

**ALASKA STATE LEGISLATURE**  
**SENATE RESOURCES STANDING COMMITTEE**

February 17, 2010

3:34 p.m.

**MEMBERS PRESENT**

Senator Lesil McGuire, Co-Chair  
Senator Bill Wielechowski, Co-Chair  
Senator Charlie Huggins, Vice Chair  
Senator Hollis French  
Senator Bert Stedman  
Senator Thomas Wagoner

**MEMBERS ABSENT**

Senator Gary Stevens

**COMMITTEE CALENDAR**

SENATE BILL NO. 267

"An Act relating to the duties of the Department of Labor and Workforce Development; relating to the tax rate applicable to the production of oil and gas; relating to a rebate of the production tax on oil and gas based on the employment of resident workers; relating to credits against the oil and gas production tax; relating to the period in which oil and gas production taxes may be assessed; relating to the interest rates applicable on certain amounts due related to various taxes, penalties, payments, and the Alaska Gasline Inducement Act; and providing for an effective date."

- HEARD AND HELD

SENATE BILL NO. 220

"An Act declaring a state energy policy; relating to energy efficiency and alternative energy; establishing the energy efficiency grant fund, an emerging energy technology fund, a renewable energy production tax credit, and an energy use index; and relating to a fuel purchasing cooperative, to energy codes and efficiency standards, to energy conservation targets in public buildings, to a state agency energy use reduction plan, to the alternative energy revolving loan fund, and to the renewable energy grant fund."

- HEARING CANCELED

**PREVIOUS COMMITTEE ACTION**

BILL: SB 267

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(s): SENATOR(s) MCGUIRE

02/10/10	(S)	READ THE FIRST TIME - REFERRALS
02/10/10	(S)	RES, FIN
02/17/10	(S)	RES AT 3:30 PM BUTROVICH 205

**WITNESS REGISTER**

DAN DICKINSON  
Legislative Consultant  
Legislative Budget and Audit Committee  
Alaska State Legislature  
Juneau, AK

**POSITION STATEMENT:** Presented SB 267.

JOE MATHIS, President  
Nana Pacific  
Nana Development Corporation  
Anchorage, AK

**POSITION STATEMENT:** Commented on loss of jobs on the North Slope.

DAVE CRUZ  
President, Cruz Construction  
President, Associated General Contractors  
Palmer, AK

**POSITION STATEMENT:** Described loss of jobs on the North Slope.

JIM GILBERT, President  
Udelhoven Companies  
Anchorage, AK

**POSITION STATEMENT:** Described loss of projects on the North Slope.

COMMISSIONER PAT GALVIN  
Alaska Department of Revenue (DOR)  
Anchorage, AK

**POSITION STATEMENT:** Agreed with Mr. Dickinson's presentation on SB 267.

**ACTION NARRATIVE**

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**CO-CHAIR LESIL MCGUIRE** called the Senate Resources Standing Committee meeting to order at 3:34 p.m. Present at the call to order were Senators French, Wielechowski, Stedman, Huggins and McGuire.

**SB 267-OIL AND GAS PRODUCTION TAX**

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CO-CHAIR MCGUIRE, sponsor of SB 267, said her intent in introducing the bill is to recognize the changes made in Alaska's Clear and Equitable Share (ACES) and about possible significant deterrents it made to drilling and job loss in the state. She said small business owners, in particular, have lost a number of opportunities for employees and as a result had layoffs.

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She said SB 267 combines a few elements, but the biggest one pertains to the progressivity elements in ACES. She explained that this committee was a big part of the work that was done; it was here for months looking at charts and graphs knowing that the economic limit factor (ELF) method of taxing on the gross was a broken system. In an attempt to reach a better tax system, they looked at all kinds of data and had experts from all over the world. They did the best they could to establish a formula that would strike a healthy balance between the state's royalty and severance taxes and private industry's take on the risk they were taking to develop these oil resources. She said they experimented with a variety of rates for the progressivity element. She said that SB 267 has a starting point of reducing the progressivity factor from .4 to .2 at \$30/barrel and up.

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CO-CHAIR MCGUIRE said some people think that the marginal tax rate, itself, becomes so high at certain points that when companies are competing on a global scale for that kind of high risk investment opportunity that the risk/reward ratio is not competitive with other jurisdictions.

She said the committee worked on getting some kind of a credit that would incentivize the hiring of more in-state workers - a very difficult area of the law because in-state hire provisions have been thrown out as unconstitutional based on right to work, the commerce clause and other things. But the question about incentivizing that remained open enough that they took a healthy

stab at trying to establish at various percentage rates the employing of more in-state workers.

Finally, if there were a constitutional challenge, she supposed it would be on the part of an out-of-state worker working for a company or maybe a company would challenge the state based on the fact they thought it was unfair that another oil and gas company got the incentive for in-state hire. It would be an interesting argument that could play out in the state's favor. Lastly, she said, SB 267 incorporates the Governor's provisions that she wanted to hear comment on from the administration.

CO-CHAIR MCGUIRE said that first they would hear from Dan Dickinson, Legislative Consultant, about the impact of ACES. Then they would hear from two industry representatives on their perspectives, the administration and others.

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DAN DICKINSON, Legislative Consultant, Legislative Budget and Audit Committee, said he is a CPA. In the 1980s and 1990s he was an expert in some tax and royalty cases brought by the Department of Natural Resources (DNR) and the Department of Revenue (DOR), and he was in the DOR for seven years mostly as the director of the Tax Division.

He said he was going to talk to them basically about the technical aspects of SB 267 [Technical Aspects of SB 267 (Version A), by Dan Dickinson, CPA, Senate Resources Committee, Feb. 17, 2010]. The mechanics of tax issues tend to be complex, he said, and the bill has six changes:

1. Changes progressivity from .4 percent to .2 percent per dollar
2. Well credit for well work
3. Tax rate tied to resident hire
4. Interest not due on retroactive rate changes until those regulations are implemented
5. Interest rate is lowered to fed funds +2 or 11 percent
6. Restore three-year statute of limitations from the six years that was implemented in 2007.

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He emphasized that most of the provisions in SB 267 have nothing to do with the changes he just mentioned. The bill changes the structure of the interest provision, AS 43.55.225, which goes from being a single section to sections A and B. This means that every time interest is referenced in Title 43 it had to be

changed; so most changes in the bill change the reference from AS 43.55.225 to AS 43.55.225(a) with no substantive change.

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MR. DICKINSON said the first substantive change is to the progressivity feature. He reviewed the current base production tax rate that is 25 percent on the net value at the well (TTV) that is combined with a progressivity tax that can range from 0-50 percent; so the total effect of those two together is somewhere between 25 and 75 percent. The current progressivity is triggered when the net value of oil is \$30/barrel. Under current law it increases .4 percent for every dollar over \$30. Then there is a "bend over point" or "wrap around point" at \$92 when it drops down to .10 percent for every dollar. This bill drops the rate from .4 percent to .2 percent and to make the math work out the bend-over point is at \$155.

In 2008, he said, the total base tax generated about \$4.2 billion; the progressivity generated about \$3.2 billion (for comparison, roughly the same size as all royalties and much larger than the income and property taxes).

SENATOR FRENCH said most of them know what \$30 net value means when progressivity kicks in, but that is after all the shipping and production costs have been deducted. He asked him to clarify that more.

MR. DICKINSON responded saying, for instance, if oil is selling at \$90 on the U.S. West Coast, it would cost about \$5 to get it to that market from the North Slope (using TAPS and tankers). If you are at Prudhoe Bay, you have to deduct the costs of getting it out of the ground (operating expenses); if you're at a further field, like Kuparek, then you subtract the pipeline to Kuparek (up to another \$1). You deduct the costs in the field - around \$20/barrel and include the capital investments that are being made for the future. The DOR uses \$26 for the difference between the value of where the oil is sold on the West Coast and the value on the North Slope.

SENATOR FRENCH said from \$0-26/barrel, the company is recouping its costs of doing business and paying no production tax; from \$26-56/barrel it's paying 25 percent tax (the base rate), and above \$56/barrel is when progressivity kicks in.

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MR. DICKINSON agreed "roughly," but it's important to note that when progressivity kicks in it applies to *all* the production

whereas federal income tax applies different tax rates to different income levels individually.

SENATOR FRENCH asked if he calculated what the state would have collected under this bill if it had been in effect in 2008.

MR. DICKINSON answered no, but to a degree it's a linear extrapolation and the progressivity would have roughly cut the state's take in half or \$3.2 billion down to about \$1.6 billion. The price was beyond the bend-over point two months out of the year.

SENATOR FRENCH asked if they were to give back that \$1.6 billion, how much oil production would be needed to make up that difference.

MR. DICKINSON replied that obviously, it would depend on the price.

SENATOR FRENCH said \$80/barrel.

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MR. DICKINSON explained how the formula works. With roughly \$7 billion in production taxes and other things to reach \$10 billion, you would be looking at roughly 15 percent of that total. At current production levels which are 600,000 barrels/day, that would be about 80,000 barrels/day.

MR. DICKINSON went on to explain the marginal rate that says every additional dollar earned will affect this tax. So as soon as progressivity is hit (slide 9), the marginal rate starts to jump greatly. For comparison, he said, under an income tax system when one passes from one bracket to another, his tax rate goes up a little bit, but not by a large leap (slides 12-20 showed how progressivity works compared to personal income tax).

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He said Governor Palin actually proposed a less aggressive progressivity tax, but her proposal would have been .2 percent hitting a ceiling at 25 percent. The law that eventually emerged and became ACES has a cap at 50 percent instead of 25 percent (slide 23). This is all on top of the 25 percent base tax. His graphs compared progressivity to personal income tax. The net effect of changing the cap is to move the slope of the rate out so it climbs at a less dramatic rate.

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Under SB 267, Mr. Dickinson explained, the jump up in marginal rate continues to grow, but at a lesser rate than under current law. The final graphic (slide 26) looked at not just the production tax but property, production and a special income tax as well as a royalty that is paid by most of them. So the nominal rate that most taxpayers would face is 50-60 percent. The marginal rate under current law can hit 100 percent at certain prices. He summarized that the effective rate in this bill would fall somewhat lower than the current effective rate and the marginal rate wouldn't have the dramatic increase.

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CO-CHAIR WIELECHOWSKI asked him how the credits are tiered.

MR. DICKINSON replied that in general the credits aren't tiered or dependant on anything, although some provisions apply to producers producing fewer than 50,000 barrels/day (those other than the three largest producers). In general, the credits are at face value and can be transferred around; so the marginal effect is not going to be as price-dependent.

CO-CHAIR WIELECHOWSKI asked if the credits are 20 percent in-field and 30 percent for exploration.

MR. DICKINSON responded that he has a slide that summarizes all of that but it was later in the presentation.

CO-CHAIR WIELECHOWSKI said he would wait until they got there.

MR. DICKINSON said SB 267 also gets into marginal rates that exceed 100 percent, but they don't get there until prices get somewhere north of \$200/barrel.

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The second piece on progressivity, Mr. Dickinson said, is on slide 29 and addressed Senator Wielechowski's question. Under current law there is a 30-percent credit for exploration wells, a 40-percent if that well is both outside of an existing unit by more than 25 miles and 3 miles from any other wells (with special rules for Cook Inlet), and finally a general 20 percent capital investment (not cumulative if you take a dollar under one of the other programs) that would deal with more development and production investments. One of the important points is that under this bill there is no change to the exploration credits. This credit has been placed in the AS 43.55.023 credits.

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Compared to the Governor's proposal, he said, both create a 30-percent credit for well work and both include CAPEX and OPEX. SB 267 should be effective on the first day of the month so they don't have costs within a month; the Governor chose July 1, 2010.

MR. DICKINSON said the differences are that the Governor's bill places the credit in the AS 43.55.025 section which is an exploration section, renames it "exploration development" and rewrites a lot of that current law. SB 267 places this particular credit in the section called "Tax credits for certain losses and expenditures."

A second, critical, difference is that there is a different definition of well-related expense and the Governor's bill did a systematic rewrite of the exploration credits. Part of it was entirely appropriate in the sense that the exploration credits came in 2003 and have been amended basically every other year since then; the structure was getting more and more bizarre and this clarified it. But he had other concerns that he would cover later.

MR. DICKINSON explained that there are lots of differences between putting the bill in to AS 43.55.023 or AS 43.55.025. Basically, two different structures are created. AS 43.55.023 deals with capital costs in section (a); it deals with lease expenditures in section (b) and the rest of the sections refer back to sections (a) and (b). So in some sense, looking at the bill putting well work credit into AS 43.55.023 fits nicely. AS 43.55.025 is currently meant to be just about explorers; so the administration suggested totally rewriting and re-titling this work and talks about "explorers and producers" instead of just "explorers." Ultimately none of that matters, he said, because you can cross-reference, but what is more important is how the two credits are structured. Anything under AS 43.55.023 starts out by being a lease expenditure. (AS 43.55.165(e) is the 21 specific disallowances - things that folks cannot do.) So if you put a capital or operating cost in AS 43.55.023, then all those disallowances apply. On the other hand, if you go to AS 43.55.025 that has one paragraph saying the credit can't be these things - the words are not the same. And as they generally know, a judge seeing different words would assume they didn't mean the same thing. So lots of things, like how costs that are considered internal transfers or dealing among related parties, are handled differently between AS 43.55.023 and AS 43.55.025.

Finally, he said, the "clawback" provision on how credits interact with the limitations that have been put on Cook Inlet gas and oil taxes (AS 43.55.011(m) all apply if the well work credit is put in AS 43.55.023, but not if it's put in AS 43.55.025. These could all be cross-referenced, but if it is simply "dropped in" one or the other, all the rules would apply.

Another caution Mr. Dickinson raised is if it's necessary to totally restructure AS 43.55.025 to fit the well credit in, the last thing explorers, who are comfortable with AS 43.55.025 now, and the department that is comfortable with how they are auditing under those rules now, want to have is a total revamp seven years later - and everyone has to figure out if the new rules apply.

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MR. DICKINSON said the definition of "well work" should be better. SB 267 starts out by talking about a lease expenditure, which immediately presents pages and pages of law, but not what is considered a well and what isn't. It doesn't deal with the chronological issue - if he has to put in a road and a bridge and a support camp for a well - is that part of the well costs or not? It should be better defined in the bill.

SB 267 talks about lease expenditures for the purposes of side tracking, well deepening, well completion, and well workover; the sort of comparable list over in the Governor's bill is re-drilling, casing, cementing, logging, completing well work over operations or other operations intended to increase or enhance well production from a known productive pool. Then there is sort of a flip side provision in SB 267 that very specifically says you would include an injection well (designed not to bring more oil or gas to the surface but to put liquids in to force it up elsewhere) whereas the Governor's language specifically says that a service well (the definition includes an injector) is not permitted. Neither is a stratigraphic test well.

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MR. DICKINSON moved on to the third item - the tax rate tied to resident hire - and said according to the Department of Labor and Workforce Development (DOLWD), Alaska has 17,000 oil field workers on the North Slope, but as of 2008, roughly 5,000 of those don't meet their definition of resident and are considered non-resident hires.

The general approach of SB 267 is to say there is a base tax rate of 25 percent. At the end of the year, they go back and

look at the labor that was part of their tax calculation, and see how much of it was resident and how much of it was non-resident; then they apply for a rebate of taxes if they had a residential hire rate above 80 percent. The rebate could take them from an effective tax rate of 25 percent down to 20 percent. So the 20 percent would become the new floor for someone who had 100 percent resident hire.

CO-CHAIR WIELECHOWSKI asked if that is realistic. Could those 5,000 non-resident hires all be filled with Alaskans?

MR. DICKINSON said he didn't know; but he observed if it's an issue of training, in the recent DOLWD regulations, training employees for oil field jobs is not considered a deduction. That might be worth looking at if they want to encourage training residents, but he also had other mathematical issues with the number.

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CO-CHAIR WIELECHOWSKI asked if he had any sense of the constitutionality of this provision.

MR. DICKINSON said he was addressing a number of attorney's there and as a CPA, he had learned he couldn't get anywhere near giving a legal judgment.

SENATOR STEDMAN remarked that the 25 percent credit amounts to a couple billion bucks.

MR. DICKINSON said he would give some examples and if he didn't answer his question, to remind him of it at the end of this section. Slide 36 showed the resident hire ratios. Moving from 70 to 80 percent has no effect to the tax rate; the conversation doesn't start until one is at 80 percent. After that, between 80 percent up to 97.5 percent, basically for every 2.5 percent increase in hire rate the rebate goes up by 2 percent. An easier way to think about the net effect is a half percent drop in your effective nominal tax rate. Then from 97.5 - 100 percent is just a little bit steeper.

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An extreme quote he pulled out of the Anchorage Daily News when the companion bill, HB 308, was discussed is that according to DNR hiring one Alaskan could mean \$30 million in tax savings. But the math works out just about right. In his example he used calendar year 2009 that had a high price and a tax base of \$13 billion. So, if one company was responsible for half of that,

the base tax involved would be \$1.6 billion. His point was if a company were right up against one of these brackets and needed one more hour to complete its ratio, in fact, that one hour could derive the \$30 million effect. He explained that the bill is based on the number of hours worked by residents or non-residents not on the number of people. But, Mr. Dickinson said he wanted to focus on the opposite effect, which is when a company is below 70 percent (which is where the DOLWD says we are starting). It would have to add 649 Alaskans as workers, but the tax rate would not change by one iota - and that would just be getting it to where the conversation starts.

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MR. DICKINSON said that folks tended to focus on what happens if they were right on one side of the bracket and moved just a half a percentage point to the other side and their tax rate would jump by a half percent - but a half percent for this purpose is hundreds of millions of dollars. But equally true is if he is exactly at 80 percent and kept adding workers his tax rate wouldn't change one bit. So, a hypothetical company with 6,500 contractors, employees and laborers could add 162 workers and get no effect on their tax rate. Mr. Dickinson suggested that it would be very easy to translate this into a formula where they didn't have these brackets.

CO-CHAIR MCGUIRE said that committee staff, Mike Pawlowski, was indicating he would work with him on that.

MR. DICKINSON said one thing that is more problematic and worth focusing on is the question of if the law is put in place and then it goes to the folks who are obligated to try to pay the least tax possible as long as it can be done within the rules. They would say why not go through the tax return and pull out every single non-resident hour; taxes would go up because they would be pulling out deductions, but they would get a benefit at the other end when they get their rebate. For example, he said if the tax base is \$10 billion, the base tax would be \$2.5 billion. The maximum rebate would be 20 percent or about \$500 million. At the other end, assuming 5000 workers at \$100,000 each/year (\$.1 million), the total non-resident payroll would be \$500 million. If he took that out of all his costs, his tax base would go up by \$500 million (25 percent of that for base tax) and the net effect of not claiming the non-residents would be \$125 million. But because he went to 100-percent resident hire by the test that was established in the bill, he picked up a tax benefit of \$500 million. So, the net effect of not claiming non-resident workers would be a \$375-million benefit.

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MR. DICKINSON said he had four suggestions for avoiding this kind of problem:

1. Shift the scale so the maximum tax savings are not 5 percent but 1 percent
2. Require that any labor be allowed as a lease expense
3. Focus on new hires only
4. Have the commissioner of DOR determine a tax rate every year.

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MR. DICKINSON said it is very important to understand that there really are just three tax payers. That's all they are really talking about here. The producers are the taxpayers in Alaska; they have the working interest in the leases. They go out and hire an operator to run those leases. The operators also have employees, but they generally hire contractors to do the actual work. If you come right down to it, direct employment from oil and gas is 4000; the oil field services, the people that are working on the leases is 13000. The thing to focus on is that most of the employment is with people who are not taxpayers who will not flow through to the tax return as various items.

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CO-CHAIR WIELECHOWSKI asked under the bill's current structure if the resident hire kicks in only for employees of the oil company or does it pass through to contractors.

MR. DICKINSON replied it would pass through to contractors, but how it passes through would have to be resolved (not in regulation). The bill talks about "labor." The question is if you buy a module, are you buying X amount of labor in a module or what happens if you have a turnkey contract or a fixed price contract. The concept that becomes a deduction is fair game for the resident hire calculation (slide 47).

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SENATOR WAGONER said that it is pretty evident that this would be much better structured in two different bills, one for oil taxes and one for local hire. He didn't see SB 267 going a long ways in the next 60 days if it didn't get a lot of clarification.

MR. DICKINSON said slide 49 showed who the largest taxpayers are on the North Slope. Cook Inlet is another unit that represents

about 10 percent of the state's total production (mostly gas), but it's less than one half of one percent of the tax due to the "J&K" limitations that basically say "no production tax on oil and gas is limited to something like 17.5 cents/mcf." So, total Alaskan production is 280,000 barrels and 251,000 of that is on the North Slope.

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CO-CHAIR WIELECHOWSKI asked for an estimate of barrels of oil left in Cook Inlet.

MR. DICKINSON said he couldn't hazard a number, but the DNR publishes those numbers.

CO-CHAIR WIELECHOWSKI asked the tax rate in Cook Inlet.

MR. DICKINSON answered the production tax rate for oil is zero and the production tax rate for gas is frozen (from 2006) at 17 or 18 cents/mcf.

CO-CHAIR WIELECHOWSKI asked how exploration for oil in Cook Inlet is doing with that low tax rate.

MR. DICKINSON said other folks could speak to that more specifically than he could, but some exploration is going on.

SENATOR WAGONER said the tax rate for oil is at zero (from PPT discussions). He didn't know how much was recoverable and he reminded them of a royalty reduction in some cases depending on the amount of production.

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MR. DICKINSON said a credit for up to \$1 million/month is available in Cook Inlet that most of the players - Aurora, Pacific, Marathon, and ML&P - would qualify for. The only folks not qualifying for that would be ExxonMobil and ConocoPhillips who are also on the North Slope. The small players on the North Slope - Nenana, Doyon, Forest, ENI, and Pioneer - are covered by that. The \$1-million credit would eat into what Anadarko and Chevron owes, but they would probably still owe something and so the 95/5 split is probably closer to 97/98 being paid by three taxpayers with 2 percent being paid by the remaining two.

According to DOLWD data, he said, the employers are ASRC, CH2MHill, Nabors, and Schlumberger - the oil field services companies. He remarked that instead of mandating local hire, the whole theory behind this bill is when BP and ConocoPhillips go

out and hire operators or when the operators go out and look for contractors that the resident hire ratio is important. And, therefore, it's a bid variable.

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Slides 55-60 show how the mechanics of the change would fit together and his next two issues concerned the regulations now coming out on the new set of rules the Legislature created in 2007. The question is if a producer didn't know he owed tax, and suddenly a rule change says he owes tax, under current rules, he would owe an interest all the way back to when that tax was first due. SB 267 and the Governor's bill set up a situation where the interest would not start running until some period after the regulation had taken place. When SB 267 was put together it was with the real intent of not having any retroactive rules. But for this particular issue it is very hard to come up with a rule that isn't backward looking. Governor Parnell's bill is retroactive.

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Slides 60-61 show state and federal fund interest rates; the federal rate is calculated with the formula of the base rate +5 percent. From June 1991 until now, except for a handful of months, the state's has always been below that. So, essentially the state has an 11 percent interest rate. Now the federal fund rate is .5 percent and the interest, which is not supposed to be a penalty, is at 11 percent. He hoped to illustrate that historically when the 11 percent was put in the interest rate situation was very different than the one we find ourselves in today. The numbers that this bill incorporates are very close to what the federal income tax uses. The major difference is that this bill also puts in a ceiling of 11 percent; the federal funds have no ceilings or floors.

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The last issue is simply changing the statute of limitations the department has to assess tax from three years to six and now back to three. It's important to understand that if there is a false or fraudulent return or intent to evade taxes, the statute of limitations doesn't apply. This items is just in the course of events when the department issues an assessment for a change.

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JOE MATHIS, President, Nana Pacific, a wholly-owned subsidiary of Nana Development Corporation, Anchorage, said he was invited to present here today because his is one of the larger companies that lost a lot of jobs in the last two years. He said that Nana

Development Corporation has many areas of business that it conducts in the oil field, primarily in the security business - protecting the oil field, along with some food services, maintenance of shops, housing, engineering, construction and personnel services.

He said that approximately two years ago they had about 650 engineering-related jobs in Anchorage. Now they are down to just over 350. It would be nice to be able to say they lost those jobs to competition, but they disappeared because projects disappeared. When Nana had the 650 employees they were looking at lots of projects coming up and they leased a tremendous amount of space for them. Now they have a lot of vacant office space in mid-town, down-town and south Anchorage. He said that unfortunately those people who lost their jobs don't have another project to move to; they are going to have to move Outside where the demand is.

MR. MATHIS said their other business sectors have seen about a 12-percent decrease in employment. This particular one was related to project engineering and it was severely affected by the cutbacks.

SENATOR WAGONER asked for a breakdown in the kinds of engineers he lost.

MR. MATHIS answered mechanical, electrical, and petroleum engineers.

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DAVE CRUZ, President, Cruz Construction, Palmer, Alaska, said he is also president of Associated General Contractors. He wanted to speak firsthand about the impact they had seen on the North Slope. His company supplies ice roads, rig moving, oil field support, rig maintenance, rig service and various other services associated directly with the oil companies up North, small and large. Two years ago they worked solid from October to May and ran 200 folks in their field operation; last year at this same time they ran 150. Today he has 8 people working out of Prudhoe. He has seen a significant downturn; no projects are coming out and he attributed it to strangling the only industry we have that has been sustaining jobs.

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CO-CHAIR MCGUIRE asked what kind of lead time projects need.

MR. CRUZ replied that projects generally need a year in advance for planning and budgeting.

CO-CHAIR MCGUIRE asked if he talks to producers who hire him about why there isn't project development.

MR. CRUZ answered yes; he is being told that Alaska is not a good place to do business in because of the current taxation system on oil. It takes about two weeks to get a drilling permit in Alberta, but in Alaska it takes about a year. There is a lot of work that goes into getting a drilling permit in Alaska; so things are substantially more expensive here than working in other places.

SENATOR HUGGINS said what he is saying is very interesting, because they are seeing bar graphs that essentially describe a very rosy-colored scenario about employment. But then hearing people like him and Mr. Mathis describing what is happening to their employment force you get a different picture. Then, he also listened to Kevin Banks, Division of Oil and Gas, in particular, who said that in 2009 there were 13 developmental permits, but in the prior year there was 33, the year before that there were 39, and before that 43. That is a dramatic decrease that tells a completely different story that is very alarming.

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JIM GILBERT, President, Udelhoven Companies, Anchorage, Alaska, said he was asked how long it would take for him to see a change in business if ACES passed. His answer is almost immediately. His personnel work is in project management for the producer companies, primarily in capital expansion. They were just starting to staff a job involved in long-term western region development at Prudhoe Bay - at least four to five years with a sealift of large modules - and less than two years into the project it was canceled. He had about a dozen skilled project engineers working on that; about half of them have had to relocate to Louisiana on two projects they started down there. Mr. Gilbert said he thinks ACES is broken and needs to be fixed. Progressivity seems to be the biggest component that needs repair.

He related that at about the same time in 2007, ConocoPhillips was preparing to start its ultra-low sulphur diesel (ULSD) project and Udelhoven already had people working on it; but there again, because of the tax situation, they canceled the project. It's not a coincidence; ACES is broken.

MR. GILBERT said that many projects don't make it through the review stage, because they cannot withstand the tax or bottom line scrutiny. As production continues to decline, people can't stand in the way of the means and methods to increase exploration, development production, but ACES does just that. It blocks efforts by producers to increase production and it stifles development. It hurts Alaska.

SENATOR FRENCH thanked him for coming down and bringing them some real stories. He said he had a pair of graphs; one is for U.S. workover rigs and the other is for rotary drill rigs. Both show a dramatic drop in drilling activity across the nation in 2008/09 that happened coincidentally when ACES was passed. He didn't think that ACES affected the U.S. drilling activities; something else did. Everyone knows that oil prices went from \$145/barrel down to much lower. He was interested in stimulating jobs in Alaska, but he wanted to be cautious about drawing too many conclusions in seeing this kind of drop across the nation in drilling activities.

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MR. GILBERT said he wasn't sure where Senator French's data came from, but he knows that areas in the Gulf of Mexico, Texas and Louisiana, are booming.

SENATOR FRENCH said his data came from the most recent edition of a magazine called "World Oil" that he found in the State Library.

CO-CHAIR MCGUIRE said she would be interested, generally, in taking suggestions on what kinds of things Texas and Louisiana governments do to make it easier to do business in those places. She said on a broader perspective, that the state hadn't been competitive the way they would like to be in terms of drilling wells, ACES aside.

MR. GILBERT said it's really a single word - taxation. He said he has an office in Canada also and agreed with Mr. Cruz that they can get a drilling permit in two weeks there - the same for the Gulf of Mexico where Udelhoven has been doing business for eight years. He sees an adversarial relationship in this state with industry.

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SENATOR HUGGINS thanked him for testifying. He also pointed out that the one state agency that substantiates what he is telling

them about the numbers is the Alaska Department of Labor and Workforce Development and they have to pay attention to those numbers.

CO-CHAIR MCGUIRE thanked him, too, and said they offered equal time to the Department of Revenue.

SENATOR WAGONER said they have heard the same story continuously about permitting times for the eight years he had been here. Maybe they should bring someone in from the permitting division and walk through the permitting steps when they have some time. He knew the owner of Pelican Oil had walked his permit through himself much faster than one year.

CO-CHAIR MCGUIRE said she had heard that some jurisdictions around the world have people apply for "bundled" permits. So she thought permitting would have opportunities as well.

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COMMISSIONER PAT GALVIN, Alaska Department of Revenue (DOR), Anchorage, Alaska, agreed with Mr. Dickinson's presentation. He said that Senator Stedman [Finance Committee] had asked the department to present a lot of this kind of information that would be beneficial to anybody looking at this issue. He didn't have much to add.

COMMISSIONER GALVIN said that Mr. Dickinson had successfully walked them through the different issues associated with the current structure in SB 267 regarding resident hire and the opportunities to change that structure. He said the administration is interested in doing anything it can to encourage local hire. It is a struggle the state has been up against in terms of the constitutional limitations.

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The issue they have with the concept of providing a tax rebate is that they want to insure it is done in the most efficient manner and has the desired results. This philosophy would also carry over to the issue of the 30 percent credit for drilling and the change in the progressivity. They are interested in pursuing a way to get what they are all striving for, which is more investment in more drilling rigs and more Alaskans being hired to ultimately result in more production.

CO-CHAIR MCGUIRE said that she thought this was a worthy credit to give. It's an incentive not a requirement. And she invited

him to continue to offer suggestions to the Legislature on how to do that.

COMMISSIONER GALVIN said they had presented the mechanics of how the credit would work for resident hire. He added that Mr. Dickinson in his presentation also provided a picture of the choice that has to be made if they are looking at putting the 30 percent drilling credits into AS 43.55.023, the standard credits, or into the exploration credits in AS 43.55.025.

With regard to the interest rate, they share the goal of trying to insure that the retroactive application of the regulations does not operate as an unfair penalty for those who are affected by it in a good faith attempt to actually comply with the law. He thought they had a fairly straight-forward way to get there.

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With regard to the change in the interest rate calculation method, Commissioner Galvin said his primary concern is that it may provide an incentive for a taxpayer to basically use the state as a bank by not paying a tax. If the interest rate calculation method provides a rate that is substantially below either what a taxpayer would get by borrowing from a commercial bank or what their normal cost of capital would be, it would provide a disincentive for them to make a payment in a more expeditious manner.

COMMISSIONER GALVIN said he shared the recognition that the current methodology might not be the best with the automatic 11 percent floor given where current interest rates are, and probably an area in between would actually work for both sides.

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Finally, he mentioned the statute of limitations is an area of concern he would have if they bring it back to three years. It was discussed in detail during the ACES session with regard to the complexity of the tax system and the issues associated with how to mechanically be able to accomplish an audit in three years. Three years is not an adequate time to have a certain fairness between the taxpayer and the state in accomplishing that exercise. If three years were imposed given the current system in place, the state would be in a position at the end of that time to basically put a "blue sky number" out there and just say this is what we're going to assess simply because we don't have the data to give an accurate reflection.

COMMISSIONER GALVIN said he would be happy to talk about any of these issues in more detail as they go forward with evaluation of this and the Governor's bill.

CO-CHAIR MCGUIRE found no further discussion or questions from the committee and adjourned the meeting at 5:06.