

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON ECONOMIC DEVELOPMENT, INTERNATIONAL
TRADE AND TOURISM

January 26, 2012
10:18 a.m.

MEMBERS PRESENT

Representative Bob Herron, Chair
Representative Kurt Olson, Vice Chair
Representative Neal Foster
Representative Reggie Joule
Representative Wes Keller
Representative Steve Thompson
Representative Berta Gardner
Representative Chris Tuck

MEMBERS ABSENT

Representative Cathy Engstrom Munoz

OTHER LEGISLATORS PRESENT

Representative Bryce Edgmon
Representative Paul Seaton

COMMITTEE CALENDAR

HOUSE CONCURRENT RESOLUTION NO. 19
Acknowledging the lessons learned from the 2011 Norway Policy
Tour and encouraging investment in the state's oil and gas
industry.

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HCR 19
SHORT TITLE: OIL & GAS POLICY/NORWAY TOUR
SPONSOR(S): REPRESENTATIVE(S) HERRON

01/17/12	(H)	READ THE FIRST TIME - REFERRALS
01/17/12	(H)	EDT
01/26/12	(H)	EDT AT 10:15 AM BARNES 124

WITNESS REGISTER

NILS ANDREASSEN, Managing Director
Institute of the North
Anchorage, Alaska

POSITION STATEMENT: Representing the sponsoring organization, discussed the 2011 Norway Policy Tour.

IRA PERMAN, Chair
Board of Directors
Institute of the North
Anchorage, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation entitled, "Public Policy Report: How Norway Develops Its Oil and Gas," dated 1/26/12.

REPRESENTATIVE PAUL SEATON
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Discussed various aspects of the Norwegian government and his experiences during the 2011 Norway Policy Tour.

BRADFORD G. KEITHLEY, Attorney at Law; Partner and Co-Head
Oil and Gas Practice
Perkins Coie LLP
Anchorage, Alaska

POSITION STATEMENT: Discussed Norwegian oil and gas policy.

REPRESENTATIVE BRYCE EDGMON
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Discussed his participation in the 2011 Norway Policy Tour.

LONE SEMMINGSEN, Deputy Director General
Tax Policy Department
Ministry of Finance
Oslo, Norway

POSITION STATEMENT: Described the government of Norway's natural resource taxation policy and answered questions.

WILLIAM BARRON, Director
Central Office
Division of Oil & Gas
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: Discussed oil and gas tax policy.

ACTION NARRATIVE

[10:18:07 AM](#)

CHAIR BOB HERRON called the House Special Committee on Economic Development, International Trade and Tourism meeting to order at 10:18 a.m. Representatives Herron, Gardner, Thompson, Keller, and Tuck were present at the call to order. Representatives Foster, Olson, and Joule arrived as the meeting was in progress. Also present were Representatives Edgmon and Seaton.

HCR 19-OIL & GAS POLICY/NORWAY TOUR

[10:18:50 AM](#)

CHAIR HERRON announced that the first order of business would be HOUSE CONCURRENT RESOLUTION NO. 19, Acknowledging the lessons learned from the 2011 Norway Policy Tour and encouraging investment in the state's oil and gas industry. He explained that the resolution would be held for further action at the committee meeting of 2/2/12, and introduced representatives from the Institute of the North.

[10:21:50 AM](#)

NILS ANDREASSEN, Managing Director, Institute of the North, informed the committee representatives from the Institute of the North ("Institute"), and a contingent of 45 Alaskans from the public, private, academic, and nonprofit sectors participated in a week-long policy tour to Norway in September, 2011. The participants now seek to share what they learned about Norway's oil and gas development, economy, tax structure, and development climate - particularly pertaining to Alaska's competitiveness. Impetus for the tour came from the Institute's commitment to bring new ideas, best practices, and strengthened partnerships to Alaska. A strengthened relationship with Norway is important because of its role in Arctic governance, its government's relationship with the private sector, and its leadership's priority of strong communication and collaboration. These relationships with the private sector are supported by Norway's core values of competitiveness, capacity-building, and competency. Although there are many differences between Alaska and Norway, the trip presented an opportunity to examine a system that effectively manages development, encourages investment, and ensures that citizens get a fair share of government-owned resources. In today's economy, the Institute encourages the state to study other systems, adapt the lessons

learned from others, and share experiences while building partnerships.

[10:24:45 AM](#)

IRA PERMAN, Chair, Board of Directors, Institute of the North, provided a PowerPoint presentation entitled, "Institute of the North Public Policy Report: How Norway Develops Its Oil and Gas." Slide 1 was a map of the Arctic Circle surrounded by the Arctic nations. Slide 2, entitled "Why We Went: Oil Production in Decline," was a graph of Alaska's oil flow from 1977-2019. He explained that because Alaska's economic future is uncertain, the Institute decided to look at Norway's oil and gas production. Slide 4 was a graph that forecast Alaska will have surpluses for seven years due to the flow of oil and high oil prices; after that revenue will decline and "we want to find ourselves a way out of that ... with some speed and haste but with careful deliberation." Slide 5 was a map of Norway with three Alaska cities superimposed on top. Norway's latitude and coastline are similar to that of Alaska. Mr. Perman continued to "what we found," and described the construction - financed largely by the private sector - that is underway in Oslo. Slide 8 indicated that Norway has more jobs in the oil and gas sector than does Alaska; in fact, the oil and gas sector is "extraordinarily active." Slide 9 indicated Norway's oil fund is worth US\$570 billion compared to the Alaska Permanent Fund, which is worth about \$40 billion. He pointed out that Norway's first deposit in the oil fund was in 1996, and it has produced 12 billion barrels of oil since that date. Total savings for Norway over the life of its oil and gas resource is expected to be \$3 trillion. Norway statistics: population - 4,888,000; income per capita - \$88,400, although living expenses are very high and value-added taxes are 25 percent; gross domestic product purchasing power parity - \$59,100 versus \$47,700 in the U.S; unemployment rate - 3 percent; percentage of government annual expenditure paid by oil and gas revenues - 10 to 26 percent versus 80 to 90 percent in Alaska; and a democratically elected unicameral Parliament with a ceremonial monarch.

[10:34:03 AM](#)

REPRESENTATIVE KELLER asked whether the income comparison included the income taxes paid by Norwegians.

[10:34:24 AM](#)

MR. PERMAN said yes.

[10:34:29 AM](#)

REPRESENTATIVE GARDNER understood in Norway preschool, a university education, and technical training are free.

[10:35:09 AM](#)

MR. PERMAN heard that income taxes in Norway pay for pre-kindergarten through doctorate education, even for a resident living in a different country.

[10:35:27 AM](#)

CHAIR HERRON noted a student does not have to be a citizen to receive a free education.

[10:35:52 AM](#)

REPRESENTATIVE PAUL SEATON, Alaska State Legislature, added that the retirement system in Norway is not associated with one's job, but through the government, and is available to everyone. In fact, the retirement funds and universal medical care costs are paid by the oil fund. He encouraged the committee to recognize these differences.

[10:37:01 AM](#)

BRADFORD G. KEITHLEY, Attorney at Law, Partner and Co-Head, Oil and Gas Practice, Perkins Coie LLP, provided a brief history of his background. Mr. Keithley's purpose as a representative on the 2011 Norway Policy Tour was to focus on the oil and gas aspect of the Norwegian system to understand its differences from the Alaska system, and to identify areas of benefit to Alaska. Norway's oil and gas industry is the world's sixth largest exporter of oil, and Europe's second largest exporter of gas. Slide 12 was a map that indicated the three primary areas of Norway's oil and gas production are the North Sea, which is also the location of the world's second largest new discovery, the Barents Sea, and the Norwegian Sea. Oil and gas fields in the Norwegian Sea have had limited development because this is an important fishing ground for Norway. Norwegians are not worried about their economic future because Norway has flattened its oil and gas production decline by attracting investment capital and co-investing in its own oil and gas development. Slide 14 entitled, "Norway's Oil and Gas Production:" compared Norway and Alaska's production curves and illustrated that

Norway's oil decline curve does not approach the severity of Alaska's. In addition, he pointed out that Norway has maintained a high level of investment for oil and gas development, and Alaska has undergone a decline. Mr. Keithley advised there is a direct relationship between investment and production when the investment is in productive assets. Slide 15 indicated that the primary lesson learned on the 2011 Norway Policy Tour is that Norway has successfully attracted private investment to help develop its oil and gas resources; in fact, over 60 international oil and gas producers are investing in Norway including ExxonMobil, BP, ConocoPhillips, Chevron, Statoil, and many others.

[10:43:18 AM](#)

CHAIR HERRON requested an example of how Norway attracts private investment.

[10:43:33 AM](#)

MR. KEITHLEY said Norway acts as an investor by co-investing with the private sector. The government participates as a producer in the development of the resource. In Alaska, producers pay a bonus prior to production, and then pay a royalty during production. In Norway, there is no bonus system, but there is more focus on development; as a matter of fact, upon the licensing of a new area the government will co-invest alongside of industry. This system aligns the interest of the government with that of the producer during the development of the resource, and provides the producer with a level of comfort. He opined this factor "has had the most significant impact on ... attracting and maintaining private investment in the country." The system is termed State Direct Financial Interest (SDFI), and the government participates directly in the development of the resource, substitutes definitive work and investment commitments for an upfront lease bonus, and participates in development decisions. Mr. Keithley further advised that the most significant lesson learned was that SDFI creates an alignment of interests between the government and the producers because the government gains an understanding of oil and gas development decisions, participates as a working-interest owner; contributes to the costs of development, and has access to data. Moreover, as the Norwegian government increases its understanding of oil and gas development, suspicions of the producers are reduced and there is a higher level of confidence and a more positive environment. He recalled that Norway once used a bonus and royalty system, but during the '80s,

transitioned away from that system - on both new and existing fields - because it impaired investment decisions. The Norwegian hosts acknowledged that the lease, bonus, and royalty system generates a lot of cash from the producers, but after time does not produce development since producers can hold onto property without developing the property. Through government investment, and by taking a working-interest owner position, development is better driven. Mr. Keithley displayed slide 22, entitled, "Implementing SDFI in Alaska," and explained that SDFI can be offered as an option in new leases at the time of the lease sale; however, that would not produce the desired result, and making SDFI an option for developing existing resources is a challenge. One important lesson from Norway's experience is to organize a professional, non-politicized board - similar to the Alaska Permanent Fund Corporation board of trustees or the Alaska Housing Finance Corporation board of directors - to administer the state's interest. The next step, with the cooperation of the oil companies, is to convert the existing leases to SDFI with a focus on undeveloped and underdeveloped fields. Mr. Keithley reiterated that this is a way to drive increased investment and increased development over time. He displayed slide 24 entitled, "The Goal: Change the Curve," that showed three different alternatives for Alaska's future: zero investment which results in approximately a 15 percent decline rate; investment of \$1 billion to \$1.5 billion per year which would result in approximately a 6 percent decline; and an investment of \$4 billion to \$5 billion per year that would result in approximately a 3 percent decline. He estimated that the current rate of investment is approximately \$1.6 billion to \$1.75 billion per year.

[10:55:28 AM](#)

REPRESENTATIVE SEATON asked Mr. Keithley to discuss the misstep made by Norway surrounding the Statoil model, specifically to differentiate between the Statoil model and "what was the right amount of state direct financial investment that got the right balance between state participation and not interfering with projects."

[10:56:13 AM](#)

MR. KEITHLEY explained that Norway originally invested through Statoil, which is now a partially privately-held company. In the early '70s, Statoil was 100 percent government-owned and served the purposes of holding Norway's interest in the development of oil and gas resources, and to act as an operator. As an

operator, Statoil helped develop the service sector industry, gained expertise in oil and gas operations, and began service operations outside of Norway. The company grew very large and powerful and lost its focus on Norwegian projects, so in the '90s Norway reduced Statoil's share in oil and gas resources to 50 percent, and transferred the other 50 percent interest to Petoro. Subsequently, Statoil increased its international focus and shares were sold to the public, although 67 percent is still owned by the Norwegian government. In contrast, Petoro is focused solely on Norwegian resources and is a small, non-operating, efficient, and professional investment company.

[10:59:32 AM](#)

REPRESENTATIVE SEATON recalled the Norwegian officials stressed that Statoil's growing independence threatened Norway's policies thus "that model didn't work." Conversely, Petoro is funded by the government, does not collect profits independently, and acts as a manager.

REPRESENTATIVE TUCK understood that Statoil invests on a field-by-field situation, and negotiates terms with other companies that want to invest.

[11:01:15 AM](#)

MR. KEITHLEY clarified that Statoil is its own entity. At the time of licensing - which is the equivalent of leasing in Alaska - Petoro determines what the government's share will be, therefore, private companies know what the government's financial share will be in terms of investment responsibility and revenue. Norway participates in all fields at an average of 20 percent; moreover, Norway does not want to take a high or total percentage of a field, but wants to remain a co-investor alongside of industry.

[11:02:24 AM](#)

REPRESENTATIVE TUCK asked about any obstacles to overcome.

MR. KEITHLEY acknowledged that in the beginning there was a lack of success due to a few dry holes, raising concerns about investment decisions; however, spreading out the investment and risk over all of the fields, and co-investing with industry, was highly successful.

REPRESENTATIVE SEATON explained the difference between a lease in Alaska and a license in Norway: In Norway, the government provides industry with two-dimensional (2D) seismic work for their bids and as a result plans of development are submitted for the license. The government then selects the preferred plan of development for the field, thereby reducing the time of the development phase. He opined this process is a little more complicated, but possible to do for fields in Alaska.

[11:04:34 AM](#)

MR. PERMAN further explained that Norway's SDFI is part of a larger licensing system which includes benefits such as initial seismic and consistent rules and regulations on environmental protection and safety, yet without the "wild cards" investors find in Alaska. The Institute sees a great potential benefit for Alaska in pursuit of SDFI.

[11:06:12 AM](#)

REPRESENTATIVE BRYCE EDGMON, Alaska State Legislature, said he was extremely fortunate to have participated in the 2011 Norway Policy Tour experience. Norwegians are unified on their strategy in "going forward" and their overall goal to take profits from their nonrenewable resources and put those profits into a renewable vehicle: the oil fund. There are many similarities between Norway and Alaska such as the coastal waters, a small population, and competing interests between fisheries and oil and gas development. Norway is also a major player in the opening of the Arctic and is a leader in the generation of hydroelectric power. Representative Edgmon said he was especially interested in Norway's success bridging differences between commercial interests and promoting corporate social responsibility. Norway also maintains friendly relations with neighboring countries and cultures even after a history of occupation and war. In fact, many agreements between the fishing industry and the oil and gas offshore industry involve other countries. Returning to corporate social responsibility, he stated that Norway recognizes that developers need to make profits, but they also have to show responsibility toward local communities and cultures in order to alleviate controversy.

[11:11:38 AM](#)

REPRESENTATIVE SEATON said the trip emphasized some of the differences between Norway and Alaska, such as the impact of the North Atlantic Current on Norway's northern coast which remains

ice-free for 200 miles. He also found that another of Norway's policies that could apply to Alaska is that all of the oil companies who do business in Norway pay corporate income tax on the profits made in Norway. He recalled that in 1978 Alaska realized that apportioned worldwide corporate tax would - when production in Alaska was more profitable than elsewhere - lower the taxes received by the state, thereby subsidizing less profitable operations around the world. At that time Alaska passed a separate accounting tax rate; however, in 1981 - after a court challenge by the oil companies - the tax rate was returned to worldwide apportionment. Even after the separate accounting rate was upheld on appeal, the state has never returned to that system. Representative Seaton pointed out that this means an all-Alaska oil company pays the corporate income tax rate on its income in Alaska, but an international oil company may pay much less. He opined a return to separate accounting ensures all companies pay the same rate.

[11:14:48 AM](#)

CHAIR HERRON restated the intent of the resolution is to create a bill which will ask the legislature to discuss oil and gas policies in committee.

[11:16:00 AM](#)

REPRESENTATIVE SEATON, in response to Chair Herron, said if the legislature is to look at the lessons learned from the 2011 Norway Policy Tour, SDFI is an important aspect, as is the fact that in Norway everybody pays the same tax rate. He confirmed that this is a subject he would like to see discussed along with others.

[11:17:17 AM](#)

LONE SEMMINGSEN, Deputy Director General, Tax Policy Department, Ministry of Finance, Government of Norway, informed the committee she shares the responsibility of resource rent taxation with a counterpart in the Tax Law Department of Norway's Ministry of Finance. She said Norway taxes natural resources differently from other sources of income for the following reasons: when a natural resource is exploited there is the potential for an extraordinary rent, known as the resource rent; natural resources are generally immobile; and natural resources belong to the public, thus the resource industry is a legitimate tax base. While ensuring a reasonable public share to the profits from the petroleum sector, Norway believes it is

important to attract investment by reliable investors. Therefore, Norway provides a stable tax system and a policy framework that are free from frequent changes. Today, Norway takes 80-85 percent of the value of petroleum production. Also, it is important to provide simple tax rules that apply to all investors including Statoil - which is partially owned by the government. In fact, equal tax treatment of all companies is essential to reduce the administrative burden. A simple tax system reduces the opportunity for the companies to avoid paying taxes and ensures that taxes are correct and enforced. Ms. Semmingsen said the ministry has a highly competent tax administration and also ensures taxpayers' rights by allowing extensive opportunities for complaints and court filings. The ministry uses a variety of government-take instruments: direct taxation of petroleum companies; indirect taxes; a tax incentive to reduce carbon dioxide emissions; and an area fee. In Norway the central government holds direct financial interest in several oil and gas fields thus the government, as do all other licensees, pays a share of all investments and operating costs, and receives deductions thereof. The amount of the government's direct share is decided for each field and varies between fields. Norway owns 67 percent of Statoil and receives a corresponding share of its dividend. There are no upfront payments or fees on production, and royalty payments were totally phased out in 2006. She acknowledged that royalty payments were an important source of income to the Norwegian government, but today, taxes and SDFI are the most important government-take instruments.

[11:24:01 AM](#)

MS. SEMMINGSEN continued to describe the petroleum tax system, saying that the petroleum sector is subject to a uniform net profit tax at a rate of 28 percent levied on a broad tax base. In addition, there is a special tax on production on the Norwegian continental shelf. Production began there in 1971 and the resource rent tax was in place by 1975. This is a relatively stable system as the marginal tax rate has been the same since 1992. The special tax is a net-surface taxation levied on a company basis, and companies are allowed to consolidate costs and income from all fields in their portfolios. The additional tax rate is 50 percent levied on extraordinary profits; however, an extra deduction - known as the uplift - is given to shield an ordinary return from the special tax. Since 2002, uplift and losses can be carried forward with interest; further, if a company withdraws from the Norwegian continental shelf, losses are transferable or the tax

value will be paid by the government. Ms. Semmingsen noted Norway has a similar system for hydroelectric production which is also a natural resource. Norway's profit-based taxation system promotes investment and implies a sharing of risk and return between the government and the investor. Turning to the other large source of government income from petroleum activities, she explained SDFI is an arrangement whereby the government holds an interest in oil and gas fields, pipelines, and onshore facilities. The SDFI program was instituted in 1985 and was managed by Statoil until 2001, when Statoil was partially privatized and the administration of the portfolio was transferred to Petoro. She emphasized that Petoro does not receive income from SDFI and is not an oil company. Each participant's interest in SDFI is decided when the license for a field is awarded, including the size of the government's interest, which can vary. The government, along with the other licensees, pays its share of investments and costs, and receives gross income from the license. Currently, SDFI is an important instrument for increasing the government's take in licenses with high expected profitability. Therefore, SDFI works similarly to a "cash-flow" tax of 100 percent on the government's share of the license, in addition to the ownership of the real capital of the installations on the shelf. Ms. Semmingsen concluded that this policy has secured for Norway government income from petroleum activities, while allowing for the resources to be exploited in an economically efficient way.

[11:30:04 AM](#)

CHAIR HERRON commended Ms. Semmingsen on her professionalism.

REPRESENTATIVE SEATON asked whether Ms. Semmingsen had any experience with negotiating SDFI on old, existing fields that may require the demobilization and remediation of facilities.

MS. SEMMINGSEN restated that SDFI is determined at the time the license is awarded. Previously, there was a sliding scale that allowed SDFI to increase its share on more profitable fields; however, this system was not supported by the oil companies and has been abolished.

REPRESENTATIVE SEATON understood that Norway makes no changes to its share from the issuing of the license through the time of production.

MS. SEMMINGSEN said correct.

[11:33:57 AM](#)

REPRESENTATIVE TUCK asked whether there is a lot of competition at the time of licensing.

MS. SEMMINGSEN said there is open bidding - similar to an auction - and companies describe their plans for development of the field. The Ministry of Petroleum and Energy then decides on the license-group.

CHAIR HERRON thanked the presenters.

CHAIR HERRON asked Mr. Barron how to begin a dialogue between the Department of Natural Resources and the legislature on Norway's oil and gas tax policies.

[11:37:47 AM](#)

WILLIAM BARRON, Director, Central Office, Division of Oil & Gas, Department of Natural Resources, said the Norwegian model is interesting but is not unique to the industry; in fact, many countries have the opportunity to initially, or at a later date, participate in a working-interest share in the development of their natural resources. He said he was familiar with the oil and gas fields of Norway, and others that are similar. Mr. Barron supported opening a dialogue on the subject and continuing investigation; however, the conversion from a tax and royalty system to a system wherein the state has a working interest in a property "is quite a conundrum. How do you go from being the regulator to being regulating the regulator?" A plan for exploration and a plan for development are distinctly different programs. He pointed out that having the state pay for upfront 2D seismic in the North Slope foothills would cost \$1.6 billion to \$1.8 billion over five years, and it would take an additional three to four years to complete primary analyses of the data. Mr. Barron cautioned that a working-interest owner has many responsibilities such as losing money, being outvoted by other owners, abandonment liabilities, environmental disasters, dismantlement, removal, and restoration liabilities, and changes in fiscal regimes. He advised that most of the questions that first arise are policy, directional, and philosophical questions, and - after a dialogue takes place - if the state is prepared for this action, there will be technical and administrative questions. Furthermore, if the state cannot get into existing fields, becoming a working-interest owner may not be an advantage in terms of new exploration and subsequent development. Mr. Barron opined there would be a "time-delay in

exploration effort ... in exchange for our current program." He concluded that the Norwegian model is good for Norway; however, "these are very complicated, negotiated, concession terms that cover all sorts of socio-economic parameters."

[11:44:08 AM](#)

[Although not formally stated, HCR 19 was heard and held.]

[11:44:38 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Economic Development, International Trade and Tourism meeting was adjourned at 11:45 a.m.