

HOUSE FINANCE COMMITTEE
March 28, 2011
1:37 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:37 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 Mike Hawker (alternate)
Representative Reggie Joule
Representative Tammie Wilson

MEMBERS ABSENT

ALSO PRESENT

Representative Alan Austerman; Senator Cathy Giessel; Rena Delbridge, Staff, Representative Mike Hawker; Donald Bullock, Legislative Counsel, Division of Legal and Research Services, Legislative Affairs Agency; Bryan Butcher, Commissioner, Department of Revenue; Bruce Tangeman, Deputy Commissioner, Department of Revenue; Roger Marks, Petroleum Economist, Logsdon and Associates.

SUMMARY

HB 110 PRODUCTION TAX ON OIL AND GAS

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

#hb110

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 discussed that Rena Delbridge, Staff, Representative Mike Hawker would provide an overview of the proposed CS HB 110 (FIN) 27-GH1007\I (Bullock 3/27/2011).

Vice-chair Fairclough MOVED to ADOPT workdraft CS HB 110 (FIN) 27-GH1007\I (Bullock 3/27/2011).

Co-Chair Stoltze OBJECTED for purpose of discussion.

Representative Gara had several questions for the Department of Revenue (DOR) related to the Fraser Report. Additionally, he had read an article that called into question some of the prior testimony by petroleum economist Roger Marks related to the tax system in the United Kingdom.

Co-Chair Stoltze relayed that the bill sponsor would be available for additional questions at a later time. He clarified that his office would relay the question to DOR.

Representative Gara communicated that he would like to speak to Commissioner Bryan Butcher in person during a committee meeting.

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RENA DELBRIDGE, STAFF, REPRESENTATIVE MIKE HAWKER, discussed the proposed CS HB 110 (FIN) 27-GH1007\I (Bullock 3/27/2011). She informed the committee that two changes had

been made to the title to conform to Section 8 in the CS. Sections 1 through 5 that related to interest rates had not changed.

Representative Doogan wondered what specific changes had been made to the title. Ms. Delbridge explained that the terms "estimated," in Line 4 and "relating to the determination of," in Lines 6 and 7 had been deleted from the title.

Co-Chair Stoltze discussed that a redline version of the bill would be provided.

Ms. Delbridge continued to address changes that appeared in the CS. Section 6 limited the lowered tax rate eligibility to the first seven years of sustained production. Section 7 included new language that clarified the "brackets" and had been recommended by Donald Bullock, Legislative Legal Counsel. She explained that the change did not alter the net effect of the original brackets that had been proposed by the governor. Section 7 of the House Resources Committee (Resources) version had been deleted and Section 8 of the CS restored a monthly progressivity tax calculation. Sections 9, 10, and 11 were unchanged from the Resources Sections 10, 11, and 12. Sections 12 and 13 in the CS modified the issuance of tax certificates to occur within one year instead of over two years. Sections 14 through 17 related to the well expenditure lease credit that increased from 20 percent to 40 percent and a ten-year sunset on the increase related to the North Slope. Section 18 was unchanged from the Resources Section 18. Section 19 was unchanged from the Resources Section 20. Section 19 from the Resources version was not included in the CS.

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Representative Gara asked about the details of Section 19 that was included in the Resources version. Ms. Delbridge responded that Section 19 had related to an increase in the small producer credit from \$12 million to up to \$15 million.

Ms. Delbridge discussed that Section 20 in the CS had been unchanged from Section 22 in the Resources version. Section 21 was unchanged from Section 23 in the Resources version. Sections 22 and 23 in the CS were new conforming amendments that accommodated the ten-year sunset on the well lease

expenditure credit that had been added in Section 14. Section 24 was unchanged from the Resources Section 28. Section 25 was unchanged from the Resources Section 29. Section 26 was unchanged from the Resources Section 30. Section 27 was unchanged from the Resources Section 31. Section 28 was unchanged from Resources Section 32. Section 29 dealt with applicability. Sections 30 through 36 addressed retroactivity and effective dates.

DONALD BULLOCK, LEGISLATIVE COUNSEL, DIVISION OF LEGAL AND RESEARCH SERVICES, LEGISLATIVE AFFAIRS AGENCY, discussed that one of the most significant effective dates in the CS related to the 25 percent and 15 percent tax changes and the two levels of progressivity that took effect January 1, 2013.

Representative Gara asked whether there had been any additional changes related to the credits that were included in the Resources version of the bill. Ms. Delbridge responded in the affirmative and explained that the Resources Section 21 that established a new credit for 30 percent of exploration outside of an existing unit or within a unit formed after a certain date had not been included in the Finance CS.

Representative Gara wondered whether, aside from conforming language, all of the credit provisions were the same as in the governor's original legislation. Ms. Delbridge replied that she would follow up on the question.

Co-Chair Stoltze noted that the provisions were substantially the same.

Representative Hawker clarified that the change was related to the implementation of a 10-year sunset on the well lease expenditure credit that increased from 20 percent to 40 percent.

Vice-chair Fairclough added that the 15 percent tax base in the second tax bracket was limited to the first seven years of production. The producer would then go up to the second tier or first tier at the 25 percent rate. She explained that the limit would apply to each individual well, the producer of the well, and the time period that the well had to recover its cost at the lower rate.

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Co-Chair Stoltze discussed his desire to adopt the CS but did not want to move faster than the committee was comfortable with. He believed there would be a vigorous amendment process.

Representative Doogan asked for detail on the portions of the Resources version that had not been included in the current CS. Ms. Delbridge discussed that the current CS did not include the Resources language that had lowered the floor for the minimum tax. Section 17 of the Resources version that provided a new credit related to wages paid to Alaska workers in the Resources version was not included in the Finance CS. Section 19 of the Resources version that increased the small producer credit from \$12 million to \$15 million was not included. Language from the Resources version that created a new credit for 30 percent of exploration outside of existing units or within units formed after a certain date was not included. Additionally, Resources Section 24 that eliminated the distance from existing unit boundaries in well requirements in order to be eligible for the 30 percent credit was not included.

Co-Chair Stoltze appreciated the clarification.

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Ms. Delbridge relayed that the Finance CS maintained the extension of the eligibility for exploration and small producer credits from the current statute date of 2016 to 2021 that had been included in the Resources version.

Representative Doogan wondered about the additional changes in the legislation that did not involve the Resources version. Ms. Delbridge communicated that the CS limited the benefits of the 15 percent base rate tier to the first seven years after sustained production began and at that point the production would be taxed at the 25 percent base rate tier.

Representative Doogan asked for confirmation that at year eight the 15 percent base rate tier would increase to the 25 percent base rate tier. Ms. Delbridge replied in the affirmative and explained that after seven years of sustained production a producer would be moved to the higher bracket.

Ms. Delbridge continued to discuss the additional changes in the Finance CS. She explained that the CS restored the progressivity tax back from an annual calculation to a monthly calculation. Additionally, the CS included a 10-year sunset on the 40 percent well lease expenditure credit that had been extended to the North Slope in both the original and Resources versions of the bill.

Mr. Bullock discussed that the CS excluded an amendment to AS 43.55.160 that provided instruction on how to determine the production tax value. He explained that the governor's bill had amended the section to address the new tax plan that took out the monthly progressivity determination. The proposed CS returned to the current status, including fixed rates of 15 percent and 25 percent in 43.55.011(e), and the progressivity rates in AS 43.55.011(g). The existing 43.55.160(a) that addressed the annual calculation and the monthly calculation would work with the current version without an amendment.

Co-Chair Stoltze asked whether the objection to the adoption of workdraft CS HB 110 (FIN) 27-GH1007\I (Bullock 3/27/2011) was maintained.

Hearing no further objection the CS was ADOPTED.

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AT EASE

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RECONVENED

BRYAN BUTCHER, COMMISSIONER, DEPARTMENT OF REVENUE, discussed that DOR had not had ample time to thoroughly read the CS, but would be happy to discuss any other questions the committee had.

Co-Chair Stoltze communicated that there would be time to digest the changes to the bill.

Representative Gara asked whether the commissioner remembered telling the Resources Committee that the Fraser Report (a survey of oil company executives) showed that only 56 percent of the executives saw Alaska's oil tax system as a non-deterrent to investment and 44 percent saw it as a deterrent. Commissioner Butcher responded in the affirmative.

Representative Gara relayed that his office had spoken with the author of the report who had explained that the pertinent information on oil tax and royalties was located in the fiscal terms section. He discussed that the fiscal terms section showed that 74 percent of companies found Alaska's oil tax system as a non-deterrent to investment. He expounded that DOR had mistakenly referenced an incorrect section of the report. Commissioner Butcher agreed that DOR had been trying to present its focus on the tax regime. However, he discussed that DOR's testimony had not been related to production tax and the department felt it had provided a snapshot that depicted how the oil industry viewed Alaska. He relayed that the tax regime in Alaska was extremely low and there was no state sales or income tax. He reported that out of all of the states that had been studied the only states the industry rated as having a works tax regime than Alaska were California, New York, and Florida. He reiterated that the survey provided a snapshot which showed that the general view of Alaska was much more pessimistic than it deserved to be. He discussed that the department had discontinued using the Fraser Report and the Wood Mackenzie Report, which rated Alaska's fiscal situation as 129 out of 141, and had begun to narrow its focus to specific items that were known such as the decline, the lack of exploration, etc.

Representative Gara discussed that "tax regime" was the Fraser Report's definition of personal taxes, corporate payroll and capital taxes; however, the report indicated that there was a much higher number than DOR had previously testified that saw Alaska's oil royalty and production tax system as favorable. Commissioner Butcher answered in the affirmative, but noted that DOR had been attempting to present something a bit different.

Representative Gara discussed that DOR had characterized the Alaska tax system as out of whack; however, when the Fraser Report ranked Alaska's production taxes it put more than half of the jurisdictions that had been surveyed as less competitive than Alaska in terms of production taxes and royalties. Commissioner Butcher replied that the more DOR had dug into the issue it had discovered that there was never an apples to apples comparison. In addition to the Fraser Report, the department had pulled the Wood McKenzie report that had been much more negatively weighted towards Alaska compared to other reports. He explained that there

were a significant number of variables to consider and DOR did not want to lose the focus on what the decline and exploration activity had been in the state.

Representative Gara responded that the department had presented the wrong chart to the Resources Committee and the chart that applied to Alaska's oil taxes ranked the state much more favorably. He emphasized that DOR should have corrected its mistake and presented the appropriate chart to the House Finance Committee.

Vice-chair Fairclough believed there did not appear to be a way to compare one Fraser Report to another to determine whether respondents had changed their views. There was not a defined set of criteria to provide a consistent look at something. She believed that Wood Mackenzie polled from the same type of people on a continuous basis. She discussed that the Fraser Report had been pulled because its accuracy had been brought into question. She added that respondents were paid \$1000 for their response and it did not provide a consistent message given that there was no way to know who the respondents were. She had heard the administration voice that there was a different look each time the information was presented and that sometimes it looked favorable and other times it did not. She hoped that the committee would listen to Alaskans who were telling them that there was job loss and that there was production loss in the service industry that supplied labor and materials to North Slope production.

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Representative Hawker had a copy of the Fraser Report in question and believed that the entire report should be taken with a grain of salt. He read from the survey methodology that "names of potential respondents were taken from publicly available membership lists of trade associations. Some Canadian trade commissioners abroad provided names of individuals in their host countries. Some trade industry associations assisted by providing contact information with individuals of member companies." He relayed that there were a total of 645 responses, but they only represented 364 different companies. He emphasized that only three out of every five respondents indicated that they held a managerial position or were officers of companies. He read from a copy of the solicitation for the 2011 Global Petroleum Survey: "please note that if you

complete the survey and provide us with your contact information, at the end of the questionnaire you will be entered into a drawing for \$1000."

Co-Chair Stoltze appreciated the clarification.

Representative Doogan hoped that the Fraser Report discussion was at an end and noted that the administration should not have presented the report if it was not a reliable form of information. He asked for clarification on the department's response to Question 7 in its March 28, 2011 letter that was provided to the committee (copy on file). He wondered whether the legislature would not have the full cost of HB 110 until 2014. Commissioner Butcher replied in the affirmative.

Representative Doogan thought costs to the state that were indicated by DOR for 2014 were between \$1.3 billion and \$1.5 billion plus additional costs that had not been determined. Commissioner Butcher replied in the affirmative.

Representative Doogan asked why it was not possible to figure out what the additional costs would be. Commissioner Butcher discussed that it was impossible to determine whether there would be a net positive or net negative in 2014 related to a change in interest rate. There would be a 15 percent tax rate for areas that were not currently being developed. The state was currently not receiving any revenue from the areas; however, when development occurred the number would become positive.

Representative Doogan surmised that it would be a good thing if it happened at all. Commissioner Butcher answered in the affirmative.

Representative Doogan asked about item 9 in Question 7 related to the expansion of exploration credits that was listed as indeterminate in the March 28 letter from DOR. Commissioner Butcher responded that the exploration credit item had been added in the House Resources Committee and that DOR considered it as an indeterminate cost because the department did not know to what degree the credits may or may not be used. The number would be zero in the event that the exploration credits were not used; however, it would be an undetermined number in the event that the credits were used.

Co-Chair Stoltze noted that there would be a committee discussion related to the fiscal impact of the CS. He encouraged Representative Doogan to continue with additional questions.

Representative Doogan asked about items 10 and 12 that were listed as indeterminate in Question 7. Commissioner Butcher responded that item 10 related to the extension of the small producer credit from 2016 to 2021. The department had no idea what activity would be used for the credit. Item 12 that added a credit in the amount of producers' wages and compensation paid to Alaska resident workers that exceeded 80 percent, was not in the current CS. The cost was indeterminate because it had been nearly impossible to determine how the credit would be used. He explained that many companies had a small number of employees and a large number of contractors that could potentially manipulate the system so that over 80 percent of the company's five employees would be Alaska workers, and it was next to impossible to determine what impact it would have on the state.

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Representative Doogan asked whether it was really impossible to estimate what the additional costs would be in the event that all of the provisions listed in Question 7 were included in the bill. He understood that the items were not all included in the CS and that it would be necessary to make that distinction as well.

Commissioner Butcher supposed that DOR may have been able to come up with a no-clue guess for five to ten years in the future. He used the 2016 to 2021 language from the bill as an example and explained that DOR would have to try to estimate the amount of credits that would be used five years from the present date and going out to ten years without any knowledge about what bill the legislature would decide to pass. He added that it had been too difficult to come up with a number in the time that the department had been given.

Representative Doogan expressed his desire for the department's best guess regarding the potential cost of the bill prior to its departure from committee. He believed the claim that it was impossible to be certain what the costs

would be was not a persuasive argument given that fiscal notes were frequently a best guess. Commissioner Butcher responded by providing an example related to the small producer credit from 2016 to 2021 that was likely to be a very small number. A 15 percent bracket for areas that were not currently under development could have been in the hundreds of millions to billions of dollars depending on the areas such as Great Bear or the Brooks Range. He opined that the indeterminate negatives would be much smaller than the indeterminate positives. The department could not provide a prediction on what the exact production would be in different areas in the future as a result of the legislation.

Representative Doogan understood that it was difficult to determine an estimate but he expected the department to provide a verifiable price tag on the legislation. Commissioner Butcher responded that he would look at the data but he did not have a crystal ball and could not estimate what the production would be with an acceptable validity.

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Representative Costello wondered whether DOR had looked at the levels of production that were needed in order for the present legislation to result in revenue that would surpass funds generated from ACES. She recounted testimony from a DOR presentation that for HB 110 to surpass the revenue of ACES that the state would need a 5 percent increase in production at \$80 a barrel, a 10 percent increase at \$100 a barrel, and a 15 percent increase at \$120 a barrel. She had found the presentation helpful because it was not possible to predict what would happen. She noted that companies had testified that they would take another look at their inventory and consider investing in Alaska when the bill passed. Commissioner Butcher replied that the department had worked to look at as many angles as possible, but unfortunately it was extremely difficult because of the multiple variables involved that included tax, price of oil, and how production might increase or decrease. He explained that when numbers were indeterminate the department worked to avoid providing the committee with guesses that could have been misleading. He provided an example that DOR could put an estimate in the fiscal note that 15 percent over the next five years would bring in \$600 million to \$1.2 billion in revenue. He explained that

DOR was working to provide the committee with the most precise information possible and did not want to mislead them with a guess.

Representative Gara wondered whether the department would incorporate its new price estimates in the existing fiscal note dated January 18. He elaborated that DOR had recently raised its forecast for the price of oil and that with a higher price in oil the loss in tax revenue between ACES and the proposed legislation would be greater. The fiscal note showed that the price of oil was estimated at \$1.3 billion in FY16; however, with the revised figures the number would be greater that year. Commissioner Butcher answered in the affirmative. He added that just as it saw increased revenue coming into the state and potentially more revenue in the Constitutional Budget Reserve (CBR), the increased price of oil would result in a larger short-term potential loss in revenue.

Representative Gara wondered whether the department could provide an estimate of the fiscal cost to the state for reducing the tax from 25 percent down to 15 percent for fields that were going to move forward regardless of the tax decrease. He explained that ConocoPhillips had announced its desire to move forward on NPRA [National Petroleum Reserve-Alaska] development with the approval of the Army Corps of Engineers. He believed there was evidence that Great Bear and fracking technology would result in increased production. He relayed that there had also been discussion about delayed but eventual production at Umiat. Commissioner Butcher responded that from the department's perspective that it was premature to make assumptions about the future. He used shale and Great Bear as an example and explained that it was promising, but the cost of drilling a well in Alaska was three times more than in North Dakota. He discussed that it would be much harder to have an economic small volume well in Alaska than it would be in North Dakota. He relayed that it did not make sense for the department to try to make an assumption about potential development that could occur under the current tax when it was not sure what would occur under a 15 percent tax.

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Co-Chair Stoltze remarked on the impact of environmental policy regarding fracking.

Representative Gara disagreed with the department's stance. He believed that DOR would start taxing fields at 15 percent that would have been developed and taxed at 25 percent and that it would cost the state a significant amount of money.

Vice-chair Fairclough relayed that Representative Gara's statement may have been accurate for a future field that currently did not have a permit; however, there were existing producers that were caught in the middle of the present debate and had been negatively impacted. She discussed that there had been testimony the prior week related to companies that had entered Alaska's regime under the Petroleum Production Tax (PPT) and had been caught off guard when ACES had been implemented. She relayed that there were currently uneconomical fields that had been forced to produce due to debt in excess of \$140 million. The fields would begin operating in order to recover shareholders investments based on a regime that no longer existed.

Representative Gara remarked that they disagreed on the issue.

Representative Guttenberg wondered when the department would provide the committee with updated fiscal notes. He thought that DOR could provide projections that used the current tax system compared to the proposed tax for fields that were known to be coming online. He had received a letter from Professor Reynolds, an oil economist at the University of Alaska Fairbanks who projected oil would increase to \$200 or \$300 based upon world-wide production levels and decline. He was concerned about the department's overall inability broadcast and to forecast way out into the future when it talked about the bill's focus on changing behavior and making things more economical and the relationship with world competitive costs. Over the years the legislature had received reports from Wood Mackenzie and Gaffney, Cline & Associates that discussed the expensive but lucrative nature of doing business on the North Slope. The whole premise of the bill was that there would be a change of behavior; however, it appeared the department was asking legislators to take a leap of faith and that it had no ability to make projections about new wells, exploration, and the location of new fields.

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Co-Chair Stoltze replied that the department would have the fiscal notes ready the following day.

Commissioner Butcher responded that the department would provide a fiscal note to the committee after it had reviewed the CS. He added that DOR had made it known that the U.S. Department of Energy had reported that the state was not close to a mature field. There had been next to no exploration on 75 percent of state land, which was the focus of the 15 percent tax. He relayed that questions related to geological information should be directed to the Department of Natural Resources (DNR).

Representative Wilson wondered whether the state was trying to make it more economical to extract the oil that was becoming harder to get. She believed the bill was about increasing activity and not about changing behavior. She discussed that activity could increase as a result of new technology. Commissioner Butcher replied in the affirmative. In discussions with DNR the department had learned that the giant Prudhoe field and the majority of the most easily obtained oil had already been produced. The state was looking at heavy oil, infrastructure, challenges away from the Prudhoe Bay field and TAPS [Trans Alaska Pipeline System], and issues that were continuing to spur production that were much more cost intensive and complex than they were 30 years earlier.

Representative Wilson opined that there appeared to be a gap in the correlation between explorers and producers in the state. She knew that the number of explorers had increased in Alaska. Commissioner Butcher agreed. He elaborated that it was necessary to explore in order to develop and produce, but without production the state would not receive what it hoped to from its natural resources.

Representative Wilson ascertained the system was not working and that the purpose of the bill was to sustain Alaska's oil fields for a longer period of time than would occur without any action. Commissioner Butcher responded in the affirmative. He elaborated that there would be a short-term reduction followed by a long-term gain.

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Representative Doogan wondered whether DOR had information to indicate that in five years there would be an equivalent amount of oil in the pipeline to match an expenditure of \$5 billion to \$10 billion. He discussed that there was a rough idea of what the costs would be that depended on items which could not be nailed down presently; however, the committee had been given no idea about what the benefit might be. He was not aware of any guarantees from oil companies that giving them \$1.5 billion a year for the next five years, for example, would result in anything like the kind of oil production that would balance out the expenditure. He thought the committee would be provided with estimates, but there had been none provided in any presentation, committee meeting, or public hearing. Commissioner Butcher responded that there were almost an infinite number of possibilities that the department would be happy to run at a member's request. He reiterated that he did not have a crystal ball and could not read the future. He stated that the bill was the governor's attempt to change that Alaska did not have the same amount of exploration that other areas had been experiencing. He stressed that it would be great if the bill was successful; however, a change in the law would likely be discussed in the future if it was unsuccessful. The department considered the bill to be a positive step forward and it hoped it was the correct solution.

Representative Doogan could not believe that the committee was discussing a bill that could potentially give the oil industry somewhere in the range of \$1.5 billion or more per year without any concrete evidence that it would have a desirable outcome. He had not heard anything that had made him want to vote in favor of the bill and believed the department was asking the legislature to "throw the money up in the air and hope that some of it lands where we want it to." Commissioner Butcher responded that the department believed the industry would perceive the bill as a material change and as something that would make them reevaluate how they viewed Alaska. The department had not received a guarantee from companies that they would increase development; however, he added that because of all of the variables in the future, he would be a little concerned if he were on the board of directors and the company had made guarantees about investment. He did not believe that ACES would have passed in 2007 if the state had looked for guarantees four years in the future regarding the price of oil and the positive or negative impact the price would

have on exploration in the state. He expounded that it would not have been possible to see what Texas, Oklahoma, North Dakota, and other areas would do in the future. He opined that in order to move forward it was necessary to make an assumption and take a look at it a few years later to determine what worked and what did not and to take appropriate action.

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Representative Hawker expressed concern that the committee was debating the bill.

Co-Chair Stoltze communicated that the topic was important and did not want to stifle the conversation.

Representative Hawker disagreed with the statement that there had been no testimony about a potential upside to the bill. He opined that there had been assumptions made about prior testimony that was not black and white. He discussed that the \$1.5 billion cost listed in the fiscal note was a worst case scenario that did not factor in any additional production into the pipeline. He believed it was a problem with the fiscal note that did not accurately characterize the debate that members had heard. He had listened to testimony from Brooks Range, Great Bear, Repsol, BP, ConocoPhillips, and from Pioneer about projects that the companies were ready to undertake provided that they were given relief in the out-year taxation on operations. He elaborated that Repsol was sitting on billions of dollars and that they had told the Petroleum News that it was great to have exploration credits but in order for them to undertake production they needed the state to reconsider the out-year taxation or the progressivity and bracketing. Brooks Range and Great Bear had both testified that they needed capital in order to pursue their investment opportunities and were also dependent on a change to the out-year taxation. He relayed that Pioneer had discussed that the expansion of its Oooguruk project was dependent on a change to the high out-year taxation that was not competitive worldwide. A ConocoPhillips press release had stated that the company's commitment for additional capital expenditure was contingent upon the outcome of the legislation. Claire Fitzpatrick with BP had testified that she was competing for capital with her peers from around the world.

Representative Gara wondered how much production would need to increase in order for there to be no loss under the proposed legislation when the price of oil was \$100 per barrel. He asked whether the commissioner had said that a 10 percent increase in production would be needed. Commissioner Butcher did not have the number with him. He added that the price of oil was not the only variable involved.

Representative Gara asked for an estimate regarding the necessary increase in production. Commissioner Butcher could not provide an estimate at the time.

Representative Gara thought the commissioner had provided the number earlier in the meeting. He wondered where the department had received its information that production would increase enough to offset the cost of the legislation. He had heard prior testimony different than Representative Hawker. He elaborated that Exxon and BP had testified that they would not drill a single new exploration well with the passage of the bill. ConocoPhillips had not been able to confirm whether it would or would not build a new exploration well with the passage of the bill. He emphasized that none of the big three oil companies had guaranteed that they would increase production with the passage of the bill. He stressed that the department was asking the legislature to pass a bill that required an increase in production that no one had guaranteed. He stated that the commissioner had said that smaller explorers in places such as Umiat and Great Bear were too speculative to consider. Commissioner Butcher responded that he had not said that they were too speculative. He had said that they were far enough out there and there were enough questions that the department did not know definitively whether they would occur under the current tax regime. He believed that proposed changes would make a definite change in how companies looked at Alaska and the administration would not have introduced the legislation if it did not believe that the bill would result in a material change. He thought the industry had room to be more forthcoming about how the bill would impact oil investment in the state; however, just because companies had not provided guarantees about increased development did not mean that the bill had no relevance as a game changer moving forward.

BRUCE TANGEMAN, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, added that there had been a lot of talk about trying to get back to a certain number. He contended that the administration would not have introduced the legislation if it had believed that the state was at that number. The department believed that the pendulum had swung too far and that the current number had caused the present situation that included no exploration and oil at over \$100 a barrel. He explained that trying to get back to a certain number meant that it would be necessary to assume that the state was at the "sweet spot" number. The department presumed that the state was not at the number. If the state was at the sweet spot number, Alaska would have been experiencing booming exploration like other areas in the U.S. He explained that DOR was not trying to get back to a number that it saw as too big, but it was trying to lower the tax structure in order to increase production in the pipeline.

Representative Gara responded that his problem with the approach was that it was based on "a hope, a wing, and a prayer." He stressed that the department was asking the legislature to give money away in hopes that it would come back, with no assurance from any company that it would happen. He could understand providing better and stronger exploration credits if the goal was to increase exploration. Likewise, if the goal was to make moderate size fields economic, it would make sense to increase production facilities. He did not believe that the department had introduced any evidence that companies would stem the production decline or increase production to the necessary levels that would be required under the proposed legislation.

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Mr. Tangeman replied that the bill was not heavy on changing tax credits but heavy on changing the current tax system. Companies had been taking advantage of the tax credits for exploration; however, the producers were seeing an incredibly high tax rate on oil production and had experienced difficulty locating partners. The only adjustments to the tax credits were the increase from 20 percent up to 40 percent for infield credit and movement from two years down to one year. The goal of the legislation was to change the tax system to increase producers' interest in investing in oil development.

Representative Gara found that the most implausible part of the bill was the assumption that companies were taking advantage of the tax credits and spending a significant amount on exploration, but that they had not thought about the cost of the production tax rate. He believed that exploration companies talked to producers to determine their interest in development prior to undertaking exploration. He believed that it was an "insanely illogical world" that the department had presented.

Commissioner Butcher responded that the department had used examples of companies such as FEX that went out, obtained leases, explored, made a discovery, and then could not find a deeper pocketed company to help them develop and produce the oil. He did not believe that companies were acting naïvely, but that it was a much graver situation than companies realized when they began. Some companies, such as FEX had begun work prior to ACES and once they had made a discovery ACES had passed and they were not able to locate a developer.

Co-Chair Thomas compared the inability to see how the bill would impact the state in the future to commercial fishing and the unforeseen changes in expenditures and pricing that impacted fishermen on an annual basis.

Vice-chair Fairclough believed that the film credit bill was a true example of operating on a hope, a wing, and a prayer because no one had demanded specifics on its future performance. She discussed that many committee members had voted for film credits and believed that it would draw industry. She relayed that the film industry had not contributed directly to state coffers. She discussed that the bill would be before the legislature again to determine whether the credits generated revenue for the state. She stressed that oil and gas credits had provided the backbone and lifeblood for Alaskans and state government for decades. Every person in the State of Alaska had benefited when companies took advantage of the oil and gas credits. She emphasized that she would rather bet on oil and gas than on film credits that may shut the state down in the future. She believed that it was important for the state to help "pony up" a portion of the risk on development that it benefited from 100 percent.

[2:51:46 PM](#)

Representative Gara referred to a March 15, 2011 presentation by Roger Marks that related to marginal tax rate in the United Kingdom. He relayed that Mr. Marks had listed the United Kingdom at a 50 percent marginal tax rate at when oil was \$100 a barrel. A recent newspaper article had reported that the U.K. charged an 80 percent tax rate for legacy field and that it charged a different rate for new fields. He asked whether the 80 percent tax on legacy fields had been reflected in the chart.

ROGER MARKS, PETROLEUM ECONOMIST, LOGSDON AND ASSOCIATES, responded that the U.K. did have some "vintaging" and older fields did pay a higher rate. He discussed that PFC Energy had done an analysis on international tax rates for the administration in 2007 and based on its extensive database had reported that there was very little production going on in fields that were subject to the old vintage tax rates and it had been the company's decision to not include the data in its report. He expressed that Representative Gara was correct, but very little current activity was subject to the higher rate. He would be interested to know if Representative Gara had found different information.

Representative Gara did not know what barrels were paying the 80 percent rate and hoped that Mr. Marks would have included a breakdown on the barrels that paid the higher rate. He added that according to the newspaper the UK was raising its oil tax rate significantly as of the current month.

Co-Chair Stoltze asked which newspaper Representative Gara was referring to.

Representative Gara cited the New York Times as his source.

Representative Doogan wondered whether Mr. Marks had used the word "vintaging." Mr. Marks responded in the affirmative.

Representative Hawker discussed an earlier statement that the big three oil companies would not invest more money in new exploration. He opined that the comment may have been true but that it was only half of the story. He expressed that 90 percent of the state's future production would come from legacy fields and that BP, ConocoPhillips, and ExxonMobil corporations were all heavily invested in these areas. He thought it was a putdown to refer to BP as

British Petroleum and clarified that the company's correct name was BP Alaska. He discussed that with the exception of Badami that BP had never discovered oil in Alaska. The company's business profile was to buy oil producing assets from exploration companies. He emphasized that both Exxon and ConocoPhillips had provided testimony regarding legacy field development projects that they would like to move forward on. He believed that it was a disservice to mischaracterize the debate by using only a portion of the testimony that had been provided by the companies.

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

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ADJOURNMENT

2:58:25 PM

The meeting was adjourned at 2:58 PM.