually purchase, although it has purchased some. It is easier to have the state purchase the credits at face value so there is no paperwork. In further response, he said the state sees the same impact and changing this part of the statute would allow other explorers to receive full value for the money they are spending. For those explorers looking at only one prospect that does not pan out, there is nothing left to spend and the explorer may be unable to sell its credits.

[2:50:31 PM](#)

REPRESENTATIVE GUTTENBERG asked what happened during the years of ELF when the tax rate was so low, yet there was no exploration. He noted that this was the time period when Mr.

Hanley was a member of the legislature and asked why the tax rate was not changed then.

MR. HANLEY replied that when he left the legislature the price of oil was \$10 per barrel. At some point the price is so low that things are uneconomic, he said. Revenue for both the industry and the state has gone up because the price of oil has gone up, which has made prospects more economic. However, a company must still compete and show a certain rate of return; so, if a project elsewhere is better a company will go there. Technically, he continued, a company can be losing money and still have to pay severance taxes, which is why the net profit system makes sense. For example, a system with just a fixed rate on the production times the price is a regressive system - if a company makes \$100, but it cost \$100 to produce the oil and the severance tax rate is 10 percent, the company still pays \$10 even though it had no income. Although ELF tried to address some of that, it was not a particularly elegant solution to some of the problems.

CO-CHAIR NEUMAN quipped that during the time of \$10 oil the cost of running state government was about \$9.50 and now with \$75 oil the cost of government is \$74.

[2:53:00 PM](#)

REPRESENTATIVE KAWASAKI inquired whether Anadarko is party to any of the closed leases depicted on the map that was presented by Ms. Crockett.

MR. HANLEY answered yes, Anadarko gave up a couple hundred thousand acres, as well as some acreage in some other areas. He explained that Anadarko sees what is most likely and decides whether to pay rent on it. Some sites are so far out that the thought may be never for drilling. He noted that not as many wells are being drilled and only two exploration wells are being drilled this winter.

[2:54:38 PM](#)

REPRESENTATIVE KAWASAKI referred to slide 16 from the same 2/4/10 Department of Revenue presentation that Mr. Hanley took his graph from. He noted that slide 16 shows higher North Slope capital and operating expenditures for the same time period [of FY 2007 - FY 2010]. Therefore, he opined, the current mantra of higher taxes means less jobs does not seem to play out.

MR. HANLEY allowed that some things have been done because the price of oil went up. He suggested, however, that a lot of work has been spent on pipeline replacement during this same time frame. Right after the first petroleum production tax (PPT) was passed, some things happened that required a lot of maintenance work. While he is not discounting that there have been ups and downs, the question is what the spending is on and whether it is actually producing more oil. The older fields have higher costs just to maintain existing production, and the same applies to the aging TAPS pipeline. Anadarko will not spend money just for the purpose of getting credits, he said. Income must be received from that expenditure. Spending will not happen if it does not make sense to spend as a company.

MR. HANLEY said the big picture to him is that money is being spent, yet total production is still declining in Prudhoe Bay, Kuparuk, and the North Slope. While the number of workers is a consideration, he urged members to not lose sight of whether the decline is being offset and whether there are things in the state's control that can be used to attack it. While there is a risk to whether lowering taxes will actually result in more production, he said he thinks the lower the taxes the more likely more production. He pointed out that to the extent the state has risk, the risk happens at higher prices when progressivity kicks in. Therefore, the state has some flexibility in changing the progressivity rate because that is at the high end of prices, not the low end. He suggested this is a risk worth taking should new investment and increased production not happen.

[2:58:28 PM](#)

CO-CHAIR NEUMAN commented that throughput in TAPS, and jobs and production, probably run at about the same level.

CO-CHAIR JOHNSON, in response to Representative Kawasaki, said Pioneer Natural Resources Alaska, Inc. ("Pioneer") was invited to testify, but had a conflict.

REPRESENTATIVE KAWASAKI related that when Pioneer Oil Company went on line at the Oooguruk Unit it applied for royalty relief to make the economic model work. [Under HB 308], portions of the two-year-old ACES legislation would be completely gutted because it is being said there is less investment. Given there are now royalty relief provisions in statute, he asked why smaller companies like Anadarko do not apply for royalty relief to prove to the state it is not marketable.

MR. HANLEY responded he cannot speak for Pioneer Oil Company, but pointed out that they were during the ELF period.

[3:00:24 PM](#)

REPRESENTATIVE SEATON, in regard to exploring for oil, inquired how big of a deal it is to not be able to sell the gas that comes with the oil.

MR. HANLEY replied it is pretty important. He said he thinks having a gasline will help with oil recovery, exploration, and gas exploration.

REPRESENTATIVE SEATON further inquired whether this is another one of the qualifications where the Gulf of Mexico has gas saleability while Alaska does not.

MR. HANLEY answered yes.

CO-CHAIR NEUMAN pointed out that written testimony from Ken Sheffield of Pioneer is in the committee packet.

[3:02:34 PM](#)

DALE PITTMAN, Alaska Production Manager, ExxonMobil Production Company ("ExxonMobil"), noted that he commenced his position as Alaska Production Manager in June 2009 and has been with ExxonMobil for nearly 30 years. He said he is looking forward to continuing the current progress to develop and operate Point Thomson. He paraphrased from the following written statement while making a PowerPoint presentation [original punctuation provided]:

ExxonMobil has been working in Alaska for more than 50 years. We have been a key player in Alaska's oil industry development, spending and investing well over \$20 billion dollars during that time. As you know, we are currently active with our co-owners at Prudhoe Bay, Kuparuk, Duck Island and Granite Point. We are also excited about our progress at Point Thomson and remain on track to achieve a 2014 production startup. We look forward to being a part of Alaska for many years to come.

[3:03:57 PM](#)

At the outset, let me say that ExxonMobil supports the presentation you heard today from the Alaska Oil and Gas Association. I do not intend to repeat the thorough technical comments from that testimony.

As for our specific comments, I would like to state, consistent with our prior testimony during the hearings on both the PPT and ACES, that ExxonMobil believes Alaska's current production taxes are too high to result in the additional investment needed to maximize the development of Alaska's resources. It is our belief that even the proposed 20 percent tax rate that was in the original PPT bill would not encourage the full development of Alaska's resources.

Alaska is rich in undiscovered resource potential. To date, Alaska has produced more than 15 billion barrels of oil from the North Slope, and according to the DNR there are approximately 6 billion barrels of known resources remaining. These resources represent a known opportunity, but their development is at risk under the current tax system. Oil production today is one-third of the peak oil production of more than 2 million barrels per day in 1988, and annual production continues to decline.

[3:05:24 PM](#)

Spending on the North Slope has remained relatively flat since the enactment of ACES, as you have heard in prior testimony. But the majority of that investment has been for maintenance or production enhancement efforts for existing operations, not for new exploration and development opportunities. In fact, the industry currently invests more than \$1 billion per year just to maintain North Slope oil production at the current decline rate of about 6 percent annually. Without that continued investment, the annual production decline would not be 6 percent, but would actually be closer to 12-15 percent annually.

What this means is in just 10 years, the majority of future oil production will need to flow from new investments - investments that are at risk today under Alaska's current production tax regime.

Let me explain.

Time in the oil and gas industry is not measured in business cycles. It is measured in decades and in generations. Today's production rates are the product of government policies, technical work, and investment decisions that in many cases were made decades ago. Increasing production rates in the decades to come will result from sound policies, decisions, and commitments that are made today. As policy makers, you will need to decide whether Alaska's current high production tax regime is the right course for Alaska or - given the current high costs and steadily declining oil production rates we face - if another course is necessary to harness the remaining resource potential.

3:06:37 PM

It is important to recognize that any decision made today impacts much more than tax revenue in the future. Decisions made today impact jobs for Alaskan workers, revenue for many Alaska businesses, and infrastructure that benefits Alaskan communities and extends the life of production in existing fields.

To encourage full development of Alaska's resources, we believe production taxes should be lowered. The high base tax rate and the higher taxes due to the additional progressivity tax are major disincentives to the high risk investment opportunities required in Alaska.

3:07:17 PM

Companies like ExxonMobil are willing to accept the risks of long-term, capital intensive investments when there is a stable tax structure that allows and encourages investment and ensures a corresponding opportunity for upside potential. Upside factors such as increased production and higher prices should be a benefit for risks taken, because companies are certainly negatively impacted when lower than expected production or prices occur. When you take away the upside potential that companies can achieve you reduce the overall attractiveness of those capital intensive investments.

Alaska faces significant challenges. Costs are high, exploration is down and production continues to decline. We all need to work together to achieve the right balance - a balance that maximizes the benefit to Alaskans while encouraging industry to continue to invest in Alaska.

[3:08:09 PM](#)

We advocate a collaborative approach to develop a sustainable long-term resource development policy that will encourage the needed investments to build the future of Alaska for many generations to come.

Alaska's resource development policy should identify and characterize state-wide resource potential, identify key issues challenging exploration and development, and encourage investment needed to mitigate production decline. Such a policy should also consider key factors that impact resource value, such as research and technology, exploration and development costs, regulatory and environmental considerations, and land access. A reassessment of Alaska's high production taxes is a critical part of that long-term resource development policy.

[3:09:03 PM](#)

Committee Substitute to House Bill 308 is best characterized as a first step toward what we believe should be a comprehensive examination of Alaska's production tax structure.

It will take everyone working together to achieve that long-term policy. Government leaders, industry representatives, contractors and citizens all stand to benefit from developing Alaska's resources.

ExxonMobil looks forward to working with the Administration, the legislators, industry and the people of Alaska in the future pursuit and development of Alaska's oil and gas resources.

[3:09:41 PM](#)

REPRESENTATIVE P. WILSON agreed that it will take comprehensive examination and working collaboratively, which has been tried in

the past. She inquired whether Mr. Pittman believes that this time collaborative work can be done so that both the state and industry benefit, and that things will not be like they were in the past.

MR. PITTMAN responded that as a newcomer he cannot judge the past and allowed that it is very complex problem. He said ExxonMobil focuses on large, long-term projects and therefore looks at 30- to 50-year time horizons, although some in the industry are looking for returns in the next two to five years. The state must appeal to both types of investors, he advised, as well as those that are middle-term investors. While he does not understand all of the taxes and their implications, he is worried that it is bigger than everyone in this room. He suggested that the state needs a long-term policy that people can understand as they begin to make those investment decisions.

3:12:30 PM

REPRESENTATIVE SEATON related that when ACES was being considered, the mantra from ExxonMobil and others was that taxes needed to remain stable and should not be changed. This is now an intermediate change, because once a gasline goes through there will need to be negotiation on those taxes. He asked whether Mr. Pittman is now saying that stability on the tax system does not mean anything and the taxes should be changed.

MR. PITTMAN replied he appreciates that view and has heard it before. He said ExxonMobil is suggesting that someone needs to make that investment decision knowing what that tax structure is going to be for the next 30 years. If this is it, and it will never be changed, ExxonMobil can make those decisions now. ExxonMobil has stated its opinion that the taxes are too high and that it would help the state to lower those taxes. He said he thinks it would be beneficial if the state could tell people what taxes will look like for the next 30 years and that those taxes will not change, at least from the investment decisions that are made today. Taxes and fiscal policy are only one part when making a decision. The other parts include resource potential in a prospect, whether it is gas or oil that is being looked for, and political stability.

3:14:22 PM

CO-CHAIR NEUMAN commented that ExxonMobil did ask for a stable tax base and the legislature increased taxes with ACES, and now after a couple of years there is concern by folks like the

sponsor and the governor that production may have been affected. He inquired whether industry is receptive to the provisions in HB 308, such as more and different credits.

MR. PITTMAN answered absolutely. He added, however, that there is still a benefit to stability and he does not want people to think that ExxonMobil is looking to change taxes every two years only if it benefits the company.

[3:15:25 PM](#)

REPRESENTATIVE SEATON pointed out that there is the stable system under statute to apply for royalty relief if a project is uneconomic. He asked whether the royalty relief is not functional for ExxonMobil such that it prefers to have the taxes changed.

MR. PITTMAN responded that the hypothetical answer to this hypothetical question is that ExxonMobil has to look at the economics of that particular project. If royalty relief is needed to move the project forward, ExxonMobil would obviously entertain that. He said his overall message, however, is that legislators must strike the right balance for Alaska and the right balance for the state's investors, and then find a way to make that a stable policy that can be counted on for the future.

CO-CHAIR NEUMAN remarked that in regard to royalty relief there is a price for everything.

MR. PITTMAN agreed.

[3:16:53 PM](#)

REPRESENTATIVE KAWASAKI inquired whether the \$1 billion in annual investment mentioned by Mr. Pittman is for the oil industry as a whole.

MR. PITTMAN replied that the number is very conservative and he suspects others would say a much larger number. He said his focus there was on the money ExxonMobil spends just on well enhancements and workovers to try to keep that decline rate at the 6 percent level. In further response, he said the \$1 billion is ExxonMobil's best guess for the North Slope producers that it is involved with.

[3:17:58 PM](#)

REPRESENTATIVE KAWASAKI asked whether ExxonMobil would be willing to provide legislators with a 10-year capital spending plan if the entire legislature agrees not to change anything now and agrees to not touch taxes for ten years.

MR. PITTMAN answered that that would be a challenge for ExxonMobil as a company, and certainly for him as an individual.

CO-CHAIR NEUMAN inquired whether there are any guarantees on how much oil and gas ExxonMobil will find in the next 10 years.

MR. PITTMAN responded no.

CO-CHAIR NEUMAN said he did not think so.

[3:18:54 PM](#)

REPRESENTATIVE KAWASAKI asked whether Mr. Pittman's statement on page 4 of his testimony that exploration is down refers to ExxonMobil and the folks it does business with dollar-wise, or is about the number of wells drilled, or about contracts.

MR. PITTMAN replied his personal view is talking about the decline rate and knowing how the State of Alaska is dependent upon those revenues. Declines rarely go above 6 percent, and while it can be larger, he is worried about what things will look like in 10 years at even a 6 percent rate.

CO-CHAIR NEUMAN recessed the meeting to a call of the chair.

[6:05:39 PM](#)

CO-CHAIR NEUMAN called the meeting back to order at 6:05 p.m. Representatives Kawasaki, P. Wilson, Olson, Johnson, and Neuman were present at the call back to order. Representative Seaton arrived as the meeting was in progress.

[6:06:34 PM](#)

BRIAN WENZEL, Vice President-Finance, ConocoPhillips Alaska, Inc. ("ConocoPhillips"), stated that ConocoPhillips supports HB 308 as a step in the right direction for creating a more favorable investment climate. He qualified that HB 308 does not address all of the company's concerns with the current ACES tax structure and the proposed amendments are not an optimal structure. He added that a more favorable investment climate would create increased business confidence which would lead to

increased investment in Alaska, which in turn would lead to more jobs and purchases of goods and services from Alaskans, and more royalties and production taxes to the state.

[6:08:52 PM](#)

MR. WENZEL began his PowerPoint presentation with a map of ConocoPhillips' assets on the North Slope [slide 2]. He said ConocoPhillips is a 5 percent owner in Point Thomson, a 36 percent owner in Prudhoe Bay where "BP" is the operator, a 55 percent owner in Kuparuk where ConocoPhillips is the operator, and a 78 percent owner in Alpine. All of these assets, as well as the company's assets in Cook Inlet, are subject to various forms of government take, such as property tax, royalties, production tax, state corporate income tax, and federal income tax. On average, government take in Alaska ranges from 65-75 percent, based on oil prices between \$70 and \$115 [per barrel]. This means that for a given \$100 of net cash flow the producer keeps only \$25-\$35 and the rest is government take of one form or another. He explained that progressivity is dramatic when looking at an incremental dollar. For example, if the price per barrel goes up by \$1, the marginal take on that incremental dollar can be as high as 93 percent, leaving the producer with only 7 cents from that \$1.

[6:09:46 PM](#)

CO-CHAIR NEUMAN requested Mr. Wenzel to address the concept that while all the forms of government take might total 80 percent, the producer is left with a 20 percent net margin and most companies would consider a 3-4 percent margin as doing well.

MR. WENZEL responded that the total take by the various government forms is 65-75 percent of the net cash flow. While some people might view the producer's net margin as a significant margin, it is ConocoPhillips' view that it is the one taking the risk. At times, larger returns are received and at other times the returns are zero or negative.

[6:11:33 PM](#)

MR. WENZEL returned to his presentation, stating that HB 308 attempts to partially rectify the extreme nature of the progressivity that creates a marginal tax rate of 93 percent.

MR. WENZEL explained that as a result of investment, the decline profile shown on slide 3 is shallower than it would otherwise

be. Everyone is looking to the day when technology allows the development of heavy oil, Alaska North Slope (ANS) gas, and the Outer Continental Shelf; however, this technology is at least 10 years away. ConocoPhillips is concerned about how to bridge the gap between now and then so that production does not fall so precipitously that it creates problems. ConocoPhillips believes it is going to take another \$40 billion in expenditures over the next decade just to deliver the profile shown on slide 3. Less investment will mean a faster decline rate.

[6:13:36 PM](#)

CO-CHAIR NEUMAN related that at a presentation on 3/9/10, Alyeska Pipeline Service Company ("Alyeska") said the decline would reach 300,000 barrels [per day] within 8-10 years. He asked for an explanation as to why the decline depicted on slide 3 is an additional 20 years out.

MR. WENZEL replied he has not listened to all of Alyeska's comments, but he understands that Alyeska has said that significant operating issues [for TAPS] begin at 500,000 barrels per day and 300,000 barrels per day is worse.

[6:14:34 PM](#)

CO-CHAIR NEUMAN offered his understanding that at 300,000 barrels a day the pipeline cannot be operated.

MR. WENZEL answered he must have missed that because he would have thought Alyeska would say that [TAPS] can be operated, but it just comes with additional cost and difficulty, which is something everyone is concerned about. The point is that Alyeska is questioning whether it will be economic to operate the pipeline at that point, and ConocoPhillips would agree. He noted that the data on slide 3 is from the Department of Revenue, not ConocoPhillips. He said ConocoPhillips would agree that it is one more reason for not letting production fall too far before bringing on heavy oil or the Outer Continental Shelf.

CO-CHAIR NEUMAN added it is not just the economic, but also actual physical properties such as viscosity, water, waxes, and such.

MR. WENZEL agreed.

[6:15:42 PM](#)

CO-CHAIR JOHNSON observed that slide 3 is data forecast by the Department of Revenue, and Alyeska's forecast at its 3/9/10 presentation was less than projected by the department. He inquired whether ConocoPhillips has conducted a forecast or is depending upon the Department of Revenue.

MR. WENZEL responded ConocoPhillips is probably not depending upon the Department of Revenue exclusively, but it did choose the numbers depicted on slide 3 because they are public numbers. ConocoPhillips has not put out its own numbers; it is a way for the company to get a total industry view as opposed to simply taking ConocoPhillips' view and factoring it up.

[6:16:32 PM](#)

MR. WENZEL resumed his presentation, noting that slide 4 uses production at the Kuparuk and Alpine oil fields to illustrate the importance of additional investment. He explained that the orange-colored portions of the two graphs depict the base production off the initial asset investment and the green-colored portions depict the incremental investment. The incremental investment is additional project development that increases production beyond what was originally expected and is the type of investment that helps to mitigate production decline.

MR. WENZEL pointed out that the new projects being discussed, such as Point Thomson, Nikaitchuq, Liberty, and Oooguruk, are relatively small in terms of remaining barrels over the next 40 years from 2010-2050 [slide 5]. According to a 2008 Department of Revenue forecast, the vast majority of remaining barrels will come from the core fields of Kuparuk, Prudhoe Bay, and Alpine. Therefore, when structuring fiscal policy to incentivize additional barrels, it is the view of ConocoPhillips that those core fields are what should be looked at.

[6:18:40 PM](#)

MR. WENZEL noted that the 2009 Department of Revenue forecast predicts a 20 percent reduction in production from the core fields [slide 6]. The department steepened its decline rates because it is now expecting less recovery. He reminded members that in a February [2010] presentation the Department of Revenue showed a slide depicting investment falling off dramatically in the core fields. He said it is ConocoPhillips perspective that the two are inextricably tied - losing investment increases the steepness of decline.

MR. WENZEL reviewed ConocoPhillips' concerns regarding the leading indicators of problems in Alaska [slide 7]. He pointed out that ConocoPhillips has been the state's leading explorer for many years. However, it will not be drilling an exploration well in 2010, the first time in 45 years that it has not drilled an exploration well. Of industry's four wells that are permitted for 2010, he is unsure whether all of them will happen. The dramatic decrease in industry exploration wells [depicted by the graph on the left side of slide 7] cannot be ignored. He said the [14 percent] decline in industry well completions [from 2007-2009] is a leading indicator to ConocoPhillips of problems within the state. If wells are not being drilled and are not being completed, new barrels of oil are not being found and brought on.

6:20:55 PM

MR. WENZEL, in response to Co-Chair Neuman, said ConocoPhillips is not drilling an exploration well in 2010 for a number of reasons that are combined together when making decisions. One reason is ConocoPhillips' view of prospectivity in some of its acreage. Another reason is that ConocoPhillips is spending a fair amount of money in getting ready for exploration in the coming years in the Chukchi Sea. An additional reason is the fiscal system. As ConocoPhillips looks into the uncertainties of the future, and the average and marginal take by the State of Alaska, it gets to a point where it does not make sense. He noted that ConocoPhillips is doing things in-field because that is seen as a much more efficient way to bring on additional barrels.

6:22:12 PM

REPRESENTATIVE KAWASAKI inquired as to ConocoPhillips' activity levels in the other countries in which it operates.

MR. WENZEL responded he does not have a full laundry list, but a few months ago Larry Archibald, Vice President of Exploration, stated in a presentation that ConocoPhillips sees its operations in the Gulf Coast off Texas and in Australia as being more attractive regimes for its exploration dollars than Alaska.

MR. WENZEL continued his discussion of leading indicators in regard to drilling activity [slide 8]. He drew attention to the black line at the top of the graph depicting historic oil prices and the green line below that which depicts the U.S. oil rig

count [from 2005 through 2009], and pointed out that they move up and down in tandem, although the oil rig count is somewhat delayed in its reaction given it takes awhile to get rigs engaged or disengaged. He said the troubling thing is that the rig trend for core fields in Alaska, depicted by the red bars on the graph, is flat or down from second quarter 2006 through fourth quarter 2008, while the U.S. oil rig count increased steadily over this same time frame. Additionally, oil prices went up in late 2009 and the U.S. rig count responded accordingly, but Alaska's rig count declined. For ConocoPhillips, this is a leading indicator of problems yet to come in Alaska, he said.

[6:24:39 PM](#)

MR. WENZEL, in response to Representative Kawasaki, explained that the core fields being depicted on slide 8 are Kuparuk, Alpine, and Prudhoe Bay, as was also depicted on slide 5. The core fields represent 90 percent of North Slope production in 2009 and also represent the vast majority of expected remaining barrels over the next 40 years relative to some of the other projects that are going on today. He said ConocoPhillips thinks the core fields are the areas of opportunity in terms of incentivizing new investment and new production.

REPRESENTATIVE KAWASAKI asked whether the rig count has a direct correlation to the volume of oil.

MR. WENZEL replied yes, there is probably some natural correlation but it is not a direct linear formula. As an industry, the goal is to have more rigs drilling because more rigs either finds more barrels or brings on more barrels when conducting in-field drilling.

[6:26:32 PM](#)

MR. WENZEL, in response to another question from Representative Kawasaki, explained that the green line for the U.S. rig count does not depict the actual number of rigs. He explained that he normalized the line and forced it to meet the top of the red bar for Alaska for the first quarter of 2005. The total number of U.S. rigs is much larger than the red bars; he just brought the green line down so the correlation could be seen. For example, the peak number of U.S. rigs for fourth quarter 2008 is 145.

[6:28:10 PM](#)

MR. WENZEL returned to his discussion of leading indicators, saying that the second leading indicator of concern to ConocoPhillips is the overall spending level. He said ConocoPhillips has a different view than does the administration regarding the increasing levels of expenditures which have led the administration to conclude that it is too early to decide whether there is a problem coming. He explained that the red bars on slide [9] represent the industry's total capital and operating expenditures, which increase from fiscal year 2007 to 2009 and which are forecast to decrease in fiscal year 2010. The yellow bars adjust those expenditures for inflation and these bars indicate that in reality those expenditures are flat over this time frame, which is not indicative of a growing and vibrant industry.

MR. WENZEL moved to slide [10] and pointed out that investment is flat in development projects, which are the new production projects that bring on new barrels. However, investment is increasing for maintenance/replacement/repair projects, which are projects that maintain current-level production. Thus, less and less of the total expenditure is on rate-adding production that puts more barrels down the pipeline and brings more revenue to the state.

[6:30:15 PM](#)

REPRESENTATIVE SEATON noted that due to deflation the cost of drilling wells and installing pipe has decreased. In regard to slide 9, he surmised that this would raise the red bars from the prior year where the costs were unitized higher.

MR. WENZEL answered the yellow bar, yes. To the extent that deflation was seen, it would possibly reflect in a higher number there.

CO-CHAIR NEUMAN asked whether ConocoPhillips' year-to-year operating expenses have ever decreased.

MR. WENZEL responded they have not in the recent past, but he does not know further back than that.

[6:32:00 PM](#)

MR. WENZEL, in response to Representative Seaton, said the expenses shown on slide 10 are not adjusted for inflation. He said he thinks if they had been adjusted, the development projects would be down a little and the maintenance/

replacement/repair would still be increasing but at a flatter rate. He pointed out that for 2008 and 2009 more than half of the expense was going for maintenance/replacement/repair as opposed to rate-adding.

CO-CHAIR NEUMAN inquired how the declining throughput in TAPS for the years 2005-2009, would equate to the graph on slide 10.

MR. WENZEL replied there would be a steady downward decline of production through TAPS, so the costs per barrel are increasing dramatically. In further response, he said the goal should be to increase the height of the red bars [on slide 10] over time because ConocoPhillips believes that will lead to more production which then lessens the slope of production decline; however, there would still be production decline.

[6:33:40 PM](#)

REPRESENTATIVE WILSON observed that many factors happened at the same time, such as pipeline leaks that needed to be repaired, coupled with the economy falling and the declining production. She asked whether ConocoPhillips had to therefore shift its money from development to maintenance and repair.

MR. WENZEL presumed the question is whether ConocoPhillips has some pre-set idea of how much it is going to spend per year in Alaska. He said that is not case; ConocoPhillips will spend as needed to affect the necessary repairs and be able to operate safely. At the same time, the development projects in Alaska compete independently with other projects around the world and those funds will be allocated according to where it is most economic with the least amount of risk and uncertainties. Part of ConocoPhillips' concern in Alaska is that as that proportion of maintenance and repair is masked by the overall increase, it sees a greater decline in the future. ConocoPhillips will get through this repair of its 30-year-old assets and this bubble will come off in 3-4 years, but addressing how to incentivize development projects needs to be started now or it will be even more difficult in the future.

[6:36:12 PM](#)

REPRESENTATIVE SEATON understood that most of the production is in the core fields, but that does not mean that most of the investment is necessarily in the core fields. He inquired whether there is a graph looking at the total investment that includes Point Thomson and the other development projects.

MR. WENZEL answered he does not have anything that splits out the investment by core field versus other fields. However, pointing back to slide 5, he noted that the opportunity is in the core fields; thus, he recommends setting up a fiscal system that incentivizes more investment in those core fields. The opportunity in Point Thomson, Nikaitchuq, Liberty, and Oooguruk is relatively small in terms of remaining barrels. He said HB 308 makes sense because it expands the tax credit system to apply to investments in those core fields.

REPRESENTATIVE SEATON requested Mr. Wenzel to provide the committee with material that looks at the total investment for both core and new projects.

[6:38:08 PM](#)

REPRESENTATIVE KAWASAKI asked how much of the maintenance investment [on slide 10] is due to new requirements by the Department of Transportation & Public Facilities or other state agencies.

MR. WENZEL responded he does not have those numbers and will get back to members with that information.

MR. WENZEL commenced his presentation with discussion of a third leading indicator - oil and gas employment [slide 11]. He related that the administration sees increasing levels of employment. Employment peaked in mid-2009, but has fallen in the last few months. He said ConocoPhillips is of the view that part of that employment increase is also driven by the increase in spending on repair and refurbishment activities. He also noted that usage of the Kuparuk camp is down 20 percent.

REPRESENTATIVE KAWASAKI related that according to the last [Department of Labor & Workforce Development] report the total number of nonresident hires in the oil industry is increasing. He further related that another report regarding economic trends shows that the largest percentage of increase in the oil sector of new hires is from nonresidents. He requested Mr. Wenzel to address this from the perspective of the industry as a whole.

MR. WENZEL offered to speak to this when he gets to slide [16].

[6:40:44 PM](#)

MR. WENZEL resumed his presentation and addressed the administration's talk about additional projects that are being approved and moved forward. He reminded members that Oooguruk was sanctioned prior to ACES becoming effective, so there was no chance to change the investment decision. Both Oooguruk and Nikaitchuq had royalty relief to help their economics. Liberty is not subject to the ACES tax system. He said ConocoPhillips is aware of \$2 billion in projects that have been deferred since the passage of ACES. These projects include the [Prudhoe Bay] I-Pad and gas partial processing project, [West Sak] 1N and 1P, and the ultra low sulfur diesel (ULSD) topping plant.

REPRESENTATIVE KAWASAKI inquired with Mr. Wenzel is alleging that ACES is the cause of the deferral of these projects.

MR. WENZEL replied he is indicating that \$2 billion of projects has been deferred since ACES was passed. While he cannot say why ConocoPhillips' working interest partners came to their conclusions, he can say that ConocoPhillips supported these deferrals and the ACES tax law was part of that decision.

[6:42:36 PM](#)

REPRESENTATIVE KAWASAKI asked whether changing ACES would mean these projects would come off the shelf.

MR. WENZEL answered he cannot promise the projects would come off the shelf because ConocoPhillips is only a working interest owner. However, ConocoPhillips supports HB 308 because it provides additional incentives for these projects and ConocoPhillips would definitely re-evaluate these projects. If they met ConocoPhillips' hurdle rates, the company would try to convince its working interest partners the same.

[6:43:35 PM](#)

MR. WENZEL commenced his presentation with a \$1 billion investment example. He said the first example applied to an offshore project like the Gulf of Mexico or the Chukchi Sea where there is no production tax [slide 13]. The yellow bars on the graph are the industry keep of the incremental cash flow of profits off the project and the red bars are the government take. It can be seen that as oil prices increase the investor keep and government take are about the same, making it a win-win situation. However, for this same scenario of investment and oil prices in Alaska [slide 14], the investor keep remains relatively flat even when high oil prices are reached, resulting

in a very unbalanced sharing of the upside. This unbalanced sharing is caused by progressivity in which the state government takes a greater share of the net profits as oil price goes up. He said investors in ConocoPhillips are not looking for a profile like the one on slide 14; investors are looking for exposure to upside prices and a profile that is more balanced like the one on slide 13.

[6:45:23 PM](#)

REPRESENTATIVE SEATON offered his hope that Mr. Wenzel is not suggesting Alaska should have the profile of zero production tax and no royalty. He pointed out that slide 14 shows there is protection on the downside at low oil prices when there is no production tax, something that industry supported.

MR. WENZEL responded ConocoPhillips would suggest that Alaska find a way to provide a more balanced sharing of the upside. He said HB 308 by no means creates this profile, but is a step in the right direction. As long as there is progressivity, there is always a greater share going to the government on the upside. In regard to industry support for protection on the downside, he said ConocoPhillips at that time was not arguing for protection on the downside. ConocoPhillips saw the natural balance of having the downside be exposed also, but ConocoPhillips would much rather be fully exposed or at least have a balanced approach to the upside. He said investors believe in upside price appreciation and understand the risk if prices go down.

[6:47:56 PM](#)

REPRESENTATIVE SEATON presumed ConocoPhillips would be willing to have a per barrel flat tax when the price is below \$50 as a balancing mechanism.

MR. WENZEL replied he cannot speak for the whole industry, but should a more balanced approach be created for the upside, ConocoPhillips would definitely be willing to talk about shaping an appropriate tax system that applies to the downside. He said that can already be seen today in ACES where there are protections, and in royalty fees which are flat regardless of oil prices. Additionally, ACES has a graduated floor tax that currently provides protection for the state on the downside.

REPRESENTATIVE SEATON said it is production tax that is being talked about here, not the state's ownership share in royalties.

He said he appreciates Mr. Wenzel's comments and as things go forward he will look at the taxes below \$50.

CO-CHAIR NEUMAN stated that other companies that have testified have said it is not so much production tax but the myriad of other things that also happened in ACES.

The committee took an at-ease from 6:49 pm. to 6:56 p.m.

[6:56:39 PM](#)

MR. WENZEL pointed out that the charts he is displaying show total government take, not just production tax. Production tax drives the progressivity. Total government take includes state income tax, property tax, production tax, and royalty.

MR. WENZEL discussed another leading indicator - production [slide 15]. He said the historical production decline rate is 6 percent, and Conoco Phillips believes it will take another \$40 billion over the next decade just to deliver that 6 percent decline rate. Without that \$40 billion investment, ConocoPhillips believes the natural decline rate would be 10-16 percent, which would make it very difficult to run TAPS.

[6:58:05 PM](#)

MR. WENZEL noted that his whole presentation is about the importance of investment for delivering production and for delivering jobs. He pointed out that the Department of Revenue forecast is for only a 2.5 percent decline rate. Delivering a 2.5 percent decline rate requires finding a way to incentivize new, additional investment above the \$40 billion, he said. It is not just about whether enough is being invested today, but also about what is being done to increase investment.

MR. WENZEL addressed Representative Kawasaki's question about employment [slide 16]. He said 88 percent of ConocoPhillips direct employees are Alaska residents. However, the vast majority of people working on ConocoPhillips operative assets are employees of subcontractors and the majority of those employees are also Alaska residents [ASRC Energy Services - 81.5 percent, Doyon Universal Services - 92.9 percent, Kuukpik Arctic Catering - 92.8 percent, Doyon Drilling - 89.8 percent, Halliburton Energy Services - 74.3 percent, and Nabors Alaska Drilling - 78.1 percent].

[7:00:02 PM](#)

REPRESENTATIVE SEATON, in regard to slide 15, asked what the liability risk is for dismantling, removal and restoration (DR&R) should the companies decide not to invest and the TAPS throughput subsequently goes below the necessary minimum.

MR. WENZEL answered the dismantlement and refurbishment activities are not a risk, but a reality; the companies have that obligation at some point in time. It is to the advantage of both the industry and the state to delay that period as long as possible because that would mean oil is still being produced and shipped.

REPRESENTATIVE SEATON inquired whether ConocoPhillips looks at investing in well-related activities so as not to incur the significant costs of DR&R sooner rather than later.

MR. WENZEL responded no, that is not part of ConocoPhillips' consideration in terms of how quickly it might be faced with its DR&R liabilities. ConocoPhillips knows those are out there and is accruing for them. ConocoPhillips is very much motivated by production, just as the state is, and wants to increase production wherever, whenever, and as quickly as possible. For ConocoPhillips it is all about how to continue or increase production in an economic fashion.

[Co-Chair Neuman passed the gavel to Co-Chair Johnson.]

[7:02:53 PM](#)

MR. WENZEL reiterated that ConocoPhillips supports HB 308, saying that while the bill does not go far enough, it is a step toward creating a more favorable investment climate that builds business confidence [slide 17]. The bill would reduce progressivity which would create a more balanced risk/reward environment, incentivize new investment in core and new fields, and support increased long-term jobs and investment in riskier projects. The bill would provide expanded credits for expense activities which would incentivize well-related activity inside the core fields. The bill would provide for restoration of the 3-year audit period, something that is important to the state as well as the taxpayer to ensure that both are aligned in their interpretation of the tax law and the regulations. The bill would provide waiver of interest due to delayed regulations, which is the only fair way to do this. Lastly, HB 308 would provide a more reasonable interest rate that is more in keeping with other states and other commercial contracts.

7:05:17 PM

MR. WENZEL summarized, stating that ConocoPhillips sees several leading indicators that cause it concern. It is past time to make a change to the production tax system in Alaska because the government take is too high. The most leveraging way to adjust that, while still creating a semblance of a balanced sharing of the upside with the state, is to adjust the progressivity, and HB 308 attempts to do that. The number of wells and rigs are down, expenditures on the North Slope are flat after taking out inflation, development expenditures are down, employment is trending down, camp usage is down 20 percent, and there are \$2 billion in deferred projects that are partly due to ACES. Production decline is key to everyone, he stressed. It will require \$40 billion over the next decade just to maintain the 6 percent decline rate, yet the state is projecting only a 2.5 percent decline; therefore, a way must be found to incentivize dramatically more investment on the North Slope. He said HB 308 is an opportunity to create a climate that is more favorable toward future investment, future jobs, and future revenues for both the industry and the state.

7:07:04 PM

REPRESENTATIVE SEATON asked whether ConocoPhillips has estimation that it will be able to declare actual expenses now that there is no longer the standard deduction for the core fields. He understood that actual expenses exceeded the standard deduction that was put in place during the time period that ACES regulations were not yet adopted.

MR. WENZEL replied he believes the number put out by the Department of Revenue was \$300-\$400 million in expenditures that were not allowable because of the standard deduction. Thus, those expenditures will come into play and will reduce the profitability per barrel, which reduces the progressivity going into 2010. He said it is not a standard deduction like a state income tax and is not a simple way to take just one deduction and not have to prove it. In reality, all expenses must still be proved up to that number, which means it does not save effort. Rather, it is a cap on expenditures and ConocoPhillips believes it is an inappropriate cap because all expenditures are legitimate and should be deductible against a net profits tax.

[Co-Chair Johnson returned the gavel to Co-Chair Neuman.]

[7:09:35 PM](#)

REPRESENTATIVE SEATON said he does not disagree with Mr. Wenzel. He inquired whether Mr. Wenzel knows how much the profitability numbers will be moved downward.

MR. WENZEL answered he has not done that calculation to see what it does in terms of changing the production tax value (PTV) per barrel of oil equivalent (BOE). He offered to provide the calculation for members.

[7:10:37 PM](#)

REPRESENTATIVE KAWASAKI asked how much ConocoPhillips intends to spend for capital infrastructure in the state of Alaska over the next 10 years under the current ACES provisions.

MR. WENZEL responded that number has not yet been set.

REPRESENTATIVE KAWASAKI inquired how much ConocoPhillips would intend to spend on capital infrastructure in the state of Alaska if HB 308 was passed.

MR. WENZEL replied he cannot say, but that he can say it would create a more favorable business climate and will, in the view of ConocoPhillips, incentivize new investment.

[7:11:34 PM](#)

REPRESENTATIVE KAWASAKI asked why Mr. Wenzel has not mentioned the local hire provision of HB 308 as one of the reasons for ConocoPhillips' support of the bill.

MR. WENZEL answered there was a fair amount of debate on that provision at earlier hearings and he does not want to start that debate. If the provision stays in the bill, ConocoPhillips would be happy to see it there because it has a defensible and impressive record on Alaska hire. That aside, ConocoPhillips would support the bill for the reasons he has suggested.

[7:12:30 PM](#)

REPRESENTATIVE KAWASAKI inquired whether ConocoPhillips has calculated how much more money it would have made if ACES and progressivity not been in place.

MR. WENZEL responded no. He said the question is multi-fold as to whether to go back to ELF or PPT, and it is not considered a loss because ConocoPhillips pays its taxes under the law of the day. However, ConocoPhillips talks to members and recommends changes it thinks are necessary for creating a healthy and vibrant oil industry and economy for Alaska.

[7:13:19 PM](#)

CO-CHAIR NEUMAN asked whether ConocoPhillips knows how much oil and gas it is going to produce in the next 10 years.

MR. WENZEL replied no.

CO-CHAIR JOHNSON said he thinks members are asking Mr. Wenzel to give certainty in an area that no one could give certainty to, and the crux of the argument is if the legislature does this, then what will ConocoPhillips guarantee. However, guarantees are few and far between, whether for the state or industry.

[7:14:03 PM](#)

REPRESENTATIVE SEATON inquired at what point ConocoPhillips would decide that this is an unstable tax regime because it is being changed every two years or so.

MR. WENZEL allowed that Representative Seaton is correct. At the time of the most recent change, ConocoPhillips was definitely concerned, and is still concerned, about the business climate in Alaska. He said ConocoPhillips is not looking for stability at the tax system that exists today. While stabilization of the tax system today would provide certainty for decision making, he is afraid it would be a negative decision for ConocoPhillips. He strongly suggested that the state and legislature find a way to change this tax system and create one that provides a more balanced sharing of the upside and a more incentivizing environment.

[7:15:51 PM](#)

CO-CHAIR NEUMAN understood that Mr. Wenzel is before the committee because ConocoPhillips is concerned about the effects ACES has had over the past two years and would accept changes to ACES to make a more appropriate business environment.

MR. WENZEL answered correct, ConocoPhillips thinks there is an opportunity to bring more investment and production to the state than there would be without the change.

[7:16:35 PM](#)

CO-CHAIR NEUMAN held over HB 308.

The committee took an at-ease from 7:16 p.m. to 7:18 p.m.

HB 369-IN-STATE PIPELINE/COORDINATOR /TEAM

[7:18:54 PM](#)

CO-CHAIR NEUMAN announced that the third order of business is HOUSE BILL NO. 369, "An Act relating to an in-state natural gas pipeline, the office of in-state gasline project manager, the Joint In-State Gasline Development Team, and the In-State Gasline Steering Committee; and providing for an effective date." [Before the committee was Version E, the proposed committee substitute for HB 308, labeled 26-LS1527\E, Cook, 3/2/10.]

[7:19:08 PM](#)

CO-CHAIR JOHNSON moved the committee adopt a new proposed committee substitute for HB 308, labeled 26-LS1527\S, Cook, 3/10/10 ("Version S"), as the working document.

CO-CHAIR NEUMAN objected for explanation purposes.

TOM WRIGHT, Staff, Representative Mike Chenault, Alaska State Legislature, explained that the changes incorporated into Version S are mostly deletions of items from Version E. The provision for an In-state Gasline Steering Committee was removed, the duties of the steering committee were moved to subsection (a) of the provision for the Joint In-state Gasline Development Team, and the conflicts of interest and ethics provision for steering committee members was removed.

[7:20:15 PM](#)

CO-CHAIR NEUMAN asked whether Representative Seaton's concerns are addressed by Version S.

MR. WRIGHT responded he would prefer to let the sponsor discuss those concerns later.

CO-CHAIR JOHNSON inquired why the provision for a steering committee was removed.

MR. WRIGHT replied a number of members thought the steering committee would be somewhat cumbersome. The reason for having the steering committee provision was to ensure good public participation in the development of the gasline. Removal of the committee does not preclude the Joint In-state Gasline Development Team from calling on others with the expertise or calling on affected communities when the need arises. In response to Co-Chair Neuman, he added that the sponsor hopes there will be a lot of public participation in this process.

[7:22:27 PM](#)

CO-CHAIR NEUMAN removed his objection to Version S. There being no further objection, Version S was before the committee.

The committee took an at-ease from 7:23 p.m. to 7:24 p.m.

[7:25:01 PM](#)

REPRESENTATIVE SEATON moved Amendment 1 written as follows [original punctuation provided]:

Page 3, line 18, following "communities,":

Insert "the cost of transporting natural gas to other locations in the state,"

Page 3, line 26, following "tidewater":

Insert "in the state and to other locations in the state"

Page 5, line 5, following "state":

Insert "and to other locations in the state"

CO-CHAIR JOHNSON objected for discussion purposes.

REPRESENTATIVE SEATON explained that the proposed Joint In-state Gasline Development Team would exist for quite some time and after a North Slope pipeline is constructed to tidewater, a number of in-state gaslines may be developed. Amendment 1 would give this team the authority to look at these other in-state pipelines to provide natural gas to residents at reasonable cost. He said there are three different places where language would be inserted into Version S.

7:27:08 PM

REPRESENTATIVE SEATON, in response to Co-Chair Neuman, noted that the first insertion on page 3, line 18, does not mean the state would be subsidizing; rather the state would be computing and looking at plans for delivery and costs.

REPRESENTATIVE MIKE CHENAULT, Alaska State Legislature, sponsor of HB 369, stated that while he supports the idea of the cost for transportation, he is concerned that it would dilute the major focus of costing out an in-state gasline so that it can be moved forward. The provisions of Amendment 1 would need to become a part of the process if this process does go forward, but now may not be the right time to include them. He is concerned about spending time and effort to study these other transmission lines rather than getting to the real problem of a main line for in-state gas.

7:29:51 PM

CO-CHAIR NEUMAN surmised it is the sponsor's intent that once a big in-state gasline is developed, gas be delivered to as many communities as possible.

REPRESENTATIVE CHENAULT answered correct.

REPRESENTATIVE SEATON argued that Amendment 1 does not dilute anything, given all the team duties that are outlined on page 3, starting at line 11.. The intent and structure of Amendment 1 is for after an in-state gasline is built, so its provisions would not come ahead of building a gas pipeline.

7:32:24 PM

REPRESENTATIVE CHENAULT reiterated his agreement with where Representative Seaton is headed because, in time, every area of the state will need to be looked at. However, his concern is that the state must first focus on developing and building a main line before looking at the other options.

CO-CHAIR JOHNSON added that the reason for HB 369 is because the state has taken its eye off building an in-state gasline. He said Amendment 1 did not concern him at first, but after hearing the sponsor's concern he must agree about staying focused, although he, too, supports where Representative Seaton is going.

CO-CHAIR NEUMAN offered his support for where Representative Seaton is going, but said he agrees with staying focused.

[7:34:41 PM](#)

CO-CHAIR JOHNSON moved that Amendment 1 be divided into three parts: lines 1 and 2 becoming Amendment 1, lines 4 and 5 becoming Amendment 2, and lines 7 and 8 becoming Amendment 3.

REPRESENTATIVE SEATON said he would consider that a friendly amendment.

CO-CHAIR NEUMAN opened discussion on the new Amendment 1, consisting of lines 1 and 2 of former Amendment 1, written as follows [original punctuation provided]:

Page 3, line 18, following "communities,":

Insert "the cost of transporting natural gas to other locations in the state,"

[7:35:39 PM](#)

REPRESENTATIVE SEATON said that if the bill does not look at the communities he represents, then they will be out of the picture forever because there would be no authorization in statute to do so subsequent to completion of the main in-state gasline. Thus, he would like to request that lines 16-18 on page 3 of Version S be deleted, because they would also deflect from the main focus of constructing an in-state gasline. He noted that lines 16-18 do exactly the same thing for other communities in the state as Amendment 1 would do for his communities.

[7:37:04 PM](#)

REPRESENTATIVE OLSON inquired whether Homer and Seward are considered coastal communities.

REPRESENTATIVE SEATON offered his belief that the construction of line 18, page 3, Version S, "Yukon river and coastal communities" would probably be tied together as the coastal communities along the Yukon River. Additionally, the pipeline specified in line 18 is for liquefied natural gas or propane, not natural gas.

[7:38:00 PM](#)

CO-CHAIR JOHNSON inquired whether Representative Seaton is looking for propane to go to his communities as well.

REPRESENTATIVE SEATON reiterated that the coastal communities on line 18 are in reference to liquefied natural gas or propane. His communities would be served by a transmission pipeline after a mainline has been built from the North Slope and ties into Southcentral. If it is being said that the parallel language, "the cost of transporting natural gas to other locations", is superfluous and detrimental to a pipeline, then the same could also be said of the language on lines 16-18 which states, "delivery and costs of natural gas to communities along the pipeline route, manufacturing opportunities for gas-to-liquids, plans for delivery and costs of liquefied natural gas or propane to Yukon river and coastal communities".

[7:39:30 PM](#)

CO-CHAIR NEUMAN stated that lines 16-18 relate to being along the way of a main in-state gasline.

CO-CHAIR JOHNSON removed his objection to Amendment 1, saying the more this has been explained to him the more he likes it.

CO-CHAIR NEUMAN objected to Amendment 1.

REPRESENTATIVE CHENAULT, after looking at how lines 16-18 are written, said he can more or less agree with Representative Seaton. He changed his objection and accepted Amendment 1, saying he does not want members of the legislature or residents of Alaska to feel shortchanged.

CO-CHAIR NEUMAN withdrew his objection. There being no further objection, Amendment 1 was adopted.

[7:41:49 PM](#)

REPRESENTATIVE SEATON moved Amendment 2 written as follows [original punctuation provided]:

Page 3, line 26, following "tidewater":

Insert "in the state and to other locations in the state"

REPRESENTATIVE SEATON explained there was earlier discussion about whether tidewater could be a Canadian port or something

else. Amendment 2 clarifies that "tidewater" is a tidewater port in the state as well as other locations in the state.

[7:42:53 PM](#)

CO-CHAIR NEUMAN noted that the duty of the team is to consider all aspects. He asked how far out those duties would extend; for example, tankers associated with a liquefied natural gas (LNG) facility.

REPRESENTATIVE CHENAULT, in regard to Amendment 2, said Version S states to select a route for an in-state natural gas pipeline from the North Slope to tidewater. It is his intention the completion of that pipeline is at tidewater in the state of Alaska and not in Canada or elsewhere.

[7:44:12 PM](#)

CO-CHAIR NEUMAN related that "Shell" intends to put LNG facilities on floating platforms. He presumed the sponsor's intent is not to have a floating platform for an LNG export facility in the northwestern corner of the state, but to bring gas to the core area of the state through the Railbelt.

REPRESENTATIVE CHENAULT responded his intent is tidewater in the Southcentral region of the state. He said it is not the intention of HB 369 to go to the Bering Sea in any form or fashion with the main pipeline. Additionally, he believes any ports in the Chukchi or Beaufort seas would be too shallow to accommodate an LNG tanker. In further response to Co-Chair Neuman, he said that when originally proposed, the in-state gas pipeline was to go to Valdez because that is a deepwater port that can handle tankers large enough to economically carry the LNG all over the world. Cook Inlet is not as deep as Prince William Sound, which requires the use of smaller tankers for the LNG facility that is shipping to Japan.

There being no objection, Amendment 2 was adopted.

REPRESENTATIVE SEATON elected not to offer Amendment 3.

[7:48:17 PM](#)

REPRESENTATIVE KAWASAKI moved to adopt Amendment 4 written as follows [original punctuation provided]:

Page 3, line 22:

Delete "by July 1, 2011, and take actions necessary"

Page 3, line 23:

Delete "2015."

Insert "2016. The development team shall make a commercial offering by July 1, 2011. The commercial offering must consist of the issuance of a request for proposals to potential in-state natural gas pipeline project developers who will own the project or a portion of it. The request for proposals must require that commercial evaluations in the proposals be based on engineering and permitting completed by the state and its contractors and that proposals include reimbursement for the cost incurred by the state of engineering work and gathering and interpreting data. The request for proposals must include notice that proposals will be analyzed by the state, together with terms and conditions for selection. The development team shall report to the legislature on the date the commercial offering is ready."

Page 4, line 8:

Delete "for construction of"

Insert "to meet construction deadlines for"

Page 4, line 15:

Delete "by July 1, 2011, and report to the legislature by that date"

Insert "to enable natural gas to flow down the pipeline by 2016"

CO-CHAIR JOHNSON objected.

[7:48:41 PM](#)

REPRESENTATIVE KAWASAKI explained that Amendment 4 is similar to an amendment to Version E that was offered [and withdrawn] by Co-Chair Johnson on [3/8/10]. He said Amendment 4 is conforming language as mentioned by Mr. Bob Swenson, In-state Gas Project Manager [on 3/8/10]. The amendment would require that the entity building the pipeline reimburse the state for its engineering costs.

CO-CHAIR JOHNSON maintained his objection to Amendment 4.

[7:50:04 PM](#)

CO-CHAIR NEUMAN said he strongly objects to Amendment 4. He recalled that during discussions on [3/8/10] there was a problem with the word must. If the state must receive 100 percent reimbursement of its engineering expenses through purchase of the permits for the pipeline, and the purchase offer does not do this, then this pipeline could not happen. He argued that the purchaser will be spending billions of its own dollars to build the gasline and diversify the state's economy; thus, it does not hurt the state to have its own money in the game, which is something that states and communities do all around the world.

[7:52:37 PM](#)

CO-CHAIR JOHNSON agreed with Co-Chair Newman, saying Amendment 4 could exclude a viable builder of the in-state pipeline. This should be a decision that is made by members of the legislature at that time should the purchase offer not be for a 100 percent reimbursement. He said he wants to send the signal that Alaska is invested in this project and wants to make it happen. There could be negotiations at the time to get the money back through tariffs. He said he objects to Amendment 4 for the same reasons he had on [3/8/10].

[7:53:51 PM](#)

REPRESENTATIVE SEATON, on behalf of Representative Chenault, moved friendly Amendment 1 to Amendment 4, as follows:

Line 13:
Delete "state"
Insert "Joint [In-state] Gasline Development
Team"

CO-CHAIR NEUMAN objected, reiterating his opposition to the requirement that the state be reimbursed for 100 percent of its expenses. In response to Representative Seaton, he removed his objection to Amendment 1 to Amendment 4, but maintained his objection to Amendment 4.

There being no objection, Amendment 1 to Amendment 4 was adopted.

[7:57:28 PM](#)

CO-CHAIR NEUMAN said his interpretation of Amendment 4, as amended, is that if the state does not receive a purchase

proposal that provides 100 percent reimbursement of its expenses, the in-state project will not go forward.

CO-CHAIR JOHNSON said he does not read the amendment quite like that, although he did at first and for which he apologizes. He pointed out that the language says "include reimbursement"; it does not say full reimbursement. Thus, a proposal of just \$1 in reimbursement would qualify.

CO-CHAIR NEUMAN said he would be more comfortable with line 9 stating "may" require instead of "must" require.

REPRESENTATIVE CHENAULT agreed with Co-Chair Neuman.

[8:00:32 PM](#)

CO-CHAIR JOHNSON said it is important to retain the word "must" on line 9 to ensure proposals are based upon engineering and sound economics. He suggested the word "may" be inserted on line 11 after "proposals" because that would accomplish the same goal of not requiring full reimbursement of the state's expenses, but still requiring that the commercial proposals be based upon the state's engineering and permitting. He offered Amendment 2 to Amendment 4 as follows:

Line 11, after "proposals":
Insert "may"

REPRESENTATIVE KAWASAKI accepted the amendment. There being no objection, Amendment 2 to Amendment 4 was adopted.

[8:03:40 PM](#)

REPRESENTATIVE P. WILSON asked why Representative Kawasaki believes the following language needs to be included in Amendment 4: "proposals may include reimbursement for the cost incurred by the state of engineering work and gathering and interpreting data."

REPRESENTATIVE KAWASAKI replied the state spends a lot of money collecting data that is utilized by the public, such as aerial mapping and right of way information. Since public money is being used for this project, it is fair to ask that the private company undertaking this project repay the state in return for receiving valuable information.

[8:06:05 PM](#)

REPRESENTATIVE SEATON added he is more comfortable with Amendment 4 as now amended because the word "may" allows the latitude to not collect full reimbursement should the project not be fully economic.

REPRESENTATIVE OLSON inquired whether the maker of the amendment objected to the Alaska Gasline Inducement Act's \$500 million signing bonus.

REPRESENTATIVE KAWASAKI answered he does not remember.

[8:07:43 PM](#)

CO-CHAIR JOHNSON moved Amendment 3 to Amendment [4] to delete lines 1-2.

REPRESENTATIVE KAWASAKI objected.

CO-CHAIR JOHNSON opined that removal of the deadline date from HB 369 would soften the urgency of building the pipeline. Pressure needs to be continued and the team needs empowerment to move as quickly and expeditiously as possible.

CO-CHAIR NEUMAN agreed, saying the purpose of HB 369 is to provide dates and ensure that work toward a pipeline continues as fast as possible. He would like to see construction ready by July 1, 2011; therefore, he wants to see deadlines and an aggressive timeline.

[8:09:40 PM](#)

REPRESENTATIVE CHENAULT, in response to Representative Seaton, said Amendment 4 is the same as an amendment that was seen on [3/8/10], and it would delay the project. He said he objects to Amendment 4 and agrees with the co-chair about moving an in-state pipeline forward on an aggressive schedule. He related that he told the administration he has no problem with the proposed fiscal note of \$380 million, given that \$500 million was provided for the pipeline project outside of this one.

[8:11:38 PM](#)

REPRESENTATIVE KAWASAKI maintained his objection.

A roll call vote was taken. Representatives P. Wilson, Johnson, Seaton, Olson, and Neuman voted in favor of Amendment 3 to

Amendment 4. Representative Kawasaki voted against it. Therefore, Amendment 3 to Amendment 4 passed by a vote of 5-4.

[8:13:17 PM](#)

CO-CHAIR JOHNSON moved Amendment 4 to Amendment 4 to delete the entirety of lines 16-22.

REPRESENTATIVE KAWASAKI objected.

CO-CHAIR JOHNSON said this amendment speaks to the same thing of lengthening the dates, and the purpose is to construct a pipeline as quickly as possible.

REPRESENTATIVE KAWASAKI withdrew his objection. There being no further objection, Amendment 4 to Amendment 4 was passed.

[8:14:44 PM](#)

CO-CHAIR JOHNSON moved Amendment 5 to Amendment 4 as follows:

Line 5:
Delete "Delete '2015.'"

Line 6:
Delete "2016."

There being no objection, Amendment 5 to Amendment 4 was passed.

[8:16:27 PM](#)

REPRESENTATIVE OLSON moved Amendment 6 to Amendment 4 to delete lines 6-14.

REPRESENTATIVE KAWASAKI objected.

CO-CHAIR NEUMAN supported the amendment.

REPRESENTATIVE P. WILSON said she thinks lines 6-14 are good because the commercial proposals and the evaluations need to be based on facts.

[Members discussed the protocol of Amendment 6 to Amendment 4 versus voting for Amendment 4, as amended.]

A roll call vote was taken. Representatives Olson and Neuman voted in favor of Amendment 6 to Amendment 4. Representatives

Kawasaki, P. Wilson, Seaton, and Johnson voted against it. Therefore, Amendment 6 to Amendment 4 failed by a vote of 2-4.

[8:21:28 PM](#)

CO-CHAIR JOHNSON withdrew his objection to Amendment 4, as amended.

REPRESENTATIVE OLSON objected to Amendment 4, as amended.

A roll call vote was taken. Representatives Seaton and Kawasaki voted in favor of Amendment 4, as amended. Representatives Olson, P. Wilson, Neuman, and Johnson voted against it. Therefore, Amendment 4, as amended, failed by a vote of 2-4.

[8:23:57 PM](#)

REPRESENTATIVE SEATON noted that at an earlier meeting he had inquired about how an open season would be conducted by the Regulatory Commission of Alaska (RCA) and whether the pipeline would be a common carrier or a contract carrier under HB 369.

CO-CHAIR NEUMAN said the information Representative Seaton had requested about pipeline corridor statutes on common carriers was delivered just prior to the start of this meeting, and those corridors are not included in HB 369.

[8:25:17 PM](#)

REPRESENTATIVE SEATON clarified he is referring to the July 1, 2011, date on page 4, line 15. He said Mr. Swenson was to report back about whether the pipeline would be a common carrier or contract carrier and how HB 369 would deal with that.

CO-CHAIR NEUMAN said he believes that is yet to be determined.

REPRESENTATIVE CHENAULT agreed.

ROBERT SWENSON, Project Manager, In-State Gas Project, Alaska Mental Health Trust Land Office, Department of Natural Resources, stated he does not have the expertise to answer the question. He did visit with Mr. Balash and his understanding is that an in-state pipeline would be required to be common carrier pipeline that is regulated by the RCA.

[8:27:37 PM](#)

CO-CHAIR NEUMAN presumed that current plans include bringing in collector pipes and to re-distribute gas throughout the state to act as a common carrier.

MR. SWENSON responded correct; it is to maximize the distribution of gas to consumers within the state.

REPRESENTATIVE SEATON inquired whether under RCA jurisdiction any new gas finds would be excluded from being carried in the pipeline or rolled into the pipeline.

MR. SWENSON understood that if a producer and a consumer are using 100 percent of the pipeline and another producer wants access to that line to provide gas to a consumer, then that access would have to be allowed in a common carrier system. Under a contract carrier system, the contract would take precedence and access to that pipeline would then have to be through expansion.

[8:29:34 PM](#)

REPRESENTATIVE SEATON said he thinks it is very important for members to be able to tell the people of the state that this is an open access pipeline under HB 369.

CO-CHAIR NEUMAN commented that having as much deliverable gas as possible will keep the costs down.

REPRESENTATIVE SEATON said he is unfamiliar with pipelines that would be regulated by the RCA and since that is the intention with this pipeline it is good to know that information.

CO-CHAIR NEUMAN opened public testimony, then closed it after ascertaining that no one wished to testify.

[8:31:22 PM](#)

REPRESENTATIVE P. WILSON asked whether the intent is still to have requests for proposals, given that Amendment 4 failed.

REPRESENTATIVE CHENAULT answered that is exactly what he is after. When a proposal is put together, decisions will be made whether to have a pipeline company or the state build the pipeline. The reason for HB 369 is because he would like to see the state get to this point sooner rather than later. This project is only one of several options, but it cannot be an option without information on whether it is a viable project.

He is interested in providing gas to communities throughout the state at every opportunity possible. The intent is to get to a project that can actually be looked at by combining the talents of the agencies that have been looking at a pipeline over the past years.

[8:35:13 PM](#)

REPRESENTATIVE CHENAULT, in response to Co-Chair Neuman, said it seems like the state continues to delay on this project and will be in the position of wishing it had started earlier.

CO-CHAIR NEUMAN opined that HB 369 is about thousands of good-paying jobs throughout Alaska. This project would empower communities and enable them to finance their own destinies rather than relying on state funding, and it is a priority project for 82 percent of Alaska's residents. He warned that 90 percent of Alaska's revenue is coming from just three companies, and the state must diversify its economy to change this.

[8:38:26 PM](#)

CO-CHAIR JOHNSON moved to report HB 369, Version 26-LS1527\S, Cook, 3/10/10, as amended, from the committee with individual recommendations and any accompanying and forthcoming fiscal notes. There being no objection, CSHB 369(RES) was reported from the House Resources Standing Committee.

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 8:38 p.m.