

SENATE FINANCE COMMITTEE
March 16, 2012
9:03 a.m.

9:03:57 AM

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:03 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Lesil McGuire, Vice-Chair
Senator Johnny Ellis
Senator Dennis Egan
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

None

ALSO PRESENT

Senator Joe Paskvan; Senator Cathy Giessel; Kara Moriarty, Executive Director, Alaska Oil and Gas Association; Cathy P. Foerster, Commissioner, Alaska Oil and Gas Conservation Commission; Doug Smith, President and CEO, Little Red Services

PRESENT VIA TELECONFERENCE

Rick Rogers, Resource Development Council, Anchorage

SUMMARY

SB 192 OIL AND GAS PRODUCTION TAX RATES

SB 192 was HEARD and HELD in committee for further consideration.

HB 307 SUPPLEMENTAL/CAPITAL/OTHER APPROPRIATIONS

CSHB 307 (FIN) was REPORTED out of committee with a "do pass" recommendation.

#hb307

CS FOR HOUSE BILL NO. 307(FIN)

"An Act making supplemental appropriations, capital appropriations, and other appropriations; amending appropriations; repealing appropriations; making appropriations to capitalize funds; and providing for an effective date."

[9:05:01 AM](#)

Co-Chair Hoffman MOVED to report CSHB 307(FIN) out of committee with individual recommendations. There being NO OBJECTION, it was so ordered.

CSHB 307(FIN) was REPORTED out of committee with a "do pass" recommendation.

#sb192

SENATE BILL NO. 192

"An Act relating to the oil and gas production tax; and providing for an effective date."

[9:08:18 AM](#)

KARA MORIARTY, EXECUTIVE DIRECTOR, ALASKA OIL AND GAS ASSOCIATION (AOGA), presented a PowerPoint Presentation, "Oil and Gas: Fueling Alaska's Economy" (copy on file).

Ms. Moriarty displayed slide 2, "AOGA Member Companies." She stated that AOGA was a business trade association whose mission was to foster the long-term viability of the oil and gas industry for the benefit of all Alaskans. She stated that the member companies represented the majority and account for the majority of the oil and gas exploration, production, transportation, refining, and marketing activities in Alaska. The AOGA member companies reflected the breadth and scope of the oil and gas industry across the state. She emphasized that AOGA required a 100 percent consensus of all member companies in order to allow AOGA to testify on matters of tax policy. She stated that the Alaska Clear and Equitable Share Act (ACES) affected

continued production decline on the North Slope and had a negative impact on the economic future of Alaska.

Ms. Moriarty discussed slide 3, "Decoupling - Sections 5 and 11 of CSSB 192 (RES)."

AOGA Opposes Proposed Language

- Proposed Language results in a tax increase.
- Recognize need to eventually resolve the concern that combining the value of gas with that of oil when significant gas sales occur will reduce the tax on the oil, unless they are decoupled.
- AOGA open to trigger mechanism, but reserve right to evaluate proposed language.

Ms. Moriarty looked at slide 4, "Petroleum Information Management System, Sections 2 and 3 of CSSB 192 (RES)."

- New section would blur the current clear authorities and accountability of DOR (Taxation Power) & AOGCC (Police Power).
- Could lead to companies providing the same information over and over or in different formats to different agencies.
- Proprietary/confidential information may not be adequately safeguarded.
- Creates unrealistic expectations about public access to certain specific kinds of information.
- May create federal disclosure issues.

[9:20:56 AM](#)

Senator McGuire wondered what possible opportunities the members of AOGA would be open to regarding more meaningful financial disclosure arrangements. She remarked that there were some concerns addressed in the Senate Resources Committee, with respect to the Gleeson Agreement. She pointed out that there was an issue regarding proprietary agreements, and stated that it was only "proprietary" if the company states it as such. Ms. Moriarty agreed to provide that information.

Co-Chair Stedman noted that Commissioner Butcher would be testifying to the committee at a later date regarding disclosure issues. Ms. Moriarty looked forward to the result of the disclosure issues conversations.

Ms. Moriarty discussed slide 5, "Progressivity and 'base' tax rate, Sections 5, 7, and 8 of CSSB 192 (RES)."

- 25 percent base rate is too high.
- CS does not provide brackets - brackets are meaningful.
- CS lowers starting slope by merely one-eighth.
- The new cap will not be reached until approximately \$244/barrel.

Ms. Moriarty discussed Section 13 of CSSB 192 (RES). She remarked that it was "essentially impossible" to know in advance exactly how successful an investment would be. She explained that ACES encouraged investments by rewarding tax payers to make the decision to invest in Alaska, rather than rewarding the successful production as a result of investment. She stated that ACES tax credits were similar to the tax credits given to movie producers. She explained that CSSB 192 (RES) proposed to reward actual increases in production from the prior year's level. This reward took the form of a \$10 a barrel reduction in the tax payer's production tax value for a calendar year for each taxable barrel produced over the production in the prior year. She stated that some North Slope fields may have decline rates substantially greater than the 6 percent historical average for the North Slope, so under CSSB 192 (RES) there would be no reward for the success in keeping production significantly higher than it otherwise would have been.

Ms. Moriarty looked at page 19, sub-Section G of CSSB 192 (RES). She stated that the proposal would limit the effect of the \$10 a barrel reductions in the production tax value by prevent the tax payer from being considered for purposes of setting the progressivity tax rate. She remarked that AOGA did not understand why the \$10 allowance would not be applied to progressivity. She stated that Senator Wagoner had proposed a tax holiday conceptual amendment that would provide a similar, but more effective reward for a producer's success in slowing down its rate of decline. The conceptual amendment would set a target level of production for each year, by applying the decline rate during the three most recent years to the producer's production in the prior year. Therefore, if a production beats the target for the year, the above-target production would receive a tax holiday by excluding its gross value at the point of production from the calculation of the production tax value for the producer's taxable production during that year. She

stressed that the proposal would reduce the amount of production tax values (PTV) subject to the tax, and if progressivity were applicable, it would also reduce the progressivity tax rate.

[9:31:33 AM](#)

Ms. Moriarty discussed slide 6, "New Minimum Tax - or 'Floor', Section 13 of CSSB 192 (RES)."

- Only applies to legacy fields (Prudhoe & Kuparuk).
- Creates a disincentive to invest in legacy fields, especially at low prices.
- Requires allocation of costs among the two fields & a producer's interest in their other fields.

Ms. Moriarty looked at slide 7, "Summary."

- AOGA Opposes CS SB 192 (RES).
- Overall government take for Alaska would still be too high under this CS.
- AOGA supports meaningful changes - such as progressivity brackets.
- Tax Policy does affect business decisions
- CS will not improve ability to attract more investment.
- CS will not lead to more production.

Co-Chair Stedman noted that there was no limit to the amount of credits in the current tax structure. He stated that FY 12 expected credits reaching approximately \$8 million to affect the treasury. He stressed that there needed to be a solution, and was open to suggestions. He stressed that it was a problem to have an exposure of an over-abundance of tax credits. Ms. Moriarty stated that the proposals would be evaluated, to determine the impact to the State.

[9:38:57 AM](#)

CATHY P. FOERSTER, COMMISSIONER, ALASKA OIL AND GAS CONSERVATION COMMISSION, read from a prepared testimony, "Impact of Section 3, CSSB 192 on the Alaska Oil and Gas Conservation Commission" (copy on file):

The AOGCC, an independent quasi-judicial State agency, is the State's permitting and regulatory authority

over hydrocarbon and geothermal wells. The Commission's duties include ensuring the maximum recovery of hydrocarbon and geothermal resources, preventing hydrocarbon and geothermal waste, ensuring well safety, and protecting underground sources of drinking water and correlative rights. Given the nature of the Commission's duties and responsibilities, apart from support personnel, it is staffed by expert petroleum engineers and petroleum geologists. Because its expertise is so carefully tailored to its statutory duties and responsibilities, the Commission functions well and Alaska has an unrivaled record with regard to well safety and production.

Section 3 of the committee substitute for SB 192 seeks to effectuate a substantial change in the AOGCC by requiring the Commission to establish, operate and maintain an electronic petroleum information management system comprised of available and non-confidential information. The vast majority of the information the Commission must include in the petroleum information management system has nothing to do with the Commission's mission or function - "unit and joint operating agreements," exploration licenses and leases, "work programs and budgets," "development plans," operating and capital expenditures and projections, "oil and gas sales, revenue and pricing," transportation agreements, abandonment plans and budgets, resident and non-resident hiring information, training opportunities, and other information "the commission determines necessary and relevant to the oil and gas production tax and to the exploration, development, and production of oil and gas resources." Much of this information is currently already gathered and maintained by other state agencies or is not available to any state agency.

After careful review and consideration of Section 3, the AOGCC is of the view that Section 3 radically changes the AOGCC's longstanding role as the State's petroleum technology and geology experts and jeopardizes the Commission's ability to discharge its primary duties and responsibilities in those realms. The Commission has neither the expertise nor the infrastructure to construct, maintain and operate information management systems, computer systems, and

the gathering of information on other subjects not related to the safe, efficient production of hydrocarbon resources from wells. Implementation of Section 3 will create - at a substantial fiscal outlay - an additional distinct state bureaucracy within the AOGCC which duplicates functions currently performed by other state agencies.

The AOGCC's non-confidential information is already publically available on its website. Other agencies are currently working to provide similar web availability of their data. Once those agencies do so, the information will be far more readily accessible to the public on those websites and at a substantially reduced cost.

Co-Chair Stedman stated that there would be discussions with the Department of Revenue (DOR), and noted a concern regarding the information disclosure to the legislature. Commissioner Foerster replied that the AOGCC was doing important work to solve the issue of financial disclosures.

[9:44:48 AM](#)

DOUG SMITH, PRESIDENT AND CEO, LITTLE RED SERVICES, introduced himself. He encouraged the committee to ask questions. He presented a PowerPoint Presentation, "The Alliance and CSSB 192" (copy on file).

Mr. Smith looked at slide 3, "Our Story Hasn't Changed." He stated that Alliance members, at their own expense, have traveled to Juneau more than 10 times during the 27th Alaska Legislature. He furthered that they had consistently advocated for significant tax reform. He explained that members and their employees had participated in every public testimony opportunity in 2011 and 2012. He stated that the McDowell Report confirmed the facts they had presented: Alliance companies average between 70 percent and 90 percent Alaska hire; Alliance companies employed non-residents who were formerly long-term Alaska residents; and record employment on the North Slope had not led to a reduction in the production decline.

Mr. Smith discussed slide 4, "Alliance Member Composition."

- The Alliance is comprised of 460 member businesses.
- 35,000 employees.

-Our membership is comprised of businesses in 43 different sectors from Automotive to Welding.

-Our mission statement is to "promote responsible exploration, development and production of oil, gas and mineral resources for the benefit of all Alaskans."

9:50:52 AM

Mr. Smith looked at slide 5, "The Current Investment Climate Impact on Alliance Members."

1. Continued decline in projects.

-Three largest fabrication shops in the state are currently operating at a loss, with little to no work, in order to keep core employees on staff.

2. Alaskan companies are looking for work, resulting in many relocating or shifting resources and investment to the lower 48 (CIRI, Solsten, Fairweather, Builders Choice, Northern Industrial Training, Carlile, Lynden, Peak Oilfield Services, Cruz Construction, etc.).

Mr. Smith discussed slide 6, "Jobs."

1. As indicated in the McDowell study, record high employment on the North Slope does not represent a thriving oil industry.

A. 2000 - 108,000 barrels of annual production for every job.

B. 2010 - 28,000 barrels of annual production for every job.

2. Loss of highly trained professionals to outside competition.

3. Reduction of jobs based in Anchorage and Fairbanks like engineers, fabrication work, etc.

9:57:01 AM

Mr. Smith looked at slide 7, "My Company - Little Red Services."

1. Letter in your committee packet (copy on file).

Dear Senator Stedman:

I am writing on behalf of myself and the 90+ Alaskans we employ at Little Red Services. We are requesting your support of ACES tax reform that will result in substantial new investment in our primary oilfields that are declining in production at a very concerning rate.

Our company engages in work activities that are substantially subsurface, from the well head down, and are usually associated with production related activity. AN issue that many legislators are struggling with is the employment statistics that demonstrate that employment is up on the North Slope after the implementation of ACES. This I believe is an undeniable fact and should be embraced as such. The concern is what are the jobs and do they result in new or increased production benefits. I cannot speak for all sectors of business conducted on the North Slope but I can provide a short view into a specific instance within our company that indicates a shift from production related effort to maintenance.

After the enactment of ACES the production based activity of ConocoPhillips slowed in Kuparuk and we had to remove a truck from service resulting in the layoff of 13 people in 2009. We eventually found work for the truck in Prudhoe Bay. Unfortunately for Alaska, this work was not our usual production related support. Instead the truck was put to us heating water from a lake on the west side of Prudhoe to support the washing of snow and ice from flow lines so they could be inspected for corrosion. This adaptation may help to maintain our revenue but it also clouds the employment view of the North Slope and masks the real issue of the significant number of jobs that are related to non-production activities.

A recent jobs study conducted by the McDowell Group demonstrated the negative trend in the production and jobs relationship. The relationship between production and jobs on the North Slope had steadily decreased since peak oil production in 1988. In 1987 the barrels of oil produced per North Slope job was at 255,000

barrels per job (measured on an annual average basis). In the year 2000 North Slope oil production totaled approximately 108,000 barrels for every oil and gas industry job. By 2010 North Slope oil production had further declined to approximately 28,000 barrels for every oil and gas industry job on the North Slope.

While Alaska has maintained a reasonable level of employment, our production decline and current levels of investment is concerning and needs a response from our legislature to stimulate additional investment from the existing and potential new producers on the North Slope. The legislature and all Alaskans are aware of thousand significant activity and investment occurring in the other competing oil and gas regions of Canada and the United States. It is our long term future and fiscal stability that is of concern. Now we look to our legislative leadership to find the correct balance of fiscal terms that can extend our oil production and bridge our fiscal needs to the possible development of gas, unconventional oil and OCS resources that will offset our declining legacy fields and Alaska's treasury.

There is no easy answer but dealing with progressivity and providing reasonable tax brackets and base rates are good steps in the right direction. We do not believe industry needs to be unfairly subsidized nor should treasury be upside down on oil and gas activities in our state. We do support measures that place us in a competitive posture with other areas of investment opportunity in North America like those contained in HB 110. An effective fiscal structure can only be measured in the form of increased production that slows decline or actually increases levels of production for the next several years.

We applaud your commitment to the people of Alaska and dedication to public service. Please act wisely and swiftly during this session on our behalf and help us preserve a healthy oil and gas industry in Alaska for decades to come.

Sincerely,
Douglas Smith

-Relocating an asset from production-related activity to maintenance activities that do not increase production.

2. Financing.

-Banks outside of Alaska are concerned about our current tax policy and its potential impact on future financial forecast of our service company.

Mr. Smith Discussed slide 8 titled "The Future of Alliance members in the oil Business."

Oil tax reform must address the following:

- Existing light oil production
- New light oil production
- Viscous
- Exploration
- New companies and investment in the Alaska market

Mr. Smith spoke to a slide on page 9 titled "Observations."

Existing production

- Low-cost light oil (existing production)
- "Government take of 70-75 percent is reasonable. It is maybe slightly on the high side." (PVM slide 28, presentation to Alaska Support Industry Alliance)

[10:02:00 AM](#)

Mr. Smith explained the slides on pages 10 and 11 titled "Observations."

New production

- The allowance for production increases in CSSB 192 does not reflect the recommendation of Dr. van Meurs: "the 60-65 percent government take for more costly new light oil resources as proposed in HB 110 and HB 17 is a reasonable level from an international perspective." (PVM slide 38).
- Dr. van Meurs includes in-field drilling of existing fields as new high-cost light oil production (PVM slide 16).
- Dr. van Meurs "The main reason for major companies to be in a harvest mode is that projects outside Alaska

are more attractive. No large attractive projects available in Alaska under current fiscal terms for major oil companies" (PVM slide 15).

-Both Gabon and Trinidad applied an approximate 12 percent drop in order to attract new investment in an effort to offset declining production (PVM slide 31).

a. Marginal government take in Gabon at \$100/bbl is 52 percent.

b. Marginal government take in Alberta is 57 percent.

c. Marginal government take in Alaska under ACES is over 80 percent (PFC Energy, slide 49).

Mr. Smith did not see Alaska "giving in" to a harvest mentality and indicated that Alaska's resources oil resources were vast.

[10:05:51 AM](#)

Mr. Smith discussed a slide on page 12 titled "Observations."

1. Viscous (called heavy by Dr. van Meurs)

-Dr. van Meurs "To be competitive Alaska would have to offer government takes for heavy oil at 55-60%." (PVM Slide 42).

2. Exploration

-Tax credits have stimulated significant exploration this season.

-Will this result in the required investment to bring new discoveries to production under the current ACES tax structure?

Mr. Smith looked at slide 13, "Observations."

New companies in the Alaska market

-CSSB 192 does not simplify our tax structure for companies looking to invest in new markets and it does not make us competitive for new projects.

-ACES does not compete well when developing higher cost light oil (PVM slide 37).

-"ACES inhibits the development of new projects and resources that might help stem or even reverse decline." (PFC slide 28).

Mr. Smith discussed slide 14, "Observations."

There is probably a point where industry and the State share the pain of low prices:

-Industry should not have to give up total profits to taxes.

-The State treasury should not collect zero tax at low prices.

A healthy partnership should exist on both ends of the price spectrum.

Mr. Smith looked at slide 15, "Observations."

-Decoupling may be in the State's best interest if it is revenue-neutral to industry.

-The Alliance feels this bill, in its current form, does not go far enough to encourage a significant shift in investment.

-Although we have touched on several points from Dr. van Meurs on different types of production and corresponding tax rates it would be difficult to implement the approach.

-The method and levers to be adjusted is the challenge before the senate but we support a magnitude of change that would place us in the middle of a comparative chart produced by PFC Energy.

10:11:50 AM

Co-Chair Stedman stated that PFC Energy had been asked to examine Gabon and Trinidad, so there would be further information forthcoming regarding the issues in slide 11. He felt that Alaska had followed Gabon and Trinidad's examples to stimulate investment. He commented that the State did not have the ability to parse out individual employment in the service companies, because they dealt with labor issue on a macro level. He added that Exxon, ConocoPhillips, and British Petroleum were often referred to as the "big three" because the intricate details of each company were unknown. He recognized that the employment numbers were at maximum capacity, there was still the issue of incremental production, which required a different type of work force. Mr. Smith replied that his company was fortunate, because the employment had been relatively flat over the years. He felt that flat employment was "a win", because there was declining production. He noted that the more concerning issue was the low production, despite high employment.

10:17:16 AM

RICK ROGERS, RESOURCE DEVELOPMENT COUNCIL, ANCHORAGE (via teleconference), read from a prepared testimony.

Good morning Co-Chairs Stedman and Hoffman and members of the committee. My name is Rick Rogers, Executive Director of the Resource Development Council for Alaska (ROC). ROC is a statewide membership-funded non-profit trade association representing the common interest of the Forestry, Fishing, Tourism, Mining and Oil and Gas industries in Alaska. Our membership is truly a broad cross section of Alaska businesses including the aforementioned industries as well as communities, all twelve Alaska Native Regional Corporations, organized labor, utilities and support business that recognize the important role resource development plays in our economy.

ROC thanks the committee for this invited testimony. I regret being unable to be with you today in Juneau, and appreciate the LIO and staff facilitating testimony from Anchorage. I have prepared no Slides for today's presentation.

ROC is appreciative of this committee's recognition of the need to improve the investment climate in Alaska's oil and gas industry to stem TAPS throughput decline. I hope to emphasize the sense of urgency and the broad base of support from ROC membership towards meaningful adjustment to the production tax to achieve a more attractive investment climate in Alaska. Some of the most vocal proponents of production tax reform among our membership are not directly involved in the oil and gas industry. The business community is fearful what continued TAPS throughput decline will do to our economy as a whole.

We are convinced that ACES in its current form is retarding investment and contributing to an accelerating production decline. Alaska is sitting on the edge of a fiscal cliff. A sobering outlook can be found in the Governor's budget, the ten-year budget projection that shows several plausible scenarios with significant budget deficits by 2014. While meaningful tax reform will result in short-term revenue decline, long term it is imperative that we sacrifice some

short-term tax revenues to reinvigorate production. From the ROC perspective, this is about acting in the long-term interest of Alaskans.

[10:28:48 AM](#)

Senator Ellis noted the state's base tax rate of 25 percent. He wondered what the ideal base tax rate would be, from the perspective of the members of the Resource Development Council. Mr. Rogers replied that it would be difficult to determine the base tax rate without looking at the progressivity formula and the entire structure and regime.

SB 192 was HEARD and HELD in committee for further consideration.

#

ADJOURNMENT

[10:30:21 AM](#)

The meeting was adjourned at 10:30 AM.