

**ALASKA STATE LEGISLATURE**  
**SENATE RESOURCES STANDING COMMITTEE**

April 24, 2012

9:07 a.m.

**MEMBERS PRESENT**

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

**MEMBERS ABSENT**

Senator Thomas Wagoner, Co-Chair

**OTHER LEGISLATORS PRESENT**

Senator Cathy Giessel  
Senator Dennis Egan  
Senator Joe Thomas

**COMMITTEE CALENDAR**

SENATE BILL NO. 3001

"An Act relating to adjustments to oil and gas production tax values based on a percentage of gross value at the point of production for oil and gas produced from leases or properties north of 68 degrees North latitude; relating to monthly installment payments of the oil and gas production tax; relating to the determinations of oil and gas production tax values; relating to oil and gas production tax credits including qualified capital credits for exploration, development, or production; making conforming amendments; and providing for an effective date."

- HEARD & HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SB 3001

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

04/18/12           (S)           READ THE FIRST TIME - REFERRALS

04/18/12 (S) RES, FIN  
04/19/12 (S) RES AT 3:30 PM SENATE FINANCE 532  
04/19/12 (S) Heard & Held  
04/19/12 (S) MINUTE(RES)  
04/20/12 (S) RES AT 10:00 AM SENATE FINANCE 532  
04/20/12 (S) Heard & Held  
04/20/12 (S) MINUTE(RES)  
04/24/12 (S) RES AT 9:00 AM SENATE FINANCE 532

#### **WITNESS REGISTER**

REPRESENTATIVE MIKE HAWKER, Chair  
Legislative Budget & Audit Committee  
Alaska State Legislature  
Juneau, Alaska

**POSITION STATEMENT:** Testified during the discussion of SB 3001.

JANAK MAYER, Manager  
Upstream & Gas  
PFC Energy  
Washington, DC

**POSITION STATEMENT:** Provided information during the discussion of SB 3001.

#### **ACTION NARRATIVE**

[9:07:57 AM](#)

**CO-CHAIR JOE PASKVAN** called the Senate Resources Standing Committee meeting to order at 9:07 a.m. Present at the call to order were Senators French, Stevens, McGuire, Stedman, Wielechowski, Co-Chair Paskvan.

#### **SB 3001-OIL AND GAS PRODUCTION TAX**

CO-CHAIR PASKVAN announced consideration of SB 3001. He said Representative Hawker would clarify PFC's role in SB 3001.

CO-CHAIR WAGONER was excused.

[9:09:18 AM](#)

REPRESENTATIVE MIKE HAWKER, Chair, Legislative Budget & Audit (LB&A) Committee, testified during the discussion of SB 3001. He thanked Co-Chair Paskvan for the opportunity to clarify the issue regarding who PFC's consultants are working for, their relationship with the Department of Revenue (DOR), and their fiscal system model. He related that he and Senator Bert Stedman, Vice Chair of LB&A, realized the need for top notch

consultants to evaluate oil and gas fiscal systems and legislative proposals. He said they requested that LB&A engage PFC Energy to support the legislature in the development and evaluation of the fiscal systems. One of the critical elements of the contract with PFC Energy was that they would have to develop a comprehensive fiscal model of the current oil and gas system in order to analyze the consequences of proposed policy changes. The goal was to avoid any controversy regarding dueling models. Within the process of developing models, PFC was encouraged to talk to all parties regarding new models and their consequences.

[9:12:47 AM](#)

He continued to say that analysis occurred with PFC's modeling as it related to the final work product from the Senate Finance Committee near the end of the legislative session. He said DOR was using the same input data and coming up with a different consequential analysis than PFC did. PFC took a limited function (snapshot) calculation of data to see why DOR was not coming up with same numbers. That resulted in a change to PFC's numbers that required an amendment in the Senate Finance Committee.

REPRESENTATIVE HAWKER repeated that PFC works solely for LB&A and for the legislature. He said he verified the truth that PFC's modeling was not used in any of DOR's modeling related to SB 3001.

SENATOR STEVENS said that is what they suspected and he was pleased to have it confirmed. He inquired if there were additional consultants available to work with the legislature during this special session.

REPRESENTATIVE HAWKER replied that LB&A has PFC Energy consultants, as well as David Wood Associates for modeling gas fiscal systems, and small contracts for quick services with Roger Marks and Dan Dickinson.

SENATOR STEDMAN agreed with that inventory.

[9:16:28 AM](#)

SENATOR WIELECHOWSKI recalled that in the past, during ACES, the legislature had had unfettered access to the consultants. In this process, the legislature has been told it needs to go through LB&A in order to access the consultants. He requested unfettered access to PFC Energy.

REPRESENTATIVE HAWKER replied that all legislators have access to PFC; however, there is a need to perform triage in order to use consultants effectively. Their main function is to perform support services for committee work. Service requests are contractually required to go through the chair of the LB&A Committee. He did not believe anyone had been denied access to PFC Energy. If someone wants specific work done they can request it, but it will be prioritized.

[9:19:29 AM](#)

SENATOR FRENCH reported that the Commissioner of Revenue described how DOR had built the numbers for SB 3001 by working in conjunction with PFC Energy. He said he understood that the legislature would receive a model from PFC and he was surprised that DOR had the information. He asked Representative Hawker if he expects the legislature to receive a model from PFC, and if so, when.

REPRESENTATIVE HAWKER said the contractual arrangement with PFC states that their fiscal system model will be turned over to LB&A at conclusion of their engagement. The reason is that the model evolves each time a new proposal is introduced.

SENATOR FRENCH suggested that the contract with PFC could be interpreted in several ways. He said it would have been more helpful to get evolving models with the caveat that they are not representative of the final product.

REPRESENTATIVE HAWKER said he understood, but maintained that evolving models would be an entirely different work product than was in the contract. PFC was engaged to provide reactive analytical modeling services to policy developments proposed by committees. He maintained that Senator French's suggestion of a "dashboard" model would be too complex. He opined that another consultant might be found to develop a backstop model.

[9:24:31 AM](#)

CO-CHAIR PASKVAN said he appreciated Representative Hawker's explanation. He asked if Gaffney Cline advisors have been participants in the "truing up" of the models to prevent dueling models.

REPRESENTATIVE HAWKER said he had no knowledge of anything to do with Gaffney Cline. He concluded that credibility and respect of the consultants is critical. He voiced concern about bringing an incomplete work product into the public domain during the interim.

SENATOR STEDMAN noted that it is standard procedure to ensure that models from the industry, the administration, and the legislature result in reasonably close output, so the concentration is on policy, rather than on who has the best model. It benefits all three participants.

CO-CHAIR PASKVAN agreed that was important.

[9:27:02 AM](#)

REPRESENTATIVE HAWKER reported that PFC has satisfied their initial contractual obligation to the legislature, which was to provide models and services during the regular session. He noted the decision to rehire PFC for special session will come before the LB&A Committee tomorrow. He spoke in favor of providing a new contract with PFC.

SENATOR STEDMAN commented that PFC began its work for the legislature in December.

REPRESENTATIVE HAWKER agreed. He said that PFC did preliminary work, meeting with the industry and identifying their understanding of the state's fiscal regime.

SENATOR STEDMAN noted the compressed time frame PFC had to put a complex model together.

REPRESENTATIVE HAWKER added that both DOR and the industry have had to update their models constantly.

CO-CHAIR PASKVAN remarked that it has been useful to hear the foundation information.

SENATOR WIELECHOWSKI requested PFC's billing records.

REPRESENTATIVE HAWKER said they were public records. He noted that LB&A doesn't have PFC's internal time records, which would require a specific request.

[9:31:12 AM](#)

JANAK MAYER, manager, Upstream & Gas, PFC Energy, provided information during the discussion of SB 3001. He noted he was project manager for the Alaska Legislature contract through LB&A.

MR. MAYER began by discussing the impact of ACES and SB 3001 on existing legacy assets and on higher cost new assets. He related the problem of the increasingly high costs of developing

new projects in Alaska. He showed a slide which depicted the costs of bringing on a new barrel of oil in Alaska, as compared to other regimes. The cost of new oil in Alaska is comparable at times to the capital costs of unconventional oil in the Lower 48. Alaska's government take has risen significantly over recent years, meaning new project economics can be very challenging.

He explained that an analysis was done on new oil at different prices under ACES and under new incentivized models.

CO-CHAIR PASKVAN asked how the bars would change if credits were included in the analysis.

[9:35:47 AM](#)

MR. MAYER responded that Alaska certainly is unique in the types and amounts of credits it provides. However, government take must also be considered in the equation and is very high. ACES exemplifies that combination of high number of credits and a high government take.

CO-CHAIR PASKVAN said he wanted to be cautious in only looking at one component of the economic analysis. Alaska is a participant with the industry in operating and capital expenses.

SENATOR WIELECHOWSKI understood that the state picks up 60 percent of development costs.

MR. MAYER replied that it varies a lot depending on the circumstances.

SENATOR WIELECHOWSKI requested more information on the subject. He maintained that the credits and deductions and tax breaks would knock down production costs even lower than some of the Lower 48 regimes. He disagreed with the information portrayed on PFC's chart.

MR. MAYER commented that one needs to compare Alaska to other regimes that have similar credits. He maintained that Alaska takes in more than it gives credit for.

[9:43:21 AM](#)

CO-CHAIR PASKVAN stressed the importance of knowing that Alaska will have invested \$5 billion of credits in North Slope infrastructure through 2013, even to the extent of providing cash to those who don't have production.

MR. MAYER agreed.

[9:44:47 AM](#)

SENATOR FRENCH drew attention to the comparison of Alaska to Bakken fields' costs of \$22/boe for operation and capital costs. He pointed out that he has seen numbers far higher for Bakken, up to \$50/boe. He asked where PFC got their numbers and how sure PFC was regarding them.

MR. MAYER offered that there was a PFC team in Huston that focuses on unconventional oil development costs in North America. This data comes from their cost estimates. He noted that there are huge amounts of variation in estimations of wells. It is PFC's best estimate.

SENATOR FRENCH asked if the estimate is homogenized across Bakken fields.

MR. MAYER offered to provide more information on the Bakken fields. He said the Haynesville fields have lower capital costs due to Exxon's highly economic influence. He noted he was talking about actual companies, more than a homogenized look.

[9:48:00 AM](#)

CO-CHAIR PASKVAN referred to a previous presentation regarding Capex cost structures where North America was being used by companies as a cash source for funding overseas operations and vice versa. He called these areas "cash deficit" regions. He asked if Alaska were to develop shale oil, if Capex investment would increase.

MR. MAYER replied a lot would depend on the nature of the shale resource. There is nothing uniform or predictable about the development of unconventional play in North America or elsewhere.

CO-CHAIR PASKVAN noted that the Senate passed a new field tax incentive bill which includes shale oil. He inquired if a new field tax incentive would provide significant incentive for shale field development.

MR. MAYER replied that compared to the existing system, it provides a significant incentive. However, it could still be challenging even with most generous credits.

[9:52:45 AM](#)

SENATOR WIELECHOWSKI referred to an article in Petroleum News where it said that Bakken producers, depending on location and

other factors, must receive from \$40 to \$60 per barrel of oil to stay in business, according to industry representatives. He questioned the \$22 amount shown in Mr. Mayer's chart.

MR. MAYER countered that if one removes government take at 50 to 60 percent, it would bring the cost down.

MR. MAYER addressed the effect of progressivity under ACES on price upside to oil companies. The graphs depict two new development scenarios, one under ACES and the second using a flat 25 percent profits-based tax using net present value (NPV) and internal rate of return (IRR). The picture changes with higher costs of development.

He turned to a slide that showed the project value under ACES with cost and price sensitivity.

CO-CHAIR PASKVAN returned to the charts on page 4 and asked if at \$100/bbl, the internal rate of return is 20 percent. He wondered if that was an acceptable rate.

MR. MAYER replied that the example is a hypothetical analysis of new development with attractive economics.

[10:00:35 AM](#)

SENATOR FRENCH asked how far back you have to go to get a clear picture of the capital spend impact on IRR.

MR. MAYER replied that to get a meaningful picture you must go back to when the field was developed.

SENATOR FRENCH questioned if the initial spend diminished as an impact on IRR.

MR. MAYER emphasized that the IRR can't be calculated unless the initial spend is used.

SENATOR FRENCH referred to the chart and asked how the calculations were made without knowing all the capital costs on the North Slope.

MR. MAYER replied that the high cost developments are compared, using various costs and prices, to low cost light oil averages on the North Slope today. The chart is not a perfect example of the rate of return of actual initial investments made by companies thirty years ago. They are hypothetical examples.

SENATOR WIELECHOWSKI asked what discount rate is used in the calculations.

MR. MAYER said for NPV it was 10 percent.

SENATOR WIELECHOWSKI asked if 10 percent is a reasonable rate. He inquired about the standard hurdle rate an oil company uses when trying to determine whether or not to make an investment.

[10:04:38 AM](#)

MR. MAYER related that NPV 10 is a common way to measure economic value. Hurdle rates are considered an initial hurdle to even get a project considered and depend on many factors.

MR. MAYER noted the point of slide five is to show that the economics of low cost production can be attractive. At higher cost levels, the economics are very challenging and the progressivity factor, which is good for low cost fields, achieves only break even rates.

SENATOR WIELECHOWSKI returned to the issue of credits. He pointed out if the state is picking up half the cost, the economics of a field is significantly improved.

MR. MAYER said the chart was made by running an actual profile through the model and the figures account for the capital credits. A slight improvement would be shown if this was done for a stand-alone project.

[10:07:40 AM](#)

SENATOR FRENCH asked if PFC Energy has access to company books that show costs of projects on the North Slope.

MR. MAYER related that PFC has no access to confidential company information, but does have conversations with companies.

SENATOR WIELECHOWSKI reported on a discussion with the Commissioner of Revenue about getting access to that information. He opined that DOR already has that information in the form of oil company tax returns.

MR. MAYER agreed that DOR has access to a lot of confidential tax information. He opined that simply having access to aggregate costs reported by companies doesn't provide that much information about development costs, due to the variation of types of production. He said looking at what a company is spending doesn't accurately reflect what the field will make.

10:10:32 AM

SENATOR FRENCH asked, if PFC had access to individual taxpayer information, if they could construct a far more accurate picture of the North Slope.

MR. MAYER replied that he didn't think tax data would provide enough detail.

SENATOR FRENCH said he couldn't tell what Mr. Mayer's answer was. He restated the question. He thought PFC could construct a clearer picture of the economics of the North Slope with a company's actual figures.

MR. MAYER stated that he did not know enough about what information DOR collects. He cautioned that looking at historical data doesn't tell you much about future developments and costs.

SENATOR FRENCH concluded that Mr. Mayer was resisting the idea that actual tax numbers would provide important data.

MR. MAYER replied it could be very useful data, however, one can't necessarily say it would provide data about future projects.

10:14:17 AM

SENATOR WIELECHOWSKI suggested the legislature could try to guess what the oil companies' profits are, but it would be more informative to look at the actual profit figures. For example, ConocoPhillips produced 226 million barrels of crude oil in Alaska in the first quarter of 2012, as compared to 201 million barrels produced in the Lower 48 during that time. ConocoPhillips made \$616 million in Alaska the first quarter of 2012, versus \$254 million in the Lower 48. He concluded that Alaska is an extremely profitable place to do business.

MR. MAYER did not disagree. He pointed out some of the differences in production in the Lower 48, as compared to Alaska. He questioned why oil companies are investing in the Lower 48 as opposed to Alaska. He said there is a fundamental difference between an oil company's base portfolio in the Lower 48 and in Alaska. Alaska is a highly profitable current day location for ConocoPhillips. He noted that profit information doesn't help predict what companies will do in the future. He spoke of ways to incentivize new production.

[10:20:21 AM](#)

CO-CHAIR PASKVAN pointed out that slide 5 talks about project value based on oil price sensitivity. He noted that royalties in North Dakota and Texas are 25 to 30 percent. He asked if Alaska's resource was located in either state if it would receive 25 percent or more in royalties.

MR. MAYER replied that Alaska gets significantly more than that in government take.

CO-CHAIR PASKVAN restated the question to say if Alaska's resource was located in those jurisdictions would Alaska also get 25 to 30 percent in royalties as the resource owner.

MR. MAYER replied that when comparing Alaska to other areas, PFC uses an average number; however, due to Alaska's high government take, it is difficult to compare numbers.

CO-CHAIR PASKVAN asked if it is Alaska's fiduciary responsibility to act like a sophisticated owner of a world class resource.

MR. MAYER said yes.

[10:23:46 AM](#)

Mr. Mayer turned to a discussion of ACES as a successful production tax in a harvest area fiscal regime.

CO-CHAIR PASKVAN pointed out that Alaska went into harvest mode many years before the current tax structure was created.

MR. MAYER agreed. He stated that ACES didn't create the harvest mode situation. He maintained that ACES inhibits the development of new projects and resources that might help stem or even reverse the decline in oil production.

CO-CHAIR PASKVAN said he has heard about potential investment in the legacy fields of \$5 billion over the next five to ten years. He wondered if that was consistent with the legacy fields remaining in harvest mode.

MR. MAYER related that companies are looking at specific projects on their books that are struggling, but are being considered for going forward.

CO-CHAIR PASKVAN asked if the \$5 billion amount was consistent with "debottlenecking procedures" related to remaining in a harvest mode.

MR. MAYER said he would have to look closer at that issue. It is a very hypothetical discussion at this point.

10:28:46 AM

CO-CHAIR PASKVAN asked how many exploration wells have been drilled by the majors on the North Slope in last 10 years.

MR. MAYER didn't know.

CO-CHAIR PASKVAN asked if a lack of exploration wells on the Central North Slope is an indication that the field is in the harvest mode.

MR. MAYER replied that it did not necessarily lead to that conclusion. He did not expect to see a huge amount of exploration wells in that area.

CO-CHAIR PASKVAN reported that the last major treatment facility was completed in 1995. He asked if that was consistent with the legacy fields being in harvest mode and staying in harvest mode.

MR. MAYER explained that there are many ways of determining a companies' status, such as the level of investment versus the cash that a region produces, and future spending plans.

10:31:20 AM

CO-CHAIR PASKVAN asked if TAPS throughput is a result of treatment facility throughput on the Central North Slope.

MR. MAYER said that was a technical question he was not qualified to answer. He deferred to DNR testimony about facility limitations.

SENATOR WIELECHOWSKI referred to Mr. Mayer's statement that ACES inhibits the development of new projects and resources that might stem or reverse the decline in oil production. He asked if Mr. Mayer was aware of how many companies were doing business in Alaska before ACES and how many companies are doing business now.

MR. MAYER said no. He thought there were more today.

SENATOR WIELECHOWSKI reported an increase of 253 percent in the number of companies doing business since ACES was passed. The number has gone from 18 to about 63 companies. He questioned if that would indicate that Alaska's tax structure inhibits development.

MR. MAYER explained that he expects that most of those companies are in Alaska due to generous exploration credits. He discussed a problem where the incentive provides development activity in order to claim the credit, but not necessarily results or long-term development plans. The exploration credit raises the question of what it does for Alaska in the long run.

SENATOR FRENCH requested a working definition of harvest mode.

MR. MAYER reported that it's a region that is a net cash producer that lacks new investment potential.

SENATOR FRENCH noted that analysis is buttressed by a 1994 BP memo on the length of the life of the pipeline and how Alaska is a great place to make money and ship it somewhere else to invest.

MR. MAYER said harvest is a natural part of an economic cycle of oil and gas development. It's typical for any large company in the world to use profits from one project to develop another.

SENATOR FRENCH pointed out that it has been 18 years since that memo was written and Alaska is still in the same mode.

MR. MAYER did not disagree. He suggested that there are economic scenarios that could potentially change that.

[10:38:04 AM](#)

SENATOR FRENCH asked for examples of aging, conventional reservoirs around the globe where a reasonable tax change produced a different direction, from a harvest mode to a favorable investment climate. He voiced concern that a small tax change just means Alaska's money continues to go to some other project elsewhere.

MR. MAYER offered to provide that information in a future presentation.

SENATOR FRENCH asked if his request for information should go through Representative Hawker.

MR. MAYER thought it there were a number of examples he could provide.

[10:40:03 AM](#)

CO-CHAIR PASKVAN said it doesn't ring true that ACES is not progressive with regard to costs. He noted when costs go up, Alaska's deductibility of those costs increases. If Capex increases, the deductions and credits increase.

MR. MAYER replied if one just looked at the production tax in isolation, without considering the capital credits, it would be a cost neutral system. But other elements of the tax regime are highly regressive. Not only does the overall rate of government take not decrease, it either stays flat or increases.

CO-CHAIR PASKVAN asked if he is saying that jurisdictions with royalty rates of 35 to 40 percent are highly regressive.

MR. MAYER said yes. He added that ACES is especially regressive at high oil prices.

[10:42:42 AM](#)

CO-CHAIR PASKVAN asked if it is correct to say that under Alaska's current cost structure, at high prices and low costs, there may be a taking away of some upside potential. The rate progressivity magnifies itself when one has high oil prices and low operational costs.

MR. MAYER replied that in Alaska the system doesn't really change that much with regard to cost of project. Government take does not decrease as costs go up, which is not considered attractive economics.

[10:44:15 AM](#)

SENATOR WIELECHOWSKI turned to the issue of state participation. He gave an example of a producer that produces 25 million barrels in a year, with an average tax value of \$80, total production tax is \$2 billion, with a tax rate of 45 percent, and \$900 million in taxes paid. If the producer decides to spend \$100 million on a new capital project that will result in future production, the production tax value is reduced from \$2 billion to \$1.9 billion, which drops their per barrel production tax value from \$80 to \$76 and drops their tax rate to 43.4 percent and their taxes from \$900 million to \$824 million, less a \$20 million capital credit. There is an immediate tax savings of \$95.4 million. He asked if that was correct.

MR. MAYER thought the basic concepts of the example were correct.

SENATOR WIELECHOWSKI asked if he has to go through LB&A to discuss this further.

MR. MAYER offered to look at the calculations.

SENATOR WIELECHOWSKI inquired if state participation would be 95 percent.

MR. MAYER thought it could be that high, but said he would have to look at the numbers.

[10:47:42 AM](#)

CO-CHAIR PASKVAN brought attention to the fact that there have not been any complete-year audits under ACES. The trend for capital expenditures has gone up and will continue to go up, and new operators have been coming to Alaska. He questioned how Mr. Mayer could say that ACES is inhibiting new production spending.

MR. MAYER replied that there is very limited new investment in new production, and the economics of new production is not very attractive.

CO-CHAIR PASKVAN provided an example of BP spending a lot of money on heavy oil, which is new production. ConocoPhillips has also invested in new projects, as has Pioneer and ENI, in the last 4 to 6 years.

MR. MAYER agreed that Pioneer is an example of new investment decisions before PPT or ACES were in place; however, Alaska has made it difficult for Pioneer to make a good return on their projects. A lot of the examples reached sanction before ACES was put into place. There has been little investment in high cost new development.

[10:52:15 AM](#)

At-ease from 10:52 a.m. until 11:09 a.m.

[11:09:31 AM](#)

CO-CHAIR PASKVAN reconvened the meeting.

CO-CHAIR PASKVAN asked Mr. Mayer if he could modify the chart on slide 3 to reflect credits and deductions.

MR. MAYER said he would look into it, but was wary of the answer. The point of the slide was to talk about the difference in actual costs of development.

CO-CHAIR PASKVAN wanted a clearer understanding of the net the company is expending and what portion of those expenses the state is supporting.

MR. MAYER agreed to provide that information.

[11:12:28 AM](#)

MR. MAYER reiterated the conclusions regarding ACES and turned to options to spur new development. There are a varied of approaches: uniform lowering of government take, differentiating between old and new production, and enhancing cost progressivity of ACES. There are costs and benefits to all approaches.

He related that in terms of lowering government take, one does not need to add any increased complexity into the system. The disadvantage is moving cash to producers who are extremely profitable today. If that approach is unacceptable, then the answer lies in being able to differentiate between old and new production. It is easy to set specific terms in new areas; however, this approach has disadvantages, also. No approach has the perfect option for spurring new developments.

He explained a third approach to enhance the cost progressivity of ACES. This method may exacerbate the problem of poor cost control incentives and may have unintended consequences.

MR. MAYER analyzed the three options to spur new development in terms of SB 3001. Overall, the bill allows significant reductions in government take on new and costlier developments, as well as for existing fields. It also provides for a 40 percent well lease expenditure credit in the North Slope.

[11:18:39 AM](#)

MR. MAYER reviewed the main aspects of SB 3001. For production from new North Slope fields, a 30 percent gross revenue exclusion applies to the calculations of both base and progressive tax amounts and does not apply to the progressivity rate calculation. It applies for 10 years.

For all other North Slope production, a 40 percent gross revenue exclusion applies to the calculation of the progressive tax amount only, and not to the base tax amount or to the progressivity rate calculation. It applies indefinitely.

The maximum progressive tax rate is capped at 60 percent, reduced from 75 percent. A 40 percent well lease expenditure credit applies now also to the North Slope. Capital credits can be redeemed in a single year, rather than spread over two years.

[11:20:28 AM](#)

MR. MAYER explained how the gross revenue exclusions are figured. He described slide 9, which takes data from DOR's Revenue Sources Book for showing calculations that occur at a high level of oil price under ACES and under SB 3001, for new and for existing fields. He described the process of finding the gross value at point of production (GVPP) and the production tax value (PTV), yielding the estimated total tax after credits.

SENATOR FRENCH questioned the 40 percent GVPP.

MR. MAYER clarified that it was 40 percent of \$17 billion. He continued to explain that the red numbers show the differences between the tax structures.

He said the far right column depicts the calculations for new fields under SB 3001. The GVPP allowance is 30 percent for new fields and applies to the base tax and the progressive tax.

[11:25:50 AM](#)

CO-CHAIR PASKVAN explained that the charts are just showing the application of the system to numbers, not to dollars on existing legacy fields.

MR. MAYER agreed.

SENATOR FRENCH asked if the calculations would apply to new shale oil developments that are outside of existing units.

MR. MAYER said if those developments were to reach production in 2013, that would be correct.

SENATOR FRENCH added that it could be in 2014 or 2015. He stated that it would not apply to heavy oil development in Prudhoe Bay or in Kuparuk.

MR. MAYER agreed.

MR. MAYER described the purpose of the gross revenue exclusion concept. It is a concept that allows the reduction of government take on some fields of production under the existing tax

structure. ACES is a profit-based tax that taxes wellhead revenue net of costs. Under ACES it is very difficult to vary either the base or the progressive rates for some forms of production and not others. The only way to do that requires "ring-fencing" to allocate costs between different streams of production. The only way to vary tax rates under ACES is by using a gross revenue exclusion.

[11:29:18 AM](#)

SENATOR FRENCH focused on Prudhoe Bay and Kuparuk reservoirs. SB 3001 reduces taxes on all of the oil there, whereas the Senate was trying to think of ways to reward investment performance such as oil production that beats the decline curve as seen in SB 192. He suggested using the gross revenue exclusion to reward oil production that beats the decline curve.

MR. MAYER said that was correct.

SENATOR FRENCH inquired if the same was true for heavy oil.

MR. MAYER said yes, and it could be done at a higher rate, due to high costs.

MR. MAYER continued to say that gross revenue exclusion makes it possible to distinguish between production streams and provide incentives for the most challenged.

He said SB 3001 takes the concept of gross revenue exclusion and uses it to lower government take across all North Slope fields. If one wants to reduce government take, it would be easier to reduce the progressivity rate rather than use a gross revenue exclusion.

[11:32:37 AM](#)

MR. MAYER turned to slide 11 to show how SB 3001, ACES, and HB 110 would look in the 2013 revenue comparison chart, based on DOR assumptions in costs and levels of production. He described the columns under each scenario at various oil prices.

[11:37:04 AM](#)

CO-CHAIR PASKVAN referred to page 19 of a recent publication entitled, "Fiscal Systems for Hydrocarbons." He noted that government take is listed as a fiscal statistic, as compared to an economic measure. The article maintains that a lot of confusion can arise out of a discussion of government take. Comparisons of government take across jurisdictions can be very

difficult. He requested Mr. Mayer's opinion regarding government take.

MR. MAYER agreed that benchmarking government take across different fiscal regimes is difficult. He noted that PFC tries to do analyses based on production profiles and cost estimates from PFC's databases on new projects in a broad range of jurisdictions around the world. He said they try to be as accurate as possible.

[11:39:56 AM](#)

SENATOR FRENCH asked what the publication date of the report was.

CO-CHAIR PASKVAN said it was 2007.

SENATOR STEDMAN inquired where it came from.

CO-CHAIR PASKVAN said it was called, "Fiscal Systems for Hydrocarbon Design Issues, published by World Bank, Washington, DC, working paper 123. It is posted on BASIS and is 31 pages.

[11:41:33 AM](#)

MR. MAYER turned to slide 12 which deals with government take comparisons in FY 2013 under ACES, SB 3001, and HB 110 at various price levels.

CO-CHAIR PASKVAN related that the committee received information from Pedro Van Meurs which said that government take at 70 percent to 75 percent in existing fields was an appropriate range to look for. He asked if the chart depicting government take of 70 percent at \$100 oil under ACES included legacy fields.

MR. MAYER said yes. He stated that government take of 75 percent was reached under ACES at about \$135 oil.

[11:44:15 AM](#)

MR. MAYER described the project value of a field under different fiscal options. He referred to charts 13-15 to explain the differences in value at \$17/bbl fields, \$25/bbl fields, and \$34/bbl fields. The differences in project value become magnified at higher cost of production.

[11:47:38 AM](#)

SENATOR WIELECHOWSKI asked what sort of assumptions Mr. Meyer was using in terms of size of project, number of barrels

generated per day, upfront costs, and amount of time taken before the initial investment.

MR. MAYER replied that he used the same level of hypothetical series of cash flows used previously: a small 10,000 barrel/day new field, with two years of heavy Capex spending, and five or six years of drilling costs ongoing, start up after two years, three years to ramp up to production, and then a relatively shallow decline.

SENATOR WIELECHOWSKI requested a copy of that model.

MR. MAYER said that the model being used is a working model that changes every day. He did not recommend anyone else's use of the model until it was finished.

SENATOR WIELECHOWSKI asked Mr. Mayer to provide the specific assumptions and said it would be helpful to have access to some sort of model, even a rough model. He did not see any benefit in receiving the model after all their work was finished.

SENATOR FRENCH referred to the World Bank document previously discussed and suggested that pages 22 and 23 offer a helpful framework for analyzing future developments. It uses four different field characteristics and then applies each tax regime to the various models. He asked if that process could be used for analyzing Alaska's tax regimes.

MR. MAYER requested a copy of the document. He said he would prefer to review the information before commenting.

SENATOR FRENCH commented that the analysis was done for fields of different sizes in order to determine where the sweet spot was. He said that was helpful.

[11:54:05 AM](#)

MR. MAYER offered to look over the material.

He continued with an explanation of how 40 percent exploration well credits would create high levels of government support. The interaction of the well credits with the high rates of progressivity under ACES means that very high levels of effective government support on a large tax cash flow basis can be achieved. This is also the case when extending the 40 percent well credit to the North Slope.

SENATOR STEDMAN requested the information in table format up to \$160.

MR. MAYER said that was possible.

SENATOR FRENCH opined that this slide was one of the most revealing slides of the day. He summarized that at \$90 barrel, 80 percent was the after tax effective government well work contribution. He inquired if the government was picking up 80 percent of the costs of the well work.

MR. MAYER replied that it depends on the situation and who does the well work. The costs are picked up in the form of reduced tax liability and tax credit.

SENATOR FRENCH asked if there is any jurisdiction in the world that provides that kind of government support.

MR. MAYER said that not many jurisdictions provide that level of support. The 40 percent is high level of support, but also at play is the combination of the high level of progressivity and the credit. He noted there was also a high level of tax in Alaska. It is difficult to make direct comparisons between jurisdictions.

[11:59:00 AM](#)

SENATOR FRENCH said Mr. Van Meurs characterizes Alaska's credit system as very generous. He asked if the 40 percent well credit makes Alaska even more generous.

MR. MAYER agreed that it was a generous credit system that makes a high level of government take workable.

SENATOR WIELECHOWSKI asked if countries with higher levels of government support have higher levels of government take.

MR. MAYER said not always. He pointed out that it is important to make sure revenue goes back to companies early in the process for cost recovery.

[12:01:42 PM](#)

MR. MAYER summarized the key issues in his presentation. He said that across-the-board reduction in government take is the simplest approach. There is significant cost in doing so, such as foregoing activities that are currently economic.

CO-CHAIR PASKVAN emphasized that all elected officials have fiduciary duties. He asked why one would agree to doing across-the-board reductions on fields that are economic.

MR. MAYER said that depends on many things, for example, how one interprets fiduciary duties to the state, and what level of revenue the state needs, and what the state sees as its role. It also depends on an interpretation of what the fiscal system should do and what framework it should take.

[12:04:53 PM](#)

CO-CHAIR PASKVAN maintained that it is a complex issue when one is analyzing current economic activity and unknown future activities.

MR. MAYER commented that it is not impossible to have increased revenue simply by cutting taxes. A decline on legacy fields could be reduced to 2 percent from 6 percent, and revenue from 2020 onward could be higher than under the current scenario, by cutting taxes.

He suggested another possibility would be to differentiate between existing and incremental production from legacy fields. It would require significant complexities to do so effectively.

He concluded that SB 3001 does not address key issues with ACES such as oil and gas decoupling, or high levels of spending support through high credits and progressivity.

CO-CHAIR PASKVAN thanked Mr. Mayer for his presentation.

[SB 3001 was held in committee.]

[12:08:56 PM](#)

There being no further business to come before the committee, Cc-Chair Paskvan adjourned the Senate Resources Standing Committee at 12:08 p.m.