

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

March 28, 2013

6:07 p.m.

**MEMBERS PRESENT**

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

**MEMBERS ABSENT**

Representative Mike Hawker

**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  
 03/27/13 (H) Heard & Held  
 03/27/13 (H) MINUTE(RES)  
 03/28/13 (H) RES AT 6:00 PM BARNES 124

**WITNESS REGISTER**

DAN SULLIVAN, Commissioner

Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** During the hearing of CSSB 21(FIN) am(efd fld), provided a PowerPoint presentation in consort with Department of Revenue Commissioner Bryan Butcher.

BRYAN BUTCHER, Commissioner  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** During the hearing of CSSB 21(FIN) am(efd fld), provided a PowerPoint presentation in consort with Department of Natural Resources Commissioner Dan Sullivan.

WILLIAM C. BARRON, Director  
Division of Oil & Gas  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions regarding CSSB 21(FIN) am(efd fld).

JOE BALASH, Deputy Commissioner  
Office of the Commissioner  
Department of Natural Resources (DNR)  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions regarding CSSB 21(FIN) am(efd fld).

MICHAEL PAWLOWSKI, Oil & Gas Development Project Manager  
Office of the Commissioner  
Department of Revenue (DOR)  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions related to CSSB 21(FIN) am(efd fld).

ROGER MARKS, Economist  
Logsdon & Associates  
Anchorage, Alaska

**POSITION STATEMENT:** As consultant to the Legislative Budget and Audit Committee, answered questions regarding CSSB 21(FIN) am(efd fld).

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

**POSITION STATEMENT:** As consultant to the legislature, answered questions regarding CSSB 21(FIN) am(efd fld).

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

**POSITION STATEMENT:** As consultant to the administration, answered questions regarding CSSB 21(FIN) am(efd fld).

**ACTION NARRATIVE**

[6:07:10 PM](#)

**CO-CHAIR ERIC FEIGE** called the House Resources Standing Committee meeting to order at 6:07 p.m. Representatives Seaton, Olson, Tarr, P. Wilson, Saddler, and Feige were present at the call to order. Representatives Tuck and Johnson arrived as the meeting was in progress.

**SB 21-OIL AND GAS PRODUCTION TAX**

[6:07:29 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."

[6:07:55 PM](#)

DAN SULLIVAN, Commissioner, Department of Natural Resources (DNR), began the administration's PowerPoint presentation entitled, "Oil Tax Reform - Arresting TAPS Throughput Decline". He said an argument being heard in debates on the tax reform proposal is that Alaska does not have much of a problem, business is booming, the tax system is working, and employment and capital expenditures are up [slide 3]. He and Department of Revenue Commissioner Bryan Butcher have been relentlessly trying

to get new investment and new production in Alaska and he would like to believe that "business is booming and all is well" in the state. Unfortunately, he and Commissioner Butcher do not believe that is the case, particularly when focusing on the metrics of production and what is happening throughout the United States and the world. When those comparisons are made, it is very clear Alaska has a system that needs to be fixed.

6:10:40 PM

COMMISSIONER SULLIVAN declared the unequivocal good news is that Alaska still has a massive resource base that is well recognized around the world [slide 4]. The state is also one of the most relatively unexplored and is on the cusp, he believes, of big potential for unconventional resources. Alaska has a resource base that can keep the state's economy, government revenue, and citizens with good jobs healthy and strong for decades to come.

COMMISSIONER SULLIVAN recounted that a question asked during work on the governor's bill was whether other declining basins have been turned around. The answer is pretty much that everybody, at these high sustained prices in the U.S. and other countries, is turning around their declines, with the very depressing exception of the state of Alaska. Drawing attention to slide 5, he pointed out that as prices start to spike and stay at sustained high levels, basins like North Dakota, Texas, and Alberta have flattened out their declines and then turned around to increased production. The one exception is Alaska and [the administration] believes the reason is because Alaska's tax system does not provide incentive for companies to invest at the higher prices in terms of profits, but it does everywhere else.

6:13:21 PM

BRYAN BUTCHER, Commissioner, Department of Revenue (DOR), addressed the argument that it is all about shale and not really Alaska's tax system. He allowed that, currently, shale is certainly contributing to a tremendous increase in North Dakota and Texas. However, he pointed out, Texas flattened out and began to turn around with just conventional crude oil. Slide 5 makes sense in that it shows prices rising, production rising, because things became more economic at oil prices of \$80-\$100 than they were at prices of \$40-\$50. What does not make sense is that over the last few years the Alaska North Slope (ANS) price has been \$5-\$20 more per barrel than West Texas Intermediate (WTI) prices. However, one would think the last of

the jurisdictions to continue to see a decline would be Alaska since the other jurisdictions are tied to the WTI.

6:14:22 PM

COMMISSIONER SULLIVAN stressed slide 5 is not good news. People claiming that things are going well and business is booming are not focused on this slide, which [the administration] thinks is the most important metric to focus on - production. He said slides 6-10 provide a snapshot of what is happening in other states by year at different prices. They depict a positive story in that they show older basins can be turned around, but they are negative when looking at Alaska. In the year 2007-2008, [five states were in decline], but by year 2011-2012 and prices having gone up [Alaska is the only state still in decline]. Every basin in the country has turned around its production decline, except Alaska.

COMMISSIONER BUTCHER interjected that what makes slide 10 odder is that Alaska has more resources than any of the other states. Between 2011 and 2012, the one state out of all of the oil producing states that did not see an increase in production was the state with the most resources.

6:16:11 PM

COMMISSIONER SULLIVAN noted slide 11 is from Econ One Research, Inc., and it tells the same story regarding production declines. He explained that 2003 is the base year in the slide, equalizing the different levels of production. [From 2003 to 2012], U.S. production dips a little bit, flattens out, and then increases significantly, and a similar production pattern occurs for countries in the Organisation for Economic Co-operation and Development (OECD). Alaska, however, is producing at nearly half of what it was producing just 10 years ago. Alaska has the resources to turn it around and [the administration] believes that the people who think business is booming in the state are very misguided.

COMMISSIONER SULLIVAN said claims are heard that investment [in Alaska] is at an all-time high [slide 12]. But of importance is investment relative to what? The world, and the U.S. in particular, are going through probably the biggest investment boom ever seen. There is capital that wants to be deployed in hydrocarbon-producing basins. The International Energy Agency (IEA) has predicted that by 2020 the U.S. will be the biggest producer of oil and gas in the world. That is great news for

the U.S., it should be great news for Alaska. Global investment in oil and gas in 2012 was \$600 billion and for 2013 it is projected to be \$650 billion. In 2012, Alaska got about one-half of 1 percent of that, despite being one of the world's great hydrocarbon basins. That is bad news for Alaska. Slide 13 is another way of telling the investment story [for the years 2003-2012], he continued. Dramatic increases in investment occurred in the U.S. and globally during this time period, but investment in Alaska increased a little bit and then flattened out. Alaska is on the sidelines with the global investment boom. Alaska is the anchor in the U.S. energy renaissance.

[6:19:30 PM](#)

COMMISSIONER SULLIVAN posited that all of the aforementioned begs the question of whether the current tax system is working for Alaskans [slide 14]. He emphasized "for Alaskans," given there is a lot of talk about "big oil." From the perspective of [the administration] this whole debate is about the future of Alaskans, he said. Slide 15, prepared by the legislature's consultant, [PFC Energy], answers the questions in an important way. At an oil price of \$100, Alaska's government take is one of the highest in the world. This is combined with the high cost of doing business in Alaska due to remoteness, extreme arctic climate, and limited exploration seasons. Between high government take and high costs, Alaska has been uncompetitive relative to other areas despite a global economic boom in investment and production.

[6:21:23 PM](#)

COMMISSIONER SULLIVAN maintained the current system is not working for Alaskans in another way [slide 16]. He said a term used during the debates is "giveaway," and it is usually mentioned in regard to what might happen in the future relative to prices, production, or investment. He argued the real giveaways have already happened - money that is already not circulating in terms of tax revenue collected or economic activity circulating through the economy. Between fiscal years 2008 and 2014, the production tax collected under Alaska's Clear and Equitable Share (ACES) will decline by an estimated \$3 billion despite the dramatic increase in oil prices; that is \$3 billion in unrestricted general fund revenue that will be gone. Today, about 14.6 million barrels a year fewer are flowing through the Trans-Alaska Pipeline System (TAPS) than a year ago. At \$100 per barrel, that is about \$1.5 billion that is not

circulating through the economy this year. That is a very clear giveaway, he asserted, because it is gone.

6:23:33 PM

COMMISSIONER SULLIVAN said much of the focus has been on current producers and current production, but another issue is companies that might be considering investing in Alaska [slide 17]. Part IV of the administration's comprehensive strategy to reverse the TAPS throughput decline is to pitch to companies of all sizes, including private equity companies and investment banks. Over the last few years the administration has been trying to recruit as many companies as possible to come, invest, and produce in Alaska. In addition to the high cost of doing business in Alaska, a concern heard almost every time a pitch is made is the tax rates, particularly progressivity. He recalled testimony before the committee by Brooks Range Petroleum Corporation [on 3/27/13] about the many investors the company approached and how hard it was to get investment dollars. While it is unknown who has been looking at Alaska and is not here because of the current tax system, the system is very well known because the administration is asked about it all the time.

6:25:26 PM

COMMISSIONER SULLIVAN stated Alaska's ultimate new entrant is Repsol E & P USA Inc. [slide 18]. Regarding people who are not interested in tax reform and who say there is no problem because Repsol came to Alaska under the current ACES regime, he reported that what the administration hears from Repsol is similar to what it is hearing from other companies: great resource base; very interested; high costs, particularly the tax regime. [Citing Repsol's 3/6/13 letter to the Senate Finance Committee], he said Repsol came to Alaska after it saw that the state was serious about tax reform. Thus, Repsol has a different view about ACES than the people who think there is no problem with ACES. Repsol is the exact kind of company [the administration] wants in Alaska - big, can provide more competition on the North Slope, and very interested in finding and producing new fields. Repsol sees tax reform as critical and if Repsol finds oil, the action on tax reform is going to be very important as to whether Repsol moves into production.

COMMISSIONER SULLIVAN pointed out that production is the focus of the governor's bill and what elements need to be fixed, while ACES incentivizes spending [slide 19]. Production is the

correct place for this bill to be focused, not just spending, but on what is needed - production and rigs [slide 20].

[6:28:09 PM](#)

COMMISSIONER BUTCHER drew attention to slide 21, saying it shows what a company currently producing in Alaska would have to do to qualify for \$100 million in credits from the state. Under ACES, the company would need to spend \$500 million in capital to qualify for \$100 million in qualified capital expenditure credits. Under CSSB 21(FIN) am(efd fld), that same company would have to produce 20 million barrels to qualify for \$100 million in credit from the \$5 per barrel credit. From the state's perspective, it is much better to pay out \$100 million in credits for 20 million barrels of oil produced than to pay out \$100 million in credits for \$500 million spent on anything that qualifies as capital spending, not just specifically for new development and new production of oil. He further specified that the gross value reduction is limited to new participating areas either inside or outside a legacy unit; thus, it is for oil that is not currently being produced.

[6:29:33 PM](#)

COMMISSIONER SULLIVAN concluded the presentation by stressing that Alaska's status quo of continued decline, when everybody else is turning around their declines, is an unacceptable path for the state. With tax reform that is focused on incentivizing production, Alaska can do the same thing as the others. He noted the Alaska Native Claims Settlement Act Regional Association is calling for increased production as a way of benefitting all Alaskans. This bill is about the future of Alaska's citizens.

[6:30:59 PM](#)

REPRESENTATIVE SEATON, regarding the prospect of a gas sales agreement and fiscal certainty, noted the three producers have insisted they want 35 years. He inquired whether the administration is ready to do a gas sales agreement with fiscal certainty so that the fiscal system would be locked in for both oil and gas for 20 or 25 years.

COMMISSIONER BUTCHER replied the administration is not at this time looking at an extended period of locking something in. On the oil side, it needs to be seen whether it works and if it does not he thinks pretty much everybody is in agreement that it

will be changed. Gas is something that will occur down the road and [the administration] has not gotten to the point in the process that those conversations will occur. Determining what can be done constitutionally in terms of giving fiscal certainty over a long time period is a very complicated issue.

[6:32:41 PM](#)

REPRESENTATIVE SEATON commented there would be no need to worry if that was the case. However, since the Alaska Stranded Gas Development Act, and every time there has been talk about a gas sales agreement, the three producers have been very specific that that is only going to take place if there is fiscal certainty over a long period of time. He said he wants to make sure the administration is not looking at this the same way he thinks the producers are, which is that it is going to be locked in for a very long period of time. While it is nice to say the state will change it if it is not working, fiscal certainty by itself says that if the tax rate is changed there is a guarantee that money will be taken out of the treasury to reimburse them for any increase in tax costs. It would give much more security if it was known "that the administration was going to oppose fiscal certainty in a gas sales agreement and not lock in a tax regime that is not automatically compensating in itself."

COMMISSIONER BUTCHER responded "that is certainly not anything that has been discussed by the administration" that he is aware of. At the moment it is premature and is not something that a tremendous amount of time is being spent on.

COMMISSIONER SULLIVAN added durability is one of the governor's four principles in terms of oil production. If the state changes its tax regime every couple years it is not good for the investment climate in Alaska. The other regimes discussed today, like Texas and the Gulf of Mexico, have been durable and [the administration] thinks that helps incentivize investment.

[6:35:26 PM](#)

COMMISSIONER SULLIVAN, responding to Co-Chair Saddler about slide 4, explained that the broadest definition for hydrocarbons is the U.S. Geological Survey's estimates of what is technically recoverable but undiscovered, which is estimated at 40 billion barrels [of conventional oil for Alaska's North Slope]. The figure of 3.7 billion barrels is for known reserves [remaining on the North Slope], which is the most narrow definition and most exact.

CO-CHAIR FEIGE asked whether it is the difference between "P1" and "P3" reserves. [P1 = proved, P2 = probable, P3 = possible]

COMMISSIONER SULLIVAN answered it is beyond "P3."

6:37:07 PM

REPRESENTATIVE SEATON, regarding a durable system that may get locked in for a long period of time, related it is projected that the in-field producing areas are where quick turnaround could come from when people talk about three years. He inquired whether it would be advisable to have some criteria built in around production. For example, if a company were to cut its specific rate of decline by 50 percent it would receive a per barrel credit of \$7 instead of \$5, or if a company did not meet that requirement its per-barrel credit would be reduced from \$5 to \$2. He said it seems there needs to be some hook in the tax system that gives more advantage or disadvantage for actual production. He further asked whether the administration has thought about doing anything that actually requires production.

COMMISSIONER BUTCHER replied it was looked at, but did not make sense for two reasons. First, a simple tax structure that is easier to understand has value. Second, many different variables play roles in what a decline has been for a company, what a decline has been for a field. For example, in Field A it makes sense economically for the company to spend a lot to stem the decline to, say, 2 percent over a period of time, but in Field B a company has a 7 percent decline and does not spend as much. By incentivizing the rate of decline you would be rewarding the company in Field B that might not have been putting the work into stemming the decline that the company in Field A would be. Issues like that are what play into variables that result in unintended consequences.

6:39:38 PM

REPRESENTATIVE SEATON posited it sounds like it is being said the state is not going to reward production because the tax base is company-wide, not field-wide. It is not hard for the three big producers on the North Slope to figure out their company-wide decline rate. If it does not matter whether the companies stem their declines, then it is exactly the opposite of the administration saying that it wants to focus on production. He encouraged the administration to think more about building in some lever for the producing companies so there is focus on

production and not just on a tax decrease. If a tax decrease does not yield additional production, he said, the state has not accomplished its goal.

COMMISSIONER SULLIVAN responded the administration has been very focused on the current system that has paid out enormous tax credits and cash payments and does not require any commitment to production at all, which is one of the flaws of ACES. The governor's bill and CSSB 21(FIN) am(efd fld) make that nexus between tax benefits and production much tighter. A nexus does not exist under ACES and is one of the problems with ACES. The administration is addressing Representative Seaton's concern, he said. Right now, companies that have received hundreds of millions in cash from the state could pack up and walk away without having produced one drop of oil. The well-intentioned, but flawed system under ACES is one reason why the administration is focusing on production in this bill and companies get the benefits of tax credits when they are producing, unlike the current system.

[6:43:11 PM](#)

CO-CHAIR FEIGE clarified the gross value reduction is for new participating areas and new units, so it is for oil that is not being produced now.

COMMISSIONER SULLIVAN concurred the reduction is received when new oil is produced.

REPRESENTATIVE SEATON argued the \$5 per barrel would go on whether it is old or new production; if a company stays where it is and keeps declining, it gets \$5 a barrel. If the purpose of the bill is to ensure the state gets new production, it seems that building in a single lever that if a company slows its decline by over 50 percent within three years, it will get a bump. If a company does not accelerate its production, then it would get a penalty. That is simple and gives a goal. He urged the administration to look at that idea more carefully because he agrees the state wants to incentivize production, but the worry is about the state not getting to that point.

CO-CHAIR FEIGE said he does not know why the administration is being blamed, given the bill is in its third committee of referral and is the now the legislature's bill.

[6:44:50 PM](#)

REPRESENTATIVE TARR recalled that yesterday the small explorers testified the credits were essential to their coming to Alaska. Had those credits not been in place, the Mustang project would probably still have gone forward, but would have been delayed by a few years. Thus, the next project that is going to bring new oil is because of the tax credit system in ACES. Two of the producers testifying yesterday said they scratch their heads whenever they hear that the [ACES] credits are not leading to new oil because new exploration and drilling is exactly what these credits are being used for. She asked why these companies are saying something that completely contradicts what the administration is saying.

COMMISSIONER SULLIVAN answered the companies are not lying to the committee, but if they packed up today they would walk out with a lot of cash in their hands that they got from tax credits from the State of Alaska that did not relate to any production.

[6:46:02 PM](#)

REPRESENTATIVE TARR asked whether Commissioner Sullivan is suggesting the state might encounter a situation where companies come to Alaska, spend hundreds of millions of dollars, and then just pack up and leave.

COMMISSIONER SULLIVAN replied he is suggesting it is strongly in the state's interest to make the nexus between tax benefits, whether they are reductions or credits, strongly tied to actual production. That is what the administration is trying to do in this bill and that is what ACES does not do.

COMMISSIONER BUTCHER added nothing is being done with most of the credits in the state's tax code. There is no suggestion that the small producer tax credit or the explorer tax credit be eliminated. This bill speaks specifically to eliminating the qualified capital expenditures, which is the 20 percent credit that currently-producing companies receive. This is the credit that the administration is saying has no data showing that it has led to new production.

[6:47:06 PM](#)

REPRESENTATIVE TARR understood the small producer credit and exploration credit will be eliminated in 2016 under CSSB 21(FIN) am(efd fld). She said she is concerned about what the small explorers said regarding the need for legacy field development and new exploration and drilling work happening simultaneously

because this bill seems to seriously disadvantage that kind of work, as explained by the companies doing that work. She posited the state will miss a big part of the opportunity to get new oil if that is not considered.

COMMISSIONER BUTCHER responded 2016 is in current law; it is not being made shorter. If it is not extended further, it will remain 2016. Previous versions of the bill had it extended to 2022, which is something [the administration] would be interested in discussing with the committee if the committee wants to go in that direction.

CO-CHAIR FEIGE told Representative Tarr he would entertain an amendment to that effect.

[6:48:13 PM](#)

CO-CHAIR SADDLER asked what Alaska's other options are for revenue from natural resources or other sources, if no action is taken and this production decline continues.

COMMISSIONER BUTCHER answered as has been seen in the last few years, and what has made this such a critical issue to deal with today, is that the state is losing tens of thousands of barrels a day, so the price of oil must keep going up to keep the state's level of revenue up. Fortunately for the state, the price has gone up over the last few years, but that is not going to continue. If the decline continues at its current rate and Alaska continues losing barrels of oil, the gap would have to be made up by many of the things that were discussed at the [March 2011] Fiscal Policy Caucus, which includes statewide income tax, statewide sales tax, and the Permanent Fund. Currently, the state has ample reserves to bridge the gap between where it is today and when new production will occur, assuming this bill passes and new production does in fact happen. In further response, Commissioner Butcher said it is the administration's view that decline in Alaska is continuing to occur at these high prices while not appearing to be happening anywhere else. If Alaska does not become more competitive, there no reason why the decline would turn around since it has yet to happen [at these high prices].

[6:50:17 PM](#)

CO-CHAIR FEIGE qualified he is not advocating this, but asked how much oil revenue could be replaced by implementing a state sales tax and state income tax.

COMMISSIONER BUTCHER replied he does not have those numbers off the top of his head, but said it is absolutely the case if the point being made is that it is a relatively small amount of money compared to the oil revenue. He said if Alaska had no oil revenue, like most of the lower 48 states, there would be no way the state's small population of residents could be taxed to the level needed to pay for the current budget.

[6:51:08 PM](#)

CO-CHAIR SADDLER inquired what the risk would be if the state let ACES ride for another couple of years to see if it turns around and is going to work.

COMMISSIONER BUTCHER responded decline would continue to be seen, which is troubling because the North Slope is a much more severe climate and much more expensive place to do business. Places like Texas and Louisiana can explore for oil, find it, and get to a point of production in 18 months, while the historical average in Alaska is about 10 years. It is not a situation where the state can sit around for a couple of years, realize things are not getting any better, and then start turning the wheels. These wheels need to start as soon as possible because it is going to take a while to get on line, particularly for the newer fields outside the legacy areas.

COMMISSIONER SULLIVAN said another issue is that as throughput declines, TAPS tariff rates increase, which becomes an inhibitor to new entrants. Getting new entrants is critical and the administration has been working hard on this. New explorers and new plays are needed, such as shale oil plays. If Alaska is made more competitive, the resource base and the interest from companies of all sizes is high, as far as getting that production turnaround that is needed so badly.

[6:53:28 PM](#)

REPRESENTATIVE TUCK expressed his concern about the statement that the credits do not lead to production. The small companies testified last night that they are scratching their heads as to why this statement was made. He said he is also concerned about the statement that these explorers are profiting off Alaska's tax credits and will cut loose and take their money out of the state. The administration just showed a slide indicating the state is giving these companies 20 percent in capital credit, meaning they have to invest quite a bit, and he does think they

are investing to try to get that 20 percent from the State of Alaska so they can cut loose and leave. He has problems with these statements because these small companies are serious and want to get to production on the North Slope; the state has invested in them and partnered with them. In December 2011, Pedro van Meurs compared Alaska with 120 other places that also have shallow water oil and concluded that Alaska is in the ballpark. Alaska has a lot of frontend loading which is so attractive that the Department of Natural Resources is even placing advertisements about it. It takes 7-15 years to make new oil happen, so it is a combination of trying to maximize what the state has right now with its current production and partnering with industry to ensure long-term oil. North Dakota's new production is unconventional production, and this new production is applying new technologies due to high oil prices. They are able to quickly get into the shale and fracture it to start bringing wells, a luxury Alaska does not have. Alaska recognizes the high cost of exploration and development and the limited facilities in the state. Much of the current investment is in facilities because the facilities are needed to be able to drill. He maintained the state is on a hope and a prayer if it relies on the type of economic policies that just lower taxes and do nothing more than that.

[6:57:34 PM](#)

COMMISSIONER BUTCHER said the administration is not suggesting that the small producer credit or exploration credit be reduced or eliminated. The 20 percent being looked at for elimination is for companies that are currently producing. The folks being heard from are not benefitting from the credit that would be eliminated because they are not currently producing. The percentage received in state credits is considerably higher for the exploration companies referenced by Commissioner Sullivan. Depending on what they are doing, what they take advantage of, and where they are, the State of Alaska reimburses a company anywhere from 40 to 60 percent of what it spends.

[6:58:40 PM](#)

COMMISSIONER SULLIVAN added he does not think he said the administration wants the small producers and new explorers to leave the state. To the contrary, the administration has been working very hard recruiting some and helping some of the ones that have testified before the committee. The focus has been to get them and more of them up to Alaska. The advertisement is part of the recruiting effort; it was highlighting what is

currently in the law that is attractive; it did not include that at \$120 the government take in Alaska is close to 80 percent. Based on his talks with different companies, he allowed they do have different views depending on where they are in their finances and strategies, but the general view is that there needs to be a balance of having some limitations on credits up front and a reduction in the progressivity, which the companies clearly see as the most uncompetitive long-term capital return element of investing in Alaska, particularly at high prices.

7:00:27 PM

CO-CHAIR FEIGE asked whether the ad mentioned by Representative Tuck has generated any interest.

COMMISSIONER SULLIVAN answered it is always hard to tell. The administration sees companies and goes back to see them after being told to "take a hike," so the administration is relentless on this. It is a long-term horizon with this industry as far as things becoming positive from one year to the next.

CO-CHAIR FEIGE surmised that even though the 40 percent support for exploration wells is being advertised, it is not necessarily generating a lot of exploration.

COMMISSIONER SULLIVAN replied he would say the state needs more exploration.

7:01:37 PM

REPRESENTATIVE P. WILSON observed from slide 20 that Alaska only has 8 [active] rigs compared to 830 in Texas, 183 in Oklahoma, and 174 in North Dakota. That tells her Alaska is in trouble and she is concerned about it. The Fiscal Policy Committee she was on looked at income tax, sales tax, even a school tax, to try to bring in income. A 3 percent sales tax was nothing given the number of people in the state, and the cost of setting up the bureaucracy to put the tax in place made it pathetic. Alaska is in a mess and something different must be done.

7:03:30 PM

REPRESENTATIVE JOHNSON noted production is increasing in the U.S. and understood the current ANS West Coast price is \$109 and the West Texas Intermediate (WTI) price is \$90.

COMMISSIONER BUTCHER responded the WTI is a little higher, about a \$12 difference the two prices.

7:04:05 PM

REPRESENTATIVE JOHNSON opined Alaska has been saved by high prices; if prices were at \$80 per barrel Alaska would be in very bad shape. He inquired how much longer the ANS price premium can be expected.

COMMISSIONER BUTCHER answered this has been looked at with great interest because it used to be the WTI was \$1 to a barrel premium to ANS and that has flipped. Experts brought in for [DOR's] forecasting session had thought that as more pipeline capacity came on line in the Lower 48 near the gulf the WTI would come up a lot more than the ANS would drop, eventually shrinking the ANS premium of \$20 to more or less what it used to be. The experts thought this because ANS and Brent are both within a dollar or two of each other and the real outlier is WTI. Over the calendar year of 2011 into 2012 the difference did shrink from \$20 to \$4 or \$5 and it appeared to be doing what everyone thought it was going to do, but then it turned around, going back up into the high teens and now back down to \$12. The U.S. is starting to outperform Saudi Arabia and there is concern that it is going to affect the price of oil because a lot of states, such as North Dakota, filled the pipelines, then they filled the railcars, and now they are trucking to the West Coast where they get more for their oil; the added expense of trucking is made up by this premium. Canada is looking at the same thing. The price per barrel in Canada is in the fifties because the first oil in is getting sold in the gulf. The further away from the gulf, such as North Dakota, the price is \$10 or so under WTI, and once into Alberta it is dire straits. Alberta is looking at whether to build a pipeline to the East Coast or to the West Coast. Many factors are in play largely due to the low price of WTI compared to ANS.

7:07:07 PM

REPRESENTATIVE JOHNSON said Alaska is blessed to have that premium because the state would be in severe deficit spending with the continued decline in production. The WTI and ANS could become comparable very quickly - that does not mean the WTI is coming up, the ANS could go down in a matter of months. If today's price was \$90 a barrel, Alaska's revenue picture would look considerably different than what DOR forecasted. Alaska

cannot forever depend on price to save itself, Alaska must depend on volume.

COMMISSIONER BUTCHER replied it is a frightening exercise when playing with the production and the price. There have only been a handful of years in history in which the price has been higher than \$90 a barrel. If the price of oil over a fiscal year were to drop to \$85, Alaska would be in billions of dollars deficit for its current budget. That is how precarious Alaska's budget situation is given its declining production.

7:08:38 PM

REPRESENTATIVE JOHNSON inquired how many millions less to the treasury for each \$1 drop in oil price.

COMMISSIONER BUTCHER responded he will get back to the committee because the figure changes each year. Responding further, he confirmed the dollar amount less depends on the oil volume.

7:09:18 PM

REPRESENTATIVE TUCK, regarding slide 20 and the low number of drilling rigs in Alaska, said much of that has to do with being unable to park the rigs on the back of a truck as is done in many places. Having worked on modules on the North Slope, he knows the drilling rigs are extensive rather than small ones that can be moved around. It would be nice to have additional active rigs - Repsol has had an aggressive drilling schedule but there are not enough drilling rigs or drillers on the North Slope due to the amount of activity that is taking place.

7:09:54 PM

REPRESENTATIVE TUCK, moving to slide 15, posited that if there is a direct correlation between tax regimes and investments, it could be said that Syria, Pakistan, and Bolivia probably have very low investments [due to high government take], while Ireland, Peru, and New Zealand [with low government take] would probably have more investment.

CO-CHAIR FEIGE asked whether there is any oil in Ireland.

REPRESENTATIVE TARR said that is the point.

COMMISSIONER BUTCHER answered slide 15 was prepared by the legislature's consultant, so the administration had no input as to what countries or states were included in the slide.

COMMISSIONER SULLIVAN added that slide 15 is a snapshot of one critical element of competitiveness, others being infrastructure and climate. A positive for Alaska, however, is its small resource risk - most companies think that when they come up to Alaska to look for oil they will find it. When the administration talks to companies, [government take] is something heard from them almost across the board.

[7:11:53 PM](#)

REPRESENTATIVE TUCK asked whether at \$85 per barrel Alaska would be better off under SB 21 because it would not be losing so many billions.

COMMISSIONER BUTCHER replied he cannot speak to CSSB 21(FIN) am(efd fld), but he said Alaska would be better off under the original SB 21. Would the state be better off billions more? No, but the point he was trying to make is that as production declines by tens of thousands of barrels a year, no bill or tax structure is going to save that. It must be more development and ultimately more production because that one factor that will turn it around and be of more benefit to the treasury. Alaska's reliance on high prices really gives the administration pause.

[7:13:10 PM](#)

REPRESENTATIVE TARR related that according to a slide prepared by the administration's consultant, Econ One, more people are working on the North Slope now than in 1990. She inquired why so many people would be working if nothing is happening.

COMMISSIONER BUTCHER responded it can be seen on the slide that the increase in employment began before ACES, which shows it is an aging infrastructure. The increase continued the year after ACES passed and then flattened out. If looking at Alaska in and of itself, it looks like the state gained a little bit and then flattened out. But in other oil producing jurisdictions, such as North Dakota and Alberta, labor numbers are going through the roof - tens of thousands of jobs - and those places are having trouble keeping people in high school and college. A flat labor force in a world of tremendous growth is not a positive piece of the state puzzle from the administration's perspective.

COMMISSIONER SULLIVAN added it goes to the administration's original comments that the statistics being cited as indicating things are going great are not being looked at in the overall picture of the industry in the U.S. and the world. Comparing it to other jurisdictions is critical and keeping an emphasis on production is what most of the administration's focus has been.

[7:16:06 PM](#)

REPRESENTATIVE TARR conceded Alaska's marginal rate ranks at the bottom, but said Alaska's various credits are in the top ten rankings and those credits are considered to have high or moderate-to-high economic impacts. Alaska is more attractive when looking at the whole package; progressivity and the credits were a balance in putting the package together and incentivizing the behavior that was wanted. Similarly, she posited, the bill being contemplated now needs to be considered as a package in regard to attractiveness.

COMMISSIONER BUTCHER concurred there are things that make ACES attractive; for example, no other state pays for 40-60 percent of a company's costs. However, things are breaking down when the transition is made from the work on the front end to the work on the production end because those companies are looking at the tax rates. Alaska is the only oil-producing jurisdiction still in decline. He agreed that that is what was trying to be achieved with ACES, but said it is obvious to the administration that it has not been achieved and is not working.

[7:18:17 PM](#)

REPRESENTATIVE SEATON drew attention to slide 21, noting Commissioner Butcher had said the 20 percent capital expenditure credit did not apply to small oil fields. He surmised the commissioner wants to correct that to ensure there is not misrepresentation. He understood from slide 21 that the gross value reduction (GVR) is limited to new participating areas whether inside or outside a legacy unit. He said he is pleased if that is the administration's position because it is something that can be determined fairly clearly.

COMMISSIONER BUTCHER deferred to Michael Pawlowski to answer the question, but said everything is looked at in terms of having a balance. He explained slide 21 is not a listing of what the administration supports but is merely pointing out what is in CSSB 21(FIN) am(efd fld) compared to ACES. He concurred he misspoke if he said the capital expenditure credit did not

qualify for smaller fields with smaller companies. He said the credit can be used against a company's tax liability regardless of the size of the field.

REPRESENTATIVE SEATON stated the [gross value reduction]/gross revenue exclusion (GVR/GRE) makes it simple and clear and he hopes the administration will be supporting that as the standard instead of using something that is unclear and subject to administrative determination, which will be challenged.

7:21:13 PM

CO-CHAIR SADDLER related it has been heard that Alaska should demand guaranteed production before adjusting its current tax rate. He asked what elements are in current state laws that guarantee current levels of any level of production.

COMMISSIONER BUTCHER answered those do not exist and said his opinion is that the state is never going to get any kind of a guarantee from a company, given all the variables that go on, such as an oil spill that costs the company billions of dollars or a better opportunity someplace else. To ask for a guarantee is almost to say the state does not want to change the law so it is going to set up a hurdle that is probably not going to be attained. Does it need to be heard from companies that [the bill] is material and do legislators need to be convinced by what they say? Sure. However, he cannot imagine a board of directors that would agree to expect a guarantee that if the company does this the state will do that when the companies are looking worldwide at opportunities at today's high oil prices.

COMMISSIONER SULLIVAN interjected that the status quo is not working and it is going to be more [of what is seen on slide 10], and that should be a very big concern for everyone.

7:24:02 PM

REPRESENTATIVE TARR noted a concern is how the third element of the GVR/GRE would be defined. As the bill is currently written, the GVR/GRE is at the discretion of the DNR commissioner. She asked how the department would meter and measure the production and what areas might qualify. She paraphrased from the provision on page 21 of the bill, beginning on line 25, which reads as follows:

(3) the oil or gas is produced from a well that has been accurately metered and measured by the operator

to the satisfaction of the commissioner, and the producer demonstrates to the department that the metered well drains a reservoir or portion of a reservoir that the Department of Natural Resources has certified was not contributing to production before January 1, 2013, and the producer demonstrates to the department that the volume of oil or gas produced from the well was subject to certification by the Department of Natural Resources.

7:25:38 PM

WILLIAM C. BARRON, Director, Division of Oil & Gas, Department of Natural Resources (DNR), responded to Representative Tarr by displaying slide 13 from DNR Deputy Commissioner Joe Balash's 3/22/13 PowerPoint presentation to the committee. He explained the slide depicts a "bubble map" of the Kuparuk River Unit, in which the oil that has been produced is represented on the map in one color and the size of each bubble represents the volumes of oil produced from each well. This simplified type of map is used as an aid in reservoir management in terms of where oil has been produced. The blue bubbles are water injection. As water is injected and sweeps the oil from the injector to the producer, a defined pattern can be seen, which is a very classic water flow pattern and is actually a world class pattern. In the southwest and southcentral-east edges are areas that currently exist within the participating area (PA) that clearly do not have wells and, where there are wells, the magnitude of the bubbles indicate that those are very low producing wells. The same exists in the gap between the PA boundary and the unit boundary. Those are the areas that, under the current proposal, the companies could bring to the division and demonstrate to the division's satisfaction that they are not currently contributing even though they are part of the PA. Demonstration is through three dimensional reservoir modeling, such as streamline models, pressure waves, water fronts, and oil migration patterns. When a PA is originally created, the boundaries are established as generously as possible, given these are giant fields and protection must be provided to all parties so those parties on the fringe of a field will not be harmed by not being in the center part - so, trying to establish areas and establish tract factors that allow smaller players or players on the fringe to also participate in the production and the cost. The companies would have to prove that those areas are not contributing. Those would be areas that the division would say is really an acceleration of existing proven reserves. Is it new oil? Yes, it is new production. But it is not new oil that would be

necessarily bookable because it is already booked in the U.S. Securities and Exchange Commission (SEC) definitions. The division struggles a bit with that because that would be the hardest form of the oil or the area to prove definitively that it is not contributing. In theory and in spirit the companies should be moving forward toward that development in the natural course of development of field.

[7:29:11 PM](#)

MR. BARRON moved to slide 14 from Mr. Balash's 3/22/13 presentation, saying that in 2012 ConocoPhillips Alaska, Inc. drilled the Sharks Tooth Well. Even though the company classified it through the Alaska Oil and Gas Conservation Commission (AOGCC) as an exploratory well and had a discovery according to the benchmarks, it is actually discovery within a PA, so it is kind of an oxymoron. That being said, that really kind of showed that, yes, the PA was of the appropriate size. In the proposed statute, that specific area would be an area that the company could carve out, show that it was not currently contributing, and then proceed with drilling operations, facility installations, hookup, and modules to bring those facilities on as new oil or accelerated oil through a PA - much more difficult for the company to definitively prove than a PA expansion or a new PA. In the hierarchy of new oil or expansion of product, clearly the simple one is new units and within those new units clearly new PAs. The stepwise procedure is to form a unit and then build out the PAs in strata. The next step would be expansion of PAs, where the size of the PA is looked at or what can be proven geologically or through engineering with the exploration and delineation wells. There are many times that wells can actually be drilled side-by-side that really do not communicate, especially when it is thin or lenticular or sands that are part of a braided stream that meander through the area. Those could be either new PAs or a new PA expansion, since it could be said that they are in close participation areas and are contributing with each other. As a company fills out its drilling program it can begin to expand its PAs and a PA can be expanded in a couple of ways. The division's preference is that a PA be expanded by drilling rather than geologic modeling. Geologic models are good, but they are fraught with error and uncertainty that can only be proven by drilling.

[7:31:44 PM](#)

MR. BARRON continued, explaining that a company has its original units, PAs within those new units, as well as new PAs within old

units, which happens quite often. How PAs come in over time was shown in the 3/22/13 presentation, he noted. There are still potential PAs within Kuparuk, between Kuparuk and Coleville, and maybe within Prudhoe. So, there are the PAs, and the PA expansions are off of that. This is really the next hybrid and it will be more difficult to show that this production is already in a PA but not contributing. It is doable mathematically and scientifically, but the division's preference is for the companies to come in and absolutely convince the division that it is not contributing, a high hurdle to jump.

MR. BARRON addressed metering, noting industry's conventional standard is to meter wells on a monthly basis and the aggregate of their production at that drill site is based on an allocation process that is approved by AOGCC. It is doable to install multi-phase meters on every well, but it is expensive. It is doable to install new facilities, and have a test separator for every well, but probably not very efficient and not very operationally friendly, so companies would probably shy away from that. Multi-flow, multi-phase meters are fairly common these days and reasonably accurate, plus or minus 8-9 percent on total fluid. Those vary with difference of water cut and vary with difference of gas to oil ratios and liquid ratios. The more gas, typically the less accurate they are. The metering could be individually by well or in aggregate. In Sharks Tooth, for example, if a new pad was set and drilling went out from that pad, then that area could be isolated off and metered and monitored independently of the rest of the Kuparuk fields.

[7:34:37 PM](#)

REPRESENTATIVE JOHNSON inquired about the cost of a meter.

MR. BARRON estimated at least \$10,000 and maybe \$100,000 for the facilities themselves. In further response, he said he is sure his estimate is not low and said a multi-phase meter is probably in the ballpark of \$10,000. He offered to find out exactly.

REPRESENTATIVE JOHNSON asked how many people know the technology for repairing these meters.

MR. BARRON replied the University of Alaska Anchorage (UAA) and University of Alaska Fairbanks (UAF) have good programs for training the state's high school graduates and college kids as technical people for the oil field. Instrument technicians are capable of doing this kind of calibration every day. Responding further, he said it is one thing if it is only Alaskans that are

being looked at for doing this work, but in the greater world of the oil industry instrument technicians is an up and coming part of the business. Years ago instrument technicians worked solely with pneumatics, gas and air pressure equipment, but now they have gone to small wires. It is basically a migration of technologies, and small wire personnel are now regularly available. Many companies have very good training programs to support that and many are building from the ground up.

[7:37:11 PM](#)

CO-CHAIR FEIGE inquired how oil is typically measured as it is transacted between the companies and the state.

MR. BARRON posed a scenario of a drill site with a group of 20 wells, explaining every well must have its own individual test. Each well goes through a test separator or has a multi-phase meter on it, depending upon what is needed for reservoir management purposes. Currently, AOGCC requires a monthly well test, which can be certified and corroborated through the company. Once that well is out of test it is put into a bulk or group separator, which is where everything goes if it is not in test. It is a simple system - just valves on a header to move the oil around. That oil is then shipped from that drill site to a flow station or gathering center for further processing. That is typically where most of the gas is knocked off and water extracted, and that is metered at every step of the way - not for allocation purposes, but for leak detection. As the oil and fluids migrate from a drill site to a gathering center and then from a gathering center to Pump 1, all of that is metered so the oil companies can look for leaks. Discrepancy of the incoming and outgoing meters is what sends the alarm for leaks. At that point is where the transaction occurs between the industry and to the pipeline. For the state, the well test is the earmark that [the division] works from through AOGCC for reservoir management, production allocations, and royalties.

MR. BARRON, responding further to Co-Chair Feige, said a revenue transaction is a rollup based on production from the well itself from that well test. The companies have to identify from the well test what each well has contributed to that drill site and then that is where the royalties and revenues come from, corroborated by all the meters along the way.

[7:40:14 PM](#)

REPRESENTATIVE SEATON commented he was pleased when he saw slide 21 and it appeared that the administration was favoring new participating areas. He asked about the number of personnel that would be required by the division or whether it would be in conjunction with AOGCC for handling the acceleration within a participating area, the claims, the data, and appeals.

MR. BARRON responded that it is a hard question to answer. The burden of proof still needs to be on the industry/companies for all of that, even the PA expansions. The division has the staff that can look at the information and make the determination as to whether it is in fact contributing based upon the technical presentation. If the division is inadequately staffed, it can gather consultants. The AOGCC is more involved with well metering, well allocation processes, and well inspection. The AOGCC is also involved with any federal, Native, or private leases; the division is blind to those because it has no jurisdictional claim over anything other than state lands. He would say, at this point, that the division would not need any additional staff to do this piece, but might have to reach out periodically for consultant services, which would be budgeted for. It is hard to say right now, he continued, given how the PAs are built and how many of them would have the kind of demonstration that is had at Sharks Tooth.

[7:42:52 PM](#)

REPRESENTATIVE SEATON posited that with the 20 percent GVR/GRE there will be a real impetus to forward every possible well for consideration and proof. Another consideration is shale oil, he said. He asked whether every shale oil well is going to be considered a new PA for the purposes of this determination.

MR. BARRON, regarding every well for the GVR/GRE, noted that wells clearly within the pattern would be very difficult for a company to say is new oil. Regarding shale, he said it is a bit of a conundrum that everyone is trying to get their arms around. The division does not currently see overall justification for forming broad units for shale because part of the definition of the reason for having a unit is for the correlative rights of players. A single well can only really contribute unto itself and not have any interference or contribution from outside of its drainage area because of the tightness of shales, so every one of those would be maybe its own unit. He said he does not know that he would call it a PA. Under this definition every shale well would arguably be new oil.

7:44:47 PM

REPRESENTATIVE SEATON related that on a recent [legislative] field trip, ConocoPhillips had a coiled tube drilling unit and was using seismic to look at fault blocks. He posited the company will propose that each fault block and well - and there are going to be eight wells - is new oil. The company is drilling in existing well bores, but it is going out to other areas beyond to accelerate the flow and that is his concern when talking about within existing participating areas. A company would be presuming every one of those as being an acceleration of a PA or accessing something that was not being produced and he sees a lot of proposals coming to the division on that basis. He inquired whether, instead of doing an enhanced oil project in a well, a company might do something else so that 20 percent of the revenue can be excluded.

7:46:24 PM

MR. BARRON answered that, typically, the company is using multi-lateral and coiled tube drilling to look at its current reservoir model and the bubble map and trying to augment its current enhanced oil recovery (EOR) projects. Through infill drilling, increasing sweep efficiencies, modeling, and pressure results, the company is finding areas that are not currently being swept. It is infield work. Each one of those would clearly not be new oil. If the proposed program was put in place, the company would have to come to the division and originally prove it through reservoir modeling. He proffered the division would also ask as part of the stipulation that once drilling is commenced a series of very extensive tests be conducted to show to the division that it had not previously been contributing. For example, if an area was drilled into that was said not to be contributing and the pressure was found depleted, the division would say it is obviously in communication and has been contributing in some degree. So, there would probably have to be a two-stage test associated with reservoirs or new oil within existing PAs. This is the piece that is the most difficult to get one's arms around.

7:48:38 PM

MR. BARRON, continuing his answer, said he does not know that he would support the idea that there would be a lot coming in. When looking at a field like Kuparuk or Prudhoe that has been extensively delineated and developed, he would not expect to see many isolated fault blocks that are not in some form currently

producing or contributing to production - it would be unique. Areas that are on the fringe, the fringe oil, the PA expansions, he would offer, would be quite likely. Originally some of the PAs were designed and established with 20 and 30 foot pay cutoffs, today the limit would probably be a 10 foot or 5 foot cutoff. Some of these PAs could easily be expanded by lateral drilling into thinner and thinner zones. Those would be clearly new oil and the company would have to show the division what it was going to do and how the company is going to do it.

[7:49:53 PM](#)

CO-CHAIR SADDLER requested clarification about whether most fault blocks are currently contributing production.

MR. BARRON replied it is a generalized statement. Each field in each area would have to be looked at to make that determination, which is why it is so critical the burden of proof be placed on the oil company itself. The areas that Pioneer and ENI are developing are uniquely different than the areas of Coleville River, or Kuparuk, or Prudhoe, or Badami. Each is a unique reservoir system and reservoir management system, which is why a blanket statement that all fault blocks are contributing is not fair or reasonable. When answering Representative Seaton's question, he was trying to discuss fields that are extensively developed, like Kuparuk or Prudhoe. In his opinion, the likelihood of such fields having new areas that are not currently contributing, with the exception of the fringe, would be on the lower side rather than the higher side.

[7:51:08 PM](#)

CO-CHAIR SADDLER understood Mr. Barron to be saying that the third category of GVR/GRE determination is unlikely to produce much oil qualified as new oil under this current definition.

MR. BARRON responded that would be a reasonable way to phrase it, but qualified his comment is speculative and he put it out there just as a speculative comment. Much of it will depend on how aggressive the companies are. The conundrum needing to be solved here is that this is oil that is already within the PA. The first hurdle to get past in the division's dialogue with the industry is that this is oil the company has already established within the PA and should already be in the company's development scheme. The company would have to explain to the division why this oil is not in the development scheme and where it was in the company's original planning; for example, whether there were

geologic or engineering factors that precluded doing this originally.

[7:52:24 PM](#)

CO-CHAIR SADDLER surmised a company making an investment decision would not know whether the oil would qualify as new oil under the GVR/GRE definition when running its economic modeling. He inquired whether the GVR/GRE would be easy to factor.

MR. BARRON said the answer is "probably yes." When a company looks at the natural step out from the center to the edge of a field, it will have a reasonable idea of what that timing is going to look like. The further away from infrastructure the higher is the cost, which is why the fringe areas tend to be the last to be developed. It is his experience that most companies will run a series of economics with tax credits, or with the GVR/GRE, included and excluded and will find that balance of how and when and what the difference between the two are - this series of economics is run anyway. The real question is if the company runs it and it is not economic and yet it is not contributing. His question to the company would then be, If it is not contributing and not going to be done, why not collapse the PA? If the end result is collapsing the PA to where the company is going to have its producing boundaries, then that is a business call that the company should make.

[7:54:20 PM](#)

CO-CHAIR SADDLER asked whether there is any benefit to a company to collapse its PA.

MR. BARRON answered "not necessarily."

CO-CHAIR SADDLER inquired whether there are any costs associated with that.

MR. BARRON replied the only cost is making sure the interests of all parties are protected in terms of another player and that that player is in tune with what is being done and come back through with tract allocation factors and rejig financials. Again, it is a burden on the industry.

[7:54:55 PM](#)

CO-CHAIR FEIGE invited the DNR deputy commissioner to comment.

JOE BALASH, Deputy Commissioner, Office of the Commissioner, Department of Natural Resources (DNR), added the awkward part of this is going to be when companies come in the door looking to have part of an existing PA qualify for the GVR/GRE because it is not contributing to production. Probably one of the first questions the department will ask is, "Well, why is it in the PA?" The likelihood is that the company thought it was going to contribute at one point or another and it turned out that it did not because of something unforeseen. In looking at the broader boundaries of a PA and where the wells are and which ones are producing and contributing, the question is, "At what point is there too much of a cushion there?" At what point should those PAs be a little more actively managed and trimmed back so that if through an expansion of the PA, there is a really clear delineation and understanding of what will be done, what would be contributing to production. He said the previous iteration of this language had something that the department was quite comfortable with in terms of the cascade that Mr. Barron referenced earlier - units, new PAs, expansions of PAs, and then this, which could be nicknamed a sub-PA.

[7:56:54 PM](#)

REPRESENTATIVE SEATON read from [slide 13] of AOGA's [3/27/13] presentation which states: "CSSB 21 attempts to expand GRE to 80-90 [percent] of the potential development on North Slope in legacy fields." Thus, he said, AOGA's perception of what is going to qualify for the GVR/GRE is much broader than what DNR seems to be talking about and seems to be at odds with DNR's perception. He also recalled AOGA talking about the companies not knowing if something qualifies for the GVR/GRE until after the investment is made so they will be unable to use the GVR/GRE as a factor for determining investment. He further commented that 80-90 percent is quite a bit in any accelerated production out of the legacy fields.

MR. BARRON responded he did not see AOGA's presentation, but in looking at the slide he clearly cannot identify where 80 percent of Kuparuk would satisfy the GVR/GRE of not currently contributing to production. There is a disconnect if 80 percent is AOGA's understanding, he said. The entire intent that DNR would be presenting is that if a company thinks an area is not currently contributing, then prove it, and that is the threshold that the company would have to climb.

CO-CHAIR FEIGE pointed out ConocoPhillips Alaska, Inc. is not a member of AOGA.

REPRESENTATIVE SEATON said he is just talking about AOGA's presentation on the legacy fields.

[7:59:43 PM](#)

CO-CHAIR FEIGE asked whether it is technically possible for the state to give a company assurance before it makes its investment decision that that "shape in the ground" will actually fall within this particular GVR/GRE.

MR. BARRON answered "not definitively" and said that is why as part of the process, probably through regulations, DNR would stipulate a multi-step process: 1) identify the sub-PA area and prove it as best as possible, and then 2) drilling and testing to confirm the company's reservoir modeling or justification. The threshold the state would take is if at step 2 it was proven that it was previously contributing it would be excluded from the GVR/GRE. Thus, a company would not know definitively before it makes the investment, but the company would probably be running dual economics to determine whether it is economic.

CO-CHAIR FEIGE, assuming that that "shape in the ground" falls in a GVR/GRE, inquired whether the oil coming out of the ground could be accurately measured in an economical and practical way to sufficiently satisfy DOR.

MR. BARRON confirmed it would be to the standards of DOR for that department's purposes, but in conjunction with AOGCC. Through interaction between AOGCC, DNR, and DOR, programs and protocols could be established that would satisfy all parties in terms of accurate measurement of those areas.

[8:02:25 PM](#)

REPRESENTATIVE TARR, noting the fiscal note was prepared quickly after CSSB 21(FIN) am(efd fld) passed the Senate, asked whether the bill's estimated fiscal impact is accurate, given the uncertainty and evaluation that has taken place since that time. For example, the fiscal impact for fiscal year 2015 is estimated at \$25-\$175 million.

MR. BALASH replied that today Oooguruk and Nikaitchuq would qualify for this category within the GVR/GRE, and hopefully a couple more units would as time goes on. He offered his understanding that DOR took a conservative approach when estimating the potential applicability of the third category.

He posited DNR would push that estimate to the lower end if it was making the estimate, but said DOR wants to provide a broad, but reasonable, estimate for the legislature as it considers the impact of the provision.

[8:04:11 PM](#)

REPRESENTATIVE SEATON requested Mr. Balash to provide an estimate of the fiscal impact should 80-90 percent of new oil produced from the legacy fields qualify for that provision of the GVR/GRE, as anticipated by the industry. Legislators need to know what it would be using industry's numbers as well as the state's conservative numbers, he said.

MR. BALASH deferred to DOR to put that together. He said he thinks the 80-90 percent figure is just in reference to the percent of oil that is out there in the fields, not necessarily inferring that 80-90 percent of the production is going to qualify for the GVR/GRE.

CO-CHAIR FEIGE reread the AOGA statement cited by Representative Seaton, emphasizing 80-90 percent of "potential" development.

[8:05:59 PM](#)

REPRESENTATIVE TARR inquired how DNR is incorporating the natural decline curve of 10-12 percent into the overall picture of decline. For example, ConocoPhillips has said it can get the decline curve to 3 percent.

MR. BALASH responded a substantial amount of work on declines and decline curves has been done by the Division of Oil & Gas in conjunction with DOR for purposes of revising the production forecast methodology. He offered that, rather than slog through another presentation, DNR prepare materials for forwarding through the co-chairs' offices. Because natural decline is a term of art, he urged that thought be given to what the decline would be if no additional work was done. A tremendous amount of work continues to be done in legacy fields - new wells are continually drilled to bring on additional rate or reserves and DNR thinks much more could and should be done. In the whole scheme of things, what is trying to be done is get the state's base tax system to a point where those things will happen, that a GVR/GRE is not needed for doing the normal course of business and activity in those legacy fields. Fundamentally, the base system needs to drive the investment behavior, not the bells and whistles. The bells and whistles - the GVR/GRE - is really

something that is intended to help bring on new reserves in new units in outlying areas or reserves that are not currently in a participating area (PA). Since PAs should be booked, it is known that Alaska has approximately 3.3 billion barrels in proven reserves and it is estimated that in just the onshore central North Slope area there is over 3 billion barrels in undiscovered economically recoverable oil at today's prices. Finding those accumulations will start to add to Alaska's reserve base because one of the most important things in the oil business is the bottom line number of how many reserves. If that number is going down it means going out of business and Alaska's number is going down. The GVR/GRE is a mechanism to encourage companies to put more reserves on the books, more of Alaskans' reserves, on Alaska's books.

[8:10:44 PM](#)

CO-CHAIR FEIGE observed the third category of GVR/GRE uses the term "accurately measured and metered". He asked whether it is possible to satisfy DOR's requirements for accurately metering that oil to determine how much is new oil.

COMMISSIONER BUTCHER replied the short answer is yes, DOR believes it would be able to do that. He deferred to Mr. Pawlowski for providing more detail in this regard.

[8:11:52 PM](#)

REPRESENTATIVE SEATON inquired whether oil coming from an existing well bore that is tapping new areas through coiled tubing can be accurately metered to determine how much of the production is new oil.

MICHAEL PAWLOWSKI, Oil & Gas Development Project Manager, Office of the Commissioner, Department of Revenue (DOR), answered it certainly poses a challenge and will require collaboration by the three departments to develop the standards for that particular measurement. The other body's intent in developing the provision was to expand the realm of possible application of the GVR/GRE to target as much potential new production as possible. It is certainly difficult and there is a higher level of threshold that needs to be met for the commissioner. Individual wells could pose a problem, while aggregating the wells into a multi-well development is much easier. Those things would be defined by the departmental collaboration and regulatory process.

8:13:30 PM

CO-CHAIR SADDLER asked whether the determinations through collaboration of the departments would be on a de novo basis every time there was an application or would there be, over time, the development of a precedent.

MR. PAWLOWSKI replied the intent of the departments in working with the other body in developing this language was that the maximum of clarity be put before industry so that the processes and procedures are known at the time. The intent is to put as much clarity up front as possible, while retaining the flexibility as described by DNR to make those determinations in the state's interests.

CO-CHAIR SADDLER, while understanding that every circumstance cannot be foreseen, inquired whether that standard would evolve as applied and the back and forth happened.

MR. PAWLOWSKI responded DOR's understanding is that development of the metering and measuring, the basic counting, would be a standard that would be reached and be fairly fixed. He said DOR's teams are concerned with how many barrels are coming out of a particular development and once the standard is developed, it is the standard.

CO-CHAIR SADDLER asked whether this system is used in other tax regimes to identify new oil.

MR. PAWLOWSKI answered he does not know and suggested asking DNR. It is known that other jurisdictions look at things on a well-by-well basis, he said. In Alaska's system, royalty is allocated back to the wells on a lease basis. To provide that type of clarity will require development of an appropriate standard through a collaborative process with industry.

8:15:52 PM

REPRESENTATIVE TARR observed this provision would become effective 1/1/14 and posited that, due to the elimination of progressivity, this would be done on an annual basis, so the state would not know if it had missed the ballpark in its estimates for the GVR/GRE.

MR. PAWLOWSKI clarified the elimination of progressivity is not affecting the monthly payment of tax or the annual true-up of tax at the end of the year. The repeal of progressivity affects

Alaska's tax rate such that under the proposed bill Alaska's tax rate would remain at the fixed rate of 35 percent, while under the current regime of ACES it varies wildly from month to month.

REPRESENTATIVE TARR inquired when the state will be able to audit how the GVR/GRE is applied.

MR. PAWLOWSKI replied it would be in the normal course of the auditing process.

[8:17:06 PM](#)

REPRESENTATIVE TARR understood that currently the auditing process is still looking at 2007.

MR. PAWLOWSKI confirmed DOR is still looking at 2007. Part of that continuation is that changes in the system have an effect. He pointed out changes have also been made at the federal level that have re-opened some portions of some of those returns. Returns get amended as retroactive changes apply, he explained. In addition, the state has changed regulations in a retroactive manner, interest penalties being an example. Going back to the question of audits, he allowed it will certainly take time, but should accelerate a little once DOR's [new] tax revenue management system is implemented, and the process of going through the production profits tax (PPT) to ACES is completed.

REPRESENTATIVE TARR requested DOR to provide the committee with a walk through on the timing of that.

[8:19:25 PM](#)

The committee took an at-ease from 8:19 p.m. to 8:26 p.m.

[8:26:23 PM](#)

REPRESENTATIVE SEATON recounted how [last week] he asked the consultants whether a system could be designed where there is a trust account under which tax is calculated as it is and also calculated in the new amount and then there is a revolving amount that would be held over and if the producer did not meet benchmarks of production within so many years that portion would be lost and revert to the state. The consultants answered that they could not figure out a way to do that without having a lot of interferences. Earlier tonight with Commissioner Sullivan and Commissioner Butcher he put forth the idea that if Alaska's tax regime is changed there is a way for ensuring that the state

gets the increased production it is looking for. Now, he said, he is wondering whether the consultants can look at the \$5 per barrel credit and suggest some benchmarks such that if in three years, given it is the legacy producers being talked about here, an individual company does not cut its decline rate by 50 percent the credit would be reduced to \$2, but if a company meets or exceeds that 50 percent reduction in the decline the credit would rise to \$7. This way there would actually be a tie to increasing production. He requested the consultants to discuss having the credit on this type of basis.

8:29:43 PM

REPRESENTATIVE SEATON, at the request of Co-Chair Saddler, restated his question. The bill includes a \$5 per barrel credit for every barrel that is produced, he said. The intention in this tax regime is to incentivize increased production, yet the \$5 credit will still be given even if production is declining. He asked whether benchmarks could be built into the system such that if the production benchmarks are exceeded the credit would be more than \$5 per barrel and if a reasonable benchmark is not met within three years, given this would apply to the legacy fields, then the credit would be reduced by \$3 per barrel.

8:30:55 PM

ROGER MARKS, Economist, Logsdon & Associates, consultant to Legislative Budget and Audit Committee, responded by first noting that the reason everyone is here is the perception that Alaska's tax system is not competitive and, because of that, people are dissatisfied with the amount of production and investment. The goal is to make the tax system competitive. Producers are not investing in Alaska simply because they can make more money putting money in other places where they do not have to pay as much tax. Producers will perceive a risk if benchmarks are put out, he advised. The future is uncertain, there are many things over which producers have no control, and there is the risk that if they invest and then do not make the benchmarks then the oil produced is penalized by high tax just like it is today. Uncertainties include external events, such as a drop in oil prices or the situation like ConocoPhillips where it took more than five years to get a permit from the Environmental Protection Agency (EPA) to put a bridge across the Coleville River. There are situations where investments are very lumpy - a company could go along for a while not doing much and then suddenly a big investment raises its production, but then it has the same decline but from a higher rate. At Prudhoe

Bay there are three major working interest owners; their other interests in different fields vary and investment for one producer may help that producer's overall decline rate for one field but not another. Working interest owners in a given field might have vastly different interests in where they put their investments. For these reasons, when the question was put to him last week, he could not see a meaningful way to come up with any benchmarks that would not scare producers into doing no more investing than what they are now just because of the uncertainty that they might be left with what they have now. He deferred to the other consultants for their opinions.

[8:34:07 PM](#)

REPRESENTATIVE SEATON said he wants to make sure it is not his question about a trust account that is being talked about by Mr. Marks. He said he has set that question aside and is now talking about having benchmarks on that \$5 per barrel credit. He chose three years because that is the time period stated by producers for the legacy fields.

MR. MARKS replied he sees coming up with a benchmark for that sort of mechanism no less challenging. He suggested the other two consultants, Mr. Mayer and Mr. Pulliam, be asked for their perspectives on the question.

[8:35:48 PM](#)

JANAK MAYER, Manager, Upstream and Gas, PFC Energy, consultant to the legislature, stated there is a carrot aspect and stick aspect to what is being posited by Representative Seaton - if a producer meets its benchmark it gets an improved dollar per barrel credit and if it fails the dollar per credit is reduced. He said he is less concerned about the carrot aspect than he is about the stick aspect. How a producer sees it will vary depending upon cost assumptions and whether it is one year that is being looked at or across the project lifecycle. The bill's current structure of a 35 percent rate and a \$5 per barrel credit is a tax increase. The 35 percent rate and a \$2 per barrel credit would be a fairly substantial tax increase at lots of prices. Therefore, he advised, the idea that if a producer fails to meet a benchmark and the state's response to that is to raise the producer's taxes even further at most price levels, is probably not going to be a strong move to build confidence in future investment in the North Slope.

[8:37:21 PM](#)

BARRY PULLIAM, Economist & Managing Director, Econ One Research, Inc., consultant to the administration, concurred with Mr. Marks and Mr. Mayer. Mechanically, such a thing could be designed, he said, but the challenge would be to get those carrots and sticks at the right place. Designing a good, competitive system at the base level is what is being sought; the bells and whistles are not what should be had as the main feature of the system. The bill's current rate and per barrel credit operate in conjunction with each other, both to provide a credit that is tied to barrels and as an important way to get the right tax rate over the price range. Should the committee go down the road that is being posited, he would urge there be nothing punitive, such as lowering the credit to \$2 if a benchmark is not met, because going punitive does not send a good signal at all. The 35 percent rate and \$5 credit is designed to get Alaska to a point that is competitive and that should attract. If the committee is going to do something, although he does not know he would encourage that, he would suggest looking at the carrot side, such as offering a higher incentive to get to a certain level; for example, raise the \$5 credit to \$7, provided the state can do that fiscally.

[8:40:05 PM](#)

REPRESENTATIVE JOHNSON asked whether a company would, should such a system be adopted, do its modeling using the stick, possibly taking away the attractiveness of the project.

MR. PULLIAM responded that that would become their stress test, the project would have to meet the worst case scenario.

[8:40:42 PM](#)

REPRESENTATIVE TUCK understood Representative Seaton's proposal to be that the credit is \$5 per barrel and if the benchmark is exceeded the credit would be more and if the benchmark is not met then the credit would be less. He posited that this is less of a carrot rather than being a stick.

MR. MAYER answered the problem is that concurrent with this the base rate is increased from 25 percent to 35 percent, and 35 percent with a \$2 credit is a substantial tax increase at quite a wide range of prices compared to the current tax under ACES. So, what is essentially being said is that if a producer fails to meet the state's performance benchmark the producer's taxes will be raised even further above where they are today.

[8:41:34 PM](#)

CO-CHAIR FEIGE understood the problem with a performance benchmark in a field with shared ownership is that a producer would have to depend on its partners to come through to make all that happen.

MR. MARKS replied correct. Each company will have different working interests in each field and will therefore have different incentives to put investment in different fields, which would create a misalignment within the units.

MR. PULLIAM added that, while not the mechanism described by Representative Seaton, there is a carrot to add barrels, which comes in the form of the GVR/GRE. The GVR/GRE is an additional benefit over and above the [\$5 credit]. If producers can find new barrels to add, they will have the benefit of the GVR/GRE, which is, basically, an additional credit.

[8:42:56 PM](#)

REPRESENTATIVE JOHNSON, tying the aforementioned question and the GVR/GRE together, noted producers will do their base case on "the stick" and will not know about the GVR/GRE until they drill the well, jump through hoops, and prove it. He therefore asked what value is it when it comes to project economics.

MR. PULLIAM responded it is known with respect to the new unit and new participating area (PA). For the others, he concurred there is more of a hurdle. As described by Mr. Barron, the intent would be to have to have those barrels proved up and the ultimate proof would involve at least making some investment because the producer would have to drill and do some appraisal to satisfy DNR that this does indeed meet the requirements. He said his sense is that the majority of the investment for the full development would probably then take place after that.

[8:44:26 PM](#)

REPRESENTATIVE JOHNSON posed a scenario of a producer doing project economics for oil that may or may not be there, and if the project qualifies it is a good project. But, if it does not qualify it is not a good project, so why drill that first hole.

MR. MAYER explained that that same circumstance of decision making uncertainty applies to almost any risk-taking activity in

the upstream sector. An initial exploration well is drilled with a strong chance of drilling a dry hole, an appraisal well is drilled to delineate a field with the possibility the result will not be as big as was thought. He allowed there could be further work to do in defining this aspect of the GVR/GRE, and trying to create better certainty as to how exactly it applies and what that process would be. As described by DNR, there may be some investment required in terms of drilling a well in the same way as when drilling a well to delineate and appraise a known prospect; that is not the same as an ultimate final investment decision on an entire development of that area.

[8:45:45 PM](#)

REPRESENTATIVE JOHNSON said attracting new development is what is being looked at and he is one of those people who believe the next Prudhoe Bay is Prudhoe Bay and that drilling must be done in the legacy fields. The GVR/GRE may or may not make certain areas profitable within an existing PA, and while clarification of the GVR/GRE is needed, he is wondering the value of it. He agreed with Representative Seaton that putting new oil in the pipeline should be able to be done within three years and that that oil will come from the legacy fields. He wants Alaska to be real attractive, not in the middle of attractive. He said he thinks any oil from a new hole in the ground should qualify, although he recognizes he is probably alone in that thought. He said he would like to work on cleaning up the GVR/GRE so that it is a more attractive investment matrix on paper before the producer has to go through the investment process. He requested the opinion of Mr. Marks in this regard.

MR. MARKS replied it is what the committee wants. He said his understanding of the existing North Slope reservoirs is that there are hundreds of isolated fault blocks or stratigraphic traps that have weak communication with the rest of the reservoir that really need to be drilled directly to produce. His impression from Mr. Barron's comments this evening is that very few of those would qualify for the GVR/GRE or there is the possibility that very few would qualify, as the bill is currently written. Doing reconnaissance work means drilling the well, which is the main cost. If indeed these targets may be contributing to existing production, but not in a material way, maybe it would be possible to re-craft the language to address those kinds of targets, if that is what the committee wants.

[8:49:02 PM](#)

REPRESENTATIVE JOHNSON expressed his concern that the weak connection mentioned by Mr. Marks would disqualify that well. He further argued that while weak pressure means the oil is going somewhere, it may not be going to the well that is being drilled. He would like to explore [re-crafting the language] because increased production needs to happen in three years, not seven, and will need to come from the legacy fields which may be excluded under the current language. He said he will be looking to the consultants and the co-chairs for help in this regard.

8:50:20 PM

CO-CHAIR SADDLER said he would be open to suggestions for clarifying the GVR/GRE if it is determined to be the best tool. He, like industry, would feel more comfortable with more clarity as to how the language before the committee would actually be applied. He inquired whether the GVR/GRE is the best tool, or should there be something else, if the goal is to have an element of Alaska's tax encourage development of new oil.

MR. MARKS responded the whole point is to be competitive with other jurisdictions that have the same general risk/reward balance. The first step is to figure out the jurisdictions Alaska is competing with, what the government take is in those jurisdictions, and where does Alaska want to land as a target. A number of tools can then be used to get to that target. When he was looking at the competition while the bill was being developed, his judgment was that a government take of about 62 percent across a broad spectrum of prices would be competitive with Alaska's peer group. The consensus was to have as flat a rate as possible through a spectrum of prices because the international landscape is fairly flat. The question is how to achieve that take. The main thing is the target of 62 or 64 percent, regardless of the method used for getting there. A challenge with Alaska's tax system is that it has high tax rates at low prices due to the royalty, which is regressive. This needs to be offset, especially when costs are high. The \$5 per barrel credit and the GVR/GRE are used to get as flat a rate as possible at low prices and across the spectrum.

8:54:06 PM

MR. MARKS, continuing his answer, noted that targeted tax credits are a tool not being used [in this bill], but that could be. Targeted tax credits have advantages and disadvantages, and the disadvantages were discussed today by the administration. At low prices credits provide a lot of cash, and he has no doubt

[that under ACES] they have incentivized development, especially at the new small fields. However, there is some concern that they have been used for maintenance items rather than getting new oil and that is why tax credits could be used for targeted things that are conducive to producing oil rather than maintenance; for example, air fields and dining halls are needed to produce oil but they are not directly involved in producing. An advantage of credits is that they provide an incentive, especially since they are received on the front end and provide a net present value boost as well; a company can actually decrease its tax rate by investing. If concerned about cash flow or cash flow at low prices, something could be set up where credits cannot exceed "X percent" of gross value or "X percent" of production tax value.

MR. MARKS said another advantage of a credit is that it recognizes a company's actual economics and provides an automatic offsetting mechanism, whereas the GVR/GRE and \$5 per barrel credit are one-size-fits-all. There is a broad spectrum of costs on the North Slope - one development might be \$10 a barrel in capital cost and another might be upwards of \$30. A \$5 per barrel credit means much different for a \$10 cost than for a \$30 cost, and anything based on gross does not recognize actual costs at all. Because a credit recognizes a company's actual economics, a development having higher costs will receive a higher credit and, automatically, the higher costs with the higher credit will bring the company's taxes down more at a time when more help is needed. With lower costs and a lower credit, a company's tax will be brought down less at a time when not as much help is needed. Thus, credits are a tool other than a GVR/GRE. The main thing is to figure out what take to get and get there; regardless of which mechanism is used for getting there, it is the same amount of money.

[8:57:40 PM](#)

REPRESENTATIVE TARR noted a government take of 62 percent has been suggested by the other two consultants as well Mr. Marks.

MR. MARKS referred to his [3/4/13] presentation to the Senate Finance Committee to provide an answer. He explained Alaska is not competing with every other jurisdiction in the world, and slides 5-7 are his assessment of the jurisdictions comprising Alaska's peer group because they have a risk/reward balance similar to Alaska. He said it has been demonstrated that producers will pay more where the reward is greater and less where the reward is less. The peer group must be ascribed to

figure out what the competition is and the group he came up with is similar to the one that Mr. Mayer came up with. In comparing Alaska to its peer group at per barrel prices of \$110, \$70, and \$160, his judgment is that [a government take] of about 62 percent across all prices would be competitive. At current prices of \$110, the United Kingdom and North Dakota are at 62 percent. Other people could look at these numbers and land at a different target, he allowed, but this is his judgment for what would be a reasonable target.

[8:59:55 PM](#)

REPRESENTATIVE TARR surmised a big problem in the development of ACES was that modeling was not done above the price of \$90. In regard to a government take of 62 percent, she asked whether adjusting progressivity at higher prices, along with the credits, could be a system that would work as a package.

MR. MARKS answered there are pros and cons to progressivity. A pro is that progressivity means low take at low prices, not just getting high take at high prices. So, a progressive system protects the producer's interest at low prices and protects the state's interest at high prices. The challenge is that it must be balanced and not too aggressive. Because of the royalty it is very hard to design something that protects the producer's interest at low prices in a balanced way that gets upside potential with progressivity. In looking at the competition, only one or two other jurisdictions have progressivity. At a price of \$200, the state would be making lots of money whether under progressivity or the proposed Senate bill. Progressivity creates the impression that there may be some fiscal instability. In many countries in the world where investors perceive fiscal instability, they will actually prefer a progressive system so they know what the deal is if prices go up. "One could picture investors looking at their economics and looking at what happens in the high price world and they say in Alaska if it gets to \$200 a barrel we do not think this will hold so we do not know what the situation is, which is not good." Progressivity only works if it is balanced on both the high and low ends. It would be difficult to design something that is truly balanced on the low side given how much the royalty takes as a percentage of net at low prices.

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REPRESENTATIVE TARR posited that on the low price end it could be controlled by not having the progressive feature apply until a certain price.

MR. MARKS drew attention to slide 13 of his 3/4/13 presentation to the Senate Finance Committee and explained that the royalty is based on gross value. Because royalty is based on the gross, it is the same whether the field's costs are high or low. For example, at a price of \$70, the royalty itself takes 100 percent of the net value of the oil. This challenge at low price is why designing a balanced progressive system may be difficult.

[9:04:57 PM](#)

CO-CHAIR SADDLER, returning to slide 5 of the aforementioned presentation, inquired how static the government takes are for Alaska's peer group.

MR. MARKS replied most of the jurisdictions are tax and royalty systems; so, because of royalty, they are slightly regressive like Alaska is. They have higher takes at lower prices and lower takes at higher prices.

[9:05:55 PM](#)

CO-CHAIR SADDLER qualified that his question is not just about royalty and re-stated the question by asking whether, in general, the trend globally has been toward higher government takes or has oscillated over the decades.

MR. MARKS responded that, generally, some jurisdictions will try raising rates when prices spike. For example, Alberta, which is mostly a royalty jurisdiction, raised its royalty significantly in 2007. As opposed to Alaska where producers cannot move their investments very much, many of the producers in Alberta reacted by putting their rigs on their pickup trucks and driving to British Columbia and Saskatchewan, so production plummeted in Alberta. In 2010 Alberta dropped the royalty and it all came back. In general, when prices go higher there is a slight movement for higher takes, but the take seen now for many of these jurisdictions is what was seen when oil was \$60 a barrel.

[9:07:30 PM](#)

MR. MAYER added it varies enormously by the timeframe being considered and the sorts of countries being considered. The 1960s had a period of substantial increases in government take

over a wide range of countries when a number of recently post-colonial countries found themselves with low levels of royalty. A number of particularly big national resource holders looked to production sharing contracts that would give them a much bigger share of the upside, rather than having regressive royalty systems. A second price shock was the Arab oil embargo. If this conversation were taking place five years ago, a number of regimes could have been identified that in the previous decade had raised government take, particularly as prices were starting to rise. Probably the biggest thing in the last five years, as a strong counter to that trend, is that high oil prices have brought renewed production from a range of sources in the Organisation for Economic Co-operation and Development (OECD) that all have relatively speaking low levels of government take. The logical competition for Alaska is no longer as it might have been five to ten years ago - major producers with production sharing contracts. It is now the Lower 48 and other places with substantially lower levels of government take, and that has been a very strong moderating influence in the opposite direction.

[9:09:14 PM](#)

CO-CHAIR SADDLER recalled DNR's earlier suggestion that it was appropriate for operators on the North Slope to keep shuffling through their PAs and to discard areas that were not producing to keep them narrowly defined. He asked whether it is reasonable to require old companies to go through their participating agreements and filter out the areas they are not actually producing from.

MR. MARKS answered he thinks it would be prudent administrative practice on the part of DNR to weed out areas of PAs that are not being produced. In further response, he said it would be possible that DNR would want to offer those for lease to someone else who might see something different there, given the state makes money from lease sales.

CO-CHAIR SADDLER inquired whether there is a mechanism for the state to offer area inside a unit that is a putative participating area to lease to somebody else.

MR. MARKS replied the leases are surface acreage so he cannot see how that would work.

CO-CHAIR SADDLER understood Mr. Marks to have said it would be appropriate to release the non-producing area so it could be leased to somebody else.

MR. MARKS responded correct, if the area was not being used. In further response, he said the state will not be able to release it around the land area so he cannot see how it could be done within a unit because the same land would be involved.

[9:11:33 PM](#)

REPRESENTATIVE SEATON returned to slide 13 of Mr. Mark's 3/4/13 presentation to the Senate Finance Committee and addressed the point made by Mr. Marks that at the price of \$70 per barrel the royalty would eat up all the profit. He inquired whether producers were losing money during the years prior to 2005 when prices were below \$65 a barrel.

MR. MARKS answered the high operating and capital cost that he used [for the slide] was on the order of \$50 a barrel and he doubts that back in those years anyone would have pursued production at those costs. In further response, he said that, today, \$50 is the end spectrum with what might be possible with viscous oil and other oil that is in remote areas. A producer would not want to develop that oil if the price was \$70, but would need to be aware of what happens if it is.

[9:13:07 PM](#)

[CSSB 21(FIN) am(efd fld) was held over.]

[9:13:22 PM](#)

#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 9:13 p.m.