

SENATE FINANCE COMMITTEE  
April 11, 2012  
5:56 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 5:56 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, Senate Finance Committee; Janak Mayer, Manager, Upstream and Gas, PFC Energy; Representative Les Gara; Gerald Kepes, Partner, PFC Energy; Senator Hollis French; Senator Tom Wagoner; Senator Linda Menard.

SUMMARY

SB 25 AIDEA SUSTAINABLE ENERGY PROGRAM

CSSB 25(FIN) was REPORTED out of committee with a "do pass" recommendation and with the previously published zero fiscal note: FN2 (CED), one new fiscal impact note from the Senate Finance Committee, and one forthcoming zero (EDC) fiscal note.

SB 192 OIL AND GAS PRODUCTION TAX RATES

SB 192 was REPORTED out of committee with a "do pass" recommendation and with new fiscal impact notes from the Department of Natural Resources, the Department of Administration, and the Department of Revenue.

HB 302 CONTRIBUTIONS FROM PFD: UNIV/AUDITS

HB 302 was SCHEDULED but not HEARD.

HB 366 DISASTER PLANNING AND SERVICES

HB 366 was SCHEDULED but not HEARD.

HCR 23 ALASKA ARCTIC POLICY COMMISSION

HCR 23 was SCHEDULED but not HEARD.

#sb25

SENATE BILL NO. 25

"An Act relating to participation by the Alaska Industrial Development and Export Authority in energy projects."

5:57:52 PM

Co-Chair Hoffman MOVED to ADOPT the proposed committee substitute for SB 25, Work Draft 27-LS0290\S.

Co-Chair Stedman OBJECTED for purpose of discussion.

DARWIN PETERSON, STAFF, SENATE FINANCE COMMITTEE, explained the changes for CS SB 25 version S. He stated that Sections 3,4, and 5 had been added to the bill, and would exclude the value of the lease hold interest on AIDEA owned properties for the purpose of determining the full and true value by the state only if the local government chooses to exempt that property from the taxation. He furthered that AIDEA owned 5 major properties in Alaska that were leased to private operators: the aircraft maintenance facility at the Ted Stevens International Airport, the Skagway Ore Terminal, the Ketchikan Shipyard, the Red Dog Road and Port, and the Snettisham Hydroelectric Dam and Power Station. He said the full and true value determination was important to municipal governments in a number of ways; it determined the magnitude of the required local contribution

component of state education aid, it impacted the required local share for school construction and major maintenance, it effected the amount of federal impact aid to which municipal school districts were entitled, and it limited property taxing capacity. He relayed that the exemption of the Red Dog Road and Port from the determination of the full and true value had allowed the Northwest Arctic Borough to avoid a loss of education funding estimated at \$1 million annually. He concluded that the legislation would treat the rest of the AIDEA owned properties equally, giving the municipalities the choice of imposing property taxes or opting for the reduction in the local education contribution.

Mr. Peterson discussed further changes in the bill:

Section 6 The following changes were made to new section 6/old section 3:

1. No changes

Section 7 The following changes were made to new section 7/old section 4:

1. No changes.

Deletion Section 5 (page 4 lines 1-15 of the X version) was removed from the bill:

1. The subsequent sections were renumbered accordingly.

Section 8 The language in section 8 retains the language found in section 6 of the X version with the following changes:

1. Replaced "energy project" with "qualified energy development" on page 6, line 28 and page 7, line 23.

Section 9 The language in section 9 retains the language found in section 7 of the X version with the following change:

1. Replaced "energy project" with "qualified energy development" on page 8, line 20.

Section 10 The language in section 10 retains the language found in section 8 of the X version with no changes.

Section 11 The language in section 9 retains the language found in section 9 of the X version with no changes.

Section 12 The language in section 9 retains the language found in section 10 of the X version with the following change:

1. Deleted the word "energy" preceding "loan" on page 9, line 17.

Section 13 The language in section 13 retains the language found in section 11 of the X version with the following changes:

1. Deleted the word "energy" preceding "loan" on page 9, line 19.
2. Deleted the word "energy" preceding "loan" on page 9, line 28.
3. Deleted the word "energy" preceding "loan" on page 10, line 12.

Section 14 The language in section 14 retains the language found in section 12 of the X version with the following change:

1. Deleted the word "energy" preceding "loan" on page 10, line 11.

Section 15 The language in section 15 retains the language found in section 13 of the X version with no changes.

Section 16 The language in section 14 retains the language found in section 14 of the X version with the following changes:

1. Replaced "energy projects" with "qualified energy development" on page 11, line 9-10.
  2. Replaced "energy projects" with "qualified energy development" on page 12, line 2.
  3. Replaced "energy projects" with "qualified energy development" on page 12, line 3.
  4. Replaced "energy projects" with "qualified energy development" on page 12, line 7-8.
  5. Replaced "energy projects" with "qualified energy development" on page 12, line 13-14.
  6. Replaced "energy projects" with "qualified energy development" on page 12, line 17.
  7. Inserted New Subsection (8) granting AIDEA the power to pay off the principal and interest on bonds issued by a municipal public utility and retain the payments from the utility in a sinking fund.
  8. Replaced "energy projects" with "qualified energy development" on page 13, line 1.
  9. Replaced "energy projects" with "qualified energy development" on page 13, line 8-9.
- Sect. 16 (Cont.)
10. Replaced "energy project" with "qualified energy development" on page 13, line 11-12.
  11. Replaced "energy project" with "qualified energy development" on page 13, line 14-15.

Section 17 Section 17 retains the language previously found in section 15 of the X version with the following changes:

1. Replaced "energy project" with "qualified energy development" on page 13 line 19.
2. Inserted "conservation" preceding "storage" on page 13, line 21.
3. Removed the conversion of natural gas, coal or biomass to liquids (page 11, line 8), the processing, refining, or upgrading of oil (page 11, line 9) and enhanced oil recovery or carbon sequestration (page 11, line 11) from the definition of "qualified energy development."

New Sect. 18 Added a new section 16 repealing Sections 2 and 8 of ch. 10, SLA 2010 (the language exempting an integrated transportation and port facility owned by the authority from taxation and the sunset of the exemption.)

Section 19 Section 19 retains the language previously found 16 of the X version.

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Co-Chair Stedman WITHDREW his OBJECTION. There being no further objection Work Draft 27-LS0290\S was ADOPTED.

Senator McGuire remarked that the changes in the bill correctly reflected the current financial climate. She relayed interest in partnering with venture capitalists across the globe. She hoped that the legislation would contribute to the diversification of the state's economy.

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Co-Chair Stedman clarified that the legislation created a stable energy and transmission supply development program intended to generate more energy and electricity for the state.

Co-Chair Stedman noted the two fiscal notes: FN2 (DCCED); NEW FN (SFIN). He added that a new fiscal note from the Department of Education and Early Childhood Development that reflected the changes made in Sections 3, 4, and 5 was forthcoming.

Co-Chair Hoffman MOVED to report CS SS SB 25 (FIN) out of committee with individual recommendations and the

accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

CSSB 25(FIN) was REPORTED out of committee with a "do pass" recommendation and with the previously published zero fiscal note: FN2 (CED), one new fiscal impact note from the Senate Finance Committee, and one forthcoming zero (EDC) fiscal note.

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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."

[6:08:09 PM](#)

Co-Chair Hoffman MOVED to ADOPT Committee Substitute for Senate Bill 192, Work Draft 27-LS1305\Y (Nauman/Bullock 4/11/12).

Co-Chair Stedman OBJECTED for purpose of discussion.

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Mr. Peterson discussed the changes reflected in the committee substitute (CS). He shared that the first change was located on Page 5, line 10, subsection (a), which dealt with the incremental production rate above the producer targeted decline rate. He stated that the previous trigger price on progressivity for incremental production was \$60; the same as for existing production, and had been changed to \$75. He added that conforming changes could be found on Lines 18 and 21. He relayed that the next change could be found on Page 5, line 23, which extended the lowest progressivity rate for new production from 7 years to 10 years. He continued that Line 31 reflected the increase in the progressivity trigger for the price of a barrel of oil for new production to \$90. He concluded that on Page 6, section 4, the adjustment price for progressivity for the calculation of the Consumer Price Index (CPI) would include

the \$75 trigger price for incremental production and the \$90 trigger price for new production.

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Co-Chair Stedman WITHDREW his OBJECTION. There being no further objection Work Draft 27-LS1305\Y was ADOPTED.

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JANAK MAYER, MANAGER, UPSTREAM AND GAS, PFC ENERGY, introduced the PowerPoint Presentation, "Discussion Slides: Alaska Senate Finance Committee, April 11, 2012 (copy on file).

Co-Chair Stedman requested a definition of the term "upstream" as it would be used in the discussion.

Mr. Mayer explained that "upstream" was a term used in the oil industry to refer to all activities from the initial phases of exploration; from the development of projects to the production of crude oil. Alternately, "downstream" activities were considered the activities onward, from crude oil production to refinement.

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GERALD KEPES, PARTNER, PFC ENERGY, shared that PFC Energy was an oil and gas expertise consultancy with global government entity, national oil company, and private sector clients.

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Mr. Mayer looked at Slide 2: CSSB 192-Approximated Company Decline-Based Production Targets. He explained that the decline curve analysis on the slide multiplied the most recent 2010 Department of Natural Resources analysis by the working interest of the three main companies: BP, ConocoPhillips, and ExxonMobil. He stated that the decline curve in the bill had been based on the methodology; any production above the green wedge on the graph would receive the lower level of progressive tax on gross. He added that any production below that would receive the full 20 percent capped rate. He spoke of the decline rate and the forward bending curve, which he believed mirrored one another. He said that the target, using the equation of a 6 percent

decline rate at 200 thousand barrels per day, would be established by multiplying the 200 thousand barrels per day by 94 percent; or 1 minus the 6 percent decline rate.

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Co-Chair Stedman interjected that the equation used the inverse of the year date. Mr. Mayer responded that the curve forecast forward was to the power of the year date; determining the decline rate, the inverse would be used. He furthered:

"Calculating the question: "What is the decline rate?" It is the exact inverse of that calculation. In this case taking a fixed number of years, 2011 and 2008, and determining the difference between those two numbers. We'll put the later number over the first number and raise it to the inverse of the number of years and calculate what that effective decline rate is. It's doing exactly the opposite of what we did when we forecasted the curve forward, and again it's the same math that goes with calculation ones effective interest rate on a mortgage payment."

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Co-Chair Stedman explained to the committee that he had requested that Mr. Mayer present a slide with the production numbers in order to review the decline curve calculation. He thought that the formula had been presented as complicated; he believed it was straight forward. He suggested likening the formula to compounding interest, only backwards.

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Mr. Mayer stated that the remaining slides in the presentation focused on the economics of how changes in the rates applied to new development and incremental production. He pointed to Slide 3: ACES (\$34/bbl Capex New Development.) Mr. Mayer referred to previous discussions about the cost of new development and the concerns voiced that moving to the gross would increase the sensitivity of the tax both in terms of OPEX and CAPEX. He noted concerns that due to the high cost of development, new developments should be incentivized as well as development in legacy fields. He shared that he had run projections for new

development using capital expenses at \$34 per barrel. He relayed that the result of the projections looked challenging for industry; they were net present value (NPV) negative at \$100 per barrel and faced high rates of government take under ACES. The government take under ACES ranged from 77 percent over the lifecycle at \$100 per barrel, to as high as 84 percent at levels above \$200 per barrel. He stated that under the structure of shifting the tax to the gross, high-cost fields could look even worse for industry because of the sensitivity when the tax was done on the net. He stressed that if the new rate were to be considered the high-cost would have to be compensated for and significantly lower rates should be applied to new development.

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Mr. Mayer looked at slide 4: CS SB 192 20% Max Rate (\$34/bbl Capex New Development.) He explained that under this scenario the levels of government take were lower, but the economics were worse because the instance of the tax in those first years would be high during a time of ongoing drilling costs. He warned that a higher tax during the crucial first economic metric years would cause the economic impact to deteriorate.

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Mr. Mayer discussed slide 5: CSSB 192 5 percent Max Rate for 7 years (\$34/bbl Capex New Development.) He said that dropping the max rate to 5 percent for 7 years could marginally improve the economics. He pointed out the scenario still presented challenges of being NPV negative at a 10 percent discount rate.

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Mr. Mayer looked at slide 6: CSSB 192 5 percent Max Rate for 10 years (\$34/bbl Capex New Development.) He relayed that to further stimulate the economics within the structure, progressivity on new development could be completely removed, or the 5 percent rate period could be extended. He shared that the CS extended the 5 percent rate from 7 to 10 years, which dropped the rates of government take to 70 percent at the highest price levels and reduced the NPV from negative 50 to negative 34.

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Mr. Mayer discussed slide 7: CSSB 192 5 percent Max Rate, \$90 Threshold, for 10 yrs (\$34/bbl Capex New Development.) He explained that the price levels at which progressivity kicked in could be adjusted. He relayed that the CS increased the price level to \$90 in the first 5 year period. He stated that progressivity would begin at the \$90 threshold and would continue at the 0.5 rate until reached the 5 percent maximum.

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Senator Ellis queried how much the big three oil companies would pay at the top rate in 2025 under the legislation. He asked if it would be close to 227,000 barrels.

Mr. Mayer agreed to provide the information at a later date.

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Senator McGuire wondered whether it would be worthwhile to eliminate the 10 year cap. She queried what the rate would revert to after 10 years. She understood that it would depend on the decline curve at the time.

Mr. Mayer replied that under the CS the rate would be the full 20 percent maximum.

Senator McGuire recommended that the rate be reduced to the incremental level. She worried that a rate increase in 10 years would affect initial investment decisions.

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Co-Chair Stedman requested an explanation on the impact of the timing of the cash-flow as the scenario moved from 7 to 10 years.

Mr. Mayer responded that many things could be done to further improve the equation. He shared that the easiest solution would be to remove the time limit altogether, or to extend it further. He stated that what happened in the first 10 years would be most crucial. He relayed that

extending the time period further would be easier than changing the rate after 10 years.

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Senator McGuire stressed that industry should not be penalized with a less attractive rate after 10 years.

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Co-Chair Stedman requested an approximation of the sensitivity using a \$30 and \$28 CAPEX, and with incremental dollars at \$100 NPV.

Mr. Mayer divulged that a \$17 dollar per barrel scenario had been run while working with the profile of capital cost and production represented in the presentation. He shared that the result had been NPV positive, with a 16 to 17 percent rate of return. He added that that was the level that would be required to pass the threshold hurdle rate, but would probably not "set the world ablaze" in terms of competitiveness for capital on an international basis. He furthered that as capital costs went up the NPV and rates of return lowered. He cautioned that the undertaking was highly stylized, and that the actual spending and production profiles of anything being currently considered were well north of \$17. He stressed that the numbers reflected in the slides were not necessarily indicative of the projects being considered by any of the companies. He reminded the committee that the intent of the analyses was to provide indicative ideas of sensitivities about how the numbers reflected the different rates of government take. He thought that any of the lower rates for new development would be an improvement over ACES however, they did not necessarily make high cost developments competitive for capital.

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Mr. Mayer noted that all of the slides reflected that despite having moved the threshold up to \$90, the progressive severance tax on gross still kicked in above the \$60 level. He said that the figures were undiscounted figures that ranged across the 30 life-cycle of the project. He furthered that the 10 year limit meant that the threshold became less sensitive to movement in the case of new development. Because there was no time limit on the

different rate for the incremental production, moving the threshold had a greater affect.

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Mr. Mayer discussed Slide 8: ACES (\$25/bbl Capex Incremental Development.) He explained that a higher cost new development, assuming \$25 per barrel in capital costs for an incremental development, would prove NPV positive at \$100 per barrel with an 11 percent rate of return.

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Mr. Mayer explained Slide 9: CSSB 192 20 percent Max Rate (\$25/bbl Capex Incremental Development.) He stated that the full 20 percent maximum rate resulted in little change in the economic metrics, but an overall slight reduction in government take at high levels could be gleaned. He noted that the change was not great, and in some cases would be marginally worse at the given price levels.

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Mr. Mayer discussed Slide 10: CSSB 192 10 percent Max Rate (\$25/bbl Capex Incremental Development.) He said the scenario presented a lower tax burden and a higher cash flow at the tail end of production; the only costs being operating and maintenance, but a slightly higher tax burden and lower cash flow in the early years.

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Mr. Mayer continued to Slide 11: CSSB 192 10 percent Max Rate, \$70 Threshold (\$25/bbl Capex Incremental Development). He explained that the legislation moved the threshold to the \$75 level at which progressivity at the 10 percent maximum rate kicked in. He shared that the presentation did not contain a slide for \$75, but did for \$70 and \$80 [see Slide 12], and the result would logically fall halfway in between. He noted that slide 11 showed that when the threshold was moved to \$70 the progressive severance tax on the gross kicked in only above the \$70 level. He said that when the threshold moved up to \$80, government take was further reduced. He reiterated that the hypothetical showed the numbers just approaching the basic hurdle rate for capital; not necessarily highly competitive on a broader basis, but an improvement.

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Co-Chair Stedman requested that a slide be created detailing the \$75 threshold. Mr. Mayer replied that he would do so.

Co-Chair Stedman noted the three new fiscal notes: NEW FN (DOR), NEW FN (DNR), NEW FN (DOA).

Co-Chair Hoffman MOVED to report CS SB 192 (FIN) out of committee with individual recommendations and the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

SB 192 was REPORTED out of committee with a "do pass" recommendation and with new fiscal impact notes from the Department of Natural Resources, the Department of Administration, and the Department of Revenue.

#hb302

CS FOR HOUSE BILL NO. 302(FIN) am

"An Act requiring each campus of the University of Alaska to apply to be included on the contribution list for contributions from permanent fund dividends; requiring a university to pay an application fee for each campus separately listed on the contribution list for contributions from permanent fund dividends; and repealing certain audit requirements for entities receiving contributions from permanent fund dividends."

HB 302 was SCHEDULED but not HEARD.

#hb366

HOUSE BILL NO. 366

"An Act establishing an Alaska intrastate mutual aid system and relating to the duties of the Alaska division of homeland security and emergency management and the duties of the Alaska State Emergency Response Commission."

HB 366 was SCHEDULED but not HEARD.

#hcr23

CS FOR HOUSE CONCURRENT RESOLUTION NO. 23(FIN)

Establishing and relating to the Alaska Arctic Policy Commission.

HCR 23 was SCHEDULED but not HEARD.

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ADJOURNMENT

6:41:18 PM

The meeting was adjourned at 6:41 PM.