

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

February 23, 2011

1:06 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
Representative Scott Kawasaki

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Les Gara

COMMITTEE CALENDAR

HOUSE JOINT RESOLUTION NO. 9

Urging the United States Congress to pass legislation to open the coastal plain of the Arctic National Wildlife Refuge to oil and gas exploration, development, and production.

- MOVED CSHJR 9(RES) OUT OF COMMITTEE

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."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HJR 9

SHORT TITLE: ENDORSING ANWR LEASING

SPONSOR(S): REPRESENTATIVE(S) PRUITT

01/18/11 (H) READ THE FIRST TIME - REFERRALS
01/18/11 (H) RES
02/23/11 (H) RES AT 1:00 PM BARNES 124

BILL: HB 110

SHORT TITLE: PRODUCTION TAX ON OIL AND GAS

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/18/11 (H) READ THE FIRST TIME - REFERRALS
01/18/11 (H) RES, FIN
02/07/11 (H) RES AT 1:00 PM BARNES 124
02/07/11 (H) Heard & Held
02/07/11 (H) MINUTE(RES)
02/21/11 (H) RES AT 1:00 PM BARNES 124
02/21/11 (H) Heard & Held
02/21/11 (H) MINUTE(RES)
02/21/11 (H) RES AT 5:15 PM BARNES 124
02/21/11 (H) Heard & Held
02/21/11 (H) MINUTE(RES)
02/23/11 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

JENNA CROUSE, Staff
Representative Lance Pruitt
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Presented HJR 9 on behalf of Representative Pruitt, sponsor.

DIRK CRAFT, Staff
Representative Lance Pruitt
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Explained the changes that would be made to HJR 9 by the proposed committee substitute.

BRYAN BUTCHER, Acting Commissioner
Department of Revenue

Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 110, answered questions.

MICHAEL HURLEY, Director
Government Relations and Community Affairs
ConocoPhillips Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 110, answered questions.

JOSEPH BALASH, Deputy Commissioner
Office of the Commissioner
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: During the hearing on HB 110, described the process for putting state land into oil and gas leases, units, and Participating Areas.

ACTION NARRATIVE

[1:06:51 PM](#)

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 1:06 p.m. Representatives Feige, Seaton, Gardner, Munoz, Foster, and Dick were present at the call to order. Representatives Kawasaki, P. Wilson, and Herron arrived as the meeting was in progress.

HJR 9-ENDORSING ANWR LEASING

[1:07:41 PM](#)

CO-CHAIR FEIGE announced that the first order of business is HOUSE JOINT RESOLUTION NO. 9, Urging the United States Congress to pass legislation to open the coastal plain of the Arctic National Wildlife Refuge to oil and gas exploration, development, and production.

JENNA CROUSE, Staff, Representative Lance Pruitt, Alaska State Legislature, introduced HJR 9 on behalf of Representative Pruitt, sponsor. She spoke as follows:

House Joint Resolution 9 urges the United States Congress to pass legislation to open the coastal plain

of the Arctic National Wildlife Refuge to oil and gas exploration and development.

The Alaska National Interest Lands Conservation Act of 1980 prohibited leasing or other development leading to production of oil and gas from the Arctic National Wildlife Refuge. Today domestic demand for oil continues to rise while domestic crude production continues to fall, with the result that the United States imports additional oil from foreign sources.

New technology has greatly reduced the environmental impact of development on the North Slope. If Prudhoe were built today the footprint would be as small as 1,526 acres. Oil and gas development has also proven it can successfully co-exist on Alaska's arctic. The Central Arctic Caribou Herd at Prudhoe Bay has grown from 3,000 to as high as 23,400 in the last 20 years alone.

HJR 9 mirrors previous legislative resolutions and includes provisions for renewable and alternative energy sources, protection of wildlife, and the use of directional drilling. We encourage you to join these past legislative efforts in sending this unified resolution to Congress.

[1:09:26 PM](#)

DIRK CRAFT, Staff, Representative Lance Pruitt, Alaska State Legislature, explained the changes that would be made to HJR 9 by the proposed committee substitute [labeled 27-LS0379\B, Luckhaupt/Bullock, 2/21/11]. He said the following language would be added to page 1, line 1, to better reflect all the language included in the resolution:

relating to oil and gas exploration, development, production, and royalties; and relating to renewable and alternative energy technologies.

MR. CRAFT explained that another change would be the deletion of "any" from page 3, line 21, to eliminate redundancy. On page 3, line 22, and page 4, line 5, the words "and alternative" would be added. On page 3, line 29, the words "the Alaska State Legislature urges that oil and gas exploration, development, and production" would be added for clarification.

MR. CRAFT, in response to Co-Chair Seaton, clarified that the last proposed change is located in the original bill on page 3, line 29, and in the proposed committee substitute (CS) the change is located on page 3, line 28.

1:11:43 PM

CO-CHAIR SEATON moved to adopt the proposed CS, Version 27-LS0379\B, Luckhaupt/Bullock, 2/21/11, as the working document. [No objection was stated, therefore Version B was before the committee.]

REPRESENTATIVE GARDNER asked whether the sponsor would accept the following amendment to the original bill:

Page 2, line 5:

Delete "state's"

Insert "state and the nation's"

MR. CRAFT responded that the amendment would be accepted.

REPRESENTATIVE GARDNER elaborated that it is really about national security. In response to Co-Chair Feige she said that on Version B the amendment would be located on page 2, line 6. She said national security is one of the state's strongest arguments with Washington, DC, about the Arctic National Wildlife Refuge (ANWR).

MR. CRAFT offered to have this amendment taken up in a future CS if the committee did not have time to act on it today.

There being no objection the amendment was adopted.

MR. CRAFT, in response to Representative Munoz, explained that the difference between HJR 9 and [HJR 11] is that HJR 11 specifically opposes wilderness designation in Area 1002 of the Arctic National Wildlife Refuge, whereas HJR 9 deals with the more general opening up of the refuge for development and production.

1:15:04 PM

REPRESENTATIVE MUNOZ moved to report HJR 9, Version 27-LS0379\B, Luckhaupt/Bullock, 2/21/11, as amended, out of committee with individual recommendations and the accompanying zero fiscal note.

CO-CHAIR FEIGE objected for purposes of the record and asked that a roll be taken. Representatives Dick, Gardner, Kawasaki, P. Wilson, Munoz, Foster, Feige, and Seaton voted in favor of reporting HJR 9, Version 27-LS0379\B, Luckhaupt/Bullock, 2/21/11, as amended, out of committee. Therefore, CSHJR 9(RES) was reported from the House Resources Standing Committee by a vote of 8-0.

[1:17:01 PM](#)

The committee took an at-ease from 1:17 p.m. to 1:19 p.m.

[1:19:59 PM](#)

CO-CHAIR SEATON moved to [rescind the committee's action in reporting CSHJR 9, Version B, as amended] from committee.

REPRESENTATIVE MUNOZ moved to [report CSHJR 9, Version 27-LS0379\B, Luckhaupt/Bullock, 2/21/11, as amended, out of committee with individual recommendations and the accompanying fiscal notes].

[1:20:47 PM](#)

CO-CHAIR FEIGE asked that the roll be taken. Representatives Foster, Dick, Gardner, Kawasaki, P. Wilson, Herron, Munoz, Seaton, and Feige voted in favor of reporting HJR 9, Version 27-LS0379\B, Luckhaupt/Bullock, 2/21/11, as amended, out of committee. Therefore, CSHJR 9(RES) was reported from the House Resources Standing Committee by a vote of 9-0.

HB 110-PRODUCTION TAX ON OIL AND GAS

[1:22:36 PM](#)

CO-CHAIR FEIGE announced that the next order of business is 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."

[1:23:14 PM](#)

CO-CHAIR SEATON drew attention to question 13 on page 16 of the Department of Revenue's 2/21/11 letter responding to questions from the committee's 2/7/11 meeting. He read the question: "If 44% of respondents to the Frasier survey indicated that Alaska's tax regime deters investment, what did the other 56% say?" He said he asked this question because the main reason purported for HB 110 is that Alaska is seen as uncompetitive with other regions around the world. Results of the [Frasier Institute 2010 Global Petroleum Survey] relating to Alaska's tax regime [were presented to the committee by the Department of Revenue on 2/7/11, slides 9-15]. Putting more oil into the Trans-Alaska Pipeline System (TAPS) is what everyone is trying to do, he continued, and his concern is that the right lever be pulled for getting the response that the state wants. In its answer to question 13 the department provided a breakdown of industry responses that were depicted on [slide 14]: 25 percent of respondents said Alaska's tax regime "encourages investment," 31 percent said Alaska's tax regime "is not a deterrent to investment," and 25 percent said Alaska's tax regime "is a mild deterrent to investment." [Sixteen percent said Alaska's tax regime "is a strong deterrent to investment and three percent said they "would not invest due to this criterion."]

CO-CHAIR SEATON calculated that by adding the first two responses together it can be seen that [56] percent of industry respondents identified Alaska's current tax regime as either encouraging investment or not a deterrent to investment. By adding the first three together it is seen that 81 percent identified Alaska's current tax regime as either encouraging or only a mild deterrent to investment. He said the tax changes proposed by HB 110 would run the state into deficit spending of up to \$2 billion per year after the bill's provisions are fully implemented. Therefore, he concluded, given that over half of the survey respondents said the current regime either encourages or is not a deterrent to investment, it seems that running the state into deficit spending is the wrong lever to pull. Alaska will not get the response it desires from the oil companies by using this particular vehicle.

[1:28:23 PM](#)

REPRESENTATIVE MUNOZ asked whether the 81 percent is of the 56 percent that responded favorably.

CO-CHAIR SEATON said he believes the department's answer includes the full response from industry because adding together the last three responses of 25, 16, and 3 percent equals the 44 percent [that was depicted on slide 14].

BRYAN BUTCHER, Acting Commissioner, Department of Revenue, in response to Representative Munoz and Co-Chair Feige, explained that the numbers provided in the department's answer is a breakdown of 100 percent of the responses. In further response to Co-Chair Feige, he confirmed that the breakdown includes all of the survey's 645 respondents.

REPRESENTATIVE P. WILSON understood that the first two groups [of 25 percent and 31 percent] add up to 56 percent.

ACTING COMMISSIONER BUTCHER nodded yes.

[1:31:04 PM](#)

CO-CHAIR FEIGE asked whether any of the 645 professionals were actually considering investing in Alaska.

ACTING COMMISSIONER BUTCHER said the Department of Revenue (DOR) has not talked to the 645 respondents, but the state has done a good job of getting information out about the tax credits available in Alaska. Many independents are excited about Alaska as a result of this effort. Unfortunately, companies have come into Alaska, received leases, and found oil, only to abandon the leases because they were unable to find partners. When looking at the lack of exploration and the continued decline of oil, one can look at an opinion poll and glean some things from it, he continued. The department showed half of the opinion poll and now the other half is being discussed, but it does not change the bottom line of what is going on in the state.

[1:32:02 PM](#)

REPRESENTATIVE GARDNER said she appreciates the question asked by Co-Chair Seaton because she thinks the department presented a distortion of what the Frasier study actually concluded.

ACTING COMMISSIONER BUTCHER replied that when presenting the slide the department stated 44 percent and did not try to make it sound like every respondent looked at Alaska's tax regime in

a negative way. The department was pointing out that almost 50 percent of the 645 respondents listed Alaska's tax regime as either a mild deterrent, strong deterrent, or would not invest under any circumstances. He said these were numbers that the department did not feel comfortable about when discussing Alaska's tax regime.

REPRESENTATIVE GARDNER contended that Alaskans would want to know that another way of looking at these numbers is that 81 percent of respondents said Alaska's tax regime encourages investment, is not a deterrent to investment, or is simply a mild deterrent to investment.

ACTING COMMISSIONER BUTCHER appreciated the point being made but countered that it could also be looked at as 25 percent of the respondents saying it encourages investment and 75 percent saying it is either a negative or not a deterrent.

CO-CHAIR FEIGE commented that numbers can be made to reflect about anything that is wanted.

[1:34:26 PM](#)

REPRESENTATIVE DICK said that if he was a respondent he would be counted as someone with an opinion, but his potential to develop oil would be way smaller than one of the "big three." Therefore, to make an accurate assessment, each response would need to be weighted in terms of the respondent's potential. For example, each of the 25 percent of respondents listing Alaska's tax regime as encouraging investment could be so tiny that it would not matter, yet they are given the same weight as someone who might put billions of investment in exploration. Therefore these numbers do not give him a true picture either.

ACTING COMMISSIONER BUTCHER agreed, but said department was trying to provide this information because it gets many questions about how Alaska is viewed. By no means was the department stressing that this was a foolproof way of looking at it, he added, it was just a piece of information.

CO-CHAIR FEIGE asked whether it is known how the people holding leases in Alaska feel.

ACTING COMMISSIONER BUTCHER replied he does not have an answer other than what has been heard in committee.

[1:36:34 PM](#)

CO-CHAIR SEATON said the Frasier survey is of the oil industry, not a random survey off the street. If the basis for [HB 110] is the perception that Alaska's tax system makes it an unfavorable place to invest, the data is that the majority do not view it that way. The question is whether to pull the lever that shows not much effect on the industry's attitude towards investing in Alaska. That is the point that should be looked at, not the absolute details of the survey.

CO-CHAIR FEIGE remarked that this is only one survey among many.

[1:38:18 PM](#)

CO-CHAIR SEATON drew attention to slides prepared by the Alaska Oil and Gas Conservation Commission (AOGCC) depicting production and exploratory wells drilled between 1996 and 2010 [slides 9 and 10 of the AOGCC's 2/21/11 presentation to the committee, dated 1/4/11 and 2/24/10, respectively]. He said it used to be that basically only three companies were exploring and producing in Alaska, but the slides show that since ACES many more companies are now doing so. [Further discussion on this topic was interrupted until copies of the slides could be obtained, see timestamp 1:56:44 p.m.]

[1:39:18 PM](#)

The committee took an at-ease from 1:39 p.m. to 1:42 p.m.

[1:42:09 PM](#)

REPRESENTATIVE P. WILSON asked for a review of item 10, page 8, of DOR's 2/23/11 letter responding to questions from the committee's 2/21/11 meeting. [Item 10 is the department's response to the committee's request to, "Produce an estimate of what the price of oil would have to be to cover the cost of the Governor's proposed FY 12 budget were all the provisions of HB 110 in effect currently."]

ACTING COMMISSIONER BUTCHER replied that if the bill were to pass today it would not have an effect on the fiscal year (FY) 2012 budget because the effective date takes place in the future. However, he said he believes the intent of the question was for if it was a full fiscal year, in which case it would be approximately \$90-\$92 per barrel to balance what has been submitted for the governor's budget for FY 2012.

[1:44:24 PM](#)

REPRESENTATIVE P. WILSON asked whether that would be \$90-\$92 a barrel more than it is now.

ACTING COMMISSIONER BUTCHER clarified that with passage of HB 110, meaning taking out the credits and with the tax reduction, it would be \$90-\$92 a barrel for that fiscal year and would not be in addition to anything. Without HB 110 passing, it would be \$81 per barrel. In response to further questions, he said the cost to the state for a full fiscal year would be \$9-\$11 per barrel of oil.

REPRESENTATIVE P. WILSON surmised that \$9-\$11 is what it would cost even though the bill would not be in effect yet.

ACTING COMMISSIONER BUTCHER responded correct.

REPRESENTATIVE P. WILSON understood that even when it is not into effect it will cost the state \$12 a barrel. She asked what the cost would be when it is in effect.

ACTING COMMISSIONER BUTCHER replied that if the changes in HB 110 were in full effect for the fiscal year, an increase of \$9-\$11 per barrel of oil would be needed to balance the FY 2012 budget.

[1:46:30 PM](#)

REPRESENTATIVE P. WILSON presumed that if it would cost the state \$12 a barrel when the provisions are not in effect, then when in effect it would cost the state more.

ACTING COMMISSIONER BUTCHER answered that under the current scenario it is \$81. If HB 110 was fully in effect now instead of current law, it would be \$90-\$92. So the difference between the status quo and the passage of HB 110, if it were in full effect for the fiscal year, would be \$9-\$11.

REPRESENTATIVE P. WILSON understood that the \$12 a barrel is if HB 110 were fully in effect for a full year.

ACTING COMMISSIONER BUTCHER said, "Correct, \$9-\$11."

CO-CHAIR SEATON requested the department to provide the calculations for how it arrived at these figures. He noted that

this does not show the difference in revenue between the two for the year, it just shows how much underwater the state would be.

ACTING COMMISSIONER BUTCHER agreed to provide the information. He said the department has had a lot of information to provide and apologized that preparing the responses has taken longer than hoped.

[1:48:30 PM](#)

REPRESENTATIVE MUNOZ asked how much revenue is represented by the \$9-\$11 per barrel.

ACTING COMMISSIONER BUTCHER explained it is the per barrel price that would be required in each of the two scenarios to reach the amount of the governor's amended budget. It is a matter of how the tax is affected, which determines whether the state needs more or less per barrel.

REPRESENTATIVE MUNOZ said she is trying to understand the real dollar impact because she has heard differing reports on what it would be. She understood that at last year's price per barrel the state is bringing in roughly \$5.5 billion. Based on that number she asked what the impact of \$9-\$11 per barrel would be going forward.

ACTING COMMISSIONER BUTCHER replied it would be approximately \$1 billion, more or less, in production tax, plus the \$200-\$400 million estimate, for a total of \$1.0-\$1.4 billion.

[1:50:53 PM](#)

The committee took an at-ease from 1:50 p.m. to 1:52 p.m.

[1:52:51 PM](#)

REPRESENTATIVE P. WILSON inquired whether the proposed increase in tax credits would result in the state receiving less money. She further asked about the reasons for setting the tax credits as proposed.

ACTING COMMISSIONER BUTCHER explained that credits for well lease expenditures are currently 20 percent for the North Slope and 40 percent for the rest of the state. The bill would increase this credit for the North Slope from 20 percent to 40 percent because the department believes it would increase investment. The department estimates this would affect the

state by approximately \$200-\$400 million annually. In further response, he clarified that this \$200-\$400 million would be in addition to what the amount is currently.

[1:54:55 PM](#)

ACTING COMMISSIONER BUTCHER added that at the previous meeting he estimated that changing the progressivity from monthly to annual would be \$100-\$400 million, which is not inaccurate. However, he said he was thinking about what the number was under the current scenario with the high marginal rates. Under HB 110, which would switch progressivity to brackets, it would be much smaller, at probable tens of millions of dollars as opposed to hundreds of millions.

CO-CHAIR FEIGE understood that companies would not receive this credit unless they had spent money in the first place.

ACTING COMMISSIONER BUTCHER responded that this particular annual to monthly would apply to the companies that are producing on the North Slope and paying taxes.

[1:55:42 PM](#)

REPRESENTATIVE P. WILSON referenced the graph depicted on page 4 of DOR's 2/23/11 letter responding to questions from the committee's 2/21/11 meeting. She said the graph compares the current nominal tax rate under ACES and what that would look like if it were a bracketed system. However, she observed, there appears to be no difference between the two.

ACTING COMMISSIONER BUTCHER answered that Representative Herron had asked what it would look like if the current law was bracketed without any of the tax reductions proposed by HB 110. That pretty much speaks to the 50 percent cap that would be implemented by HB 110 as opposed to 75 percent under ACES, he said, so the bracket would continue to go up as opposed to reaching a plateau at 50 percent.

[1:56:44 PM](#)

CO-CHAIR SEATON returned to his earlier discussion about the number of new companies investing in oil exploration in Alaska between 1996 and 2010, as depicted on Alaska Oil and Gas Conservation Commission slides [Co-Chair Seaton distributed slides 8 and 10 dated 1/4/11 and 2/9/11 in the bottom right corner, respectively, and dated 2/22/11 in the bottom center].

He reiterated that in the earlier years there were basically only three companies drilling production wells, but that in later years many more players have come in and drilled production wells (slide 10). This same scenario can be seen for exploratory well permits (slide 8). He cautioned that there not be confusion between permits and wells and drew attention to the graph on page 6 of DOR's 2/23/11 letter responding to questions from the committee's 2/21/11 meeting, which depicts the number of exploration wells actually drilled on the North Slope between the years 1995 and 2010. In the four years after ACES was instituted, an average of 12 exploration wells per year were drilled. In the four years preceding ACES, an average of 7.8 exploration wells per year were drilled.

[2:00:18 PM](#)

CO-CHAIR FEIGE maintained that the variety of new explorers that came into Alaska corresponded to the spike in oil price. From 2001-2002 the price was below \$20 a barrel, but after that the price was generally upward. He drew attention to the spike in exploratory wells drilled in 2007 depicted on page 6 of DOR's 2/23/11 letter responding to questions from the committee's 2/21/11 meeting.

CO-CHAIR SEATON said he wants to make sure the committee is looking at the data for what those averages are, not just explanations of why the averages are the way they are.

CO-CHAIR FEIGE understood.

[2:02:01 PM](#)

CO-CHAIR FEIGE asked how many years it takes, in general, from the time a decision is made to drill a well until the well is actually drilled on the North Slope.

MICHAEL HURLEY, Director, Government Relations and Community Affairs, ConocoPhillips Alaska, Inc., explained that after a well is planned, the permitting, environmental, and site clearance work must be done. An ice road often has to be constructed if the well is in an area of no development. The timing will vary, but the quickest would be about 18 months. However, it could be up to 2.5 years because of the seasonality when the decision is made; for example, there may be a wait for the season to construct the ice road. In further response, he agreed that the average length of time would be about 2 years.

2:03:04 PM

CO-CHAIR FEIGE inquired whether companies will change their plans or stop their plans once the decision to drill has been made if something changes in the short term with the economy or price of oil.

MR. HURLEY replied that it depends on the nature of the decisions. An example of being committed and going through with the development anyway is the Ooguruk field developed by Pioneer Natural Resources. He said he thinks Pioneer was at the point of no return when the tax laws were changed in 2007. Once to a certain point and enough dollars have been sunk into a process, whether it is development or an exploration well, the company must look at it point forward and continue despite the economic conditions at the time. He added that a company always looks point forward in its economics.

CO-CHAIR FEIGE returned to the graph on page 6 of DOR's 2/23/11 letter responding to questions from the committee's meeting of 2/21/11. He drew attention to the 2007 and 2008 spikes in the number of exploration wells drilled and surmised that the decisions to drill those wells were made, on average, in 2005 and 2006.

MR. HURLEY responded, "That is quite likely."

CO-CHAIR FEIGE further surmised that the decisions to drill the exploratory wells drilled in 2009 and 2010 were therefore made in 2007, 2008, and 2009.

MR. HURLEY answered, "Yes."

2:05:29 PM

REPRESENTATIVE P. WILSON, following the aforementioned train of thought, presumed that this could be illustrated in a graph by sliding the numbers of exploratory wells over by two years so it could be seen that what happened in 2008 was because of decisions made in 2006.

MR. HURLEY replied, "Generally, on average, that is true." Much of it depends upon the particular decision being made and the time of the decision relative to seasonality for the field work that needs to be done at a new site.

REPRESENTATIVE P. WILSON surmised that the activity occurring two years after the [2007] enactment of ACES was unrelated to the bill's passage; however, the big drop in activity in the third and fourth years afterward would be related to the bill. She asked how long it would take after a bill's passage for the state to see the shift in activity related to that bill by a company like ConocoPhillips Alaska, Inc.

MR. HURLEY responded that ConocoPhillips Alaska, Inc. goes through a budgeting process pretty much every year. During this annual process, the various exploration and development opportunities are ranked. He reminded members that ACES was passed in November 2007, so ConocoPhillips Alaska, Inc. was already committed to the things it was going to do in 2008 and partially into 2009. The budgetary process for exploration wells and other short-term decisions usually starts in the spring, he continued, so the rankings for these types of projects occur each year even though the projects may not be undertaken until the next spring. Long-term development projects become part of the ongoing budget in subsequent years once a commitment has been made to the project and the authorizations for expenditure (AFE) have been signed.

REPRESENTATIVE P. WILSON commented that this means about two years.

[2:09:49 PM](#)

CO-CHAIR SEATON, in regard to exploratory well permits, noted that ConocoPhillips Alaska, Inc. drilled only one exploratory well in 2007, which means the decision for that well was made in 2005. He contended that ConocoPhillips Alaska, Inc. therefore stopped exploration decisions prior to enactment of the 2006 production profits tax (PPT) and [2007] ACES. Between 2003 and 2005 "BP" had zero exploratory wells and it had only one exploratory well in 2006, he observed, so BP's decisions for that time period would have been made under the fiscal regime previous to PPT and ACES, under which there was very low production tax.

MR. HURLEY said he follows the co-chair's chain of logic, but that he cannot speak to whether "BP" or "ExxonMobil" made those kinds of decisions in those time frames.

CO-CHAIR FEIGE noted that ConocoPhillips Alaska, Inc. drilled four wells in 2006, one well in 2007, and three wells in 2008. He asked whether there was any particular reason.

MR. HURLEY answered that it is always about the availability of opportunities and where the rocks are seen. Sometimes there are projects that are ready to drill and sometimes it takes several years of seismic work, along with acquiring land positions in the lease sale so a company knows it has the land where it wants to drill. Those things can take time, so it can take years to develop a prospect to the point where it is ready to be drilled.

CO-CHAIR FEIGE asked whether those wells could have been an aberration.

MR. HURLEY said, "It could easily have been."

[2:12:23 PM](#)

CO-CHAIR SEATON said development and service wells can be looked at without backing up two years because acquiring the land and access is not a consideration for those types of wells. Also, with infield drilling there is no looking for the resource. He observed that for companies doing infield drilling, the number of production wells was low during the years 2005-2007, which was a time of generally rising oil prices [AOGCC slide 10]. This could not have been driven by consideration of a profit tax rate because it was before the PPT, he maintained. The philosophy behind HB 110 is that dropping the state's tax rate will result in a different response than what happened during those years of low production, low tax rates, and rising oil prices. Based on this, it appears that the wrong lever is being pulled to reach the desired goal of putting more oil into the pipeline.

[2:15:24 PM](#)

REPRESENTATIVE GARDNER inquired whether ConocoPhillips Alaska, Inc. would be drilling exploration wells this year in the National Petroleum Reserve-Alaska (NPR-A) had it received the permits that it had expected to have by now.

MR. HURLEY explained that the CD-5 field is a development opportunity, not an exploration opportunity. Exploration wells are not needed because discovery wells have already been drilled and the area delineated. It is simply a question of when the field can be developed. ConocoPhillips Alaska, Inc. has not yet signed and committed the authorization for expenditure (AFE) to do the development because it is waiting on the permit from the U.S. Army Corps of Engineers. Once that permit is received a

decision must be made on whether the economics still stand up for that particular project given any stipulations that may be put on the permit and the conditions at the time.

[2:17:05 PM](#)

CO-CHAIR FEIGE drew attention to the AOGCC graph for exploratory well permits (slide 8) and noted that in 1996 four companies were engaged in exploration, the number expanded quite a bit by the mid-2000s, and then in 2010 the number of companies was down to five and only one well was drilled out of those five permits. He said he recognizes some of the company names listed on the slide because of his former work and some of the names include companies in Cook Inlet, but that many of these companies have pulled out of Alaska. For example, "FEX" drilled a number of exploration wells in NPR-A which have now been plugged and abandoned and the leases turned back to the state. "Fowler Oil and Gas," a coalbed methane developer in the Matanuska-Susitna Valley, never got off the ground. "Renaissance" folded up and went home, although it may still exist on paper.

CO-CHAIR SEATON pointed out that three exploration wells, not one, were drilled in 2010, and that one exploration well is projected for 2011.

CO-CHAIR FEIGE said two of the three wells were at Point Thomsen.

[2:19:16 PM](#)

REPRESENTATIVE GARDNER turned to Item 3 of the analysis page in Fiscal Note 1 regarding the change in calculating the tax rate annually rather than monthly. She observed that Item 3 lists the revenue impacts [for the fiscal years 2013-1017 that would result from passage of HB 110].

[2:20:03 PM](#)

The committee took an at-ease from 2:20 p.m. to 2:22 p.m.

[2:22:39 PM](#)

REPRESENTATIVE GARDNER asked what the price per barrel of oil would have to be to balance this budget in FY 2017.

ACTING COMMISSIONER BUTCHER said he does not have that number off the top of his head and will provide it to members later today.

[2:23:43 PM](#)

REPRESENTATIVE P. WILSON referenced an electronic mail document from Linda Hay dated 2/23/11, 10:29 AM, to which a two page document from DOR was attached entitled, "Revenue Impact of Provisions of HB 110 and SB 49 as compared to Fall 2010 Forecasted Revenue." She observed that page 2 of the document states the revenue impact of HB 110 for FY 2013 would be -\$582 to -\$782 million, whereas Item 3 of Fiscal Note 1 states an impact of -\$382 million.

ACTING COMMISSIONER BUTCHER explained it is the same numbers as in the analysis section of the fiscal note; the analysis takes it issue by issue, whereas this document puts those numbers into a spreadsheet format rather than a narrative.

[2:25:43 PM](#)

REPRESENTATIVE DICK described a graph with one line being state revenue and one line being the oil production decline. He understood that at \$90 per barrel the state's income will decline because of the production decline. He further understood that what is being talked about here is reducing that income for a time, but at some point that income will either increase or be at a lower rate of decline. Given a best case scenario in which exploration actually takes place, he asked how many years would it take before the two lines crossed and how many years beyond that would it take for the state to recover the money that it had lost.

ACTING COMMISSIONER BUTCHER replied that DOR has done work on that, but it is difficult to make an estimate on where the two lines would cross because so many different variables could be considered. For example, one variable is the price. If the price went up to \$120-\$130 per barrel for a couple of fiscal years these numbers would completely change, just as they would change if the price went in the opposite direction and dropped to \$50 per barrel. It is so complex that every one of DOR's assumptions in a best guess estimate could be questioned. He said DOR would be happy to work with members in developing possible scenarios to determine where the lines might cross.

[2:27:52 PM](#)

REPRESENTATIVE DICK said it would help him get a better picture even if a scenario stuck with just \$90 per barrel. He surmised that where the lines would cross in a best case scenario might be three or four years down the road, and perhaps another four years beyond that before the state gained what it would have invested into this. Thus, in a best case scenario it would be eight or nine years before the state broke even.

ACTING COMMISSIONER BUTCHER agreed it would be a number of years and it would be determined by how quickly the anticipated increase in exploration and development occurred under the bill, as well as the size of the fields that are found. The state could be pleasantly surprised or not. He added that Mr. Balash is available to address the discussion that occurred in a previous committee meeting about what constitutes a unit.

CO-CHAIR FEIGE recalled that Mr. Bart Armfield of Brooks Range Petroleum Corporation brought up that issue during his [2/18/11] testimony.

[2:29:49 PM](#)

JOSEPH BALASH, Deputy Commissioner, Office of the Commissioner, Department of Natural Resources, said the state has the right to make state land available to lessees. This is done by dividing blocks of land into individual leases that are made available at competitive sales once a year. The state's oil- and gas-prone regions are broken into five areas: the Beaufort Sea, North Slope, North Slope Foothills, Cook Inlet, and Alaska Peninsula. A sale occurs for each area once a year, so five area-wide sales occur at different times throughout each year. All of the available leases within an area are available for bid at that area's annual sale.

MR. BALASH explained that once a lease is obtained the company has a maximum of 10 years under state law to exclusively explore the land on that lease. If after 10 years the company has not obtained a certified well or successfully put that lease into production, the term will end and the lease will terminate, come back to the state, get a new lease number, and be offered at the next area-wide lease sale. If the lease is drilled and oil is found, the lease itself is unlikely to be the only place where the oil is located, so there will probably be additional leases for the area surrounding that well. This collection of leases is grouped together, put into a unit, and a single operator identified to develop that unit. The unitization process is

therefore a means for efficiently developing a pool of oil underlying multiple leases.

2:33:22 PM

MR. BALASH said a unit can be formed through the Division of Oil & Gas, or the Alaska Oil and Gas Conservation Commission, or, for federal lands, the U.S. Bureau of Land Management. If the unit contains all state acreage or some state acreage it can be formed and filed at the Department of Natural Resources. Once that unit is petitioned and agreed to be formed by the Division of Oil & Gas, the company must provide either a Plan of Exploration (POE) or a Plan of Development (POD). Under the regulations at the Division of Oil & Gas, there is no distinction between an exploration unit and a development unit. It is just a matter of whether the unit is being operated under the terms of a Plan of Exploration or a Plan of Development.

MR. BALASH related that if oil in the unit has been delineated and is ready to be produced, the Plan of Development will lay out the facilities that need to be constructed and a timeline under which they will be constructed and put into production. However, if all that is present in the unit is a discovery, then additional drilling needs to be done to delineate the oil field or pool. In this case, a Plan of Exploration is submitted that guides the development or delineation of the field. The department tracks what is going on and makes sure that it is occurring. If the unit does not go into production within five years it is subject by law to terminate. Any leases within the unit that are beyond their primary term would then terminate and go back into the pool for the next area-wide lease sale.

2:35:58 PM

MR. BALASH stated that once a specific unit is formed and a reservoir is identified within that unit, then a Participating Area (PA) is defined to locate the exact position of where that area is. A Participating Area is almost always smaller than the unit. There can be multiple Participating Areas within the unit, but once the Participating Area has been formed within the unit, any leases within the unit that are not part of the Participating Area are then contracted out of the unit, unless there is a plan of exploration to further explore those leases within the unit. If those leases are at the end of their primary term, they will terminate and go back into the general pot for the next area-wide lease sale. When they are made available for re-leasing, they get a new lease number.

REPRESENTATIVE GARDNER inquired whether an area that has been contracted out but then re-leased to a new owner would automatically be part of the operating area or on its own within a Participating Area.

MR. BALASH clarified that when a lease within a unit is contracted out, the unit's boundary shrinks to just the leases that are in the unit, which is roughly the size of the Participating Area or the Plan of Exploration for any other leases that are part of the Participating Area. A Participating Area is a subset of the unit. In further response, Mr. Balash explained that within the collection of leases in the unit, there may be more than one Participating Area. There may be some gaps where there are leases that are not part of a Participating Area, but these gaps with leases would require a Plan of Exploration. The gap is either subject to a Plan of Exploration or is part of a Participating Area and, if it is neither, it goes back into the pool of available leases.

MR. BALASH, in response to Co-Chair Seaton, agreed to provide his written crib notes.

[2:41:15 PM](#)

CO-CHAIR SEATON understood from previous testimony before the committee that Alaska is not equal to other jurisdictions around the world in its requirement for submission of data from companies for leases on state land. He requested that the Department of Natural Resources let the committee know what data the department would like to have and provide an analysis for what would be a reasonable length of time for that data to remain confidential. He further requested that the department provide its position on whether data from an abandoned lease should become the property of the state. Data from abandoned leases would help make the state more competitive, he opined, because that information could help lower the cost of future development of the state's resources.

MR. BALASH pointed out that a variety of seismic and geologic geotechnical information is collected on any given lease. Additionally, the department draws a line in the treatment of information that has to do with interpretation by the lessee or a contractor for the lessee. He asked for clarification about which information the co-chair would like identified.

CO-CHAIR SEATON said he would like Alaska to be competitive and have the same information that the producers and explorers are required to give to other jurisdictions in the world, such as Norway or the United Kingdom. For example, he understood that some jurisdictions require field-by-field data. He would like to know what data the Department of Natural Resources thinks would be useful and reasonable for the state to require.

[2:47:22 PM](#)

REPRESENTATIVE HERRON noted there is a variety of opinion on the bill, with some people saying it is a huge leap of faith. He asked whether Acting Commissioner Butcher believes that HB 110, as currently written, is the correct size parachute for Alaska.

ACTING COMMISSIONER BUTCHER responded that he believes this is the way forward for the state. He related that in delving into the issue, the department kept coming back to three things that are known definitively: there is oil to be found in Alaska, production is continuing to decline in the state and, as the price of oil has gone up over the last few years, exploration has risen considerably in other states but not in Alaska. He allowed that there will be changes made to the bill through amendments, but said the three lynchpins of HB 110 are: the 15 percent tax rate for new explorers, the change to brackets for progressivity, and the increase to 40 percent for well credits on the North Slope. It has now been nearly four years under ACES and there are some positives to it that the governor believes should not be thrown out; for example, independent operators have come into Alaska as a result of ACES. However, there is also an alarmingly low amount of exploration in the state as a result of ACES. The administration believes this is a critical time in the state's history and this is an opportunity to change the direction in which the state is going. If the bill passed today, there might not be a flood of money within a year from today, but at that time the industry could be invited to address the legislature and say what is going on.

[2:52:37 PM](#)

REPRESENTATIVE GARDNER recalled that in testimony before the committee Brooks Range Petroleum expressed concern about being excluded from the bill's provision for unitized development because its leases were unitized before 12/31/10. She inquired whether the administration will be proposing any language to allow Brooks Range Petroleum to participate in this benefit.

ACTING COMMISSIONER BUTCHER answered that the department has had conversations about this issue and is open to discussing a change in this regard.

CO-CHAIR FEIGE pointed out that there are several units within the state that do not yet have any production. He provided an amendment, labeled 27-GH1007\A.2, Bullock, 2/22/11, to Acting Commissioner Butcher for his comment prior to the amendment being offered on 2/25/11. He said the amendment is an attempt to encourage production in areas that are not yet producing, whether or not they are in a unit.

[2:55:09 PM](#)

CO-CHAIR FEIGE said that after listening to testimony and talking to many people, he has taken this apart in as many different ways as possible and he keeps coming back to the governor's bill. It is well crafted legislation, he opined, and strikes a good compromise between the revenue needs of the state and trying to relax the fiscal terms of the state so that more development and production are encouraged on the North Slope.

[2:57:24 PM](#)

CO-CHAIR SEATON inquired as to the status of the department's response to his question that the fiscal note does not take into account the proposed 15 percent tax rate in the future.

ACTING COMMISSIONER BUTCHER replied that the response has been dropped off in the co-chair's office.

[2:58:26 PM](#)

The meeting was recessed at 2:58 p.m. until 7:00 p.m. that evening.

[7:05:23 PM](#)

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting back to order at 7:05 p.m. Representatives Feige, Seaton, Dick, Kawasaki, P. Wilson, and Herron were present at the call back to order. Representatives Munoz, Foster, and Gardner arrived as the meeting was in progress.

REPRESENTATIVE HERRON asked the Department of Revenue whether any of the committee's requested information is still pending.

ACTING COMMISSIONER BUTCHER responded that the department will provide the remaining information to the committee as quickly as it can. In further response, he nodded to confirm that there is still one more packet of information yet to be provided.

7:07:14 PM

REPRESENTATIVE DICK requested that the committee be provided with a projection of how many years after passage of HB 110 it would take for the state's investment to equal the return under best-case and worst-case scenarios.

ACTING COMMISSIONER BUTCHER answered that the department will try to put together that information. He said the department will also use testimony provided by Great Bear Petroleum to project industry response if HB 110 was passed.

7:10:01 PM

CO-CHAIR SEATON presumed the department would do this by looking at oil production status quo compared to a change resulting from the bill.

ACTING COMMISSIONER BUTCHER said correct. The department would keep the same assumptions on oil price and same assumptions on production forecast out into the future, and then incorporate what might be an increase in production as a result of the passage of the bill. In further response, he said the department will try to provide a side-by-side graph of where the state would expect to be under the status quo and with the passage of HB 110.

[HB 110 was held over.]

7:11:41 PM

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 7:11 p.m.