

SENATE FINANCE COMMITTEE

April 9, 2012

1:06 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 1:06 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

Weston Eiler, Staff, Senator Bert Stedman; Karen Rehfeld, Director, Office of Management and Budget; Angela Rodell, Deputy Commissioner, Tax Division, Department of Revenue; Senator Cathy Giessel; Janak Mayer, Manager, Upstream and Gas, PFC Energy;

PRESENT VIA TELECONFERENCE

Stephen Ribuffo, Interim Director, Port of Anchorage, Anchorage; Allen Joseph, Vice-Chair, Sea Lion Corporation, Bethel; Christine Klein, Calista Corporation, Anchorage; Martin B. Moor Sr., City Manager, City of Emmonak, Emmonak; Bosco Olson, Senior City Administrator, City of Hooper Bay, Hooper Bay; Wilbur R. Hootch, Mayor, City of Emmonak, Anchorage; Gordon Seversen, Michael L. Foster and Associates, Anchorage; Jomo Stewart, Self, Fairbanks;

SUMMARY

SB 163 G.O. BONDS FOR PORTS

SB 163 was HEARD and HELD in committee for further consideration.

SB 192 OIL AND GAS PRODUCTION TAX RATES

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

#sb163

SENATE BILL NO. 163

"An Act providing for and relating to the issuance of general obligation bonds for the purpose of paying the cost of municipal port projects; and providing for an effective date."

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Co-Chair Hoffman MOVED to ADOPT the proposed committee substitute for SB 163, Work Draft 27-GS2769\D (Finley/Kirsch, 4/7/12.)

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Co-Chair Stedman OBJECTED for the purpose of discussion.

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WESTON EILER, STAFF, SENATOR BERT STEDMAN, highlighted the changes in the committee substitute (CS). He cited that Page 1, line 1, contained a title revision that expanded the bill's coverage exclusively from ports to other state transportation projects. He added that Page 1, line 10, amended the amount of the general obligation bonds (GEO) to \$453,499,200. He reported that on Page 2, line 1, renamed the project fund to the "2012 State Transportation Project Fund". He noted that on Page 2, line 8, Section 3 broadened the grant award statutes, AS 37.05.316, and changed the grant fund total to \$188.4 million (line 13.) He listed the transportation grant projects, which contained changes from previous versions of SB 163. He read the list beginning on Page 2 line 16:

PROJECT AMOUNT

Anchorage - Port of Anchorage \$50,000,000

Expansion

Bethel - Harbor Dredging 4,000,000
Bristol Bay Borough - Port of Bristol Bay 7,000,000
Expansion and Pile Dock Replacement
Haines Borough - Boat Harbor Upgrades 12,000,000
Kodiak - Pier III Replacement 15,000,000
Kotzebue - Cape Blossom Road and Port 10,000,000
Matanuska - Susitna Borough - Bogard Road Extension
13,500,000
Matanuska-Susitna Borough - Port Mackenzie
30,000,000 Rail Extension
Nenana - Totchaket Resource Development 6,500,000
Corridor Access
Newtok Traditional Council - Mertarvik Evacuation
4,100,000
Road Construction
Nome - Port Design and Construction 10,000,000
Sand Point - Sand Point Road Rehabilitation
2,500,000
Seward - Marine Industrial Center Expansion
10,000,000
Sitka - Sawmill Cove Industrial Park Dock 7,500,000
St. George - Harbor Reconstruction 3,000,000
Togiak - Waterfront Transit Facility 3,300,000

Mr. Eiler directed attention to Section 4, line 6, which added a new section that authorized (AS 37.07.080(e)) the Department of Transportation and Public Facilities (DOT) to appropriate the following from the 2012 State Transportation Project Fund:

PROJECT AMOUNT

Anchorage - Glenn Highway, Hiland Road to Artillery
Road 35,000,000 Reconstruction
Anchorage - Glenn Highway/Muldoon Road Interchange
15,000,000 Reconstruction
Anchorage - New Seward Highway/36th Avenue
26,000,000 Reconstruction
Anchorage - New Seward Highway - MP 75 - 90
10,000,000 Bridge Repairs
Anchorage - O'Malley Road Reconstruction 15,000,000
Fairbanks - Elliott Highway, MP 108 - 120
Reconstruction 6,500,000
Fairbanks - Old Steese Highway to McGrath Road
24,000,000 Reconstruction and Extension

Fairbanks - Wendell Street Bridge Replacement

14,400,000
Haines - Maintenance Shop Replacement 3,000,000
Juneau - Glacier Highway, MP 4 - 6 Improvements
5,500,000
Juneau - Mendenhall Loop Road Improvements 6,000,000
Kenai - Kenai Spur Road Rehabilitation 20,000,000
Ketchikan - Shelter Cove Road Construction and
Improvements 19,000,000
Mat-Su - Fairview Loop Road Reconstruction 10,000,000
Mat-Su - Knik Goose Bay Road Reconstruction
15,000,000
North Pole - Plack Road Improvements 5,000,000
Platinum Airport Runway Extension 3,100,000
Port Clarence Access Improvements 4,000,000
Richardson Highway - Ruby Creek Bridge Replacement
11,000,000
Sitka - Katlian Bay Road Construction 14,000,000

Mr. Eiler noted that Section 5, Page 4 contained instructions and authorizations for the State Bond Committee. He read the following language (Page 4, Lines 11 - 15):

If the issuance of the bonds is ratified by a majority of the qualified voters of the state who vote on the question, the amount of \$3,599,200 or as much of that amount as is found necessary is appropriated from the 2012 state transportation project fund of the state to the state bond committee to carry out the provisions of this Act and to pay expenses incident to the sale and issuance of the bonds authorized in this Act.

He concluded with Section 7 (Page 4, line 26), which contained the ballot question and the total amount [\$453,499,200] of the bond package.

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Senator Thomas referred to Page 3, line 23; Fairbanks - Elliott Highway, MP 108 - 120 Reconstruction 6,500,000 and indicated that the project was located 118 miles outside of Fairbanks. He did not want the project attributed to Fairbanks.

Co-Chair Stedman replied that the language would be remedied later on in the process.

Co-Chair Stedman REMOVED his OBJECTION. There being NO further OBJECTION, Work draft 27-GS2769\D was ADOPTED.

KAREN REHFELD, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, spoke to the original version of the bill. She reported that the original version of SB 163 authorized \$350,000,000 in general obligation bonds for six port projects around the state. Four new projects were incorporated into the CS.

ANGELA RODELL, DEPUTY COMMISSIONER, TAX DIVISION, DEPARTMENT OF REVENUE, spoke to the fiscal note. She explained that \$3,500,000 of the bond total, \$453,499,200 was the associated costs to issue the bonds. Upon ballot approval, the first issuance would begin in February, 2013 and would continue into FY 14 and FY 15. She assured the committee that the proceeds would be expended in a timely manner. She expected a low cost for the first bond issuance of approximately 2.6 percent. She commented that the projects were long-term and anticipated a 20 year bond issue. The administration planned to finance the projects over the 20 year period to free up funds for other priorities.

Co-Chair Stedman cited the fiscal note from the Department of Revenue (DOR) that appropriated \$900,000 in general funds for FY 2013.

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STEPHEN RIBUFFO, INTERIM DIRECTOR, PORT OF ANCHORAGE, ANCHORAGE (via teleconference), testified in support of SB 163. He thanked the committee for the additional funding totaling \$50,000,000 but related that the funding fell short of the \$350,000,000 requested by the municipality. He considered the port a statewide project and felt that it benefited the entire state.

ALLEN JOSEPH, VICE-CHAIR, SEA LION CORPORATION, BETHEL (via teleconference), expressed his support of SB 163. He worked in collaboration with the city of Hooper Bay on various projects. Currently, the community sought to construct a small boat harbor at a cost of \$8,000,000 and to extend a road at a cost of \$700,000, for the transportation of goods that arrive by barge. The harbor was unprotected and the goods brought in by barge were trucked on the beach. The residents of Hooper Bay were concerned that a barge or

truck accident would affect subsistence fishing. He requested the project's inclusion in SB 163.

CHRISTINE KLEIN, CALISTA CORPORATION, ANCHORAGE (via teleconference), testified in support of including the Emmonak port project in SB 163 and clarified that the project was included in earlier versions of the legislation. She explained that the Emmonak port was the hub for villages along the Yukon River. The port was relied on for fuel deliveries and utilized by the fisheries plant that provided jobs for residents. She detailed that the project design was complete and it was "shovel ready." The total cost was \$16,500,000. The cost of Phase 1 was \$10 million for construction of the dock and wharf. The landing ramp cost \$6,400,000. The project was supported by Kwik'Pak Fisheries, the City of Emmonak, Calista Regional Corporation, and the Tribe of Emmonak.

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MARTIN B. MOOR SR., CITY MANAGER, CITY OF EMMONAK, EMMONAK (via teleconference), testified in support of including the Emmonak port and dock facility project in SB 163. He noted that the city was located 10 miles from the mouth of the Yukon River and served as the regional hub. He served the city since 1963, which included some time as mayor. He spoke of interior Alaska's increasing costs for fuel and basic necessities, which threatened rural Alaska's physical survival. Every necessity must be shipped in. He shared that expanding the Emmonak port benefited the entire region and could potentially reduce the costs.

BOSCO OLSON, SENIOR CITY ADMINISTRATOR, CITY OF HOOPER BAY, HOOPER BAY (via teleconference), expressed his support of the inclusion of the road extension and the small boat harbor in SB 163. He explained that the road extension would expand the road over a slough and that the small boat harbor protected boats from potentially destructive storms in the fall.

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WILBUR R. HOOTCH, MAYOR, CITY OF EMMONAK, ANCHORAGE (via teleconference), testified in support of including the Emmonak port and dock facility project in SB 163. He remarked that the region was experiencing a crippling

energy crisis and listed the positive effects of the project for the region.

GORDON SEVERSEN, MICHAEL L. FOSTER AND ASSOCIATES, ANCHORAGE (via teleconference), testified in support of the City of Emmonak's port and dock facility project. He voiced that in 2009, 80 barges off loaded 1,500 containers in Emmonak. The dock area was too small, congested, and inadequate. Barge offloading caused bank erosion.

JOMO STEWART, SELF, FAIRBANKS (via teleconference), testified in support of expanding the legislation to include funding in SB 163 for solutions to the "crippling energy needs" in Fairbanks. He remarked that the actual definition of "port" in the statutes was fairly broad; "a facility of transportation related commerce located within the state." He briefly shared his ideas for funding.

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SB 163 was HEARD and HELD in committee for further consideration.

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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."

JANAK MAYER, MANAGER, UPSTREAM AND GAS, PFC ENERGY, discussed a PowerPoint presentation titled "Discussion Slides: Alaska Senate Finance Committee, April 9, 2012 (copy on file).

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Mr. Mayer announced that the information in the presentation was in response to questions from the committee on CSSB 192 and previous testimony. He explained Slide 2, titled "Cost Sensitivity-From April 3 Testimony and Discussion - Impact of Rising Revenue Costs." The slide

graphed the "Revenue Difference Between ACES and Progressive Severance Tax Options under Different Opex/bbl Assumptions" for the producer, proposed in CSSB 192. He determined that the impact of the tax systems varied depending on the level of costs the producer incurred. He noted that the chart, originally presented on April 3, 2012 was slightly outdated since the committee recently increased progressivity from .25 to .27. The impact increased taxes for the producer at the \$80/bbl. to \$100/bbl. (price per barrel) range as a result of the change. He pointed out that the cost sensitivity was calculated on opex (Operating Expenditure). Capital expenses (capex) were not factored in because of the impacts of the capital credit for the producer and that typically, high cost capital expenditure was associated with new production. New production received reduced tax rates under CSSB 192. Cost sensitivity was relative to opex. He reminded the committee that the system was calibrated to be revenue neutral at \$100/bbl. at average operating costs of \$12/bbl. as forecast by the Department of Revenue (DOR) for FY 2013. He related BP's (British Petroleum) previous testimony that the consequence of the revenue neutral structure meant the producer incurred a higher tax burden in CSSB 192 than under ACES if the per barrel costs were higher than the average operating costs. He concurred with BP's point of view. He recapped that if opex rose as production declined and opex costs were not variable on a cost per barrel basis the result was a tax increase.

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Mr. Mayer pointed out that the effect was a direct result of the committee's desire to structure a tax with more incentive for cost control and less state support for spending at high levels of progressivity "because of the interaction of high progressivity with full capital deductibility" under ACES. He exemplified a scenario under ACES where progressivity was triggered and the producer incurred a production tax rate of 40 percent, each dollar of operating or capital costs can be deducted from the production tax liability. Since the production tax per barrel also decreased the result was to move "further down the curve of progressivity." He emphasized that under ACES the costs were fully deductible from the 25 percent production tax but under CSSB 192 progressivity was no longer taxed on the net. The ability to reduce

progressivity as costs escalated was lost. He believed that conclusion was the fundamental difference between ACES and CSSB 192. He reiterated that CSSB192 created a tax structure that reduced "excessive support" for rising costs and incentivized cost control. He stressed that the direct consequence of increasing incentives for cost control was higher taxes for producers with higher costs.

Mr. Mayer indicated that CSSB 192 did offer a substantial form of mitigation, which was the reduced rate of progressive tax on the gross for new production in new areas and on incremental production above the decline curve. Also, companies producing in a completely new area incurred only a 5 percent tax for seven years which diminished the impact on costs. He warned that the seven year cycle limited the impact of lower taxes on higher operating costs overall. He reminded the committee that new production incurred the highest operating costs. In order to achieve cost sensitivity it was imperative that recently completed developments like Ooguruk was included under new production due to high costs well above the \$12 fixed rate designated in CSSB 192. The effect reduced taxes for the first seven years. He cautioned that the reduction was offset by the full tax rate kicking in after the 7 year period. He suggested that extension or elimination of the seven year period could mitigate the impact. Similarly, mitigation was possible by reducing or excluding progressivity and simply charge the base tax. The same scenario applied to high cost incremental (new production) production from existing fields.

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Mr. Mayer addressed the conclusion of the DOR testimony on CSSB 192 that sensitivity to higher costs encouraged a "further retreat to harvest mode" since companies would "face lower tax rates due to lower costs that disincentivized harvest production." He disagreed with the conclusion. He reasoned that as production falls operating costs were likely to stay flat and costs per barrel rose. "Harvest mode did not imply low costs per barrel."

Mr. Mayer refuted DOR's assumption that tax incentives for existing production under CSSB 192 were not as strongly supported as under ACES. New capex, which created new production and was taxed at a lower rate, acted as an offset. He revealed that DOR's testimony ignored that

interaction. Lastly, he contended that production volume and the resulting revenue generated was more significant than the tax rate. It would take an "extraordinary reduction in tax" to incentivize a producer to deliberately produce less revenue, especially if costs were not decreased.

Mr. Mayer addressed Slide 3, "FY 2013 v Lifecycle Analysis - Impact of Costs & 7 year Time Limit." The slide reproduced slides from previous presentations from April 4, 2012 and April 5, 2012 that related to government take for new development under CSSB 192. He clarified that the slides contained seemingly conflicting data on government take. The FY 2013 data showed government take in the mid-sixties percent and the lifecycle slide in the mid-seventies percent. He explained that one analysis was based on FY 2013 and the later benchmarking data was done as a life cycle analysis. The April 4th analysis was based on FY 2013 outcomes factoring in revenue neutrality at \$100/bbl. The April 5th data was based on benchmarking, which was always based on lifecycles. A lifecycle analysis used generic new development costs as opposed to North Slope average costs for FY 2013 which moved the government take upward. In addition, the FY 2013 data included the new production cap of 5 percent, which drove government take down.

Mr. Mayer stated that the lifecycle analysis included the higher tax rate on new production after the 7 year, 5 percent cap expired, which increased government take.

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Co-Chair Stedman surmised that one analysis was run using life cycle new production data and the other was run on FY 2013 blended numbers. Mr. Mayer agreed.

Mr. Mayer discussed the slide 4:

Some Goals Are Mutually Exclusive

- Achieve decoupling
- Reduce high levels of support for spending, and poor incentives for cost control
- Minimize complexity, including need for separate cost accounting
- Reduce government take on new/incremental production

- No increases on any taxpayers
- Revenue neutral at \$100+ /bbl.
- More even split between state and companies above \$100/\$120/bbl.

He stated that the fundamental issue was that all goals cannot be achieved in any single tax structure.

Mr. Mayer turned to slide 5:

Some Goals Are Mutually Exclusive

ACES with a 40% Cap

- Achieve decoupling
- Reduce high levels of support for spending, and poor incentives for cost control
- Minimize complexity, including need for separate cost accounting**
- Reduce government take on new/incremental production
- No increases on any taxpayers**
- Revenue neutral at \$100+ /bbl**
- More even split between state and companies above \$100/\$120 / bbl**

[Items in Bold were achievable goals.]

Mr. Mayer moved to slide 6:

Some Goals Are Mutually Exclusive

ACES with a 40% Cap & SB 305-Style Decoupling

- Achieve decoupling**
- Reduce high levels of support for spending, and poor incentives for cost control
- Minimize complexity, including need for separate cost accounting
- Reduce government take on new/incremental production
- No increases on any taxpayers
- Revenue neutral at \$100+ /bbl**
- More even split between state and companies above \$100/\$120/bbl.**

[Items in Bold were achievable goals.]

Mr. Mayer directed attention to slide 7:

Some Goals Are Mutually Exclusive

HB110

- Achieve decoupling
 - Reduce high levels of support for spending, and poor incentives for cost control**
 - Minimize complexity, including need for separate cost accounting
 - Reduce government take on new/incremental production**
 - No increases on any taxpayers**
 - Revenue neutral at \$100+ /bbl
 - More even split between state and companies above \$100/\$120 / bbl**
- [Items in Bold were achievable goals.]

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Mr. Mayer addressed slide 8:

Some Goals Are Mutually Exclusive

CSSB192

- Achieve decoupling
 - Reduce high levels of support for spending, and poor incentives for cost control**
 - Minimize complexity, including need for separate cost accounting**
 - Reduce government take on new/incremental production**
 - No increases on any taxpayers
 - Revenue neutral at \$100+ /bbl**
 - More even split between state and companies above \$100/\$120 / bbl**
- [Items in Bold were achievable goals.]

Mr. Mayer pointed out that CSSB 192 accomplished all of the goals except for one; no increased taxes. He believed that the committee must consider "fundamental tradeoffs" to achieve all of the goals. He summarized the ways to mitigate increased taxes: eliminate progressivity on new and incremental production, raise the progressivity threshold, or compromise on the goal of revenue neutrality at \$100/bbl.

Mr. Mayer discussed Slide 9 titled, "Regime Competiveness: Relative Government Take." He spoke to previous testimony that suggested that ACES was a good system at \$100/bbl. but

at higher prices was problematic or that 75 percent levels of government take was a desirable goal. He shared that PFC Energy held the position that approximately 75 percent government take under ACES at \$100/bbl. depicted in the ranking on slide 9, was very high by world standards. He noted the ranking was higher than any oil producer in the Lower 48 states. The Lower 48 states were faced with much lower costs, which increased its competitiveness with Alaska. He observed that Norway's government take was higher but maintained a National Oil company. Norway provided active equity participation through Petoro, which ensured ongoing investment in its oil sector. He explained that instead of setting a target rate for a desired outcome, PFC Energy recommended incentivizing production. He detailed that new investment was typically accompanied by high production costs. Flexibility in government take must be built into a tax regime in order to incentivize production. He reiterated the ways to accomplish reduced government take on new production.

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Senator Thomas asked for clarification regarding the chart on slide 2. Mr. Mayer responded that the chart illustrated the difference between ACES and CSSB 192 at different price levels and opex assumptions. The horizontal axis was set at zero. Any point below the zero line represented a revenue or tax decrease. Conversely, every point above the zero line represented a tax increase compared to ACES.

Senator Thomas asked for a clarification on the second goal on slide 8, "Reduce high levels of support for spending..." Mr. Mayer interpreted the goal as high levels of support from the state to industry.

Co-Chair Stedman exemplified that the state cannot subsidize capital expenditures at levels close to or above 100 percent. Mr. Mayer agreed.

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

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ADJOURNMENT

[2:21:47 PM](#)

The meeting was adjourned at 2:21 PM.