

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

February 22, 2013

1:05 p.m.

**MEMBERS PRESENT**

Representative Eric Feige, Co-Chair  
Representative Dan Saddler, Co-Chair  
Representative Peggy Wilson, Vice Chair  
Representative Mike Hawker  
Representative Kurt Olson  
Representative Paul Seaton  
Representative Geran Tarr

**MEMBERS ABSENT**

Representative Craig Johnson  
Representative Chris Tuck

**COMMITTEE CALENDAR**

HOUSE BILL NO. 72

"An Act relating to appropriations from taxes paid under the Alaska Net Income Tax Act; 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; relating to the determination of annual oil and gas production tax values including adjustments based on a percentage of gross value at the point of production from certain leases or properties; making conforming amendments; and providing for an effective date."

- HEARD & HELD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 72

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/16/13            (H)            READ THE FIRST TIME - REFERRALS

01/16/13	(H)	RES, FIN
02/11/13	(H)	RES AT 1:00 PM BARNES 124
02/11/13	(H)	Heard & Held
02/11/13	(H)	MINUTE(RES)
02/13/13	(H)	RES AT 1:00 PM BARNES 124
02/13/13	(H)	Heard & Held
02/13/13	(H)	MINUTE(RES)
02/15/13	(H)	RES AT 1:00 PM BARNES 124
02/15/13	(H)	Heard & Held
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02/18/13	(H)	RES AT 1:00 PM BARNES 124
02/18/13	(H)	Heard & Held
02/18/13	(H)	MINUTE(RES)
02/20/13	(H)	RES AT 1:00 PM BARNES 124
02/20/13	(H)	Heard & Held
02/20/13	(H)	MINUTE(RES)
02/22/13	(H)	RES AT 1:00 PM BARNES 124

#### **WITNESS REGISTER**

BARRY PULLIAM, Economist & Managing Director  
 Econ One Research, Inc.  
 Los Angeles, California

**POSITION STATEMENT:** Testified and answered questions during discussion of HB 72.

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

**POSITION STATEMENT:** Testified during discussion of HB 72.

#### **ACTION NARRATIVE**

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**CO-CHAIR ERIC FEIGE** called the House Resources Standing Committee meeting to order at 1:05 p.m. Representatives Seaton, P. Wilson, Hawker, Saddler, and Feige were present at the call to order. Representatives Olson and Tarr arrived as the meeting was in progress.

#### **HB 72-OIL AND GAS PRODUCTION TAX**

[1:05:42 PM](#)

CO-CHAIR FEIGE announced that the only order of business is HOUSE BILL NO. 72, "An Act relating to appropriations from taxes paid under the Alaska Net Income Tax Act; 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; relating to the determination of annual oil and gas production tax values including adjustments based on a percentage of gross value at the point of production from certain leases or properties; making conforming amendments; and providing for an effective date."

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BARRY PULLIAM, Economist & Managing Director, Econ One Research, Inc., stated he had reviewed the presentations by the producers' representatives and would comment on that material.

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MR. PULLIAM addressed slide 14 of the Pioneer Natural Resources presentation to the House Resources Standing Committee on February 18 which used Econ One data for the economics of [HB 72] versus ACES for a new development. He opined that his conclusion for this data differed from the Pioneer conclusion. He directed attention to the \$115 million on the right of the slide, explaining that this referred to the difference between the net present values under HB 72 and ACES for a new producer developing a 50 million barrel field with capital costs of \$16 per barrel. He offered his belief that slide 16, developed for Pioneer Natural Resources by Palantir, used the same 50 million barrel field, and was modeled for the Nuna Project. He declared this to have capital spending of almost \$900 million, similar to the Econ One analysis, although the production profile was "a little different than what we had used." He noted that, instead of a \$115 million benefit, Pioneer analyzed this to reflect a \$92 million detriment. He pointed to the assumptions at the bottom of the slide, which he stated were similar to his analysis. He pondered why there was an "opposite conclusion essentially." He declared that the assumption for price, \$100 per barrel ANS West Coast, was the same, but that he had assumed the price would increase over time at the rate of inflation, about 2.5 percent per year. He offered his belief that Palantir

did not make this same assumption for inflation, which would result in a 2012 price of \$78 per barrel, and would account for the different conclusion.

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CO-CHAIR SADDLER, referring to the aforementioned slide 16 of the Pioneer Natural Resources presentation, asked for a comparable Econ One slide to show its results.

MR. PULLIAM, in response, referenced the top box of the aforementioned slide 14, which listed the net present value for ACES as \$192 million compared to the net present value for proposed HB 72 of \$309 million. He reported that differential to be about \$115 million.

REPRESENTATIVE HAWKER, clarifying that the Econ One model included annual inflation to the \$100 per barrel price, asked what that inflation rate was.

MR. PULLIAM replied it was 2.5 percent.

REPRESENTATIVE HAWKER asked if this annual increase was compounded or linear.

MR. PULLIAM responded it was compounded, and reflected that the compounded price would be about \$170 per barrel in 30 years, but that the linear mean price would be about \$129 per barrel.

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REPRESENTATIVE SEATON opined that it was not possible to compare outcomes if an annually inflated price was now being introduced in only one of the evaluations.

MR. PULLIAM explained that all of his presented analyses were for real terms, so a specific price over an extended time period would include inflation adjustment. He offered to clearly label his projections as a 2012 dollar value. He surmised that this was the common way to present assumptions.

CO-CHAIR FEIGE affirmed that any calculation for net present value (NPV) in the future should reflect that inflation adjustment.

MR. PULLIAM expressed his agreement, and indicated that a NPV of 12 percent was consistent with an inflationary assumption of 2.5 percent.

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REPRESENTATIVE SEATON asked if, at \$100 per barrel, the NPV would be 9.5 percent.

MR. PULLIAM confirmed this to be correct on a real basis.

MR. PULLIAM said that it was important to understand whether the analysis was done in real or nominal terms, as each could create a very different outcome. He opined that a fixed price scenario for real terms would be adjusted for inflation over time, and would then use a discount rate with the same inflationary assumption.

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JANAK MAYER, Manager, Upstream and Gas, PFC Energy, concurred with the analysis by Mr. Pulliam, stating that all the PFC presentations to the Alaska State Legislature had factored in the impact of inflation, usually a 2.5 percent rate. He declared that the real or nominal analysis models for many fiscal regimes did not necessarily make a huge amount of difference when the fundamentals of the fiscal system did not change with nominal prices. He declared that these models did not work in Alaska, however, as ACES and progressivity were not indexed to inflation, but were set in nominal terms, which allowed for "bracket creep." He stated that as nominal prices rise, the production tax value point for progressivity would move lower in real terms. He confirmed that there was a fundamental difference for a one year review for ACES and a review for an extended time frame. He pointed out that the government take became higher and the economics for ACES looked worse when an extended time frame was analyzed with the impact of inflation factored in because of the effect of "bracket creep."

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REPRESENTATIVE SEATON questioned if inflation was factored on expenses, which were all deducted prior to the progressivity point, then that point would not "bracket creep" because the inflation was below the tax point. He stated that the inflation was assumed in the costs.

MR. MAYER pointed out that the inflation was also in the oil price.

REPRESENTATIVE SEATON questioned whether the consumer price index in Anchorage was related to the actual oil prices.

CO-CHAIR FEIGE surmised that there was a theoretical nature to predicting future prices.

REPRESENTATIVE SEATON expressed his difficulty for understanding the different models if the calculations were not the same. He asked if the models for NPV 10 and NPV 12 would only be 0.5 percent different.

MR. PULLIAM, in response to Representative Seaton, said that it would be better if the cash flow and the discount rate were not inflated, however, the challenge would be that an assumption for constant oil prices in real terms, a common forecasting method, would differ from nominal terms as these would be rising and would affect the ACES tax. He declared that it was not as valid to ignore the effects of inflation in an analysis, as it would understate the taxes due under ACES because the rate rises as the price rises.

REPRESENTATIVE SEATON asked if the basis of all the considerations had been the DOR Revenue Sources Book, and were these projections all inflated by 2.5 percent to the consumer price index.

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MR. PULLIAM offered his belief that the figures presented in the DOR Revenue Sources Book were nominal, or dollars of the day, but when the costs and prices were forecast there was consideration for the effects of inflation. He pointed to the gradual increase of prices in the forecast, which reflected the inflationary effect.

CO-CHAIR FEIGE surmised that, if history was any guide, that the price had steadily increased.

MR. PULLIAM suggested that, although there was some disagreement for the direction of oil prices, even a conservative forecast would reflect no growth, or a constant, in real terms.

MR. MAYER opined that no economist would say that time series data could be looked at in nominal terms and generate meaningful conclusions, as inflation was a fact of life. He pointed out that the price of oil in the 1960s, when reviewed in nominal terms, offered no information for a meaningful conclusion. It would be necessary to inflate that 1960s oil price to 2012 dollars to gain a sense of the purchasing power.

MR. MAYER affirmed that for any of these current analyses, the point was not to forecast the exact oil price, but to compare using certain assumptions. He declared that the crux of the matter was to determine the nominal price for its impact.

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CO-CHAIR SADDLER asked if it had been an omission with ACES in not accounting for inflation.

MR. MAYER opined that, as Palantir was a software company, the Pioneer Natural Resources analysis was not necessarily a commissioned report from Palantir. He pointed to a white paper produced by Palantir, which included an analysis using nominal terms. In response to Co-Chair Saddler, he surmised that it was not an uncommon oversight, as few people realized the significance that "bracket creep effect of ACES is over time." He stated that he had not specifically reviewed the Pioneer Natural Resources analysis for real or nominal basis.

CO-CHAIR SADDLER asked how significant was the bracket creep.

MR. MAYER replied that it had a noticeable effect on government take and on the price level at which progressivity would kick in.

MR. MAYER, in response to Co-Chair Saddler, said that the price level for progressivity became significantly lower over a 20-30 year time frame.

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REPRESENTATIVE SEATON asked about the inflation rate for in-field project costs, and whether it had been entered into the analysis. He opined that these project costs had increased more than the consumer price index.

MR. PULLIAM offered his belief that, on average, there had been a greater increase for project costs. He reported that the

inflationary pressure on oil project costs was greater than the consumer price index, and that these had been factored into the Econ One analyses. If one simply assumed that oil prices and costs were going to rise at the level of inflation, or somewhat higher, the tax rate for ACES would go up because of it, as the taxable base for the price of oil was larger than the taxable base for costs.

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REPRESENTATIVE HAWKER reflected on the initial dialogues regarding the production profits tax (PPT), which had a lower progressivity level than ACES. He stated that there had been discussion for bracket creep, with recognition that there would be opposing consequences for cost and revenue inflation, which would tend to be offsetting for the tax calculations over time. He indicated that, as progressivity rates under ACES had never been modeled or evaluated significantly for the possible consequences, there now existed a potentially profound bracket creep.

CO-CHAIR FEIGE reviewed that, although inflation affected the revenues and the expenses evenly, there were other factors that affected expenses.

REPRESENTATIVE HAWKER replied that these were relatively equal and offsetting under the original PPT. However, under ACES the differential became quite profound, which resulted in the current bracket creep.

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REPRESENTATIVE SEATON confirmed that bracket creep had been discussed for ACES. He opined that bracket creep entered when there were higher prices, as there was then more revenue in the progressivity range.

MR. PULLIAM declared that this was the margin over the progressivity trigger, and inflation would increase that margin resulting in an increasing tax rate with progressivity. He noted that the "upside gain" on slide 16 was the amount saved when not paying any progressivity, and he opined that similar results would be reflected if he assumed a real price of \$80 per barrel.

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REPRESENTATIVE TARR recalled that Mr. Pulliam had stated that the tax credits were not an important aspect for decision making; however, she pointed out that all of the independent producers testified to the importance of the tax credits for commitment to investment in Alaska.

MR. PULLIAM replied that he did not recall offering those opinions as he had intended to indicate that the overall economics of the project, including the credits, were important to review.

REPRESENTATIVE TARR asked how to attract the small producers to invest in Alaska, as the proposed bill would remove those credits.

MR. PULLIAM suggested making it attractive for the enhanced present value of the projects. Even without credits, there were enough other benefits to enhance the project's present value.

REPRESENTATIVE TARR asked, if the proposed bill passed, at what point and for how many barrels of oil it would take to recoup the \$1.5 billion revenue loss.

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MR. PULLIAM replied that he was not familiar with the \$1.5 billion revenue loss, although DOR had analyzed the impact for new production. He explained that it depended on the response from the producers, although no one could predict the time line. He stated that it was possible to make the system more attractive to encourage greater participation.

REPRESENTATIVE TARR asked whether he had an estimation for the number of barrels of new oil production necessary to recoup the losses from the change in tax structure.

MR. PULLIAM replied that the calculation and analysis could be done and he opined that some of this information had been provided.

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MR. MAYER shared his conclusion that, should there be no change in current production until 2017 when new production came on line, it was necessary for an additional 20,000-barrel-a-day project to come on-line each year after that. By 2019 - 2020,

there would be greater revenue than currently under ACES, and real revenue to the state would level off.

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CO-CHAIR SADDLER requested Mr. Mayer to repeat his response.

MR. MAYER explained that, if one assumed no change in the rate of decline between now and 2017, it would be necessary for an additional 20,000 barrels of oil a day each year in order to hold state revenues steady. By 2020, the state would then be in a net positive position compared to the current system with ACES, if the additional barrels were a result of the tax change.

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REPRESENTATIVE SEATON directed attention to page 3 of the attached fiscal note [Included in members' packets] and asked about the \$1.5 billion loss in 2015 and the additional loss each year after. He declared that there would be some balance against this loss if the credits were also removed. He surmised that the total negative fiscal impact would be over \$1 billion in 2017 - 2019 according to the fiscal note. He questioned whether the buy-down provision of progressivity was an incentive to invest in Alaska, when the capital credits were also removed. He asked how removal of these incentives to reinvest in Alaska offered an overall fiscal system incentive that would counter balance these.

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MR. PULLIAM expressed his disagreement with the conclusions of the Palantir white paper with respect to the legacy fields. He declared that the combination of the two changes in proposed HB 72 made the system more attractive. He allowed that there was a question whether the buy down would act as strongly as an incentive for a lower tax rate. He pointed out that the buy down required continued investment in Alaska rather than the freedom to invest elsewhere.

REPRESENTATIVE SEATON reflected on the "quality of the cash" for the incentives, which was dependent on the ability to take it wherever desired. He asked for any financial mechanism that would hold funds until the investments or production commenced under the proposed tax system. This would allow Alaska to retain the revenue until the incentives offered had been met.

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MR. PULLIAM suggested an escrow-type account, which allowed access to the funds given the adherence to certain conditions.

REPRESENTATIVE SEATON offered his belief that this would give comfort to many Alaskans regarding the proposed bill.

MR. PULLIAM opined that the value would be determined by the hurdles to access the escrow funds, and whether there was interest accrued for those funds.

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REPRESENTATIVE HAWKER reflected on an earlier dialogue during the debate on ACES that the high marginal rates were an incentive to the industry to buy-down their taxes through additional investment in Alaska. At that time, he had questioned the validity of the premise, and he noted that these buy-downs had not happened.

CO-CHAIR SADDLER asked if Representative Seaton intended the escrow money to only be available as script to use at "the company store of Alaska."

REPRESENTATIVE SEATON explained that there was a need to guarantee that the proposed bill would encourage investment, hence the money in the escrow account would be returned given investment and increased production in Alaska. He offered his belief that the other exclusions in the proposed bill created winners and losers, and he was in search of a solution. The escrow money would be available for redemption upon attainment of the benchmarks. He offered his belief that this would assuage any concerns for the loss of revenue with no guarantees.

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CO-CHAIR FEIGE relayed that all of these companies had stated that they would miss the capital credits. He opined that the capital credits had led to spending, but not to an increase in production necessary to level out or reverse the production decline. He asked whether a credit to encourage increased drilling and new oil production would accomplish the goals as stated by Representative Seaton.

MR. PULLIAM declared that the goal was to get more oil, and that the current credits had been valuable, in so far as the current

tax structure without these credits was abominable. He clarified that the credit did not offset or make up for the tax structure. He expressed preference for a credit tied to actual barrels, rather than spending, and he suggested a per barrel allowance that would exempt new barrels from some or all of the tax. He pointed out that this would allow the producers and the engineers to determine the best means to access the oil. This would tie the incentive to the end result, which would effectively offer a lower tax rate. He offered an example that a credit tied to drilling could be a disincentive for facilities.

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MR. MAYER expressed concern for the impact from complete elimination of the capital credits. He noted that the crossover price point whereby there was a tax decrease for high price of oil and a tax increase at low price levels, was "potentially, at the moment, uncomfortably high, particularly when it comes to more expensive new production." He offered that the gross revenue exclusion addressed completely new areas. When the current system for profit based production tax was first proposed by Pedro van Meurs, it was for a flat 25 percent base tax, without a progressive component, but had included a capital credit to mitigate the project economics at low price levels. He opined that the capital credit played a significant role in the improvement of project economics. However, a credit based solely on production would not necessarily offset, as it was applied later in the cash flow cycle to reduce the overall tax burden, but did not help with the initial economics for rate of return. He asked how concerned the state was for the downside liability from the tax credits and if there were other ways of providing the incentive that the credits offered. He suggested more limited credits for spending, credits that are tradable with other companies, or credits that allowed more discretion by the state.

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CO-CHAIR FEIGE outlined the process for finding and developing new oil fields, and asked if there were different credits which were more helpful at different points of the timeline. He suggested a credit system be structured to allow companies to elect which credit they preferred to use.

MR. MAYER said he would like to think about that.

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REPRESENTATIVE TARR pointed out that removal of the tax credits in the proposed bill would create difficulties for the small producers and for exploration, and that the gross revenue exclusion (GRE) would create difficulties for the large producers as it did not apply to the legacy fields where the majority of new oil was projected to be produced. She noted that 20,000 new barrels of oil per day was necessary to offset the loss of tax revenue, and yet, the only accomplishment for the proposed bill was "giving the oil companies more money." She stated that it did not attract small producers with new investment, or incentivize legacy field development. She questioned why Alaska would move forward with the proposed bill. She suggested a change of the gross revenue exclusion to include the legacy fields, and she asked for comments.

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MR. PULLIAM expressed his understanding for the producers' desire to have the tax credits extended to include the legacy field. He shared his confidence that the economics of production and additional investment in the legacy fields would be better under the proposed bill than currently under ACES, and therefore, the proposed bill should be an incentive to continue production in the legacy fields. He offered his belief that the GRE and similar incentives could be applied to new developments within existing fields which were "getting at new oil." He acknowledged that it could be more difficult to measure new production in an existing field. He reported that the United Kingdom had a similar approach with their brownfield allowance, which was designed for mature fields with pockets that were less economic to produce. In this system, the operator would make a proposal to the government and upon approval an exclusion was granted.

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MR. PULLIAM addressed earlier points by Representatives Hawker and Seaton that ACES was designed to allow a buy down for the tax rate, which should encourage investment. He referenced earlier analysis that had been focused on internal rate of return (IRR), which reflected that additional investments in legacy fields were huge. He directed attention to a slide [not distributed to members] which depicted the IRR on incremental investments in a legacy field under ACES and other systems with different rates for progressivity. He noted the flat 25 percent

tax rate, which offered an IRR that increased linearly over the price range. He shared that as progressivity was added, the tax rate went up and the IRR was increased. He declared that it was an odd result, as it appeared that an increase to the tax rate would make the investment more attractive. He mused why the companies did not also see this. He opined that the resulting IRRs were attractive and should be stimulating investment. He asked which system would be preferred as a taxpayer.

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REPRESENTATIVE TARR opined that, as this was a much higher price environment than possibly envisioned, there were much higher effective production tax rates. She pointed out that this tax rate was only 10 percent when the price of oil was \$60 per barrel. She suggested that it was now necessary to offer an approach that more appropriately responded to the higher prices. She asked if he had made calculations for progressivity at these higher prices.

MR. PULLIAM replied that he had reviewed a variety of potential progressivity scenarios, and that he used a model which allowed changes to predict various outcomes.

REPRESENTATIVE TARR asked if these were available for review.

MR. PULLIAM stated that he would request approval from Department of Revenue (DOR).

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REPRESENTATIVE SEATON questioned whether to tie credits to production, as it increased the risk to exploration and drilling because a dry hole would not allow for any credit. He asked if this revision of the credit would discourage drilling and exploration to both the new producers and the legacy field producers. He offered his belief that it was the reverse of an incentive.

MR. PULLIAM replied that part of a lease agreement was for exploration and development, which was a risk to which the company agreed in the hope of having a big reward. He suggested that any mitigation of that risk was favorable to them as long as they did not have to give up part of the reward. He declared that the advent of technology today had greatly reduced the probability of a dry hole, as extensive work was done in advance of drilling. He opined that the risk was not overwhelming when

it was commensurate with the potential reward. He noted that there was a program which offered credit for exploration drilling, although there were some limitations, and he suggested a review of this program with some modifications.

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REPRESENTATIVE SEATON asked to clarify that Mr. Pulliam was saying that a company would bid on a lease if the opportunity for reward was good and the tax rate was down, therefore the credits were not necessary.

MR. PULLIAM, in response, offered his belief that overall, while trying to help, "we tend to try and micromanage a little bit what it is that the companies do." He established that, as the companies take on risk and explore, the state would be better off letting them do that without trying to provide so much assistance. He nominated that streamlined permitting and reasonable tax rates would accomplish the goal, more so than trying to offer incentives.

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CO-CHAIR SADDLER asked about the link of tax relief with production, pointing to an allowance for production of new barrels of oil, credits to drilling, and credits for facilities. He summarized that Mr. Pulliam had suggested the state leave the decision to producers for the most efficient allocation to the credit. He inquired whether the current credit system was working toward that end, or were there other ways to modify the tax credit system which would address production and abnormal cost structures, while limiting exposure by the State of Alaska.

MR. PULLIAM, in response, offered his belief that, if there were going to be credits, the current credit was better than having more specific credits directed to activities, which could lead to unexpected consequences. He opined that a credit would best be tied to barrels instead of spending, because that would get to what was desired. He suggested that it may be worthwhile to investigate a definition for new barrels of oil, suggesting that these may be barrels which exceeded the natural decline rate. He proposed an engineering review of specific developments to guarantee new production, and then to offer those new barrels a greater per barrel credit.

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MR. MAYER mused that there was a fundamental question to the philosophical approach for the achievement of a fiscal system. He opined that the approach in Alaska had been to micromanage the systems. He assessed that the exploration credit, especially when combined, was overly generous and was not affected by the proposed bill. He reported that exploration risk was the one form of risk that most taxing jurisdictions were unwilling to risk, as it was similar to the economics of venture capital. He surmised that a substantial part of the problem with Alaska's fiscal system was the concern for minimizing risk to take as much as possible return on the upside. He suggested a rebalancing to take less on the upside, while taking even less risk.

MR. MAYER reflected on the overall approach to this goal, and he considered the balance for a high level of take with the creation of a competitive, attractive fiscal regime to incentivize behaviors. He noted that substantially reduced government take and relatively few specific interventions was one solution, although there was a significant cost to the state treasury as companies would receive cash back for activities that were currently economic. He pointed out that a lot of the spending on the North Slope was currently economic. However, there was also the alternative for a simpler, competitive regime with reduced exposure and reduced revenue, which would require specific interventions with possible unintended consequences. He considered that, to the extent that one was trying to create specific incentives, approaches that provided the producer with greater discretion were preferable. He referred to the aforementioned brownfield solution in the United Kingdom, which applied to incremental new developments that produced oil from mature fields. Approval was given after plans were reviewed, the incremental new production over the status quo was determined, economics were finalized, and agreement to the allowance was negotiated. He opined that this solution was much more sensible than simply giving a tax credit.

CO-CHAIR SADDLER asked to clarify that this was a negotiated level of credit.

MR. MAYER expressed his agreement, and noted that there were parameters.

CO-CHAIR SADDLER asked how there was a determination for new production.

MR. MAYER replied that the government had to make that judgment. He commented that the tax code was the worst way to incentivize incremental production, especially if it required a written formula for calculation. He stated that DNR had experts for well level analysis and determinations, although it was necessary for trust among the branches of government.

CO-CHAIR FEIGE reflected on the quandary for defining a decline curve that arose during the last year's special session. He noted that it was necessary to agree on the point of decline, in order to define new oil.

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REPRESENTATIVE SEATON, noting that this would be a field by field specific policy, pointed out that the three major oil companies had significantly different company rates of decline. He asked how to retain the elements of a profit-based tax while putting in the separate elements for field development.

MR. MAYER stated his support to the legislature for making the overall playing field more competitive in Alaska, while recognizing the costs to future revenues. He declared that rigid incentives through the tax code were often not the best approach, and instead, specific incentives could be negotiated for a specific field.

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MR. PULLIAM added that the tax code was the least flexible option when conditions warranted a change. He announced that royalty relief offered additional incentives and was an example of what had worked along those lines. He explained that Department of Natural Resources (DNR) would review the application and the proposed development, and then evaluate the need for royalty relief in order to be economic. He declared this to be "a scalpel as opposed to a chain saw approach."

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REPRESENTATIVE HAWKER expressed his appreciation to Mr. Mayer's and Mr. Pulliam's commentaries, and disclosed that "I may have just heard one of the greatest understatements that I have ever heard in the oil and gas tax debates in this legislature in eleven years, and that was when Mr. Pulliam said the legislature attempts to micromanage the companies a little bit." He concurred with the statement that Alaska would be a lot better

off if the legislature focused on removing obstacles and let the companies do what they do best.

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REPRESENTATIVE TARR, noting that testimony had stated that ACES had not yet been in place for many years, exploration was anticipated to lead to new production, and that the audits for those ACES years had not yet been completed, asked how it could be determined that the capital credits were working or not.

MR. MAYER replied that the state did not lack adequate exploration, but lacked the ability to turn known resources into reserves and production. He explained that capital credits were essential in the current system, as no development activity, given the high level of take under ACES, would be economic without this credit. He suggested that a small amount of credit was necessary to reduce the base tax. He characterized the tax code as a blunt instrument used to incentivize particular behavior.

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CO-CHAIR SADDLER asked for suggestions to reduce the regressive elements of the proposed bill at lower prices, for consideration to a GRE at \$80 per barrel which increased as the price per barrel decreased, and for a progressive gross tax as prices moved above \$100 per barrel in the legacy fields.

[2:50:18 PM](#)

MR. MAYER expressed his agreement that these were the most obvious solutions. He explained that the cause of regressivity in this proposed bill was the fixed royalty, which he called regressive by nature. As long as this remained, there was the need for a progressive wedge. If the wedge was solely progressive, then the problems were those which had already been discussed, including decoupling and the impact of gas production on progressivity, or the incentives for cost control. He offered that levying this on the gross was a means to overcome some of the problems, however the difficulty would be at the intersection of the 25 percent base rate and the gross progressive element. He opined that the situation could arise for some companies that low prices would mean an effective tax increase. In that case, it would be necessary to either reduce the base rate and have a progressive tax, or keep the base rate and have a progressive GRE.

2:52:54 PM

CO-CHAIR FEIGE pointed out that Mr. Mayer was the consultant hired by the Alaska State Legislature, while Mr. Pulliam was the consultant hired by the governor and the administration.

MR. MAYER, in response to Co-Chair Feige, said that the quality of Mr. Pulliam's work was very high, and that ongoing dialogue between he and Mr. Pulliam would improve the quality of both their models and presentations. He declared his faith and confidence in the quality of the models and assessments presented by Mr. Pulliam. He opined that Mr. Pulliam had presented one possible solution of many to the particular issues of HB 72, and that potential solutions would continue to be reviewed in more detail.

2:55:04 PM

CO-CHAIR FEIGE lauded the discussions and presentations.

2:55:36 PM

REPRESENTATIVE SEATON referred to net operating loss, posing a scenario in which oil prices went down and expenses were high, and questioned whether the state had any liability under the proposed bill, specifically from the Big 3 producers.

MR. PULLIAM expressed his belief that proposed HB 72 would allow for those losses to be carried forward for a certain time period. He mused that prices would need to be low for an extended period of time to create losses, and he did not put a high probability on significant state exposure. He offered to review the price levels that would create an exposure.

MR. MAYER clarified that the state's biggest net operating loss liability would come from the small operators, those below production of 55,000 barrels each day, and not the Big 3 producers. These operators could claim their net operating loss directly from the state treasury, whereas the larger operators could only claim this loss against future production.

REPRESENTATIVE SEATON surmised that the state was at a greater risk for net operating loss under ACES than it would be under proposed HB 72. He noted that a tax on the gross would always generate income for the state, which was not the case with a net

operating loss. He questioned whether it was necessary to address this possibility in proposed HB 72.

[2:59:32 PM](#)

CO-CHAIR SADDLER recounted the effective tax rates of previous tax regimes, and asked if it was a surprise that the effective tax rate under ACES of 26 percent was so much higher than previous tax systems.

MR. PULLIAM, in response to Co-Chair Saddler, said that this rate was not a surprise, and he clarified that the earlier data was the tax rate on the gross value of the oil, and not the net value. He noted that the effective tax rate was generally declining under ELF in the five years prior to ACES, although, as the data was from fiscal years, it did include a little bit of PPT in the time period. He pointed out that the changes for ACES significantly increased the tax rates, and that there was also a rise in oil prices.

[3:01:56 PM](#)

CO-CHAIR FEIGE urged members to be thinking of amendments to the proposed bill, and, in response, he said that he would not limit the number of amendments. He noted that he planned to hold the proposed bill until the Senate version was passed over to the House.

[HB 72 was held over.]

[3:03:07 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:03 p.m.