

HOUSE FINANCE COMMITTEE

April 9, 2013

1:36 p.m.

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CALL TO ORDER

Vice-Chair Neuman called the House Finance Committee meeting to order at 1:36 p.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

Sara Obed, Director, Government Relations, Doyon Limited;
James Mery, Senior Vice President, Lands and Natural Resources, Doyon Limited; Michael Pawlowski, Advisor, Petroleum Fiscal Systems, Department of Revenue; Barry Pulliam, Managing Director, Econ One Research Inc.; Bruce Tangeman, Deputy Commissioner, Tax Division, Department of Revenue.

PRESENT VIA TELECONFERENCE

Tara Sweeney, Arctic Slope Regional Corporation, Anchorage;
Michelle Anderson, President, Ahtna Inc., Glennallen; Helvi Sandvik, President, NANA Development Corporation; Kim Reitmeier, President, ANCSA Regional Association.

SUMMARY

CSSB 18(FIN) am
BUDGET: CAPITAL

CSSB 18(FIN) am was SCHEDULED but not HEARD.

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

CSSB 21(FIN) am(efd fld) 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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TARA SWEENEY, ARCTIC SLOPE REGIONAL CORPORATION, ANCHORAGE (via teleconference), spoke to the legislation. She read from a document (copy on file) titled, "Testimony of Arctic Slope Regional Corporation by Tara Sweeney, Senior Vice President of External Affairs on CSSB 21 HRES Version K."

ASRC is Alaska's largest Alaskan-owned company, with approximately 10,000 employees nationwide, of which nearly half are Alaskan jobs. ASRC represents 11,000 Iñupiat shareholders of the North Slope, and we have been successful in striking a balance between

representing the business interests with the subsistence needs of our shareholders. We have five major business lines: 1) energy support services, 2) petroleum refining and marketing, 3) government services, 4) construction, and 5) resource development.

The work performed by ASRC's family of companies within the oil and gas industry on the North Slope returns tangible benefits to our shareholders and thousands of Alaskans. We are a \$2.6 billion company and our enterprise is heavily invested in this state. I appreciate the opportunity to introduce to you some of the members of our family of companies.

ASRC Energy Services performs an array of oil field engineering, operations, maintenance, construction, fabrication, regulatory, permitting and other services to some of the world's largest integrated oil and gas companies. With more than 3,000 Alaska employees, Energy Services provides more jobs in Alaska than any other locally-owned employer and has emerged as the state's largest oil field services company. ASRC Energy Services also has a presence in Louisiana, California, Utah, Hawaii, Indiana, Washington, and a growing presence in North Dakota.

Another member of our family of companies is Petro Star. Petro Star is the only Alaskan-owned refining and fuel marketing company. Petro Star's two refineries located in North Pole and Valdez, draw crude supply from the Trans Alaska Pipeline System (TAPS) to produce highway, off-road and marine diesel, as well as jet fuel and home heating oil. The North Pole refinery supplies the mining industry, military operations at Eielson Air Force Base, and it provides heating oil to communities throughout Interior Alaska. The Valdez refinery produces and transports marine fuels to coastal communities reaching as far as St. Paul Island. The Valdez refinery also produces ultra-low sulfur diesel, and it supplies jet fuel to commercial cargo carriers refueling at Ted Stevens Anchorage International Airport and to the military operating at Joint Base Elmendorf-Richardson. Through its operations in Dutch Harbor, Petro Star supplies fuel to the largest commercial fishery in the United States. In addition to its refining and distribution

assets, Petro Star also operates fueling stations, convenience stores and heating oil distributorships. We are a service provider and refiner. We are also a resource owner, developer and explorer in this state.

Some of our ownership interests are subject to Section 7(i) of the Alaska Native Claims Settlement Act (ANCSA), and our ability to explore, develop and produce on those lands benefit every region in this state. The absence of a stable tax regime and positive investment climate for the oil industry has a material impact on how we develop or not develop those lands.

As a result of our land entitlement under ANCSA, ASRC owns nearly five million acres on the North Slope. In most cases, ASRC's subsurface holdings were primarily selected for their natural resource potential.

We have a significant royalty position in the Colville River Unit (CRU), home of the Alpine oil field, one of the largest oil producing fields on the North Slope. While the Alpine field production peaked four years ago, the CRU satellite developments have helped slow the rate of decline. These satellites currently account for nearly 35 percent of the oil production in the CRU and are processed through the main Alpine facility. Additional development in the CRU is challenged by a complex and unfriendly permitting regime that impedes timely development.

ASRC has also invested in the exploration and development of State-owned lands on the North Slope. With investment in the Badami and Placer Units, our exploration company experiences the same tensions regarding the State tax regime similar to other small producers and independent explorers.

As part of our investment in the Badami Unit, ASRC Exploration, LLC (AEX) owns a 32.5% working interest. AEX and operator Savant Alaska continue to work toward increased production. However, due to the high cost environment and current low throughput, it is extremely important that the Small Producer Credit stay intact and be extended in order for continued investment in the Badami Unit.

The tax reform discussion highlights good perspectives and has spurred meaningful debate. We ask that as you go forward you remain mindful of the Alaskan companies involved in the industry. There has been a lot of focus on the multi-national and independent explorers and small producers, so sometimes the local voice gets muffled in the process.

As an employer, service provider, resource owner, explorer, producer and developer, ASRC is in a unique position to provide comments. I submit our comments from the perspective of a local company with an enterprise involved in the value chain of oil development in this state, from exploration through refining product and all services in-between.

This committee substitute is an improvement over the current ACES and also the Senate version. There are several provisions we support and areas that still need improvement.

- We support the repeal of progressivity.
- We support the base rate change from 35% to 33%.
- The community sharing provision is a good start, and we encourage the Legislature to continue to consider linking it to a percentage of the tax, versus the current language of a legislative appropriation. We feel this is a more objective approach to sharing revenues with Alaskan communities.
- We support the 35% Loss Carry Forward (LCF) Credits, as currently written. They enable explorers, small producers, majors and organizations like ASRC to receive carry-forward loss credit, through a transfer, refund or tax deduction. This flexibility is attractive to us.
- We support the Gross Value Reduction (GVR) formula contained in the bill. It makes investment opportunities even in marginal fields more attractive for companies like ASRC. It encourages development of new production for all producers, as well as new entrants.

- We support linking the \$5 per barrel tax credit to the production subject to the GVR for the reasons listed above; this creates a more level playing field for all players.
- We support the 10% service credit because it stimulates the economy within the service industry. Our subsidiary, ASRC Energy Services, employs thousands of Alaskans, and this credit could help us revamp our fabrication and construction services in the state.
- We support the AIDEA bonding capability - this will give new entrants another avenue to finance facilities that have the capability to bring new production online.
- The sliding scale provision for non-GVR production provides for tax benefits to producers at low oil prices and increases the State's 'take' at higher oil prices. This, again, provides the right type of incentives in a changing price environment, and the State benefits on the upside swing of prices.
- Refining the definition of Lease Expenditures on what counts for tax filings provides necessary clarity to both the explorers, producers and the Alaska Department of Revenue.
- Finally, I want to impress upon the committee the importance of the small producer credit to ASRC. The extension of this credit to 2022 goes a long way for the "little guy". Through our subsidiary, AEX, this extension improves our ability and that of the other small producers, to maintain or grow existing production. This extension makes it more attractive for companies like AEX to explore for and develop oil and gas deposits on leaseholds outside of our units that could add new production to our unit positions. This is good. Elimination of this credit would impact how we choose to invest our capital in this company, or if it makes more sense to invest in other parts of our business.

There are two areas of concern for us. First, the expiration of the Qualified Capital Expenditures (QCE)

in 2014 is too soon. We support a phase out program over a slightly modified period, like 2015. This is important because investments planned with the credit as part of project financing will require replacement of this source of investment capital or the project will be shelved. Phasing this out over a longer period makes more sense for the current explorers and potential developers.

Finally, deletion of the proposed modification of the Exploration Tax Credit (ETC) that eliminated the 3-mile buffer for drilling and extended the deadline for ETC's to 7/1/2022 would remove any incentive for a small producer to add new production to its unit or create other opportunities for new production.

In closing, on behalf of Arctic Slope Regional Corporation, I want to thank you for your leadership on this issue. We appreciate your dedication to public service and taking the time to work to reinforce Alaska's economic foundation. While some may be looking at this issue through a narrow lens, we have the fortune to see this issue from several important viewpoints. ASRC strategically plans for a sustainable future in Alaska and we support a healthy and robust oil industry here. Thank you for the opportunity to provide our perspective.

Ms. Sweeney continued to discuss the members of the corporation including Petro Star. She noted that Petro Star was the only Alaskan owned refining and fuel marketing company. The company owned two refineries located in North Pole and Valdez, which drew crude supply from the Trans-Alaska pipeline to produce highway, off road and marine diesel as well as jet fuel and home heating oil. The North Pole refinery supplied the mining industry, military operations at Eielson Air Force Base and provided heating oil to communities throughout Interior Alaska. Petro Star also produced ultra-low sulfur diesel fuel and supplied jet fuel to commercial cargo carriers refueling at Ted Stevens Anchorage International Airport and to the military operating at joint base Elmendorf Richardson.

Ms. Sweeney continued that Petro Star supplied fuel to the largest commercial fishery in the U.S. Fueling stations, convenience stores and heating oil distributorships were also operated by Petro Star. The company was a refiner,

resource owner, developer and explorer in Alaska. The ability to produce on Native settlements benefitted every region in the state with ownership of approximately five million acres on the North Slope. She spoke to the significant royalty position in the Colville River Unit (CRU), home of the Alpine oil field. While the Alpine Field Production peaked four years ago, the CRU satellite developments helped slow the rate of decline. The satellites accounted for nearly 35 percent of the oil production in CRU and were processed through the main Alpine facility.

Ms. Sweeney explained that additional development in the CRU was challenged by a complex and unfriendly permitting regime. She pointed out the Arctic Slope Regional Corporation (ASRC) investment in exploration and development of state-owned lands on the North Slope. Tensions regarding the state tax regime were experienced by her company. The high-cost environment and current low-throughput required that the small producer credit stay intact and be extended in order for continued investment in the Badami unit. She stated that the tax reform discussion highlighted good perspectives and spurred meaningful debate. She requested consideration of the Alaskan companies in the oil industry.

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Ms. Sweeney stated that ASRC provided comments with the perspective of a local company. She relayed that HCS CSSB 21(RES) was an improvement over the current system. They supported the 33 percent tax, and other items related to the bill. She spoke in support of the repeal of progressivity. She supported the community sharing provision and she encouraged the legislature to consider linking it to a percentage of the tax versus the current language, which was a more objective approach to sharing revenues with Alaskan communities. She supported the 35 percent loss carry forward credit, which enabled owners to receive carry forward loss credit through a transfer, refund or tax deduction.

Ms. Sweeney continued that ASRC supported the GVR formula in HCS CSSB 21(RES), which allowed investment opportunities in marginal fields to be more attractive for companies like ASRC. The GVR formula encouraged the development of new production for all producers including new entrants. She

supported linking the \$5 per barrel tax credit to the production subject to the GVR, which created a more level playing field. She supported the 10 percent service credit, which stimulated the economy within the service industry. She supported the Alaska Industrial Development and Export Authority (AIDEA) bonding capability, which allowed new entrants another avenue to finance facilities. The sliding scale provision for the non-GVR production provided tax benefits for producers at low oil prices and increased the state's take at higher oil prices.

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Ms. Sweeney stressed the importance of the extension of the small producer credit to ASRC. The extension of the credit to 2022 would improve the ability of small producers to maintain or grow existing production. The extension made exploration for oil and gas deposits on lease holds outside of current units that could potentially add new production to the unit positions. Elimination of the credit would impact capital investment. She expressed concern regarding expiration of the Qualified Capital Expenditures (QCE) in 2014. She supported a plan that would phase out QCE's by 2015. She supported the deletion of the proposed modification of the Exploration Tax Credit (ETC) that eliminated the three mile buffer for drilling. She stated that ETC would remove any incentive for a small producer to add new production to its unit or create other opportunities for new production.

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Co-Chair Stoltze thanked ASRC for their contribution.

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MICHELLE ANDERSON, PRESIDENT, AHTNA INC., GLENNALLEN (via teleconference) shared information about the company. She noted that 55 miles of the Trans-Alaska Pipeline System (TAPS) crossed Ahtna land. She pointed out that Ahtna provided pipeline maintenance, construction and oil-spill response over the last 40 years. She stated that Ahtna encouraged the legislature to remain focused on the goal of increased production from both legacy and new oil fields by lowering the base tax rate from 35 percent to 33 percent and extending the small producer credit to 2022.

Ms. Anderson reported to the committee that 56 percent of Alaskans supported oil production tax reform. She stated that SB 21 would help all Alaskans have a prosperous future by making Alaska more attractive for private sector investment. She noted that continuation of ACES would lead to continued declines in throughput. She supported revision of the new frontier basin tax credits by stemming the exploration terms and eliminating the 3 mile limit, making it comparable to the Cook Inlet Basin.

Vice-Chair Neuman asked Ms. Anderson to provide her written testimony.

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SARA OBED, DIRECTOR, GOVERNMENT RELATIONS, DOYON LIMITED, provided information about the native corporation, which was headquartered in Fairbanks. She stated that land owned by Doyon Limited spanned the Brooks Range in the north to the Alaska Range in the south and extended to Norton Sound. She stated that Doyon Limited had 18,700 shareholders and 2,700 employees. She shared that Doyon Drilling was the premier company that owned 7 advanced drill rigs specifically designed to operate in Alaska's northern climates. The company prided itself as an industry leader among support service contractors in Alaska. She continued to discuss the company's structure and work. She testified in support of the oil tax reform effort. She stated that the company was comprised of beneficiaries and participants who knew oil and gas exploration was declining.

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JAMES MERY, SENIOR VICE PRESIDENT, LANDS AND NATURAL RESOURCES, DOYON LIMITED, spoke about areas the company was exploring for hydrocarbons in Interior Alaska (middle earth). He pointed to exploration credits that were not addressed in the bill that sunset in 2016. He also addressed a cap on production tax that applied only to middle earth. He shared that the company was conducting frontier exploration. He believed that areas in middle earth were capable of generating billions of barrels of oil. He noted that Doyon Limited's efforts were focused on finding oil for the Trans-Alaska Pipeline System (TAPS). Another company goal was to find gas for local use. The company's risk was shared with the state through the expiring exploration credits programs. Without state

assistance, the company's exploration efforts would not have been successful. He noted exploration in the Nenana Basin, where the company held 400 thousand acres in state leases.

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Mr. Mery continued to discuss the company's exploration efforts. He shared that Nenana was the company's highest priority and was also exploring the Yukon Flats. He mentioned two seismic programs at Stevens Village. Success in the Yukon Flats could lead to renewed exploration near the Canadian border. These areas enjoyed significant exploration by major oil companies a generation ago, including Arco Alaska, Shell, ExxonMobil, Amoco and Chevron. Smaller companies followed with new hydrocarbon finds. He believed that the five areas mentioned held hundreds of millions of barrels of recoverable oil.

Mr. Mery respectfully requested a five year extension of the 30-40 percent exploration credits. Without the state sharing the risk, exploration by Doyon Limited would likely cease. He mentioned legislation passed last session that placed a cap of 4 percent of the gross value production for a limited period of time on new production from middle earth. The provision was critically important to Doyon Limited in navigating unknown permitting and litigation risks during the capital investment recovery phase of new projects lacking production infrastructure. He advocated for an extension of the sunset date to 2027.

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Vice-Chair Neuman requested written testimony from Doyon Limited.

Representative Wilson asked about the 4 percent tax on new production and how certainty regarding taxes provided an opportunity for the company to move forward. Mr. Mery answered that it was certainty and a lower rate for a set period of time that allowed for exploration and production. The simplicity and certainty helped the company in their exploration efforts.

Representative Wilson asked if location and tax certainty were related. Mr. Mery replied that tax certainty was advantageous in any location. The situation was exaggerated

in the case of his company because of their exploration risk.

Representative Wilson was interested to know if middle earth was different than the North Slope. She asked if the company would not move forward if the two items mentioned in Mr. Mery's testimony were not in place. Mr. Mery responded that the state was a great partner with respect to the exploration credits. If the items were not extended the company may not move forward with frontier exploration.

Representative Wilson asked if other private entities might be willing to partner with Doyon Limited. Mr. Mery replied that his company was the only one interested in frontier exploration in Alaska. His company had more reasons to pursue frontier exploration because of their unique location.

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HELVI SANDVIK, PRESIDENT, NANA DEVELOPMENT CORPORATION (via teleconference), spoke in support of the legislation. She stressed that it was critical to address tax reform in the current session. She communicated that the company's shareholders made significant investment in the oil industry. She noted that her company was one of the largest employers in the state, employing approximately 4000 Alaskans. She noted the company's practice of reinvesting in new facilities and equipment to sustain Nana oil field services for the next 40 years. She spoke to the value of leveraging the experience gained from work in the oil sector leading to significant investments in other state industries. The company's priority was natural resource development and support.

Ms. Sandvik expressed alarm at the decline in business activity in companies serving the sector. Alaska talent was migrating elsewhere to pursue economic opportunity in the oil sector. She hoped that her children would have the ability to work and live in Alaska. She recognized the increase in activity seen in the Lower 48 and international locations. Those locations created an environment that invited investment as opposed to discouraging it. Without investment, Alaska will see no financial return. She believed that SB 21 lent the most promise for new investment and increased production. She mentioned the crisis in the North West Arctic Borough with an

unemployment rate of approximately 15 percent. She spoke to limited infrastructure and high energy costs.

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Ms. Sandvik expressed that her only hope for the future was an increase in economic activity, opportunity and stability. She urged the committee to remember that the future of Alaskans depended on the decisions made in this legislature. She opined that the bill struck a balance between Alaska's short and long term needs. She supported the middle earth amendments discussed by Doyon Limited that would strengthen future development opportunities in areas of the state with limited exploration and development. She urged the passage of SB 21 to create a stable climate to serve all Alaskans well into the future.

Vice-Chair Neuman asked Ms. Sandvik to provide written testimony.

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KIM REITMEIER, PRESIDENT, ANCSA REGIONAL ASSOCIATION (via teleconference) testified in favor of SB 21.

My name is Kim Reitmeier, President of the ANCSA Regional Association. The ANCSA Regional Association's membership includes the CEOs of the 12 land-based regional Alaska Native Corporations. Our corporations are owned by over 100,000 Alaska Native people and were formed under the Alaska Native Claims Settlement Act of 1971. Our mission is to collaborate in creation of a sustainable socioeconomic future for Alaska Native people.

I would like to thank Co-Chair, Rep Bill Stoltze for extending a personal invitation to our Regional Corporations to participate today. You've heard from of our Regional Corporations this afternoon; unfortunately, many of our CEOs are traveling today, and extend their regards for not being able to participate in this very important legislative discussion.

On March 28th the ANCSA Regional Association issued a press release calling for a robust oil and gas industry with a stable tax regime. Tax reform for the oil and gas industry that truly results in increased production will give communities across the state

access to important economic opportunities. We can't stress enough the importance of new and increased production with long-term benefits to Alaskans. We hope that the final bill will benefit all Alaskans, including our rural residents.

Our membership recognizes the importance of a robust oil and gas industry for our state, and for our people, to thrive. It's about sustainability - and without it the entire state treasury is in jeopardy. Alaska Natives have lived here for 10,000 years, and we will be here for 10,000 more. A healthy oil and gas industry is vital for all Alaskans. As you go forward, we ask that you be guided by the values of responsibility to our communities and cooperation to sustain our connection to the land; and have tangible results for all of Alaska.

In closing, on behalf of ANCSA Regional Association, I would like to thank you for your leadership on this issue. We appreciate your dedication and work to ensure Alaska's economic future. Thank you for the opportunity to provide our comments.

Representative Edgmon thanked the ANCSA Regional Association for prioritizing the survivability of rural Alaska.

Representative Wilson asked if the benefits of the legislation outweighed the risks. Ms. Reitmeier answered in the affirmative. Representative Wilson asked if additional jobs would become available for all Alaskans as a result of the legislation. Ms. Reitmeier answered yes.

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RECONVENED

MICHAEL PAWLOWSKI, ADVISOR, PETROLEUM FISCAL SYSTEMS, DEPARTMENT OF REVENUE, introduced Econ One's presentation on oil production decline rates. He stressed the goal of mitigating those decline rates.

BARRY PULLIAM, MANAGING DIRECTOR, ECON ONE RESEARCH INC., provided a PowerPoint presentation titled "Additional Comments on HCS CSSB 21(RES)" (copy on file). He explained that he had reviewed various decline rates in preparation

for the presentation. He pointed to slide 2 and the red line projecting production on the North Slope under rates ranging from 6 percent long-term to no decline (blue line). He noted that a 6 percent decline rate would include a reduction from 500 thousand to 100 thousand barrels of oil per day. Mitigation of the decline rate to 3 percent would change the overall production considerably by adding approximately 900 million barrels of total recovery over the next 30 years.

Mr. Pulliam continued that a further reduction to 1 percent would add another billion barrels. If decline could be stemmed altogether, the recovery would include 5.5 billion barrels of total recovery over the next 30 years.

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Representative Wilson asked if the graph depicted the barrels of oil required to prevent a decline in production.

Mr. Pulliam clarified that the graph followed the long term decline path and would include production of approximately 3 billion barrels. If decline was stemmed, the oil companies would recover an additional 2.5 billion barrels, or 5.5 billion total barrels.

Mr. Pawlowski added that the Department of Natural Resources (DNR) estimated production in legacy fields at approximately 3 billion barrels. There was an estimated 3 billion barrels that were yet to be discovered on state lands. The chart took into account legacy fields and undiscovered oil.

Representative Wilson asked if the state could predict ample oil resources through 2042 in the absence of a decline rate.

Mr. Pulliam replied in the affirmative. He added that the question was about oil discovery and recovery.

Representative Gara asked about responses to questions the committee had posed. He pointed to a question related to a comparison in revenue between HCS CSSB 21(RES) and ACES using a range of realistic prices.

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Mr. Pawlowski apologized for not including the range of questions in the presentation. He offered to present the information using different price scenarios.

Representative Gara stated that he would appreciate answers to his questions.

BRUCE TANGEMAN, DEPUTY COMMISSIONER, TAX DIVISION, DEPARTMENT OF REVENUE, stated that the department provided responses to members' questions over the weekend. He interpreted that Representative Gara wished to receive data regarding a 3 percent decline rate. He pointed out that the department had worked hard on the issues for the committee and he apologized for the misinterpretation.

Mr. Pawlowski surmised that the department must address the questions.

Representative Gara noted that his questions were in writing.

Representative Wilson added that she had not received answers to her questions either.

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Mr. Pawlowski apologized.

Mr. Pulliam pointed to slide 3 titled "Impact of New Drilling on Production 10 New Wells Drilled Annually 2013 - 2042." He modeled a decrease of a 6 percent decline rate to 3 percent, which would require additional development. The additional requirement would occur over time and the expected recovery was depicted in slide 3. The slide illustrated an increase of 10 wells annually. The wells were expected to produce at a rapid rate initially and then decrease over time. He expressed that the plan outlined in the slide would allow for the needed 30 million barrels of development per year, which would stem the decline at 3 percent.

Mr. Pawlowski added that the focus of barrels per day for production targets must be supplemented by the production levels of already existing wells. Wells that were drilled in previous years were still contributing to production, which created the "layering effect" illustrated in slide 3.

Ten wells drilled annually would create the production needed to limit the decline from 6 percent to 3 percent.

Mr. Pulliam agreed that the chart displayed wells that contributed to already existing production.

Representative Wilson interpreted the chart to show that of the 300 wells drilled, only 26 would produce.

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Mr. Pulliam replied that the base level of production was represented by the color red and depicted 1000 producing wells. Each additional year's color represented 10 wells.

Representative Wilson asked if the state required 600 wells to prevent any decline whatsoever.

Mr. Pulliam opined that the goal of 20 additional wells per year was realistic.

Representative Wilson clarified that the state would require 600 new producing wells to stem decline between 2013 and 2042.

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Mr. Pulliam moved to slide 4 "Impact of New Drilling on Production 20 New Wells Drilled Annually 2013 - 2042." He explained that the increase in wells drilled would stem decline to approximately 1.5 percent annually.

Representative Edgmon asked what the slide depicted inside and outside of the legacy wells. He recalled earlier testimony from Pioneer that 11 oil wells must be drilled to arrive at one functioning well.

Mr. Pulliam responded that the data in slide 4 assumed successful development of the drilled wells.

Representative Edgmon asked if the chart accounted for location of the well.

Mr. Pulliam responded that the chart did not represent a prediction, but instead the activity necessary to stem decline.

Representative Edgmon understood that the effort of HCS CSSB 21(RES) was to increase development and activity.

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Vice-Chair Neuman asked if DOR staff could respond to questions like Representative Edgmon's. Mr. Tangeman replied that he had staff online responsible for noting the important questions posed.

Representative Gara asked how many oil wells existed on the North Slope in 2006.

Mr. Pulliam asked if Representative Gara was referring to producing or new wells drilled.

Representative Gara responded that he was interested in the wells drilled annually in 2006. Mr. Pulliam replied that approximately 100 wells were drilled annually in 2006.

Representative Gara noted that the decline rate was between 5 and 8 percent per year between 2004 and 2007 despite the fact that 100 wells were drilled annually.

Mr. Pulliam responded that that the base level was much greater between 2004 and 2007. In 2013 the base level was 500 thousand barrels per day, as opposed to 1 million barrels per day in 2004 - 2007.

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Vice-Chair Neuman asked if a new well meant a new site.

Mr. Pulliam replied that he was referring to a new well. Additional production could be obtained from an existing well.

Representative Thompson asked if the graph on slide 4 depicted 20 new producing wells versus 20 wells drilled annually.

Mr. Pulliam replied 20 new producing wells.

Representative Kawasaki wondered about the assets provided in the 100 existing producing wells. He wondered how many new wells were built and capped or reworked and capped. He

asked the cost per company for the 20 producing wells drilled annually.

Mr. Pulliam estimated the cost to be \$15 million per well. He anticipated that the combination of production and injector would cost \$25 to \$30 million.

Representative Kawasaki clarified that the total cost was approximately \$300 million for the industry.

Mr. Pulliam responded \$600 million annually for 20 new producing wells per year.

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Representative Gara thought that the number of wells drilled was not one-to-one. He clarified that the anticipation was for 20 new producing wells. Mr. Pulliam replied in the affirmative.

Representative Gara wondered how many exploratory wells were required to find 20 producing wells.

Mr. Pulliam responded that he heard testimony that a handful of exploration wells drilled led to approximately 20 wells.

Representative Gara expressed difficulty understanding Mr. Pulliam's answer. He recalled testimony stating that 20 wells must be drilled to arrive at new oil.

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Mr. Pulliam disagreed. He stated that once a pool of oil was found, multiple wells were then drilled. He added that much of the initial work was performed above the ground with the use of seismic tests prior to drilling.

Representative Kawasaki expressed surprise because prior testimony stated that "dry holes" were part of the industry's cost. He understood that the industry was aware of the location of 2 billion barrels of recoverable oil and the committee hoped for the production of that oil.

Mr. Pulliam replied that drilling in an exploration and appraisal fashion would eventually yield a pool of oil. The pool would be initially located through seismic test, which

advanced in recent years. He noted that once the oil was discovered, the reservoir would be further developed leading to multiple wells. He noted the difference between drilling in a new area without any existing discoveries. Drilling in those areas was often referred to as wildcatting and could potentially lead to dry holes.

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Representative Munoz understood that it would take between three to five years to see new production in the state. She wondered about the possibility of transitioning the credits to depreciate over a three to five year period.

Mr. Pulliam asked if she was speaking about capital credits.

Representative Munoz nodded.

Mr. Pulliam replied that the capital credits would be eliminated with the passage of HCS CSSB 21(RES) at the end of 2013.

Representative Munoz asked if there were other deductible expenses that could be depreciated over time in HCS CSSB 21(RES).

Mr. Pulliam responded that the option of depreciating capital over time was proposed, but he did not advocate for that choice. He opined that HCS CSSB 21(RES) proposed a cleaner and more robust system. He stated that a depreciation of capital would complicate the system considerably.

Mr. Pawlowski elaborated that the capital depreciation idea might lead to a tax increase for certain types of development over the current system (ACES).

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Representative Gara heard rumors that Alaska was unique in allowing all of the deductions and capital expenditures to be taken in one year.

Mr. Pulliam replied that petroleum taxes based on the net were commonly deducted in one year. He suggested that the question be posed to Mr. Mayer from PCE.

Representative Gara understood that the United States taxed on the gross, which allowed deductions to come out of their income tax. He wondered if those deductions came out of income tax rather than royalty.

Mr. Pulliam answered that Alaska's severance tax was a net tax, while the Lower 48 had a gross tax. The income tax in Alaska and the Lower 48 capital was depreciated over time.

Representative Gara pointed to a gross tax in the Lower 48 the deductions given for capital were derived from the income tax, which depreciated over a number of years. In Alaska the main deduction was on the profits tax, which came in one year.

Mr. Pulliam stated that Alaska had a fundamentally different tax rate than in the Lower 48.

Representative Gara clarified that the gross tax on oil in the Lower 48 with an income tax that also applied, the deductions for capital were deducted over a number of years.

Mr. Pulliam replied that it was correct in the Lower 48 and in Alaska. In both places the capital deduction was depreciated over time. Against the severance tax the capital deduction was not an issue in the Lower 48, but in Alaska was deducted in one year.

Representative Gara asked if there was a place in the Lower 48 where capital expenses could be deducted in one year.

[2:56:05 PM](#)

Mr. Pulliam replied that there was not a place in the Lower 48 with a tax system similar to that of Alaska.

Representative Wilson understood that even in the event of an oil discovery, a well must first compete with other projects for investment. She stated that Alaska must revise the tax structure to allow for better competition.

Mr. Pulliam replied in the affirmative.

Representative Wilson stated that a small producer would benefit most from a change in the tax structure.

Mr. Pulliam replied that smaller companies would often look for capital outside of the firm where large companies possessed efficiencies.

Representative Wilson noted that the state was competing in a global market.

Representative Costello asked if increased production from legacy fields had been included in slide 4.

Mr. Pulliam answered that the analysis assumed that the legacy fields were producing in the base production. The colorful wedges were representative of development outside of the legacy fields.

Mr. Pawlowski added that the first two slides related to production. The decline was based on the currently producing legacy field infrastructure. He noted the possibilities for additional production from those legacy fields.

[3:00:26 PM](#)

Representative Costello clarified that the industry's interest in Alaska would equate to wells drilled. The increase in wells would stem the decline.

Mr. Pawlowski answered that the intent was to provide information on the scale of activity. The administration believed that the number of wells proposed in slide 4 was achievable.

Representative Costello clarified that the slide should indicate 10 annual production wells.

Mr. Pulliam moved to slide 5: "Estimated Average 2013 - 2042 State Oil Revenues (\$2012 Billion Dollars) Under Potential Production and Tax Scenarios ACES v. HCS CSSB 21(RES) \$100 West Coast ANS (\$2012)." The graph's blue bars depicted a 33 percent base tax rate. He explained that the graph illustrated state revenues under ACES with a 6 percent decline and displayed annual average revenue of \$3.3 billion. With the passage of HCS CSSB 21(RES) and a decline rate of 3 percent the revenue would increase to \$3.6 billion annually. With a 1 percent decline rate, the revenue would increase to \$4.4 billion annually. With a

zero percent decline rate the revenue would increase to \$5 billion annually. The slide assumed that all of the barrels produced over the base decline would be developed with the GRE.

Mr. Pulliam continued that the green bars depicted the revenue impact difference with a 35 percent base rate. The revenue would increase by approximately \$100 million annually with the increased base tax rate.

Representative Gara requested modeling an assumption using \$120 per barrel.

[3:04:36 PM](#)

Mr. Pulliam replied that the graph's bars would all increase with the use of \$120 per barrel and the gap between the ACES bar and the others would narrow with the increased price of oil.

Representative Gara asked why \$100 had been used in the presentation.

Mr. Pulliam replied that the figure was a typical reference price used in presentations that was comparable to the price of oil in 2013. He offered to run the data using alternative price scenarios.

Vice-Chair Neuman requested the data run using \$110, \$120 and \$130 as the price of oil.

Mr. Pulliam clarified that his use of \$100 per barrel of oil was stated in "real" dollars. He assumed 2.5 percent inflation annually.

[3:06:01 PM](#)

Mr. Pawlowski clarified that early reductions in state revenues were illustrated in the fiscal note. Slide 5 depicted average state revenues over 30 years.

Representative Gara pointed to the use of a 6 percent decline rate under current law when ConocoPhillips testified to a projected 3 percent decline rate under ACES. He pointed to Prudhoe Bay, Kuparuk, Alpine and other fields. Econ One used low price of oil and a 6 percent

decline rate. He believed the presentation was crafted to provide a result that the consultants wanted to show.

Mr. Pulliam moved to slide 6: "Estimated Average 2013 - 2042 State Oil Revenues (\$2012 Billion Dollars) Under Potential Production and Tax Scenarios ACES v. HCS CSSB 21(RES) \$100 West Coast ANS (\$2012)." Slide 6 depicted a 3 percent decline rate. The long-term decline on the North Slope was 6 percent.

Vice-Chair Neuman clarified that individual companies might anticipate 3 percent decline, but the data was based on overall throughput through the Trans-Alaska Pipeline with a 6 percent rate of decline.

Mr. Pulliam replied in the affirmative. The scenarios depicted in slide 6 utilized a 3 percent decline until 2017, which was consistent with DOR projections.

Mr. Pawlowski stated that the additional development predicted above the decline was included for all GRE barrels, which would derive lower revenue per barrel for the state. The slide illustrated the lowest possible tax rate at the prices to underrepresent the potential revenue understanding that production from the legacy fields would incur a higher revenue rate.

Mr. Pulliam discussed slide 6 and the 3 percent decline scenario. Under ACES, a 3 percent decline rate would yield \$4.3 billion per year. If the decline was stemmed to 1 percent, revenue would increase to \$4.5 billion annually. He added that a decrease from 3 to 1 percent required 10 additional new producing wells per year.

Mr. Pawlowski clarified that the consultants were not presenting base rates as recommendations.

[3:11:14 PM](#)

Representative Holmes asked for verification that the slides included a 3 percent decline until 2017 and were then adjusted.

Mr. Pulliam replied in the affirmative.

Representative Holmes asked about different tax rates. She noted that the zero percent decline rate under the

different tax rates were the same, yet the 1 percent decline rates appeared to be "off."

Mr. Pulliam replied that the slide assumed that the incremental oil was taxed at the lower GRE rate.

Representative Holmes clarified that slide 5 assumed a six percent base for the various percentages of decline, whereas slide 6 assumed a 3 percent decline moving from 1 percent to zero percent.

Mr. Pulliam replied in the affirmative.

Representative Wilson pointed to slides 5 and 6. She wondered about potential comparisons to other slides in the presentation.

Mr. Pulliam recommended that slides 5 and 6 be compared to slide 2. He noted that the different production scenarios provided a valuable comparison with the various decline rates when used within ACES and HCS CSSB 21(RES).

Representative Wilson asked for verification that production would continue through 2042.

Mr. Pulliam replied in the affirmative.

[3:14:41 PM](#)

Representative Gara pointed to slide 6. He understood that the difference between the 33 percent and 35 percent decline rate was \$200 million per year, yet the slides in the Econ One presentation depicted a \$100 million per year difference.

Mr. Pulliam answered in the affirmative. He elaborated that both figures were correct and compatible. His presentation depicted inflation-adjusted dollars where the \$200 million difference was illustrated in nominal dollars.

Representative Gara wondered about the practice of placing ACES in a 6 percent decline rate while HCS CSSB 21(RES) illustrated a lower decline rate. He wondered if Mr. Pulliam received industry input on the projected decline rate if HCS CSSB 21(RES) passed.

Mr. Pulliam replied that the scenarios were intended for illustrative purposes only.

Representative Gara asked if Econ One would provide modeling for committee members' questions.

Vice-Chair Neuman would speak to Co-Chair Stoltze about the request.

Representative Gara believed that modeling scenarios would be helpful for the committee.

Representative Thompson expressed appreciation for the department's cooperation and quick response.

[3:18:02 PM](#)

Representative Kawasaki asked about Alberta's tax reduction and the availability to access the relevant data.

Mr. Pawlowski replied that the data was located in a larger packet of responses. He offered to present it to the committee members. He noted that the data was an excerpt from an Exxon One presentation for the public. He pointed out that the information could be found on BASIS with a search for the February 13, 2013 in the presentation related to benchmarking.

Representative Gara clarified the process for submitting questions.

Vice-Chair Neuman replied that the questions must be submitted to the Co-Chair Stoltze' office for efficiency.

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

#sb18

CS FOR SENATE BILL NO. 18(FIN) am

"An Act making, amending, and repealing appropriations, including capital appropriations, supplemental appropriations, reappropriations, and other appropriations; making appropriations to capitalize funds; and providing for an effective date."

CSSB 18(FIN) am was SCHEDULED but not HEARD.

ADJOURNMENT

3:20:22 PM

The meeting was adjourned at 3:20 p.m.