

SENATE FINANCE COMMITTEE

April 3, 2012

9:05 a.m.

9:05:45 AM

CALL TO ORDER

Co-Chair Hoffman called the Senate Finance Committee meeting to order at 9:05 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

Tim Lamkin, Staff, Senator Gary Stevens; Senator Linda Menard; Christine Marasigan, Staff, Senator Kevin Meyer; Katya Wassillie, Intern, Senator Betty Davis; Representative Max Gruenberg; Phillip Mitchell, Section Chief, Bureau of Vital Statistics, Department of Health and Social Services; Marie Darlin, Alaska Association of Retired Persons; Representative Mike Hawker; Tony Reinsch, Senior Director, Upstream & Gas, PFC Energy; Janak Mayer, Manager, Upstream & Gas, PFC Energy; Darwin Peterson, Staff, Senator Bert Stedman; Senator Joe Paskvan.

PRESENT VIA TELECONFERENCE

Stephen Haycox, University of Alaska, Anchorage; Claus Naske, Self, Texas; Terrence Cole, History Professor, Fairbanks; Mary Ehrlander, University of Alaska, Fairbanks; Byron Charles, Self, Ketchikan.

SUMMARY

SCR 24 COMMISSION ON 100TH ANNIV. OF LEGISLATURE

SCR 24 was HEARD and HELD in committee for further consideration.

CSSB 151(JUD)

FETAL ALCOHOL SPEC. DISORDER AS MITIGATOR

CSSB 151(JUD) was REPORTED out of committee with a "do pass" recommendation and with a new indeterminate fiscal note from the Department of Law and previously published zero fiscal notes: FN2 (CRT), FN3 (DOA), FN4 (DOC).

CSSB 159(RES)

SUSITNA STATE FOREST

CSSB 159(RES) was REPORTED out of committee with a "do pass" recommendation and with a previously published indeterminate fiscal note: FN1 (DNR).

SB 179 MISSING VULNERABLE ADULT RESPONSE PLAN

SB 179 was REPORTED out of committee with a "do pass" recommendation and with previously published zero fiscal notes: FN1 (DPS), FN2 (DMVA).

SB 192 OIL AND GAS PRODUCTION TAX

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

SB 210 CRIMES AGAINST CHILDREN

CSSB 210(FIN) was REPORTED out of committee with a "do pass" recommendation and with a new indeterminate fiscal note from the Department of Corrections; previously published indeterminate fiscal notes: FN1 (DOA), FN2 (DOL), FN4 (DOA), FN5 (CRT); and previously published zero fiscal notes: FN3(DPS), FN6 (DOA).

SB 226 PURCHASE & LEASE OF NOME OFFICE BUILDING

CSSB 226(FIN) was REPORTED out of committee with a "do pass" recommendation and with new fiscal impact notes from the Department of Administration and the Department of Revenue.

CSHB 129(FIN)

DECEASED VETERAN DEATH CERTIFICATE

CSHB 129(FIN) was HEARD and HELD in committee for further consideration.

CSHB 245(FIN)

GAMING:SNOW CLASSIC/BROADCASTING/INTERNET

CSHB 245(FIN) was REPORTED out of committee with a "do pass" recommendation and with a new zero fiscal note from the Department of Revenue.

[9:06:15 AM](#)

Co-Chair Hoffman discussed the meeting's agenda.

#scr24

SENATE CONCURRENT RESOLUTION NO. 24

Establishing the Alaska Legislative Celebration Commission to organize events to commemorate the 100th anniversary of the first convening of the legislative branch of government in Alaska.

[9:07:39 AM](#)

TIM LAMKIN, STAFF, SENATOR GARY STEVENS, introduced SCR 24 and stated that it commemorated the 100th anniversary of the first convening of the territorial legislative branch of government in Alaska. He furthered that March 3, 2013 marked the 100-year anniversary and that the intent of the legislation was to recognize and potentially follow up the anniversary with other events throughout the year. He remarked that in the first session of the legislature there were 13 committees in the Senate alone; the equivalents of the Senate Finance Committee were the Finance Contingent Expenses and Printing Committee and the Revenue and Taxation Committee. He noted that the first legislature passed 84 bills during the 60-day session; the bills involved issues such as the women's right to vote, the registration of lobbyists, regulations on physicians and

dentists, the eight-hour work shift, the compulsory school age, and punishment for pimps.

[9:09:39 AM](#)

STEPHEN HAYCOX, UNIVERSITY OF ALASKA, ANCHORAGE (via teleconference), testified in support of SCR 24. He related the importance of establishing a commission and recognizing the anniversary. He observed that the first convening of the legislature gave Alaskans their first opportunity to express the collective will of the constituency. He offered that on March 3, the legislature could devote a half day session to recognizing the anniversary or something similar in order to direct the public's attention towards its significance. He observed that there were limitations on the first convening legislature and that Congress had not been ready to turn over some critical issues to the territory of Alaska.

[9:11:51 AM](#)

CLAUS NASKE, SELF, TEXAS (via teleconference), expressed support of SCR 24 and believed that it was appropriate to establish a commission to celebrate the 100-year anniversary of the first convening legislature. He observed that it was important to note that the federal government had still retained a significant amount of control over Alaska's resources. He furthered that there had been a clause inserted into the Second Organic Act that expressly forbade the Alaska Legislature to alter, amend, modify, or repeal fish and game related measures; it also forbade interference with the primary soil disposal. He added that Congress had retained the exclusive rights to legislate on matters such as gambling, the sale of liquor, the incorporation of towns, and taxation. He noted that it had been a sore point for many years that the federal government had maintained the exclusive rights and that it had not been until Alaska achieved statehood that the legislature was able to fully represent Alaska's population. He concluded that the legislation did not need to be costly, but that it was worthy and appropriate that the commission be established.

Co-Chair Hoffman noted that Senator McGuire had joined the committee shortly after the meeting had started.

[9:14:36 AM](#)

TERRENCE COLE, HISTORY PROFESSOR, FAIRBANKS (via teleconference), expressed his support of SCR 24 and shared that the anniversary was a momentous occasion. He related that the Second Organic Act, which had passed Congress, was the bill that created the Alaska Legislature; the act was the fundamental congressional law that had set Alaska on the road to eventual statehood. He furthered that the act had been passed despite strong objections by President Taft. He explained that the president did not want Alaska to have a legislature, but had instead wanted the state to be governed by a non-elected commission. He observed that at the time, the most important restriction on Alaska had been the lack of control over natural resources and that the first convening legislature had been referred to as the most feeble legislature in the history of democracy. He noted that the reason there were no counties in Alaska today was because they were expressly forbidden by the Second Organic Act. He observed that the act had been passed despite the president's objections largely because of the delegate Judge James Wickersham's efforts. He reiterated the importance of establishing the commission and stated that it involved modest costs.

[9:17:51 AM](#)

MARY EHRLANDER, UNIVERSITY OF ALASKA, FAIRBANKS (via teleconference), testified in support of SCR 24 and stated that the legislation was appropriate. She reiterated the support of prior testifiers and opined that the struggle to achieve representative government in Alaska should not be taken for granted. She furthered that it was worthy to note the difference it made to have an elected, rather than an appointed governing body. She shared that women's suffrage was the first act passed by the Alaska legislature and related that the first legislature illustrated the importance of federalism, state and local control, regional differences within the country, and the importance of keeping governance close to the people. She firmly supported the establishment of the commission and urged the committee's support.

[9:19:54 AM](#)

BYRON CHARLES, SELF, KETCHIKAN (via teleconference), spoke to SCR 24 and related that the federal law had applied before Alaska's statehood. He inquired whether legislators

believed that the original intent was provided for the people of the state prior to statehood and if "they" had a knowledge and understanding of the workings of an equally shared processing system on a government to government level.

[9:21:18 AM](#)

Co-Chair Hoffman discussed the fiscal note in the packet.

SCR 24 was HEARD and HELD in committee for further consideration.

[9:21:37 AM](#)

AT EASE

[9:23:04 AM](#)

RECONVENED

#sb159

CS FOR SENATE BILL NO. 159(RES)

"An Act establishing the Susitna State Forest; urging the Governor to acquire forest land that is currently in the Tongass National Forest; and providing for an effective date."

[9:23:27 AM](#)

SENATOR LINDA MENARD, explained that the bill established the Susitna Forest as a state forest. She detailed that the Susitna Forest would be the fourth state forest in Alaska and that years of work had gone into its creation. She furthered that the forest was 763,200 acres in the Mat-Su borough and that it would greatly benefit the area.

Co-Chair Stedman discussed the fiscal note in the packet.

Co-Chair Hoffman MOVED to report CSSB 159(RES) out of committee with individual recommendations and the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

CSSB 159(RES) was REPORTED out of committee with a "do pass" recommendation and with a previously published indeterminate fiscal note: FN1 (DNR).

#sb151

CS FOR SENATE BILL NO. 151(JUD)

"An Act relating to mitigation at sentencing in a criminal case for a defendant found by the court to have been affected by a fetal alcohol spectrum disorder."

[9:25:20 AM](#)

CHRISTINE MARASIGAN, STAFF, SENATOR KEVIN MEYER, related that Senator Meyer was attending a State Affairs Committee meeting and that he sent his regrets for being absent. She explained that SB 151 provided Fetal Alcohol Spectrum Disorder as a mitigating factor during sentencing and that it allowed judges to have more flexibility when dealing with offenders who had a brain dysfunction.

Co-Chair Stedman discussed the fiscal notes in the packet.

Co-Chair Hoffman MOVED to report CSSB 151(JUD) out of committee with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

CSSB 151(JUD) was REPORTED out of committee with a "do pass" recommendation and with a new indeterminate fiscal note from the Department of Law and previously published zero fiscal notes: FN2 (CRT), FN3 (DOA), FN4 (DOC).

#sb226

SENATE BILL NO. 226

"An Act relating to the purchase by the Alaska Housing Finance Corporation of an office building in Nome; approving the issuance of bonds for the purchase of the office building; providing notice of, and authorizing the commissioner of administration to enter into, a lease-purchase agreement with the Alaska Housing Finance Corporation for the office building; and providing for an effective date."

[9:26:59 AM](#)

Senator Olson explained that SB 226 was introduced to address the need for a new state office building in Nome and shared that the current building had major structural

problems. He stated that the project had lost momentum in recent years and that the Alaska Housing Finance Corporation had been used as an alternative funding source. He commented that the legislation would replace the current building that contained asbestos.

Co-Chair Stedman discussed the fiscal notes in the packet.

Co-Chair Hoffman MOVED to report CSSB 226(FIN) out of committee with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

CSSB 226(FIN) was REPORTED out of committee with a "do pass" recommendation and with new fiscal impact notes from the Department of Administration and the Department of Revenue.

#sb179

SENATE BILL NO. 179

"An Act relating to missing vulnerable adult prompt response and notification plans."

9:29:09 AM

KATYA WASSILLIE, INTERN, SENATOR BETTY DAVIS, explained that SB 179 would create an alert system for missing vulnerable adults called the "silver alert" system that would be similar to the amber alert system. She furthered that the Department of Military and Veterans Affairs and Department of Public Safety would work together to raise a response to missing adults by utilizing radio and television stations throughout the state.

Co-Chair Stedman discussed the fiscal notes in the packet.

Co-Chair Hoffman MOVED to report SB 179 out of committee with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

SB 179 was REPORTED out of committee with a "do pass" recommendation and with previously published zero fiscal notes: FN1 (DPS), FN2 (DMVA).

#sb210

SENATE BILL NO. 210

"An Act relating to crimes against children; establishing a new aggravating factor at sentencing in certain crimes against children; relating to criminal nonsupport; adding to the list of crimes against children that bar the Department of Public Safety from issuing to a person a license to drive a school bus; adding an exception to a provision that requires the Department of Health and Social Services to make timely, reasonable efforts to provide family support services to prevent out-of-home placement of a child; and providing for an effective date."

[9:30:31 AM](#)

Co-Chair Hoffman MOVED to ADOPT the proposed committee substitute for SB 210, Work Draft 27-LS1362\T (Wayne, 4/2/12).

Co-Chair Stedman OBJECTED for the purpose of discussion.

Senator McGuire explained the changes in the legislation and stated that Page 3, lines 16 and 18 were altered to clarify that subsections A and B would apply to a person of any age.

Co-Chair Stedman REMOVED his OBJECTION. There being NO FURTHER OBJECTION, Work Draft 27-LS1362\T was ADOPTED.

[9:31:50 AM](#)

Co-Chair Stedman discussed the fiscal notes in the packets.

Co-Chair Hoffman MOVED to report CSSB 210(FIN) out of committee with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

CSSB 210(FIN) was REPORTED out of committee with a "do pass" recommendation and with a new indeterminate fiscal note from the Department of Corrections; previously published indeterminate fiscal notes: FN1 (DOA), FN2 (DOL), FN4 (DOA), FN5 (CRT); and previously published zero fiscal notes: FN3(DPS), FN6 (DOA).

#hb129

CS FOR HOUSE BILL NO. 129(FIN)

"An Act relating to providing a death certificate for a deceased veteran without charge."

9:33:10 AM

REPRESENTATIVE MAX GRUENBERG, introduced HB 129 and stated that the bill provided four certified copies of a deceased veteran's death certificate without cost to the requestor. He explained that the legislation would enable the estate of a deceased veteran to obtain benefits; the term benefit was not limited to governmental benefits, but could involve benefits such as life insurance. He noted that the bill was modeled on an Arizona law and that it would help Alaska's veterans. On page 3 of the bill, a veteran was defined as an individual who was on active duty at the time of his or her death, or someone who had received an honorable or general discharge from a branch of the armed services; the individual must have also been an Alaska resident at the time of their death. He added that service branches such as the National Guard, the Alaska Scouts, the Alaska Territorial Guard, and the Alaska Naval Militia were included in the legislation.

Co-Chair Stedman discussed the fiscal note in the packet.

9:35:19 AM

PHILLIP MITCHELL, SECTION CHIEF, BUREAU OF VITAL STATISTICS, DEPARTMENT OF HEALTH AND SOCIAL SERVICES, relayed that his intent was to explain the fiscal note attached to HB 129 and that administration had no position on the bill. He related that on average, five copies of certificates were requested for each death; approximately 30 percent of the death certificates per year were for veterans. Assuming that three to four copies would be issued per person and free of charge, the expected impact was 3,000 to 4,000 copies per year. The department currently charged \$25 for the first certificate and \$20 for each additional copy. The department estimated that the bill would reduce the fees collected by the bureau by up to \$75,000 the first year and to \$100,000 by year five. He stated that 3 percent of the bureau's budget was based on general funds and that the remainder of the budget was fee-based and was built in. The fiscal note was submitted for the purpose of covering the cost of the decreased program receipts. He related that the fiscal note was a fund change

and that it did have a zero net cost. He furthered that in order to maintain current service and staffing levels, the lost receipts would need to be replaced with general funds.

[9:37:14 AM](#)

MARIE DARLIN, ALASKA ASSOCIATION OF RETIRED PERSONS, testified in support of the legislation. She related that Alaska had the highest per capita number of veterans in the United States and that the bill was another way to recognize a veteran's service.

[9:38:37 AM](#)

Senator Olson queried whether the legislation included the Alaska Naval Militia as recipients of the benefits. Representative Gruenberg responded that the group was well established in statute. He furthered that the militia was mainly active during Alaska's territorial days and that they were mostly very elderly individuals.

Senator Olson referenced a rogue militia situation in Fairbanks and expressed concerns regarding how a militia was defined under the legislation.

Representative Gruenberg responded that the Alaska Scouts, the Alaska Territorial Guard, and the Alaska Naval Militia were specifically set forth in statute and that they were nothing like the "patriot militia." He concluded that the groups that were included in the bill were all statutorily recognized and that the legislation was crafted to include all legitimate veterans.

CSHB 129(FIN) was HEARD and HELD in committee for further consideration.

#hb245

CS FOR HOUSE BILL NO. 245(FIN)

"An Act establishing a snow classic as an authorized form of charitable gaming; and relating to the use of broadcasting and the Internet to promote a raffle and lottery."

[9:41:02 AM](#)

REPRESENTATIVE MIKE HAWKER, introduced HB 245 and stated that it was the companion bill to legislation that had been previously heard in the committee. He communicated that the bill added another segment to the charitable gaming statutes. The legislation would enable the Four Valleys Community Schools Inc. to conduct a "Snow Classic," in which a contestant would guess or predict the date and time when the snow would reach a certain level on Mt. Alyeska. He explained that Four Valleys Community School was huge non-profit organization that was very active in the community of Girdwood and that legislation added a means for the organization to continue to fund itself. He explained that a House Finance Committee amendment had been made to Sections 4, 5 and 7 that clarified the state's existing gaming statutes and specified that the use of the internet to promote a raffle was not considered broadcasting. He observed that there was some convolution in the existing statutes regarding the definition of broadcasting. He added that use the of the internet was not viewed as broadcasting and that it was only allowed for informational materials to be presented; the internet did not allow, in any form, the ability of a person to acquire a raffle ticket or participate in a gaming event.

[9:43:32 AM](#)

Co-Chair Stedman discussed the fiscal note in the packet.

Representative Hawker remarked that although people were prepared to testify on the bill, they had elected not to out of respect for the committee's time.

Co-Chair Hoffman MOVED to report CSHB 245(FIN) out of committee with individual recommendations and the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

CSHB 245(FIN) was REPORTED out of committee with a "do pass" recommendation and with a new zero fiscal note from the Department of Revenue.

[9:44:32 AM](#)

AT EASE

[9:52:59 AM](#)

RECONVENED

#sb192

SENATE BILL NO. 192

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

Co-Chair Stedman stated that there would be a short presentation by PFC Energy and that the committee would adopt a committee substitute (CS) for SB 192. He furthered that PFC Energy would be brought back for further discussion regarding a component that had not been included in the CS. He noted that the committee would also be discussing how it would balance the schedule between the Finance Committee, PFC Energy, and the industry so that there was ample time to analyze the information. He observed that there were differences in some of the modeling, cost assumptions, as well as other aspects.

Co-Chair Stedman asked for a brief description of PFC Energy. He pointed out that PFC Energy was hired by the Legislative Budget and Audit Committee, a joint House and Senate committee that handled consultants.

9:54:56 AM

TONY REINSCH, SENIOR DIRECTOR, UPSTREAM & GAS, PFC ENERGY, explained that PFC Energy was an above ground risk and analytical consultant to the oil and gas sector. He detailed that PFC Energy advised international oil companies, governments, regulators, and national oil companies on issues of policy finance economics.

9:55:23 AM

JANAK MAYER, MANAGER, UPSTREAM & GAS, PFC ENERGY, began a PowerPoint presentation titled "Discussion Slides: Alaska Senate Finance Committee" (copy on file) and explained slide 2 titled "Difficulties in Existing Fiscal Structure":

- The incorporation of progressivity into the Profit-Based Production Tax (Net) in ACES creates three significant problems
 - Large-scale gas production at low gas prices could in the future significantly reduce

production tax revenue from existing oil production

- Resolving this problem within the framework of ACES requires significant complexity
- Approach to decoupling in CSSB 192 requires ability to split costs between oil and gas production, creating high degree of administrative burden, and limiting capacity of state to effectively audit
- Combination of high credits with high tax rates can produce excessive levels of support for certain spending, and weak incentives for cost control
 - Effective After-Tax rate of Government support for exploration can be over 100% at high price levels
- Options for incentivizing new production are limited, and relatively complex
 - Proposed incentives within existing framework focus on either allowances to reduce Production Tax Value, or revenue exclusions (tax holiday)

[9:58:25 AM](#)

Mr. Mayer discussed slide 3 titled "Summary of Progressive Severance Tax (Gross) Structure":

- A Progressive Severance Tax (Gross) option would instead remove progressivity from the Profit-Based Production Tax (Net), instead levying this tax at the flat, base rate of 25%
- To retain an element of progressivity, a new Progressive Severance Tax (Gross) would then be added to the system. The tax would:
 - Be non-deductible for Profit-Based Production Tax purposes

- Be levied on gross production (net of royalties)
- Be levied solely on oil
- The tax would use a progressivity structure not dissimilar to that under the current system, with progressivity coefficients that apply at different thresholds.
- The proposed Progressive Severance Tax would use the following parameters:
 - No severance tax below \$65 Gross Value at Point of Production (GVPP)
 - Progressivity of .25% commencing at a threshold of \$65 GVPP
 - At \$125 GVPP, a tax rate of 15% is reached. At this point, progressivity is reduced to 0.05%
 - Progressivity is capped at 20%

[10:00:00 AM](#)

Mr. Mayer spoke to slide 4 titled "Benefits of Progressive Severance Tax (Gross) Structure":

- By removing progressivity from the Profit-Based Production Tax (Net), and having the progressive element of the structure be a Progressive Severance Tax (Gross), two things become much easier to achieve
 - The issue of gas production reducing production tax revenue ceases to be a problem without progressivity in the Profit-Based Production Tax
 - Complex provisions to split costs between oil and gas production under CSSB 192 are thus no longer required
 - Much of the issue of excessive spending support ceases to be a problem

- Even with 40% exploration credit, effective after-tax Government support for exploration flat at 65%
- Significant incentives can be provided to new production, by eliminating or reducing the Progressive Severance Tax (Gross) for new production
- A wide range of levels of government take can be achieved using this structure, depending on the parameters applied

[10:02:19 AM](#)

Mr. Mayer turned to slide 5 titled "FY 2013 Revenue Comparison." He stated that the slide showed a revenue comparison of how the severance tax option compared to some of the other alternatives. He related that the red and yellow lines depicted ACES and CSSB 192 as being very similar in terms of revenue, but there was a very slight reduction from ACES in CSSB 192. He stated that the severance tax option was represented by the light blue line and that it diverged from ACES and CSSB 192 from around \$100 to \$110 per barrel; furthermore, from \$130 per barrel and upwards, the scenario flattened and evened out the split between the government and producers at around the 72 percent or 73 percent government take level. He pointed out that the slide compared the severance option to the placement of a 40 or 50 percent cap on progressivity under the current system. The 50 percent cap option was represented by the darker blue line and the 40 percent cap option was reflected by the green line. He observed that the chart was based on FY 13 Department of Revenue (DOR) numbers for production and costs; on that basis, the severance tax option's split of revenue from production tax and the split between cash to companies versus revenue to the state were in between the 40 and 50 percent cap options.

[10:04:14 AM](#)

Mr. Mayer looked at slide 6 titled "FY 2013 Revenue Comparison." He pointed out that in terms of total state and government take, the severance tax option was between the 40 and 50 percent cap options.

Mr. Mayer highlighted slide 7 titled "FY 2013 Revenue Comparison." He stated that the comparative revenue table showed that at around the \$100 per barrel price level, the total revenue under the severance tax option was projected be slightly above that of the Senate Resources Committee version of CSSB 192; at prices above \$100 per barrel (i.e. a \$150 to \$200 per barrel) there was a balancing of the government take "between the two." He referenced the government take figures on the lower right table and stated that the severance tax option's government take flattened out at about 73 percent from the \$150 per barrel range and above.

Co-Chair Stedman pointed out that there were a lot of numerics in the tables and that although it may take some time, it would be helpful if the committee had some comparison material. Mr. Mayer replied that the table in question was done consistent with DOR methodology and that it did not include tax credits that were claimed against current production. He noted that the state was expected to expend \$400 million in FY 13.

[10:05:59 AM](#)

Mr. Mayer looked at slide 8 titled "FY 2013 Revenue Comparison - Adjusted for Credits Not Claimed Against Current Production." He stated the slide's table examined the production tax in terms of total state take in order to include the \$400 million tax credit expenditure.

Senator McGuire noted that when the decoupling issue was discussed, the state projected about \$80 million in losses per year. She inquired if the projected losses were reflected in the cost chart as a savings that would be returned to the state. Mr. Mayer replied that the projected losses were not included in the figures and that the chart was based solely on FY 13 revenue numbers. He stated that the projected losses would come to the state as savings in the event of significant gas production.

Senator McGuire commented that the point was important to note.

[10:07:12 AM](#)

Mr. Mayer discussed slide 9 titled "Impact of Rising Operating Costs." He shared that the slide showed an

important impact that came from shifting progressivity from the net to the gross; the impact was a question of what the shift looked like in different cost environments compared to the existing system. He noted that DOR projected that in FY 13, the cost per barrel of oil produced would be \$11.70. He observed that the chart compared the difference in revenue under ACES and the severance tax option; anything above the zero line represented an increase in revenue compared to ACES, while anything below the line was a decrease in revenue. The slide showed that at the \$70 per barrel price level and at \$12 per barrel operating costs, the revenue between ACES and the severance tax option were identical; the two options also generated the same revenue at the \$60 per barrel level and the same cost per barrel level. He stated that revenue increased below the \$60 per barrel level in all of the instances because of the impact of the higher floor that was in CSSB 192. He related that in the \$12 per barrel cost scenario, the severance tax option had reduced revenue at the \$100 per barrel tax level when compared to ACES; in comparison, it had relatively similar revenue compared to CSSB 192 at the \$100 to \$130 per barrel level, but had significant reductions in revenue past \$130 per barrel as the split between producers and the state was capped.

[10:09:05 AM](#)

Mr. Mayer stated that when looking at what would happen under significantly higher operating cost assumptions, it was important to understand that the progressive severance option saw an increased take at price levels in the \$70 to \$140 per barrel range. He explained that at \$12 per barrel operating costs and at a \$100 per barrel price, production tax rates under ACES were probably around 35 percent. He furthered that if the operating costs were at a higher rate of \$24 per barrel, the tax rate under ACES could drop to 28 percent; the drop in the rate was a result of a reduction in the production tax value (PTV) after the costs had been deducted. He related that in some of the higher cost per barrel cases, the progressivity that was put in place on the gross (through the progressive severance option) may be higher than the progressivity experienced under ACES when production costs were particularly high; this was a result of the progressive option being calibrated to the \$12 per barrel level.

Mr. Mayer reiterated that a \$12 per barrel operating cost was the current average on the North Slope. He noted that from a producer perspective, the progressivity at higher cost levels may be viewed as problem; however, on the other hand it was important to consider the current system's lack of cost control incentive. He furthered that particularly at high marginal tax rates and when there was the ability to deduct costs from progressivity, the effective support from the state for new capital and operating expenditures could be very high; in that sense, it was a significant incentive for controlling costs in the future. He concluded that part of the discussion going forward would be about the two sides of the progressive option's progressivity at higher operating costs.

[10:11:55 AM](#)

Mr. Mayer discussed slide 10 titled "Data on Operating Costs." He stated that the top right chart depicted the historical average costs for Prudhoe Bay, Kuparuk, and the North Slope; in recent years, operating costs in the areas were between \$10 and \$12 per barrel. He noted that in 2010, Prudhoe Bay had a slightly higher operating cost of \$12 per barrel compared to Kuparuk's cost of around \$10 per barrel and that the North Slope average was a bit over \$10 per barrel. He pointed out that based on FY 13 numbers, the North Slope average was projected to rise to \$11.70 per barrel. He directed the committee's attention to the chart on the upper left portion of the slide that showed a longer time period. He related that ConocoPhillips was unique because it reported Alaska separately as a region in its financial reporting. ConocoPhillip's 10-K reports [required annual report to the U.S. Securities and Exchange Commission] showed an operating cost of about \$12.50 per barrel in 2011 and costs below the \$10 per barrel mark for prior years. He spoke to the chart in the lower middle portion of the slide. He related that the DOR forecast for average operating costs on the North Slope predicted a cost around the \$12 per barrel mark until around 2017, at which point the costs were expected to continue to rise every year.

Mr. Mayer explained that the levels of averages on slide 10 could disguise some of the granularity that existed (e.g. BP's costs may reflect something different than what was shown for ConocoPhillips). He opined that although Prudhoe Bay and Kuparuk's costs were probably similar for both

companies, BP's other assets might have higher operating costs. He added that new producers could have higher cost assets that would involve higher operating costs (i.e. \$16 to \$18 per barrel). He pointed out that new production, which would have a higher cost structure, could have lower rates of progressivity applied to it. He offered that the committee may also want to have the lower rate of progressivity apply to higher cost projects that had been brought on line in the recent past.

[10:14:46 AM](#)

Mr. Mayer spoke to slide 11 titled "Impact of Inflation":

- Under ACES, thresholds and coefficients for progressivity are specified in nominal terms, without indexation
 - As a result, when economics over the long-term rather than just 2013 are examined, we see the effects of 'bracket creep' or 'stealth tax'
 - In real terms, as prices increase, thresholds for progressivity decrease, and the higher take that comes with progressivity occurs at lower and lower price levels
- Similarly, unless progressive severance thresholds are indexed to inflation, progressive severance will apply at steadily lower thresholds over time
 - Indexing thresholds will also go some way to addressing the cost sensitivity issue

Mr. Mayer noted that it was particularly important to put in place indexation for inflation in reference to the two prior slide's information regarding the impact of costs when progressivity was levied on the gross rather than the net. As long as the real costs did not also rise, the indexing would result in progressivity rising along with it if costs rose in nominal terms. He added that cost rising in real terms was another question related to the issue of incentives for cost control.

10:16:19 AM

Mr. Mayer discussed slide 12 titled "Incentives for New Production":

- Significant incentives can be provided to new production, by eliminating or reducing the Progressive Severance Tax (Gross) on any combination of:
 - Production from new areas
 - Production from new plans of development (determined through the regulatory process to be for "new production")
 - Production above a fixed decline rate
- One possibility for a reduced rate of Progressive Severance Tax is:
 - No severance tax below \$65 Gross Value at Point of Production (GVPP)
 - Progressivity of .05% commencing at a threshold of \$65 GVPP
 - Progressivity capped at 5%

Mr. Mayer stated that based on some of the numbers, the slide's example of a possible way to reduce progressivity would result in a significant improvement in the economics for some projects and would have levels of government take around the mid-60 percentage range instead of the mid-70 percentage range.

10:17:23 AM

Mr. Mayer highlighted another consideration related to incentivizing new production. He explained that production from new areas was straight forward; however, the impact of new areas would be minimal because in the near term most of the new production would come from existing areas. He stated it was important to think about how incentivizing production above a fixed decline rate would work.

Mr. Mayer spoke to slide 13 titled "Production Above a Decline-Fixed v Annual Calculation." He pointed out that the slide's two charts used DOR revenue production forecast data and that data was looked at in two different ways. He noted that the slide was an exercise and that it was important to pretend that the production was reflective of one producer rather than multiple producers. The charts depicted what the production from a single producer would look like if production above a decline rate was determined in two different ways. The left chart assumed there was a determined rolling average decline; the option would use the recent average decline to determine how much new production there was in the current year when compared to the prior year. He stated that based on the slide's production curve, the rolling average method resulted in very little production being classified as new production. He stated that there two reasons for the lack of new development classification under the rolling average option: (1) only the previous year was examined to determine a production level above the decline rate and (2) in any years in which incremental new production existed, the rolling average went from a decline to an incline and as a result, it became difficult to produce additional production above the high threshold.

[10:19:46 AM](#)

Mr. Mayer continued to speak to slide 13 and offered that the chart on the right depicted the scenario with a simpler and more "effective" method by selecting a specific point in time and projecting what production would look like going forward based on the decline rate; there would be a significant "wedge" of new production if anything above the decline rate would be incentivized with a lower taxation rate. If the goal was to incentivize production above the 6 percent decline, the strategy provided was useful and would allow companies to work towards a lower tax rate in a way that a year-by-year process would not allow.

[10:21:15 AM](#)

AT EASE

[10:24:33 AM](#)

RECONVENED

[10:25:01 AM](#)

Co-Chair Hoffman MOVED to ADOPT the proposed committee substitute for SB 192, Work Draft 27-LS1305\T (Bullock, 4/2/12).

Co-Chair Stedman OBJECTED for the purpose of discussion.

10:25:29 AM

DARWIN PETERSON, STAFF, SENATOR BERT STEDMAN, reviewed the changes in the new CS for SB 192. He relayed that all sections (Sections 1, 5, 7, 8, 10, 11, and 12) pertaining to oil and gas tax decoupling had been removed from the bill because the process of removing progressivity from a profits based production tax and applying it to the gross value was a de facto decoupling. The increased production allowance (Section 13) was removed, which had proposed a \$10 per barrel reduction in PTV for each barrel of oil delivered to the Trans-Alaska Pipeline System that was above the base volume as determined from the prior calendar year.

10:26:20 AM

Mr. Peterson walked through the bill sections. Section 1 amended the production tax so that progressivity on oil was calculated on the gross value at the point of production. The section maintained the 25 percent base tax on the PTV of oil and gas that was currently included in the ACES statute. He relayed that Section 2 was identical to Section 6 from the previous bill version. The section repealed AS 43.55.011(f) and set a new minimum tax of 10 percent of the gross value at the point of production for areas with historical production of 1 billion barrels of oil to date; the provision would apply only to the Kuparuk and Prudhoe legacy fields.

Mr. Peterson explained that Section 3 repealed the existing progressivity based on the PTV (AS 43.55.011(g)) and replaced it with a new progressive severance tax on the gross value. He elaborated that on a monthly basis progressivity on oil produced in a legacy field would be calculated as follows: no severance tax below \$65 gross value at the point of production, progressivity of 0.25 percent commencing at \$65 gross value at the point of production at \$125 gross value a tax rate of 15 percent was reached progressivity would be reduced to 0.05 percent, and

progressivity would be capped at 20 percent. He furthered that the concept had been introduced by PFC Energy on March 30, 2012 and had been referred to as "Severance Tax Option Number 1."

[10:27:51 AM](#)

Mr. Peterson turned to Section 3, page 3 that would establish a reduced rate for the progressive severance tax on oil produced outside of the legacy fields. The rate would be calculated as follows: no severance tax below \$65 gross value at the point of production, progressivity of 0.05 percent would commence at a \$65 gross value, progressivity would be capped at 5 percent, and the lower tax on fields outside Prudhoe and Kuparuk was only applicable for the first seven years of production (page 3, line 2).

Mr. Peterson relayed that Section 4 was a conforming amendment to statute that dealt with the payment of taxes by a producer; the section included the new progressive severance tax and the 10 percent minimum tax. Section 5 (page 6) was a conforming amendment that instructed DOR to adopt regulations to calculate the new progressive severance tax based on the gross value at the point of production.

[10:29:06 AM](#)

Mr. Peterson shared that Section 6 was identical to Section 12 from the previous bill version. The section amended AS 43.55.160 by adding three subsections to describe the allocation of lease expenditures to oil or gas production or exploration in different areas of the state. Section 7 was same as Section 14 of the previous bill version and would amend AS 43.55.165(h), which dealt with lease expenditures. The Section required DOR to allocate lease expenditures between oil and gas production based on the gross value at the point of production.

Mr. Peterson explained that Section 8 (page 8) was the same as Section 15 of the previous bill version; it added a new subsection to AS 43.55.170, which was the section of statute that dealt with adjustments to lease expenditures. The section would require DOR to adopt regulations that provided for reasonable methods of allocating adjustments

to lease expenditures, payments, and credits between different categories of oil and gas production.

10:30:06 AM

Mr. Peterson communicated that Section 9 included the Petroleum Information Management System. The only change was the placement of the system under the purview of DOR instead of AOGCC. Section 10 repealed AS 43.55.160(a)(2) that dealt with the monthly progressivity calculation based on the production tax value. He expounded that under the new CS the section was irrelevant given that progressivity would be taxed on the gross value at the point of production.

Mr. Peterson discussed that Section 11 was uncodified law that required DOR to develop a work plan for the Petroleum Information Management System; the section required that the system be operational before January 1, 2014. He concluded with Section 12 that established an effective date of January 1, 2013.

Co-Chair Stedman REMOVED his OBJECTION. There being NO FURTHER OBJECTION, Work Draft 27-LS1305\T was ADOPTED.

10:31:36 AM

Co-Chair Stedman noted that the incremental production from Prudhoe Bay and Kuparuk was not included in the CS; his office was working with PFC Energy and would meet with them to work out details related to the item. He had concern about using the 2013 decline curve versus the curve from 2011 or 2012; he believed the committee needed to take a look at the item. He shared that his intent was to "get a CS on the table" in order for the industry offer a more fine-tuned opinion on the bill.

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

Co-Chair Stedman discussed the following meeting's agenda.

#

ADJOURNMENT

10:35:10 AM

The meeting was adjourned at 10:35 AM.