ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE
February 8, 2012
3:34 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Senator Cathy Giessel

COMMITTEE CALENDAR

OVERVIEW: GLEASON DECISION OF 12/30/2011 REGARDING THE ASSESSED VALUATIONS OF THE TRANS ALASKA PIPELINE

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

ROBIN BRENA, Attorney
Brena, Bell, and Clarkson, P.C.
Anchorage, Alaska,
POSITION STATEMENT: Testified during the presentation on the Gleason Decision.

CRAIG RICHARDS, Attorney
Walker and LeBreck
Anchorage, Alaska,
POSITION STATEMENT: Testified during the presentation on the Gleason Decision.

ACTION NARRATIVE

3:34:13 PM
CO-CHAIR JOE PASKVAN called the Senate Resources Standing Committee meeting to order at 3:34 p.m. Present at the call to order were Senators Wielechowski, French, Stevens, Co-Chair Wagoner and Co-Chair Paskvan.

OVERVIEW: GLEASON DECISION OF 12/30/2011 REGARDING THE ASSESSED VALUATIONS OF THE TRANS ALASKA PIPELINE

CO-CHAIR PASKVAN said the committee would continue to take up the only order of business today, a review of the decision following the Trial de Novo of the 2007, 2008 and 2009 assessed valuations of the Trans Alaska Pipeline System (TAPS), known as the Gleason Decision of 12/30/2011.

3:36:06 PM
CO-CHAIR WAGONER asked what the current status of the Gleason Decision was. He inquired if a judgment was handed down and if a judgment was necessary prior to an appeal.

ROBIN BRENA, Attorney, Brena, Bell, and Clarkson, P.C., related that no judgment had been made and one is required prior to an appeal. He continued to say that the 2006 case is being briefed to the Alaska Supreme Court, there has been a judgment, and it has been appealed. The 2007 - 2009 cases have not yet received a judgment.

CO-CHAIR WAGONER asked when the judgment might be made.

MR. BRENA said that it takes three-and-a-half years to move from a Superior Court decision through an Alaska Supreme Court decision.

CRAIG RICHARDS, Attorney, Walker and LeBreck, added that in the 2007-2009 case, Judge Gleason left the state bench and went to the federal bench. The case is in the process of being handed over to a new judge.

SENATOR STEVENS requested clarification of the logic of the saying "as the price of a barrel of oil increased by $10, the expected life of TAPS increases by 5.5 years."

MR. BRENA explained that it is the statistical correlation of BP Exploration's description of the expected economic life of the

Prudhoe Bay field at different price points. He referenced a graph that depicted price data points and Security Exchange Commission (SEC) filings.

3:38:41 PM
SENATOR WIELECHOWSKI asked for clarification of "duty to produce". He brought up the argument that Alaska is competing with other places around the world for investment dollars. He shared his understanding of "duty to produce" by relating that the CEO of ConocoPhillips indicated if the legislature passes HB 110, it would invest $5 billion and produce roughly 90,000 barrels of oil. That would generate about a $3 billion net present value profit to the companies at about a 92 percent rate of return under the DL 1 leases. He questioned if it was a valid argument that if a company can make money somewhere else, they can ignore what their leases say.

SENATOR MCGUIRE joined the committee.

3:40:02 PM
MR. BRENA acknowledged the presence of Bill Walker, co-counsel on the case.

MR. RICHARDS addressed Senator Wielechowski's question. He explained that American oil and gas leases contain understood terms and covenants, some implied and some expressed. One of the fundamental tenants of oil and gas law is that if a landowner leases their land to an oil company, the oil company has an obligation to undertake all development projects if there is a reasonable expectation of profit. That is called an obligation to explore, produce, and market. If there is a net present value positive project, the company is required to undertake that project. That is often characterized in the "reasonably prudent operator" standard, which says it would be unfair of the operator to not undertake a profitable project in a lease and take their money elsewhere. The operator is not allowed to "high grade" investment projects with different leases.

MR. RICHARDS noted that these cases are litigated all the time in Texas. As it applies to ACES, if an operator says they can make more money undertaking a project in Trinidad than from an Alaskan project, it is a violation of their lease obligation.

MR. BRENA related that he looks at it as to "whether you pay somebody twice to do what they agree to do." They are paid once to develop the North Slope resources and paid a second time

through a tax incentive. He discounted a need to pay them a second time.

3:43:40 PM
SENATOR WIELECHOWSKI summarized the analysis under ACES as it relates to Mr. Brena's philosophy. He said the state should be looking to see if there is a positive net present value under ACES for a future oil production project, and if there is, the company would be legally required under their lease to go forward.

MR. RICHARDS agreed. He said the law is clear on that point. He suggested that the state would want to make sure that the taxing regime is not driving out investment dollars.

3:45:06 PM
MR. BRENA summarized, "What they can and cannot make in another lease in another part of the world is irrelevant to their duty to produce the resource in Alaska."

MR. BRENA addressed Senator French's request for backup and support to the suggestion that TAPS tariffs represent over-collection of $13.5 billion. He referred to a packet of information which provides that information: Judge Gleason's order to that effect, order number 151 from the Regulatory Commission of Alaska, and charts from Cicchetti Report 1525. He listed several return deficiencies.

He pointed out that $13.5 billion of extra transportation rates is a significant barrier to entry to independents that would have to pay the full cost. The amount does not include the demolition removal and restoration obligations or earnings.

3:48:46 PM
CO-CHAIR PASKVAN noted that the aforementioned documents are available on BASIS and in the committee room.

MR. BRENA addressed Senator Wagoner's question about the impact to producers from taking away existing tax credits. Mr. Brena clarified that he was not suggesting that the legislature do that.

CO-CHAIR WAGONER noted that his question was in regards to taking tax credits away from explorers.

MR. BRENA said he was not suggesting taking away any existing tax credits from anyone.

MR. BRENA summarized yesterday's hearing. He said it is important to note three things: Judge Gleason used proven reserves only in evaluating the life of TAPS, which would last until about 2065 to 2068. Using proven reserves, Judge Gleason set the limit at 100,000 barrels per day, even though the evidence shows that TAPS could operate below that level. No witness suggested a single example of a pipeline anywhere in the world that could not figure out how to transport economic oil.

MR. BRENA referred to slide 84 as an example of minimum throughput economics of continued operation of TAPS. He opined that the oil companies would figure out how to transport the stranded oil due to its tremendous value. He maintained that TAPS will be operating when everybody in the room was dead.

3:54:55 PM
MR. BRENA turned to slide 86, the frustrations of obtaining access to industry information. He expressed frustration that the Department of Revenue makes little effort to find out information that enables them to administer AS 43.56 properly. He stressed that the department has the power to compel the information, but doesn't. Instead, they rely on information reported to the SEC, which is off by decades, and from experts who don't have confidential information.

He said he believed both the department and the legislature should use their power to get this information in order to fulfill their duties to Alaskans. The department has chosen a cooperative approach and they haven't gotten the information they need.

MR. BRENA addressed another problem whereby the department stamps everything "taxpayer confidential," whether it is or not. It is difficult to determine what the tax policy should be without necessary information from the companies.

3:59:38 PM
MR. BRENA said the statute allows the department to enter into cooperative administrative agreements with municipalities so that confidential taxpayer information could be shared with municipalities. However, efforts to do so have been unsuccessful.

He related that Steven Van Zant observed that the oil companies provide experts that are not privy to necessary information. He predicted that the legislature would run into problems with the

department because it lacked the data and information needed to develop a tax policy.

4:01:55 PM
SENATOR STEDMAN joined the committee.

SENATOR WIELECHOWSKI thanked Mr. Brena for bringing up what he called "one of the critical issues that we face." He noted that this issue came up during the discussion of ACES. The consultants hired at that time were shocked at the lack of information the legislature had. Five years later the same holds true. He maintained that DOR has stonewalled repeatedly despite numerous requests for information. He inquired what the department was saying to Mr. Brena.

MR. RICHARDS reported that he deposed the state assessor who was very frank about the fact that the department has made a policy decision to work cooperatively with industry because they believe that doing so will result in more information. Mr. Richards opined that history has shown that not to be true. The state assessor made it clear that he has never used the authority he has to compel the oil companies to provide information. He would first have to receive permission from the commissioner to do so.

CO-CHAIR PASKVAN asked if the effect of the policy is that the State of Alaska is in the dark when making these policy decisions.

MR. RICHARDS said that was a fair characterization of the department's position on AS 45.56.

MR. BRENA discussed the kinds of information the legislature ought to have from the oil companies. Legislators should demand accurate information regarding the information oil companies use for their own decision making, such as which projects they intend to develop without the use of tax incentives.

4:07:53 PM
He related that the information used in the Ad Valorem Case was inconsistent with what was actually used to make internal company decisions.

He said that the information companies provide to the investment community tends to exaggerate their worth, production schedule, and oil value in order to increase the value of their company and their ability to finance. He noted they share their

development plans with the BP Royalty Trust because they are obligated to do so for the purpose of SEC filings. The department should have all of that information, also.

He continued to say that when a company prepares for a sale, such as of the assets on the North Slope, it provides information to potential purchasers, including documents detailing the value of those assets. The legislature has no access to that kind of information.

SENATOR FRENCH said he shared Mr. Brena's concerns. He reported that he has requested an example of, under the category of information used for internal decisions, a project made uneconomical by ACES. He said he sent a letter to BP and ConocoPhillips requesting one example of a project on hold due to ACES and has received no response, in spite of the industry having said those projects exist.

4:13:38 PM
MR. BRENA related that the areas of information that he is presenting to the Senate Resource Committee have been found to be inconsistent and not credible based on Judge Gleason's public ruling, in the context of ad valorem tax litigation. He opined that the legislature has a duty "to run this to ground" and obtain hard date in order to make good policy decisions regarding the future of Alaska.

MR. RICHARDS said he views ACES as a complex tax and to understand the impact it has on decision making at the corporate level, a person needs the data that goes into the model. Without that information, there is no way to know whether any reduction in taxes is the right amount or that it's targeted in the right manner.

MR. BRENA provided an example of testimony by Jeff Bray from Exxon. He said one contradiction he took advantage of during the ad valorem litigation was the "doomsday throughput scenarios." He read a quote where he was trying to get Mr. Bray to provide evidence that the throughput profile would change if the tax is changed. Mr. Bray said he certainly hoped that it would be the case, but it would be speculative to say it would. He continued to say, "We wouldn't give that much weight with all the uncertainties involved."
Mr. Brena concluded that what people tell SEC matters; if they lie, they go to jail. What people do internally matters; they get fired if it's not accurate. What people tell purchasers, they don't want to litigate forever and it proves out to be

wrong in a multi-billion transaction. What people tell the legislature, taxing authorities, and rate regulators seems to be different than what they are telling everybody that matters.

CO-CHAIR PASKVAN asked if that witness was under oath.

MR. BRENA said yes.

4:20:09 PM
MR. RICHARDS made some points about DOR's treatment of confidentiality. He turned to slide 97 to provide examples. There are two statutory provisions that provide an exception to the Alaska Public Records Act for taxpayer information. One is an exception for taxpayer information, which includes particulars of business affairs of the taxpayer or items divulged on tax returns. The department takes that exception and paints it as broadly as possible to include everything a taxpayer provides. The department even treats production forecasting information as taxpayer confidential material. It is not even for tax purposes, but rather for budgeting purposes for its Revenue Sources Book.

Judge Gleason observed that the department was treating budget information as confidential material. He opined that it was a policy call by DOR to allow the producers to feel comfortable about providing information. It also reflects a lack of desire by DOR to sift out what is confidential and what is not. He believed that in a state where 80 percent of revenues come from a couple taxpayers on the North Slope, and with a history of "closed door deals," it should be the policy of DOR and the legislature to encourage full disclosure of information.

MR. BRENA reported that the standard for making something public within the context of litigation is whether there is competitive harm and the public interest or right to know does not outweigh the potential.

4:24:35 PM
MR. BRENA provided a summary of the presentation with six take away points:

> Don't use bad tax policy to correct a failed competitive marketplace; instead insure an open, competitive market. Sound tax policy should consider the market structure and should not substitute tax incentives for behavior which would normally and organically occur in an open marketplace. Market

dominance by the "Big Three" is real and results in the underdevelopment of Alaska's resources. One need not look any further than the Big Three for the raw power that they exercise over the development of Alaska's natural gas resources as leverage to lower their oil taxes. Alaska is "outgunned" by the Big Three.

Don't pay the Big Three producers to do what they are already contractually obligated to do. Sound tax policy should not incent behavior and goals that producers are otherwise already doing.

If you have to pay more to get the job done, pay the producers most willing to do the job. Two out of the Big Three have demonstrated that they are not interested in expanding exploration and development in Alaska. Independents are knocking at the door.

Increases to the price of oil are making exploration and production more profitable, regardless of the progressivity of the tax structure. At issue is how to divide up profit at higher oil prices. Investment decisions are justified based on long-term forecasts. Projects will get done regardless of how the state divides up the pie.

It is absolute fiction that TAPS is in imminent threat of shutting down. Sound tax policy should not be deliberated under the context of a fictional cloud or crisis. There is evidence that production will stabilize and increase over time, with or without tax incentives.

4:31:04 PM

MR. BRENA mentioned one of Mr. Bradford Keithley's rebuttal points, "It's about production, stupid," and agreed that it was about production, but added that the state needed to "take off the table" that TAPS will shut down any time soon. He noted that Mr. Keithley didn't appear in the Gleason Decision case and isn't familiar with the discovery and the confidential materials.

MR. BRENA noted the last of six concluding points:

The legislature should have complete and accurate information upon which to base its tax policy. The legislature has a fiduciary responsibility to all

Alaskans and should look at the oil company's data used for internal decision making, financial communities, and potential purchasers.

MR. BRENA thanked the committee for the opportunity to speak.

4:34:30 PM
CO-CHAIR WAGONER returned to Mr. Brena's first point. He related that he believed in "trust but verify." He said he planned to offer an amendment providing a tax holiday if a company shows proof that they will increase production over and above their current level of production. He stated he did not have a concern about TAPS shutting down any time soon. Instead of giving back $2 billion, he suggested incentivizing increasing production.

4:36:05 PM
MR. BRENA said he shared many of the views Senator Wagoner expressed. He opined that when there is a closed market and barriers to entry, the first thing that should be done is to open up the market to competition. In order to promote a tax holiday, a base line would be needed to assure that companies don't currently plan to increase production and haven't already budgeted money to do so. He reiterated that production will stabilize, followed by upward production, regardless of what is done.

CO-CHAIR PASKVAN asked where the state is on the decline curve and how policy makers should react to it.

MR. BRENA reported that "elephant fields follow hyperbolic decline curves." Those fields can remain flat for a long period of time. The state is currently on the "drop down to the point of flattening out." When TAPS was built there were 9.6 billion barrels of proven reserve; today there are 7 billion or 8 billion. He predicted that those barrels would be coming through the line due to high prices of oil.

4:40:39 PM
CO-CHAIR PASKVAN asked Mr. Richards about the federal mineral law comparing Alaska with other U.S. jurisdictions and questioned how Alaska might be unique.

MR. RICHARDS responded by agreeing with what former-Governor Wally Hickel pointed out in the Mineral Leasing Act of 1920. The federal government made a policy decision that when they got rid of federal lands, they were going to keep the mineral deeds. That requirement became imbedded into the statehood compact for

Alaska. Alaska received 103 million acres and when it disposes of its acres, it will keep the mineral deeds. Alaska will always be the resource owner, unlike Texas or Oklahoma, and should act like a landowner.

CO-CHAIR PASKVAN requested continuing substantive factual information from Mr. Brena and Mr. Richards.

SENATOR WIELECHOWSKI thanked the presenters.

4:43:26 PM
There being no further business to come before the committee, Co-Chair Paskvan adjourned the Senate Resources Standing Committee at 4:43 p.m.