

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 30, 2011

3:32 p.m.

MEMBERS PRESENT

Senator Joe Paskvan, Co-Chair
Senator Thomas Wagoner, Co-Chair
Senator Bill Wielechowski, Vice Chair
Senator Bert Stedman
Senator Hollis French
Senator Gary Stevens

MEMBERS ABSENT

Senator Lesil McGuire

OTHER LEGISLATORS PRESENT

Senator Cathy Giessel
Senator Joe Thomas

COMMITTEE CALENDAR

SENATE BILL NO. 85

"An Act providing for a tax credit applicable to the oil and gas production tax based on the cost of developing new oil and gas production; and providing for an effective date."

- HEARD AND HELD

SENATE BILL NO. 49

"An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; relating to the oil and gas production tax rate; relating to monthly installment payments of estimated oil and gas production tax; relating to oil and gas production tax credits for certain expenditures, including qualified capital credits for exploration, development, and production; relating to the limitation on assessment of oil and gas production taxes; relating to the determination of oil and gas production tax values; making conforming amendments; and providing for an effective date."

- ITEM REMOVED FROM AGENDA

PREVIOUS COMMITTEE ACTION

BILL: SB 85

SHORT TITLE: TAX CREDIT FOR NEW OIL & GAS DEVELOPMENT

SPONSOR(s): SENATOR(s) WAGONER

02/07/11	(S)	READ THE FIRST TIME - REFERRALS
02/07/11	(S)	RES, FIN
02/25/11	(S)	RES AT 3:30 PM BUTROVICH 205
02/25/11	(S)	Heard & Held
02/25/11	(S)	MINUTE(RES)
02/28/11	(S)	RES AT 3:30 PM BUTROVICH 205
02/28/11	(S)	Heard & Held
02/28/11	(S)	MINUTE(RES)
03/07/11	(S)	RES AT 3:30 PM BUTROVICH 205
03/07/11	(S)	Heard & Held
03/07/11	(S)	MINUTE(RES)
03/09/11	(S)	RES AT 3:30 PM BUTROVICH 205
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03/28/11	(S)	Heard & Held
03/28/11	(S)	MINUTE(RES)
03/30/11	(S)	RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

BART ARMFIELD, Vice President of Operations
Brooks Range Petroleum Corporation

POSITION STATEMENT: Testified in support of SB 85.

MARK R. LANDT, Executive Vice President
Land & Administration
Renaissance Alaska, LLC

POSITION STATEMENT: Testified on SB 85, and highlighted the significant challenges to develop the Umiat Oil Field.

KEN THOMPSON, Managing Director
Alaska Venture Capital Group LLC.

POSITION STATEMENT: Testified on SB 85, and provided perspective on how to re-incentivize investment and increase Alaska's competitiveness relative to other oil basins.

ED DUNCAN, President and Chief Operating Officer

Great Bear Petroleum, LLC
Austin, Texas

POSITION STATEMENT: Testified on SB 85, and focused on how unit definition and pooling rules and regulations would apply to unconventional resource development.

RYAN MOYNAGH, Vice President of Finance and
Chief Financial Officer
Great Bear Petroleum LLC

POSITION STATEMENT: Testified on SB 85 focusing on the application of the development cost credit in unconventional plays, and the proposed oil and gas competitiveness review board.

GEORGE PIERCE, representing himself
Kasilof, AK

POSITION STATEMENT: Testified that SB 85 was the only way to go and a good start.

PAUL KENDALL, representing himself
Anchorage, AK

POSITION STATEMENT: Testified on SB 85 and offered his perspective on the future of energy.

ACTION NARRATIVE

[3:32:59 PM](#)

CO-CHAIR THOMAS WAGONER called the Senate Resources Standing Committee meeting to order at 3:32 p.m. Present at the call to order were Senators Stedman, French, Wielechowski, Stevens, Paskvan, and Wagoner. Senator McGuire was excused.

SB 85-TAX CREDIT FOR NEW OIL & GAS DEVELOPMENT

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CO-CHAIR WAGONER announced SB 85 to be up for consideration. [CSSB 85(), version 27-LS0484\E, was before the committee].

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BART ARMFIELD, Vice President of Operations, Brooks Range Petroleum Corporation (BRPC), observed that SB 85 was drafted to provide tax support for new field development, to encourage new throughput into TAPS, and to encourage more production. As currently drafted, the .023 credits and the balance of the qualified capital credits would bridge the tax impacts for BRPC. But the largest impact is that it would encourage and increase

the activities associated with surface projects that are required to support field development. Things like gravels roads, inter-field pipelines and surface facility construction are the lifeblood of new field development. He highlighted the diversity on the North Slope in operating area and business agendas and observed that that the correct tax policy wasn't necessarily going to be a one-size fits all. However, the design should ultimately be to increase throughput and generate stable tax revenues for ongoing state operations.

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MR. ARMFIELD urged the committee to keep an open mind regarding the options, and to take time to realize that TAPS throughput was declining at an alarming rate with very few projects in the wings to make any near-term course corrections. It's quite possible that a variety of items will be needed to allow existing Alaskan companies and new entrants an opportunity to select the best options for their individual companies. He concluded that SB 85 provides an option for Brooks Range Petroleum in that it covers the impact associated with taxes through discovery drilling, delineation, gravel roads, pipelines and facilities.

SENATOR FRENCH asked if the Brooks Petroleum Corporation that was quoted in the Petroleum News last week was his company or another one.

MR. ARMFIELD replied he couldn't say one way or the other because he wasn't familiar with the article.

SENATOR FRENCH related that the company was quoted saying that the state had been a good partner for new explorers.

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MARK R. LANDT, Executive Vice President, Land & Administration, Renaissance Alaska, LLC, said his testimony would address the significant challenges Renaissance foresees in developing the Umiat Oil Field. He applauded Alaska's efforts to incentivize drilling in the Cook Inlet, and suggested that similar leadership and progressive action was required to revitalize oil and gas activities on the North Slope. He highlighted that Alaska was going to become increasingly dependent on the discovery and development of smaller fields, technically challenged resources, and known reserves that are remote from existing infrastructure.

He explained that the Umiat Oil Field was discovered in the late 1940s and remains undeveloped today because of remoteness, low reservoir energy, and the fact that part of the reservoir is in permafrost. Renaissance has addressed these challenges with technology, but remoteness is still a key challenge.

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MR. LANDT said Renaissance has also focused on a plan of development and contracted with third parties on pipeline routing costs, facility layout and cost, horizontal/lateral development techniques and obtained an independent reserve report. The report estimated 250 million barrels of recoverable oil from the shallow zones at Umiat with peak field production of about 50,000 barrels per day. In addition, the University of Alaska, Fairbanks (UAF) has a \$3 million DOE grant to confirm cold gas injection as the preferred maintenance mechanism. He explained that one of the development considerations is to bury the pipeline on the shoulder of the road to lower costs and lessen the visual impact. The oil is produced cold to eliminate the risk of melting the permafrost and then heated to pipeline specifications at the TAPS connection.

He said the project's unique characteristics and distance from infrastructure has made it difficult to compete for investment capital. Clearly there is risk, but the Roads to Resources and specifically the Department of Transportation preparing the environmental impact statement for the transportation corridor between Umiat and TAPS goes a long way to reduce the risk. The current estimate to bring Umiat to production is \$1.3 billion, and to date Renaissance has spent \$43 million. He concluded that the proposed amendments to ACES to create development tax credits under SB 85 will make Alaska more competitive as an oil producing state.

SENATOR STEDMAN asked how much Renaissance had received from the state in credits.

MR. LANDT answered Renaissance Umiat received a little more than \$15 million in tax credits.

SENATOR STEDMAN asked if that was inclusive or if more was due.

MR. LANDT explained that some of the credits were under appeal. Responding to a further question, he said if Renaissance prevails on all the appeals the credits will total about \$18 million on the \$43 million in expenditures.

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KEN THOMPSON, Managing Director, Alaska Venture Capital Group LLC., (AVCG), said this was the parent corporation and owner of Brooks Range Petroleum Corporation (BRPC), Alaska's main exploration company. He said he would provide his perspective on re-incentivizing investment and increasing the competitiveness of Alaska relative to other oil basins. The common goal is to make a larger pie of revenues with both the state and industry sharing fairly.

MR. THOMPSON said that over the last few years the tax credits have been very helpful, but fundamental improvements to ACES are needed. The experiment has continued long enough to see production decline even though the resource base in the Cook Inlet and on the North Slope is sufficient to level the decline. He said the "next frontiers" for major developments on the North Slope are:

- Exploration with smaller fields sharing regional processing facilities.
- Low-permeability sands that would perhaps have 10-20 percent recovery.
- Source rock shales. AVCG has studied this for over nine months and has substantial acreage to the west of the North Slope that has high potential. Geological studies are underway looking at a project the next winter or two.
- North Slope viscous oil for which there is substantial upside potential.
- Major projects in existing fields, including North Slope offshore oil and natural gas, which are most probably for the major producers.

SENATOR PASKVAN asked him to define "regional processing facilities" and the concept of "sharing" in that context.

MR. THOMPSON explained that for smaller fields it's difficult to get economies of scale in facilities. AVCG would like to share facilities at some of the major fields like Prudhoe Bay and Kuparuk, but many are at capacity, particularly for handling natural gas, water and water injection. AVCG would like to build its own scaled up, modular facilities that can accommodate other nearby exploration and production companies. The capital credits proposed under SB 85 could facilitate that construction. With the right fiscal structure, AVCG would be willing to post processing rates and allow others to see the costs. This would only be practical and fair for new facilities.

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CO-CHAIR PASKVAN asked if he saw the potential in Alaska to have multiple regional processing facilities.

MR. THOMPSON answered yes, and AVCG intends to test the concept of getting other companies to feed into their facility.

CO-CHAIR WAGONER recognized that Senator Joe Thomas had joined the committee.

CO-CHAIR PASKVAN asked how much each of the regional processing facilities is estimated to cost.

MR. THOMPSON replied the cost estimate for one facility that would potentially process 25 million barrels of oil was \$238 million. The costs haven't been optimized and that was the only facility that AVCG analyzed.

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Continuing with the presentation, he displayed a map of the 240,000 acre AVCG joint venture leasehold portfolio. He pointed out that drilling was currently taking place near the Kuparuk River Unit, a small scale development was under consideration at Ivishak and seismic work was planned next winter on a large area to the east. He clarified that BRPC handles the field operations for the joint venture.

MR. THOMPSON said his main job was to attract new investors and capital to Alaska and that gives him good insight as to what is being said on the street about Alaska. For example, Dana Petroleum was asked to participate in AVCG's North Slope operations, but elected to invest in the North Sea instead because that tax and fiscal regime is far better than Alaska's. Each new field development in the North Sea is exempt from high taxation until it has earned \$1.3 billion in profit. He noted that AVCG ended up buying Dana Petroleum, and was still looking for another partner.

AVCG recently approached a major independent because of their technology in oil source rock shales and low permeability sands. That company said no to Alaska, but it does have a major gas discovery offshore Israel where the tax rates are low until 200 percent of the capital investment has been recovered. In another effort, AVCG showed its properties to companies that attended the Houston North American Prospect Exposition. One hundred companies stopped to look, 11 expressed interest in coming to Alaska, and 1 is still interested. All 11 of those companies are

invested in North Dakota where the incentives are good, including deferred severance tax for the first 18 months.

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SENATOR FRENCH asked if he had considered updating the information on slide 5 in light of the recent news that the United Kingdom was taking steps to increase their oil taxes.

MR. THOMPSON responded that the U.K. increases and decreases their tax depending on activity, and he can guarantee that industry will stop spending when the taxes are increased. If Alaska makes the right changes, it can potentially attract companies that no longer want to invest in the U.K.

SENATOR FRENCH asked him to comment on the news that the Madrid-based company Repsol was pledging to make substantial new investments on the North Slope.

MR. THOMPSON said he didn't know much about the deal and how much Repsol would actually invest, but he understands that they and other companies saw the potential for change and were coming on the bet.

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CO-CHAIR PASKVAN referred to the North Dakota and Alaska comparisons on slide 5, and asked if the reserve estimate of 13 billion barrels for Prudhoe Bay was a conventional oil reserve.

MR. THOMPSON replied most of the reserves in North Dakota are in the Bakken and for the most part it's considered an unconventional oil resource. To get things going, North Dakota literally had a tax holiday; there were no severance taxes for the first 18 months of production for new wells that were drilled horizontally and fracked. He offered his belief that some of the shales on the North Slope would also be able to use that technology.

CO-CHAIR PASKVAN asked if he had an estimate of the shale oil reserves in the central North Slope area.

MR. THOMPSON answered no, and suggested he ask Great Bear Petroleum.

Continuing with the presentation, he displayed data from the Frasier Institute 2010 Global Petroleum Survey that compared 133 jurisdictions worldwide in terms of overall attractiveness for investment, and noted that Alaska was in the middle. Although

there is nothing intrinsically wrong with being in the middle, he said Alaska probably needs to be in the top quartile to level production.

MR. THOMPSON said AVCG supports the SB 85 development cost credit for a credit of up to 100 percent of qualified capex. But because AVCG develops facilities in modular stages, it would like the 100 percent credit to apply to all capex in the approved field development plan rather than just until the start of production. He suggested that perhaps this could be limited to two years after initial production startup. He reiterated that to level production, comprehensive change must address all the "next frontiers." Because SB 49 addresses all oil sources, he asked the committee to consider merging it with SB 85.

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SENATOR STEDMAN asked if he was suggesting the committee consider a 100 percent capex credit.

MR. THOMPSON replied his understanding was that it could add credits up to 100 percent for the capital expenses until the start of production. That would be particularly helpful on things like regional processing facilities.

SENATOR STEDMAN said there's a difference between allowing 100 percent recovery of expenditures before escalating to a higher royalty or higher base tax or higher progressivity and having a 100 percent capital credit. If the state is going to pay for all the capital that's invested, he questioned the point at which it should take an equity ownership position as a sovereign.

MR. THOMPSON responded that's something the state should probably always consider, but sharing in part of the risk via the capital credits is a good alternative.

SENATOR STEDMAN clarified that he wasn't advocating the state change its fiscal structure and start taking an equity ownership position, just pointing out that some of the requests for capital credits were excessive.

CO-CHAIR PASKVAN asked if Alaska shale could be developed in a process substantially similar to the shale oil development in North Dakota, and if the development costs were potentially comparable.

MR. THOMPSON replied the North Dakota shales may be more similar to the Eagle Ford shales in Texas where the development is long

horizontal wells. AVCG's 100,000 acre holding to the west could be prospective in shales, but in the near term the focus will be on the 16 conventional exploration plays on that same acreage. Any focus on shales probably wouldn't be until 2013.

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CO-CHAIR PASKVAN asked how the cost structure in Alaska compares to the Eagle Ford shale oil development.

MR. THOMPSON said Great Bear Petroleum may have an answer, but AVCG wouldn't finish its cost analysis until later in the year.

Continuing the presentation, he reiterated the notion of merging SB 49 and SB 85. In particular, AVCG supports the following:

- Revise the progressivity surcharge to the "bracketed tax structure" with calculations made annually rather than monthly.
- Cap the total tax at 50 percent when oil prices top \$92.50/bbl
- For new field development outside existing production units, set a base tax rate of 15 percent instead of 25 percent and a total tax cap at 40 percent.
- Accelerate the payment for exploration and other qualified capital investments to one year versus two years to stimulate exploration activity.
- Increase the tax credits for qualified capital investments from the current 20 percent to 40 percent.
- Extend the small producer tax credit for another 5 years to May 1, 2021. HB 110 does that.

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MR. THOMPSON recapped that there are some great "next frontiers" of development including: smaller field exploration with regional processing; lower-permeability sands & source rock shales; growing existing fields bigger; and viscous oil. The concern with SB 85 is that it alone will not stem the production decline. SB 49 merged with SB 85 is the comprehensive change that's needed for everyone to share in a much bigger pie of revenues.

SENATOR STEDMAN asked how much of every dollar would the state and the federal government return if the capital credit was increased to 40 percent and there was an immediate write off.

MR. THOMPSON said the combined government take can exceed 70 percent, but with the credits Alaska is sharing part of the

risk. He reiterated that since the credits started, AVCG has redeployed them directly into the drill bit and seismic. They would continue to do that with the additional credits.

SENATOR STEDMAN said he didn't hear an answer, but it would have to be calculated if the committee decided to go down that road.

CO-CHAIR WAGONER thanked Mr. Thompson and said perhaps the committee could discuss his suggestions in more detail at some later time.

4:27:52 PM

ED DUNCAN, President and Chief Operating Officer (COO), Great Bear Petroleum, LLC ("Great Bear"), Austin, Texas, said he and Mr. Moynagh would provide their perspective of SB 85 and respond to questions. He noted that the technical information on the company was the same as when they presented to the committee about a month ago.

MR. DUNCAN said Great Bear has most recently been working on a commercial model of Alaska's fiscal regime that can be "flexed" to accommodate changes proposed under SB 85 and HB 110. Of particular interest is how unit definition and pooling rules and regulations will apply to unconventional resource development. Great Bear's specific business focus in Alaska is unconventional resource play development of both oil and gas. It is volumetrically the largest oil and gas play yet to be developed in Alaska and provides the state the best opportunity to build a growing production profile over the long term. Great Bear was undertaking a permitting process that would lead to an exploration program this year.

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RYAN MOYNAGH, Vice President of Finance and Chief Financial Officer (CFO), Great Bear Petroleum LLC, thanked the committee for the opportunity to discuss aspects of SB 85 that directly impact Great Bear. He said that their view is that the lessee should not be burdened or impacted by lack of success or lack of activity from previous operators. Certainly one thing they would like to see is that the application of the cost credit would not be impacted by a qualification under sustained production.

He highlighted that the definition of "pools" and "fields" was more appropriate for conventional oil and gas fields. Unconventional resources are different in geologic nature and cannot be appropriately defined using conventional terminology. He asked the committee to review whether or not the definitions

in the legislation really capture the unconventional perspective.

CO-CHAIR WAGONER said the committee was trying to address that point and the Alaska Oil and Gas Conservation Commission (AOGCC) was reviewing how other jurisdictions define what a production unit is in shale plays.

MR. MOYNAGH said the intent of the legislation is to increase oil production, and Great Bear wants to make sure that all players, regardless of business strategy, have access to the incentives.

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He said that one difference between conventional and unconventional development is the window for qualified development expenditures under the tax credit. Those costs are sort of quarantined between the first discovery well and the start of sustained production as determined by the AOGCC. Conventional field development typically requires a very large up-front capital expenditure to bring the field into production followed by minimal maintenance capex going forward, whereas unconventional development activity requires sustained capital expenditure throughout the life of the project. Under the current wording, the proportion of development costs of an unconventional prospect would be quite small in comparison to the capital expenditure that would be incurred over the life of the project. Part of Great Bear's business strategy is to bring production on as quickly as possible, but there may be instances where the legislation may dis-incentivize early production or a stage development. The legislation may sometimes force people to delay product sanctioning or start up in order to qualify more costs, which isn't necessarily good for all parties concerned. Great Bear would welcome anything that expedites the development and brings oil production forward as quickly as possible.

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MR. MOYNAGH characterized the oil and gas review board as an excellent idea, because it's an overwhelming task for any one person or even the largest of companies to understand and compare the nearly 200 fiscal regimes the world over. However, it is incredibly important to understand the reality of one's fiscal competitiveness and how it is viewed by others. He was pleased to learn of the efforts in the Division of Oil and Gas to produce commercial models that are available to the industry. Anything that can be done to advance the understanding of the fiscal regime is to be encouraged.

Ultimately, Alaska's fiscal competitiveness will be judged on the basis of its success in attracting new investment. Exploration going forward is the leading indicator of whether or not the fiscal regime is being competitive on a global scale. He encouraged review in light of how industry is mobilizing.

CO-CHAIR WAGONER thanked Mr. Moynagh and Mr. Thompson for taking time to express their views on SB 85.

MR. THOMPSON said Great Bear was happy to be in Alaska and feels the future there is bright for the oil and gas industry. Their plans are to play a large role in that future.

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GEORGE PIERCE, representing himself, said his opinion is that SB 85 is the only way to go and a good start. By comparison, HB 110 gives too much away. The talk is about investments and incentives. Making an investment is always a challenge, and the incentive is the potential to make billions of dollars. He suggested the committee level the playing field and give Alaskans their fair share. "We don't want the taxes lowered," he stated. Give a little to get new investors, but make it worthwhile to Alaskans.

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PAUL KENDALL, representing himself, said all the laws need to be scratched and an "Open for Business" sign posted, because energy will be so volatile in the future that there won't be models of predictability. New territory is ahead as carbon-based energy is left behind. He cautioned that legislators were being played by industry that was portending brave new oil frontiers, and that it was folly to believe that the big oil companies didn't own the playing field.

MR. KENDALL said Alaska has a chance to lead the world and he would suggest the state invest in 100,000 electric vehicles for use in the Anchorage area. This would save about 2.5 million barrels of oil per year and keep \$400 million in the community. Clearly the new economy will be to replace carbon-based energies.

In conclusion he expressed concern about transparency in conducting the public's business, and that his emails to legislators were never acknowledged.

CO-CHAIR WAGONER thanked Mr. Kendall and closed public testimony. [SB 85 was held in committee.]

4:56:38 PM

There being no further business to come before the Senate Resources Standing Committee, Co-Chair Wagoner adjourned the meeting at 4:56 p.m.