

SENATE FINANCE COMMITTEE
April 4, 2012
2:05 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 2:05 p.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

Janak Mayer, Manager, Upstream and Gas, PFC Energy;
Catherine Reardon, Staff, Senator Joe Thomas.

SUMMARY

SB 192 OIL AND GAS PRODUCTION TAX RATES

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

SB 203 ENERGY ASSISTANCE PROGRAM & VOUCHERS

CSSB 203(FIN) was REPORTED out of Committee with two new fiscal impact notes from the Department of Revenue and one new fiscal impact note from the Department of Administration.

#sb203

SENATE BILL NO. 203

"An Act establishing an energy assistance program in the Department of Revenue to issue an energy voucher to Alaska permanent fund dividend recipients; and relating to the analysis and recommendation of an energy assistance program by the governor."

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Co-Chair Hoffman MOVED to ADOPT proposed committee substitute for SB 203, Work Draft 27-LS1363\E, (Nauman, 4/3/12). Co-Chair Stedman OBJECTED for purpose of discussion.

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Senator Thomas explained that SB 203 would provide Alaskans with relief from the effects of high 2011 energy costs through distribution of energy vouchers in the fall. The voucher program would recognize and address the disparate cost of energy depending on the type of fuel and the community in which it was used. The bill would direct the governor to evaluate options and make a recommendation for the best energy relief program to be instituted in FY 14.

Senator Thomas noted that the current work draft, version E, incorporated suggestions made by the Department of Law and the Alaska Housing Finance Corporation (AHFC) for the purpose of addressing legal issues.

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CATHERINE REARDON, STAFF, SENATOR JOE THOMAS, explained the changes to the legislation. With one exception, the changes included in the CS had been suggested by the Department of Law or AHFC in order to address legal concerns. The three substantive changes were:

1. Allow people who did not apply for the 2012 Permanent Fund Dividend (PFD), but would have qualified for that PFD, to apply separately for the energy voucher. Many veterans do not apply for the PFD to avoid reductions in their veterans' benefits. This amendment would allow them as well as others to receive the voucher. A voucher denial appeal process was also provided;

2. Expand the hold-harmless section to cover reductions in federal supplemental security income (SSI) benefits and food assistance through WIC (Women, Infants and Children) and the federal Commodity Supplemental Food program. The change would result in a fiscal note from the Department of Health and Social Services; and
3. Add 31 million British thermal units of hot water or steam district heat to the voucher. District heat is piped to houses in downtown Fairbanks in a manner similar to natural gas distribution in Anchorage. Thirty-one mmbtu represented approximately 2 months of district heat used by the average residential consumer, which was the focus of the voucher.

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Ms. Reardon observed that there were four minor technical changes:

1. Changing "state" to "corporation" on page 2, lines 23 & 29 to clarify that AHFC is responsible for issuing voucher payments to distributors and for receiving any unused voucher credit when utility accounts are closed;
2. Specifically authorizing the Department of Revenue to share the physical addresses, as well as the mailing addresses, of PFD applicants with AHFC for the purpose of administering the energy voucher program, on page 7, lines 22-23;
3. Inserting "physical" in the eight locations where the bill refers to the voucher recipient's "primary residence in the state." The purpose of this change is to clarify that the energy provided by the voucher must be used in the place the recipient physically occupies; and
4. Replacing "incompetent" with "incapacitated" in subsections (j) and (k), which relate to legal guardians signing vouchers for people who cannot act on their own behalf.

Ms. Reardon concluded that "incapacitated" would be the more appropriate term. A definition of incapacitated had been incorporated into the bill.

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Co-Chair Stedman WITHDREW his OBJECTION. There being NO further OBJECTION, Work Draft 27-LS1363\E was ADOPTED.

Senator Thomas explained that the bill would allow the opportunity for an energy voucher that could be turned into a verified registered dealer that dealt in natural gas or fuel oil on a regular basis. The Alaska Permanent Fund Corporation (APFC) would provide data to AHFC to keep track of vouchers, which would be sent to the head of every household throughout the state. The voucher would provide compensation for heating costs that individuals could submit to their supplier. Most of the natural gas supplied in Anchorage was through Enstar. The Alaska Housing Finance Corporation would administer the multiple distributors that supplied fuel oil throughout other areas of the state. Distributors would be able to create accounts, which would simplify the process. The maximum amount would be 250 gallons of fuel oil. Those that did not use fuel oil could seek a \$250 payment in lieu of fuel.

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Co-Chair Stedman reviewed the three new fiscal impact notes attached to the bill: Department of Revenue for \$15 million in CIP receipts for FY 13 and 10 full-time positions to administer the program (The fiscal note assumed a \$465 million appropriation in the FY 13 capital budget to pay for vouchers); Department of Revenue for \$219,000 from the Alaska Permanent Fund Dividend Division and two new temporary positions for increases in appeals and auditing expenses; and Department of Administration for \$113,600 in interagency receipts for the anticipated increase in administrative hearings.

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Co-Chair Hoffman MOVED to report CSSB 203(FIN) out of Committee with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

CSSB 203(FIN) was REPORTED out of Committee with two new fiscal impact notes from the Department of Revenue and one new fiscal impact note from the Department of Administration.

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AT EASE

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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 noted that an expenditure had accidentally been included twice in the PFC Energy morning presentation, which, moved a \$150 million net in the numerics. The updated presentation adjusted the progressivity trigger and held revenue constant at \$100 per barrel in FY 13. The intent was to hold revenue neutral below \$100 per barrel (not including the \$40 floor). The progressivity trigger was lowered by \$5, the upper level was increased by \$5, and the slope was increased from 0.25 percent to 0.27 percent. He summarized that revenue was neutral at 0.275 percent, but the number had been rounded up to 0.27 percent.

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JANAK MAYER, MANAGER, UPSTREAM AND GAS, PFC ENERGY, CONTRACT, LEGISLATIVE BUDGET and AUDIT COMMITTEE, provided members with PowerPoint presentation titled "Discussion Slides: Alaska Senate Finance Committee" dated April 4, 2012 (the presentation was updated from the morning meeting version with the same name) (copy on file). He compared revenue from production tax and cash to companies under Alaska's Clear and Equitable Share (ACES), CSSB 192(FIN), and HB 110.

Mr. Mayer outlined the thresholds of the progressive severance tax on gross option as adjusted to match FY 13 numbers at the \$100 price per barrel. The proposed Progressive Severance Tax would use the following parameters:

- No severance tax below \$60 Gross Value at Point of Production (GVPP);
- Progressivity of .27 percent commencing at a threshold of \$60 GVPP;
- At \$120 GVPP, a tax rate of 16.2 percent is reached. At this point, progressivity is reduced to 0.03 percent; and
- Progressivity is capped at 20 percent.

Mr. Mayer referred to the graphs on slide 3, which compared revenue under ACES, CSSB 192(FIN), and HB 110. He concluded that revenue from the severance scenario would be close to that of the production tax at \$100 per barrel. The comparable revenue diverged at the \$120 per barrel market, which became more significant as price increased beyond that point.

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Mr. Mayer noted that slide 4 compared total state and total government take under ACES, CSSB 192(FIN), and HB 110. He observed that production tax at \$100 per barrel would be \$3.628 billion under ACES versus \$3.577 billion under CSSB 192(FIN). The total state take at \$100 per barrel would be \$7.629 billion under ACES compared to \$7.582 billion under CSSB 192(FIN).

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Co-Chair Hoffman referred to the cash that oil companies would receive when oil prices were high and concluded that one billion dollars would be "passed back" when prices were under \$70 per barrel (between ACES and CSSB 192(FIN)). Mr. Mayer responded in the affirmative.

Co-Chair Hoffman pointed out that revenue to oil companies would increase to \$1.7 billion at \$200 per barrel.

Co-Chair Stedman concluded that the change in cash to companies [ACES compared to CSSB 192(FIN)] would be: \$31 at \$100 per barrel; \$92 million at \$110 per barrel; and \$180 million at \$120 per barrel. He reviewed changes in government take at different prices [ACES compared to CSSB 192 (FIN)]. Government take [under CSSB 192 (FIN) compared

to ACES] would be: down \$5 million at \$90 per barrel; up \$12 million at \$80 per barrel; down \$7 million at \$70 per barrel; down \$92 million at \$110 per barrel; down \$180 million at \$120 per barrel; and down \$340 million at \$130 per barrel. He added that numbers would change as expenditures changed and time ensued. He concluded that expenditures [under ACES] would change as prices increased. He did not expect that [the spread of government take] would materialize at \$200 per barrel since expenditures underneath would advance. He stressed that the comparisons were as close as they could achieve.

Co-Chair Stedman noted that a comparison had been made to HB 110 for discussion purposes.

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Mr. Mayer noted that slide 6 showed the same numbers [as slide 5] adjusted down by \$400 million to account for credits not claimed against current production.

Mr. Mayer noted that slide 7 addressed issues with the tax floor for large fields. There were significant issues with specifying any tax floor regardless of the level set. The language in CSSB 192(FIN) addressed the tax floor for large fields: fields that had produced one billion barrels cumulatively and 100,000 barrels per day in the current year.

Mr. Mayer observed that the intent had been to simplify and get away from accounting for costs separately for different streams of production, which was done for oil and gas decoupling by taking progressivity out of the net profit tax and substituting gross profit tax. He speculated that costs would have to be calculated if a particular minimum floor was leveled only on particular assets and not on others. He suggested that [the tax floor] created an issue related to multiple streams of cost accounting for diverse assets for different producers.

Mr. Mayer observed that the 100 mb/d (million barrels per day) production threshold had the potential to create an undesirable incentive. He noted that Kuparuk was only four years away from meeting the threshold. He concluded that the floor was not a significant incentive given that it only applied at very low price levels that were not highly likely in the near future. He noted that making the

distinction at the company level instead of the asset level would be easier administratively. He concluded that small producers could be exempted if the desire was to ensure that they would not face the floor, instead of making the distinction on the asset basis.

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Mr. Mayer spoke to incentives for new production and the possibility of incentivizing new production associated with plans of development during the regulatory process. He felt there were difficulties with the approach of incentivizing new production above a fixed decline rate and that the same outcome could be achieved with greater simplicity. He spoke to a reduced rate of the progressive severance tax on gross for new production and modeled a progressivity of .05 percent commencing at a threshold of \$60 gross value at the point of production (GVPP) and capped at 5 percent.

Mr. Mayer observed that taxation on incremental production from existing fields above a fixed decline rate could not have a specific limit of time in the same way because it would be difficult to identify a particular stream of production begun at a specific time. He suggested one option would be an intermediate regime with no time limit for incremental production, for instance:

- Progressivity of .14 percent commencing at a threshold of \$60 GVPP
- At \$120 GVPP, a tax rate of 8.4 percent is reached. At this point, progressivity is reduced to 0.03 percent
- Progressivity is capped at 10 percent

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Mr. Mayer reviewed how the production decline curve was calculated on slide 9: Production Above a Decline - Fixed v. Annual Calculation. He discussed the difference between performing an annual calculation (based on the prior year and a target that was slightly less based on a rolling average decline) and setting a fixed point (based on 2011 production figures and applying a company-wide decline rate for any given producer). The fixed point would be determined by forecasting the curve forward; any production above the amount would be incentivized and would represent

a meaningful benefit that would not be shown if the calculation was redone on an annual basis. He continued to address the decline rate and referred to legislation that had been introduced by Senator Tom Wagoner related to decline rate calculation; the methodology could be applied in 2011 looking back to 2009 and rather than calculating the rate on each year's production it could be extended forward.

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Mr. Mayer concluded with slide 10: Total Government Take Comparison Including New Production Incentives." The government take comparison for FY 13 related to the overall rate for mature production included: ACES, CSSB 192(FIN), CSSB 192(FIN) (incremental production 10 percent maximum progressivity), CSSB 192(FIN) (new production 2 percent maximum progressivity, CSSB 192 (new production 5 percent maximum progressivity), CSSB 192 (new production, no progressivity), HB 110, and HB 110 (new production). The chart provided a look at government take for any given year.

Co-Chair Stedman communicated that development of the language related to incremental production was currently underway. He discussed work that was in progress related to the mechanics of the statutes.

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Senator Ellis asked several questions that had been provided by another Senate majority member. He pointed to the revenue comparisons on slide 4 of the morning meeting presentation (Discussion Slides: Alaska Senate Finance Committee, April 4, 2012); the slides assumed a certain amount of oil production. The oil production numbers were derived from the Department of Revenue Fall Source Book, which showed the FY 13 forecast was for 550,000 barrels per day (page 31). He asked whether any of the 550,000 barrels per day would be counted as new oil under the proposed concept. He wondered which sources would be new (using page 101 of the source book as a reference). He queried whether the revenue comparisons on slide 4 took the data into account.

Mr. Mayer responded that the revenue comparisons were generated on the maximum rate that applied to everything.

One issue was how to treat new production from new areas that did not have three years of historical production on which to base the decline and did not have declining production. He relayed that one option would be to include the new areas in the new production components. The specific data was only for a period of a couple of years and the projects were mainly high cost, which could face a more significant tax burden at current prices under the gross tax option. He opined that under the scenario an adjustment to the revenue figure would probably need to be made.

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Co-Chair Stedman surmised that the adjustment would be relatively minor given the 450,000 barrels out of 600,000 coming out of Prudhoe Bay and Kuparuk. He relayed that there was a struggle to determine how to work the particular incremental. Petroleum consultant Pedro van Meurs and PFC had suggested that the committee address the incremental production out of the legacy fields; however, it was a policy call. He opined that it was necessary to address an incentive for incremental production above the decline curve on the legacy fields. He relayed that the committee would want to look at a projection if it decided to use a specific algorithm, especially if 2009 through 2011 were used as a base to project forward. He wondered how the data would look compared to 2012 and 2013 and where the mathematical line would come to the projections looked at by the committee.

Co-Chair Stedman discussed that the incremental production cap of 10 percent was essentially a reduction in the progressivity to .14 percent, which had been cut in half to .27 percent. He addressed the magnitude of going from zero to nothing; it was a numeric that would be set by the committee. He relayed that a number would need to be on the table for people to have a good feel for; it could be anywhere from no incremental incentive to zero progressivity. He opined that zero progressivity was too extreme. He expressed his desire to have input from committee members. He concluded that it was a linear relationship and that different increments could be used if members were interested; the base progressivity began at .27 percent. There were some increments that went down to zero, but he wondered what the base rate of 25 percent would be at that level.

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Senator Olson pointed to slide 10 and questioned what made up the new production incentive calculations other than tax credits. Mr. Mayer responded that the comparison looked at lower taxation rates for new production and their impact on government take.

Senator Olson asked for verification that the comparison did not include tax credits. Mr. Mayer answered that the model included the 20 percent capital credit.

Co-Chair Stedman added that progressivity was the only component that changed in the model on slide 10. The number could be increased or decreased. He reiterated that PFC could run the model with a different numeric if committee members were interested.

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Senator McGuire wondered whether new production with a 2 percent maximum progressivity or new production with no progressivity was easier to administer. Mr. Mayer clarified that removing the progressive tax took one element of the tax out and made things slightly simpler; however, the progressive tax calculation only required production volume and price and was not administratively complex.

Senator McGuire asked for copies of past slides that showed cash flows with government take and industry take at different ranges (fields producing 200,000 barrels per day versus fields producing 10,000 barrels per day). She explained that progressivity had been adopted at .4 percent under ACES, but no one had looked at how punitive the percentage would be at the high end of the oil price spectrum; she wanted to avoid a similar situation on the low end. She believed the rates of taxation at the \$40 per barrel were very high because of the floor that was included. She wanted a system to work at all prices. She referred to oil price fluctuations and how removing oil from strategic reserves nationally and internationally could impact prices.

Senator McGuire was interested in an overarching perspective about jurisdictions that had adopted progressivity and how they kept it as an incentive and not

a detriment. She requested more information on where PFC believed the "sweet spot" was in respect to new production and the progressivity rates. She compared the progressivity to the Internal Revenue Service system; some people felt that the harder they worked the higher their taxes were. She was fine with reducing the progressivity on new production, but she was interested in learning how to change behavior. She appreciated information that PFC had provided on its experience in Canada; the company had discussed its observations with policy makers, which had led industry to pick up. She reiterated that the goal was to change industry behavior.

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Mr. Mayer addressed the question related to high rates of taxation at low oil prices. He agreed that a portion of the high rate was related to the impact of the floor, but the general increased slope of the curve was also due to regressive nature of the tax regime at low prices, which was almost entirely a function of the 12.5 percent fixed royalty. He elaborated that with any fixed royalty there was a price level at which the royalty could consume almost all of the divisible income, which resulted in high rates of government take.

Mr. Mayer spoke to progressivity and incentives for new development. He discussed that there were two purposes of progressivity: (1) was to create a system that worked at a variety of prices and created stability. He detailed that progressivity was intended to counter the decrease of government take as oil prices increased and to avoid a need to restructure the tax regime as prices rose. The goal of the progressivity under the gross was to counteract the regressive effects of the royalty at the rate and to maintain an overall neutral regime going forward; (2) progressivity was also used by government to increase its share of the take at higher levels. The strategy could be useful if there was a fiscal target that needed to be met; however, there also needed to be workable economics for companies.

Mr. Mayer believed that progressivity was so substantial under certain tax regimes (e.g. ACES) that there was less and less benefit for companies with every additional \$1 increase in oil price. He stressed that an efficient system was not necessarily a competitive system; it was possible

to have an efficient regime that did not tax basic capital returns that simultaneously sought to tax access profits or economic rents; high progressivity levels could be very compatible with such a system. He pointed to significant investment currently going into areas in the Lower 48 that had lower levels of government take and overall cost. He emphasized the importance of competitiveness in fiscal regime design.

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Co-Chair Hoffman commented on the loss of government take at high oil prices versus the assured government take when prices were low. He referred to testimony from Mr. Mayer stating that the likelihood of seeing low oil prices was not very high. He pointed out that at \$40 a barrel companies would be responsible for \$194 million in taxes, but at \$120 a barrel companies would gain revenue. He stressed that at \$170 a barrel companies would earn \$1 billion and at \$200 a barrel they would receive \$1.7 billion. He discussed the importance of taking into consideration what the state may be giving up under the scenario and the probability that oil would ever go back to \$40 per barrel.

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

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ADJOURNMENT

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The meeting was adjourned at 4:57 PM.