

SENATE FINANCE COMMITTEE

March 21, 2012

9:02 a.m.

[9:02:59 AM](#)

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:02 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

Representative Berta Gardner; Bob Heinrich, Vice-President Finance, ConocoPhillips Alaska; Scott Jepsen, Vice-President External Affairs, ConocoPhillips Alaska; Senator Linda Menard; Damian Bilbao, Head of Finances, Developments and Resources, British Petroleum, Alaska

SUMMARY

SB 192 OIL AND GAS PRODUCTION TAX RATES

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

SENATE BILL NO. 192

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

[9:03:34 AM](#)

Co-Chair Stedman stated that the meeting would consist of testimony by representatives from ConocoPhillips, British Petroleum (BP), and ExxonMobil related to Alaska's oil and gas basin. He anticipated some questions that would be answered later via email, but hoped that some responses could be given during the meeting.

BOB HEINRICH, VICE-PRESIDENT FINANCE, CONOCOPHILIPS ALASKA, introduced himself.

SCOTT JEPSEN, VICE-PRESIDENT EXTERNAL AFFAIRS, CONOCOPHILIPS ALASKA, introduced himself.

Mr. Heinrich discussed the PowerPoint Presentation, "Senate Finance, Discussion of CSSB 192" (copy on file).

Mr. Heinrich looked at slide 2, "Agenda." He stated that the CSSB 192 provisions were progressivity change, discretionary production incentive, increased gross minimum tax, oil information system, and decoupling. He added that he would also address the framework for modifications.

[9:06:02 AM](#)

Mr. Heinrich addressed slide 3, "Progressivity Change." He stated that the graph represented the split of cash flow between the State of Alaska and the producers across a range of prices. The data was used from the most recent Revenue Sources Book, and the modeling defects for FY 13. The x-axis was the Alaska North Slope crude price, rather than the production tax value (PTV). He stated that in order to determine the PTV, \$40 would be deducted. The solid red and green lines represented the Alaska and producer share at the industry level under ACES. The diamond-marked lines represented the Alaska and producer share under CSSB 192. He stated that "Alaska share" included production taxes due under ACES, royalties, state income tax, and property tax paid within the state. The producer share was a net, after federal income tax, and incorporated all of the fiscal taxes paid. He noted the 0.05 percent decrease in progressivity provided only minimal impact over a narrow price range. He furthered that the 60 percent tax cap had no impact below \$230/bbl, and did not anticipate existing in that price environment in the near future.

Co-Chair Stedman noted some discussions regarding the inaccuracies about the actual revenue that is different than what was presented. Mr. Heinrich replied that ConocoPhillips paid some of the highest taxes of any fortune 500 company. He stressed that each taxpayer's position would be different.

[9:11:39 AM](#)

Co-Chair Stedman stated that after the last tax restructuring, there was an expectation of higher State revenue, but that did not happen. He stressed that changes and expectations should materialize, so the presentations should reflect actual numbers. Mr. Heinrich replied that the model was merely a static model, and there were other factors that influence the company take. He furthered that variable such as prices, cost structures, and capital investments affect the capital credit programs on the split of cash flow.

Co-Chair Stedman stressed that there could be similar charts, with different assumptions. He surmised that the presentation was put together based on the Department of Revenue (DOR) Source Book. Mr. Heinrich replied that the presentation was based on the producer's perspective on the legacy fields, or slow-point production based on the Revenue Source Book.

Co-Chair Stedman noted that if a company has no income, Alaska's share decreases. Mr. Heinrich agreed.

Co-Chair Stedman looked at the price range from \$70/bbl to \$150/bbl, and wondered if the split should ever be split so the lines run parallel.

Mr. Jepsen felt the lines should parallel, but there needed to be an examination of all the components. He did not want to state a specific number, without analyzing all the attached components.

[9:16:05 AM](#)

Co-Chair Stedman noted testimony from consultants that declared that the relationship of the sharing of profit oil could be in a reasonable range around \$100/bbl. He wondered where specifically the tax issue landed: \$80/bbl, \$100/bbl, \$130/bbl, or \$150/bbl. Mr. Jepsen stated that it was

approximately \$100/bbl in other investment areas in the North America.

Mr. Heinrich added that there needed to be an examination of the effective tax rates, so the areas that are "most attractive" are at the lower end of the price range.

Senator Thomas wondered why each industry partner did not present their own individual story, because it was important to understand each company's objective. He would like to see the individual company's projections. Mr. Heinrich replied that ConocoPhillips was not able to provide that information, because projections were considered confidential.

Mr. Jepsen furthered that the State of Alaska should look at the presentation as a "portfolio." He stressed that the individual company's actions culminate into a higher level. He felt that ConocoPhillips' "story" would be very similar to what was presented.

Senator Thomas knew DOR's perspective, and stressed that he would like to see ConocoPhillips' individual outlook based on their own business's financial considerations. Mr. Jepsen responded that the graph was very reflective of ConocoPhillips' numbers. Senator Thomas surmised that it was proprietary, and that was the reason for "lumping" the numbers together.

[9:21:41 AM](#)

Co-Chair Stedman stressed that there were multiple presentations regarding Alaska's share versus the producer's share. He would like to have further discussions with consultants, because he felt that ConocoPhillips presentation overstated the State's share, and understated the producer's share. He felt that there was most likely a \$200 to \$250 million spread at \$109/bbl for income tax. He stated that the government take number referred to property tax, royalties, income tax, severance, and corporate income tax. He noted that the consultants had suggested a range from 70 to 75 percent, with the analyses using 75 percent government take at \$100/bbl. He alleged that those numbers might not actually materialize. He felt that there needed to be a more accurate analysis of the projected impact on the State treasury. Mr. Heinrich replied that the State of Alaska had a different marginal tax rate, and there were several assumptions across the board.

Co-Chair Stedman agreed, and furthered that there were many comparative analyses that used the 35 percent corporate rate in the jurisdiction. He stressed that the focus should be on the State of Alaska's revenue.

Co-Chair Hoffman stated that the goal of tax revision was based on getting more oil into the pipeline, and the governor had a goal of an increase from 550,000 to 1 million barrels a day. He wondered if ConocoPhillips felt that the governor's goal was realistic. Mr. Jepsen replied that the governor's goal was very challenging, and ConocoPhillips liked that challenge. He stated that drilling in legacy field was a great challenge, because of the lack of motivation to explore an older field. He noted that there was some heavy oil that could be developed, but that would require great investment.

[9:29:18 AM](#)

Co-Chair Hoffman felt that the goal of off-shore drilling was potentially realistic, but the proposed changes that SB 192 addressed did not affect off-shore drilling. He noted that tariff costs could be reduced, but the basic question was whether or not the changes would be beneficial to both the State and the producer. Mr. Jepsen responded that a later slide would address ConocoPhillips' proposed alternative to the Alaska Clear and Equitable Share Act (ACES). He was confident that if there was an environment that promoted investment, then there would be healthy oil production for many years. Mr. Heinrich furthered that there were many comparisons between tax reductions equal to capital investment, and felt that comparison was not helpful. He stated that there needed to be comparison between tax reduction and what is actually generated. He noted that every project was different in terms of the types of returns, nature of the cash flow, and timing of the cash flow; but generally it was a two to one ratio in terms of the investment dollar. Every investment dollar generated approximately two dollars in royalties and production taxes.

[9:33:08 AM](#)

Co-Chair Stedman noted that Prudhoe Bay was producing approximately 300,000 barrels a day, and Kuparuk was producing approximately 133,000 barrels a day. He wondered how ConocoPhillips could move from about 150,000 to between 200,000 through 250,000 a day. Mr. Jepsen responded that in order to stop the decline, there needed to be additional drilling. He stressed that Alaska was at a big disadvantage, because of the intense ecological environment. He stated that there was some examination of new technologies, and the new technologies were fairly sophisticated and expensive. He stressed that it was possible to level out the decline, if there were additional resources. He pointed out that the development of new resources within new fields required cutting edge technology. He did not know if the governor's goal of 1 million barrels a day could be reached, but pointed out that skill and science would encourage new development.

[9:38:04 AM](#)

Co-Chair Stedman remarked on some discussions regarding above-ground and below-ground processing facilities. He wondered if the processing facilities were a high priority on the list of capital improvements for ConocoPhillips. Mr. Jepsen replied that Kuparuk did not face many significant capital constraints. He added on the hottest day of the summer, there might be decrease of 3,000 or 4,000 barrels a day for a short period of time; in the winter there might be a decrease of 1,000 barrels a day. ConocoPhillips was continually looking at ways to efficiently and cost-effectively handle the production that was available at the wells.

Co-Chair Stedman referred to some testimony from consultants regarding profitable in-field drilling at \$100/bbl in the legacy fields. He wondered where ConocoPhillips' concerns lie. Mr. Jepsen responded that decisions were not made based on a single variable. He stressed that most of the revenue flows to the State; it did not come back to the producer.

Co-Chair Hoffman wondered if there would be harvesting for another 50 years, if there was no change to ACES. Mr. Jepsen replied that ConocoPhillips was investing \$90 million a year in Alaska, and restated that it was difficult to fully exploit the resources under ACES. He alleged that if ACES was reformed, there would be greater desire to fully develop the fields.

[9:44:00 AM](#)

Co-Chair Stedman stated that Pedro Van Meurs was surprised at the small amount of capital expenditures, and the maximum amount of harvest mode investment in the Arctic. He assumed that ConocoPhillips did not agree with that perspective. Mr. Jepsen affirmed that ConocoPhillips did not agree with that point of view, but furthered that the tax environment in Alaska did not allow for rapid new investment. He stressed that ConocoPhillips was pursuing state of the art, cutting edge drilling technology in Alpine and Kuparuk. He felt that new oil fields were essentially being developed, because the current technology did not exist when the fields were initially developed. Pools of oil were currently being accessed that were not accessible 20 years prior.

Co-Chair Stedman felt that prospectivity needed to be a focus. Mr. Jepsen agreed, but stressed that ACES did not promote investment.

Senator Thomas pointed out the production decline of 5 percent, and wondered how much investment it would take to increase production. Mr. Jepsen remarked that half of the

production in Kuparuk was a result of in-field drilling, well optimization, and production optimization. He noted that the decline was substantial, but felt it was possible to have significant results from increased drilling and investment in the legacy fields.

Co-Chair Stedman stated that PFC Energy would help with that analysis.

Senator Thomas stressed that there was still decline at Kuparuk, so he requested a model from ConocoPhillips regarding their plan to at least reduce the decline.

[9:50:41 AM](#)

Mr. Heinrich explained slide 4, "Discretionary Production 'Incentive'." He stated that discretionary production did not incentivize the significant investment required just to offset decline. Production aggregated by the producer had no benefit derived by new satellite of production offset by decline at other fields. He explained that for the short-lived benefit period, the PTV reduction impact was immaterial. He noted that there was no way to plan for discretionary production. He stressed that a discretionary production "incentive" could not improve the investment climate.

Co-Chair Stedman explained that there were various perspectives that were considered to boost production and revenue. He noted there were some discussions regarding changing the \$10 allowance to \$20 or \$30, and lengthening it over time to determine if the concept could mature and be more effective. He stated that there was also a consideration regarding a tax holiday, and the consultants were going to present the benefits thereof, and other recommendations to boost production. Mr. Jepsen felt that the changes to ACES must apply to the legacy fields, and must encourage investment. He declared that Alaska needed to be an attractive place for additional capital investment. He felt that the impacts would be beneficial to the state treasury over the long-term, but could have a negative impact in the short-term. He felt that there needed to be a focus equally on legacy fields and new fields.

[9:56:49 AM](#)

Co-Chair Stedman stated that there was testimony from consultants that showed that \$100 a barrel was very profitable for the industry. He explained that if there was a broad adjustment for all production, then too much cash was moved unnecessarily.

Mr. Jepsen stated that if there was a significant reduction in severance tax, the State would see an immediate change in

its revenue. However, over the long-term, the State's revenue would balance out, and even be positive. He added that ConocoPhillips would be willing to work with the committee to determine the best approach.

Co-Chair Stedman observed that the consultants were analyzing the language in the bill, and running various numbers to determine whether or not the bill was aggressive for incremental production. He encouraged the industry to provide some input.

[9:59:41 AM](#)

Mr. Heinrich stated that healthy legacy business was important to future development on the North Slope. The assets that currently exist were the "backbone" to future investment.

Senator Thomas understood the industry's concern and wanted their thoughts on how they would structure something that would clearly delineate new oil other than current year's investment and revenue. Mr. Jepsen responded that ConocoPhillips had invested billions of dollars in operating expenditures (OPEX) and capital expenditures (CAPEX). Senator Thomas furthered that there needed to be a fair definition to determine what was considered "new oil."

Co-Chair Stedman stated that there would be a presentation by PFC regarding the incremental issue. He indicated that he expected the number to be billions every year. He encouraged industry to help the State solve the problem. Mr. Jepsen replied that they were trying to be as transparent as possible and that under ACES Alaska was not as attractive of a place to invest.

Co-Chair Stedman noted he would be surprised to hear any agreement with the producers at any set tax rate.

Senator McGuire felt that there was an assumption that the tax system at \$100 a barrel was "good" and "competitive." She remarked that there was a philosophical divide in the Senate regarding tax reform. Some felt that the tax system needed to be altered for future barrels as opposed to improving the overall tax system. She stated that the focus should be on every price per barrel, and on analyzing the entire tax system.

[10:04:59 AM](#)

Mr. Heinrich discussed the slide on page 5, "Other Provisions."

1. Increased gross minimum tax.
-A minimum tax is already in place under ACES

- Increased minimum tax triggers at higher price than under ACES.
- Impact is increased taxes at low to moderate oil prices.
- 2. Oil information system.
 - Provides for a sweeping list of data to be warehoused.
 - a. Burdensome and potentially duplicative.
 - b. Includes data considered to be trade secrets.
 - c. Confidentiality concerns.
 - Creates unrealistic expectations about public access to specific data.
- 3. Decoupling.
 - Administratively burdensome.
 - Cost allocation mechanism unknown -left to discretion of DOR.
 - Implementation should be tied to major gas sales.

Mr. Heinrich stated that the provisions in the bill did not improve the current investment climate.

Co-Chair Stedman indicated that committee would deal with the issue of changing the tax process on the upper end later in the process. He was worried about the production tax value going in the negative, because of high volume of tax credits.

[10:07:09 AM](#)

Mr. Heinrich stated that ConocoPhillips supplied a large amount of data to DOR. Some of the information should not be made publicly available. They were not against decoupling oil and gas, but they wanted clear regulations before implementation of decoupling. Co-Chair Stedman pointed out that the document from DOR showed that not decoupling oil and gas would result in a loss of \$80 million dollars to the State. He noted that decoupling would provide billions to the state per year in the event of a major gas sale.

Mr. Jepsen discussed the slide on page 6, "Capital Allocation." He explained that the graph demonstrated ConocoPhillips' budget history in Alaska from 2010 to 2012, and compared it to the capital budget history in the Lower 48. He stated that with the higher prices, one would expect to see more investment in Alaska. He stressed that Alaska had a low investment profile.

Co-Chair Stedman alleged that the graph represented the gross rates. Mr. Jepsen replied that it was actually the net income. Co-Chair Stedman wondered what would happen if the comparative states allowed for capital expenditure write-offs.

[10:12:55 AM](#)

Mr. Jepsen replied that the severance tax write-off was meant to be a tax on the cash margin. It took into account operating costs and capital costs to determine "free cash", but it was still taxed at a very high rate. He did not feel that it should be considered a write-off, rather a mechanism at which to arrive at the cash margin to apply the severance tax.

Mr. Heinrich furthered that many of the expenditures did benefit from the 20 percent capital credit, which was put in place to off-set the high progressivity on the calculation of tax.

Co-Chair Stedman stated that one way of looking at it was as an accounting entry, but that he was concerned that capital credit could swing against the treasury. The State could be in a position where they were covering all the capital expenses. He observed that consultants had informed them that the state would be left in an exposed position.

[10:16:11 AM](#)

Mr. Jepsen replied that ConocoPhillips allocated the actual dollar for the project. He stressed that the graph represented an accurate depiction of investment. Co-Chair Stedman stressed that he was very curious about the net income of the producers after tax credits had been applied.

Senator McGuire queried how ConocoPhillips felt about credits and how the credits influenced their investments. Mr. Heinrich replied that every producer would have a different perspective. The biggest priority for ConocoPhillips was the change in progressivity, because of the impact it had on long-term cash flow, cash generation, and net income per barrel. He stated that after the first few years of tax credit benefit, there would be a burden with an impaired asset from a profitability or cash generation standpoint.

Mr. Jepsen furthered that there were many ways to determine how Alaska could promote investment, but ConocoPhillips looked at every possible mechanism to become a more profitable company.

Co-Chair Stedman felt that a good discussion would be about pre- and post-tax consequences. He stressed that the net cash flow was a concern for both ConocoPhillips and the State.

[10:21:14 AM](#)

Mr. Jepsen looked at slide 7, "Will Alaska Benefit from Reduced Oil Taxes?" He pointed out the letter on the right side of the slide from ConocoPhillips.

Last spring, ConocoPhillips made the following commitments to Alaska if the business environment is improved:

-We will pursue increased drilling activity on the North Slope.

-We will aggressively pursue more satellite developments at Alpine and Kuparuk.

-We will work with partners to develop major projects at Prudhoe Bay.

-We will proactively pursue other projects that can move the needle on oil production.

Co-Chair Stedman queried the date of the published letter. Mr. Jepsen replied that the letter was dated the year prior. Co-Chair Stedman stressed that the discussion had moved further from what was addressed in the letter.

Co-Chair Stedman wondered if there was a potential for disagreement between Exxon, ConocoPhillips, and BP. Mr. Jepsen replied that BP and ConocoPhillips had to agree on major capital expenditures in Kuparuk. He furthered that all three parties had to agree on capital expenditures in Prudhoe Bay, and encouraged the committee to query each company's level of commitment.

Senator Thomas looked at slide 5, and queried what specifically was duplicative and what would be considered "trade secrets."

Co-Chair Stedman interrupted that there would be a presentation from DOR, so there would be further information later regarding the oil information system. He felt that a response from industry should wait until after DOR's presentation.

Senator Thomas looked at slide 6, and wondered if the Mr. Heinrich agreed with Co-Chair Stedman regarding the impact of credits. Mr. Jepsen stated he agreed with Co-Chair Stedman's point of view regarding credits.

Senator Thomas wondered if the new projects referred to on slide 7 needed long development periods. Mr. Jepsen replied that some projects had been put aside, but there was a pursuit of new projects if there was significant change to ACES.

[10:26:57 AM](#)

Senator McGuire requested an example another democratic jurisdictions that ConocoPhillips struggled with tax rates. Mr. Jepsen stated that Alberta, Canada had seen significant reduction in production and they adjusted their tax structure and saw more development.

Mr. Jepsen explained slide 8, "Framework for Modifications."

1. CSSB192 as currently proposed does not improve the investment climate.
2. Focus the legislation on elements that will make the Alaska North Slope an attractive place for investment.
 - Significantly reduce rate of progressivity or incorporate bracketing.
 - If decoupling is included, make implementation contingent upon major gas sales.
 - Meaningful change must include the legacy fields -this is where the largest potential production gains reside.
3. Changes on same order of magnitude as HB110 will lead to more investment and production.

Co-Chair Hoffman looked at slide 3, and noted that flattened out the progressivity to between 130 and 150 per barrel. He wondered if that would be significant impact.

[10:32:02 AM](#)

Mr. Heinrich felt that it was at too high of a price-point and the problem with progressivity was at the lower end of the price range.

Co-Chair Hoffman remarked that there had been continual focus on the progressivity change at the high end of the price range, and the focus should continue to be on the high end. He remarked that the issue with ACES fell at the low end.

Co-Chair Hoffman felt that there would be a reduction in the State's coffers of \$4 billion if the price of oil was at \$150/bbl. He wondered if the \$4 billion would be significant. Mr. Jepsen replied that the State's revenue would continue to rise at \$4 billion. He stressed that the current structure did not make Alaska competitive even at lower prices per barrel. He agreed that a cap to severance was a helpful component, but there needed to be an examination of the rate of progressivity. He noted that even at \$110/bbl there was an 80 percent marginal tax rate.

Co-Chair Stedman felt that the focus should be equal between the effective and marginal tax rates. Mr. Heinrich agreed.

[10:36:41 AM](#)

Co-Chair Stedman wondered if \$4 billion was significant number. Mr. Jepsen replied that \$4 billion was a large number, but could not reply accurately, because he felt that his calculations would not produce a similar number.

Co-Chair Stedman stated that the numbers could be determined by PFC. He furthered that he had requested more analysis from DOR, from concept purposes. Once the mechanics were determined, there could be a policy discussion. Mr. Jepsen replied that a cap was an important component, but there was an issue when oil was below \$130/bbl.

Senator Thomas referred to slide 8, and felt that the gas tax should be in place from the point of view of the State. Mr. Heinrich stated that decoupling would be contingent on major gas sales and development.

Senator Olson commented that rural Alaskans were "hyper-sensitive" to the high price of oil because of the limited amount of deliveries they receive each year. When there were high oil prices, the affordability and out-migration was a major issue. He felt that the perspective of rural Alaskans was an important issue in the discussion.

[10:43:45 AM](#)

AT EASE

[10:48:57 AM](#)

RECONVENED

DAMIAN BILBAO, HEAD OF FINANCES, DEVELOPMENTS AND RESOURCES, BRITISH PETROLEUM, ALASKA, discussed the PowerPoint Presentation, "BP Testimony to Senate Finance."

Mr. Bilbao looked at slide 2, "Alaska's Future." He stressed that ACES was not working, more investment was needed to increase production, and policy must focus on long-term solutions.

Co-Chair Stedman stressed that ACES had worked as a harvesting tax structure, but did not promote incremental production. Mr. Bilbao clarified that ACES did not provide incentive for increased production, and felt that the record reinforced that perspective.

Mr. Bilbao looked at slide 3, "Declining Production is a crisis for the State." He stated that Alaska general fund revenue was projected to decline through 2017.

Co-Chair Hoffman wondered if the general fund expenditures included operating and capital expenditures. Mr. Bilbao agreed to provide information.

Mr. Bilbao stressed that there was a crisis for the State, and added that the policy in place did not support Alaska's infrastructure.

Co-Chair Stedman stressed that the legislature would not accept a substantial deficit, and pointed out that there was

continual close examination of the numbers. He noted that there was no blind acceptance. He stressed that there was not going to be an acceptance of the operating side of stemming the decline of production. Mr. Bilbao understood that the committee was looking forward, explained that increased investment and production would occur after meaningful tax reform.

Mr. Bilbao looked at slide 4, "State's Experts - ACES is not working." He felt that there were serious concerns with ACES regarding incentivizing investment and production. He stressed that there were multiple data points that require a need for tax reform. Fundamentally, there was a serious concern for the long term issue, and needed to be addressed currently. He stressed that ACES was a "failed fiscal policy."

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

ADJOURNMENT
[10:59:48 AM](#)

The meeting was adjourned at 10:59 AM.