

HOUSE FINANCE COMMITTEE
March 26, 2011
1:41 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:41 p.m.

MEMBERS PRESENT

Representative Bill Stoltze, Co-Chair
Representative Bill Thomas Jr., Co-Chair
Representative Anna Fairclough, Vice-Chair
Representative Mia Costello
Representative Mike Doogan
Representative Bryce Edgmon
Representative Les Gara
Representative David Guttenberg
Representative Reggie Joule
Representative Tammie Wilson

MEMBERS ABSENT

Representative Mark Neuman

ALSO PRESENT

Representative Mike Hawker; Senator Cathy Giessel; Bryan Butcher, Commissioner, Department of Revenue; Bruce Tangeman, Deputy Commission, Department of Revenue; Dan Stickel, Petroleum Economist, Tax Division, Department of Revenue; Roger Marks, Consultant, Legislative Budget and Audit Committee.

PRESENT VIA TELECONFERENCE

Lennie Dees, Audit Master, Tax Division, Department of Revenue.

SUMMARY

HB 110 PRODUCTION TAX ON OIL AND GAS

HB 110 was HEARD and HELD in committee for further consideration.

#HB 110
HOUSE BILL NO. 110

"An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; relating to the oil and gas production tax rate; relating to monthly installment payments of estimated oil and gas production tax; relating to oil and gas production tax credits for certain expenditures, including qualified capital credits for exploration, development, and production; relating to the limitation on assessment of oil and gas production taxes; relating to the determination of oil and gas production tax values; making conforming amendments; and providing for an effective date."

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Co-Chair Stoltze announced to the committee that Representative Hawker would be the designated alternate for Representative Neuman, who was out of town because of a family emergency.

Representative Doogan asked if Representative Hawker would be able to debate and vote with the committee. Co-Chair Stoltze replied that as an alternate Representative Hawker would be both debating and voting.

Representative Doogan announced to the committee that he had obtained a legal opinion that stated that Representative Hawker was forbidden from voting.

Co-Chair Stoltze replied that he could produce a legal opinion to the contrary. He noted Representative Doogan's objection and forthcoming legal opinion. Representative Doogan maintained that Representative Hawker should not have a vote on the committee.

BRYAN BUTCHER, COMMISSIONER, DEPARTMENT OF REVENUE, provided a PowerPoint presentation, "Proposed Changes to the Oil and Gas Production Tax, March 26, 2011." (copy on file). He cited Slide 3, "HB 110 Goals":

1. Improve investment climate
2. Increase production
3. Create jobs for Alaskans

Commissioner Butcher continued to Slide 4, "The Problem":

1. Oil production is declining in Alaska, faster than the rest of the U.S.
2. Higher taxes have chilled investment in Alaska
3. Alaska's economy is fueled by a robust oil patch,

however the pipeline currently runs two-thirds

EMPTY.

4. Low through-put levels increase maintenance costs

and threaten a shutdown.

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Commissioner Butcher discussed Slide 5, "The Solution":

We MUST:

1. Reform our oil taxes to be globally competitive.
2. Provide tax credits for drilling in technically challenged fields.
3. Lower the tax rate for drilling new, untapped fields.
4. Cap taxes to encourage more immediate investment at higher oil prices.

Commissioner Butcher stated that Alaska had the highest oil taxes in North America. High taxes coupled with the remote location of the state had made it difficult for new exploration and new development to occur in Alaska.

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Commissioner Butcher continued to Slide 6, "North Slope Production," which was a graph depicting the annual North Slope production and contribution of fields. He shared that the department would be presenting a preliminary spring

forecast to the committee. He explained that the forecast was preliminary because the department waited until after March 31st, when the oil companies would balance their numbers form 2010, to project their actual numbers.

Commissioner Butcher continued to Slide 7, "North Slope Development Drilling," which was a bar graph depicting development and service wells drilled on the North Slope. He emphasized that current levels were not as high as those previously seen.

Commissioner Butcher discussed Slide 8, "North Slope Exploration Drilling," which was a bar graph that illustrated that exploration drilling had peaked in 2001 and again in 2007, but had significantly declined since 2007.

Commissioner Butcher discussed Slide 9, "There's lots of oil left in Alaska...":

- Cumulative production through 2010 has been over 16 billion barrels
- Remaining North Slope recoverable volumes exceed 5 billion barrels
- Geology-based estimates of total oil volumes are

much higher. For instance, we do not include any of the approximately 20 billion barrels in the giant Ugnu deposit, or offshore volumes from the Chukchi or Beaufort Seas, in our forecast

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Commissioner Butcher read from the 2009 United States Department of Energy Report on North Slope Potential:

From an exploration perspective, the North Slope and adjacent areas are far from resembling a mature petroleum province. **The majority of the wells in both the state onshore and near-shore Beaufort Sea are clustered along the Barrow arch trend with only 47 of the 323 exploration wells located south of 70° north latitude Figure 2-2).** The area south of 70 north latitude constitutes nearly 75% of the state acreage.

This southern portion of the state land holdings has a well density of one well per 367 square miles. Thus only the area along the Colville-Canning portion of the Barrow arch and the adjacent portion of the Beaufort Sea has experienced moderate to high exploration drilling activity. Here, the drilling density is approximately one exploration well per 21 square miles.

[The full report can be found at www.doe.gov.]

Commissioner Butcher surmised that the state was not looking at a mature basin, tens of billions of barrels were yet to be discovered on the North Slope, and the state should focus on the giant area south of where most of the development had occurred; this was where the department believed great exploration, development, and production would occur as a result of the HB 110 incentives.

Commissioner Butcher continued to Slide 10, "Development Timeline for North Slope Oil Fields," with a line graph illustrating development timelines for fields on the North Slope. The department believed that much of the in-field development for legacy fields could occur more quickly. New fields that were further from infrastructure had an ultimate timeline of up to seven years. He stressed the importance that the state acts right away.

Representative Gara understood that according to Slide 7, decline in recent years was not due to Alaska's Clear and Equitable Share (ACES), but began declining under the Economic Limit Factor (ELF). He wondered how the drilling of wells on the uptake under ACES and decline under ELF related to HB 110. Commissioner Butcher replied that there had been a one year uptake in 2010 - all other years had been the lowest seen by the state in 15 years. He shared that much of the capital had been put into the legacy fields and that something had to be done to encourage new exploration.

Representative Gara pointed out the second worst year in 15 years had been 2006, which had been under ELF. He did not believe that the graph was convincing in relating the decline to ACES.

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Commissioner Butcher maintained that the difference between the exploration in the last five years and the more successful years in the past was startling.

Representative Wilson asked what current available credits could be used in producing wells, and how they compared to exploratory credits.

LENNIE DEES, AUDIT MASTER, TAX DIVISION, DEPARTMENT OF REVENUE (via teleconference), replied that a 20 percent credit was currently available for development drilling under AS 43.55.023 (tax credits for certain losses and expenditures). Credits for exploration wells were dependent on location, and ranged from 20 to 40 percent. In addition to exploration, if the company was experiencing a net operating loss, a 25 percent net operating loss credit was available.

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Representative Wilson asked if numbers could be provided to highlight where development was still occurring versus where it had declined. She wondered if the decline had been in existing fields or in new areas.

Mr. Dees assumed that the wells depicted on Slide 8 would qualify for the 40 percent credit under AS 43.55.025 (alternative tax credit for oil and gas exploration). The wells on Slide 7, to the extent that they were located in existing fields, would qualify for the 20 percent credit.

Commissioner Butcher continued with the presentation. He introduced Slide 12, "Main proposed changes":

Progressivity Rates & Cap: Progressivity levied as discrete brackets, rather than as a continuous function, and applied only to incremental revenue.

Base Tax Rate: Base tax rate of 15 percent, plus progressivity for leases or properties neither unitized nor producing as of 12/31/2008. Base rate of 25 percent plus progressivity for currently producing fields.

Tax Credits: Extension of 40 percent well lease expenditure tax credits to North Slope. Tax credits can be claimed in a single year instead of two years.

Tax Calculation: Yearly tax calculation based on average prices and costs, instead of monthly tax calculation impacted by short term price and cost peaks.

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Commissioner Butcher discussed Slide 13, "HB 110 compared to ELF and ACES," which was a bar graph showing where the department saw ACES if the bill did not pass, and where ELF would be in terms of production tax revenue if ACES had never been passed. He said that the production tax revenue under ACES needed to be addressed. The legislation would keep the revenue higher than under ELF but not as high as under ACES. Under ACES, the department believed that too much was being given to the state. Under ELF, the department believed too much was going to industry. Therefore, the department had worked to find a balance.

Vice-chair Fairclough asked whether the analysis showed any increase production that the state could expect by offering the incentives. Commissioner Butcher replied that it did not. The analysis reflected where the department predicted the future would be under the current scenario.

Representative Gara wondered if the bar graph included the loss in revenue that would be incurred by shifting from monthly to annually.

BRUCE TANGEMAN, DEPUTY COMMISSION, DEPARTMENT OF REVENUE, responded no. He explained that oil prices were projected annually and not monthly. He stated that the monthly-to-annually calculation was different from month-to-month, and that the department did not project from month-to-month.

Representative Gara opined that the loss was significant. He reminded the committee that in 2008, the legislation would have cost the state \$400 million, had it been in place. He believed that the loss should have been included in the analysis. Commissioner Butcher interjected that based on the previous two years the loss would have been \$10 million to \$20 million, which was relatively insignificant. He said that there could be situations where the number was negative, but that it was impossible to determine how to calculate the loss into the analysis.

Representative Gara offered that there were two companies already proposing projects; Repsol and Great Bear on the North Slope. He wondered if lowering the tax rate on projects that had already been planned to move forward would result in a loss of revenue.

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Commissioner Butcher replied that the department had heard nothing about the exploration wells. Petroleum News had alluded to Repsol spending \$768 million on the North Slope project. However, the total investment could be much more if HB 110 were to pass. He thought that having a Repsol representative on hand during the HB 110 debates would be beneficial. He reminded the committee that the plan was preliminary and could drastically change as a result of the passing of HB 110.

Co-Chair Stoltze informed the committee that invitations to the meetings had been distributed universally. Repsol Oil, among others, had chosen not to be present.

Mr. Tangeman noted that the fields referenced by Representative Gara had not been included in the budget forecast for the department.

Representative Guttenberg referenced the development timeline on Slide 10. He stated that the Kuparuk River meltwater development timeline was uniquely short. He wondered when the department expected new fields to be online, and if different timelines were expected for infield and outer-field development. Commissioner Butcher expected potential infield development to occur before outer-field development.

Representative Guttenberg asked if there was any of way of projecting the timeline. Commissioner Butcher replied in the negative.

Representative Doogan asked if the department could project the possible losses or gains HB 110 would have generated within the last five years. Commissioner Butcher said the information would be provided to the committee.

Mr. Tangeman highlighted that proposed development in Umiat was included in the department's forecast.

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Representative Gara wondered if the legislation was similar to the Petroleum Production Tax (PPT). Commissioner Butcher offered to provide comparison information.

Representative Wilson questioned the average barrel dollar amount for each year from 2013 to 2015.

Commissioner Butcher listed the dollar amounts:

FY 13 - \$95.79
FY 14 - \$96.33
FY 15 - \$100.76
FY 16 - \$103.60

Representative Wilson requested the FY 11 per barrel dollar amount. Commissioner Butcher replied that the estimate for FY 11 was \$91.13; FY 12 was estimated at \$94.70.

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Commissioner Butcher added that the FY 10 oil price per barrel was \$74.90.

Representative Hawker questioned the success the state had had in achieving past production forecasts. He noted that the analysis on Slide 13 was based on the fall 2010 revenue forecast. He queried whether the department anticipated the numbers to be higher in the spring forecast when updated. Commissioner Butcher replied that the price of oil was expected to be higher.

Representative Hawker asked about the volume numbers. Mr. Tangeman said that an initial drop was anticipated in 2013. Volume numbers were expected to increase slightly in the years following.

Representative Hawker wondered if the department had researched the historic underachievement of the production forecasts. Commissioner Butcher admitted that the forecasts could be optimistic when compared to the actual numbers. He

offered that the actual numbers were often affected by project delays.

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Representative Joule asked whether the forecasts would be more accurate if the projects were on target. He wondered if the department could study the pattern of projects that had eventually been completed, but not in the projected timeframe. Commissioner Butcher imagined that an examination of projections over the last 20 years would reveal that some projects had been delayed, and some had never come to fruition. He believed that if a pattern existed, it would take a tremendous amount of work to examine its effects.

Mr. Tangeman added that there were two variables to consider when examining the projections: time and quantity.

Vice-chair Fairclough said that the Palin Administration had proposed a bill for ACES that included the 25 percent flat tax. She explained that amendments to the legislation had changed progressivity to a "Draconian take," which prompted her to vote no on the legislation. She relayed the desire to view the Palin introduction bill. Commissioner Butcher offered to get the information to the committee.

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Commissioner Butcher continued to Slide 14, "Outline for Presentation: Outlook and Conclusion."

Commissioner Butcher cited Slide 15, "HB 110 Fiscal Projections":

- General Fund Revenue, General Fund Appropriations, and Savings Balances (CBR / SBR only).
- Based on 10-year Fiscal Model developed by DOR Tax Division, DOR Treasury, and OMB.
- Incorporates preliminary Spring 2011 revenue forecast, production forecast, and investment forecasts.
- Spending projections using LFD presentation from March 1, 2011.

- Key provisions of HB 110 / SB 49 added - tax rate change, tax calculation, well lease expenditure credit.
- Alternative production scenarios & associated costs developed to evaluate various possible outcomes

Commissioner Butcher discussed the five possible scenarios. Based on the preliminary spring forecast, which was not concrete, the department would be laying out potential scenarios predicting future production. The department did not know what would happen, but wanted to offer many scenarios. The department would also show the effect of HB 110 with no new development and would compare the possible revenue with the Legislative Finance Division (LFD) budget predictions. All of the projections would vary from year to year. He stated that the projections would include General Fund revenue, General Fund appropriations, and the saving balance. Projections would be based on a ten-year fiscal model established by DORs Tax and Treasury Division and the Office of Management and Budget (OMB). He added that when looking at HB 110 the department had also factored in the credit increase of 15 percent. Not only was the department looking at what the potential increase in revenue would be, but also removing the increased capital expenditures, operating expenditures, and credits.

Representative Hawker understood that the spring 2011 forecast had been used in the development of the scenarios. He asked if the department was factoring in any increased production as a result of HB 110 passing. Commissioner Butcher replied that the department would have scenarios that would show increased production as a result of the passing of HB 110. Representative Hawker clarified that a full spectrum of potential new development would be presented to the committee. Commissioner Butcher replied in the affirmative.

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Commissioner Butcher continued to Slide 16, "Preliminary Spring 2011 forecast compared to Fall 2010 forecast." He noted that there were changes at the bottom level of production, but the larger changes between fall and spring occurred with the price of oil. He noted that unrest in the Middle East would result in increased oil prices into the future. He added that more detail on the matter would be available in the spring forecast.

Commissioner Butcher discussed Slide 17, "Forecasted ANS production FY 2010 - 2020," which illustrated historical decline, as well as the breakdown of the spring forecast: under evaluation, under development, and currently producing. Currently producing included: base production, fields that were currently producing, and where the department saw continuing production over the next 10 years. The decline curve mirrored what the curve had been over the last 10 years. It was projected that current oil production was forecasted to decline an average of 9.3 percent per year. The under development projects included projects that were currently funded, or were awaiting project sanction. The projects were not guaranteed; projections were an estimate based on when the department believed they would come online. The under evaluation area represented technically viable projects, with an emphasis on engineering cost and reward. He stated that the under evaluation area was the most vulnerable in the difference between the current tax structure and the passing of HB 110.

Representative Guttenberg asked whether the forecast would change from fall to spring. Commissioner Butcher replied there would be changes. For example, when the fall forecast was created the department had expected the Liberty project would begin production in 2012 but the project had been postponed.

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Representative Guttenberg thought that future legislators would appreciate the documentation of the variables and patterns that affected oil revenues. Commissioner Butcher replied that it sounded like a great deal of work. He said he could see the potential value of researching the effects of year-to-year delays, smaller output numbers, and permanently shelved projects on the forecast.

Representative Gara asked if a major factor of the decline in production since 1990 was that the fields at Kuparuk and Prudhoe Bay had naturally declined at a steep rate. Commissioner Butcher replied the department believed that the state was not in harvest mode but in a growth mode. He said that a very small amount of the area on the North Slope had been explored, and it was rumored that a very large field would be found. He maintained that there were

potential tens of billions of barrels yet to be drilled that would mitigate the decline.

Representative Gara repeated the question. Commissioner Butcher agreed that the natural decline could be a factor. He said that all fields declined over time but that the decline would vary from field to field.

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Vice-chair Fairclough referred to Slide 6. She stated that the state's largest fields had hit a place where production could be maintained. She said that looking at 2007 forward, producers had found a way to flatten decline on the larger fields. She pointed out to the committee that doing more to develop the fields already identified as having oil could be as beneficial as an entirely new discovery.

Representative Hawker recalled a presentation given during the original ACES legislation that had used the North Sea as an example of natural decline. The example was that the North Sea had reached its peak and was in precipitous decline, much like the charts currently presented for Alaska. He relayed that at that time there had been a windfall profits tax in place, which was repealed in 1993. The production recovery after the tax was repealed brought the North Sea back up to peak levels. He suggested that the department consider the fact that natural decline could very well be impacted by tax decisions. Commissioner Butcher agreed to look into the presentation.

Commissioner Butcher continued to Slide 18, "Scenario 1: ACES Tax Structure, No 'Under Evaluation' and only 75 percent of 'Under Development' Production." The line graph depicted numbers working under the assumption that the under evaluation component of the DOR forecast did not materialize, and only 75 percent the of under-development component materialized.

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Commissioner Butcher continued to Slide 19, "Scenario 1: ACES Tax Structure, No 'Under Evaluation' and only 75 percent of 'Under Development' Production," which was a bar graph illustrating what Scenario 1 might look like going forward using the current tax structure. Year-to-year production was anticipated to drop to approximately 370 barrels in FY 20. The bottom of the page illustrated

through 2020: the forecasted oil price, General Fund revenues, General Fund expenses, and Budget Surplus/(Deficit); total reserves were predicted to drop to \$12,775 billion.

Commissioner Butcher continued to Slide 20 "Scenario 2: Preliminary Spring 2011 Forecast." Scenario 2 examined what was predicted to happen if HB 110 passed and if there was no new production other than production already anticipated by the department. He believed the scenario was unrealistic, as did the governor. He said that the scenario would occur only if the legislature and the governor did nothing after lowering the tax. Slide 21, "Scenario 2: Impact of HB 110 on Preliminary Spring 2011 Forecast," assumed the DOR spring production forecast. The bottom of the page illustrated through 2020: the forecasted oil price, General Fund revenues, General Fund expenses, and Budget Surplus/(Deficit); total reserves were predicted to drop to \$10,378 billion.

Representative Gara queried the assumed percentage growth of the General Fund. Commissioner Butcher believed that it would be 6.8 percent per year, over a 10 year period.

Representative Gara surmised that the biggest reason why the surplus did not disappear in both charts was because the oil prices predicted were higher than almost every year in the history of the world. Commissioner Butcher replied that the numbers were assumptions. He added that there was a belief that in the out years, the price of oil would rise with the rebound of the global economy.

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Representative Gara wondered about the process the department had used in the development of the projected oil prices. Commissioner Butcher responded that the Delphi method was applied in the fall; adjustments were then made by a smaller group of production forecasters and an economics team.

Representative Gara asked if the prices projected through the Delphi were the same or less than the smaller group. Commissioner Butcher replied that in the fall of 2010, the Delphi had projected lower numbers, but that all forecasts were currently different than they had been in in fall.

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Representative Hawker commented that the Federal Energy Information Administration was working with \$130 per barrel in 2020. He stated that to him the scenario presented on Slide 21 was unacceptable. He believed that the situation was unsustainable for Alaska's public. He realized that the 7 percent used by LFD to predict the growth of Alaska's budget was based on historic trends in recent years. He thought that the slide defined the situation that the state was currently in: an unsustainable situation that held Alaska at risk. He said that the future success of the state would take both the revenue work done by DOR and spending cuts in the budget.

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Commissioner Butcher discussed Slide 22, "Scenario 3: 10 percent Additional Production From All Fields." He stated that the slide included some new production. The scenario assumed that production would be 10 percent higher than the DOR forecast beginning in FY 13. The 10 percent was not a magic number and had been chosen for illustrative purposes. He reminded the committee that the scenario included additional credits and capital expenditures that would be expected. The line graph illustrated that production through 2020 was expected to decline, but at a lesser slope than currently projected.

Commissioner Butcher discussed Slide 23: "Scenario 3: Impact of HB 110 on Preliminary Spring 2011 Forecast with 10 percent Additional Production From All Fields." The bottom of the page illustrated through 2020: the forecasted oil price, General Fund revenues, General Fund expenses, and Budget Surplus/(Deficit); total reserves were predicted at \$14,524 billion.

Representative Doogan noticed that the chart depicted a steady increase in revenue. Commissioner Butcher explained that the revenue was charted to increase 10 percent in 2013, with that amount carrying forward for the next 10 years.

Representative Doogan understood that there was going to be a constant 10 percent increase beginning in 2013. He asked where the 10 percent was going to come from. Commissioner Butcher replied that he did not have the specific

information on exactly what amount, or where, the revenue would come from. The department could not predict the future; these were simply potential scenarios.

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Co-Chair Thomas added that the administration could predict only 1 percent growth. Commissioner Butcher stated that was correct. He informed the committee that the department had been requested to draft the scenarios in order to lay out the possibilities.

Mr. Tangeman pointed out that Vice-Chair Fairclough mentioned a 1 percent increase to currently producing fields; scenario three would be the closest to her thinking.

Representative Doogan assured committee that his only critique was that projections were often wrong. However, he respected the academic exercise.

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Vice-chair Fairclough maintained that the state could see 60 thousand barrels of oil per day if greater recovery were allowed on the North Slope.

Representative Wilson asked if any of the credits expected under HB 110 were already available under ACES. She assumed the blue line on Slide 22 represented appropriations coming in based on projected oil revenue numbers, and the black line represented the difference made by HB 110. She understood that the difference between the two lines was the deficit that the state would experience until more oil was brought online. Commissioner Butcher stated that the two could be overlaid. He said that during the creation of the presentation, the department had imagined that there would be potential scenarios that would require further clarification.

Representative Wilson reiterated her desire to know how much revenue the state could possibly lose each year.

Mr. Tangeman stated that the fiscal impacts of HB 110 were included in the scenarios. He understood she was requesting further definition.

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Representative Wilson clarified that she wished to compare the two tax regimes.

Vice-chair Fairclough pointed out that Scenario 1 reflected the tax structure under ACES.

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Representative Edgmon wondered which of the five scenarios in the presentation was favored by the department. Commissioner Butcher replied that choosing a favorite scenario would be difficult. He did not believe that DOR should be the department to make the choice. He stated that even with all of the knowledge gained by researching the scenarios, predicting which scenario was going to be best for the state was impossible.

Representative Edgmon expressed concern about crafting policy to match the probability presented by the department.

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Mr. Tangeman responded that Scenario 1 showed the ACES tax structure and each scenario thereafter reflected the structure under HB 110. Each scenario added more and more production. The administration believed that it would be foolish to show what additional production would look like under ACES because they did not believe that ACES was going to draw the investment that would lead to oil production. He stressed that additional production would require significant capital. He asserted that from the administration's point of view, charting the effect of ACES through 2020 was disingenuous. He trusted that HB 110 would have a positive effect on future investment and production.

Representative Edgmon requested composite that detailed the range of outcomes under HB 110.

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Representative Hawker highlighted Vice-chair Fairclough's observation that Slide 19 illustrated the status quo with ACES in current revenue and expanding projections.

Representative Joule understood that the current tax structure did not offer incentive for activity. He recalled a previous question to the commissioner of DNR concerning whether the industry would allow the pipeline to shut down. He asked if the pipeline would be shut down if no future activity occurred under ACES. Commissioner Butcher responded that the Trans-Alaska Pipeline had tremendous value to the producers. He hoped that a shutdown would not be a step taken by producers. However, producers could drill for oil elsewhere. He reminded the committee of the shock felt when the Liquefied Natural Gas plant in Nikiski was closed down. He warned that the state had to be careful what kind of a message was being sent to industry.

Co-Chair Thomas assumed that the department had models in place that showed the difference in the projected price of oil per barrel as it raised from \$94.70 to \$108. Commissioner Butcher agreed to supply the information.

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Representative Gara noted that any loss to the state due to switching from monthly to annually had not been factored into the projection scenarios. Commissioner Butcher replied that that was correct. He added that in most years the loss was fairly minimal. He reiterated that it was virtually impossible for the department to attempt to assume what would occur in the future.

Representative Gara he reminded the commissioner that he had previously noted for the committee a year when the state would have lost \$500 million under the switch from monthly to annually. He expressed concern that no loss at all was factored into the scenarios. He queried that DOR's second scenario had shown 520 thousand barrels in 2020, but Slide 19 listed 370,000 barrels in that year. Commissioner Butcher said that Scenario 1 had been crafted in in response to request by Representative Costello and Representative Hawker to show a less optimistic forecast based on historical numbers.

Representative Gara noted that LFD had created a budget forecast using the projected prices determined by the Delphi method. The division assumed a loss of approximately \$200 million per year from going from monthly to annually. Also, in the LFD projections the surplus came close to disappearing in FY 20. He thought it was strange that DOR

would assume no loss for switching from monthly to annually, and use a higher price than the one determined by the Delphi method when creating the scenarios. Commissioner Butcher explained that that was the biggest difference between the LFD and DOR forecasts. The division's forecast was based on numbers from six months ago; all the numbers looked very different now.

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Representative Guttenberg said that the department made the assumptions for Scenario 1 under the idea that there would be no uptick in oil production; there was no oil production forecasted into the future. He perceived that the department was working under the belief that there would be no uptick under the current system, and therefore only represented possible decline. Commissioner Butcher countered that the department had started with the most conservative numbers in Scenario 1 and built to Scenario 5, which was the most optimistic. He felt that the scenarios covered the full range from the most conservative to the most optimistic.

Representative Guttenberg reiterated that the assumption for Scenario 1 only reflected decline. Commissioner Butcher rebutted that the scenario was generated by the department specifically at the request of Representative Hawker and Representative Costello: it had been intended to illustrate a scenario using historic, not current, forecast numbers.

Representative Guttenberg pointed out that every other scenario showed an increase in production, except the current scenario. Commissioner Butcher replied that it had been anticipated that there would be requests for additional scenarios, which could be provided without difficulty.

Co-Chair Stoltze advised that the line of questioning should cease. He asked the commissioner to proceed with his presentation.

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Commissioner Butcher continued to Slide 24, "Scenario 4: 10% Additional + New Alpine-Size Field + New Fields Development." He explained that the department had figured in the 10 percent production uptick from Scenario 3, and

then added a hypothetical Alpine-sized field online in 2018 and new field development expected by Brooks Range Petroleum. The department used the 15 percent tax bracket in the projection because it was an already established percentage.

Commissioner Butcher cited Slide 25, which incorporated the HB 110 tax regime, the preliminary spring 2011 price projections, and the LFD budget projections. The bottom of the page illustrated through 2020: the forecasted oil price, General Fund revenues, General Fund expenses, and Budget Surplus/(Deficit); total reserves were predicted at \$16,110 billion.

Representative Doogan probed the process of cost and credit estimations. Mr. Tangeman responded that the numbers were based on presentations given by the industry early in the process. The department had made assumptions based on graphs used by industry and had incorporated real-life knowledge of actual fields. Educated guesses were applied to the types of fields described by other presenters.

Representative Doogan asked if the credits used in the assumptions were the credits as described in the current bill. Mr. Tangeman replied in the affirmative.

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Representative Wilson asked why the numbers of barrels of oil per day decreased between 2019 and 2012.

DAN STICKEL, PETROLEUM ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE, explained that the new field scenario presented by Brooks Range Petroleum had shown that the number of barrels per day were expected to decline in 2020. He noted that production was predicted to start strong and that multiple fields were being layered in over time. He reiterated that the baseline production forecast showed a decline in 2020.

Representative Wilson asked if the same natural decline that the state was currently experiencing would be seen in 2020. Mr. Tangeman said yes. He relayed that an increase would be seen in 2013 that would climb until 2019, at which time the numbers were projected to decline.

Representative Wilson requested the approximate lifespan of an oil field. Commissioner Butcher responded that the lifespans of fields varied vastly because of the range in field size. He said that an answer could be provided at a later date.

Representative Gara understood that a lower tax rate was necessary for new fields because producing the fields was more expensive. He requested an estimate of the range of possible per-barrel lifting costs at Umiat or the Great Bear Petroleum site. Commissioner Butcher thought that the question was better suited to DNR.

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Representative Gara maintained his disagreement that tax rates should be lowered for new fields. He said that ACES had a built in lower rate for new fields. He contended that the rate for more challenged fields was already lower under ACES. Commissioner Butcher replied in the affirmative. He added that more exploration should be occurring given the historically high oil prices, as well as the amount of oil available as estimated by the state and federal government.

Vice-Chair Fairclough asked whether smaller explorers would be deterred by a tax rate that would not be profitable once production began. She said that producers had made commitments to the state under ACES, and then ACES changed. She wondered if producers, both large and small, would seek a higher rate of return in other areas of the globe. Commissioner Butcher relayed that smaller explorers that had been excited by the tax credits and found oil had experienced difficulty finding companies willing to invest in production.

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Commissioner Butcher discussed Slide 26, "Scenario 5: 20% Additional + New Alpine-Size Field + New Fields Development." The slide included the 10 percent uptick, with an additional ten percent uptick in 2017. The scenario was the most optimistic of the five. He cited Slide 27, which incorporated the HB 110 tax regime, the preliminary spring 2011 price projections and the LFD budget projections. The bottom of the page illustrated through 2020: the forecasted oil price, General Fund revenues,

General Fund expenses, and Budget Surplus/(Deficit); total reserves were predicted at \$18,259 billion.

Commissioner Butcher added that "Scenario 5b: 20% Additional + New Alpine Field + New Fields Development (with 5 % annual spending growth)" on Slide 28 emphasized the increased production and department oil price estimates. He said that one major variable was the projected budget numbers. Each scenario presented had reflected the LFD number of 6.8 percent estimated growth over the next decade. Scenario 5(b) suggested a 5 percent annual spending growth rate. The bottom of the page illustrated through 2020: the forecasted oil price, General Fund revenues, General Fund expenses, and Budget Surplus/(Deficit); total reserves were predicted at \$21,900 billion.

Representative Edgmon asked if a scenario had been considered that illustrated the lack of enough resource to accommodate all possible investors.

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Commissioner Butcher replied that he did not know. He believed that Alaska was unique among states in terms of potential production. He asserted that no other states in the Lower 48 had the kind of production potential that Alaska had. He mentioned the assertion made earlier in the meeting that North Dakota could surpass Alaska in five years in oil production, but North Dakota did not have the estimated reserves that Alaska did in the North Slope.

Representative Edgmon thought that the competition for the resources available on the North Slope could increase in the future. Commissioner Butcher agreed.

Commissioner Butcher continued to Slide 29, "Fiscal Projections Scenario Assumptions":

- DOR forecast - uses the full production forecast per Spring 2011 revenue forecast (preliminary) plus associated lease expenditures and credits. These are preliminary numbers based on the forecast which will be released in early April.
- Scenario 1 - removes "Under Evaluation" and 25% of "Under

- Development" from the forecast along with associated lease expenditures and credits.
- Scenario 2 - 10% production increment - adds an additional 10% to forecast across the board, and an associated increase in lease expenditures and credits.
- Scenarios 3, 4, 5 - Add hypothetical Alpine-size field in 2018, and new fields development
 - o Alpine size field in 2018 - production profile developed based on presentation by AOGCC to House Finance on 3/16/11. This development receives the 25% base tax rate under HB 110.
 - o New fields development - production profile developed based on presentation by Brooks Range to House Finance on 3/23/11. This development receives the 15% base tax rate under HB 110.
- LFD spending scenario - 10-year spending projections as presented in House Finance on 3/1/11 - averaging 6.4% yearly budget growth FY 13-20.

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Commissioner Butcher continued to Slide 30, "Other Oil that is not in our scenarios":

- Shale oil
- Heavy and viscous oil
- Most of the oil in the NPR-A
- Nearly all of the federal Outer Continental Shelf (OCS)
- Arctic National Wildlife Refuge (ANSR)

Commissioner Butcher finished the presentation with Slide 31, "In Conclusion":

1. Tax rates must be lowered to improve the investment climate in Alaska.
2. Our economy is at risk if we decide to do nothing. Our future is at stake!
3. The decisions made now will affect Alaska's economy for decades to come.
4. Without major new investment, new drilling will continue to suffer in Alaska.
5. Oil exploration and development will create immediate return in jobs for Alaskans.
6. Just one exploratory well creates dozen of direct jobs and hundreds of indirect jobs.
7. Industry investment and exploration should be closely monitored to make sure HB 110 has the desired effects.

Commissioner Butcher recapped that Alaska was not weighing in competitively with other states in terms of investment and exploration. He warned that the economy and future of the state was at risk if nothing was done to alter the tax regime.

Co-Chair Stoltze asked what percent of the budget had consisted of oil revenue when Governor Sean Parnell was Co-Chair of the House Finance Committee and the price of oil was \$9 per barrel. Commissioner Butcher shared that the price per barrel at the time was approximately 50 percent. Commissioner Butcher emphasized the importance of acting as soon as possible. He reiterated that without major new investment, new drilling would continue to suffer in the state. He offered the caveat that the industry investment and exploration should be closely monitored to be sure that the legislation had the desired effect.

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Representative Joule pointed out to the committee that the resources listed on Slide 30 were not listed in the five scenarios presented. He requested the anticipated credits that would be offered for heavy and viscous oils, and how the credits changed in HB 110. Mr. Tangeman replied that an immediate drop in revenue due to capital credits already in place would be seen if the heavy and viscous oil were incorporated into the scenarios. The heavy and viscous oils required considerable capital in advance.

Representative Joule said that the tax credits would hopefully lead to enough production to offset the capital investment if a credit was offered that changed explorer behavior. He stated that the heavy viscous oils were in current wells and did not need exploration. He asked how the credits that might be offered related to heavy and viscous oil, and whether a way had been found to lift the oil.

Commissioner Butcher responded that BP was optimistic and making progress in the area. The heavy and viscous oils had not been considered in the scenarios because they included too many variables. He explained that the majority of the Outer Continental Shelf (OCS) was on federal land and Alaska would not get a production tax off that land. However, the state's tariff in the pipeline would be positively affected and more jobs would be created. Ultimately, more through-put would improve the life of TAPS and help with the heavy and viscous oil that would need an estimated 50 percent mix of light oil to travel through the pipe.

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Representative Guttenberg wondered what action the state would take if the expected changes to industry behavior did not manifest due to the passage of HB 110.

Commissioner Butcher replied that it was difficult to imagine the legislature and the governor would sit back and watch nothing happen after reducing taxes in order to incentive the industry.

Representative Guttenberg asked how the state would determine whether the tax changes in HB 110 were not working.

Commissioner Butcher replied that it would be determined on a year-to-year basis.

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Representative Gara understood that the credits were "stackable"; companies could benefit from more than one credit at a time. He believed all the stackable state and federal credits and deductions for the production of heavy and viscous oil would be over 50 percent of any capital

investment. He contested that the significance of the credits already on the books had not been emphasized.

Representative Gara noted that the same presentation (tied to a completely different bill) had been shown to the committee the year prior. He wondered what was different about HB 110 that would inspire confidence that it would benefit Alaska.

Commissioner Butcher responded that he could not speak to the previous year's bill. He said that in the few months that he had been working for the governor, the governor had applied a "full-court press." He furthered that discussions concerning the future of the state had involved Roads to Resources and expanding the involvement of the Department of Transportation and Public Facilities (DOT/PF). Also involved were the Department of Environmental Conservation (DEC) and the Department of Law (DOL). From his personal viewpoint the administration had done everything possible to craft a comprehensive bill.

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Co-Chair Thomas expressed concern with the term "retroactivity," which had been written into past incarnations of the legislation.

Representative Wilson requested the simple analysis and fiscal ramifications of each section of the bill. Commissioner Butcher agreed to provide the information.

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RECONVENED

Representative Hawker stated that the Legislative Budget and Audit Committee had received a competitive proposal to procure economic consultants for the HB 110 debates. He informed the committee that he had requested a presentation from a consultant. The presentation used the same data as the presentations made by DOR and proposed that with only a five percent increase in production in five years the state would have a break even revenue scenario if HB 110 were passed.

ROGER MARKS, CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, argued that it was plausible that due to the relative international uncompetativeness of ACES, investment capital had been diverted to other parts of the globe, which had suppressed production in the state. Conversely, it was plausible that with a more competitive fiscal system the capital could be drawn back and increase production. He contended that when comparing the revenue stream with and without HB 110 it was inappropriate to use the same number of barrels per day under the status quo.

Mr. Marks introduced the presentation "HB 110 & ACES Revenue Sensitivities to Production (Logsdon & Associates, House Finance, March 26, 2010. copy on file)."

Mr. Marks began with Slide 1: "Framework":

- Over the past 10 years, looking 5 years forward, the DOR production forecast has averaged about 20% too high.
- The DOR forecast does not take the availability of capital into account in the production forecast. The availability of capital is crucial for producing barrels.
- It is plausible due to the relative international uncompetitiveness of ACES that capital has been diverted elsewhere and production has been suppressed.
- For this exercise we assume the Fall 2010 production forecast under ACES is 10% too high for 2016, and looked at total oil revenues under ACES.
- It is plausible that with a more competitive fiscal system Alaska would attract more capital and production would be enhanced.
- For this exercise we looked at total oil revenues under HB 110 at a spectrum of percentage production increases over the Fall 2010 forecast for 2016.
- We looked at \$80, \$100, and \$120/bbl prices.
- We looked at HB 110 both with and without the 40% well expenditure credit.
- Total oil revenues include restricted royalties that go to the Permanent Fund.

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Mr. Marks continued with Slide 2: "Total Oil Revenues HB 110 vs. ACES: 2016 @ \$100/bbl(\$mm)," which charted the

comparison of total oil revenues under ACES and HB 110. The chart included restricted royalties without the 40 percent well credit for HB 110. The chart illustrated that under ACES, with production 10 percent below the DOR forecast, total oil revenue would be approximately \$6.2 billion. Mr. Marks noted that the chart reflected that the state would make more money under HB 110.

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Mr. Marks continued with Slide 3: "Total Oil Revenues HB 110 vs. ACES: 2016@ \$100/bbl (\$mm). The chart included restricted royalties with the 40 percent credit for HB 110. Without the well credit, production was projected to increase 4 percent. With the credit, production was anticipated to increase 10 percent. He believed the higher oil prices got under ACES made the state less competitive with other areas in the world.

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Mr. Marks skipped to Slide 8: "Crossover Points":

Increased Percentage Production where HB 110 Revenues Exceed ACES Revenues:

- Without 40 percent well expenditure credit
 - \$80/bbl 0 percent
 - \$100/bbl 4 percent
 - \$120/bbl 11 percent
- With 40% well expenditure credit
 - \$80/bbl 5 percent
 - \$100/bbl 10 percent
 - \$120/bbl 15 percent

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Representative Gara noticed that the presentation worked under the negative assumption that no new production would occur under ACES by Great Bear Petroleum, Repsol, or in Umiat. Also assumed was that the state would lose the case surrounding the National Petroleum Reserve - Alaska. Mr. Marks replied that the presentational data assumed the DOR production numbers for 2016 under ACES.

Representative Gara restated the question.

Mr. Marks DOR relayed that he had used the DOR production forecast five years out coupled with the historical error rate and had throttled the error rate down.

Representative Doogan took issue with the term "plausibility." He wondered if there was any concrete information that could be extracted from the presentation. Mr. Marks emphasized that regardless of what would happen with or without the bill every plausible scenario should be taken into consideration.

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Representative Doogan disagreed. He argued that the committee would have to consider a fiscal note if the bill reported out. He believed that the assumptions made in the presentation lacked credit to affect the fiscal note.

Mr. Marks replied that the basic argument laid out in the presentation was backed up by rationality; investments went where the most money could be made. He felt he had presented a sound argument on why investors were making more return by investing dollars elsewhere in the world.

Representative Edgmon asked Mr. Marks to choose from the five DOR scenarios which would best represent a mid-case scenario. Mr. Marks replied that he would need to study each scenario more in-depth before giving a response. He requested more time.

Representative Edgmon expressed frustration in understanding which scenario best represented a middle point. He hoped for further enlightening discussion on the matter.

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ADJOURNMENT

The meeting was adjourned at 4:05 PM.