SENATE FINANCE COMMITTEE
April 5, 2012
2:50 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 2:50 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

Darwin Peterson, Staff, Senator Bert Stedman; Janak Mayer, Manager, Upstream and Gas, PFC Energy; Senator Joe Paskvan; Senator Thomas Wagoner.

SUMMARY

SB 192 OIL AND GAS PRODUCTION TAX RATES

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

#sb192
SENATE BILL NO. 192

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

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Co-Chair Hoffman MOVED to ADOPT the proposed committee substitute for SB 192, Work Draft 27-LS1305\O (Bullock, 4/5/12).

Co-Chair Stedman OBJECTED for the purpose of discussion.

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DARWIN PETERSON, STAFF, SENATOR BERT STEDMAN, explained the changes in the Committee Substitute (CS). He shared that Section 1 remained the same, while Section 2 included a provision that allowed exemption from the minimum floor tax for small producers. Section 3 reflected the new 3 tier progressivity approach. He added that subsection 1 on page 4, line 19 addressed existing production on legacy fields. The calculation began at $60 with a progressivity rate of 0.27 percent. At $120, 16.2 percent was reached, and at that point, the progressivity was reduced to 0.03 percent and capped at 20 percent for existing production in the legacy fields.

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He explained that page 5, line 28 updated the definition of new production with a 7-year window. The new production outside of the legacy fields was calculated at $60/bbl and a progressivity rate of 0.05 percent was applied. The progressivity was capped at 5 percent. He addressed page 6, line 1, which referred to the new production progressivity calculation "from a lease or property." He explained that the date was selected to include the Nakiachuk and Oooguruk oil Fields, which would fall under the lowest progressivity. Section 4 on page 6, line 11 adjusted the $60/bbl base amount by the annual percent increase in the United States Consumer Price Index. The indexation avoided the stealth tax as advised by the consultant for PFC energy. Page 6, Section 4, lines 23 through 29 represented the production decline calculation. The target volume equaled a volume of oil produced in 2011, multiplied by the decline percentage, calculated using the cube root method. The calculation created a fixed decline on a particular time going forward to incentivize all of the incremental production in Alaska's legacy fields. He explained that the other sections of the bill remained the same except for changes to the effective dates in Sections 13 and 14, which detailed that the Petroleum Information Management System

would take effect immediately, while the remaining sections of the bill take effect January 1, 2013.

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

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JANAK MAYER, MANAGER, UPSTREAM AND GAS, PFC ENERGY, initiated the PowerPoint presentation "Discussion Slides: Alaska Senate Finance Committee," dated April 5, 2012 (copy on file).

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Co-Chair Stedman noted that the presentation included updated slides detailing the oil decline curve. The presentation was prepared in response to Senate Finance Committee questions.

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Mr. Mayer discussed slide 2, titled "Production Above a Decline-Fixed v Annual Calculation." He reiterated questions regarding the use of decline methodology to incentivize production above the decline curve. His research included a review of previous amendments that incentivized production above the previous year's figures. He explained that his research involved a review of amendments from the Senate Resources Committee that calculated a decline curve. He proposed incentivizing above the decline curve. Decline was calculated on a rolling average, and the incentive was applied to production above a target based on last year's production.

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Mr. Mayer explained slide 3, "Approximate Decline Rates to 2010 by Start Year" and stated that the CS compared 2008 to 2011 production, particularly the implied decline rate. He noted that the graph was not a timeline but a sensitivity of an average beginning in 1995. The graph depicted an approximation using publically available production data, applying equity stakes for each company in those assets. He detailed the graph’s depiction of differences between

producers. From 2007 to 2010, Exxon Mobile had a decline curve of slightly over 6 percent; whereas decline curves for BP and Conoco Phillips were significantly higher. He stated that the higher curves came from the higher decline at Kuparuk compared to other assets.

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Mr. Mayer spoke to slide 4 titled "Approximate Decline Rates to 2010 by Start Year." The graph was modified to include the average start of the decline in 2010 for Prudhoe Bay and Kuparuk River. He commented on the higher rates of decline for Kuparuk River than for Prudhoe Bay. He revisited slide 3 stating that higher rates of decline were observed for Kuparuk and Prudhoe Bay than for Exxon Mobil. He explained that higher rates of decline created a steeper decline forecast based on the methodology along with more room for incentive. He encouraged the committee to ponder the question about whether a flat rate or a companywide approach was better.

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Mr. Mayer discussed slide 5 titled "Approximate Decline Rates to 2010 by Start Year." He explained that he employed a maximum decline curve of 20 percent, for the sake of legibility. The graph depicted a high rate of variability between different assets, with decline curves calculated on the same basis as the previous slides.

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Mr. Mayer explained slide 6 titled "Regime Competiveness: Relative Government Take." He explained that the slide provided an updated version of relative government take as a benchmarking exercise, using stylized cash flow profiles discussed in previous committee meetings. The existing producer had relatively low levels of costs, with a high level of costs for a new development. The costs for the new producer were approximately $17 per barrel. He explained that a producer interested in new production occurring without existing infrastructure would include higher costs and higher government take. He noted that the indexing of the break-point at which progressivity starts, was not included in the depictions.

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Co-Chair Stedman requested further explanation for slide 6. He asked why the bar depicting CSSB 192 (Existing Producer) was located above the bar depicting ACES (Existing Producer). Mr. Mayer responded that at $60/bbl of oil, including the impact of indexing for inflation, the two bars would be equal. He continued that Slide 6 depicted a lack of indexing for inflation, which allowed the progressivity at lower price levels throughout the 30-plus year time horizon. He credited Co-Chair Stedman for the excellent question and reiterated that incorporation of the indexing into the model would illustrate no difference between CSSB 192 and Alaska's Clear and Equitable Share (ACES).

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Co-Chair Stedman required further explanation. Mr. Mayer explained that no difference existed between ACES and CSSB 192 because of the impact of indexing. Without the impact of indexing, inflation had a disproportionate impact on CSSB 192 versus ACES because the tax was on the gross rather than the net, which made the indexing particularly important. He noted that viewing higher rates than the depicted $60/bbl created the opposite situation where CSSB 192 fell significantly below ACES.

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Co-Chair Stedman joked that if Alaska wanted to out-do North Dakota, they would keep their price at $60 per barrel. Mr. Mayer explained that the states depicted in the graph were sometimes duplicated, with the difference being the costs associated with development. He added that when costs rise in low price environments, "government take" was relatively high. He agreed that at $60/bbl, North Dakota, Texas and Louisiana remained relatively low for conventional production.

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Mr. Mayer discussed slide 7: "Average Government Take of Global Fiscal Regimes at $80/bbl" and related that ACES was the second highest regime at $80 per barrel. He observed slide 8: Average Government Take of Global Fiscal Regimes at $100/bbl" where a rise to $100 per barrel led to a significant drop of 60 percent in fixed royalty regimes.

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Mr. Mayer explained slide 9: "Average Government Take of Global Fiscal Regimes at $120 /bbl." He clarified that the graph depicted significant increases in progressivity under ACES, while government take for CSSB 192 increased much less significantly. He commented that other regimes also increased significantly in government take.

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Mr. Mayer discussed slide 10 titled "Average Government Take of Global Fiscal Regimes at $140/bbl." He noted that at $140/bbl, the gap increased dramatically and ACES was equal to Norway and became the greatest government-take level. At that point, CSSB 192 hit the 73 percent split seen in past analysis, and remained there with the higher price levels.

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Mr. Mayer explained slide 11: "Average Government Take of Global Fiscal Regimes at $160/bbl." He noted that CSSB 192 remained constant, while ACES moved further up the chart of government-take. He noted that in Slide 12: "Average Government Take of Global Fiscal Regimes at $180/bbl," the problem was further exacerbated with the higher price assumptions.

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Mr. Mayer discussed slide 13: "Average Government Take of Global Fiscal Regimes at $200/bbl." He stated that the disparity increased substantially with the increased price assumptions.

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Mr. Mayer explained slide 14: "Average Government Take of Global Fiscal Regimes at $60/bbl." He revisited the slides with the focus on new development. He stated that only a few percentage points existed in between the various producers, but the indexing of inflation would again even the field between ACES and CSSB 192 at $60 per barrel.

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Mr. Mayer explained slide 15: "Average Government Take of Global Fiscal Regimes at $80/bbl." He noted that the ACES levels were approximately equivalent to Norway.

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Mr. Mayer discussed slide 17: "Average Government Take of Global Fiscal Regimes at $120/bbl." He stated that by $120 per barrel, the government take for ACES was approximately 80 percent for a new producer, while CSSB 192 settled around 70 percent, where it remained.

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Co-Chair Stedman queried the impact on the illustrated ranking of inflation for new development using CSSB 192. Mr. Mayer replied that the difference comprised only a couple of percentage points in government take. He requested additional time to adapt the model to better answer the question. Co-Chair Stedman asked if Mr. Mayer would add the requested information to his model. Mr. Mayer agreed to incorporate the information.

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Mr. Mayer explained that with progressively and higher price levels, ACES moved higher and higher up the chart.

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Mr. Mayer detailed slide 18: “Average Government Take of Global Fiscal Regimes at $140/bbl.” He noted that while ACES continued to rise up the chart, CSSB 192 remained fixed at the 72 percent government take figure. He observed that HB 110, for new development fell below CSSB 192. He mentioned that the chart allowed for new development including the impacts of the seven year reduction down to a five percent cap in progressivity in the early years. He stated HB 110 fell significantly for new development, due to the impact of the reduced 15 percent base.

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Mr. Mayer discussed slides 19 through 21, which illustrated government take for new development at $160/bbl-$200/bbl. He noted that the difference illustrated that ACES arrived

at the mid-80 percent government take, which was among the highest in the world. On the other hand, CSSB 192 remained above most conceivable developments in the Lower 48.

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Senator Ellis asked for clarification on slide 8. He asked if revenue was neutral at $110/bbl why the disparity in government take was observed. He also queried the impact of indexing at all levels. Mr. Mayer replied that CSSB 192 was revenue-neutral at $100/bbl. He added that the cost assumptions were critical to the question regarding the neutrality. For new development, the figures used for the analysis separate the capital investment that is part of new investment from the capital investment that maintained a steady decline. He added that the impact of indexing was used to reduce government take on the life cycle basis. He mentioned that the impact of indexing, when viewed over the entire cycle of a project reduced government take slightly.

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Senator Ellis asked if indexing maintained the relationship to allow for durable and sustainable architecture. He asked why indexing was employed at the expense of the citizen take. Mr. Mayer responded that the purpose of indexing was indeed to allow for a durable and sustainable system. He stated that indexing removed the stealth tax effect.

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Co-Chair Stedman queried if ACES and CSSB 192 would incur similar government take if ACES had been indexed upon creation. Mr. Mayer replied that indexing would probably reduce the government take under ACES. He informed the committee that he required further analysis to be absolutely certain. He opined that the impact of indexing should appear greater with CSSB 192 than ACES because of leveling the tax on the net rather than the gross along with sensitivity to cost.

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Co-Chair Stedman requested modification of the model to run index figures for the committee. Mr. Mayer agreed to provide the information. Co-Chair Stedman stated that the

inflation index would allow comparison by committee members.

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Senator Ellis pointed out that industry expressed concerns that the model did not adequately calculate company costs. He expressed confidence in the consultant and the modeling. He believed that Mr. Mayer deserved an opportunity to speak to the concern of company costs. Mr. Mayer responded that the vast majority of the analysis utilized 2013 figures. He attributed the information provided to stylized field development models, which compared existing producer levels to new development levels of government take. He perceived two different questions, one being the deductible cost under the fiscal system, and the other being the question of the picture of the business. The costs illustrated for new development provided a reasonable representation of a new "light oil" development that was similar to existing production. Drilling further from existing production, for material that is more viscous would incur higher costs. He offered to provide analysis for those projects, if requested. He clarified that the analysis provided was meant to illustrate information for recent developments.

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Co-Chair Stedman noted that Mr. Mayer planned to travel through the weekend and he asked that committee members communicate their requests for further information if necessary.

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

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ADJOURNMENT

3:33:13 PM

The meeting was adjourned at 3:33 PM.