

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

April 20, 2012  
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 Lance Pruitt  
Representative Neal Foster  
Representative Bob Lynn  
Representative Dan Saddler  
Representative Chris Tuck (via teleconference)  
Representative Pete Petersen  
Representative Mike Doogan  
Representative Tammie Wilson  
Senator Cathy Giessel

**COMMITTEE CALENDAR**

HOUSE BILL NO. 3001

"An Act relating to adjustments to oil and gas production tax values based on a percentage of gross value at the point of production for oil and gas produced from leases or properties north of 68 degrees North latitude; relating to monthly installment payments of the oil and gas production tax; relating to the determinations of oil and gas production tax values; relating to oil and gas production tax credits including qualified capital credits for exploration, development, or production; making conforming amendments; and providing for an effective date."

- HEARD & HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB3001

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

04/18/12 (H) READ THE FIRST TIME - REFERRALS  
04/18/12 (H) RES, FIN  
04/20/12 (H) RES AT 1:00 PM HOUSE FINANCE 519

**WITNESS REGISTER**

BRYAN BUTCHER, Commissioner  
Department of Revenue (DOR)  
Juneau, Alaska

**POSITION STATEMENT:** Provided a PowerPoint presentation entitled, "HB 3001 Overview" dated 4/20/12.

BRUCE TANGEMAN, Deputy Commissioner  
Office of the Commissioner  
Department of Revenue (DOR)  
Juneau, Alaska

**POSITION STATEMENT:** Participated in the PowerPoint presentation entitled, "HB 3001 Overview" dated 4/20/12.

**ACTION NARRATIVE**

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**CO-CHAIR ERIC FEIGE** called the House Resources Standing Committee meeting to order at 1:06 p.m. Representatives Feige, Herron, Gardner, Dick, Munoz, Foster, P. Wilson, and Seaton were present at the call to order. Representative Kawasaki arrived as the meeting was in progress. In attendance from the House Special Committee on Energy were Representatives Pruitt, Saddler, Petersen, Lynn, Foster, and Tuck (via teleconference). Also in attendance were Representatives Doogan and T. Wilson, and Senator Giessel.

**HB3001-OIL AND GAS PRODUCTION TAX**

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CO-CHAIR FEIGE announced that the only order of business would be HOUSE BILL NO. 3001, "An Act relating to adjustments to oil

and gas production tax values based on a percentage of gross value at the point of production for oil and gas produced from leases or properties north of 68 degrees North latitude; relating to monthly installment payments of the oil and gas production tax; relating to the determinations of oil and gas production tax values; relating to oil and gas production tax credits including qualified capital credits for exploration, development, or production; making conforming amendments; and providing for an effective date."

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BRYAN BUTCHER, Commissioner, Department of Revenue (DOR), began his presentation by stating the goals of HB 3001: incentivize production on the North Slope both within and outside existing units; generate additional jobs and activity for the Alaska economy; build on work already undertaken in legislative committees during the regular session; maintain the existing structure of Alaska's Clear and Equitable Share (ACES) with slight modifications to avoid major changes in tax structure; and maintain alignment of working interest owners by not tying incentives to individual companies. He explained the last provision dealt with a situation that arose with previously proposed legislation whereas some companies received tax reductions, and some received tax increases. The five main provisions of HB 3001 are: 30 percent gross revenue exclusion for calculating a base tax and progressive tax for qualifying new North Slope fields; 40 percent gross revenue exclusion for calculating progressive tax for existing, currently producing North Slope fields; reduce the cap on the maximum tax rate from 75 percent to 60 percent; extend 40 percent well lease expenditure credit to North Slope - currently the North Slope has a 20 percent credit and the rest of the state south of 68 degrees north latitude has a 40 percent credit; and allow capital credits to be redeemed in the year they are earned because the present schedule is difficult for the cash flow of smaller companies, and is difficult to administer.

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COMMISSIONER BUTCHER said the governor used a hybrid approach and intended for the bill to utilize proposals that had been previously discussed, such as the gross revenue exclusion introduced in the Senate Finance Committee as a way to incentivize production. Furthermore, the production tax cap of 60 percent was introduced by the Senate Resources Committee as a way to limit state take at high oil prices. In addition, the

gross revenue exclusion structure for new fields was applied to existing fields and taken to a material level similar to that of HB 110, which was supported by oil and gas companies. Commissioner Butcher noted the Alaska Oil and Gas Association (AOGA) indicated HB 3001 is meaningful tax reform that would change investment in Alaska. The last provision is an expansion of the well lease expenditure credit introduced and enacted in 2010 through the Cook Inlet Recovery Act.

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REPRESENTATIVE HERRON asked how percentages for the exclusions, rates, and credits were determined.

COMMISSIONER BUTCHER explained that DOR agreed with the Senate Finance Committee on the 30 percent gross revenue exclusion for new fields. However, the percentage for calculating the progressive tax was considered along with other percentages. He restated that the governor sees the bill as a hybrid, bringing together concepts and inspiring discussion of many different approaches, such as a more gradual progressivity curve, moving the "trigger" dollar amount, changes to the base tax rate, and others. The bill will show one of many ways to get to meaningful change.

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REPRESENTATIVE GARDNER clarified that the 30 percent gross revenue exclusion on new oil fields is for 10 years, and then rolls over to the proposed 40 percent gross revenue exclusion for existing fields for an unlimited amount of time.

COMMISSIONER BUTCHER said correct, and he pointed out that the 30 percent would reduce the face tax and progressive tax for new fields.

REPRESENTATIVE GARDNER requested that the responses from DOR to questions raised by the Senate also be provided to members of House committees.

COMMISSIONER BUTCHER agreed.

CO-CHAIR SEATON asked for an explanation of the goal which read:

To maintain alignment of working interest owners by  
not tying incentives to individual companies

COMMISSIONER BUTCHER said the intent was to take an approach that would not lead to tax increases for some companies and tax decreases for others.

CO-CHAIR SEATON questioned whether allowing an equal tax break for companies - if they invest or not - would defeat the purpose of an incentive to production.

COMMISSIONER BUTCHER opined incentivizing production may be DOR's goal, however, the department did not want to make changes detrimental to some companies. He recalled testimony that a consequence of the legislation proposed by the Senate may cause a tax increase at current prices.

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CO-CHAIR SEATON encouraged Commissioner Butcher to reinvestigate this question. He then called attention to the provision which read:

Extends 40 percent well lease expenditure credit to North Slope

COMMISSIONER BUTCHER, in response to Co-Chair Seaton, said the well lease expenditure credits include capital expenditures, and replace the 20 percent credits currently applicable on the North Slope.

CO-CHAIR SEATON expressed his belief that as the bill is written, 20 percent is not replaced by 40 percent, but adds 40 percent to 20 percent.

COMMISSIONER BUTCHER said, "... we'll flesh that out."

REPRESENTATIVE KAWASAKI opined the key provisions in HB 3001 are a hodgepodge of provisions from HB 110, which passed the House but not the Senate, and from SB 192, which did not pass the Senate. He encouraged Commissioner Butcher to explain how each of the provisions taken from HB 110 and SB 192, and now included in HB 3001, will advance the state to its goals of incentivizing new production, filling [the Trans-Alaska Pipeline System (TAPS)], and getting more capital development.

COMMISSIONER BUTCHER advised the presentation would begin with the general concepts of the bill, and then go into more depth using a sectional analysis. The governor's intent was to begin with a blend of structures that have support. For example,

other jurisdictions with a progressivity system use brackets, but because using brackets was not supported by the Senate, HB 3001 uses another way "to get to what we thought was meaningful."

REPRESENTATIVE KAWASAKI heard testimony that progressivity and brackets were necessary in any oil bill for it to be considered meaningful. He asked whether there is a way to get an acceptable meaningful bill without those provisions.

COMMISSIONER BUTCHER said the administration believes it can be done. For clarity, graphs will be presented which compare projected tax revenue under ACES, HB 110, and HB 3001.

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REPRESENTATIVE PETERSEN observed that the proposed changes to the tax system are based on the premise that ACES is not working. He asked whether audits covering the time period ACES has been in effect - the last five or six years - are complete and available for review.

COMMISSIONER BUTCHER said DOR has taken many years to adjust to the changes to the regulations brought by ACES, as well as to the switch from a gross to a net tax. Currently, DOR is comprehensively auditing the first year of ACES - 2008. He said completion of the audits will speed up now and that the department is well within its statutory deadlines. However, results of the audits are confidential and will not play a role in this debate.

REPRESENTATIVE GARDNER recalled HB 110 proposed reducing the time limit. She asked what the time limit would be, had HB 110 passed, and whether DOR would still be within the limit.

COMMISSIONER BUTCHER said yes. Although HB 110 proposed reducing the time limit to four years, the current time limit is six years. He further explained that after each regulation is written and implemented by the department, the companies have an opportunity to submit a new tax return specific to the regulation, and the time limit begins anew. In most, if not all cases, DOR has received the revisions for 2008-2009, thus has remained under the statutory limit.

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BRUCE TANGEMAN, Deputy Commissioner, Office of the Commissioner, DOR, presented slide 5 entitled, "How the Gross Revenue Exclusion Works" which is the income statement format from the Tax Division Revenue Sources Book, with some additions. He observed that there has been much discussion centered on different methods of taxes, and on DOR's regulations and audits; however, the bill basically makes one calculation change for existing fields and two calculation changes for new fields. He warned against "throwing out ACES, starting over, [and] recreating the wheel." The state is often unfairly taken to task for personnel shortages that cause the division to fall behind the pace set by industry. But now, since the state has been under one tax structure for five years, the division can keep up with industry, therefore, it is very important to work within the existing system. Mr. Tangeman said the state tax division understands the current tax system as well or better than private industry, and is now on equal footing with industry.

MR. TANGEMAN returned to slide 5 and said cells D and E are the ACES and HB 3001 structures, which show how they calculate down through the income statement. The only change under this legislation for existing production is found on cell E, line 24. Everything up to that point and calculating the gross point of production and the production tax value (PTV) remains the same as under ACES. Under HB 3001, the calculation of the base tax is taken from cells D and E, line 20, and then the production tax percentage is calculated off of that. The change is shown in cell E, line 24 which is a 40 percent reduction to the gross value at the point of production shown in cell E, line 12. So, the state is taking 40 percent of approximately \$17.4 billion and that amount is a reduction in cell E, line 24 and which is then subtracted from the PTV in cell E, line 20 resulting in a new adjusted production tax value shown in cell E, line 25. Mr. Tangeman pointed out that the progressive tax rate was already calculated on the full PTV, so the 16.7 percent progressive tax rate is applied to the new adjusted production tax value. The result is shown in the difference between the amount shown in cell D, line 26, of approximately \$2 billion calculated under ACES, and the amount shown in cell E, line 26, of approximately \$900 million calculated under HB 3001. Cells D and E, line 27 add the base tax and the progressive tax rate: the difference between the total taxes before credits is approximately \$1.1 billion; the difference after credits is approximately \$1.4 billion.

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REPRESENTATIVE KAWASAKI asked whether the Gross Revenue Exclusion in cell E, line 24 is comparable to a standard income tax deduction.

MR. TANGEMAN described the difference as a tax reduction.

REPRESENTATIVE KAWASAKI asked for the origin of the 40 percent reduction and how that reduction will lead to more production and jobs.

COMMISSIONER BUTCHER explained DOR worked with the governor looking at different tax rate models - with absolute profit and with percentages of profit - to determine what would be viewed by the industry as material and similar to HB 110. The decision was made at 40 percent in the belief that companies will see this as a material change, and that will lead to more investment and production.

REPRESENTATIVE KAWASAKI asked whether the department found that a savings of \$1.5 billion was meaningful, and then deducted that amount from the Gross Revenue Exclusion.

COMMISSIONER BUTCHER said the decision was made by looking at the percentages through the effective tax curve, the absolute profit, and the percentages of profit. The reduction in HB 3001 is less than that proposed by HB 110, but is not radically less. He cautioned that a tax savings radically less would not increase the likelihood that companies would change their view of Alaska in terms of investment. In fact, there is no "perfect percent," but this is a general area to work from that will be viewed as meaningful. In further response to Representative Kawasaki, he said the term material or meaningful refers to a tax reduction that reflects looking at the tax rate, the dollar amount, the percentage change between the government and the companies, and other things.

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REPRESENTATIVE SADDLER returned attention to slide 5, and asked Mr. Tangeman to review the calculations found in cell E, lines 12-16.

MR. TANGEMAN responded that 40 percent of \$17.4 billion is the exclusion amount which is deducted from the PTV of \$12.4 billion shown in cell E, line 20.

COMMISSIONER BUTCHER pointed out 100 percent of production is taxed at the 25 percent base rate; 60 percent of the reduction is taxed at the progressivity level; and 40 percent is held harmless from the progressivity level.

REPRESENTATIVE GARDNER recalled the Senate suggested - for simplicity - that progressivity could be kept the same, and the state could take out 40 percent of the profits with the same result. She inferred DOR's method adds a layer of complexity to the tax system for the legislature and the industry to understand.

CO-CHAIR FEIGE noted the state could get rid of progressivity.

COMMISSIONER BUTCHER agreed that the change could be made in different ways, but this method is "a fairly minor tweak to us."

MR. TANGEMAN commented that the bulk of the complexity within the ACES structure is taking place "above the PTV value." The change being discussed is below the PTV calculation and is a tax capitalization change that has "minimal to no effect on us internally - and the private sector - in trying to figure out the differences here ...."

CO-CHAIR SEATON asked whether the Deductible Capital Expenditures found in cells D and E, line 16 are the aggregate deductible expenditures estimated across the North Slope and all existing fields for 2013.

MR. TANGEMAN said that estimate comes from the Fiscal Year 2013 (FY 13) Production Tax Estimate found in the Revenue Sources Book, page 104. These are allowable lease expenditure deductions; however, other expenditures that companies make - that are not deductible - are not reflected in this estimate.

CO-CHAIR SEATON requested that DOR provide models on companies that are investing and those that are not investing.

COMMISSIONER BUTCHER agreed. He further explained that the Senate bill was amended to attach progressivity to gross profits. This meant that a company working on a high-cost field trying to develop viscous or heavy oil was penalized because progressivity followed gross; however, a company "in harvest mode," saw benefits. This provision was seen as a tax increase by industry, and HB 3001 seeks to not penalize companies that have higher costs.

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CO-CHAIR FEIGE clarified that HB 3001 is configured so that the more expensive it is to run a field, and the more investment that is made, the lower the percentage of total revenue is paid in taxes. This is the advantage of making investments.

COMMISSIONER BUTCHER said correct. Currently ACES is "all net" rather than having the progressivity piece being strictly gross, and not having companies able to deduct their expenses.

CO-CHAIR SEATON reminded the committee it has not analyzed gross progressivity. He said he was interested in the incentives that are built into the structure of HB 3001 for companies that are in harvest mode, that are in expansion mode, that are investing overseas, and that are investing in Alaska. Merely reducing 40 percent of gross from progressivity does not make any discrimination between companies engaged in the various aforementioned pursuits, and he urged DOR to show what the governor and the administration believe will incentivize companies to invest in Alaska. Specifically, how HB 3001 will incentivize investment in Alaska instead of Russia.

COMMISSIONER BUTCHER acknowledged the information presented so far was more applicable to a previous meeting.

REPRESENTATIVE HERRON asked whether Gross Revenue Exclusion could be called adjusted gross revenue.

COMMISSIONER BUTCHER indicated yes. He explained DOR took the same language used by the Senate Finance Committee. Slide 6 entitled, "Effective production tax rates" was a graph showing the tax rate for ACES is substantially higher than those proposed by HB 110 and HB 3001. House Bill 3001 is a substantial reduction from current law, and a small increase from HB 110. The differences between the rates paid for HB 110 and the current bill occur mostly when the price of oil is between \$90 and \$160 per barrel. At low prices, and extremely high prices, the difference is slight. He said he believed the companies will see the reduction of taxes in HB 3001 as meaningful because the increase from proposed HB 110 is "a couple hundred million dollars."

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REPRESENTATIVE GARDNER surmised that the production tax rate shown for ACES on slide 6 assumes companies did not reinvest at all to bring down the progressivity rate and lower their taxes.

COMMISSIONER BUTCHER explained that the chart indicates what tax rates a company would pay, although if there were a lot of investment a company would benefit some from that. Ultimately, the exceedingly high ACES tax rate itself is a deterrent to investment in Alaska. Slide 7 entitled, "Marginal Government Take" illustrated a frequent complaint from oil companies that during periods of high prices, ACES takes their profit away. At high oil prices 80 percent to 90 percent of each dollar goes to government due to progressivity. Moreover, unlike federal income tax rates, where everyone pays a lower rate at a lower bracket of income, in Alaska the higher tax rate is paid on the entire barrel of oil, placing the government take at close to 100 percent. On slide 7, the ACES tax rate rises to over 90 percent when oil is approximately \$130 per barrel. The red line represented HB 110, and indicated how tax increases stepped up in each bracket, and the blue line represented HB 3001, indicating tax increases in the same manner as ACES, but at a lower rate.

CO-CHAIR SEATON pointed out high marginal tax rates mean that reinvestment by industry lowers the production tax value and dramatically lowers taxes. He posited HB 3001 is created to lower the marginal tax advantage from reinvestment in Alaska, and inquired what is being substituted for this tax advantage to encourage reinvestment in Alaska versus somewhere else.

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MR. TANGEMAN said the incentive through the operating deductibility and the capital deductibility has not changed. The method to calculate PTV remains identical to that of ACES, thus a company that reinvests will realize the same benefits. The only change is the amount of tax a company will pay; therefore, the amount of tax paid on the ultimate net PTV is going down.

CO-CHAIR SEATON acknowledged the tax credits incentive has not changed; however, the incentive of taxing a barrel as one unit means that as a company reinvests in Alaska it dramatically lowers its production tax value on all of its oil. The calculation in HB 3001 eliminates 40 percent of the gross value of production, thus the amount of tax incentive to reinvest is

lowered by 40 percent. He surmised another tax incentive must have been substituted in the bill.

COMMISSIONER BUTCHER said no. The bill keeps an aggressive marginal take from 70 percent to 80 percent. Companies have not spoken in favor of high progressivity; in fact, in the five years after the passage of ACES, Alaska has not experienced capital reinvestment at the rate that is taking place in North Dakota, Texas, and Alberta, Canada. He questioned whether the intent of ACES was to encourage reinvestment in this manner and opined oil companies would say it does not.

REPRESENTATIVE SADDLER returned attention to slide 7 and asked for the meaning of the percentages on the "y" axis of the graph.

COMMISSIONER BUTCHER said the percentages are of the additional dollar take. For example, 90 percent at \$130 per barrel (/bbl) of oil means that "90 cents of that dollar would go to the government." In further response to Representative Saddler, he said the drop in the percentage at \$130/bbl is because at oil prices lower than \$130/bbl the tax increase is point four, but at \$130/bbl the amount of the tax increase drops to a gradual point one, resulting in a lower marginal take per dollar.

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REPRESENTATIVE P. WILSON questioned why Alaska - unlike other jurisdictions - maintains a higher tax rate on the entire barrel of oil when prices are rising.

COMMISSIONER BUTCHER reminded the committee that the governor's "bill with brackets" was not supported by the Senate. The governor's intent for HB 3001 was to use the structure supported by the Senate for new fields, and to apply that to existing fields, as long as the blended legislation resulted in material change. In further response to Representative P. Wilson's comment on whether HB 3001 is passable, he noted that the effective tax rate is at a point where industry is expected to testify; as a matter of fact, AOGA sees this as a material change. Slide 8 entitled, "Absolute Profit - ACES" indicated at oil prices of approximately \$120/bbl, total government take is about \$12.3 billion and company take is \$4.9 billion. Slide 9 entitled, "Absolute Profit - CSHB 110(FIN)" indicated that at oil prices of approximately \$120/bbl, total government take would be about \$11 billion and company take would be \$6.3 billion. Slide 10 entitled, "Absolute Profit - HB 3001" indicated that at oil prices of approximately \$120/bbl, total

government take would be \$11.2 billion and company take would be \$6 billion. He concluded that under these circumstances ACES garners the state \$9.6 billion and HB 3001 would garner \$8 billion, which is still a substantial amount of money and would also increase investment and ultimate production.

COMMISSIONER BUTCHER presented slide 11 entitled, "Share of Profit - ACES" which indicated at \$120/bbl the profit to state and federal government currently is 71 percent and to companies is 29 percent. Slide 12 entitled, "Share of Profit - CSHB 110(FIN)" indicated that at \$120/bbl the profit to government would be 64 percent and to companies would be 36 percent. Slide 13 entitled, "Share of Profit - HB 3001" indicated that at \$120/bbl the profit to the state would be 46 percent and to companies would be 35 percent. This would be a substantial reduction from ACES and a small increase from HB 110, and would be viewed as meaningful by companies. Slide 14 entitled, "Effective production tax rates - new fields" indicated the rates on new fields for ACES, HB 110, and HB 3001. The rate for HB 3001 is a lesser reduction than for HB 110, was initially suggested by the Senate, and gives no tax breaks for new fields. Commissioner Butcher opined this rate will be substantive enough to gain meaningful investment.

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CO-CHAIR SEATON asked for information on the effects of post-tax, post-credits, and well lease expenditure credits that are applied to profits by HB 3001.

MR. TANGEMAN said the 40 percent well lease credit would take the HB 110 line from "20 to 40."

CO-CHAIR SEATON asked whether the difference between the red line [HB 110] and the blue line [HB 3001] was made by 20 percent tax credits on well lease expenditures on the North Slope.

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The committee took a brief at-ease.

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COMMISSIONER BUTCHER clarified that both the red and blue lines include the well lease credits; if the 40 percent credits were taken out of the bill and the current 20 percent remain, there would be "a little bit less of a tax reduction, compared to

current law." He offered to provide an additional graph to reflect this scenario.

REPRESENTATIVE MUNOZ understood from the administration that approximately \$14 billion in reinvestment may happen if there is meaningful tax reform. She inquired as to how much reinvestment is expected specifically for legacy fields.

COMMISSIONER BUTCHER related the governor estimated \$5 billion of investment from companies working in existing fields and \$9 billion from new fields, although more investment is anticipated. Slide 15 entitled, "Marginal Government Take - new fields" indicated "where the percentage would be of each additional dollar increase in the price of oil." Similar to that of the existing fields, the blue line [HB 3001] showed there would be lower marginal take for the government than is provided by ACES, and tracked a little higher than the red line [HB 110], because there are no brackets. Slide 16 entitled, "Share of Profit - ACES new fields" indicated at oil prices of \$120/bbl the prospective percentage of profit to government is 71 percent and to companies is 29 percent. Slide 17 entitled, "Share of Profit - CSHB 110(FIN) new fields" indicated at \$120/bbl the prospective percentage of profit to government would be 59 percent and to companies would be 41 percent. Slide 18 entitled, "Share of Profit - HB 3001 new fields" indicated at \$120/bbl the prospective percentage of profit to government would be 61 percent and to companies would be 39 percent. He pointed out the substantial benefit to companies that do the exploration, investment, and development in expensive new fields.

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REPRESENTATIVE SADDLER asked for a projection on the cost of a barrel of oil over the next five to ten years.

COMMISSIONER BUTCHER stated DOR expects the price of oil to stay around the \$110/bbl range. Other projections range from \$70-\$170/bbl. He noted that at the time ACES was under discussion, oil prices were around \$50-\$60/bbl, thus consideration of its outcomes at higher prices were not fully explored.

MR. TANGEMAN added that the absolute profit slides are based on consistent prices for one entire year.

CO-CHAIR SEATON disagreed with Commissioner Butcher and related that the discussion of ACES did cover high marginal tax rates

with data provided by oil and gas consultants. He then asked whether the small producer tax credit is incorporated in DOR's overview figures. This is important because he assumed the prospective percentages on new fields are focused on non-legacy producers.

COMMISSIONER BUTCHER said no.

CO-CHAIR SEATON stressed that ACES incorporates a small producer tax credit specifically tasked to change some of the economics for small fields and new producers. If this aspect is not included in the present analysis, the picture will not be complete; he urged for this subject to be included in subsequent field-by-field analyses.

REPRESENTATIVE PETERSEN returned to the subject of new investment and asked for the period of time during which the expected investment would take place.

COMMISSIONER BUTCHER estimated three to ten years.

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REPRESENTATIVE PETERSEN called attention to slide 5, cell E, line 32 and observed that the total tax after credits reduction of \$1.46 billion, when multiplied by 10 years, equals the expected investment amount of \$14 billion.

COMMISSIONER BUTCHER said this is a coincidence.

MR. TANGEMAN, also referring to slide 5, pointed out that DOR estimated 47 percent of the total oil production 10 years from now must come from new sources. The proposed legislation is intended to ensure that significant investment is made, and new sources are realized.

CO-CHAIR SEATON returned attention to slide 18, and asked how much of the state take is projected from production tax.

COMMISSIONER BUTCHER said DOR would provide a breakdown.

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MR. TANGEMAN, also in response to Co-Chair Seaton's question, said he did not want to speculate at this time.

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CO-CHAIR SEATON reminded the committee he has requested modeling of HB 3001 based on the 4/11 analysis of a "Great Bear type" production field that showed at \$100/bbl through 2028, the state would have a negative loss of production tax of \$2 billion. He remarked:

And if we averaged, I think it was, on that analysis, \$80 a barrel, we have a negative \$7 billion from production tax. And so I'm trying to figure out how - if we're looking at a negative \$2 billion in production tax loss over the first 15 years of operation of that style of a field, how we can have that not calculated into this, as far as share of revenue. And so, I'd appreciate that, and I know that the Great Bear ... people are trying to say ... they're not capable of drilling 200 wells a year, or something, but ... we have a commercial proposal before us, that was presented to the House, had numbers ... of wells, had production amounts per year, and so I don't want to go in and say that that's not doable by someone else, especially when we have 6,000 wells a year being drilled in other shale operations in other places, and we're trying to somehow mimic that .... If you would get back to us on the analysis of that same thing that we did just before we adjourned last year ... and then roll that into how this works, if these new fields are similar and are composed of shale oil.

COMMISSIONER BUTCHER said DOR will address this issue. He advised that shale oil is not what the department is used to dealing with in terms of using capital credits to get conventional oil. The development of shale oil is almost continual capital spending - drilling well after well - because 90 percent of the oil comes from the well in the first two years. Production is also radically different in terms of taxation and development; for example, by the installation of permanent roads, the use of many vehicles, and the number of wells drilled. This would be a huge change in oil development in Alaska, affecting taxes and permitting. Commissioner Butcher cautioned that fitting in shale oil is very difficult. Furthermore, the DNR says shale oil development is not as near as previously thought.

CO-CHAIR SEATON observed that the shale oil proposal has been underway for one year and millions of dollars have been spent on

leases and investigations in the Brooks Range. He warned that DOR may not notice, but changes in tax structure will impact shale oil development; in fact, projections of negative revenue should be considered when designing structures and incentivizing new fields.

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COMMISSIONER BUTCHER assured the committee DOR and DNR do take the potential for shale oil seriously. Returning to the presentation, slide 19 entitled, "HB 3001 Summary" read:

- Provisions in HB 3001/SB 3001 represent "meaningful change"
- Meaningful change is needed to incentivize development of Alaska's oil resources
- Meaningful change is needed to stimulate jobs and economic activity for Alaska's economy
- Producers have committed to additional investment contingent on meaningful change

COMMISSIONER BUTCHER expressed the administration's belief that production must come from known existing fields in the short-term to stem the decline of production, hence its focus on legacy fields.

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REPRESENTATIVE HERRON observed that critics believe the administration has a blind allegiance to oil producers. He asked the commissioner whether DOR could provide a written commitment from the producers to the governor saying that there will be investment contingent on meaningful change.

COMMISSIONER BUTCHER said he would provide to the committee "whatever the governor has on, on that."

REPRESENTATIVE LYNN referred to the final bullet point on slide 19 which read:

Producers have committed to additional investment contingent on meaningful change

REPRESENTATIVE LYNN asked for clarification on the form of the commitment, the meaning of "additional investment," and who will decide whether there has been "meaningful change."

COMMISSIONER BUTCHER responded:

The governor and I have both said the same thing from the very beginning which is: We can lay out what we see is the problem. We can lay out what we think is the solution, but ultimately companies are going to have to come forward and convince you ... how they're going to look at Alaska differently, that's a very big piece of this, government can't ... wrap it all up in a nice neat bow and tell you that, you ultimately have to hear from the industry: number one, that its material and number two, what that means and what that means for Alaska.

CO-CHAIR SEATON recalled that several years ago BP testified that it is not interested in the rapid acceleration of production because as the technology improves for the production of heavy oil, light oil will be needed as a diluent to ship the heavy oil through TAPS. He asked whether the industry is now willing to rapidly accelerate production and strip the light oil from the Prudhoe Bay area.

COMMISSIONER BUTCHER said no, BP is still working to determine what percentage of light and heavy oil is needed to flow down the pipeline. In addition, during the drafting of HB 110, BP indicated it is not at the point of determining what incentives are desired for the production of heavy oil. The state's role in tapping the tens of billions of barrels of heavy and viscous oil in the Prudhoe Bay/Kuparuk area is to continue to work with industry.

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CO-CHAIR SEATON stated his willingness to work with everyone on the North Slope to incentivize technology; in fact, not having ring-fencing and allowing companies to write off high costs against the existing production tax is the best way for the state to do that. However, he questioned why the state would change the taxes, thereby saving the industry billions of dollars as an incentive for accelerating infield drilling and stripping the oil out now, in spite of knowing that at least one of the big three oil companies has no intention of doing that. BP will take the tax savings, but has other strategic reasons for not accomplishing the goal. Co-Chair Seaton asked for the purpose of pursuing a tax-based incentive in light of BP's lack of interest in increasing production by stripping light oil out.

COMMISSIONER BUTCHER answered that there are billions of barrels of oil on the slope, "and in conversations I've had with DNR or anybody else, I've never heard it couched that potentially there wouldn't be the light oil available on the slope, in particular if we get more investment and, and more development." He opined whether BP holds back on light oil is not one of the big issues.

MR. TANGEMAN pointed out the goal to make Alaska more competitive is to draw investment dollars, and those investment dollars will be used by companies in different manners. BP has a huge resource of heavy oil, thus its investment will probably be used for heavy oil. Although shale oil has become a topic for discussion, shale oil is just now economic because the price of oil has risen above \$60-\$70/bbl. In North Dakota, new technology and high oil prices combined to make the development of the known reserves in the Bakken shale oil field economic. The development of heavy and viscous oil requires the same combination of technology, investment, and sustained high prices.

CO-CHAIR SEATON concluded the state is not listening to the companies that are saying the light oil will be needed as technology advances, that it intends to change the tax rates to try to force the companies to invest in the depletion of light oil, and that it is waiting for technology that is unknown at this time. He questioned whether the state should incentivize now, when there is testimony from industry that the time is not right to rapidly accelerate and deplete more easily-accessible light oil. Co-Chair Seaton cautioned that all three companies have to agree on accelerating production in legacy fields.

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REPRESENTATIVE KAWASAKI advised the Bakken shale field in North Dakota became economic not due to changes in the tax system, but because of high prices and a technological advance: hydraulic fracturing became commonplace. He encouraged more testimony on the goals and provisions of HB 3001, and asked for the actual meaning of "meaningful" beyond the dictionary definitions of "significant" and "purposeful." Representative Kawasaki heard that meaningful change means "significant dollars back to the oil industry," but targeting an oil tax regime to change the behavior of companies and which results in more production, development, and local hire, would be meaningful to him - and that is what the administration should demand from the lessees. He remarked:

I want to know exactly what the governor means by the word meaningful ... I want to know exactly how each of those specific bullets and ... each of the specific bullets points on [slide] 2, dealing with key provisions, are going to get us to more oil, producer commitments, more development on the North Slope and the rest of the state, more local hire ... I didn't see it with HB 110 ...."

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REPRESENTATIVE SADDLER heard there should be a linkage between the modification of oil taxes and a firm commitment to produce more oil. He asked whether mechanisms exist to make this linkage.

COMMISSIONER BUTCHER relayed it is unconstitutional to attach quid pro quo to state tax policy. Furthermore, industry may intend to meet a certain commitment, but changes in economic circumstances, such as a drop in oil prices or losses due to an oil spill, may intervene. He opined these are reasons that make it hard for companies to come forward; however, he does expect industry would provide details on the potential of the legacy fields and "convince you that this is going to lead to something material."

MR. TANGEMAN added that DOR is not looking in a vacuum just at the effect on Alaska, but is comparing Alaska to the rest of the world. In Alberta, North Dakota, Texas, and Russia, investment is taking place due to high oil prices. He encouraged legislators to study the economics, but to keep in perspective that Alaska is not seeing investment sufficient to turn the decline curve around.

REPRESENTATIVE SADDLER inquired as to the details of the constitutional issue broached by Commissioner Butcher.

COMMISSIONER BUTCHER said he didn't know, but had discussions with the Department of Law (DOL).

REPRESENTATIVE SADDLER requested a response for his constituents.

CO-CHAIR SEATON asked whether Commissioner Butcher believed a tax rate structured on a production rate above the decline rate of the field is illegal, or unconstitutionally changes the tax rate. He remarked:

That's a quid pro quo - you know - you get the tax reduction if you produce above the decline curve, and I just want to clarify that that's not the style of a tax quid pro quo that you're talking about being illegal.

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COMMISSIONER BUTCHER said he was talking about a situation "doing a company-specific 'We'll do this to your taxes if you this.'"

CO-CHAIR FEIGE observed decoupling becomes more of an issue if there is a large sale of gas. He asked whether the legislature should consider decoupling at this time.

COMMISSIONER BUTCHER advised the administration does not see decoupling as a serious issue at this point. If the 2013 legislative session becomes the "gas fiscal session," both the companies and the state acknowledge that changes are necessary to progress the large gas pipeline; however, the decoupling issue was not a priority for this legislation.

MR. TANGEMAN pointed to the benefit of making changes by working within an existing tax structure that is understood. There are different ways to change the existing tax structure, but moving to gas will have an effect on all of the resources. Today's changes do not require starting over.

REPRESENTATIVE DICK suggested two ways to incentivize and raise production: drill more holes into the existing, finite amount of oil, which would hasten the end of the resource; or enhance technological development. The technology does not exist to address heavy oil, although the state could invest in research in heavy and tidal oil, and he urged for a focus on research. He then asked about the possibility of being patient and waiting for oil migration within a field to drain all of the oil out through the wells that are already there.

COMMISSIONER BUTCHER expressed the administration's belief that Alaska is not running out of oil; in fact, DOR and DNR will be presenting details on production from the North Slope. When production began in Prudhoe Bay, there was very high pressure; 90 percent of the flow was oil, and less than 10 percent was a combination of water and natural gas. Now the companies are cycling eight billion cubic feet of gas to keep up the pressure

and the flow is 90 percent water, gas, and sand in many wells. Today it is much more expensive to produce a barrel of oil out of Prudhoe Bay.

MR. TANGEMAN added that the Alaska Oil and Gas Conservation Commission (AOGCC) has a significant role in that it monitors the best way to extract the most oil from a field; for example, limiting the initial flow to ensure oil is not left in the ground. In addition, the U.S. Geological Survey (USGS) determined the North Slope is 70 percent unexplored; in fact, there is agreement that there remains a significant hydrocarbon base on the North Slope - in addition to Prudhoe Bay - that can be realized with new research, development, and investment.

REPRESENTATIVE SADDLER asked whether there are fallacies or false arguments that the legislators should guard against during the subsequent testimony.

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COMMISSIONER BUTCHER said it is easy to "get bogged down into a lot of complexity." Tax rates, cost, world economics, and other issues play a part in economics, but it is possible to focus on specifics, such as the extremely high cost of development in Alaska, which foils comparisons with the Lower 48. He also recommended resisting simple answers to complex problems.

MR. TANGEMAN related the biggest fallacy is: How do we get back to that number? Instead, the question is: Are we at the right number? He explained that the state assessed a gross tax system [economic limit factor (ELF)] for many years, then changed to a net system [petroleum profits tax (PPT)], and then after one year changed to ACES. Although the state's experience with a net tax system was limited to one year, within weeks of its introduction, ACES was enacted. There was a billion plus dollar difference between PPT and ACES, and after experiencing the effects of five years under the ACES tax system, Mr. Tangeman questioned whether ACES provides the right number for the state, and suggested seeking a return to that number is a false discussion.

CO-CHAIR SEATON returned attention to the question of activity around the world that is not seen in Alaska. He has heard that HB 3001 might create a stampede; however, right now on the North Slope: there are more new players than the total of existing players; last year was the most successful lease sale ever; more companies are looking at conventional and nonconventional plays;

employment is highest of all time; and there are more international and small companies participating. Furthermore, the state is collecting income from lease sales and interest. There are 11 new companies, and he inquired how many are necessary to be regarded as investment on the North Slope. He related that Brooks Range Petroleum is producing from Mustang 10,000-13,000/bbls per day but may not be able to access TAPS in 2013-2014 when needed. Brooks Range Petroleum also has plans for constructing processing facilities. As a matter of fact, facility access is a real problem that needs to be addressed now, and he asked why is there no interest from state agencies to assist in oil production that is two years closer than that from Point Thomson, or in shale prospects. Representative Seaton asked what activities the administration is interested in, other than a high rate of investment by the big three producers.

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COMMISSIONER BUTCHER recalled employment peaked right before ACES passed because maintenance was needed on the aging fields, but over the last four or five years employment has plateaued. In other places such as Texas, employment has exploded due to high oil prices. Also, capital investment in Alaska is high for mature fields, but has "dipped a little bit" and is going crazy in other places. Triple-figure oil has made prospects economic that were not before; in fact, Texas was on the same decline curve as Alaska, but has begun to turn the decline around, and Alaska continues with a slow decline.

MR. TANGEMAN explained that ACES provides a very generous suite of tax credits which draw new companies to the state, but the money to fund the credits comes from the taxpayers, therefore, when they become producers and taxpayers, there is less enthusiasm. Companies must consider what will happen if they become producers, and what the opportunities are in North Dakota, Texas, and Alberta. Although explorers are interested "there's a definite disconnect between that side of ACES and the production tax side of ACES."

REPRESENTATIVE GARDNER asked DOR to provide information on whether the new oil production in Texas is from legacy fields that are producing more, or from all new fields.

COMMISSIONER BUTCHER said there is a mix of production from both that is now economic due to high prices.

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[HB 3001 was held over.]

**ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:06 p.m.