

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

February 11, 2011
1:03 p.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Alan Dick
Representative Neal Foster
Representative Bob Herron
Representative Cathy Engstrom Munoz
Representative Berta Gardner

MEMBERS ABSENT

Representative Scott Kawasaki

OTHER LEGISLATORS PRESENT

Representative Mike Hawker
Representative Mark Neuman
Senator Cathy Giessel

COMMITTEE CALENDAR

PRESENTATION(S): OIL & GAS PRODUCTION TAX STATUS REPORT

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

BRYAN BUTCHER, Acting Commissioner
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: Provided the portion of the Department of Revenue's presentation on the Oil and Gas Production Tax Status Report to the Legislature dated January 18, 2011.

FRANK MOLLI, Petroleum Engineer and President
Molli Computer Services, Inc.

Consultant to the Department of Revenue (DOR)
Colorado Springs, Colorado

POSITION STATEMENT: Provided the portion of the Department of Revenue's presentation on the Fall 2010 Oil Production Forecast.

RICH RUGGIERO, Vice President
Field Development & I/O Support
Gaffney, Cline, & Associates Division
Baker Hughes

Consultant to the Department of Revenue (DOR)
Houston, Texas

POSITION STATEMENT: Provided the portion of the Department of Revenue's presentation on Petroleum Fiscal System Design.

ACTION NARRATIVE

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CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 1:03 p.m. Representatives Feige, Seaton, Dick, Herron, Munoz, and Gardner were present at the call to order. Representatives Foster and P. Wilson arrived as the meeting was in progress. Representatives Hawker and Neuman and Senator Giessel were also present.

PRESENTATION(S): Oil & Gas Production Tax Status Report

[Contains discussion of HB 110]

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CO-CHAIR FEIGE announced that the only order of business is an oil and gas production tax status report by the Department of Revenue (DOR). He noted that the presentation is part of the committee's education process for HB 110.

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BRYAN BUTCHER, Acting Commissioner, Department of Revenue (DOR), related that the Oil and Gas Production Tax Status Report to the Legislature [dated January 18, 2011,] has seven sections (slide 3). The first section has to do with revenue generation and the tax rate. State revenues under the 2006 petroleum production profits tax (PPT) and the 2007 Alaska's Clear and Equitable Share (ACES) have exceeded the amounts they would have been had the state remained under the economic limit factor (ELF). A provision of the PPT required that DOR provide a status report

to the legislature in five years. Eighteen months after PPT, ACES was passed and the decision was made to leave the report in statute. The passage of ACES probably affected some of the information that DOR might have had had there not been a tax change one-third of the way into the five-year period.

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ACTING COMMISSIONER BUTCHER noted that even though the tax rate under ACES can be as high as 75 percent, it has not been nearly that high over the last four years. Since Fiscal Year 2008 the average tax rate has been just over 40 percent. The second section of the report is a look at industry investment. Capital expenditures began increasing upon passage of PPT and have continued to increase after passage of ACES. However, [regarding the third section of the report], the department does not have a breakdown of how the capital expenditures are separated between what is being done in existing facilities and what is being done for new exploration. Although DOR has considerably more information than it did five years ago under a gross-based tax, it still does not have the kind of detail that allows for separation that would provide a better idea of exactly where that spending is going. [Regarding the fourth section of the report], industry employment continued to creep slightly up in 2007, 2008, and 2009, but dipped in 2010. [Regarding the fifth section of the report], the amount of credits used continued in an upward trend. However, it is difficult to draw a hard conclusion on the credit results because they were only recently put into law. Regarding the sixth section of the report, tax administration and compliance, the department continues to write regulations for the new tax system. The first audits under the first year of the net profits tax, PPT, have just been completed and the auditors are now getting into the first year of the ACES tax. The seventh section of the report, conclusions and recommendations, will be presented at the end of the presentation.

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REPRESENTATIVE P. WILSON recalled that DOR has been hampered in its tax reporting and compliance efforts due to lack of a centralized database to house and manage the large volumes of oil and gas data. She asked about the status of that problem.

ACTING COMMISSIONER BUTCHER confirmed that the DOR tax division has had a difficult time in putting together all of the tax information and data that comes in. While data is contained in

various systems of Excel software, DOR does not have a good overall database that allows input of the information and breakdowns of the information. Given that the cost range for such a system is \$25-\$35 million, the department received \$300,000 in the current fiscal year to look into determining what would be the best system. Additionally, with the Department of Administration, DOR is looking at a statewide view of all of the information technology (IT) projects, so DOR is optimistic that by the fiscal year's end it will have a good number and good recommendation on what is needed going forward.

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REPRESENTATIVE GARDNER inquired whether the new database will be able to provide information on how much of the claimed credits is for drilling or wells and how much is for maintenance or facilities.

ACTING COMMISSIONER BUTCHER responded no, the statute is written such that DOR only receives what the capital expenditures are from the companies and the department can then determine what they are to make sure they are legitimate. The law does not require a breakdown that specifies exactly whether it is capital work on an existing facility or exploratory work. The department is very much limited by the amount of information that it gets. The companies themselves might be able to provide more insight in this regard.

REPRESENTATIVE GARDNER asked whether that is something that could be done by regulation even though it is not required by law. She said this is important because other bills are being considered that would provide incentives for new wells, but if it is unknown what is a new well and what is maintenance or facility related, then a meaningful fiscal note cannot be done.

ACTING COMMISSIONER BUTCHER answered that he suspects it would have to be statutory, but he does not know that for a fact and will have to get back to the committee on that.

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ACTING COMMISSIONER BUTCHER, returning to his presentation, compared the estimated production tax revenue for fiscal years 2007-2010 under the current ACES tax system with what it would have been under the previous two systems of PPT and ELF (slide 4). Under ACES in Fiscal Year 2008 the state received nearly \$7 billion in production tax revenue, but had ELF still been in

effect the revenue would have been less than \$2 billion. Under ACES in Fiscal Year 2010 the state received just under \$3 billion, compared to under \$1 billion had ELF still been in effect. Thus, it can definitely be said that the new tax system has been very good for state revenue over the short term.

ACTING COMMISSIONER BUTCHER reported that another known is that companies are spending more, although the state does not have a breakdown on where that is going (slide 5). Spending began to increase in the 2004 calendar year, moved up when PPT was passed in 2006, and has continued moving up since the 2007 passage of ACES. He noted that during those years the Alaska North Slope (ANS) West Coast price spiked up and down but the increase in spending remained steady, which is not the usual case because generally spending really moves up when the price of oil comes up and dips when the price of oil drops.

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REPRESENTATIVE HERRON inquired whether the governor wants to, or the legislature needs to, put something in statute to require a breakout of the information that DOR receives from companies.

ACTING COMMISSIONER BUTCHER replied that the department has not discussed this with the governor, but will if the committee would like it to.

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REPRESENTATIVE SEATON surmised that the increase in spending regardless of any decreases in oil price is because credits are dependent on expenditures and are independent of price, and thus the graph [on slide 5] indicates that the credits are working.

ACTING COMMISSIONER BUTCHER responded that DOR believes the credits are having a positive effect, particularly with some of the smaller producers. However, the number of exploratory wells has continued to drop and production continues to decline, and at this point this gives a picture that the credits have not been working in terms of getting more exploratory wells.

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CO-CHAIR FEIGE asked whether the acting commissioner agrees then that there is not necessarily a connection between capital credits and production going into the pipe.

ACTING COMMISSIONER BUTCHER answered that he does not think that DOR has the data to say one way or the other at this point in time because it is too early in the process.

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ACTING COMMISSIONER BUTCHER, continuing his presentation, noted that production continues to decline (slide 6). Additionally, over the last five years the number of exploration wells on the North Slope has continued to drop (slide 7).

CO-CHAIR FEIGE inquired whether the exploration wells [depicted on slide 7] include wells that are drilled both within and outside of the unitized areas.

ACTING COMMISSIONER BUTCHER replied that the graph represents the entire North Slope area.

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ACTING COMMISSIONER BUTCHER, turning back to his presentation, said that DOR cannot conclusively identify the ACES impact other than state revenue has increased in the short term, oil production continues to decline, and it does not appear that much exploration is taking place (slide 8). Part of why it is so difficult is because of the timeline for investment decisions that producers generally use from the beginning of evaluating a field to actually begin producing. For example, the investment decisions for fields that are currently coming online, such as Nikaitchuq and Ooguruk, were made prior to the passage of PPT five years ago and ACES three and a half years ago. He suggested having the producers address this timeline when they come before the committee next week.

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CO-CHAIR FEIGE asked whether the acting commissioner is aware of any decisions that have been made by companies to proceed with new development since PPT and ACES were implemented.

ACTING COMMISSIONER BUTCHER responded he is not, but that Mr. Frank Molli might be able to address that. Liberty Field was initially expected to begin production in calendar year 2012, but that is now potentially 2013 or 2014.

CO-CHAIR SEATON inquired whether the acting commissioner is saying that Liberty Field is related to the tax regime.

ACTING COMMISSIONER BUTCHER answered that he is not.

CO-CHAIR SEATON added that since Liberty Field is under federal control, not ACES, if oil companies are not proceeding with developments then it may be that decisions are being influenced by factors other than the tax regime.

ACTING COMMISSIONER BUTCHER agreed and said he pointed out Liberty Field only as something that is seen in the future.

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REPRESENTATIVE P. WILSON said there is a rumor that one of the reasons the oil companies are not investing in more exploration and more drilling is that the companies are concerned about the age and condition of the Trans-Alaska Pipeline System (TAPS). She asked whether this has been in anyone else's mind.

ACTING COMMISSIONER BUTCHER deferred to the Department of Natural Resources (DNR) to provide any specifics in this regard. He said DOR believes that as long as there is oil to be produced and profits to be made, the producers and owners of Alyeska Pipeline Service Company have the motivation to keep the pipeline active and in good working condition for decades.

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FRANK MOLLI, Petroleum Engineer and President, Molli Computer Services, Inc., Consultant to the Department of Revenue (DOR), first provided a history about himself, noting that he worked for "Phillips" for 12 years in various places such as the North Sea and Texas. He then started his own company and developed software to do oil and gas reserve analysis, which he uses to generate the forecasts for Alaska's North Slope. He pointed out that North Slope production peaked in 1988 at 2 million barrels [per day] but by 2010 that production had declined by 68 percent to 644,000 [barrels per day] (slide 10), which is an average production decline rate of about 5 percent per year. Over the last 10 years, the decline mediated somewhat to an average rate of about 4.2 percent per year. Looking into the future [through 2030] this decline rate is expected to flatten out a little bit further at about 3.2 percent [per year on average].

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MR. MOLLI explained that the left side of the graph on slide 11 depicts the history of annual ANS production and the right side depicts the forecast. The 68 percent decline can be seen from the [1988] peak to the current date [2010]. The drop is not quite as large over the last 10 years, and in the forecast it is less steep. The major producer by far is Prudhoe Bay, second largest is Kuparuk, and third largest is Alpine which came on in the year 2000 or so. Not included in the forecast is the outer continental shelf (OCS), the Ugnu heavy oil that is sizeable but for which there is not yet a way to develop efficiently, and the Arctic National Wildlife Refuge (ANWR).

MR. MOLLI, in response to Representative P. Wilson, confirmed that the offshore production sources depicted in the graph include North Star and Liberty.

MR. MOLLI, in response to Co-Chair Feige, said that Oooguruk is in state waters and is not considered OCS.

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CO-CHAIR SEATON, regarding the production history, understood that the rate of decline is determined by the steepness of the slope.

MR. MOLLI replied that he used data from the Alaska Oil and Gas Conservation Commission (AOGCC), which maintains production history data for every well in the state of Alaska. He imported that data into the software, looked at each well individually to find a best-fit line through the trend of that well, and then aggregated that data to come up with a field production. Thus, the trend from each individual well was used to forecast. This is called decline curve analysis and is fairly common in the industry for projecting oil and gas.

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CO-CHAIR SEATON observed that the slope on slide 11 is pretty steep between the years 1994 and 2000, which was during the time of ELF when there was a zero percent tax rate on fields like Kuparuk. From 2004 through 2007, during which there was a lesser tax rate, the decline is steeper. After ACES in 2007, the decline slope is much flatter and showing less decline. He said it is being heard that if the tax rate was less there would be less decline, yet the history does not show this. He asked whether he is analyzing this curve correctly.

MR. MOLLI responded that he does not know the answer to that, but he does know that the mitigation in decline was the result of several new fields coming on line around the year 2000. He does not know, however, whether that relates to the tax regime at the time.

CO-CHAIR SEATON said that was a specific point and he exempted that by looking at 2004 through 2007 which has a steeper curve than after 2007 when ACES came into play. He said he will get back with DOR in this regard.

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CO-CHAIR FEIGE inquired how much of an effect the price of oil has had on that decline. He further inquired whether it would be possible to come up with a graph that shows the amount of investment in fields versus the price of oil.

MR. MOLLI answered that he will have to think about that; he is sure the price of oil entered into the decisions here.

CO-CHAIR FEIGE commented that the price of oil obviously has a fairly significant effect on whether a company decides to invest in any field, whether that field is in Alaska or elsewhere. It would therefore be interesting to see statistics that also reflect the price of oil as a factor.

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MR. MOLLI, returning to his presentation, explained that the graph on slide 12 [depicting forecasted ANS production] uses the same information depicted on slide 11. However, the production forecast in this graph [for fiscal years 2010-2020] is divided into three categories - currently producing, under development, and under evaluation. Currently producing includes all existing equipment, existing wells, and existing surface equipment. Currently producing requires a high level of maintenance, so the currently producing category is the forecast at the same high level of maintenance without any new development and it can be seen that the production drops quite a bit. The under development category includes any new projects or new wells that the operators are planning to drill. To generate this forecast he looked at the plans of development submitted to the Department of Natural Resources by the operators and talked with the operators' engineers, and then developed an average well for each field. By using the drilling plans and applying an average well he came up with the development and, given that this

development is usually already funded, there is a good probably that this production will occur.

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REPRESENTATIVE GARDNER asked which companies are in which of these three categories.

MR. MOLLI replied that they all are. In further response, he said all companies are in each category.

REPRESENTATIVE GARDNER understood there are companies that have produced wells in Alaska in the last few years that are not necessarily under development.

MR. MOLLI responded that he is thinking of the majors and all of them have some developments in the existing fields.

REPRESENTATIVE GARDNER said she is trying to get at the companies that are not the majors.

MR. MOLLI answered that Great Bear Petroleum is planning some exploration soon and is not in any of the forecasts. He said he will research this information and get back to the committee.

REPRESENTATIVE GARDNER said she would like to know the under development and the under evaluation and others who are known to be working but not necessarily planning development right now.

MR. MOLLI agreed to provide that information.

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MR. MOLLI, continuing with his presentation, explained that the under evaluation category is probably the most speculative. It involves projects that are under study right now by the various companies, such as Umiat and Point Thomson. He said the three categories are added together to come up with the total forecast.

CO-CHAIR FEIGE inquired whether any percentage or probability was assigned on that curve.

MR. MOLLI replied that he does not do that; the decline curve analysis is a deterministic process, so there is not a range of probabilities.

CO-CHAIR SEATON surmised that this forecast gets more speculative the further out in time it goes; for example, the 2013 date would be more confident.

MR. MOLLI responded correct, the further out in time the more variance or error that could be introduced into the forecast, so the near term forecast, meaning the next one to three years, should be fairly confident.

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CO-CHAIR FEIGE observed that just after 2012 or 2013, Alaska will cross the line down to 500,000 barrels per day if no new production is put into the system.

MR. MOLLI concurred.

ACTING COMMISSIONER BUTCHER added that there has been discussion over the years about forecasts being more optimistic than the historical numbers show. He pointed out that Mr. Molli began doing this for DOR in 2009 and that Mr. Molli factors in the scheduled shutdowns of TAPS. However, unscheduled shutdowns such as what happened last month with Pump Station 1, will be a reduction in production that is unforeseen. Another thing that can happen is that forecasted production comes on later than expected, such as the Liberty field which was expected to come on in 2012 but is now delayed to 2013 or 2014. Delays in coming on are much more frequent than coming on earlier than expected. Therefore, the forecasts are what is being looked at or lower.

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CO-CHAIR FEIGE noted that every year there is a new forecast for the next 10-20 years. He asked whether DOR would be able to take forecasts from 1990 and onward and plot each forecast at the time against what the production actually was. It would give a better sense as to how much importance can be placed on this particular forecast and which way it can be expected to go.

ACTING COMMISSIONER BUTCHER answered that he thinks DOR can do this and can go back as far as it has the information. He pointed out that once this information is given to members, Mr. Molli will be unable to answer any questions previous to 2009 because he did not work on it before then. He added that this would apply to himself as well.

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REPRESENTATIVE HERRON inquired whether there is an error factor that could be incorporated into the forecast model to allow for variations.

MR. MOLLI replied that if an error factor was incorporated, he thinks the forecast would grow bigger and bigger as time went on and the variance between the optimistic side and the pessimistic side would be greater and greater and would be almost unusable once 10-20 years ahead was reached. It would be doable but not meaningful.

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RICH RUGGIERO, Vice President, Field Development & I/O Support, Gaffney, Cline, & Associates Division, Baker Hughes, Consultant to the Department of Revenue (DOR), noted that his firm has been working with and for the Department of Revenue since just before the ACES special session and since then has been providing testimony in both the special and general sessions on areas of fiscal policy and in helping with a comparison around the world. In response to Representative P. Wilson, he said the year this started was 2007. He added that he has over 20 years experience working for one of the major oil companies and that about half of his time in this job was spent developing large projects and negotiating with bodies like the State of Alaska on trying to put together the right commercial package in order to do those deals. He has now been in the consulting business with Gaffney, Cline, & Associates for nearly 10 years and the majority of his clients during this time period have been sovereign. He has worked for a number of governments around the world putting together different aspects of their fiscal policy on energy and development of their petroleum resources.

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MR. RUGGIERO said that after having been through several sessions, there are many people who are experts and have been before this and several other bodies, so he would like to give some background on what members are really running into. Many of the questions today and in the past have been about what does a particular number show. Fiscal design - what is the right royalty, or right tax, or right rate - is two parts art for every one part science (slide 2). A lot of science and analysis can be done; however, there is also a lot of subjectivity that goes into the design of fiscal systems as well as how the energy patch responds to that. A wide range of response will be

received because every company is driven by something a little bit differently. It will be found that everybody can always quote an excellent fiscal system and look at the amount of investment that occurred there, but even if a system worked for that state or country for awhile, over time it starts to deteriorate and changes have to be made for a number of different reasons going forward.

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MR. RUGGIERO explained that when making comparisons a number of things can impact the situation of a jurisdiction. This includes the gross domestic product (GDP) of a country or the GDP per capita and what percentage of the GDP that energy represents. In those countries where energy is not a high percentage the jurisdiction can choose to do some things differently. However, in Alaska and countries where energy is a very large portion of gross income the jurisdiction has to take a little different look at how it is going to manage that and steward that resource. Other factors include, but are not limited to, infrastructure availability and, if there is infrastructure, whether capacity is available. Building whole new facilities to bring on another 100,000 barrels a day is one set of economics, but it is a totally different economic picture if there is 100,000 barrels of excess capacity. The fiscal system will impact those two decisions very differently. Another factor is the availability of labor force and another is institutional capacity. For example, a country may not have the skill to do anything that is complex or sophisticated because that takes an army of auditors, so that country will come up with something that is very simple. Another factor influencing how sovereigns put together their fiscal system is where they want to stand within that competitive environment. Somebody will be the most competitive and somebody will be the least competitive and somewhere someone will put together an analysis or comparison and declare where the middle or the average is for going forward.

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MR. RUGGIERO pointed out that there is always the pressure to change, so Alaska is not alone (slide 3). Even a well-working fiscal system must eventually be looked at because there may be a need to do something differently. This change can be broken down into two different drivers: A) governments want their perceived fair share or B) governments think they are not getting enough investment so they do something to attract the

industry and the investment. The newspapers are full of Item A - the Venezuela's, the Bolivia's, the Peru's, the Iraq's, and the Russia's; and there are the others that have gone the other way to seek a share of those limited investment dollars. The requests for change can always be justified - torture the numbers and they will tell the story that is wanted. Any change being asked for will be justified by "objective" calculations, but understand that behind every "objective" calculation into the future is probably 20 or 30 assumptions that were made. Changes will also be justified by "subjective" calculations; an example being whether there is a correlation between how many wells will be drilled if the state does X, such as the state providing credits.

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MR. RUGGIERO shared that one thing he has learned as a producer, as well as working for governments and sitting across the table from producers, is that producers have never met a tax they liked (slide 4). Oil companies are no different than any other for-profit organization; they are in it to make as much as they can for their shareholders and tax just takes away from the profit they are setting out to make.

CO-CHAIR FEIGE commented that this is the same thing the state is attempting to do for its shareholders.

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MR. RUGGIERO said the messages that legislators will hear are that less tax means more investment dollars and more tax means less investment dollars. However, Illinois has one of the best fiscal systems for oil and gas development, yet big oil is investing nearly nothing in exploration and production in Illinois. In Iraq, government take starts and ends in the mid to high 90 percent, yet oil companies around the world have committed in excess of \$100 billion to begin developments there.

MR. RUGGIERO noted that throughout his time in Alaska he has heard that if Alaska does not do something the producers will take their money to the Gulf of Mexico or the Lower 48. Recently the [Obama] Administration talked about raising federal taxes on exploration and production and the response was that more federal taxes would push investment abroad. If the Lower 48 and the Gulf of Mexico is collectively the best place to do business as an exploration and production company - and that could be evidenced by the number of foreign companies that have

purchased assets in that area - it is interesting that money would go elsewhere if taxes were raised given that elsewhere has a higher tax base than the Lower 48 and the Gulf of Mexico. Alaska is going to hear that high tax is driving investment elsewhere. There are grains of truth to that, but there are also grains of that being something that a company has to say.

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MR. RUGGIERO addressed how fiscal systems are ranked (slide 5), while reiterating that tortured numbers can tell any story. He provided a ranking comparison between place "A" with a production sharing contract (PSC) environment, place "B" that also has a PSC environment, and place "C" that has a concession agreement environment. The average government take for each of the three places is 30 percent, 50 percent, and 60 percent, respectively, making place "A" appear to be the best place in this regard. The highest marginal government take is 45 percent, 65 percent, and 90 percent, respectively, again making place "A" appear to be the best place for materiality and net present value rate of return. However, a number of type fields can be run through the various ranking categories and because of some of the other provisions it might be found that place "A" is not necessarily the best because some of the small things can have a huge impact on the economics and it depends on what is driving certain companies. For some companies, especially those with a lot of private investment funding, the rate of return or the immediate return of capital is most important. In this case, place "C", which has a minimum capital expenditure (capex) recovery period of 1 year [compared to 7 years for place "A" and 5 years for place "B"], becomes very important to an independent investor; however, for someone long in the business that may not be as important as the materiality, which is where the money may not come back as fast, but more money comes back.

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MR. RUGGIERO, continuing his example of ranking fiscal systems, pointed out that many locales do not have credits [places "A" and "B" do not have credits; "C" has a 20 percent credit]. He next explained that cost oil is how much of a given year's revenue is available to recover costs already expended. Some locales put a limit [cost oil cap] on how fast the capital and operating costs can be returned. For example, place "A" has a cost oil cap of 60 percent, while places B and C have no limit. If the return has to be pushed forward because all the available revenue for that year has been used, the time value of money is

lost on that unrecovered capital going forward. Another category is unrecovered cost uplift. In some locales it can take as long as 11 years on average from the point of exploration to the first barrel flowing of dollar. That means that \$100 million spent today to discover a field would not be recovered for 11 years and [in locales with no uplift] it would only be the \$100 million that is recovered. In locales that have cost uplift the cost is uplifted each year by a certain percentage, and in some of these regimes as much as \$300 million can be recovered as recoverable cost because credit is given for having invested and carried that money on behalf of that development. [In the example, places "A" and "C" have no uplift and "B" has an annum uplift of 5 percent.]

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MR. RUGGIERO said ring fencing is another category used in the ranking of fiscal systems. Ring fencing denotes the taxing unit and in many locales the taxing unit is around particular leases or particular fields. [In the example, places A and B have ring fencing by field, "C" does not.] In locales where ring fencing is by field, any money spent on exploration in a particular field cannot be recovered until there is revenue from that particular field, or ring fence, to recover it. Alaska has a statewide ring fence, although there are some nuances between Cook Inlet and "north of 68," so any money on exploration can be deducted right away against current revenues. There is huge cost and huge economic impact to oil companies as they go forward and what is seen in a lot of these surveys is the "emotive factors." These are the factors that get the most optics and that become the 15 second sound bites in chamber of commerce speeches before committees, one example being Alaska's marginal tax rate of 87 percent that is said to be terrible. However, this ignores all the other aspects of the Alaska system that actually provide benefit in going forward. The emotion may be enough to cause a negative decision in a board room somewhere, but that is only one piece. When people present surveys and focus just on these emotive points, the whole story is not being seen because under most type oil fields, place "C" comes out ahead on much more on the net present value (NPV) and rate of return than "A" and "B," although "A" will come out ahead on materiality.

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MR. RUGGIERO related that his company was asked for its view on where Alaska is today and what is it that Alaska is facing. He

said it is undisputed that Alaska's production is declining and continuing to decline [despite unprecedented prices (slide 6)]. There is the looming mortality issue of the Trans-Alaska Pipeline System (TAPS), which could be either a physical limit or an economic limit. Given that physical limits can be fixed by money, everything is really an economic limit, so flow down the pipeline will be cut off at the point where it is deemed uneconomic. A number of Alaska's new resources are viewed as stranded, so the TAPS uncertainty will give new players a big cause for concern. The uncertainty of TAPS includes the material integrity of the pipeline, the economic viability, the longevity, and the cost for a company to get into it because there is a bit of a stranglehold on the pipeline by its owners. Thus, even if the economics are there with the fiscal system, some risk premiums will start to be introduced, and assessing the risks is an art rather than a science. Many companies will run a straight economics model and subtract a risk premium from that model. So, when a company compares Project A in Texas against Project B in Alaska, Alaska may have a risk premium that takes it from being better to being worse. Lastly, Alaska is a location that has long lead times.

MR. RUGGIERO said the aforementioned leads to a crossroads for the state: What path does Alaska see itself on from this point forward? This goes back to the two drivers for why the state would want to look at or think about changing its fiscal system. If the state is entering a harvest path, then it needs to think about how to get its fair share. If, however, the state wants to be on a growth path, then it must assess what it really needs to do, as opposed to what others want it do, to encourage investment and development of resources.

[2:02:49 PM](#)

MR. RUGGIERO advised that two entities can have different perceptions about the same item. For example, governments and producers have different perceptions on the various levels of producer profit (slide 7). If the profit level is a loss or break even, the government perception is that it needs a minimum amount of cash to allow development of its resources. A small profit will be seen by government as about right, a moderate profit will be seen as more than fair, and a large profit will be seen as greedy and outrageous. The perspective of producers, however, is that government is focused on a narrow range of circumstance that does not look at the big picture. Producers try to do things that avoid a loss, breaking even is nice but it is not why a producer is in business, projects that will make a

small profit generally only work when there is more capital and people than there are projects, a moderate profit is the target, and there is no such thing as an outrageous profit because that is the quid pro quo for all the losses that governments tend to ignore when millions are spent on dry exploration wells.

[2:05:20 PM](#)

MR. RUGGIERO stated that it is not the numbers that drive the decisions. While the numbers are there and part of the decision making, there are perceptions, which is where the different risk premiums come in, such as geologic, political, stability, and infrastructure risk premiums. Or, they can become matters of principles, such as certain companies will not do certain things and will not agree to certain terms and will pull up stakes and go elsewhere. Additionally, there is the fear of precedent and that doing something in one place will result in the company having to do same everywhere else that it does business.

MR. RUGGIERO, regarding future scenarios for Alaska, said any number of consultants, his company included, can make several thousand runs on all sorts of variations off certain base assumptions (slide 8). However, the more runs that are put up the more noise that is created. Instead of pinpointing to a narrow range what will happen, he suggests talking about what the goal posts are. He allowed that it is his subjective look at the goal posts as far as the upside and downside cases of doing something with HB 110.

MR. RUGGIERO pointed out that relative to many other prolific hydrocarbon-producing regimes around the world Alaska has a lack of data transparency from the producing community, which was heard today in the answers to the committee's questions. The amount of data that the State of Alaska gets is limited relative to what other fiscal regimes around the world require through either legislation or regulation.

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MR. RUGGIERO said he will try to give some perspective as to what is really before the legislature when talking about whether to change from ACES to something else. Since it is HB 110 that is before members right now, he has put together two goal posts - an upside and a downside - on that bill. One possible upside growth scenario is that the reduction in taxes soon leads to significant new investment that keeps oil and new oil coming in sufficient quantities to pay out upgrades and repairs to keep

TAPS available and flowing through 2050. He interjected that others might come up with other upside cases, but this is his. A possible downside scenario is that taxes are reduced but, for whatever reason, no new fields are developed and TAPS reaches its economic or physical limit in the 2020s.

[2:09:18 PM](#)

REPRESENTATIVE P. WILSON, regarding his statement about lack of data transparency, surmised that Mr. Ruggiero is saying that other countries ask the same questions and get better answers than does Alaska.

MR. RUGGIERO replied that other countries actually publish data, so it can be found on the web and the question does not even have to be asked. He recalled that Gaffney, Cline & Associates presented a paper in testimony to either this body or the other that went over these other regimes and what is normal reporting and what is available, whether through the local regulatory agency or the web, in each of those locations. It ranges from how many wells were drilled, to how much of the capex was spent on wells versus infrastructure, to what the forward plans are for each of the individual fields, and more. In some cases infrastructure is online and every day it can be seen what the capacity is and what the amount of unused capacity is. There is a wide range of things across the globe. He said he would provide copies of the aforementioned paper to members.

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REPRESENTATIVE P. WILSON related that in cases where two or three companies are involved in the same unit, members are told by the producers that they do not want the other producers to know what is going on. She asked whether this happens in other countries.

MR. RUGGIERO responded that just as a producer has never met a tax it liked, whenever it comes to data disclosure it is always that this is competitive and if it gets out the producer is at a competitive disadvantage. However, he noted, in countries where producers are required to do this, they still compete, and they compete quite well.

REPRESENTATIVE P. WILSON inquired whether the state could say it wants this information and the producers must provide it, or are there laws that say the producers do not have to provide it.

MR. RUGGIERO answered he is unaware of any law in either Alaska or the U.S. at this time that would prevent companies from producing information. There would have to be a closer look by someone more familiar with such things as antitrust, but in other locations and other regimes the companies are required to present more data and make more data public than is done in Alaska today.

[2:12:33 PM](#)

CO-CHAIR FEIGE requested that Mr. Ruggiero provide the committee with a reasonable sampling of the types of information that other countries make available that would increase transparency in Alaska and why that information is available in those countries and reasons why that information, based on existing U.S. laws, is not available in the U.S.

MR. RUGGIERO replied he can look at what is available in other countries and that would be the report his firm has already done for the state. Legal issues, however, are outside his firm's range of expertise.

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MR. RUGGIERO, returning to his presentation, reviewed his downside and upside goal posts, but noted that reality probably exists somewhere in between (slide 9). The downside case would include only the existing fields, a fixed 6 percent decline, no new major investments, and a TAPS minimum of 200,000 or 250,000 barrels a day. He clarified that he just picked two numbers for the TAPS minimum and there was no science in picking them. Running these numbers from 2011 through the mid-2020s, the total cash flow to the state through the production tax and the corporate income tax [under ACES] is somewhere between \$95 billion and \$110 billion undiscounted. He then reviewed a case using the terms of HB 110, but first clarified that this is for purposes of illustration only and is in no way a recommendation. For this case he assumed that the needed capital investment is actually developed, existing fields continue to produce at maybe a slower decline rate because of additional investment, new fields are discovered, and regular investment is made to keep facilities in order, and thus a vibrant industry runs through 2050. In this forecast, the state's total undiscounted cash flow or take would be around \$210 billion. So, somewhere between his downside case and his upside case, there is a difference to the State of Alaska of \$100-\$115 billion.

MR. RUGGIERO then reviewed a scenario in which the state's fiscal system is changed to HB 110 (slide 10). In this scenario he used the same aforementioned [downside] assumptions in which there is no investment, and also assumed that over the next 15 years the state did not make any changes to this investment-friendly regime (slide 10). In such a scenario the state's [undiscounted cash flow] would be reduced by about \$20 billion. He advised that if nothing actually happened under the fiscal changes made by HB 110, it would be because the bill did not pull the right levers to actually get the investment coming to the state.

2:17:23 PM

REPRESENTATIVE GARDNER, regarding the figure of \$20 billion, observed that the fiscal notes for HB 110 show [a reduction of] \$7.7 billion over five years.

MR. RUGGIERO replied that his scenarios go out to the mid- to late-2020s, so they take what is in the fiscal note and extend it further out in time. The difference in production between investment that happens and investment that does not happen gets wider the further out in time, so that number will grow more rapidly in the later years than it does in the first and early years.

2:18:05 PM

MR. RUGGIERO, turning back to his presentation, discussed a decision making process for the state that would be similar to how producers look at the probability of success versus the probability of failure (slide 11). Using the numbers he had before, and using his own view of a conservative approach, the chance of the downside occurring would be 75 percent. The aforementioned \$20 billion loss would be multiplied by 75 percent, arriving at a probabilistic outcome of minus \$15 billion. The 25 percent chance of the upside occurring would be multiplied by the difference of roughly \$120 billion, arriving at \$30 billion. Thus, in his conservative case the decision he is making right now has a probable outcome of a positive \$15 billion to the state. Under an optimistic approach, which means that the right levers were pulled by making the change, he would use a 25 percent chance of the downside occurring, and under this optimistic approach the probable outcome to the state grows to a positive \$85 billion. He pointed out that when getting into decision making theory, what is really being said is that if the belief is that the right outcome is somewhere in between

the two, then it is a risk worth taking because the upside is so much greater than the downside of having taken that risk. He further reminded members that in the downside case, the assumption was that the state did nothing with its fiscal system even after it was seen that there was no investment.

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REPRESENTATIVE GARDNER surmised that using probabilities of 75 percent and 25 percent instead of probabilities of 10 percent and 90 percent is the art that Mr. Ruggiero talked about.

MR. RUGGIERO concurred. He then calculated that a 90 percent downside would be minus \$18 billion and a 10 percent upside would be \$12 billion, which would be a negative outcome for the state. If it was thought that there was only a 10 percent chance of success, the mathematics would suggest that the state not make the decision because it is a negative decision. "However," he continued, "you get to a point where, we call it the crossover point, where somewhere between the 10 and 20 percent chance of success you cross over where any chance of success above that yields a positive outcome for the state in that decision making process. So, it is just a different way of looking at and approaching the numbers."

REPRESENTATIVE GARDNER asked whether the discounted cash flow, today's dollars versus dollars 20 years from now, is calculated in Mr. Ruggiero's example.

MR. RUGGIERO responded that if discounting is used the answer and the crossover point would be different. That is one of the pieces of noise that he did not want to get into so he took the simple approach here [of undiscounted].

[2:21:53 PM](#)

MR. RUGGIERO, returning to his presentation, provided an outsiders' view of where Alaska sits. He said the left column of slide 12 describes several aspects of Alaska's fiscal regime. In the center column labeled rank, the word "top" means the aspect is good and the word "bottom" means it is bad. The [right] column is the economic impact of that aspect. Regarding the aspect of allowing immediate deduction of capex, only Alaska and two or three countries allow immediate deduction of capex as though it is operating expenditure (opex; all other regimes require a period of time to recover that capex [giving Alaska a rank of top 1-3 and economic impact of high for this aspect].

Alaska's investment credits give it a ranking of top one-quarter [economic impact of moderate-high], and Alaska's investment credits of up to 40 percent put it in the top 10 [economic impact of high]. Alaska's unique aspect of credits to cash ranks in the top 1 or 2, [economic impact of moderate, big, huge]. Alaska's aspect of no ring fence, which is immediate deductibility, puts the state in the top 10, and this aspect has a huge economic impact. When looking at full-cycle economics, the economics in a regime as a whole, Mr. Ruggiero said Alaska's 87 percent marginal rate puts it in the bottom 5-10. However, he pointed out, to get to that 87 percent, a company would have to be operating almost like on the head of a pin because the parameters would have to be such that the company's cost structure, amount of production, capex/opex split, credits, and so forth, put it right at the \$92.50 profit per barrel. Once a company moves away from that, that 87 percent changes drastically and is a very steep curve down on both the higher and lower sides of \$92.50. [The economic impact of the 87 percent marginal rate depicted on slide 12 is moderate, but with the qualification that optically it is huge.] Regarding the cost per barrel to find or develop, Alaska is in the bottom one-quarter [high economic impact] due to the high expense of doing business in the state. However, Alaska's fiscal system allows full deduction of all costs before the state taxes, although royalty does come off the top. Mr. Ruggiero reminded members that in some other regimes, a company may not be able to recover all its costs in a given year before it is credited with income that it must pay tax on. Regarding environmental costs, Alaska is in the bottom ten [high economic impact]. So, in some cases Alaska has some things that are very, very favorable and in other cases Alaska has some things that are not so favorable. However, he advised, when looking for places to invest, always look at the package.

[2:26:03 PM](#)

CO-CHAIR SEATON noted that one provision of HB 110 is ring fencing - all new development would be taxed at a different rate and presumably these fields would be reported separately. He inquired how instituting ring fencing in the North Slope would work in the balance of the aforementioned.

MR. RUGGIERO answered that for a brand new player, what the state is really doing is ring fencing all production that develops after a certain date; it is still a statewide ring fence. A company would be starting from scratch and moving forward. Initial exploration will take some time before the

company can recover the costs associated with it, but once there is production and it is all new, it all is within the ring fence. For existing players, he said he does not know if they have the election, but something that can be looked at is that they can elect to either pull it in and have the immediate deductibility but the higher rate moving forward, or the option to choose if it is something that hits a certain set of criteria to be different and separately ring fenced. The ring fence will be looked at as either a positive or negative thing depending on individual company positions.

[2:27:43 PM](#)

CO-CHAIR SEATON asked what the effect is of the 87 percent marginal rate on investment and described a possible development scenario as an example.

MR. RUGGIERO replied that he thinks the issue that comes with the 87 percent marginal rate is that the affected rate at that point in time is in the greater-than-70-percent range. For example, in a project in Alaska that requires an investment of \$100 million, the state is an investor up to \$70 million through the deductions and credits, and the company invests \$30 million. When the revenue comes in - say it is \$200 million - the company only gets 30 percent, \$60 million, so the company's net in that project is only \$30 million. However, in a 50 percent regime in the Lower 48, that exact same project with the exact same capex and opex numbers makes the company a profit of \$100 million above its cost. So, in materiality it is the same project with the same risks with the same revenues and cash flowing around, but materially that would look a lot larger in another regime than it looks in Alaska and, to him, that is where the optics of this really comes in. This is why he put up the slide about the two different perceptions: from a government standpoint the company still made a profit of \$30 million; however, while this is a substantial profit, the company can do the same thing elsewhere and make two to three times the money.

[2:30:44 PM](#)

CO-CHAIR SEATON said he is trying to get back to the separation that capital credits and the investment are totally independent of the price and a project is not going to have a price or revenue component until after it starts producing. If a company was at that point of \$92.50 and an 87 percent marginal tax rate, the company could instead invest \$87 million in the project rather than paying it to the state in taxes. Now it is an

investment and the company will get the full 20 percent capex on top for the entire project. That is \$107 million of money that would have been in the state's pocket that is now giving a company an entire project plus \$7 million in excess. This was the gold plating that was talked about before regarding whether people would make investments that did not make economic sense because they actually make money on the investment. The return on that is totally separate because that is price control depending on what the oil price is when the production starts, not when the investment is. The investment tax credit and the moving from paying tax to putting it into the project occurs at that time, not when production starts. He asked whether he is missing something or whether he is correct.

[2:32:50 PM](#)

MR. RUGGIERO agreed that Co-Chair Seaton's description is correct, although he thinks that finding such a project is getting a bit outside the realm of reality. The payback to the state is when the revenue and the barrels would flow from that project, which could be at a higher average tax rate or a lower rate or a different marginal tax rate, so whether or not the state was ahead or behind or whether the producer was ahead or behind, is a number of what-ifs. However, the issue in Alaska is that developments are multiple-year, multiple-period developments and given that there is no price prediction accuracy anywhere in the industry, he thinks it would be real tough for the oil companies to actually manipulate the process and be just ready to spend that money when that predicted right number hits; that would be too hard, if not impossible, for any project in Alaska. Maybe with a quick, land-based rig that could drill 20 wells in a month, a company could hit the bonanza because it optimized within what this tax law allowed, but that could not be done in Alaska.

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MR. RUGGIERO allowed that members have a tough decision ahead of them. A lot is being said publically and privately about what is needed to go forward in a positive future for the state, which is the growth case instead of the harvest case. He said he has seen it time and time again as he comes to the state that the body is handicapped in trying to make informed decisions when it is not informed about what is going on (slide 13). His firm cannot help in this regard and neither can the Department of Revenue. The producers are the only people who can help with the questions of: Where has the money been spent and on what

has it been spent? What is the upside potential that actually exists out there? What are the fields that could be brought on? There is noise about possibilities and projects that have been deferred because ACES was passed, but what is the real reason that is going on? Additionally, if HB 110 is passed, will the producers invest? He said that while he is sure members will not receive any guarantees, the question is what will members get and in what form will it be received if a sacrifice is made by the state to do the right thing?

[2:36:18 PM](#)

REPRESENTATIVE GARDNER inquired who the biggest investor is on the North Slope right now.

MR. RUGGIERO said "investor" would be something that is down to working interest and total spend per field and breaking it down by field and what was spent where, so he cannot say which of the "big three" is the largest. But, he added, they are all nearly in the same boat. In response to another question from Representative Gardner, he clarified that "H S & E" on slide 2 stands for health, safety, and environment.

[2:37:15 PM](#)

REPRESENTATIVE GARDNER, regarding Mr. Ruggiero's earlier statement that investment money is limited based on the number of companies, inquired whether more companies and more investment dollars could be expected when prices are high.

MR. RUGGIERO answered that over time many things come down to how many countries are open for business and trying to attract capital. Over the last 30 or 40 years in the energy patch there have been times when there were hundreds of companies with lots of money and very few countries that were open, and therefore the governments could charge a lot. And then there are the periods of time when almost every country in the world is open; for example, there have been years where 72 different countries have held license rounds. When there are more countries than there are companies and capital chasing it, it becomes a buyer's game and the companies can dictate the terms and that is when governments usually have to lower their expectations to attract. What he meant by his statement is that at any point in time what must be looked at is the balance between opportunity and capital availability.

[2:38:32 PM](#)

REPRESENTATIVE GARDNER, regarding the producers' viewpoint that a large profit is quid pro quo for taking downside risk, asked how the state's participation in the capital cost of exploration and development is balanced into the fiscal ranking system given that the State of Alaska is buying down the risk and therefore might expect to have more of the upside.

MR. RUGGIERO replied that in his firm's investigation of the many companies that publish these rankings, the aspect of how much a company can get back for a failed exploration well is not something that is taken into account in those studies. Usually, the studies take the positive fiscal system and a typical type field and run that same type field through every one of the regimes as though money was spent, the discovery was commercial, and it was developed. Thus, the question is one of those nuances that do not get captured in these relative comparisons of regimes.

REPRESENTATIVE GARDNER inquired how the duty to develop or other elements of a lease are included in fiscal system rankings.

MR. RUGGIERO said he cannot comment on how that is done today, but back when he was in that situation if the company thought there was any chance of a commercial nature being there, that expiring lease would take priority for investment going forward.

[2:40:54 PM](#)

CO-CHAIR FEIGE asked how feasible would it be to tie the production tax to production and productivity.

MR. RUGGIERO responded that he has seen a number of systems where being able to get a certain set of commercial terms was tied to requirements for certain levels of investment or work programs. This is quite common and it could be something like the number of wells, miles of seismic, or certain training to be done. There are also a number of fiscal systems that tie the government take, be it in royalty, production share, and/or tax, to different levels of production and that production is used as a surrogate for profitability; for example, government take might be 50 percent up to 25,000 barrels a day, 60 percent up to 50,000 barrels a day, and 75 percent of everything over 70,000 barrels a day.

[2:42:26 PM](#)

REPRESENTATIVE HERRON, regarding fiscal system design, surmised that oil companies want to make a profit but accommodate their failures.

MR. RUGGIERO answered that a company looks at the totality of its business. This is not an exact science business and if added up there are more failures than successes when talking about wells that find commercial hydrocarbons. So, to stay in business, a company must make more off its successes than its failures cost in getting to those successes.

REPRESENTATIVE HERRON understood Mr. Ruggiero to have said earlier in his presentation that the oil companies do not have to invest even if HB 110 is passed.

MR. RUGGIERO qualified that he has not read HB 110 in great detail, but his understanding is that there is no requirement in the bill that companies must invest after the bill passes.

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CO-CHAIR SEATON, regarding the state's investment in failures and that this nuance is lost in analyses done by oil companies, asked whether such benefits are lost because the focus is on the negatives of the state's fiscal system.

MR. RUGGIERO answered that Co-Chair Seaton has "hit the nail on the head" in that the 15-second sound bite seems to have more validity and gets a wider audience than does a proper and detailed analysis of what is actually there and what the good versus bad points are. So, yes, what is seen in publications, speeches, and conferences is that sound bite of 87 percent. He said he is not sure that any producer has yet paid a marginal 87-percent dollar, but it is out there.

[2:45:53 PM](#)

CO-CHAIR SEATON noted that the main push for HB 110 is about Alaska's competitiveness. In this regard, he inquired whether the effective tax rate is the right thing for members to look at when comparing Alaska's structure to the structures of other countries or states.

MR. RUGGIERO replied he does not think there is any one right thing to be looking at. Going back to his statement of "torture numbers and they will tell you any story you want to tell," he said that those who want to tell the negative story have latched

on to the 87 percent and have not let go. Those who want to tell a positive story will latch on to something else. The key is convincing the decision makers within the oil companies, particularly the large oil companies. He pointed out that a circle drawn around the worst quartile in those surveys will include the names of countries where a vast majority of the investment dollars of the large oil companies are going. So, if it is location on those curves, Alaska is in a good spot and has a lot of company in where investment dollars are going.

[2:47:57 PM](#)

REPRESENTATIVE GARDNER, regarding Mr. Ruggiero's earlier statement that a system which is complex and sophisticated requires an army of auditors, asked whether the ACES system is complex and/or sophisticated.

MR. RUGGIERO responded that he thinks it is sophisticated but not complex. What becomes complex is how the data is presented that then needs to be audited. What form does the data come in? Is it in a form that is cooperative? Or is it in a form of "here is what you asked for, here is what my system just spit out in a million lines of SAP code, you figure it out"?

[2:48:53 PM](#)

REPRESENTATIVE GARDNER related that one of the arguments heard for bracketing taxes at different prices is that it makes the return simpler. However, she said it seems to her that a spreadsheet that works for 30 days could work 30 times for a day, so it is not that much more complex to calculate one way or the other.

MR. RUGGIERO answered that he thinks stepped taxation versus the continuous progressivity taxation of ACES is not to change the complexity level of the return or the mathematics to calculate. It is to change the absolute high end of the tax being paid; it reduces the amount of tax for a given set of price and cost scenarios.

[2:49:42 PM](#)

CO-CHAIR SEATON recalled that when a step or steps were being considered under ACES, there was great consternation in the industry that each time there was a step there was a fairly large jump in tax at \$1 difference in price. He asked whether that same consideration would still be there [under HB 110].

MR. RUGGIERO replied that to the extent that one step causes consternation, three steps will cause more consternation. However, he would suspect that if a system has steps, operations would be such that they do not operate near the step change to where that last dollar causes a much different rate of tax than the previous dollar. Either through cost management, production management, or something else, the companies will make sure that they pay just the fair share of what they believe they should be paying in taxes. Any fiscal system has its pluses and minuses for both government and producer; there needs to be an understanding of those nuances so an operation can be managed to that from both perspectives of government and producer.

[2:52:08 PM](#)

CO-CHAIR FEIGE related that on 2/9/11 Mr. Roger Marks stated that one of the best things that could be done to encourage more investment and more production on the North Slope would be to lower the aggressiveness of the progressivity factor. Another idea floated at the time was to have a reverse progressivity in HB 110 where the progressivity factor is a stair step going up and then at a cap of a certain price the stair step would start going down. He asked what the effect would be on an average oil company's decision making if a reverse progressivity was put on production above a certain point.

MR. RUGGIERO answered that he has a couple of emotional responses to this hypothesis. In testimony before this legislature he has heard about things that happen when the profit per barrel is \$150-\$200. However, if that happens it will not exist very long. For example, during the time that prices quickly rose from the range of \$40-\$50 to the range of \$100, which was when ACES was being discussed, costs escalated. A look back over time will show a fairly clear correlation between cost in the oil patch and price of oil. So, the point at which a decreasing progressivity would come into play at a profit per barrel of \$150 or more would soon disappear and the state would be right back into the steps where it was to begin with. He said that while Dr. Wood presented a separation of the state versus the producer at \$300 a barrel profit, he does not think that is going to happen.

[2:55:21 PM](#)

REPRESENTATIVE GARDNER inquired of Acting Commissioner Butcher whether any taxpayer has reached the 87 percent marginal rate.

Regarding audits, she noted that the 2006 audits for the PPT were just completed and that no audits have yet been done under the ACES tax structure. Therefore, without any audits under ACES, it is unknown whether the proposed changes would be pulling the right levers. However, what is known thus far is that for rebates the state cannot break out the capital expenditures which have been approved or are in the process of being approved; the state cannot tell which are drilling or well related or maintenance or facilities related. Page 6 of DOR's January 18, 2011, report to the legislature basically says there is no breakdown as to the spending that is occurring in the state and where that is going. The state has no data by field on capital spending. The credit program for Cook Inlet has been expanded, but it is unknown whether that program has changed anything. On page 9 of the January report is the statement, "It is much more difficult to measure a tax system's impact on oil development and production from existing fields." She said she finds it cumulatively alarming that when billions of dollars are being talked about, the state does not have baseline information and is potentially embarking on taking billions of dollars out of the treasury on a "flim" basis.

ACTING COMMISSIONER BUTCHER replied that the 87 percent marginal rate is a scenario that could happen, but he does not know if it has happened at \$92.50 after production tax value. While he knows it has been up over that, he thinks it was pre-ACES and will get back to the committee in this regard. In terms of the audits, he confirmed that DOR has finished with PPT and is just starting with ACES. However, the information in these audits will not provide any kind of enlightenment on these numbers because they are not broken out in a way that would show where the breakout is between what is being spent on exploratory activities and what is being spent on current infrastructure.

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REPRESENTATIVE GARDNER asked whether DOR needs statutory authority to get that information or whether the regulations can be changed in a way that would allow the state to get the information necessary to help figure out what impacts its actions are having on investments.

ACTING COMMISSIONER BUTCHER responded that he believes it is statutory and the department will get back to the committee with a definite answer.

ACTING COMMISSIONER BUTCHER, regarding Representative Gardner's question about Cook Inlet, said that the Cook Inlet bill just passed last session and a couple of companies are looking at developing. More should be known in the next six months, but he thinks it is likely to happen. Regarding the state's limited information, he related that the governor has looked at the lack of exploration under the high oil prices and has had conversations with numerous current producers as well as companies that are interested in Alaska, and feels that this is something that must be dealt with sooner rather than later. When the state was looking at changing from ELF to PPT, it had far less information than is had today, but it was a feeling that something needed to be done and action was taken.

[3:01:12 PM](#)

REPRESENTATIVE HERRON, noting that the DOR commissioner needs skilled auditors, inquired whether the state is at a complete disadvantage because the other side is willing to pay anything to keep the best from working for the department.

ACTING COMMISSIONER BUTCHER allowed that that is a very valid point. The state cannot pay to the level of private industry, but while the department has a much smaller budget its employees do a really good job and are very experienced. It is difficult to find people that look at public service as something they want to take over a large paycheck, he said, but the committee would be impressed with the folks that the department has.

[3:02:35 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:03 p.m.