

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 27, 2013

1:06 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

COMMITTEE SUBSTITUTE 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."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 21

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/16/13 (S) READ THE FIRST TIME - REFERRALS
01/16/13 (S) TTP, RES, FIN
01/22/13 (S) TTP AT 3:30 PM BELTZ 105 (TSBldg)
01/22/13 (S) Heard & Held
01/22/13 (S) MINUTE(TTP)
01/24/13 (S) TTP AT 3:30 PM BUTROVICH 205
01/24/13 (S) Heard & Held
01/24/13 (S) MINUTE(TTP)
01/29/13 (S) TTP AT 3:30 PM BELTZ 105 (TSBldg)
01/29/13 (S) Heard & Held
01/29/13 (S) MINUTE(TTP)
01/31/13 (S) TTP AT 1:00 PM BUTROVICH 205
01/31/13 (S) Heard & Held
01/31/13 (S) MINUTE(TTP)
02/05/13 (S) TTP AT 3:30 PM BUTROVICH 205
02/05/13 (S) Heard & Held
02/05/13 (S) MINUTE(TTP)
02/07/13 (S) TTP AT 3:30 PM BUTROVICH 205
02/07/13 (S) Moved SB 21 Out of Committee
02/07/13 (S) MINUTE(TTP)
02/08/13 (S) TTP RPT 1NR 4AM
02/08/13 (S) NR: DUNLEAVY
02/08/13 (S) AM: MICCICHE, GARDNER, FAIRCLOUGH,
MCGUIRE
02/08/13 (S) LETTER OF INTENT WITH TTP REPORT
02/09/13 (S) TTP AT 10:00 AM BUTROVICH 205
02/09/13 (S) -- MEETING CANCELED --
02/11/13 (S) RES AT 3:30 PM BUTROVICH 205
02/11/13 (S) Heard & Held
02/11/13 (S) MINUTE(RES)
02/13/13 (S) RES AT 3:30 PM BUTROVICH 205
02/13/13 (S) Heard & Held
02/13/13 (S) MINUTE(RES)
02/15/13 (S) RES AT 3:30 PM BUTROVICH 205
02/15/13 (S) Heard & Held
02/15/13 (S) MINUTE(RES)
02/18/13 (S) RES AT 3:30 PM BUTROVICH 205
02/18/13 (S) Heard & Held
02/18/13 (S) MINUTE(RES)
02/20/13 (S) RES AT 3:30 PM BUTROVICH 205
02/20/13 (S) Heard & Held
02/20/13 (S) MINUTE(RES)
02/22/13 (S) RES AT 3:30 PM BUTROVICH 205
02/22/13 (S) Heard & Held
02/22/13 (S) MINUTE(RES)
02/25/13 (S) RES AT 3:30 PM BUTROVICH 205
02/25/13 (S) Heard & Held

02/25/13 (S) MINUTE(RES)
02/27/13 (S) RES AT 3:30 PM BUTROVICH 205
02/27/13 (S) Moved CSSB 21(RES) Out of Committee
02/27/13 (S) MINUTE(RES)
02/28/13 (S) RES RPT CS 3DP 1DNP 2NR 1AM NEW
TITLE
02/28/13 (S) LETTER OF INTENT WITH RES REPORT
02/28/13 (S) DP: GIESSEL, MCGUIRE, DYSON
02/28/13 (S) DNP: FRENCH
02/28/13 (S) NR: MICCICHE, BISHOP
02/28/13 (S) AM: FAIRCLOUGH
02/28/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
02/28/13 (S) Heard & Held
02/28/13 (S) MINUTE(FIN)
03/01/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/01/13 (S) Heard & Held
03/01/13 (S) MINUTE(FIN)
03/01/13 (S) RES AT 3:30 PM BUTROVICH 205
03/01/13 (S) -- MEETING CANCELED --
03/02/13 (S) RES AT 10:00 AM BUTROVICH 205
03/02/13 (S) -- MEETING CANCELED --
03/04/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/04/13 (S) Heard & Held
03/04/13 (S) MINUTE(FIN)
03/04/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
03/04/13 (S) Heard & Held
03/04/13 (S) MINUTE(FIN)
03/05/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/05/13 (S) Heard & Held
03/05/13 (S) MINUTE(FIN)
03/05/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
03/05/13 (S) Heard & Held
03/05/13 (S) MINUTE(FIN)
03/06/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/06/13 (S) Heard & Held
03/06/13 (S) MINUTE(FIN)
03/06/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
03/06/13 (S) Heard & Held
03/06/13 (S) MINUTE(FIN)
03/06/13 (S) FIN AT 3:00 PM SENATE FINANCE 532
03/06/13 (S) -- Public Testimony --
03/11/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/11/13 (S) -- MEETING CANCELED --
03/11/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
03/11/13 (S) -- MEETING CANCELED --
03/12/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/12/13 (S) Bills Previously Heard/Scheduled

03/12/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
 03/12/13 (S) Heard & Held
 03/12/13 (S) MINUTE(FIN)
 03/12/13 (S) FIN AT 4:00 PM SENATE FINANCE 532
 03/12/13 (S) Heard & Held
 03/12/13 (S) MINUTE(FIN)
 03/13/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
 03/13/13 (S) Heard & Held
 03/13/13 (S) MINUTE(FIN)
 03/13/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
 03/13/13 (S) Heard & Held
 03/13/13 (S) MINUTE(FIN)
 03/14/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
 03/14/13 (S) Moved CSSB 21(FIN) Out of Committee
 03/14/13 (S) MINUTE(FIN)
 03/18/13 (S) FIN RPT CS 2DP 1DNP 1NR 3AM NEW
 TITLE
 03/18/13 (S) DP: KELLY, MEYER
 03/18/13 (S) DNP: HOFFMAN
 03/18/13 (S) NR: FAIRCLOUGH
 03/18/13 (S) AM: DUNLEAVY, BISHOP, OLSON
 03/18/13 (H) RES AT 1:00 PM BARNES 124
 03/18/13 (H) Scheduled But Not Heard
 03/19/13 (S) RLS AT 9:00 AM FAHRENKAMP 203
 03/19/13 (S) -- MEETING CANCELED --
 03/20/13 (H) RES AT 1:00 PM BARNES 124
 03/20/13 (H) Scheduled But Not Heard
 03/21/13 (S) TRANSMITTED TO (H)
 03/21/13 (S) VERSION: CSSB 21(FIN) AM(EFD FLD)
 03/22/13 (H) READ THE FIRST TIME - REFERRALS
 03/22/13 (H) RES, FIN
 03/22/13 (H) RES AT 1:00 PM BARNES 124
 03/22/13 (H) Heard & Held
 03/22/13 (H) MINUTE(RES)
 03/25/13 (H) RES AT 1:00 PM BARNES 124
 03/25/13 (H) Heard & Held
 03/25/13 (H) MINUTE(RES)
 03/26/13 (H) RES AT 6:00 PM BARNES 124
 03/26/13 (H) Heard & Held
 03/26/13 (H) MINUTE(RES)
 03/27/13 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

KEN THOMPSON, Co-Owner/Investor, Managing Director
 Alaska Venture Capital Group, LLC (AVCG)
 Owner/Operator, Brooks Range Petroleum Corporation

Anchorage, Alaska

POSITION STATEMENT: Testified on CSSB 21(FIN) am(efd fld).

KARA MORIARTY, Executive Director
Alaska Oil & Gas Association (AOGA)
Anchorage, Alaska

POSITION STATEMENT: Testified on CSSB 21(FIN) am(efd fld).

J. PATRICK FOLEY, Manager, Land and External Affairs
Incoming President
Pioneer Natural Resources Alaska, Inc.
Anchorage, Alaska

POSITION STATEMENT: Testified on CSSB 21(FIN) am(efd fld).

ACTION NARRATIVE

[1:06:42 PM](#)

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 1:06 p.m. Representatives Seaton, P. Wilson, Tuck, Hawker, Johnson, and Feige were present at the call to order. Representatives Tarr, Olson, and Saddler arrived as the meeting was in progress.

SB 21-OIL AND GAS PRODUCTION TAX

[1:07:01 PM](#)

CO-CHAIR FEIGE announced that the only order of business is 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."

[1:07:36 PM](#)

KEN THOMPSON, Co-Owner/Investor, Managing Director, Alaska Venture Capital Group, LLC (AVCG), Owner/Operator, Brooks Range Petroleum Corporation, began his PowerPoint presentation by noting that Alaska Venture Capital Group, LLC (AVCG) is the parent company of Brooks Range Petroleum Corporation, one of Alaska's most active exploration companies. He further noted he is a former president of ARCO Alaska, Inc. He said he has spent 75 percent of the last three months in the Lower 48 working to find a new funding partner to invest in his company's new Alaska development projects.

MR. THOMPSON stated why consideration should be given to his company's perspectives on CSSB 21(FIN) am(efd fld) (slide 2). He said Brooks Range Petroleum has been one of the most active exploration companies in Alaska, exploring and developing solely on North Slope state lands. From 2007-2012, Brooks Range Petroleum drilled 10 of the 36 exploration wells drilled on North Slope state lands. "That is more exploration wells than Conoco, BP, Exxon, ENI, Repsol, and Armstrong combined," he said. Brooks Range Petroleum has 105,000 leased acres in three core areas and has a joint venture partnership with Ramshorn Exploration, an affiliate of Nabors Industries. Alaska Venture Capital Group was started in 1999 and its operating company, Brooks Range Petroleum Corporation, was formed in 2006. So far, \$200 million has been invested in Alaska North Slope exploration projects, with 3 discoveries from 10 wells for about a 1 in 3 success rate. A discovery that was made in the 1970s has been acquired and is being assessed for development. Mustang, the company's first development project, is under construction; photographs of its confirmation well can be seen on slides 6-7. A gravel road is under construction and a gravel pad and facilities will be built this next year. Drilling will occur in 2014 and production will begin fourth quarter 2014. At 44 million barrels of oil, Mustang will contribute about 15,000 barrels of oil per day to the state. Between its discoveries and acquisition, the company has three other development projects in various stages of permitting or conceptual engineering. Mustang alone will be just under \$600 million in capital. In 2013, 2014, and 2015 his company will spend about \$200 million per year, about the same level of capital spending as Pioneer Natural Resources and about one-third the level of ConocoPhillips Alaska, Inc. Other development projects will total about \$1.2 billion in investment capital.

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MR. THOMPSON addressed what the state will be receiving for its investment of tax credits, which have been very important to his company. Of the \$200 million his company has spent, a total of \$69 million has been refunded in tax credits. The state will receive back all of its \$69 million in credits in the first year of production from Mustang alone, and over its field life Mustang will produce revenues to the state of \$1.2 billion. His company has redeployed all of the credits back into drilling or seismic to find and develop new oil. The credits enabled his company to drill three wells instead of two, or two exploration wells instead of one. This helped accelerate the discovery and delineation of Mustang in two years instead of the three it would have taken for the company to do on its own using only the company's budget and capital availability.

MR. THOMPSON said his company has experience in bringing other independents to Alaska and in raising capital for Alaska. It brought Ramshorn Exploration and two companies out of Calgary, Bow Valley Energy and TG World Energy, which it later bought out. Additional capital is now being sought for Mustang as well as the company's three- to five-year exploration program. When his company started fund raising 18 months ago, materials were sent to 210 firms. Of the 210, only 19 had an interest in Alaska and after further review only 2 of the 19 remained interested. In talking with many of the 210 firms, two key things were heard. Most commonly heard was that Alaska's fiscal regime is complex with a high government take. The progressivity factor was criticized, with some companies comparing it to the federal windfall profits tax of the early 1980s that caused many domestic companies to go overseas to explore. His company is encouraged the state is making positive change with SB 21 and is communicating this to others. The second most common thing heard was that companies are investing in Lower 48 source rocks and shale, which are much quicker on production and lower cost capital per reserve. He reported that his company is in final negotiations with a Lower 48 independent that has never invested in Alaska. Communication continues with this company about the legislature's progress in making Alaska more competitive through some of the changes being contemplated.

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MR. THOMPSON displayed a map depicting his company's acreage on the North Slope (slide 3). He said his company's 105,000 acres are right next to the Prudhoe Bay field, Badami, Point Thomsen, Kuparuk River Unit, the Coleville area, and the Alpine field. His company has discovered 44 million barrels of oil proved,

plus probable reserves. So far the possible reserves on all of the company's projects are around 150 million barrels. Using three-dimensional seismic his company has mapped potential prospects that are being further assessed, but the tally, which needs to be confirmed with further drilling, is about 700 million barrels gross recoverable.

MR. THOMPSON discussed the difference his company can make (slide 4). Based on his work on the North Slope as a major and now as an independent, he said he believes that "new work in the existing fields to increase production above their existing declines will not - by itself - level Alaska's oil production. It will also take production from exploration discoveries." Alaska needs exploration and production, not just production. Some companies, including some of the majors, have stopped exploring on state lands. While they do have huge resource in the existing fields, that alone is not going to solve Alaska's problem of increasing production in the existing legacy fields. To turn the production curve up, it is also going to take exploration and new discoveries like those of his company. As legislators decide on exactly what changes to make, one size is not necessarily going to fit all. There are two different businesses in Alaska in the oil industry - that of production development and that of exploration - different players and different risks so different incentives can make the difference.

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MR. THOMPSON said anything included in CSSB 21(FIN) am(efd fld) should incentivize the North Slope majors into what they do the best - safely and reliably abate the legacy fields' decline and extract the maximum amount of oil from existing fields. But the legislation must also do a second thing, and that is incentivize the explorers in what they well - find and develop the billions of barrels of additional oil still left in smaller pools on the North Slope. He explained the production graph on slide 4 is for the Mustang discovery, plus his company's other potential discoveries of Tofkat, Beechey Point, Telemark, and Appaloosa that still require delineation. Successful delineation of those in the next couple years would add production of over 50,000 barrels of oil per day. That is significant, he said, given that between 2012 and 2011, North Slope oil production declined about 50,768 barrels per day. Developments from exploration could replace all of that production falloff and the state could achieve no decline for a period of time. He said he believes that with two or three more exploration companies on the North Slope repeating what Brooks Range Petroleum is doing, and if the

majors can be incentivized in additional development in existing fields, the production curve could be turned upward like what is being seen in some of the Lower 48 states.

MR. THOMPSON noted that the aforementioned fields belonging to Brooks Range Petroleum represent about \$2 billion in capital spending, \$4-5 billion in state revenues, and significant Alaska hire. He reminded members about the testimony provided [on 3/25/13] by Econ One Research in which slide 20 showed that 40,000-44,000 new barrels of oil per day would be needed to offset the fiscal impact of CSSB 21(FIN) am(efd fld) versus ACES. Drawing attention back to the significance of slide 4 in his own presentation, Mr. Thompson pointed out that the exploration discoveries of Brooks Range Petroleum, if brought on to development, would be above 50,000 new barrels a day.

[1:22:44 PM](#)

MR. THOMPSON reviewed the positive provisions his "successful exploration company" sees in CSSB 21(FIN) am(efd fld) and discussed what could be changed in the bill to make Alaska even more competitive and to help newly started companies like his that are in different financial circumstances than the majors (slide 5). Eliminating progressivity is very positive and simplifies the tax calculation, he said. From his experience talking with over 200 companies over the last 18 months, this will be a big public relations plus for the State of Alaska. However, raising the base tax rate from 25 percent to 35 percent is a negative; he suggested a compromise of 30 percent. The \$5 per barrel produced credit is positive and an innovative way to help balance producer and state take at low oil prices, although it may be worthwhile for the Department of Revenue to retest the economics to see if more may be needed or some other mechanism may be needed at prices below \$80 a barrel.

MR. THOMPSON said very important to his company is the carry forward loss credits, given the significant investment required prior to production which will not start until fourth quarter 2014. The increase of this credit from 25 percent to 35 percent and interest on the unused credits is a big positive. Pointing out that his company does not have current production and may have these carry forward loss credits for some time in the future, he suggested it would be helpful to allow the credit to be taken against any payments to the state, such as against royalties, or to be able to transfer these credits to others rather than having to defer them.

[1:25:39 PM](#)

MR. THOMPSON noted that in the original version of SB 21 the small producer credit of \$12 million per year was extended from 2016 to 2022, something that would have really helped his company because peak production will not be reached until after 2016. [Because CSSB 21(FIN) am(efd fld) sunsets this credit in 2016], a small producer like Brooks Range Petroleum, with first production in fourth quarter 2014, will be unable to utilize these credits. This negative hurts his company's economics and presents even more challenge in having to raise even more funds. Reinstating this credit to 2022 would be a positive for the few small producers existing in Alaska because it would be more cash flow to put into facilities and drilling.

MR. THOMPSON stressed the qualified capital expenditure credit is probably the thing that has helped his company the most. None of these credits have been put into the owners' pockets, he said, this immediate cash has been put into drilling programs and seismic and right now is helping to fund part of the Mustang development facilities and the drilling in 2014. His company would not be developing Mustang right now without these credits; development would have been deferred by about a year if his company had had to live just within its capital availability. A negative in CSSB 21(FIN) am(efd fld) is that the qualified capital expenditure credit goes away at the end of 2013. Extending the qualified capital expenditure credit even to the end of 2016 would help his company get pasts its first project. Understanding the state's concern about the amount of these credits, he suggested limiting the credit to small producers and limiting the amount to \$40-\$50 million per year per company. Another way to continue this credit without hurting the state, he said, would be to target the credit to specific items where companies must show there will be a production increase. He added he is unaware of any companies that have not used these credits for anything but production or reserves, but has heard otherwise from the governor and he therefore would like to see a table of what companies have used them for.

[1:29:16 PM](#)

MR. THOMPSON stated the gross revenue exclusion (GRE) is very helpful and will incentivize new oil production on more leases. However, a negative is that the GRE was previously proposed at 30 percent, but in CSSB 21(FIN) am(efd fld) it is 20 percent. He suggested a GRE of 25 percent as a balance to state and producer take.

MR. THOMPSON concluded by pointing out his exploration company has never had an exploration incentive credit on the North Slope because it has not drilled wells more than 22 miles away; his company has drilled closer than that, but has found new oil reserves. He said his company is significantly disturbed [that the 30 percent exploration incentive credit originally included in SB 21 for exploration wells anywhere on the North Slope is not included in CSSB 21(FIN) am(efd fld)]. He urged this provision be reinstated, saying his company would put this credit to good use in additional seismic and drilling. Reinstating the credit, even if just for small producers, would be helpful. He further suggested this credit could be limited to \$25 million per company per year and could be run for five years to see if it is effective. He predicted it would be effective in his company's case because in the past the other credits helped his company drill three wells instead of two and an exploration credit could do the same thing.

[1:31:32 PM](#)

REPRESENTATIVE SEATON inquired about the plans that Brooks Range Petroleum has for production facilities.

MR. THOMPSON replied this summer his company is in the final engineering design stages for its stand-alone facilities. The company plans to be self-sufficient, building its own modular facilities with a lot of Alaska hire and then trucking them to the North Slope. Capacity is 15,000 barrels of oil per day, but each facility module can later be increased if additional oil is found. He said slides 6 and 7 include photographs of the gravel pad where the facilities will be installed in 2014.

[1:32:52 PM](#)

MR. THOMPSON, responding to Co-Chair Saddler, said the estimated cost for the aforementioned facility will be just over \$200 million for total facilities, plus \$340 million on development drilling, with the whole project being over \$570 million.

CO-CHAIR SADDLER inquired whether the credit in CSSB 21(FIN) am(efd fld) for Alaska manufacture will be attractive to Mr. Thompson's company. He further inquired whether the company intends to fabricate these modules in Alaska.

MR. THOMPSON answered it would, and said various equipment and components are made that could be ordered, but the final modular

construction, as well as hauling to the North Slope, would be done within Alaska and he would think some of that work would qualify for that particular item in the bill.

CO-CHAIR SADDLER asked how important this credit would be to Mr. Thompson's company.

MR. THOMPSON confessed he does not fully understand whether this particular credit would come to Brooks Range Petroleum or to the companies that are building the facilities. He offered to provide the committee with a figure in regard to the portion of the facilities that would qualify under this credit. He presumed the credit would help some and would incentivize that the work is done within the state of Alaska.

[1:34:45 PM](#)

REPRESENTATIVE TUCK inquired how long Mr. Thompson has been operating in Alaska.

MR. THOMPSON replied the parent company, Alaska Venture Capital Group, began leasing acreage in 1999. Seismic was run soon after that, followed by assessing and putting together a good exploration portfolio. Brooks Range Petroleum Corporation was formed in 2006, with exploration, engineering, and operating personnel located in Anchorage. The company started operating its own wells in 2006 and has drilled every year except this winter in which the focus is on development.

REPRESENTATIVE TUCK asked how soon Brooks Range Petroleum might be able to single-handedly make up that loss [equivalent] of 40,000-44,000 barrels per day.

MR. THOMPSON responded the Mustang project will be put into production in third quarter 2014 and will be ramped up by 2016 to about 15,000 barrels a day. Also being looked at for first quarter 2014 is Appaloosa, an offset to Mustang, and the Tofkat discovery. Drawing attention to slide 4, he said Brooks Range Petroleum could produce and get up to roughly 40,000 barrels a day just on its own by 2017. The hurdle of 40,000 could be achieved much faster with work in the legacy fields by the majors and by other independents that are drilling on the North Slope. It will take everyone together, but it is significant what one independent can do and one exploration company can do.

REPRESENTATIVE TUCK thanked Mr. Thompson for his quote that exploration does lead to exploration. Regarding it being said

that the qualifying tax credits do not lead to production, he inquired what could be done to make it more accountable so it can be demonstrated it leads to production.

MR. THOMPSON answered that is the most puzzling comment he has seen quoted in the newspapers and by some within the state. His company has put every dollar of credit received back into seismic or drilling, resulting in these discoveries which are confirmed, proved reserves by an outside consultant. The state owns one-sixth of those almost 50 million barrels, plus the taxation on production. He is unaware of which company is not using credits to bring reserves to the table or not be in production. His company is willing to be held accountable that if it has continued credits it shows proof it can bring production and new reserves.

[1:38:58 PM](#)

REPRESENTATIVE JOHNSON inquired whether Mr. Thompson would choose ACES or CSSB 21(FIN) am(efd fld) as written.

MR. THOMPSON replied he would rather see "SB 21" improved. For a new company without production, ACES provides a higher rate of return because of the tax credits. However, ACES becomes very penalizing at high oil prices and when his company is under production the progressivity under ACES will be very negative. In trying to attract funding his company gets nowhere with ACES; the progressivity has turned off so many companies to not even want to look at Alaska. Therefore, his answer would be for an improved "SB 21" with a balance that both industry and the state can feel good about.

[1:40:17 PM](#)

CO-CHAIR FEIGE drew attention to the last point on slide 2 regarding the sending of advertising materials to 210 firms in 2011 and today only 2 remain interested. He asked whether adoption of "SB 21" would affect investment capital becoming available to producers and explorers within Alaska.

MR. THOMPSON responded his company is in final negotiations with a Lower 48 independent that will not make its final decisions for the closing until after the legislative session. That company wants to know with certainty what the terms are going to be so economics can be run for making a final decision to invest, which is why he hopes some of these changes can be made. He shared his experience of being at a meeting in New York with

one of the largest private equity firms in the world that had expressed interest in Alaska. He said he knew he was in trouble for attracting investment when he walked into the conference room and saw that the walls from floor to ceiling were covered with geologic and seismic maps of the Lower 48 source rock plays - no conventional prospects, nothing from Alaska, just source rock plays. The equity firm was candid with him that it saw that those reserves could be put on faster, could be more significant for the firm, and were lower risk than exploration or development in Alaska. To the positive, he continued, he has found one company that does love conventional exploration and is very interested in Alaska, so he remains optimistic. Because his company's sole vision is to become Alaska's premier independent oil and gas company, it will continue to keep Alaska as its only focus.

[1:43:29 PM](#)

REPRESENTATIVE SEATON inquired how much capital for Mustang will be expended before December 31 that would qualify for the 20 percent tax credit.

MR. THOMPSON answered he does not have that table in front of him and will get the exact number to the committee, but his guess is roughly \$27 million for the road and everything that is currently underway. A lot of engineering and ordering of equipment remains to be done this year. He guessed that less than 20 percent of the total \$577 million will be spent in 2013. Most of it will be the actual equipment and modular construction in 2014 and then the drilling in 2014 and 2015, which is why he asked if things could at least be extended on some of this to 2016, and certainly the small producer credit to 2022.

[1:44:59 PM](#)

CO-CHAIR SADDLER asked whether it is Mr. Thompson's opinion that the high rates of government take under ACES are the biggest barrier to entry into Alaska, or should other things be looked at to improve investment and competition on the North Slope.

MR. THOMPSON replied the high government take is what he heard most often in his phone calls with the 200 companies that said they are not interested. The image of Alaska is hard to turn around. The start of ACES put Alaska in a negative image of high government take and the taking away of the upside at high prices. He is one of several ambassadors discussing how the

state is working to improve things and what the positives are, but ACES has certainly made it an uphill battle.

[1:46:18 PM](#)

CO-CHAIR SADDLER asked whether Mr. Thompson would say Alaska is dismissed out of hand or is dismissed after being looked at and the high government take is seen.

MR. THOMPSON responded he does not even get a foot in the door with many companies because the high government take is just dismissed out of hand. When he did get in the door with the 19 companies, which were private equity firms and other producers, they realized the take was high but wanted to see the resource base and look at the new conventional exploration. Some wanted to look at the unconventional shale resource on the North Slope, something his company plans to pursue after getting its conventional prospects on line. The resource base got the 19 companies very interested; 2 are now left after putting it to pencil. The 17 that dropped out found better rates of return elsewhere, such as the Bakken, Eagle Ford, and Gulf of Mexico.

[1:47:59 PM](#)

CO-CHAIR SADDLER inquired whether independents like Brooks Range Petroleum need a lower government take than do large producers in order to "make a buck" in Alaska, given independents do not have downstream refining and transportation interests.

MR. THOMPSON answered reasonable government take would certainly help independents, but tax credits would help companies like his the most. He said he understands if the state must limit how much that is per year and if a time table must be put on it, say five years out, to determine whether it was used wisely and got results or should be stopped. For small companies like his, credits are dollars that can be reinvested quickly and they lessen the amount of funds that must be raised until there is cash flow from oil production. The percentage of government take is certainly very important and he knows that in the legacy fields a base rate of 30 percent instead of 35 percent would help the majors. For small producers/explorers, being able to keep the tax credits for a bit would help overall.

[1:49:43 PM](#)

REPRESENTATIVE P. WILSON related it is being heard from companies that they want surety, but now she is hearing from Mr.

Thompson to try something for a while and then re-evaluate it. Because she has heard so much about surety she does not want to include something in the bill that could change later on. She asked how Mr. Thompson would feel about putting something in the bill for five years, period, with no re-evaluation.

MR. THOMPSON replied his opinion is it may be a mix of both. For example, the base tax rate, eliminated progressivity, and establishment of a per-barrel credit are the fundamental tax structure that would hopefully stay in place for a very long time. Other issues, like the small producer credit for small producers and the gross revenue exclusion for incentivizing new oil production, could be kept the same through 2022 and then reviewed for effectiveness. What hurts is putting something in and then [changing it] two or three years later. There has been such a flux for quite a period of time with ACES, the production profits tax (PPT) before that, and the economic limit factor (ELF) before that. If the basic fundamentals were set and not changed for the foreseeable future, there may be some elements the state wants to review every five years for effectiveness. A combination would perhaps be a wise thing to do.

[1:52:21 PM](#)

CO-CHAIR FEIGE inquired whether the Competitiveness Review Board proposed under CSSB 21(FIN) am(efd fld) would be suited for dealing with the aforementioned by Mr. Thompson.

MR. THOMPSON responded the Competitiveness Review Board could be very effective, in his opinion. He said he serves on a number of public company corporate boards and a board does not have time, and the board members all do not have expertise, to deal with certain topics, so committees are set up, such as a compensation committee or audit committee. So, he thinks this Competitiveness Review Board could play that kind of role. The board should not be changing things every year, the fundamentals should stay in place for a long time, but in five years such a board could look at things like an exploration incentive credit and whether it has or has not worked. A key thing is that the legislature must trust the members of that board, so would need to be very careful who it puts on the board, and would need to allow the board to hire the third-party consultants. However, it would be a challenge if there was not that trust and the legislature or legislative committees started hiring its own consultants. Also, in his opinion, anyone serving on that board should have no conflict of interest or any economic gain from the oil and gas industry. He said he does think such a board

could bring to the table the necessary expertise, because all these matters are very complex and it is hard even for people in the business to keep up with all the latest in technologies and changes. So, it could be very positive if done correctly.

[1:55:11 PM](#)

CO-CHAIR FEIGE inquired whether the proposed makeup of the board, five members from the business community and four from the government, is an appropriate ratio.

MR. THOMPSON answered this is the first time he has had to think about this issue, so his response is an off-the-top-of-his-head reaction to the question. In the end, he said, what is done or not done on policy for oil taxation or oil incentives truly affects the rate of return to other areas. If that rate of return is positive, more capital and more companies will come to the state. Because of that business aspect, it may make sense to have five business and four government members and hopefully they are all folks that can teamwork well together.

[1:56:37 PM](#)

REPRESENTATIVE SEATON asked what price Mr. Thompson meant when he talked about a high-price range.

MR. THOMPSON drew attention to slide 3 of Econ One Research's [3/25/13 presentation to the committee] and said right now ACES is detrimental when it gets above \$80 West Coast Alaska North Slope (ANS) price, and above \$100 the gap between government take and producer take really widens. After companies have taken the major risks, not being able to have as much upside at prices "anywhere north of \$100" is a fundamental principle that needs to be addressed. The graph shows CSSB 21(FIN) am(efd fld) does a better job of that.

[1:57:55 PM](#)

REPRESENTATIVE TARR stated an idea behind CSSB 21(FIN) am(efd fld) is that one size fits all, thus no winners or losers are picked. Understanding Mr. Thompson is saying an exploration company is different than the three majors, she inquired whether he therefore thinks a bill that separates explorers and majors, similar to what ACES does, is better in terms of being more specific to the business needs of small versus large companies.

MR. THOMPSON replied he does not think it necessary to separate the bill at all; with some tweaks [CSSB 21(FIN) am(efd fld)] can get there for both majors and companies like his. He recalled the 3/26/13 testimony by "BP, Exxon, and Conoco" in which all three companies felt that most of the impact in Alaska will not be from exploration but from improving production in legacy fields. However, he thinks it is going to take both. While he understood their perspectives given that a small percentage increase in fields as huge as Prudhoe Bay or Kuparuk will make a huge difference for the state, he said he thinks the state will regret that 10-20 years down the road because the state still has to have exploration. Drawing attention to slide 5, point 6, he said if the majors are not going to explore on state lands, which he heard yesterday, perhaps there is no need for them to have an exploration incentive credit. Perhaps the exploration incentive credit could apply only to small producers and explorers and be run for a few years for the state to see how effective it has been, which would limit how much the state treasury has to pay. Additionally, it could be capped; for example, each company could be limited to no more than \$25 million of credits per year for exploration drilling. A limit would prevent the state from being harmed by excessive credits and such a credit would target the small producers and explorers that, for the most part, are doing exploration on state lands. The big companies are doing wonderful exploration in other areas like the National Petroleum Reserve-Alaska and offshore.

[2:01:01 PM](#)

REPRESENTATIVE TARR observed the Mustang project was sanctioned under ACES and asked whether, if looking back, elimination of some of the credits would have prevented Mustang from going forward. Under CSSB 21(FIN) am(efd fld) the carry forward loss credit will be increased, she continued, but effectively there will be a 10 percent decrease because the other two credits [will be sunset]. She asked whether this is significant enough that Mr. Thompson's company will have to re-evaluate its plans for other projects going forward if this legislation passes.

MR. THOMPSON responded "exactly right," but said his company will continue trying to make all these projects. Without the credits his company will not have that cash to re-deploy. Additionally, his company cannot take advantage of some credits right away, such as the carry forward loss credit, because it does not have production to offset with a tax bill. His company will have to live within its capital means, which will probably slow down developments. The Mustang project is a real world

example of the difference made by the qualified capital expenditure credits, he continued, all of which his company basically returned. In winter 2011, the first wells were drilled in the Mustang prospect and discovery was made. Follow-up wells were drilled in 2012, enough oil was seen, and now things are underway, as evidenced by slides 6-7. Had those credits not been received his company would still have done the work, but not as many wells would have been drilled every year - the company would be drilling wells right now instead of building a gravel road because things would have been pushed out. For companies like his, being able to re-deploy state credits into drilling and seismic has been very helpful.

[2:03:44 PM](#)

CO-CHAIR SADDLER asked for Mr. Thompson's thoughts about the third category gross revenue exclusion qualification.

MR. THOMPSON answered about 60 percent of his career was with the large major, ARCO, focusing on the North Slope. He said he is unsure what the language means so he agrees there needs to be some clarity in that third provision around the issues of metered and measured, as well as exactly what it is that will receive that element. North Dakota, for example, has special tax incentives that are very specific for qualifying secondary and tertiary recovery projects. Montana gives reductions for horizontal wells. Also, when a new project starts, Montana has a decline curve and once production goes above that decline curve for new major projects, like tertiary recovery or enhanced oil recovery, the producer gets reduced tax rates. The United Kingdom brownfields also have clarifications. It would be helpful to everybody if industry and the state could sit down under that third element - which does not affect Brooks Range Petroleum much at this time - and really define what types of work would qualify to get that exclusion. These three examples could be looked at and put into the bill as examples. In further response, he agreed to provide by electronic mail more information about North Dakota, Montana, and the United Kingdom.

[2:07:29 PM](#)

KARA MORIARTY, Executive Director, Alaska Oil & Gas Association (AOGA), provided a PowerPoint presentation and paraphrased from the following written testimony [original punctuation provided with some formatting changes]:

AOGA is the professional trade association that represents 15 member companies who account for the majority of oil and gas exploration, development, production, transportation and refining of oil and gas onshore and offshore in Alaska [slide 1]. These comments regarding Senate Bill 21, and specifically Committee Substitute Senate Bill 21 (FIN) am(efd fld), have been reviewed by all members and have been approved unanimously.

In short Mr. Chairman, my members believe the proposed Committee Substitute represents a base for significant and crucial tax structure reform of ACES that will help move the State's fiscal policy toward Governor Parnell's four "core principles". While we are encouraged by the Committee Substitute and the efforts by the Legislature and the Administration thus far to try and significantly improve Alaska's overall global attractiveness, AOGA believes additional changes are still needed for the bill to truly change investment behaviors to the benefit of Alaskans.

[2:08:51 PM](#)

The industry's greatest challenge today, which we share with the State is the decline of oil production from the North Slope [slide 3]. A healthy oil and gas industry is one that sees the economic benefits of continuing to invest in projects in Alaska and keeping its employees here, where they volunteer their time, talent and treasure to make Alaska a better place to live for us all. Corrections to the ACES tax regime will remove impediments to development and exploration and assist the industry in investing in projects that could both extend the life of TAPS and open up new resources to long term development. We want to create developments that will last for decades more, creating jobs for our children and opportunities for our communities to flourish.

If a restructuring and tax rate reduction make investments here more competitive, or better yet, "attractive", companies will want to make more investments here for that upside. Deciding to make long term investments in Alaska's North Slope requires the industry to see potential upside to their investments and assessing that the essential risks of those investments are offset by the opportunities afforded in success. Without that potential

opportunity in Alaska, investment dollars will be spent elsewhere, where risks are less and opportunity is greater.

[2:10:18 PM](#)

MS. MORIARTY continued, paraphrasing from the following written testimony [original punctuation provided with some formatting changes]:

Core Principles to Address North Slope Production Decline [slides 4-5]

Throughout my testimony today, I will reference Governor Parnell's four "core principles" so it is important to restate them here as they offer an excellent cornerstone for you as you consider potential solutions to the challenge production decline creates for Alaska:

"First, tax reform must be fair to Alaskans."

"Second, it must encourage new production."

"Third, it must be simple, so that it restores balance to the system."

"Fourth, it must be durable for the long term."

We believe the addition of a fifth such principle would be required to meet Alaska's goals, because the challenge is not that there are too many companies pursuing opportunities, but that there are too few. Alaska should therefore avoid tax changes that artificially create "winners" and "losers."

Our goal today is to offer insights into how the CSSB21 impacts industry and we have ideas of how the current tax structure can be modified to better suit the needs of the State.

[2:11:20 PM](#)

1. Repealing Progressivity. [slide 6]

AOGA endorses the elimination of progressivity.

Impact of Progressivity as part of the ACES tax rate in industry investment decision making is the single most influential component of Alaska's tax structure negatively impacting investment decisions related to Alaskan projects. Taxes are paid by the industry in virtually every jurisdiction in which we function and so we are very familiar with how they work. But the uniformity and consistency in the application of tax impacts as they relate to

investment decision making found in almost every jurisdiction is missing in Alaska. As my member companies have testified in the past, investment decisions are driven by combining high and low case scenarios where costs and revenues are estimated and best case cash flows and worst case cash flows are measured, risked and analyzed. Each potential project, in every jurisdiction, is measured and compared and only some are funded. As one of the legislative consultants, Roger Marks, pointed out recently, the international investment climate is characterized by plenty of opportunities, fluid capital, but finite capital. To choose what they can and cannot fund, companies have compared each potential project, no matter the jurisdiction, by application of a uniform investment decision measuring formula. When Alaska's tax system is quantified and added to this measure for proposed Alaskan projects the best cases are always burdened with an excessively high tax rate and as the assumed high cases get better, the burden only increases. We can find almost no other jurisdiction that so burdens investment return where the better the cases assumed for the decision, the higher the tax burden that applies.

And as I have testified to before, progressivity brings extraordinary complexity to the tax, not only in calculating what the tax is, but also in analyzing what the amount of the progressivity is for any particular item that affects a taxpayer's Production Tax Value (PTV).

The repeal of progressivity is consistent with all the principles outlined above. Its removal improves fairness because operators that increase margins through efficiency would no longer be automatically penalized. Its removal encourages new production because it reduces the tax burden on investment, as discussed above. Its removal is a significant step toward simplicity. And, lastly, its removal enhances durability because it satisfies the three preceding core principles.

[2:14:27 PM](#)

MS. MORIARTY continued, paraphrasing from the following written testimony [original punctuation provided with some formatting changes]:

2. Increasing the base tax rate from 25 to 35%.

AOGA does not endorse increasing the base tax rate to 35%. [slide 7]

Let's go back to the industry investment decision process again. Increasing the base tax rate, burdens every investment case with a higher tax rate. The burden of a 35% versus a 25% rate is easy to envision as every middle case and every worst case scenario is burdened with an additional 10% tax rate. This assumed cost will negatively impact the potential returns deemed available for any Alaskan project and drive investments to be made elsewhere. Increasing the base tax rate is contrary to the second core principle; there is not any reasonable argument that suggests increasing the base tax rate would encourage new production. Indeed, using the progressivity formula as a benchmark, the ten percentage point increase in the base tax rate could be viewed as equivalent to a sustained reduction in oil price of \$25 per barrel, all else being equal. In other words, a sustained \$25 per barrel price change would be needed under progressivity to get the same 10% change in the base tax rate. Under progressivity, each \$1 increase in PTV (or price, all else equal) per barrel would result in a 0.4% increase in the tax rate surcharge. Thus, a 10 percentage point change in the tax rate under progressivity would be equivalent to a \$25 change in PTV or price because $25 = 10\% \text{ divided by } 0.4\%$.

3. Tax Credits [slide 8]

Industry makes investments to seek returns. In general, tax credits, because they act to offset a part of the costs of certain investments when the expenditure is made are an important tool in reducing the deemed risks of those expenditures.

It is important to reinforce that there is no tax credit liability for the State at all until an investor invests here. So it costs the State nothing to offer the credit until the investment is made and at that point the tax credit has already succeeded in what it is supposed to do - namely to attract investment dollars here.

[2:16:10 PM](#)

MS. MORIARTY continued, paraphrasing from the following written testimony [original punctuation provided with some formatting changes]:

A. Repeal of the Qualified Capital Expenditure ("QCE") Tax Credit. [slide 8]

AOGA does not support the repeal of the Qualified Capital Expenditure Tax Credit.

Even while the elimination of progressivity would improve the competitiveness of Alaskan investments from the present ACES tax, the elimination of the QCE Credit would claw back one important financial incentive and a part of ACES that actually acts to improve the competitive environment. The QCE Credit depends entirely on how much is invested here, and provides benefits for investments even when oil prices are lower. While the benefit from ending progressivity, which depends on the price of oil relative to a producer's lease expenditures, helps when oil prices are higher the QCE provides benefits across all price levels. At low to mid-range of oil prices the loss of QCE Credit would outweigh the benefit from the end of progressivity.

Repeal of the QCE credit is contrary to the second core principle. Furthermore, because every producer's costs are different and prices will impact them differentially, AOGA fears the repeal of the QCE Credit is worse than creating "winners" and "losers" because it only creates "losers" artificially among producers, and we see no sound tax policy justification for doing so.

For these reasons, AOGA believes the elimination of the QCE tax credits would not serve to attract new business to Alaska. Instead of that, one possibility might be to expand the scope of the "well lease expenditure" tax credit under AS 43.55.023(1) so it is available to producers on the North Slope. This credit has several meaningful advantages. First, it focuses investment incentives on subsurface intangible-drilling expenditures, which are a reasonable proxy for direct spending on well activity and, in turn, production. Second, the credit is clear because it uses already established concepts in the federal Internal Revenue Code. Third, it is fair because it applies equally to well-related spending in all areas of the state, without creating winners and losers merely on the basis of geography.

[2:18:53 PM](#)

MS. MORIARTY continued, paraphrasing from the following written testimony [original punctuation provided with some formatting changes]:

B. The \$5 dollar per barrel tax credit. [slide 9]

AOGA is concerned that the potential benefit of a \$5 dollar per barrel tax credit under AS 43.55.024(i) will be offset by other burdens.

There are multiple issues to balance when taking in the numerous proposed changes found in CSSB21. The removal of progressivity, the increase in base rate, elimination of the QCE credit all create interrelated issues and while a \$5 dollar per barrel tax credit would provide benefits both in real tax costs and in investment decision making, the weight of the benefit in respect to the other changes is hard to measure. AOGA applauds the concept of tying incentives to the goal of increased production and as such allowing a tax credit per barrel.

C. Small-Producer and Exploration Credits. [slide 10]

AOGA supports amending CSSB21 to extend the small-producer tax credit under AS 43.55.024 and exploration tax credits under AS 43.55.025 from the present sunset dates in 2016 to a later date.

The State had sound policy reasons for creating these small producer and exploration tax credits, and those reasons are just as valid today as they were then. The current CSSB21 does not extend the sunset dates beyond 2016, even though AOGA believes these credits have increased the likelihood of participation by new industry players and act to increase the opportunities that could be found by expanding exploration. The purpose of the small-producer tax credit was to attract new players to Alaska who might otherwise have been deterred from coming here by presumptions of increased risks and of higher-than-average costs and expenses. The success of the credit in attracting new participants is a fact that cannot be denied. AOGA sees this success in its own membership, and in other companies that have come here and are now active. Smaller producers often have a different perspective about the opportunities around them, and as such can bring with them new ideas and opportunities. New participants with new ideas can only strengthen and improve the Alaskan petroleum industry and help the state stem the decline in production. We know from testimony that the small-

producer tax credit has made a material difference in individual companies' decisions to do business and invest in Alaska.

The purpose and justification for the exploration tax credits under AS 43.55.025 are equally clear. Huge parts of this state remain unexplored or underexplored. Again, these tax credits are only earned when actual expenditures for exploration occur. The credits tangibly reduce the risks faced by an explorer and as such incentivize them to go out and search for oil and gas that is much needed. Increased exploration leads to increased development and these credits act to increase exploration and should be extended as well. Just as with the QCE credits for capital investments, there is no exploration tax credit without real money having first been spent on exploration work that qualifies for these tax credits.

[2:22:01 PM](#)

MS. MORIARTY continued, paraphrasing from the following written testimony [original punctuation provided with some formatting changes]:

D. Maintaining transferability of "carried-forward annual loss" tax credits. [slide 11]

AOGA supports the transferability of these losses.

We applaud that the CSSB21 maintains the transferability of the current "carried-forward annual loss" tax credits under AS 43.55.023(b). New participants and new explorers are many times not yet producing in the state or only producing small volumes of oil and gas and as such have little or no production tax liabilities. The ability to transfer their losses to others allows them to monetize the investments they have already made, both reducing their cost exposure on the original expenditure and hopefully at the same time acquiring additional capital for more investment.

E. New credit for Manufacturing [slide 12]

AOGA supports the new proposed manufacturing credit.

Although this credit is directed to the incentivizing of development and manufacture of drilling and exploration methods and materials, it may not have a great impact on the reduction of the current production decline. However, it is a step in the right direction to incentivize jobs and additional

investment, and having more jobs and investment in Alaska is never a bad thing.

4. Gross Revenue Exclusion. [slide 13]

AOGA endorses the proposed 20% gross revenue exclusion or GRE, but has concerns on breadth of applicability.

The GRE would, in calculation of the taxable Production Tax Value, exclude 20% of the Gross Value at the Point of Production of what we'll call "non-legacy" production, and attempts to apply to new oil within legacy fields. AOGA supports the concept of a GRE, and initially we were concerned that it was too narrowly focused because it would have only applied to those areas outside existing Units.

The Governor's second "core principle" for tax legislation is that "it must encourage new production." But, in order to get results from such encouragement, the tax legislation must incentivize the best opportunities that Alaska has for getting results. The current CSSB21 attempts to expand the application of the GRE and tries to include legacy fields, which is where at least 80 - 90 percent of the 3 billion-barrel opportunity in the central North Slope that Econ One identified as economically recoverable earlier this session.

[2:24:40 PM](#)

MS. MORIARTY continued, paraphrasing from the following written testimony [original punctuation provided with some formatting changes]:

However, the current language causes concern because of the uncertain nature of the applicability and the problem that companies won't know if they get the GRE until after the investment is made, so in essence, companies cannot utilize the GRE in modeling economics of future projects in legacy fields. Additionally, we have concerns that the determination methodology will be defined after the bill is passed and be placed in future regulations.

AOGA believes our concerns can be addressed by additional language to provide clarity and certainty so the GRE is effective for industry.

Oil and Gas Competitiveness Review Board [slide 14]

AOGA does not support the formation of the Competitiveness Review Board.

The proposed Board provides an oversight and review process that we believe would be burdensome to the industry and contravenes the Governor's principles relating durability in the long term. The perspective that the proposed changes found in the Bill would provide a long term solution to problems we know exist are placed in jeopardy because the very certainty that is required for sound investment decision making would be placed in question with each annual report of the Board. Instead of moving forward with projects that might help stem decline, industry resources would be used to assist the Board in collecting and understanding complex information of long term consequence. Finally, the documentation and information the Board might request or require is of the highest proprietary value to oil and gas companies and confidentiality concerns and related complexities would hinder the efforts of the industry as well as the Board. While we appreciate the ability to represent industry on the proposed board, our concerns cause AOGA to question both the viability and the effectiveness of the proposed Board and as such we cannot support its proposed formation.

[2:26:49 PM](#)

Reduction in Statutory Interest Rate [slide 15]
AOGA supports the lowering of the statutory interest rate.

As we have testified to in the past, the statute of limitations under AS 43.55.075(a) is six years from the date when the tax return was filed for the tax being audited, while the limitations period for other taxes under AS 43.05.260(a) is three years from the filing date of the tax return. Under both statutes, the period may be extended by mutual consent of the taxpayer and the Department of Revenue (DOR).

The current statutory rate of interest under AS 43.05.225(1) for tax underpayments is "five percentage points above the annual rate charged member banks for advances by the 12th Federal Reserve District as of the first day of that calendar quarter, or at the annual rate of 11 percent, whichever is greater, compounded quarterly as of the last day of that quarter[.]" Currently the Federal Reserve rate is very low, so 11% APR is the applicable rate.

A lower statutory interest rate is very much supported by industry, because it provides some certainty to taxpayers.

[2:27:42 PM](#)

MS. MORIARTY continued, paraphrasing from the following written testimony [original punctuation provided with some formatting changes]:

Issues that the current draft does not address.

[slide 16]

There are several significant problems in the present ACES tax that are not addressed in CSSB21, and I will address a few of them this morning.

A. Minimum tax for North Slope production. AS 43.55.011(f) sets a minimum tax that is targeted solely against North Slope production. That tax is based on the gross value of that production instead of the regular tax based on "net" Production Tax Value. The rationale for adopting it was to protect the State against low petroleum revenues when prices are low.

The minimum tax only complicates potential new investors' analyses of what their tax would be if they invest here instead of someplace else, and consequently it has, if anything, driven investments away. AS 43.55.011(f) should be repealed or consideration given to significantly reducing the rate of the minimum tax.

B. Joint-interest billings. Instead of starting with the joint-interest billings that participants in a unit or other joint operation receive from the operator, DOR regulations reflect an assumption that each non-operating participant has information, in addition to the operator's billings to them, that allows them to determine which expenditures are deductible as allowed "lease expenditures" under AS 43.55.165 and which are not. Instead of one audit of the expenses by a joint venture for any given period, the Department audits each participant separately for its respective share of the same pool of expenses.

We are not asking for legislation to put the Department's regulations on a different track. But there are some in the Department who believe that the repeal by the 2007 ACES legislation of AS 43.55.165(c) and (d) – which specifically authorized the Department to rely on joint-interest billings – means the

Department cannot legally rely on them now. While we disagree with this position (which is also at odds with what the Department testified to during the enactment of the 2007 ACES legislation), we do think it would be appropriate to restore language specifically authorizing the Department to rely on joint-interest billings if it chooses to do so.

[2:30:20 PM](#)

MS. MORIARTY continued, paraphrasing from the following written testimony [original punctuation provided with some formatting changes]:

Conclusion. [slide 17]

If I leave you with one thing today, it would be the word "enormous". While AOGA believes that Alaska's potential is enormous we are grounded by the reality that our competition is enormous as well, and they are just starting to heat up. It is estimated that the fields of South and West Texas alone could produce over FOUR MILLION barrels of oil equivalent per day by 2020. That's more than some OPEC countries. Alaska should ask themselves if they really believe a "middle of the pack" policy for the state will attract new investment capital against that type of competition.

[slide 18] We believe it is up to you, and the Governor, to shape an attractive oil fiscal policy that is supported by strong principles that will win additional capital, arrest North Slope production decline and will lead Alaska towards a prosperous future for the long-term.

As I mentioned at the beginning of our testimony, overall, AOGA's members believe the Bill represents a base for significant and crucial tax structure reform that move toward Governor Parnell's four "core principles" - fairness for Alaskans, encouraging new production, simplicity with balance, and durability for the long term, but as I have outlined today, AOGA members believe additional changes should be included for this bill to truly change investment behaviors to the benefit of Alaskans. You have a difficult task ahead and AOGA stands ready to assist you throughout this process.

[2:32:43 PM](#)

CO-CHAIR FEIGE requested further elaboration regarding AOGA's confidentiality concerns with the Competitiveness Review Board.

MS. MORIARTY replied AOGA imagines that to determine whether the state is competitive, the board is likely to ask for documents from different industry players that are of the highest confidentiality nature. A concern for AOGA is how that information will be shared and protected by a board that is outside any other industry or agency that already has confidentiality provisions, and other members of the public who do not normally have the access to that type of information. If the board moves forward it needs to be considered how that information will be shared to the public, members of the board, and how confidentiality will be protected, especially between industry players.

[2:34:54 PM](#)

J. PATRICK FOLEY, Manager, Land and External Affairs, Incoming President, Pioneer Natural Resources Alaska, Inc., began his PowerPoint presentation by noting that Pioneer Natural Resources is a large independent with about a \$19 billion [enterprise value] and \$3 billion annual capital worldwide budget (slide 4). Pioneer Natural Resources Alaska was the first independent operator on the North Slope to have a successful development. Today it has about 70 Alaska employees and over 200 contractors working for it on the North Slope at Oooguruk and Nuna. The Alaska operations capital budget for 2013 is about \$180 million. Current production at Oooguruk, Pioneer's sole development in Alaska, is about 6,000 barrels per day, with total production of about 12 million barrels. Alaska operations began in 2003 with the original project sanctioned under the economic limit factor (ELF) regime, but it has changed many times since then. Pioneer has an investment decision to make for third quarter 2013 for the Nuna project, an on-shore development that is part of the Oooguruk Unit. Nuna is a 50 million barrel opportunity with total capital expenditure of \$800 million to \$1 billion.

MR. FOLEY explained slide 5 is a general impression slide. He pointed out that Pioneer's core business is in the Permian Basin of the Eagle Ford in Texas, with business also being done in Colorado, Kansas, and Alaska. He drew attention to a listing on the left side of the slide of all of the companies currently operating in the Eagle Ford, noting that written in blue are the majors operating there and in Alaska and written in red are the independents operating there and in Alaska. Every name written in black is not in Alaska and the question is why not. What can

be done to attract every one of these companies? The reason they are not here is because the cost to do business in Alaska is higher than elsewhere. The cycle time is higher and the amount of company take is lower because of the fiscal system.

[2:38:05 PM](#)

MR. FOLEY said the core principles of the governor's bill, as introduced, included the desire to change the current production tax system in a way that was: fair, fostered new production, simple and balanced, and competitive and durable (slide 6). Every industry representative speaking before the committee has supported these goals. As the bill has started and evolved, legislators are doing a wonderful job in building a system that makes Alaska more competitive. However, he continued, the bill is not quite there.

MR. FOLEY praised the provision to eliminate progressivity and said the gross revenue exclusion (GRE) works very well for a company like Pioneer. Being able to immediately monetize the "loss carry-forward" credit is huge, he continued. A company like Pioneer that is not currently making a profit and not currently paying taxes does not get the benefit of the loss carry-forward credit until many years down the road; therefore, changing that credit so a company can immediately get the cash value of that loss is huge and is a very attractive piece of the new bill. The \$5 per barrel credit is also an attractive feature and helps to keep the total tax relatively flat over various oil prices.

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MR. FOLEY stated there are still a few negatives he would like the committee to work on. Loss of the capital credits is huge. When a company like Pioneer looks at a project under different systems, the project that has credits associated with it is more attractive. He agreed with Mr. Thompson that credits minimize the amount of cash necessary to fund a project. A company may spend all the money it has, but it can do more with that money with the state's assistance through the credits. He addressed why credits matter (slide 7), saying credits are important to the state because they will stimulate work and activity, and that work and activity results in jobs, more wells, more oil, and ultimately more royalties and taxes. Credits are good for the developer because they reduce risk by minimizing the amount of cash necessary to fund a project.

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MR. FOLEY moved to slide 8, which he noted may not be in the committee's packet and which depicts a hypothetical project with the assumptions of \$1 billion in capital expenditure and a 50 million barrel field, very similar to Pioneer's Nuna project. He then compared the current system of ACES to SB 21, as originally introduced, and CSSB 21(FIN) am(efd fld) for this hypothetical project if it was being done by a new entrant with no base production (slide 9, but labeled slide 8 in the committee packet). The red bars depict the loss of the credits and the green bars depict the upside gain from the lower tax rate, the GRE, and the \$5 credit. A brand new entrant would be \$87 million, total net present value (NPV) 10, worse off under SB 21 than it would be under ACES. Under CSSB 21(FIN) am(efd fld), this same new entrant would be \$16 million worse off than it would be under ACES.

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MR. FOLEY made this same comparison for a mid-sized producer - a company like Pioneer that has existing base production and base operating expenses that look like Pioneer's Ooguruk field (slide 10, but labeled slide 9 in the committee packet). Under SB 21 as originally introduced, Pioneer would have been \$52 million worse off than it was under ACES. Under CSSB 21(FIN) am(efd fld), Pioneer will be \$8 million worse off. If the goal is to at least put a company like Pioneer in a neutral position, no better off under the new program than under the old program, the committee has some knobs at its disposal. One knob is to extend the small producer credit until 2022, which would make it a 15-year credit instead of a 10-year credit. That knob would make this current version of the bill more attractive to Pioneer for this hypothetical project.

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MR. FOLEY discussed notes he had written to himself, one note stating, "healthy big three," his point being that legislators cannot pick winners and losers; legislators need to help the entire industry be winners. All Alaska citizens are reliant upon a healthy North Slope oil industry, he said, and he cannot imagine a healthy North Slope industry that was not prosperous for the current big legacy producers. The state needs to have a tax system that motivates the legacy producers to keep making significant expenditure within their fields. He agreed with Mr. Thompson's statement that they by themselves cannot solve the

fiscal problems in Alaska; the state also needs new players, explorers, and new producers. He further agreed with Mr. Thompson that one system is needed, but there needs to be elements in that system that are attractive to the current big legacy producers and also are attractive to new smaller producers, explorers, and developers that want to establish a business in Alaska.

MR. FOLEY said another note to himself is "canary." Pioneer is the canary in the coal mine in that it is an independent that came to Alaska before any of the tax change. Pioneer is struggling to build a business, having spent about \$1 billion at Ooguruk and spending \$100 million trying to advance the Nuna project, which the company hopes to sanction in third quarter [2013]. Pioneer has been in Alaska since 2003, but has yet to turn a profit. If Pioneer does not do Nuna it will probably make a profit and start to pay production tax in the next two or three years. If Nuna is done, that will be pushed out three to five years. He said his point is that Pioneer will have been in Alaska for 10-15 years without having made a profit. Alaska is a difficult place for a new company to come and establish a successful business. Having Pioneer be successful in Alaska might not mean there will be 10-20 other independents behind; however, legislators must pause and think about the opposite. If Pioneer fails, what message is sent to others wanting to come to Alaska?

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MR. FOLEY summarized, saying CSSB 21(FIN) am(efd fld) on balance has some very favorable attributes, such as the flat 35 percent tax rate, although a lower tax rate would be helpful. When the flat tax rate is combined with the \$5 per barrel credit, it makes for a flat tax system over a very broad range of prices, which helps Pioneer predict its business. The gross revenue exclusion is another helpful attribute. Making the loss carry-forward credit cashable is also helpful because it allows Pioneer to take advantage of the credit nearly immediately. On the negative side, the credits under ACES are a very valuable attribute and he encourages committee members to find a way to keep some element of that credit program. He appreciated the fiscal challenge that that presents to the state, but said perhaps there could be a way to cap the credits or to target the projects that would qualify for the credits.

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MR. FOLEY suggested changes to CSSB 21(FIN) am(efd fld) that would make investments in Alaska more attractive to a company like Pioneer and to all of the oil industry. One change would be to extend the small producer credit. He reminded members the small producer credit is "use it or lose it" - if no tax is paid there is no benefit. Pioneer has not yet made a profit, has not yet made a tax payment, and the odds are very high that if this credit is not extended Pioneer will never be able to take advantage of it. He offered his belief that the small producer credit is a knob that has very small cost to the state. He asked the committee to consider increasing the gross revenue exclusion to 25 percent, saying it is not a large number but would have a dramatic impact on projects. He also requested the committee consider targeted credits that could be focused on projects that members wish to incent to go forward. Right now, those credits are immediately cashable and if the credit program was extended there are changes that could be made to make it more acceptable to the state. For example, credits could be used to reduce a company's state royalty obligation net profit payment or any other liability a company has to the state; rather than the state writing a check it would instead minimize the payments a company makes to the state.

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REPRESENTATIVE SEATON drew attention to the quote on slide 7 by Roger Marks when he was before the Senate Finance Committee on 3/4/13: "Recommend targeted tax credits as being preferable [vs GRE], they provide incentive to invest." Presuming this would be significant, he inquired how those would work for a company like Pioneer.

MR. FOLEY replied it is more than just the credit. Currently under ACES there are two ways that Pioneer can have the state help with the company's investments: a 20 percent qualified capital expenditure credit and a 25 percent loss carry-forward credit. It is not as simple as adding 20 and 25 together to come up with 45 percent as the value of the credit and comparing that against the 35 percent [carry forward loss credit proposed under CSSB 21(FIN) am(efd fld)] ...

REPRESENTATIVE SEATON inquired whether a targeted tax credit would be something like the United Kingdom brownfield versus the gross revenue exclusion (GRE).

MR. FOLEY, shaking his head no, responded a targeted credit would be something that extends the current qualified capital

[expenditure] credit program for specific things legislators would like to motivate, such as new wells, new production facilities, new roads, or new gravel pits. For Pioneer, the company would ask members to look at credits that apply to new exploration wells and new development wells. He said a comment often made is that these credits are not resulting in new oil. He said he guarantees, however, that every well that is drilled results in new oil.

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REPRESENTATIVE SEATON understood Mr. Foley to be saying that targeted tax credits for certain activities would get what legislators want more than would the gross revenue exclusion, which might not be invested in Alaska because it is a reduction in tax that might go someplace else.

MR. FOLEY answered neither the credit nor the program proposed under "SB 21" makes payments until the expenditure is made. So, a company does not get the benefit of the credit, the state does not fund a company's program, until the company actually spends the money to drill that well.

REPRESENTATIVE SEATON, noting the committee has not had Mr. Marks explain this quote, said the gross revenue exclusion (GRE) just lowers the tax rate and does not target the money to something legislators are trying to incentivize; it does not necessarily get well production.

MR. FOLEY encouraged that Mr. Marks be asked to come before the committee so he can be asked this question. Mr. Foley said the GRE affects different players differently. It reduces the tax liability for a current taxpayer. For a company like Pioneer that is not now paying tax, it generates a tax loss, a loss carry forward, which the company can also monetize.

REPRESENTATIVE SEATON commented he would like to have Mr. Marks come before the committee so this topic can be discussed.

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REPRESENTATIVE P. WILSON inquired whether Mr. Foley, when talking about a targeted credit, is saying to target the loss carry forward credit or to provide another credit that would be a targeted one.

MR. FOLEY replied that when speaking of a targeted credit he is really referring back to the current ACES program under which a company qualifies for a 20 percent credit when it makes a capital expenditure, and the company gets that money nearly immediately - half this year and half next year. That helps Pioneer to immediately reduce its capital outlay because the state helps Pioneer finance its project. He said he believes there are projects for which the state could grant credits without breaking the bank. If the fear is that the state cannot have a capital credit that is spent in Prudhoe Bay, there are things that could be done to have a different program for Prudhoe Bay. If the state is fearful of very large shale play expenditures taking up too much in credits, those could be excluded from being eligible for the credits.

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REPRESENTATIVE TUCK recalled that in past testimony Mr. Foley talked about how ACES rewards investment, how Pioneer has been more focused on the credit than on the progressivity, and how Pioneer would enjoy paying some tax because the state guarantees a company is profitable before it has to pay any tax. He asked whether Mr. Foley believes it is fair to say that the investments being seen in Alaska over the past seven years are not leading to production.

MR. FOLEY responded he has to scratch his head when he hears that statement because he simply does not understand it. The credits that have been extended have been for drilling wells, building facilities, and expanding production capability within the big fields. He said he cannot imagine that any of those expenditures did not result in either new production or the ability of the current production to stay at its current level. Every investment dollar the state has made through credits has resulted in new oil.

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REPRESENTATIVE TUCK, drawing attention to slide 10, observed that CSSB 21(FIN) am(efd fld) is a significant improvement over SB 21 [as introduced], but is still not as good as the current tax regime. Looking at the history of Alaska, he inquired whether Mr. Foley would rather have had the tax regime in effect prior to ACES in terms of getting Pioneer's projects developed.

MR. FOLEY answered Pioneer came and sanctioned its project under the economic limit factor (ELF) and under ELF the production tax

rate for a field like Ooguruk would have been zero. Within months of sanctioning that project, there was a new bill with the production profits tax (PPT) and a new tax system. Pioneer met with Governor [Frank] Murkowski at the time and was advised that it might actually be better off under this new system. Doubting how anything could be better than zero, Pioneer did some discounting and analyzing and came to understand the value of the credits and how the state helps the company up front and the company pays the state back later down the road. Pioneer was actually better off under the original PPT - the state helped subsidize Pioneer's project. However, the world very swiftly became different than it was under the original "20/20 PPT proposal."

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CO-CHAIR FEIGE held over CSSB 21(FIN) am(efd fld).

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ADJOURNMENT

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