

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

April 2, 2013

9:02 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 21(FIN) AM(EFD FLD)

"An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; providing a tax credit against the corporation income tax for qualified oil and gas service industry expenditures; relating to the oil and gas production tax rate; relating to gas used in the state; relating to monthly installment payments of the oil and gas production tax; relating to oil and gas production tax credits for certain losses and expenditures; relating to oil and gas production tax credit certificates; relating to nontransferable tax credits based on production; relating to the oil and gas tax credit fund; relating to annual statements by producers and explorers; establishing the Oil and Gas Competitiveness Review Board; and making conforming amendments."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 21

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

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

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

03/12/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
03/12/13 (S) Heard & Held
03/12/13 (S) MINUTE(FIN)
03/12/13 (S) FIN AT 4:00 PM SENATE FINANCE 532
03/12/13 (S) Heard & Held
03/12/13 (S) MINUTE(FIN)
03/13/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/13/13 (S) Heard & Held
03/13/13 (S) MINUTE(FIN)
03/13/13 (S) FIN AT 1:30 PM SENATE FINANCE 532
03/13/13 (S) Heard & Held
03/13/13 (S) MINUTE(FIN)
03/14/13 (S) FIN AT 9:00 AM SENATE FINANCE 532
03/14/13 (S) Moved CSSB 21(FIN) Out of Committee
03/14/13 (S) MINUTE(FIN)
03/18/13 (S) FIN RPT CS 2DP 1DNP 1NR 3AM NEW
TITLE
03/18/13 (S) DP: KELLY, MEYER
03/18/13 (S) DNP: HOFFMAN
03/18/13 (S) NR: FAIRCLOUGH
03/18/13 (S) AM: DUNLEAVY, BISHOP, OLSON
03/18/13 (H) RES AT 1:00 PM BARNES 124
03/18/13 (H) Scheduled But Not Heard
03/19/13 (S) RLS AT 9:00 AM FAHRENKAMP 203
03/19/13 (S) -- MEETING CANCELED --
03/20/13 (H) RES AT 1:00 PM BARNES 124
03/20/13 (H) Scheduled But Not Heard
03/21/13 (S) TRANSMITTED TO (H)
03/21/13 (S) VERSION: CSSB 21(FIN) AM(EFD FLD)
03/22/13 (H) READ THE FIRST TIME - REFERRALS
03/22/13 (H) RES, FIN
03/22/13 (H) RES AT 1:00 PM BARNES 124
03/22/13 (H) Heard & Held
03/22/13 (H) MINUTE(RES)
03/25/13 (H) RES AT 1:00 PM BARNES 124
03/25/13 (H) Heard & Held
03/25/13 (H) MINUTE(RES)
03/26/13 (H) RES AT 6:00 PM BARNES 124
03/26/13 (H) Heard & Held
03/26/13 (H) MINUTE(RES)
03/27/13 (H) RES AT 1:00 PM BARNES 124
03/27/13 (H) Heard & Held
03/27/13 (H) MINUTE(RES)
03/28/13 (H) RES AT 6:00 PM BARNES 124
03/28/13 (H) Heard & Held
03/28/13 (H) MINUTE(RES)
03/29/13 (H) RES AT 1:00 PM BARNES 124

03/29/13 (H) Heard & Held
03/29/13 (H) MINUTE(RES)
04/01/13 (H) RES AT 1:00 PM BARNES 124
04/01/13 (H) Heard & Held
04/01/13 (H) MINUTE(RES)
04/02/13 (H) FIN AT 9:00 AM HOUSE FINANCE 519
04/02/13 (H) RES AT 9:00 AM BARNES 124

WITNESS REGISTER

ANDY ROGERS

Anchorage, Alaska

POSITION STATEMENT: Testified in support of CSSB 21(FIN) am(efd fld).

MICHAEL JESPERSON

Anchorage, Alaska

POSITION STATEMENT: Testified in support of CSSB 21(FIN) am(efd fld).

LAURIE FAGNANI

Anchorage, Alaska

POSITION STATEMENT: Testified in support of CSSB 21(FIN) am(efd fld).

MARLEANNA HALL

Anchorage, Alaska

POSITION STATEMENT: Testified in support of CSSB 21(FIN) am(efd fld).

KATI CAPOZZI

Anchorage, Alaska

POSITION STATEMENT: Testified in support of CSSB 21(FIN) am(efd fld).

JOHN STURGEON

Anchorage, Alaska

POSITION STATEMENT: Testified in support of CSSB 21(FIN) am(efd fld).

JIM SYKES

Palmer, Alaska

POSITION STATEMENT: Testified in opposition to CSSB 21(FIN) am(efd fld).

LISA HERBERT, Executive Director
Greater Fairbanks Chamber of Commerce

Fairbanks, Alaska

POSITION STATEMENT: Testified in support of CSSB 21(FIN) am(efd fld).

DANIEL DONKEL

Donkel Oil & Gas, LLC
Daytona Beach, Florida

POSITION STATEMENT: Testified in opposition to CSSB 21(FIN) am(efd fld).

DAVID GROSS, Consulting Geologist
East Hardwick, Vermont

POSITION STATEMENT: Provided Daniel Donkel's testimony in opposition to CSSB 21(FIN) am(efd fld).

PAMELA BRODIE

Homer, Alaska

POSITION STATEMENT: Testified in opposition to CSSB 21(FIN) am(efd fld).

LARRY SMITH

Homer, Alaska

POSITION STATEMENT: Testified in opposition to 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: During the hearing of CSSB 21(FIN) am(efd fld), provided a PowerPoint review of the provisions in the proposed committee substitute, HCS CSSB 21, Version B.

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

POSITION STATEMENT: During the hearing of CSSB 21(FIN) am(efd fld), answered questions regarding the proposed committee substitute, HCS CSSB 21, Version B.

LENNIE DEES, Audit Master
Production Audit Group
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska

POSITION STATEMENT: During the hearing of CSSB 21(FIN) am(efd fld), answered questions related to the proposed committee substitute, HCS CSSB 21, Version B.

ACTION NARRATIVE

[9:02:54 AM](#)

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting, recessed from 4/1/13, back to order at 9:02 a.m. Representatives Seaton, Hawker, Johnson, and Feige were present at the call back to order. Representatives Tarr and Saddler arrived after the meeting was called back to order.

SB 21-OIL AND GAS PRODUCTION TAX

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." [Before the committee was the proposed committee substitute, HCS CSSB 21, Version B, labeled 28-GS1647\B, Nauman/Bullock, 3/29/13, adopted as the working document on 3/29/13.]

CO-CHAIR FEIGE resumed the taking of public testimony.

[9:03:12 AM](#)

ANDY ROGERS supported CSSB 21(FIN) am(efd fld), but expressed his concern that the bill has been weakened during its movement through the committee process. He said he hopes the final compromise will be a bill that Alaska can survive and thrive with. To only pull out progressivity and then move things around such that there is still a punitively high total

government take is not enough. At the end of the day, the only thing that really matters is the total government take number. He acknowledged it will be painful to the state to reduce that number and live within its means. He urged the small producer tax credit be kept in the bill, saying it is only a small bit of economic development that can be kept in the tax code and the state wants small, young, hungry explorers and producers looking at establishing themselves in Alaska.

[9:05:17 AM](#)

CO-CHAIR FEIGE, regarding Mr. Rogers' statement that government take will still be too high, asked what amount is low enough.

MR. ROGERS replied that is the million dollar question and it is legislators who are in the seats to make that call. The easy answer is whatever number it takes to incentivize oil companies of a variety of sizes and flavors to invest in Alaska over other domestic and global opportunities. He suggested a comparison can be made to other states and the world to see what would make Alaska competitive with them, but said that right now Alaska is not in the game with any of them.

CO-CHAIR FEIGE noted that is what the committee is doing.

[9:06:32 AM](#)

MICHAEL JESPERSON supported the committee's proposed substitute (CS), but agreed the bill has been watered down and he would like to see more incentive included for exploration and new production. However, he continued, the current proposal is better than anything seen over the last several years. When today's decline in the Trans-Alaska Pipeline System (TAPS) is compared to what was predicted when Alaska's Clear and Equitable Share (ACES) was passed, the prediction was off by several years. The bill needs to be passed so his children can have a future. It will take three to four years before the state sees more investment to make up for the revenues that are predicted to be lost, but long term the incentives and reduced taxes will put more oil in the pipeline, which will give the state more money to spend over the long run.

[9:08:05 AM](#)

LAURIE FAGNANI said she is the owner of a small communications firm in Anchorage. She employs two dozen full-time graphic designers, web developers, and account planners, and she is

testifying today because her employees need her to advocate on their behalf to secure Alaska's future. Since the start of oil flowing in the pipeline, oil production levels have been directly tied to good paying jobs in the oil and gas industry. Similarly, almost all state revenues are tied to oil production. She said her employees understand this connection and see that their futures are tied to production levels in the pipeline. One of many companies indirectly reliant on oil and gas industry in Alaska, her company has a diverse portfolio in tourism, mining, and health care. The decisions legislators make today will impact the livelihood of the state as well as the future of her employees and her ability to run a business. Regarding the point of competitiveness, she explained she operates in a competitive marketplace and every day she worries about her competitiveness. If she is not competitive or if she senses she is losing market share, she changes her strategy, maneuvering herself into a more competitive position because that is how the marketplace works. Sometimes, however, a client relationship is about price; if they can get it less expensive someplace else they are going to move their business. This is how the market works and it is up to her to decide what business she wants to go after, what business she wants to invest in, and what business she wants to keep. Just like the legislature spending royalty revenues generated by Alaska's legacy fields, she has made commitments to her family and her employees that they can count on her to fund their futures. Just like the state, it is her responsibility to maneuver her company so that she remains competitive and attractive to new clients and to attract new investment from her existing clients. Clearly, Alaska has a pricing problem. Changing how the state taxes the industry, and especially how the state protects the small producers with extending credits, is a step in the right direction to increasing production and keeping Alaska competitive among a global playing field. It is time to get Alaska back in the game by changing ACES so Alaska can compete and win market share. Alaska's future depends on action now.

[9:11:11 AM](#)

MARLEANNA HALL stated she has lived in Alaska all of her life, has attended school in the state, and has a family and job in Alaska. She was educated in the public schools in Nome and Eagle River and received a bachelor's degree from the University of Alaska Anchorage. Her son is now attending public school and she hopes when he is her age that he will be able to find a well-paying job in a good economy in Alaska. She urged passage of the bill, ending progressivity and encouraging investment in

the future development of Alaska's natural resources. The bill is a start, but more needs to be done. Investment needs to be increased in Alaska, keeping the doors open of locally owned businesses. She offered her hope that the committee considers the long term over the short term. She specifically thanked her representative, Representative Hawker, and encouraged him to vote in favor of the bill.

[9:12:16 AM](#)

REPRESENTATIVE HAWKER thanked Ms. Hall and assured her he has been working on this issue for many years.

[9:12:29 AM](#)

KATI CAPOZZI said this is her third year in a row testifying before the legislature advocating for meaningful changes to Alaska's oil tax policies. When she first testified in favor of oil tax reforms in March 2011, TAPS was running at about 636,000 barrels per day. When she testified before the Senate Resources Standing Committee on February 21, 2013, TAPS was running at 580,000 barrels. When she testified before the Senate Finance Committee on March 12, 2013, TAPS was at 568,000 barrels, and yesterday it was 563,905 barrels. For nearly two years and three legislative sessions, the legislature and public have debated the merits of whether a tax reform is necessary and poured over countless slides indicating Alaska does not compete. The supply of oil in the pipeline has dropped by 72,000 barrels per day. This is concerning because there is no reason why, during historically high oil prices, Alaska should not also be enjoying the increased investment that results in production. Argument has been heard over the last several hearings that more time is needed, but she thinks three legislative sessions is quite a bit of time. The time for getting something meaningful was a few years ago. Every person living in Alaska is in the oil industry, she maintained, regardless of who the person works for. Increased investment is needed for everyone.

[9:14:12 AM](#)

JOHN STURGEON offered his support for the bill and his agreement with what has been said. He urged that meaningful tax reform be passed so Alaska's economy can continue to grow.

[9:15:14 AM](#)

JIM SYKES testified he supports increased oil production, but opposes the proposed committee substitute (CS). There are many upsides for companies, but he agrees Alaska can incentivize some of the smaller producers better. However, he sees some serious downsides to the state. The current CS essentially guarantees more corporate profits on top of already corporate profits and investment level is insufficient now, so he does not see that necessarily changing. More production is not necessarily going to mean more revenue and tax breaks are not necessarily going to mean more investment. It starts eliminating the downside price risk at about \$90, which, in his opinion does not pass the "red face" test. It eliminates the upside price risk by almost eliminating progressivity. It allows the use of the state's money without requiring actual performance of new production. It looks to him that it applies to the legacy fields, which are already among the most profitable oil fields on the planet. Alaska's legacy fields are the "ATM" that has leveled out the ups and downs of other investments made by Alaska producers elsewhere in the world. What does Alaska get out of it? It gives out cash in advance, it risks negative cash flows regardless of oil price, and it is unlikely to recoup the value of the credits under almost any likely scenario. Net profits will accrue to corporations and the state will essentially be accepting an effective lower net take per barrel.

[9:17:10 AM](#)

MR. SYKES continued, saying much more needs to be done in understanding exactly how this will work and what the state will get out of it. While he agrees a long-term solution needs to be made, this current CS is a strategy based on hope and that is not a prudent strategy. Something he finds difficult to accept in a prudent fiscal strategy is that the administration has had five years to audit the current tax regime, but has not. Until there is an audited tax regime, it is not a good idea to start changing it. He offered his belief that the State of Alaska cannot lower its taxes enough to take away another oil producing region's production boom, any more than anyone took Alaska's production boom in the late 1970s and early 1980s. Companies will go to an area, especially where technology created the boom, not any tax policy. Regarding the question of how schools will be funded unless more oil production is stimulated, he asked how will the state pay for schools, roads, bridges, hydroelectric dams, and public safety when cash is taken directly out of Alaska's cash reserve. It is just a hope that some of it may be returned. Alaska finds itself in the same place that Bob Bartlett warned about in 1955 - outside interests

are controlling the state's natural resources when they want to develop them. Without any guarantees that tax breaks are going to actually increase production or increase revenue, which is two separate questions, it really is more about price. The throughput scare being visited upon the state is really not an issue. The committee needs to ask questions, such as finding out the internal rates of return for the companies. Even if confidentiality agreements must be signed to get the information, legislators need to understand where the companies are so it is understood what the state is going to do to benefit and what the companies are going to do if they receive a break. He said he will be forwarding materials to the committee.

9:20:08 AM

LISA HERBERT, Executive Director, Greater Fairbanks Chamber of Commerce, noted the chamber represents over 700 businesses and organizations throughout the Interior. The chamber's primary purpose is business advocacy with the mission of promoting a healthy economic environment for business as well as the community at large. One of the chamber's top priorities is to encourage increased oil production by encouraging the legislature and the administration to establish competitive investment opportunity through taxation and regulatory policies that will facilitate additional oil exploration, development, and increased production. The need exists now to take the steps necessary to ensure the health and viability of TAPS. The chamber supports the governor's four guiding principles for tax reform. For the last three years, thousands of business owners, employees, and residents have testified before the legislature, or submitted comment cards, supporting reform of Alaska's oil tax policy to make the state more competitive. The chamber supports reform of oil taxes in a fair, meaningful way. Several chamber members, such as Flowline Alaska, Airport Equipment Rentals, Alyeska Pipeline Service Company, have been negatively impacted by decreased oil throughput. These and other businesses have had to lay off employees and scale back operations. Fairbanks is the hub for work on the North Slope and reforming oil taxes will regain Alaska's competitiveness. She urged the committee to pass a bill that will result in increased oil production and increased work on the North Slope. The chamber is reviewing [Version B] and will continue to remain engaged as the bill moves through the legislative process.

9:22:05 AM

REPRESENTATIVE TARR commented she thinks everyone would characterize his or her position as wanting meaningful oil tax reform. She asked whether Ms. Herbert thinks Version B is the meaningful tax reform that is needed.

MS. HERBERT replied the chamber's natural resources committee is meeting tomorrow morning, at which time its members will look at Version B and respond to the committee.

[9:23:31 AM](#)

DANIEL DONKEL, Donkel Oil & Gas, LLC, noted he has 30 years of involvement as an investor and founder of several oil companies in Alaska. Due to illness, his testimony will be read by his consulting geologist, David Gross, formerly of Chevron Alaska.

[9:24:43 AM](#)

DAVID GROSS, Consulting Geologist, provided the testimony of Daniel Donkel, founder of Donkel Oil & Gas, LLC and Danco Exploration, Inc. He read the testimony as follows:

My primary reason for being here today is to explain what I believe is necessary for this legislature to do if it wants to see those smaller companies whose business is confined to exploration, production, and sale of crude oil, companies commonly referred to as independents, flourish in Alaska. I am in the business of bringing such companies to Alaska and have been for 30 years. For my business and the business of those I bring to Alaska to be successful I believe, no, I know, this legislature needs to do three things that are not being considered in this bill. The legislature should: 1) adopt a simple, easy-to-explain 75 percent exploration production credit that cannot be manipulated to exclude independents; 2) while leaving a fixed royalty in place, provide a seven-year exemption from taxes for all new production outside the existing participating areas; 3) leave the ACES tax, including its progressivity, as is for all existing participating areas. I am going to share some information with you that the majors do not want you to know. By majors, I mean ... those fully integrated companies that explore, drill, transport, refine, and distribute refined products for wholesale and retail.

[9:26:44 AM](#)

CO-CHAIR FEIGE interjected, saying the three-minute limit on testimony is approaching and the committee is in receipt of Mr. Donkel's five pages of written testimony, which has been accepted [for the record].

MR. DONKEL requested Mr. Gross be allowed to continue, saying this is one of the most important pieces of information the State of Alaska has never heard because the existing independents with investment in the ground will not tell the legislature or the public in case of retaliation. The reason for his testimony is so the public can hear what he has to say after 30 years of investing in the state.

CO-CHAIR FEIGE stated Mr. Donkel's testimony is posted on the legislature's website for access by the public.

[9:29:30 AM](#)

REPRESENTATIVE TARR requested Mr. Donkel to explain his exploration credit idea.

MR. DONKEL responded that after listening to testimony by the Department of Natural Resources and others, it is clear to him that this bill simply strips ACES, gives all the money to the majors, and annihilates the small independents, none of which have been able to produce a profit in Alaska. For example, Pioneer testified the other day that it has been in Alaska for 10 years without a profit. Brooks Range has been in Alaska since 1999 without a profit, and Armstrong has not had a profit. He said his proposed exploration credit of 75 percent is almost equivalent to that seen in the Cook Inlet with the Cook Inlet Recovery Act combined with ACES. It was announced today that [indisc.] Energy was able to get \$17 million in credits and that has led to four wells in the Redoubt Shoal that the state almost had abandoned two years in bankruptcy court. He maintained ACES is working and suggested the [GVR] be undone and replaced with the 20 percent credits that are being taken away. This way, the state would continue to get the \$1 billion a year, not the majors, and a tax credit would be provided that is clear, simple, and reliable and that can be monetized each year. As the independents stated in their testimony, they will put this money in the ground to get the state more production. If the majors want to drill outside of participating areas in the legacy fields or the producing units, they can, and [under his proposal] they will get a seven-year tax holiday from ACES. He

maintained this would be the most single most important thing the state could do.

[9:32:25 AM](#)

PAMELA BRODIE, spoke as follows:

If SB 21 would make the difference, leading the oil industry to exploration and development they would not otherwise pursue, it would be logical and rational ... for them to guarantee such exploration. But they do not. If they would pursue this exploration regardless of the tax cut, it would be logical for them to lobby for the tax cut and wait for it, which they do, but also to give the state guarantees for future exploration and development. But they do not. It seems to me that only if they do not plan more development anyway, is it logical for them to give the state no guarantees. And this is what they are doing. It is a frightening prospect that oil throughput is declining and the oil industry is apparently uninterested in more exploration regardless of tax rates. But even more frightening would be for the state to lower taxes to no purpose as the amount of oil declines. Please vote no on SB 21 so the state won't face double losses.

[9:33:53 AM](#)

LARRY SMITH stated he has been a builder around the Cook Inlet area for the last 50 years. He said it is reasonable for Alaskans to have differing views and letting everyone speak to their own interests is how democracy works best. In listening to various experts, he has chosen Jack Roderick as the expert to listen to. He reminded members that Mr. Roderick advised that the legislature get it in writing and that the eyes of the nation are upon Alaska. Mr. Smith quoted a response from former Alaska Governor Jay Hammond when asked how he would tax the oil companies: "for every cent we could possibly get; after all, just as it is the obligation of oil company CEOs to maximize benefits for their shareholders, so it is the obligation of the state CEO to do the same for his." He noted that when SB 21 was on the Senate floor, Senator Gary Stevens offered an amendment that would have sunsetted the law, giving the legislature another chance to see if the oil industry actually had increased production, but it failed by a narrow margin. He urged that the House consider this same amendment. He recalled former Governor

Hammond's statement that the biggest mistake of his political life was when he did not veto the elimination of the state income tax and that it would have been better to suspend it. Mr. Smith said he opposes the bill as written, but if it must be passed that it incorporate a suspension of the ACES provisions rather than eliminating them. This would allow the provisions to be brought back more easily. He further reminded members that in her inaugural address, former Governor Palin used a statement made about mining by Bob Bartlett at the state constitutional convention, but she applied it to the oil industry - the days of robber barons in Alaska [are] dead.

[9:37:37 AM](#)

CO-CHAIR FEIGE closed public testimony after ascertaining no one else wished to testify.

[9:37:53 AM](#)

CO-CHAIR FEIGE recessed the meeting until 2:00 p.m.

[2:05:37 PM](#)

CO-CHAIR FEIGE called the House Resources Standing Committee meeting back to order. Representatives P. Wilson, Hawker, Olson, Seaton, Saddler, and Feige were present at the call back to order. Representatives Tarr, Tuck, and Johnson arrived after the meeting was called back to order.

CO-CHAIR FEIGE stated the committee will next hear from the administration and consultants regarding the provisions of the proposed committee substitute, HCS CSSB 21, Version B [adopted as the working document on 3/29/13].

[2:06:10 PM](#)

MICHAEL PAWLOWSKI, Oil & Gas Development Project Manager, Office of the Commissioner, Department of Revenue (DOR), provided a PowerPoint presentation entitled, "Preliminary Fiscal Impact HCS CSSB21(RES)". He said he will review the 12 key provisions of Version B, will describe the potential fiscal impacts of those provisions based on the Fall 2012 Revenue Forecast, and will review hypothetical additional production scenarios. He pointed out that this presentation is a preliminary fiscal analysis, not a fiscal note, and the presentation assumes an effective date of 1/1/2014 for the major provisions.

[2:07:40 PM](#)

MR. PAWLOWSKI addressed the first major provision in Version B, page 28, line 8, which would repeal the progressive surcharge as of 1/1/2014 that is found under AS 43.55.011(g) (slide 3). Known as progressivity, this surcharge is the additional tax that is added to the 25 percent base tax under the current tax system [Alaska's Clear and Equitable Share (ACES)]. Progressivity increases the tax rate when the production tax value is greater than \$30 a barrel. The progressive surcharge may add up to be 50 percent of the total tax rate at very high prices, for a maximum tax rate of 75 percent. The fiscal impact from eliminating this provision would vary by year depending upon price, underlying spending, and production, [reducing state revenue] by up to \$1.8 billion per year under the Fall 2012 Revenue Forecast. He said slide 4 depicts the impact of the progressive surcharge by showing the amount of 25 percent base tax in red and the amount of expected progressivity in green. He noted the figures depicted in this graph are before credits; thus the graph shows the revenue that is generated but not the revenue that is then paid out with the credit.

[2:09:32 PM](#)

MR. PAWLOWSKI discussed the second major provision in Version B, page 5, line 7, which would increase the base production tax rate from 25 percent under ACES to 35 percent (slide 5). A higher base tax rate would increase revenue through the base tax system and would provide greater protection to the state at lower oil prices. The fiscal impact would vary by fiscal year, with the increased base tax rate generating up to \$1.1 billion [more] under the Fall 2012 Revenue Forecast.

[2:10:28 PM](#)

MR. PAWLOWSKI reviewed the third major provision in Version B, page 13, lines 3-5, which would put limitations on capital credits found under AS 43.55.023(a) for qualified capital expenditures on North Slope leases (slide 6). This provision would remove the 20 percent capital credit for qualified spending [for areas north of 68 degrees North latitude] after 1/1/2014. Capital credits under the current system are taken in one of two ways: 1) as a liability against the company's tax liability, or 2) refunded. For credits taken against the company's tax liability, the state does not see actual revenues expended out. There is a suite of credits that can be issued as either a certificate that is transferred to another company or

turned into the state for a cash payment, those being the credits that the state refunds to companies that have no tax liability.

[2:12:27 PM](#)

MR. PAWLOWSKI displayed a chart depicting the estimated fiscal impact for the proposed limitations on credits as compared to the Fall 2012 Revenue Forecast (slide 7). He explained that the first line in the chart depicts the impact for capital credits that are taken against the tax liability. The effect of the proposal would begin halfway through fiscal year 2014, with fiscal year 2015 being the first full fiscal year of the effect. For fiscal year 2015, the state would no longer have a \$700 million obligation for the qualified capital credits that would be taken against the tax liability of taxpayers. The state would also see a reduction of \$150 million in credits that would need to be refunded to non-taxpayers, for a total fiscal impact of an increase of about \$850 million to the state.

[2:13:47 PM](#)

MR. PAWLOWSKI outlined the fourth major provision in Version B, page 13, lines 10-13, which would retain and increase the net operating loss carry forward credit for net losses from oil and gas operations on the North Slope (slide 8). The credit would be increased from 25 percent of those losses under ACES to 35 percent, and would be taken in one year as opposed to two. This credit, found in AS 43.55.023(b), is targeted to companies that do not currently have production and therefore no tax liability. This 10 percent increase is needed to make the economics equivalent for a company that does not have enough production to write off expenses against. This credit is transferrable or can be refunded by the state. The estimated revenue impact of this 10 percent increase in credit is a decrement of about \$40 million per year above the amount forecasted under ACES.

[2:15:24 PM](#)

MR. PAWLOWSKI, responding to Representative Seaton, confirmed that slide 7 depicts the impact of only the capital credit and that the impact of \$850 million for fiscal year 2015 is a positive fiscal impact to the state. However, he continued, the increase in the net loss carry forward credit would have a negative fiscal impact to the state.

[2:16:41 PM](#)

MR. PAWLOWSKI turned to the fifth major provision in Version B, page 24, beginning on line 20, which would establish the gross value reduction (GVR), formerly known as the gross revenue exclusion (GRE) (slide 9). He said this provision would amend AS 43.55.160 by adding a new subsection that would provide an additional incentive for "new" oil. The change in Version B from CSSB 21(FIN) am(efd fld) is a limitation on where this incentive could apply. The qualifying production would be any of the following three things: 1) Land that was not in a unit on 1/1/2003; 2) Was not produced within a participating area (PA) established after 12/31/2011 in a unit formed before 1/1/2003; and 3) Acreage that was added to an existing PA [after 12/31/12]. Regarding the third qualification, he reminded members that the Department of Natural Resources had previously discussed that the new participating areas within the existing units are geologically distinct and provable accumulations of oil. Compared to CSSB 21(FIN) am(efd fld), Version B would provide a much more narrowly defined suite of oil that qualifies for the GVR/GRE. The fiscal impact is indeterminate, but would be under \$50 million per year under the Fall 2012 Revenue Forecast.

[2:18:42 PM](#)

MR. PAWLOWSKI, responding to Representative P. Wilson, confirmed that the metering requirement [under CSSB 21(FIN) am(efd fld)] was removed in Version B.

[2:19:03 PM](#)

REPRESENTATIVE SEATON understood the acreage is the physical, top side acreage of a PA that is physically expanded, but that it does not include reservoirs underneath existing PAs.

MR. PAWLOWSKI deferred to the Department of Natural Resources deputy commissioner.

JOE BALASH, Deputy Commissioner, Office of the Commissioner, Department of Natural Resources (DNR), replied the term acreage is used because, by definition, a PA is the same reservoir. So, when discussing property, it is the acreage that is being talked about - the same leases in the same unit - more of the acreage in that unit is going to become part of the PA.

[2:20:22 PM](#)

REPRESENTATIVE SEATON related his understanding that different reservoirs that are not in communication could all be stacked up. He asked whether it is the surface acreage that is being talked about or whether the acreage is the volume of a PA that might be two or three balloons down.

MR. BALASH responded acreage is just a reference to something additional with regard to the land. It is three dimensions, not just the two dimensions of the outlines on the surface - it actually goes down into depth. When a PA is formed it is identified geologically at both the horizontal level as well as the vertical level. So, it is any additions to that PA that might be an extension of the same reservoir. Twenty years ago a given PA was drawn with current technology in mind; a company may now be able to access additional portions of that same reservoir, and because it is the same reservoir it is an expansion of the original PA or an existing PA. Just because a PA is expanded does not mean it will automatically qualify for the GVR because the company will have to count the barrels produced from that expansion in order to satisfy the Department of Revenue and qualify for the GVR.

MR. PAWLOWSKI added the key is that in CSSB 21(FIN) am(efd fld) it was going into an existing reservoir and trying to delineate and define new pockets of oil within that existing reservoir. It is the expansion of adding those new reserves that are not currently within the allowable area that is the difference between CSSB 21(FIN) am(efd fld) and Version B.

[2:23:33 PM](#)

MR. PAWLOWSKI moved to the sixth major provision of Version B, page 12, line 16, and page 13, line 19, which would eliminate the requirement that credits be taken over two years, instead allowing them to be taken in one year (slide 10). Currently, capital credits and net operating loss credits incurred on the North Slope must be split into two certificates and taken over two years. A company qualifies for a credit based on 20 percent of its spending or 25 percent of its loss carry forward and DOR issues the company two certificates; the impact of that credit benefit is therefore divided over two years. This proposed provision would particularly benefit the small producers that have testified before the committee about the importance of credits to their cash flow. Being able to get that credit in a single year does not really have a fiscal impact on the state given that obligation exists since the credit has been issued; DOR would issue one certificate rather than two. The fiscal

impact would be substantial in fiscal year 2014 because the \$400 million obligation for qualified capital expenditure credit from expenditures that happened in calendar year 2013 would be closed out in one year rather than spread over two years.

[2:25:44 PM](#)

CO-CHAIR SADDLER returned to the provision for the third category of GVR. The oil and gas produced from acreage added to an existing PA is clear, he said, but the concomitant obligation is that the producer demonstrates to the department. He inquired how easy that demonstration is and how easy will it be for the Department of Natural Resources (DNR) to make that determination.

MR. PAWLOWSKI answered that the language, "demonstrates to the department", on page 24, line 30, is a "small d" and in that reference is referring to the Department of Revenue. He said it goes back to the previously discussed issue of demonstrating where oil comes from. When the oil is coming from a lease or acreage that is delineated in that expansion, saying it is easy is an overstatement, but saying it is doable is a reasonable statement. The important tension is the balance of the GVR and the sliding scale per barrel credit, an either/or situation in Version B - the GVR is a lesser incentive that is given for those areas that do not want to go through this hoop. Under CSSB 21(FIN) am(efd fld), the demonstration was required on a well-by-well basis, but under Version B the demonstration can be done on a pad level or a large development level, which is easier to do than a well-by-well level. On a large drilling pad with 20-40 wells, the ability to aggregate those wells together and measure from that point becomes much easier in application than it does on the well-by-well basis.

[2:27:55 PM](#)

CO-CHAIR SADDLER observed the language on [page 24, line 22] that states "one or more of the following". He surmised the first criterion is real easy, the second criterion is fairly easily, and the third is not easy but doable. He asked what the process would be for demonstrating to the Department of Revenue.

MR. PAWLOWSKI replied DOR would be looking for "the similar metering concepts" and by working through the regulatory process DOR would talk with industry about how DOR is going to measure that. Currently, production is allocated back to acreage and the technical aspects of how DOR would measure it. It is

difficult to say in specificity what the burden of that actual measurement would be because of the nature of what that expansion might look like. It would probably be very difficult to measure from a narrow expansion of a participating area that has very limited infrastructure, something this provision is not designed for. This provision is designed more for the larger expansions of adding new areas that are bringing new production into the participating area where there are large pieces of infrastructure and where the amount of infrastructure needed to actually do counting can be justified.

CO-CHAIR SADDLER therefore understood it would be based on metering and then allocating back.

[2:29:32 PM](#)

REPRESENTATIVE SEATON inquired how typical enhanced oil recovery projects that increase volume will fit into this and asked how that will be measured.

MR. PAWLOWSKI offered his understanding that the typical enhanced oil recovery project would not fall under any one of these three areas because the producer is extracting more oil from the existing participating area, not actually adding acreage and making the PA bigger. The point in previous bill versions was to provide this significant incentive to geologically defined new oil that could be quantified, looked at, and expanded; it is a narrower benefit, but given the substantiveness of the benefit that threshold is a fairly limited one.

[2:30:49 PM](#)

MR. PAWLOWSKI resumed his discussion of the provision that would eliminate the requirement that credits be taken over two years (slide 10), saying this liability to the state would be closed out in fiscal year 2014. For the credits that are taken against a tax liability, the projected revenue impact is \$250 million. For the operating budget, the projected revenue impact is \$150 million - the operating budget is additional appropriations to the credit fund to pay for the small companies that turn their certificates into the state for reimbursement. He reiterated that these are credits earned before the bill goes into effect on 1/1/2014, based on projected spending in calendar year 2013.

[2:31:48 PM](#)

REPRESENTATIVE SEATON recalled a previous discussion about the forward funding of projects, noting that the credit is earned when the capital is expended, not when the project is actually undertaken. He asked whether Version B includes any controls on frontloading expenses in 2013 to qualify for the credit.

MR. PAWLOWSKI deferred to a DOR audit master for an answer.

LENNIE DEES, Audit Master, Production Audit Group, Tax Division, Department of Revenue (DOR), answered that DOR depends on accounting rules that would prevent the frontloading of expenditures from happening. Normally, when a company spends money upfront for a project, that cost is not going to be classified as a capital expenditure at the time the money is spent. More often, work is done before money is spent. Very rarely has he seen frontloading of capital projects. However, if a company did spend a lot of money like that, the cost would be classified on the balance sheet in some type of prepaid account, which would not qualify it as a capital expenditure. In DOR's reviewing of the requests and applications for qualified capital expenditure credit claims, DOR would not allow money spent in advance of work being done on capital projects to be qualified as a capital expenditure eligible for the credit.

[2:34:33 PM](#)

REPRESENTATIVE SEATON posed a scenario in which a company plans to replace 20 miles of pipeline, gets an engineering estimate, pays that upfront, and then the work is done. He surmised that DOR would, in this case, disqualify that as a capital expenditure at the time.

MR. DEES replied correct. He posed an example of a company that knows it is going to have a drilling program and wants to buy a lot of pipe upfront and warehouse it. As the company purchases the pipe, it would inventory the pipe, but at that point it would not be classified as a capital expenditure. Only when the pipe actually gets delivered to the project and is charged to the particular well, or in the case of a pipeline, to the pipeline, would it be classified as a capital expenditure. So, if a company were to do something like that at the end of 2013 it would not be classified as capital until 2014, and at that point it would not qualify for a credit because DOR would consider the capital expenditure in 2014 and at that point it would be too late to get the capital credit.

[2:36:21 PM](#)

REPRESENTATIVE SEATON clarified he is not talking about the company itself buying pipe and warehousing it, but rather the company hiring a construction company to do something. He said these parameters need to be made clear on the record. He surmised that if a company pays a construction company upfront to replace 20 miles of pipeline that that would not qualify as a capital expenditure until the construction company had put in the pipeline.

MR. DEES confirmed that that is exactly what he is saying. As the work is performed the project will get charged for that particular piece of work and at that point it would become part of the capital project. Prior to then, if it was paid up front, it would be in some type of prepaid account.

[2:37:31 PM](#)

REPRESENTATIVE P. WILSON, drawing attention to the last bullet on slide 10, surmised the \$250 million in revenue impact would be a minus impact, as would the \$150 million in operating budget impact.

MR. PAWLOWSKI responded correct, saying the \$150 million would be a minus because it would be an additional appropriation to the credit fund through the operating budget to fulfill the obligation of those credits.

[2:38:12 PM](#)

REPRESENTATIVE SEATON, noting the state is currently in deficit spending, inquired what the rationale is for changing from two years to one when the people making the capital investment did so knowing that it would be in two years.

MR. PAWLOWSKI answered the policy call was a balance between two things. First, it was recognizing that the program is ending and some companies might have made plans around those capital expenditures and getting credits for them. Allowing it to be taken in one year would benefit those companies that were making the investments. Second, the state is going to have to pay its credit obligation one way or another. Pushing that additional money off into 2015 would spread the fiscal impact of the bill out farther, but it would increase the fiscal note in fiscal year 2015. There was a concern of pushing that fiscal obligation off into the future rather than recognizing it today and closing out the program.

[2:39:47 PM](#)

CO-CHAIR SADDLER understood the two years or one year is a wash. However, he said he thinks the intent of Representative Seaton's question is whether there is a big risk that there will be a lot of frontend loading to take advantage of that capital credit before the end of 2014.

MR. PAWLOWSKI replied that is one of the key reasons the effective date needs to be as soon as it is in the bill, which is 1/1/2014. It is already going into April 2013 and the administration worried that pushing an effective date out into the future would allow for that type of planning to ramp up. While there might be some, the ability of companies to react before January of this year is relatively limited.

CO-CHAIR SADDLER understood, then, that waiting another year or two would be a risk, but waiting the seven months left in this year would not be as big a risk.

[2:40:57 PM](#)

MR. PAWLOWSKI resumed his presentation, addressing the seventh major provision in Version B, page 2, line 8, which would change the funding source for community revenue sharing (slide 11). As introduced by the administration, SB 21 recognized the soft dedication of funds from the corporate income tax to the community revenue sharing fund. Funds are still subject to legislative appropriation. The language in Version B recognizes that rather than softly dedicating revenue from the progressive surcharge, revenue is softly dedicated from the corporate income tax that is received under AS 43.20. The appropriation guidelines have not changed, it is still \$60 million or the amount necessary to bring the community revenue sharing fund up to \$180 million. Acknowledging that members had asked about the other credits and the work against the corporate income tax, he pointed out that the corporate income tax has exceeded \$500 million every year for the last 8 years. The \$60 million is in recognition of the importance of community revenue sharing and the connection of that broader base of economic activity to support it. He noted that this provision is a major change from CSSB 21(FIN) am(efd fld).

[2:42:40 PM](#)

MR. PAWLOWSKI discussed the eighth major provision of Version B, page 16, line 7, which would establish a per oil barrel tax credit (slide 12). Under CSSB 21(FIN) am(efd fld), this credit was a flat \$5 per barrel, but under Version B this is expanded with the addition of a new subsection on page 16, line 14. For each taxable barrel that does not meet any of the three criteria for the GVR in AS 43.55.160(f), there would be a sliding scale per barrel credit, as opposed to the fixed \$5 per barrel credit. As seen on page 16, beginning on line 21, below \$80 per barrel gross value at the point of production, the credit would be \$8 per taxable barrel. Between \$80 and \$90 gross value at the point of production, the credit would be \$7 for each taxable barrel, sliding down to a credit of \$0 if the average gross value at the point of production for the month is greater than or equal to \$150 a barrel.

[2:44:40 PM](#)

MR. PAWLOWSKI then reviewed the estimated fiscal impact for the aforementioned credits, noting that the numbers on the chart on slide 13 are decrements in revenue. He reminded members that fiscal year 2014 is for half a fiscal year because the bill's effective date is 1/1/2014 and fiscal years are June 30 through July 1. Fiscal year 2015 is the first full year of impact [minus \$825 million]. The value of the impact declines [with each subsequent year, going down to minus \$675 in fiscal year 2019] because the forecast is for declining production and the credit is linked directly to production since it is a credit per taxable barrel.

[2:45:22 PM](#)

REPRESENTATIVE SEATON surmised much of the estimate of revenue is for an Alaska North Slope (ANS) West Coast price range of \$110, which, at a transportation cost of \$10 would be a gross value at the point of production of less than \$100, and therefore most of the oil would be at a credit of \$6, \$7, or \$8. While he understood tapering off to a slight progressivity at higher prices, he said this proposal seems to be a fairly dramatic reverse progressivity below \$110. He requested an explanation for the "hit on the state" at lower prices when the state will have less revenue and higher deficits.

MR. PAWLOWSKI responded that, as a policy call, the concept is first tied directly to production. Second, when going from \$5 to \$8 versus from \$5 to \$0, there is actually more on the state side going up than there is going down, so there is a balance

between the upside and the downside that is being considered. Another important point is on page 16, line 18: "A tax credit under this section may not reduce a producer's tax liability for a calendar year ... below zero." These are nontransferable, use-it-or-lose-it credits. So, unlike the capital credit which is based on spending, there could be a situation where production is interrupted or production has declined and spending is happening and there is a different relationship directly to the state. Under this, the credit is linked directly to production, so the less production the less revenue to the state but also the less credits received by the company. As the presentation continues, the committee will be able to look at the balance between what the state's exposure at the low side is versus how much additional revenue the state is taking at the high side. At the end of the day it is a policy call and a balance that legislators need to consider.

[2:48:41 PM](#)

REPRESENTATIVE SEATON expressed his concern that the \$8 credit is not only at \$80 a barrel, but everything below \$80 a barrel; thus, it becomes a much higher and higher proportion of the profitable income that is going to be excluded if there is time of low oil prices. For example, if \$8 is excluded at a price of \$45 a barrel, and \$26 is subtracted for costs, a very large portion of the profit is going to be excluded from taxation.

[2:49:25 PM](#)

MR. PAWLOWSKI outlined the ninth major provision of Version B, page 3, line 17, a provision unchanged from CSSB 21(FIN) am(efd fld) which would create a service industry expenditures credit (slide 14). This credit is limited specifically to taxpayers, specifically for work that is done within the state of Alaska. It is non-transferrable, but can be carried forward against a taxpayer's liability. It is a benefit given industry doing additional work in-state for manufacturing or modification of oil and gas equipment and is only for the portion spent in the state. The fiscal note is indeterminate, but [is estimated] to be less than \$25 million a year.

[2:50:24 PM](#)

REPRESENTATIVE SEATON said this provision concerns him for the ancillary treatment that it has. Alaska has education tax credits - 50 percent tax credit from corporate income tax for education and workforce training up to \$100,000, then 100

percent tax credit for the next \$100,000, and then up to 50 percent credit for up to \$5 million. The total corporate tax paid per year for this sector is about \$10 million. He presumed everyone in this service sector is going to qualify for some credit. For this entire sector the effect of education or workforce development tax credits will be zeroed out because all the tax liability from corporations is being removed, as is the incentive to use the tax credit for workforce development, educational institutions, and processing technology facilities. He inquired whether this has been considered or whether it is a discussion the committee needs to have.

MR. PAWLOWSKI answered it has not been a detailed discussion central to this particular section. He drew attention to page 4, lines 1-3, of Version B, noting it attempts to narrow the provision to limit the double-qualifying of expenditures for different credits. Thus, companies will still need to consider which credit is actually the most beneficial to them. While the education type credits might be more beneficial to a company, the company will be unable to do both on the same expenditure. So, there has been a fair conversation, but not one that, to this point, has been a detailed conversation, other than to say that the concern of the committee in the other body was to avoid double dipping and double qualifying for multiple credits.

[2:52:55 PM](#)

CO-CHAIR FEIGE understood Representative Seaton to have said that the maximum corporate tax revenue to the state from this particular sector totals \$10 million.

REPRESENTATIVE SEATON confirmed \$10 million is about what it has been. Information from Legislative Legal and Research Services is that about \$93 million in taxes is paid by corporations other than oil and gas corporations and this sector represents about 10 percent of that. In no year has this sector paid more than \$10 million. Thus, the \$25 million per year is probably high.

[2:53:45 PM](#)

CO-CHAIR FEIGE countered that one could also look at this and say that if these incentives work as believed they will, then the demand on this particular service industry could significantly increase and the state could make up far more tax revenue simply by growing the pie than the 10 percent credit would cost.

REPRESENTATIVE SEATON said this is probably not possible because this credit is \$10 million per company or 10 percent of a company's full expenditures and the credit can be carried forward for five years. The concern is not double dipping, but elimination of the corporate income tax as a source that the state has established for educational tax credits means there will be no source for educational tax credits. The state has built in a pretty strong incentive to have corporations make educational donations and workforce development and this credit will take away all of that incentive because it will likely zero out the corporate income tax for this entire sector, especially since the credit can be carried forward five years. Since the committee is looking at workforce development, the committee should look at whether this provision is really beneficial and whether it will bring a lot more work to the state. For example, all of the pipes that are welded on the North Slope are done in the state.

[2:56:15 PM](#)

CO-CHAIR FEIGE said he will need to look at the statutes on the educational credits, but recalled that the educational credits are written off against production tax.

MR. PAWLOWSKI pointed out that the education credit is found in the corporate income tax, the production tax under AS 43.55.019, and the property tax under AS 43.56.018. Thus, there are three duplicate education credits touching three different pools of taxes. If one is diminished, there will be revenues available from the others.

CO-CHAIR FEIGE stated it is worth looking at, but will deserve a lot more development.

[2:57:12 PM](#)

MR. PAWLOWSKI, responding to Representative P. Wilson, reiterated the statute numbers and said the language is similar in each one.

REPRESENTATIVE SEATON pointed out that those companies paying production tax are not the companies that are targeted in this provision for the service industry.

CO-CHAIR FEIGE responded education is [the target].

[2:57:51 PM](#)

MR. PAWLOWSKI addressed the tenth major provision of Version B, page 2, line 18, a provision unchanged from CSSB 21(FIN) am(efd fld) which would adjust the interest rate on delinquent taxes (slide 15). He reminded members that this provision applies in both directions - when there is an overpayment and the state must reimburse the taxpayer and when there is an underpayment and the taxpayer must pay the difference to the state. Multiple sections throughout the bill are related to this interest rate provision. Under current law the interest rate is the higher of 11 percent or 5 percentage points above the annual rate of interest charged by the [12th Federal Reserve District]. Under Version B the interest rate would be 3 percentage points above the annual rate of interest charged by the [12th Federal Reserve District]. The fiscal impacts include \$100,000 in the fiscal note for operations needed at DOR to reprogram its systems. The fiscal impact is estimated to be up to [minus] \$25 million per year, increasing over time as more delinquent taxes are calculated under the new interest rates of this provision.

[2:59:18 PM](#)

MR. PAWLOWSKI reviewed the eleventh major provision, a provision that was added in Version B on page 18, lines 2, 20, and 21, which would remove the requirement that a well be three miles from an existing well to qualify for the Middle Earth frontier basin credit (slide 16). It could potentially increase costs of operations to the state in that the state is paying 80 percent through this credit. Anything that can be done to make it as efficient as possible would be a benefit to the activity. This credit cannot be taken along with net operating loss carry forward credit. The fiscal impact is already accounted for in the Fall 2012 Revenue Forecast, so there is no addition to the fiscal note. Responding to Co-Chair Feige, he clarified this credit is transferable and refundable.

[3:00:42 PM](#)

MR. PAWLOWSKI, responding to Representative Seaton, confirmed that the frontier basin credit has a limit of four wells, and added that the reference can be found in Version Bon page 18, line 7: "The persons that drill the first four exploration wells in the state"

[3:01:01 PM](#)

MR. PAWLOWSKI outlined the twelfth major provision of Version B, page 25, beginning on line 24, which would establish the Oil and Gas Competitiveness Review Board, and is a provision that is not modified substantially from that in CSSB 21(FIN) am(efd fld). He explained this would be a new state board located within DOR. Its nine members would be tasked with meeting once a year to provide an institutional warehouse for an understanding of Alaska's competitive position and to provide a report to the legislature [every four years - see timestamp 3:19:57 p.m.] on proposed changes to the fiscal system. The estimated fiscal impact of \$180,000 per year, which represents costs for travel and use of existing staff, is not included in the tax fiscal note, but in a separate fiscal note. A majority of the fiscal impact is already included in the operating budget because DOR is not adding new positions in the fiscal note to undertake this work, but rather is absorbing the work in-house.

3:02:22 PM

MR. PAWLOWSKI explained the chart on slide 18 incorporates all of the provisions in Version B to estimate the general fiscal impact [as compared to the Fall 2012 Revenue Forecast]. He reviewed the fiscal impacts for fiscal year 2015, the first full fiscal year after the bill's effective date: Eliminating the progressive tax would decrease state revenue by \$1.5 billion; raising the [base] tax rate from 25 percent to 35 percent would increase state revenue by \$1.075 billion; limiting credits for qualified capital expenditures on the North Slope would increase state revenue by \$700 million; increasing the net operating loss carry forward credit to 35 percent would result in a revenue impact [of minus \$40 million]; adding the gross value reduction (GVR) for oil production in new units and new or expanded participating areas would reduce state revenue by \$25 million; eliminating the provision that credits must be taken over a period of two years will have no fiscal impact because that program will be over in fiscal year 2014; amending the community revenue sharing fund would have no fiscal impact; adding the credit of \$5 per taxable barrel and sliding scale credit per taxable barrel would decrease state revenue by \$825 million; adding the credit for qualified oil and gas industry expenditure is indeterminate but would possibly decrease state revenue by up to \$25 million annually; reducing the interest rate is indeterminate but would possibly decrease state revenue by up to \$25 million annually; and removing the three-mile limitation for the frontier basin credit would have no fiscal impact. The total revenue impact for fiscal year 2015 would be a decrease of \$575 million to \$625 million.

[3:04:57 PM](#)

MR. PAWLOWSKI then reviewed the revenue impact on the operating budget for fiscal year 2015. He explained there would be an additional \$150 million to the state because there would be less credits on the qualified capital expenditure credit that the state would have to pay out. The increase in the net operating loss carry forward credit would be a reduction of \$40 million. Therefore, the total fiscal impact, which includes changes in revenue and appropriations that have to be made through the operating budget to pay for the credits, is a reduction in state revenues and expenditures of \$465 million to \$515 million for fiscal year 2015.

[3:06:01 PM](#)

MR. PAWLOWSKI, responding to Co-Chair Saddler, clarified that the per-taxable-barrel credit is an either/or credit. He explained the \$5 per barrel credit would also qualify for the GVR/GRE, and the sliding scale credit would be for oil that did not qualify for that "new" oil. He noted that the \$5 credit is within DOR's fiscal forecast because, when looking at the wellhead values in the Fall 2012 Revenue Forecast, "the oil is going to fall within that \$5 range", which is why there is not a different number than the \$5 number. If prices were to rise, the value of that credit would drop and if prices were to fall the value of that credit would increase.

[3:07:01 PM](#)

CO-CHAIR SADDLER surmised that if the \$5 credit and the sliding scale credit were broken into two lines, the line for the sliding scale credit would be pretty empty.

MR. PAWLOWSKI concurred.

[3:07:21 PM](#)

MR. PAWLOWSKI, responding to Representative P. Wilson, confirmed it is an either/or situation between the \$5 credit and the sliding scale credit.

[3:07:42 PM](#)

CO-CHAIR FEIGE observed from the line highlighted in yellow on slide 18 that the total fiscal impact does not include potential

revenue impacts from increases in production. He surmised that the areas that have the GVR applied to them are not considered here because those would all have to be areas of new production.

MR. PAWLOWSKI replied correct and added that the fiscal impact seen on slide 18 is based on if the bill passes and nothing changes in terms of prices and production from the way DOR has currently forecast the next five years.

[3:08:38 PM](#)

REPRESENTATIVE P. WILSON said she would like to see a comparison between slide 18 and the price going up and the price going down, given things could be different than the forecast. She further asked that the comparison be provided in graph form rather than chart form.

MR. PAWLOWSKI agreed to provide a comparison in graph form.

[3:09:32 PM](#)

REPRESENTATIVE JOHNSON asked whether it would be possible to model an increase in barrels per day in steps of 5,000, 10,000, 15,000, and so forth to see what the fiscal impact would be of adding new production.

MR. PAWLOWSKI responded DOR has tried to do a "scenario method" in all of the fiscal notes rather than doing a fixed amount of production per year. A reason for the scenario method is that production goes up and then it comes down, and along with production comes timing in investment. Thus, [in slides 19-25] DOR has prepared graphs for three scenarios.

[3:10:41 PM](#)

REPRESENTATIVE SEATON commented that if in 2019 the scenario [looks like that depicted on slide 18] the bill will have been a failure because it would not have stimulated any new production.

MR. PAWLOWSKI concurred that if absolutely no change to production happens the bill would be considered a failure. What is seen [in slide 18] is the natural limitation of fiscal notes. A dilemma of fiscal notes is that they are based on what the revenue forecast is going forward and how it moves from that. In front of the committee is something with a lot of moving parts where increased production does have material impacts on the state in the longer term. Thus, DOR wants to call attention

to the fact that this fiscal analysis, performed in the way fiscal notes are typically done, by the nature of the fiscal note is not allowed to directly include increased production.

CO-CHAIR FEIGE remarked it is "a conservative best guess".

[3:12:26 PM](#)

CO-CHAIR SADDLER pointed out for the public that this is a fiscal note which is based on assumptions and formulas. It would be nice to have various permutations in production and price, but that would be tremendously awkward and difficult to work with. He urged people not take this as gospel that this is going to be the result; rather, it is a forecast possibility under certain conditions and every future condition cannot be predicted.

CO-CHAIR FEIGE added that not changing too many assumptions in the fiscal note allows legislators to evaluate the fiscal impact of changes that are made to the bill.

MR. PAWLOWSKI agreed and reminded members that [slide 18] is not a fiscal note per se, but the elements that would go into a fiscal note. He said DOR has tried to keep them consistent through all the versions of the bill so comparisons can be made of the various fiscal analyses.

CO-CHAIR FEIGE said he has asked DOR to provide a full and complete fiscal note once the committee has reported a final version of the bill.

[3:13:49 PM](#)

CO-CHAIR SADDLER requested the committee look at the [three scenarios outlined on slides 19-25].

MR. PAWLOWSKI walked the committee through the three production scenarios. Scenario A (slide 19) is the development of a new 50 million barrel field developed by a small producer with no tax liability. The field has a peak production of 10,000 barrels a day, development costs of about \$500 million, and qualifies for the GVR/GRE and the net operating loss carry forward credit. Scenario B (slide 20) is the addition of four drill rigs in the legacy units, each rig drills four wells a year, adding 4,000 barrels a day of new production, and each well declines at 15 percent per year, and the production does not qualify for the GVR/GRE. Scenario C (slide 21) is the addition of a new drill

pad within a legacy unit, plus the four rigs working in Scenario B. In this scenario 15,000 barrels a day are added in calendar year 2014, increasing to a peak rate of 90,000 barrels a day in 2018, and the production would not qualify for the GVR/GRE. He stressed that these are just scenarios and DOR is not saying they are going to happen. They were done to illustrate the ramp-up function of production; that production does not come on all at once, but rather builds.

[3:15:54 PM](#)

MR. PAWLOWSKI, responding to Co-Chair Saddler, clarified that Scenario A and Scenario B are each a stand-alone scenario, but Scenario C is Scenario A plus Scenario B plus Scenario C.

[3:16:19 PM](#)

MR. PAWLOWSKI explained slide 22 is the projected revenues for the various scenarios at an ANS price of \$90. In the near term, ACES generates more revenue, but in the future, as production comes on line from those developments, Scenario B and Scenario C start to exceed ACES. He stated DOR will be providing the committee with the data behind this graph.

[3:17:16 PM](#)

MR. PAWLOWSKI noted a similar but more pronounced effect is seen at an ANS price of \$100 a barrel (slide 23). He clarified the Y axis is in millions of dollars, so "\$1,000" means \$1 billion and explained the comparison is between the proposed committee substitute, HCS CSSB 21, Version B, and Scenarios A, B, and C to show how much additional production the scenarios are adding to existing production. He pointed out Scenario A does not add material production - a small 50 million barrel field does not move the needle much. However, Scenarios B and C show the ability in the near term of the additional drill rigs and large development pad to increase substantial production. He said DOR was careful about saying that multiple fields would be built from scratch within the first two years since that would be an unrealistic expectation, but there is much potential for that to happen in three to five years.

[3:18:25 PM](#)

MR. PAWLOWSKI moved to slide 24, pointing out the similar effect in the near term at an ANS price of \$120 per barrel, with the high progressivity of ACES exceeding revenues under any of the

scenarios [for fiscal years 2014-2016]. However, [for fiscal years 2018 and 2019], the additional production against the forecasted decline exceeds the revenues forecast under ACES, particularly under Scenario C.

[3:19:15 PM](#)

MR. PAWLOWSKI turned to slide 25, explaining that this graph is at the forecast price in the [Fall 2012 Revenue Forecast] from which the budgets and the planning are done on. A similar situation is again seen where additional production allows the revenues to increase over [ACES]. He reiterated that these are scenarios, not predicted projects, so members can take a look at the impact of production on the base system, something that is not normally included in a fiscal note. When considering this issue, it needs to be looked at in the context of what increased production has an opportunity to bring to the state in terms of longer-term revenues.

[3:19:57 PM](#)

CO-CHAIR FEIGE returned to slide 17 and pointed out that under Version B the Oil and Gas Competitiveness Review Board would provide a report to the legislature every four years, not an annual report.

MR. PAWLOWSKI apologized for missing that.

[3:21:14 PM](#)

The committee took a brief at-ease.

[3:21:47 PM](#)

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

[3:22:19 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:22 p.m.