SENATE FINANCE COMMITTEE
February 25, 2010
9:05 a.m.

9:05:33 AM

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:05 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice-Chair
Senator Johnny Ellis
Senator Dennis Egan
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

None

ALSO PRESENT

David Wood, Consultant, Legislative Budget and Audit; Senator Joe Paskvan; Senator Gary Stevens; Senator John Coghill

PRESENT VIA TELECONFERENCE

None

SUMMARY

2010 Oil and Gas Production Tax Review

^GAS ISSUES and ALASKA'S FISCAL DESIGN

9:05:41 AM

DAVID WOOD, CONSULTANT, LEGISLATIVE BUDGET AND AUDIT, referred to a handout entitled, "Gas Issues and Alaska's Fiscal Design" (copy on file). He provided information

about his work history. He reviewed topics he covered in the previous presentation. The issue which received the most attention was effective cross subsidy between gas and oil in the progressivity component and its impact at high oil prices, mixing low margin gas with high margin oil, and the effect of significantly reducing the tax revenue to the state, especially when oil to gas price ratios were high, and gas to oil volumes were high.

Mr. Wood reported that he used a model derived from a Department of Revenue model which he adapted to show gas/oil calculations rather than just oil calculations. It was clear from the model that the "dilution effect" took place. He stressed the importance of the need to run multi-year cash-flow scenarios to analyze fiscal take from a gasline. He said that he is putting together a model to show a wide range of potential scenarios.

9:12:30 AM

Mr. Wood continued his presentation from the previous day, beginning with slide 44. He termed the presentation the Alaska Gas Fiscal Model (AGFM), but pointed out that the model could accurately address oil issues, as well. He noted that the slide shows the structure of the model: the multi-year and multi-scenario fiscal integrated upstream and downstream performance cash flow model.

Mr. Wood turned to the Alaska gas fiscal model (AGFM) - slide 45, which shows a range of legacy fields as well as hypothetical fields. He pointed out the importance of the yellow boxes which depict a scenarios macro, a sensitivity macro, and a gas tax macro. The model is able to look at a wide range of price scenarios for gas and oil, in addition to production rates, timing, and field inputs. The model is designed to look at items in detail.

9:14:44 AM

Mr. Wood explained that AGFM now evaluates in-state gas scenarios - slide 46. The downstream components can be reconfigured to model gas export routes and potential in-state routes. The model is complex because it covers a forty-year period.

Mr. Wood turned to slide 47 which shows the dashboard control sheet: high level controls: spinners and graphics.

The top graphic shows the multi-year cash flow in undiscounted terms. It can also show discounted terms. It breaks out the various fiscal elements to show how much of the revenue is coming from royalty, base production tax, progressivity, and property tax. There was a decline in the latter years in this scenario.

Mr. Wood described the pie chart at the bottom of the slide. It summarizes the multi-year cash flow into a snapshot that shows an average for the life of the scenario. He pointed to the significance of royalties and the base production tax for Alaska. Progressivity provides another component. In a higher price scenario progressivity will provide a slightly different component. The purpose of the model is to be able to look at the range of scenarios.

9:17:48 AM

Mr. Wood observed that another part of the scenario is the downstream, as depicted in slide 48 - dashboard control sheet: dynamic graphics and summary results. It shows an integrated model of upstream and downstream elements.

Mr. Wood showed a model which depicts the contributions of each fiscal element to Alaska's take for the total North Slope slide 49. The graphic shows Alaska's fiscal components undiscounted.

9:19:46 AM

Mr. Wood explained slide 50, which shows that Alaska North Slope production and reserves are dominated by three corporations. The model shows the company holdings of Exxon Mobil, BP, and ConocoPhillips. Slide 51 shows ANS production profiles forecast by AGFM for BP. The model provides the ability to see the impacts of various elements in the fiscal design to the corporate positions.

Mr. Wood discussed slide 52 - hypothetical field cases evaluated. He pointed out that in his report to Legislative Budget & Audit in December of 2008 he did not look at the legacy fields. He only looked at hypothetical gas fields in order to try to establish the significance of various fiscal components. The important point is to look at it from a range of perspectives and fields. The slide describes five non-associated natural gas fields and five oil fields with associated gas. The point is that it is

important to examine the impacts of fiscal design changes from a range of perspectives.

9:21:44 AM

Mr. Wood stated that a key component is the sensitivity of an Alaska gas field to project and market variables - slide 53. As the gas price increases, so does the net present value of the producer's share. He said the interesting aspect on the graph is the Capex curve, which is less steep than the operating cost curve. The reason is due to the impact of investment credits. The model is a way of showing the success of the investment credits, which play a significant role in keeping projects economic.

9:23:23 AM

Mr. Wood noted that base case hypothetical field models reveal high-level implications for government take - slide 54. He stressed the difference in government take of oil fields compared to gas fields and the impact of the Alaska fiscal design. The government take of destination value for a stand-alone oil field is about 60 percent. For a gas field it is about 30 percent. The difference is the high cost of getting gas to market.

Mr. Wood related that the difference in net take between oil and gas is about 75 percent for oil and about 67 percent for gas. These figures are not exceptional by international standards. Many companies around the world have government takes in excess of 80 percent. The criticism that the Alaska fiscal design is punitive doesn't hold up.

Mr. Wood showed a model of a large gas field: division of destination value - slide 55. He noted that 42 percent of the destination value is taken up by transportation costs. A major difference between gas and oil fields is the high cost of getting gas to market.

9:26:11 AM

Mr. Wood discussed a large oil field: division of destination value - slide 56. Transportation costs are less significant than for gas.

Mr. Wood turned to slide 57 - components of Alaska state take for a large gas field. The graph shows the significant components in terms of raising revenue for Alaska. Royalties and the base production tax at medium level prices account for two-thirds of Alaska's take. He noted that the combined progressivity tax or CPT is a small component, only 4 percent.

Mr. Wood compared the previous price scenario to a large oil field on slide 58 - components of Alaska state take for a large oil field. In this scenario CPT is much larger at 31.7 percent.

9:28:17 AM

Mr. Wood listed his conclusions and recommendations. Slide 60 lists his approaches to fiscal design that can improve performance and credibility. He stressed one element as the key conclusion: drive progressivity fiscal elements for gas with gas PTV (not boe). He suggested isolating the gas component.

9:30:43 AM

Mr. Wood talked about the need to clarify and optimize fiscal revenue streams from NGL's. He suggested considering state equity involvement in strategic infrastructure projects. He stressed promoting cost disclosure and control with some fiscal incentives. Finally, he said to apply time constraints to new leases to develop resources.

9:32:51 AM

Senator Thomas requested more historical information in order to have context for considering the future. That would also allow for incentives. Mr. Wood thought it was a good suggestion. He commented that there was a peak in oil that can be used to see what might have happened if a gas line was in place during those two years. He surmised that the state would have received a substantially lower amount of production tax, had the gas line been in place at past gas prices.

Co-Chair Stedman summarized that the request is for a summary of market prices for the last two years.

9:36:15 AM

Co-Chair Stedman turned to slide 13 - latest U.S. government forecast shows high oil to gas price ratios through to 2035. He asked what the probability was that projection of oil to gas ratios could be inaccurate. Mr. Wood replied that the graph has been put together using Energy Information Authority (EIA) annual energy outlook 2010 forecast. He suggested that there is no certainty that the forecast is accurate. If for only three years the price is higher, there is an impact of billions of dollars of revenue to the state. He voiced concern if price spikes were to happen. Looking back to 2008's price spike, the revenue benefits to the state were quite substantial.

9:39:17 AM

Co-Chair Stedman asked for further information about slide 12 - U.S. oil to gas price ratio and the range of fiscal designs. He wondered how often in the past spiking has occurred. Mr. Wood said that from 1996 to about 2006 the price ratio was below ten. In all of the remaining period it has been above ten consistently. He reported that since May - June 2007 the price ratio was below 10 for only four months. Since March 2009 it has been above 10 and above 20 for several months. He did not think the level would return to 6, but the state should be planning for ratios above 10 and for spikes.

Co-Chair Stedman thought the current ratio was at 15. Mr. Wood noted that there had been several months above 20 in the last six months. Co-Chair Stedman commented that the issue had moved beyond a theoretical exercise. Mr. Wood agreed.

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ADJOURNMENT

The meeting was adjourned at 9:42 AM.