

HOUSE FINANCE COMMITTEE
April 5, 2013
9:08 a.m.

[9:08:12 AM](#)

CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 9:08 a.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Mark Neuman, Vice-Chair
Representative Mia Costello
Representative Bryce Edgmon
Representative Les Gara
Representative Lindsey Holmes
Representative Scott Kawasaki, Alternate
Representative Cathy Munoz
Representative Steve Thompson
Representative Tammie Wilson

MEMBERS ABSENT

Representative David Guttenberg

ALSO PRESENT

Daniel Sullivan, Commissioner, Department of Natural Resources; Senator Micciche; Michael Pawlowski, Advisor, Petroleum Fiscal Systems, Department of Revenue; Joe Balash, Deputy Commissioner, Department of Natural Resources.

SUMMARY

CSSB 21 (FIN) am(efd fld)
OIL AND GAS PRODUCTION TAX

SB 21 was HEARD and HELD in committee for further consideration.

#sb21

CS FOR SENATE BILL NO. 21(FIN) am(efd fld)

"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; providing a tax credit against the corporation income tax for qualified oil and gas service industry expenditures; relating to the oil and gas production tax rate; relating to gas used in the state; relating to monthly installment payments of the oil and gas production tax; relating to oil and gas production tax credits for certain losses and expenditures; relating to oil and gas production tax credit certificates; relating to nontransferable tax credits based on production; relating to the oil and gas tax credit fund; relating to annual statements by producers and explorers; establishing the Oil and Gas Competitiveness Review Board; and making conforming amendments."

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Co-Chair Stoltze explained that the legislation would be presented by the Department of Natural Resources (DNR) who represented the sponsor.

DANIEL SULLIVAN, COMMISSIONER, DEPARTMENT OF NATURAL RESOURCES, presented the PowerPoint "Oil Tax Reform - Arresting TAPS Throughput Decline." He appreciated the opportunity to present a broad overview of the issues related to oil tax reform and the House Finance Committee. He intended to provide a straightforward agenda with a focus on three important topics.

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Commissioner Sullivan discussed slide 2: "Outline."

Part I: current Context - Opportunities and Challenges

Part II: Is the Current Tax System Working for Alaskans?

Part III: Production, Production, Production

Commissioner Sullivan discussed slide 3: "Part 1 Current Context Opportunities and Challenges." He noted that a common argument seen by DNR throughout the oil reform

debate was that "everything was fine" with the oil business and tax system in Alaska. The department argued with those sentiments that the tax system was functioning well. The department did not believe that business was booming. He hoped to compare production from Alaska to worldwide production. He wished to address the significant challenges faced by the state.

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Commissioner Sullivan referred to various slides as "good or bad news." The state must come to grips with the significant challenges and opportunities. He stated that comparisons with past performance, production and pricing were not always accurate, so he hoped to focus on the present day. He stressed that the United States was experiencing a hydrocarbon boom in investment and production. He opined that the country's greatest hydrocarbon basin, Alaska, was observing from the sidelines.

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Co-Chair Stoltze referred to a poll regarding public opinion about the oil industry's contribution to the state budget and oil flow through the Trans-Alaska Pipeline System (TAPS). He opined that additional information from the department could better educate Alaskans.

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Department of Natural Resources discussed slide 4: "TAPS - A Critical State and National Energy Asset."

- TAPS has transported over 16.3 billion barrels of oil and natural gas liquids since June of 1977. Production peaked at 2.2 million barrels per day in the late 1980s, representing 25 percent of U.S. domestic production
- Since its peak, however, throughput has steadily declined; today, TAPS is 2/3 empty and declining at an average of 6 percent per year
- TAPS throughput decline threatens economic disruption and the very existence of our pipeline
- 90 percent of state revenues come from oil production

- We must encourage industry to invest in exploration and development of conventional and unconventional resources on state and federal land, onshore and offshore
- TAPS has plenty of capacity for increased throughput
- Most near-term critical economic issue facing the state
- Most urgent issue facing the state - two and half years of studies

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Commissioner Sullivan discussed slide 5: "Production History." He stated that the slide represented a declining oil field, which he compared to a dried-up basin. He discussed the rig count number for various states. The rigs in Alaska were much larger than those used in other states. He concluded that business was not booming in Alaska.

2013 Rig Count:

- Texas = 830 active rigs
- Oklahoma = 183 active rigs
- North Dakota = 174 active rigs
- Pennsylvania = 80 active rigs
- Alaska = 8 active rigs

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Commissioner Sullivan discussed slide 6: "Massive Resource Base."

- USGS estimates that Alaska's North Slope has more oil than any other Arctic nation
 - Oil: Est. 40 billion barrels of conventional oil (USGS & BOEMRE)
 - Gas: Est. over 200 trillion cubic feet of conventional natural gas (USGS)
- Alaska has world-class unconventional resources, including tens of billions of barrels of heavy oil, shale oil, and viscous oil, and hundreds of trillions of cubic feet of shale gas, tight gas, and gas hydrates
- Alaska's North Slope has already produced more than 16 billion barrels of oil to date

- At year-end 2010, the Energy Information Agency (EIA) (federal Department of Energy) put remaining North Slope reserves at 3.7 billion barrels of oil
- Reforms now can create enormous future opportunities and benefits
- Compared to most hydrocarbon basins, Alaska is relatively underexplored, with 500 exploration wells on the North Slope, compared to Wyoming's 19,000.

Commissioner Sullivan stated that Alaska was on the cusp of enormous opportunity in the areas of unconventional oil. He believed that the state's geology compared to the shale oil plays in states like North Dakota or Texas. He stressed the opportunities for exploration on the North Slope. He pointed out that Prudhoe Bay had exceeded production expectations dramatically.

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Commissioner Sullivan detailed slide 7: "Other Basins have Turned Decline Around." He noted that DNR and Department of Revenue (DOR) worked together to create a tax proposal. Throughout the process, research was performed to determine which oil basins had deviated from production decline historically. The slide's graph depicted oil production increases in Texas, North Dakota and Alberta. Alaska continued to decline in oil production during the same time period. He believed that Alaska's tax system did not incentivize production.

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Commissioner Sullivan stated that the incentive to invest in Alaska was less because of the high prices of investment as related to the long-term elements of investment return. He noted that the spike in Texas was related to shale. He pointed out that Alaska was also a shale basin. If new shale technology with conventional and shale plays.

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MICHAEL PAWLOWSKI, ADVISOR, PETROLEUM FISCAL SYSTEMS, DEPARTMENT OF REVENUE, commented on slide 7. He stated that the example of Texas and its flattened production curve was the result of conventional oil development. The ability to level oil production decline was possible with conventional oil plays.

Commissioner Sullivan stressed that the slide was a "bad news slide for Alaska." The good news was that Alaska could mitigate or increase decline with the right investment environment.

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Commissioner Sullivan discussed slide 8: "Change in Average Daily Oil Production by State 2007 - 2008." He mentioned an energy renaissance in the United States. Various basins in the Lower 48 were experiencing large exploration booms. The slide compared multiple basins along with the price of oil.

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Commissioner Sullivan discussed slide 9: "Change in Average Daily Oil Production by State 2008 - 2009." He opined that the slide was a "bad news slide for the state." He stated that comparisons with the rest of the country were essential. He stressed that a competitive tax regime was important and a partnership with the federal government was beneficial.

Commissioner Sullivan discussed slide 10: "Change in Average Daily Oil Production by State 2009 - 2010."

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Commissioner Sullivan discussed slide 13: "Crude Oil Production: Alaska North Slope vs. U.S. and OECD Countries, 2003 - 2012." He clarified that the color green represented oil production in the United States, red represented Organization for Economic Co-operation and Development (OECD) production and blue represented Alaska.

Co-Chair Stoltze asked about the meaning of the acronym ODEC.

Commissioner Sullivan answered Organization for Economic Community and Development, which represented Western Europe, Norway, North America and Canada. He pointed out the graph's illustration of the significant increase in United States production. The blue bars clearly depicted Alaska's production and the decline in production by half of that recorded ten years ago. He noted that the decline in Alaska was observed despite the high prices of oil.

Alaska was the only basin in the United States that failed to experience the oil production boom.

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Commissioner Sullivan discussed slide 14: "Capital Investment and the U.S Energy Renaissance."

- Global and U.S. hydrocarbon boom
- IEA World Energy Outlook 2012 - U.S. to overtake Saudi Arabia and Russia to become the world's largest global oil producer by the second half of this decade
 - Congressional Research Service report found that since 2007, all increases in U.S. oil and gas production occurred outside federally controlled areas, with oil and gas production on federal lands decreasing by 7 percent and 33 percent respectively
- Financial Times, November 12, 2012- "U.S. set to become biggest oil producer"
- Financial Times, December 27, 2012 -"Oil and gas - hey big spenders"
 - 2012 - \$600 billion on exploration and production in oil and gas industry
 - 2013 projected - \$650 billion on exploration and production in oil and gas industry
 - Alaska one of the world's great hydrocarbon basins - accounted approximately half of 1 percent of these expenditures in 2012

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Commissioner Sullivan discussed slide 15: "Est. Capital Spending for Exploration and Development." He stated that the notion that the state did not have a problem sat in stark contrast with the data provided on slide 15. He believed that the issue of oil production would greatly affect the future of Alaskans.

[9:43:13 AM](#)

Commissioner Sullivan introduced slide 16: "Part II, Is the Current Tax System Working for Alaskans?"

Commissioner Sullivan discussed slide 17: "Average Government Take at \$100/BBL." He noted that the slide was created by PFC Energy, the state's consultant. The

government take was assessed at the price of \$100 per barrel of oil. He pointed out that Alaska was the second highest in OECD classification. For new developments, Alaska was higher than Venezuela, Russia and Kazakhstan. The high government-take combined with Alaska's arctic conditions, remote location, infrastructure issues, permitting systems and litigation worked against incentivizing investment. The issue of government-take could be modified, whereas the arctic conditions and remote location could not.

Commissioner Sullivan respected Daniel Yergin as saying, "Tax regimes are one of the most important elements of when and how oil and gas comes out of the ground, whether in Alaska, Russia or Central Asia."

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Commissioner Sullivan discussed the term "giveaway." He noted slide 18: "Current System is Not Working for Alaskans."

Examples of the Real Giveaway

- ACES has taken away most of the incentive to produce more barrels and more profit at higher prices
 - In FY 08, North Slope oil averaged \$96.51 per barrel and the total production tax collected was \$6.8 billion
 - By next fiscal year (FY 14), prices are forecasted to be \$13 higher at \$109.61, but the total production tax collected is estimated to be \$3.8 billion - a decrease of more than \$3.8 billion in unrestricted general fund revenue
- The Ultimate Giveaway
 - Comparing year-end 2011 and year-end 2012, there were ~40,000 fewer barrels of oil per day flowing through TAPS
 - Approximately 14.6 million barrels a year = \$1.46 billion in lost economic activity and value

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Commissioner Sullivan discussed slide 17 again. He mentioned Senator French and his statement that ACES was a

functional system, but the governor's proposal was flawed because it did not require more oil in the pipeline in exchange for tax reductions.

Commissioner Sullivan countered that the current tax system handed out significant tax credits and direct cash payments of approximately \$1 billion annually. He stated that the governor's bill sought to tighten the nexus between tax benefits and production. He discussed tax returns under ACES.

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Mr. Pawlowski stated that Alaska had seen an increase in the amount of companies filing tax returns in the state. He had seen an increase in returns, but not an increase in tax payers. Many of the returns were filed without payment as the companies were eligible for tax credits.

Co-Chair Stoltze requested that Mr. Pawlowski repeat his statement.

Mr. Pawlowski repeated that the state had seen an increase in the number of companies filing returns with DOR. The department had not seen an increase in the amount of companies paying taxes. When a company qualified for credits, the state paid the company through the treasury.

Co-Chair Stoltze clarified that the state was writing the oil companies checks.

Mr. Pawlowski concurred.

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Commissioner Sullivan addressed slide 19: "New Entrants in Alaska's Current Tax System."

- Secure Alaska's Future - Oil is the State's comprehensive strategy to increase TAPS throughput to one million barrels a day
 - o Enhance Alaska's global competitiveness and investment climate
 - o Ensure the permitting process is structured and efficient
 - o Facilitate and incentivize the next phases of North Slope development

- o Promote Alaska's resources and positive investment climate to world markets
- Governor Parnell's 2013 State of the State: "Our problem is not below the ground. Our problem is above the ground."
 - o The missing piece is meaningful tax reform
 - o "Our state's prosperity has always rested on natural resources. Tonight, that foundation is at risk, not because we are running out of oil, but because we are running behind the competition."

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Commissioner Sullivan agreed with Representative Gara's comments regarding the future of small and medium sized companies in the state. He saw great futures for the large companies and shale plays.

Co-Chair Stoltze asked the commissioner not to address individual members of the committee. Commissioner Sullivan agreed. Co-Chair Stoltze believed that the "personality issue" would improve if committee member were not addressed individually.

Commissioner Sullivan stated that the department would speak at a conference to large LNG companies. He pointed out the executive branch's outreach efforts. The conferences allowed the department to ascertain other company's opinions about Alaska.

[9:59:22 AM](#)

Commissioner Sullivan noted slide 20: "New Entrants in Alaska's Current Tax System."

- We came to the North Slope in 2011, after many years of reviewing numerous opportunities and turning them down. We considered the North Slope to be an especially promising area that has been shown to be oil rich and with lower exploratory risk than other regions.
- Offsetting these positive aspects were the extreme climate, and a short exploration season in a remote, expensive and environmentally sensitive area with little established infrastructure. The biggest negative factor, however, was a tax system that did not encourage long-term investment.

- With regards to investment in onshore state lands, we found that in all but the best scenarios, the progressive nature of the ACES petroleum tax structure did not allow for returns that were competitive with opportunities in the lower forty-eight states or other parts of the world.
- This view changed in early 2011 when it appeared that serious reform of the ACES tax structure would be enacted, we would risk being lost in the rush of companies to Alaska to invest in North Slope exploration and development projects.

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Co-Chair Stoltze asked if Commissioner Sullivan referred to geological structure in his statement that Alaska had the best oil and gas structure in the world. Commissioner Sullivan concurred.

[10:02:08 AM](#)

Commissioner Sullivan stressed that Alaska's high costs, difficult permitting processes, lawsuits and the issue of progressivity or high taxes at high oil prices. Those were the sentiments expressed by companies communicating with the department during recent oil and gas conferences. He had heard the argument that the Spanish oil major, Repsol made a decision to initiate projects in Alaska two years ago, when ACES was the tax regime.

Co-Chair Stoltze noted that Repsol would come before the committee to provide testimony.

Commissioner Sullivan stated that Repsol reported the company initiated its project during a time of potential tax reform.

[10:04:49 AM](#)

Mr. Pawlowski added that conversations among the executive and legislative branches regarding tax reform often led to an increase in interest in Alaskan investment.

Co-Chair Stoltze expressed familiarity with the issue. He reported to the committee rumors that he had killed the film industry by introducing a bill addressing the film industry's tax credits.

Commissioner Sullivan relayed that the broad issue was the limitation in investment caused by the high tax rate. He furthered that it was unknown how many companies were not moving to the state because of the tax system.

Mr. Pawlowski pointed to slide 21.

- Under ACES - by 2022 oil prices will have to rise to \$123.44 per barrel for unrestricted general fund oil revenues to meet the forecast
- If oil prices do not rise further or if they fall, this revenue decline becomes more severe.

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Mr. Pawlowski discussed slide 22: "The Challenge."

- If we do not make the changes today to encourage the investment that will pay dividends tomorrow we are dooming our future to deficits and decline
- If you are evaluating this challenge based simply on the range of the fiscal note, you are missing the scale of the obstacle we face in the further
- \$1.3 billion less in revenues will require more than \$4,000 in new revenues per job in Alaska - those revenues will have to come from somewhere

[10:09:35 AM](#)

Commissioner Sullivan stated that slide 21 showed revenues declining while estimated oil prices were rising. He mentioned that when oil prices declined the revenue curve followed.

Representative Gara noted that ConocoPhillips stated projections in legacy fields for production declines of approximately 3 percent. He wondered if slide 21 employed a 6 percent production decline.

Mr. Pawlowski noted that the information was based on data from the 2012 revenue sources book. He offered to provide the data underlying the chart to the committee.

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Commissioner Sullivan moved to slide 23: "Part III - Production, Production, Production." He recognized the need to be more competitive. He stated that ACES focused on incentivizing spending while the department recommended a tighter nexus on tax reform and direct oil production.

Commissioner Sullivan discussed slide 24: "Oil Tax Reform."

- Tax reform must be fair to Alaskans
- Encourage new production
- Simple so that it restores balance to the system
- Durable for the long-term

[10:12:54 AM](#)

Commissioner Sullivan discussed slide 25: "CS SB 21 (FIN)'s Major Components Are Focused on Incentivizing Production."

Alaska's Clear and Equitable Share (ACES)

- Qualified Capital Credit
 - Based on 20 percent of qualified capital expenditures
 - To generate an additional \$100 million in capital credits a company must spend \$500 million
 - \$500 mm x 20 percent = \$100 mm

CS SB21 (FIN)

- Per Barrel Credit
 - Based on taxable production
 - To generate an additional \$100 million in credits a company must produce an additional 20 million barrels
 - 20 mm x \$5 = \$100 mm
- Gross Revenue Exclusion
 - Tax benefit for new production
 - Newer units (2003 and after)
 - New participating areas in legacy units
 - Expansions of participating areas in legacy units

Mr. Pawlowski discussed the qualified capital expenditure credit. He stated that a company must spend \$500 million to generate an additional \$100 million in capital credits. With SB 21, the incentives moved away from a credit tied to spending and toward a credit based on a company's

production. The qualified capital expenditure credit would tax each taxable barrel produced. With SB 21, a company was eligible for the same \$100 million credit with production of 20 million additional barrels of oil.

Mr. Pawlowski continued with secondary incentives tied directly to production. Both options required oil productions to qualify. The gross revenue exclusion (GRE) was limited to new production (established after 2003) for new geologically distinct pieces within legacy units and expansions of participating areas within the legacy units. The value of the new incentives was based on the gross value of oil produced.

Representative Wilson asked if the department was discussing the finance version or the resource version of the bill.

Co-Chair Stoltze believed that the department was referring to broader concepts and policies.

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Mr. Pawlowski apologized for the confusion.

Commissioner Sullivan clarified that incentives provided by SB 21 focused on production rather than spending.

[10:17:44 AM](#)

Commissioner Sullivan discussed slide 26: "Status Quo of continued Decline is Unacceptable."

- This is about Alaskans' future present citizens and future generations
- We clearly have the resource base to turn our oil production decline around
- The status quo of continued decline when there is a global investment boom and literally every other basin in the United States is increasing production is unacceptable
- ACES, although well-intentioned, is significantly contributing to our production decline as well as discouraging potential new entrants.
- As the production continues to decline, the strain on the state will only grow

- Tax reform must focus on incentivizing production
- "The ANSCA Regional Association is calling on state leaders to continue moving on an oil tax reform bill. Tax reform for the oil and gas industry that results in increased production will give communities across the state access to important economic opportunities. Association members stress the importance of new and increased production with long-term benefits to Alaskans." -March 28, 2013

Co-Chair Stoltze appreciated the department's presentation and presence. He discussed future finance committee hearings with consultants. He encouraged committee members to present their written questions to his office for transmittal to the appropriate department personnel.

[10:22:45 AM](#)

Representative Gara responded to Commissioner Sullivan's statement that many legislators were content with the status quo regarding oil production. He countered that while different proposals existed, he was unaware of a legislator who was happy with the current tax regime.

Co-Chair Stoltze asked both parties to tone down the rhetoric.

Representative Holmes asked about the adoption of HCS CSSB 21(RES).

Co-Chair Stoltze replied that he intended to introduce the bill later in the afternoon meeting. He wanted committee members to take time to read the bill and return with questions.

CSSB 21 (FIN) am(eld fld) was HEARD and HELD in committee for further consideration.

ADJOURNMENT

[10:24:54 AM](#)

The meeting was adjourned at 10:25 a.m.

